After MAT, indirect transfer woes for foreign investors

Portfolio investors in India- focused funds may have to deal with tax liability of 40% of gains

Foreign portfolio investors, hit by the minimum alternate tax (MAT) issue, might find a fresh problem snapping at their heels. This time, rules governing indirect transfers are emerging as a cause for concern, especially for foreign portfolio investors running multi- billion- dollar India-focused funds.

Indirect transfer rules look to tax the transactions where foreign companies buy or sell their India assets. Sometimes, such transactions take place through holding companies set up in jurisdictions with favourable tax laws. The government has taken the position that such indirect asset transfers are also to be taxed, as the route can otherwise be used for getting around paying taxes in India.

The government recently clarified that any such transaction where at least 50 per cent of assets are Indian would require taxes to be paid in India, with some exceptions. The exceptions do not extend to foreign investors. Foreign investors coming through India- focused funds will have more than 50 per cent invested in Indian assets, experts point out. This could mean that investors in such funds would be taxed when they redeem their units.

“Investors in such India- focused funds appear to be hit by these offshore transfer provisions. These funds, in such cases, are required to withhold appropriate taxes before paying redemption proceeds to investors.

These nuances are likely to increase the administrative burden on Indiafocused FPIs, especially where the funds are listed and it is difficult to compute the withholding tax component on behalf of each investor,” says Suresh Swamy, partner (financial services), PwC Tax and Regulatory Services.

“The application of indirect transfer provisions would mean that foreign investors in offshore Indiafocused funds could risk being subject to a 20 per cent long- term capital gains tax on sale or redemption of their investments in the fund. The tax rate would be 40 per cent if investors held shares or units of the fund for less than three years,” says Rajesh H Gandhi, partner (tax), Deloitte Haskins & Sells.

CAUSE FOR CONCERN

- After being hit by MAT, FPIs are raising concerns over indirect transfer rules
- The Budget clarified that foreign transactions would be taxable if more than 50% of underlying assets are in India |India- focused funds have more than 50 per cent of their assets in India
- FPIs are raising concerns that the revenue department could interpret this way to demand tax payments from such funds

- Unit holders could be subject to 20% long- term capital gains tax on their transactions |Short- term tax (less than three years) would be 40% |Matter likely to be taken up with A P Shah Committee

(Business Standard)