Tax fog forces hedge fund shift to Singapore

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Hedge funds are continuing to reduce direct exposure to India on regulatory uncertainty and volatility.

Macquarie's Asian Alpha Fund slashed gross exposure to India in its overall $1.49 billion portfolio by exiting short positions in single-stock futures.

Instead, it took short positions in India through dollar-denominated Singapore Nifty futures ,while cutting down its shorts in local stocks to nil from 2.65% in February, Reuters said on Monday.

The Asian Alpha Fund, one of the top performing in Asia and among just the 30 or so hedge funds with $1 billion or more in the region, also cut India long exposure in March, joining a number of foreign investors reducing their holdings in the country ahead of the expected tax rules, Reuters said.

Experts said Macquarie's move would have been triggered by a combination of factors.

Siddharth Shah, head of funds practice at Nishith Desai Associates, said foreign investors continue to remain cautious despite government trying to allay investors' fear related to general anti avoidance rule (Gaar) provisions.

"Though the government has been trying to address the issue and has given assurances, foreign investors are still concerned. The panic has gone, but the environment still remains tentative and people are in a wait-and-watch mode," he said.

"Those investors who can afford to shift portfolios and risk are doing so. By moving to Singapore Nifty futures which is an offshore instrument, one can avoid capital gains tax as there is no short-term or long term capital gains tax in Singapore."

Incidentally, the average daily traded volumes on Singapore Nifty futures have picked up by almost 15% from 51,800 lots in the first two and half months of this calendar year to 58,607 lots post Budget (after March 16, 2012). During the same respective periods, the volumes on Indian Nifty futures have gone up by just 6%.

Sampath Iyengar, mananging director at ADA Investments, a US-based hedge fund, believes foreign investors are wary of volatility in currency and equity markets on top of regulatory issues.

"The regulatory uncertainty makes it difficult for FIIs and hedge funds to assess the risk adjusted returns. Also, the country risk and sharp currency movements do play a part. Though government has come out with a statement that those with proper structure won't be taxed inappropriately, there needs to be further clarity. So given these circumstances, some of them are looking at alternative opportunities," he said.

Experts believe that Mauritius-based investors are increasingly looking to shift jurisdiction to Singapore because of its better reputation.

"Though Gaar provisions would also apply to Singapore, but Singapore has better reputation in terms of its regulation and also it is a global hub. Also, those entities who have two-year track record in Singapore are not liable to pay capital gains tax there," said Iyengar.

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