

Tax Hotline

February 18, 2003

NOT ALL GOOD NEWS FOR FIIS IN THE BUDGET 2003

India is gearing up for Budget 2003 to be announced on February 28, 2003. The Budget proposals are much awaited by the masses and the intelligentsia, due to the hopes and fears raised by the recommendations of the Kelkar Committee on direct and indirect taxes.

One of the recommendations made by the Kelkar committee is the scrapping of tax on long term capital gains (gains arising on sale of investments held for more than 12 months) earned on equity investments in Indian companies. It is speculated that this would make the Mauritius route for investments into India less attractive.

This, however, is not entirely true. FIIs may still find it more lucrative to invest in India via Mauritius. Shefali Goradia, who heads the International Taxation practice at Nishith Desai Associates, explained, "Everybody is talking about the government killing two birds with one stone - reviving the markets and putting an end to the Mauritius controversy. Currently, FIIs/OCBs based in Mauritius do not have to pay tax on capital gains. So even though they will lose some advantage if the long term capital gains tax is scrapped, the 30 per cent tax on short term capital gains will still not apply to them." Thus, short term capital gains (gains arising on sale of investments held for 12 months or less) would continue to be exempt in the hands of the FIIs under the provisions of the India Mauritius Tax Treaty.

Thus clarity on the interpretation of the India Mauritius Tax Treaty and the stance of the Indian income tax authorities thereunder is more crucial than the exemption contemplated under the domestic law, the provisions of which undergo change every year.

The Delhi High Court ruling in May 2002 left FIIs open to probes on tax benefits under the India Mauritius Tax Treaty. This ruling had quashed the Circular 789 issued by the Central Board of Direct Taxes which clarified that a certificate of residence issued by the Mauritius authorities was ample proof of the residential status of FIIs. Subsequently, this ruling was stayed by the apex court of India who is hearing the appeals filed against the Delhi high court order. The matter is being heard on an expedited basis and a decision is expected soon.

Source: *The Times of India*, February 11, 2003

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