Business Standard

Major FPIs shift base after new tax treaties

More than 50 overseas investors moving to tax-friendly European nations

Pavan Burugula | Mumbai April 21, 2017 Last Updated at 01:08 IST

3

○

India's new tax regime has triggered an exodus of funds from Mauritius and Singapore to tax-friendly jurisdictions in the Eurozone, including France and the Netherlands.

According to sources, more than 50 foreign portfolio investors (FPIs), including well-known names like JPMorgan, Morgan Stanley and Sweden's SKB, are in the process of shifting from erstwhile tax havens to newer, friendly jurisdictions like the Netherlands and France.

The move comes after the government renegotiated tax arrangements with Mauritius and Singapore. Until the last financial year (FY17), all investments made through these countries were exempt from the short-term capital gains tax. Starting April 1, transactions originating in these countries will no longer qualify for the tax benefit.

Mauritius and Singapore are the second- and third-most preferred routes for overseas investors investing in India. These two jurisdictions account for nearly a third of portfolio inflows at present.

"All the major FPIs have been planning to move out of Mauritius and Singapore after the new tax treaties come into effect. However, they will not shut down their investment vehicles in these jurisdictions completely. Rather, fresh investments will be made from new locations," said a source.

JPMorgan and Morgan Stanley declined to comment on the development, while an email sent to SKB remained unanswered.

The custodian of an FPI said the decision to shift was taken as part of the firm's global strategy to relocate all investment vehicles controlled by its London subsidiary to France in the wake of Brexit.

The government has introduced general anti-avoidance rules (GAAR) to crack down on such arrangements but experts say these may not have enough teeth.

Imposing the GAAR will not be easy because it relies heavily on the "commercial substance" clause. According to the GAAR, having a permanent establishment along with employees and other infrastructure, amounts to commercial substance.

All the big players had a global presence and could easily meet the criterion, experts added.

"When a fund or a company decides to shift its base from one jurisdiction to another, usually tax is one of the reasons. For the GAAR to come into play, tax arbitrage has to be the primary reason and the arrangements must lack commercial substance or be circular or result in an abuse or misuse of the Income Tax Act, 1961," said Meyyappan Nagappan, senior member of the international tax team at Nishith Desai Associates.

"The government has clarified that merely choosing to be based in a tax-efficient jurisdiction will not result in automatic application of the GAAR," he added.

Tax experts expect the government to come out with fresh measures if there are widespread instances of tax avoidance. "Such shifts can benefit funds only in the short term because the government will renegotiate tax arrangements with other countries if it believes there is misuse. The basic reason why the government renegotiated tax treaties was to weed out tax havens and encourage long-term investments," said Tejesh Chitlangi, partner, IC Legal.

There are two ways in which a fund can shift its operations from one place to another.

The first way is to secure approval of the Securities and Exchange Board of India (Sebi). In such a move, all previous investments of the fund will be relocated to the new jurisdiction.

The other method is to apply for fresh FPI registration to Sebi from the new location. This does not involve much scrutiny by the regulator as the formalities for new registrations have been simplified over the past few years.