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New burden forces FPIs to reassess biz structures

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Mumbai: Representatives of foreign portfolio investors (FPIs) which invest heavily into India are assessing their likely tax burden and the possibility of restructuring their investment vehicle.
The announcement in Thursday's Budget of introducing a 10% tax on long-term capital gains (LTCG) exceeding Rs 1 lakh from April 1 had led to discussions with tax experts on optimising their investment structures.

Investing in India via the Netherlands, France or even Spain is being explored, as India's treaties with such countries mean that there will be no tax on capital gains in India. However, FPIs are mindful that India's general anti-avoidance provisions would apply if there is the end objective of the restructuring as mere tax avoidance.

Shefali Goradia, tax partner with Deloitte India, says, "FPIs who have tax-exempt investors such as pension funds or endowment funds will be adversely impacted as they cannot use the tax credit in their home countries. The impact of the new tax will now have to be factored in calculating returns to the investors. Overall cost will increase since Securities Transaction Tax continues to apply. Some FPIs may sell investments before March 31, and then reconsider their strategy for India investments."

Under the Netherland's domestic law, it is possible to migrate the effective place of management to Netherlands and become a tax resident of that country. Sale of shares of an Indian company are taxable, under the India-Netherlands tax treaty only in the Netherlands, provided the shares are not sold to an Indian resident. Or if less than 10% of shares of an Indian company are sold to an Indian resident, then also there is no capital gains tax in India.

Daksha Baxi, executive director, with the law firm of Khaitan and Company, says, "One cannot rule out restructuring for existing investments in listed securities, but the same will need to be done prior to March 31, if the capital gains tax is to be avoided. Also, any restructuring and subsequent reliance on a treaty, say the India-Netherlands tax treaty, would need to meet GAAR scrutiny. There will be a need to have a commercial reason for such move and tax should not be one of the main purposes of that move. Else, the treaty benefit with the Netherlands may be denied when the exit happens. As regards initial routing of fresh investments from jurisdictions such as the Netherlands, once again it should be commercially justified. We have seen the Netherlands being a preferred jurisdiction, in recent times."

Tax treaties with France and Spain give India the right to tax capital gains on sale of shares only if the holding in the Indian company is 10% or more. Richie Sancheti, head investment funds, at Nishith Desai Associates, a law firm, says, "Global asset allocators with an active India strategy will look to optimise their structures through efficient alternatives. Subject to to meeting commercial substance, the Netherlands and France based structures continue being efficient. Shift in the tax regime may also lead to a modification of asset allocation strategies." "Apart from GAAR, decision makers will also need to factor in potential treaty negotiation," concludes Goradia.