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18 April 2020

### Mauritius entities registered as Category 1 FPI under SEBI (FPI) Regulations 2019 not covered under indirect transfer provisions under the Act

Mauritius notified as jurisdiction for entities to register as Category I FPI under SEBI (FPI) Regulations 2019

The Central Government of India specifies Mauritius as an eligible country for the purpose of Regulation 5(a)(iv) of the SEBI (Foreign Portfolio Investors) Regulations, 2019<sup>1</sup>. So, the indirect transfer provisions under the deeming provisions of section 9 of the Income-tax Act, 1961 should not apply to specified entities from Mauritius that will register as Category 1 Foreign Portfolio Investors (FPI) under the SEBI (FPI) Regulations 2019.

#### Background:

Section 9 of the Income-tax Act, 1961 (the Act) deals with cases of income which are deemed to accrue or arise in India. Sub-section (1) of the said section creates a legal fiction that certain incomes are deemed to accrue or arise in India. Clause (i) of said sub-section (1) provides a set of circumstances in which income accruing or arising, directly or indirectly, from India is taxable in India. The said clause provides that all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India shall be deemed to accrue or arise in India.

The Finance Act, 2012 inserted certain clarificatory amendments in the provisions of section 9. The amendments, *inter alia*, included insertion of Explanation 5 in section 9(1)(i) w.e.f. 1st April, 1962. The Explanation 5 clarified that an asset or capital asset, being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

As concerns were raised by stakeholders that the provisions result in multiple taxation, the Finance Act 2017, amended the said section with retrospective effect from 1 April 2012, so as to clarify that the Explanation 5 shall not apply to any asset or capital asset mentioned therein being investment held by non-resident, directly or indirectly, in a Foreign Institutional Investor, as referred to in clause (a) of the Explanation to section 115AD, and registered as Category-I or Category II Foreign Portfolio Investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 made under the Securities and Exchange Board of India Act, 1992, as these entities are regulated and broad-based.

Vide Gazette Notification No. SEBI/LAD-NRO/GN/2019/36, SEBI has notified Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019 [SEBI (FPI) Regulations, 2019] and repealed the SEBI (FPI) Regulations, 2014.

The difference between these two regulations pertinent in the present context is that the SEBI has done away with the broad basing criteria for the purposes of categorisation of portfolios and has reduced the categories from three to two.

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<sup>1</sup> Notification dated 13 April 2020 issued by the Ministry of Finance, Department of Economic Affairs, Financial Market Divisions, Government of India.

In view of the same, necessary modification was needed to be made in the proviso to the Explanation 5 of Section 9 of the Act. Hence, by the Finance Act 2020 the exception from said Explanation 5 provided to an asset or a capital asset, held by a non-resident by way of investment in erstwhile Category I and II FPIs under the SEBI (FPI) Regulations, 2014 was grandfathered. Further, similar exception was provided in respect of investment in Category-I FPI under the SEBI (FPI) Regulations, 2019.

### **Key changes:**

The erstwhile SEBI (FPI) Regulations 2014 had three categories of FPIs and a broad-based fund appropriately regulated or unregulated but having a regulated investment manager could register as Category II FPI. "appropriately regulated" Entity under the erstwhile FPI Regulations 2014 meant if it is regulated or supervised by the securities market regulator. So, broad-based funds from Mauritius etc., which were regulated by the securities market regulator and subject to satisfying other conditions could register as Category II FPI.

However, under SEBI (FPI) Regulations 2019, there are only two categories of FPIs and for Funds to be registered as Category I FPI, *inter alia*, there was a requirement that it should be an entity from an FATF member country or the investment manager should be from a country that is FATF member country.

Regulation 5(a)(iv) of the SEBI (FPI) Regulations 2019 were amended by the SEBI (Foreign Portfolio Investors) (Amendment) Regulations, 2020 dated 7 April 2020, to provide that entities from country specified by the Central Government by an order or by way of an agreement or treaty with other sovereign governments in addition to entities from FATF member countries which are:

- I. appropriately regulated funds;
- II. unregulated funds whose investment manager is appropriately regulated and registered as a Category I foreign portfolio investor:  
Provided that the investment manager undertakes the responsibility of all the acts of commission or omission of such unregulated fund;
- III. university related endowments of such universities that have been in existence for more than five years;

are eligible to register as Category I FPI.

On 13 April 2020, Department of Economic Affairs notified Mauritius as an eligible country for the purpose of above regulation. Accordingly appropriately regulated funds; unregulated funds whose investment manager is appropriately regulated and registered as a Category I foreign portfolio investor and undertakes the responsibility of all the acts of commission or omission of such unregulated fund; and university related endowments of such universities that have been in existence for more than five years should be eligible to register as Category I FPI.

### **Observations:**

The FATF currently comprises 37 member jurisdictions and 2 regional organisations, representing most major financial centres in all parts of the globe.

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<a href="#">Belgium</a>	<a href="#">Gulf Co-operation Council</a>	<a href="#">Malaysia</a>	<a href="#">South Africa</a>
<a href="#">Brazil</a>	<a href="#">Hong Kong, China</a>	<a href="#">Mexico</a>	<a href="#">Spain</a>
<a href="#">Canada</a>	<a href="#">Iceland</a>	<a href="#">Netherlands, Kingdom of</a>	<a href="#">Sweden</a>
<a href="#">China</a>	<a href="#">India</a>	<a href="#">New Zealand</a>	<a href="#">Switzerland</a>
<a href="#">Denmark</a>	<a href="#">Ireland</a>	<a href="#">Norway</a>	<a href="#">Turkey</a>
<a href="#">European Commission</a>	<a href="#">Israel</a>	<a href="#">Portugal</a>	<a href="#">United Kingdom</a>
<a href="#">Finland</a>	<a href="#">Italy</a>		<a href="#">United States</a>

The FATF on 21 February 2020 released the list of "black list" and "grey List" countries.

High-Risk Jurisdictions subject to a Call for Action (black list - this was previously called as Public Statement) – 21 February 2020: Democratic People's Republic of Korea (DPRK) and Iran.

Jurisdictions under Increased Monitoring – Jurisdictions with strategic deficiencies (grey list) -21 February 2020: Albania; The Bahamas; Barbados, Botswana, Cambodia, Ghana, Iceland, Jamaica, Mauritius, Mongolia, Myanmar, Nicaragua, Pakistan, Panama, Syria, Uganda, Yemen and Zimbabwe.

Jurisdictions no longer subject to monitoring 21 Feb 2020: Trinidad and Tobago.

Of the grey list, there are entities from two countries (the Bahamas and Mauritius) that are registered as FPIs. As of date, there is only one FPI from Bahamas registered as Category II while about 574 FPIs from Mauritius of which 167 FPIs are registered as Category I and the remaining are Category II.

Post the publication by FATF, SEBI has clarified vide PR No. 10 / 2020 on 25th February 2020 that FPIs from Mauritius continue to be eligible for FPI registration with increased monitoring as per FATF norms.

Mauritius which is the second largest investor in India under the FPI guidelines, is not an FATF member country and so the funds though regulated by the securities market regulator of Mauritius which is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories), could register only as Category II FPI under the pre-amended SEBI (FPI) Regulations 2019.

With the amendment to SEBI (FPI) Regulations 2019 and the Central Government specifying Mauritius as the eligible country, those specific funds that satisfy the other criteria should now be eligible to register as Category I FPI under SEBI (FPI) Regulations 2019.

Consequently, the indirect transfer provisions under section 9 of the Act should not be applicable to specific Mauritius Entities that should now be registered as Category I FPI under SEBI (FPI) Regulations 2019.



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