

Tax net: Foreign portfolio investors caught in a bind

At least 200 investors have to furnish financial statements; move seen as part of MAT push

The tax department has asked a number of foreign portfolio investors (FPIs) to make available their profit-and-loss (P&L) statements and balance sheets, though they are not required to do so in the normal course of filing returns.

Typically, such statements are filed by companies.

The department's move is being seen by tax consultants as part of a larger push to levy Minimum Alternative Tax (MAT) on FPIs. Usually, the tax is applicable only to companies.

The department has sought the financial statements of at least 200 FPIs structured as corporate entities. They had been asked to re-file their returns for the financial year ended March 2014, said a person familiar with the matter.

CATCH-22 SITUATION

Tax department has asked foreign investors to re-file returns with financial statements

At least 200 of them have been asked to make submissions

This relates to the financial year ended March 2014

FPIs structured as corporate entities affected

Move seen to be part of push to levy MAT on them

If they refile, tax department could use profit-and-loss statement to levy appropriate MAT

If they don't, they could face penal action for not filing returns

The tax department levies MAT on companies to ensure a minimum tax payment by those earning substantial incomes but escaping taxation due to various exemptions. This levy works out to about 20 per cent of profits. Experts say if FPIs are to furnish P&L statements, the tax department can calculate the MAT they could charge FPIs structured as corporate entities.

Suresh Swamy, partner (financial services), PwC Tax and Regulatory Service, said the requirement had put clients in a position in which they could face issues either way. "Funds have been asked to re-file returns with a balance sheet and P&L account. If they do it, they could be subject to MAT, based on the P&L amount. If they don't, their tax filing will be invalid and they could be subject to penalty proceedings. This makes it a Catch-22 situation," he said.

However Sunil Badala, partner, BSR & Co, said, "The notices under section 139 (9) might be due to a system error rather than anything to do with MAT."

The number of FPIs asked to explain why MAT should not be levied on them has gone up from a handful

in September to at least 50, according to two people familiar with the matter. They said foreign funds had filed representations in this regard and were waiting for further action from the tax department.

"It is our position that there is no MAT payable by foreign portfolio investors, and we have given a representation accordingly," Badala said.

Experts say effectively, a MAT regime acts against the zero per cent long-term capital gains tax and 15 per cent short-term capital gains tax said to be applicable now. If MAT were to be applicable, the effective rate of stock market taxation becomes 20 per cent. This would mean such foreign investors could end up paying higher tax on stock market transactions than domestic investors.

"Primarily, they are relying on a recent decision pertaining to Castleton Investments, according to which MAT can be levied on foreign corporate entities. However, this is an advance ruling and not binding on other taxpayers. It might, at the most, have some persuasive value. In September 2014, the Delhi tribunal, in the case of Bank of Tokyo Mitsubishi, had observed MAT was only payable by companies required to maintain books of accounts under Indian law," said Rajesh Gandhi, director, Deloitte Haskins & Sells.

Now, the tax department is seeking to apply this not only to corporate entities but also portfolio investors structured as corporate entities.

This, experts say, might not stand scrutiny, as FPIs aren't required to maintain a book of accounts under Indian law.

Depository data show foreign investors held a total of Rs 19.03 lakh crore of equity assets and an additional Rs 2.67 lakh crore of debt assets at the end of 2014. A tax official confirmed sending notices in this regard to FPIs, without divulging the number of FPIs who had been sent such notices.

"The opinion of the department will depend on the assessing officer after examining the responses and facts of the case. It will reflect in the order, as and when passed," said an officer on condition of anonymity.

When contacted, the income tax department said it couldn't comment on the issue.

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