

Taxman Argues in Favour Of MAT, FPIs Want Govt To Clarify, End Row

BATTLE RAGES Custodian, bank account and broker contracts mean FPIs have a 'place of business' here, says tax dept

The last mile journey in the dispute over the minimum alternate tax (MAT) could turn out to be a tortuous court feud for many foreign portfolio investors if the government does not step in to keep the taxman at bay and end the controversy once and for all. Even as late as last week, arguing before the Bombay HC the counsel for the I-T department said that FPIs' bank accounts in India, relationship with the custodian that holds the securities on their behalf, and contracts with brokers would be considered to establish that an FPI has a “place of business“ in the country.

The case pertains to the ongoing litigation that followed writ petitions filed by FPIs earlier this year in the Bombay High Court. The government has told the Supreme Court, which was hearing an appeal against a 2012 ruling of the Authority for Advanced Rulings (AAR), that it has accepted the recommendations of the Justice AP Shah Committee.

The committee had said that MAT should not be levied on FPIs which do not have a “place of business“ in India. As a result the SC disposed of the case, meaning the case had become in fruituous as the government did not intend to levy tax.

But, neither the law nor the rules has a definition for “place of business“ -a void that the tax office is using to build its case in the Bombay HC and push its original demand of MAT on foreign investors in the Indian stock market.

If an FPI has a “place of business“-which is akin to be a subset of having a “permanent establishment” (another contentious issue in taxation) -the department is within its right to impose MAT. This would mean 18.5% tax on earnings of FPIs as against short-term capital gains tax for foreign investors entering from treaty destinations like Mauritius and Singapore and an exemption on long-term capital gains for those investing through nontax treaty countries.

“Under the circumstances, the Central Board of Direct Taxes (CBDT) should come out with a clarification that appointing a custodian, a broker, opening bank accounts do not construe place of business. Earlier, in a case involving a large FII, the AAR had said that these arrangements do not reflect a place of business... In fact, these are done simply to comply with Sebi regulations. But AAR rulings are specific in nature and will not hold for other cases,” said a tax expert. The department believes that even though New Delhi has accepted the recommendations of the Shah Committee, it has not accepted the report in its entirety.

The counsel for the department would present its counter-argument which would be vetted by CBDT, the apex tax authority, before the case comes up for hearing on December 3. Tax professionals believe there is a distinct possibility that the Board could clear the fog on the matter.

“If it doesn't, the court cases would be prolonged, and it would be a matter of time before other FPIs are dragged in,” said a senior partner at a reputed law firm. Indeed, left to the interpretation

of income tax assessing officers, the location of servers used by offshore investors to trade on Indian exchanges could also be construed as these investors having “a place of business in the country”.

Since servers, the conduit of algorithmic trades are considered as some kind of permanent establishment in international tax laws, from a commercial perspective most FPIs in the past few years have entered into a licensing arrangement with entities providing the server.

“This was a way to distance themselves from the servers and demonstrate that they do not own the servers which are typically housed in exchange or broker premises,” said the person.

The FPIs and their advisors are awaiting the final circular on MAT, a tax that was first brought into the Income Tax Act, 1961 (ITA) in 1987. Only this, they hope, would put an end to the controversy that had at one stage boiled over to make the market volatile and irk foreign investors.

According to the MAT provision, a company has to pay MAT if the normal tax payable by it is less than the MAT which is calculated on the basis of 'Book Profit' (in the P&L account). Such a levy was brought in to bring Indian companies, which were escaping tax due to multiple deductions, into the tax net and was not aimed at foreign companies.

(Economic Times)