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DTC will not impact foreign investor fund inflows

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MUMBAI: Foreign portfolio investors will not be materially impacted by the proposed changes in the new tax code, as long as these funds are able to claim tax credit in their home jurisdictions, say experts.

Another factor likely to mitigate the impact of the new tax rule is that India remains one of the fastest growing economies globally, and is likely to attract a sizeable chunk of the flows coming out of other troubled markets.

The proposed rule seeks to tax foreign portfolio investors' revenues from equity investments in India under capital gains tax, instead of under business income.

Business income is income that arises from the regular operations of a company, and hence are taxed at a lower rate. Capital gains are those that arise out of the sale of assets such as land, gold or in the case of FIIs-equity holdings, and hence attract a higher tax.

"The rule is likely to impact very few foreign funds," says Sukumar Rajah, MD & CIO-Asian Equities, Franklin Templeton Investments.

Suresh Swamy, ED, Financial Services, PriceWaterhouseCoopers (PwC) has similar views. "As of today, there is only a small universe of FIIs which claim their income to be business income. Most of them adopt a capital gains stand. FIIs/sub-accounts were entitled to claim treaty benefits only if they satisfied certain conditions. Not all of them satisfied those conditions," he says.

Mauritius-based institutions continue to be taxed under Mauritius laws, which exempt them from capital gains tax. India has a taxation treaty with Mauritius which is used to save on tax by foreign funds.

"For those who come in from a treaty jurisdiction, there would be little or no impact at all. But those who were from non-treaty jurisdictions and were relying on this being categorised as business income, could be impacted," says Siddharth Shah, head-funds practice, Nishith Desai Associates.

"It's ironical in some sense that such change combined with higher tax rate on capital gains may actually investors push to look at investing through treaty jurisdictions with capital gains benefits," he says.

He, however, cautions investors that one needs to watch out for GAAR provisions and applicability of the same to structures. "While the draft has removed the treaty override provisions proposed under the old draft, one will get a clear picture only when detailed GAAR rules are announced," he told ET.

Shefali Goradia, partner, BMR Advisors, believes it is aspirational for the government to curb treaty shopping by invoking GAAR. "Most other countries have not succeeded in doing this. If the tax officers challenge the Mauritius treaty due to lack of substance, this can be challenged before the courts," she adds.

Punit Shah, ED-tax & regulatory services (financial services) KPMG says that the certainty of availability of the capital gains tax exemption under Mauritius tax treaty is crucial for foreign investors.

"Even though, the discussion paper provides for beneficial provisions of the treaty to prevail, it is subject to passing anti-abuse provision tests, the application of which itself is not objectively provided for. This brings uncertainty and subjectivity in applying the beneficial tax treaty provisions," he said.