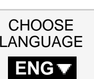

Paris replacing Mauritius as tax haven, Citi alerts Finance Ministry

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MUMBAI: Citi, once perceived as a master in regulatory arbitrage, has drawn the government's attention to Paris emerging as a new tax haven with Mauritius losing its charm.

In a recent meeting with officials of the finance ministry, Citi pointed out how some global banks and funds are taking advantage of India's treaty with France to escape tax, sources in the financial market told ET.

In the past few months, a few leading foreign portfolio investors (FPIs) have set up shop in Paris to attract offshore investors and issue participatory notes (PNs) — derivatives sold to foreign investors keen to trade in Indian stocks. Till March 31, Mauritius was the preferred location to carry out such business. But this changed with the revision in the tax treaty between India and Mauritius: there will be capital gains tax on Indian securities bought by any Mauritius entity on or after April 1.

Many French banks have been offering P-note products with a written assurance that there would be no tax on FPI returns. These banks and their FPI arms are also promising that they satisfy the GAAR test.

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Citi is understood to have taken a decision to refrain from using its Paris office to issue PNs and sell Indian equity. "I believe that Citi has taken a stand that this is only a temporary window and selling PNs from Paris would be against the spirit of regulation… I suppose they believe that it could be a matter of time before India reviews its tax treaty with France," said a senior lawyer familiar with the developments.

Citibank officials declined to comment on the matter.

"The re-negotiated India-Mauritius and India-Singapore tax treaties offer a beneficial tax rate of 7.5% on short-term capital gains on equity for investments made after April 1, 2017. The India-France treaty on the other hand provides for a NIL tax on short-term capital gains on equity. As a result, players based out of France are obviously able to offer a better product as compared to players from other jurisdiction,"

said Suresh Swamy, partner, PwC.

Experts Surprised at Move

"In view of the distinct tax advantage, investors appear to be attracted to P-note issuers based out of France," he added.

"Citi and some of the other banks are losing business as many clients are choosing to deal with FPIs located in Paris or The Netherlands," said an official with a brokerage.

Under Singapore and Mauritius treaties, the tax on short-term capital gains is 7.5% for two years and 15% subsequently. However, tax treaties with European countries including The Netherlands, France, Spain and Sweden do not have this. Many French banks have been offering P-note products with a written assurance that there would be no tax on FPI returns. These banks and their FPI arms are also promising that they satisfy the GAAR test. As per GAAR, or General Anti-Avoidance Rule, market gains could be taxed if the Indian tax department suspects that the investment vehicle lacks substance and has been set up to solely evade tax.

Are banks like Citi missing out on business opportunity? The move has surprised experts advising funds. "Typically, large global conglomerates or banks will have substantive offices in most parts of the world. The key requirement for the compliance with GAAR provisions is to demonstrate substance in the form of relevant people, infrastructure, key activities, etc in that particular jurisdiction. As long as these conditions are satisfied, the treaty benefits should be available," Punit Shah, Partner, Dhruva Advisors. According to Richie Sancheti of Nishith Desai Associates, "From a securities law perspective, the only relevant aspect is that the issuer is following the regulations for its ODI issuance program. From a tax perspective, however, structures could be scrutinised if they are designed to primarily avoid taxes. In addition to capital and liquidity exposures, a PN issuance program requires significant risk management capabilities. For an issuer, structures also evolve to drive alignment between the risks and the market from which such risks originate. All such factors need to be calibrated."

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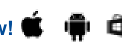

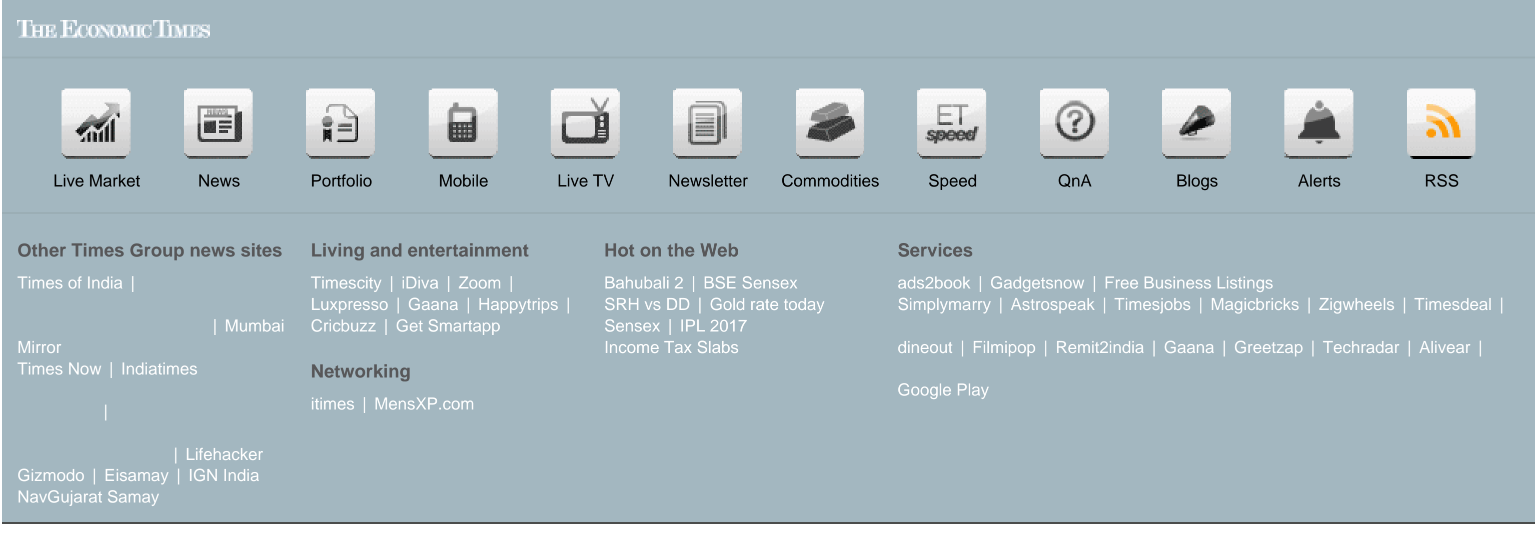

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