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Impact on Foreign Portfolio Investors (FPIs)

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The Finance Minister today presented the Union Budget for the fiscal year 2015-16 meeting most of the demands of FPIs. The key highlights of the budget impacting FPIs are summarized below:

Tax Proposals

- Minimum Alternate Tax (MAT) provisions would not apply to capital gains of FPIs except short-term capital gains which are not subject to securities transaction tax (typically off-market transactions).
Impact - This proposal is a significant relief for FPIs as application of MAT provisions could have resulted in capital gains being taxed at 18.5% instead of current tax exemption for specified long-term gains and 15% tax on short-term gains.
- General Anti-Avoidance Rules (GAAR) have been deferred by 2 years i.e. upto 1 April 2017. Further, GAAR would be applied prospectively only in relation to investments made from 1 April 2017.
Impact – Enactment of GAAR could have adverse implications for FPIs claiming exemption under treaties such as Mauritius, Cyprus, Netherlands, etc. The grandfathering provision could mean that even capital gains arising after 1 April 2017 in relation to investments made before 1 April 2017 will be protected from applicability of GAAR.
- Concessional tax rate of 5% on government securities and eligible corporate bonds extended upto 30 June 2017.
Impact – This could help to retain the attractiveness of Indian debt over other countries.
- Presence of fund manager in India would not result in creation of a Permanent Establishment (PE) for the FPI provided the FPI as well as the fund manager satisfy certain conditions concerning the shareholding pattern, place of control, investments in an Indian entity, corpus of the fund, relationship between the FPI and the fund manager, etc. The conditions are listed in Annexure 1.
Impact – The proposed eligibility conditions might disqualify several funds from benefiting from the relaxation.
- Provisions relating to taxation of indirect transfers have been significantly relaxed. Shares or interest in a foreign entity shall be deemed to derive its value substantially from assets located in India if the value of the Indian assets exceeds INR 100 million and the Indian assets represent at least 50% of the foreign entity's global assets. Also, an exemption has been provided where the transferor

of shares or interest in a foreign entity does not have the right of control and management over the foreign entity and does not hold more than 5% voting power in the foreign entity. The exemption is also available in case of transfer of shares or interest in a foreign company under a scheme of amalgamation or demerger.

Impact – Investors in FPIs which have less than 50% of their assets in India or where the investors hold less than 5% controlling interest in the FPI would be exempt from the indirect transfer provisions.

- Tax exemption for transfer of American Depository Receipts (ADRs) / Global Depository Receipts (GDRs) of Indian companies not listed in India has been removed.

Impact – This creates an uncertainty on tax treatment of gains arising to foreign investors on sale of such ADRs / GDRs.

- Merger of schemes of Mutual funds in India would not be regarded as a taxable transfer in the hands of FPIs provided the merger is between two or more equity oriented schemes or between two or more non-equity oriented schemes.

Impact - This amendment brings merger of mutual fund schemes at par with merger of Indian companies in terms of tax neutrality in the hands of investors.

- Service tax rate has been increased from 12.36% to 14%.

Impact - FPIs currently pay service tax on brokerage fees. The increase in service tax rate would result in marginal increase in transaction costs.

- Increase in surcharge from 10% to 12% on the base tax for non-corporate FPIs whose total income exceeds INR 10 million.

Impact - The increase in surcharge on base tax would effectively increase the tax amount by 1.82% for non-corporate FPIs such as trusts whose total income in India exceed INR 10 million; the current tax rates are tabulated in Annexure 2.

Policy Proposals

- Distinction between different types of foreign investments viz. foreign portfolio investment, foreign direct investment to be done away with.
- Foreign investment to be permitted in Alternate Investment Funds.

- Goods and Service Tax (GST) to be implemented from April 2016 replacing various types of taxes and duties levied by state governments. Implementation of GST would result in developing a common Indian market and reducing the cascading effect on the cost of goods and services.
- Establishment of National Investment and Infrastructure Fund (NIIF) which would raise money by debt issuances and make investments in equity of infrastructure finance companies.
- Launch of tax free infrastructure bonds for projects in the rail, road and irrigation sectors.
- The current regulator of commodities market i.e. the Forward Markets Commission to be merged with the capital market regulator i.e. Securities and Exchange Board of India (SEBI) in order to strengthen the regulatory framework for commodity transactions and thereby reduce speculation.

Economic Highlights

- The consumer price inflation has shrivelled from 11.2% in November 2012 to 5.1% currently.
- The current account deficit as a percentage of GDP has reduced from 4.6% in the first quarter of fiscal year 2013-14 to 1.3% (estimated) in the current fiscal year ending 31 March 2015.
- Gross Domestic Product (GDP) growth has accelerated from 5.1% in fiscal year 2012-13 to 7.4% (estimated) in the current fiscal year ending 31 March 2015 and the growth is expected to be above 8% during the fiscal year 2015-16.
- The fiscal deficit for the current fiscal year 2014-15 is expected to be at 4.1% of GDP as targeted. However, the target for achieving 3% fiscal deficit has been deferred from fiscal year 2016-17 to 2017-18.
- Foreign investments since April 2014 have seen a huge uptake at around US\$ 55 billion resulting in the country's foreign exchange reserves increasing to a record US \$ 340 billion.
- The Indian rupee has become stronger by 6.4% against a broad basket of foreign currencies.



Annexures

Annexure 1

Eligibility conditions for the FPI (fund) and fund manager to avoid PE risk

Fund

The offshore fund shall be required to fulfill the following conditions during the relevant year for being an eligible investment fund:

- (i) the fund is not a person resident in India;
- (ii) the fund is a resident of a country or a specified territory with which an agreement referred to in sub-section (1) of section 90 or sub-section (1) of section 90A has been entered into;
- (iii) the aggregate participation or investment in the fund, directly or indirectly, by persons being resident in India does not exceed five percent. of the corpus of the fund;
- (iv) the fund and its activities are subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident;
- (v) the fund has a minimum of twenty five members who are, directly or indirectly, not connected persons;
- (vi) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;
- (vii) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%;
- (viii) the investment by the fund in an entity shall not exceed twenty percent of the corpus of the fund;
- (ix) no investment shall be made by the fund in its associate entity;

- (x) the monthly average of the corpus of the fund shall not be less than one hundred crore rupees and if the fund has been established or incorporated in the previous year, the corpus of fund shall not be less than one hundred crore rupees at the end of such previous year;
- (xi) the fund shall not carry on or control and manage, directly or indirectly, any business in India or from India;
- (xii) the fund is neither engaged in any activity which constitutes a business connection in India nor has any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf.
- (xiii) the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken on its behalf is not less than the arm's length price of such activity

Fund Manager

The following conditions shall be required to be satisfied by the person being the fund manager for being an eligible fund manager:

- (i) the person is not an employee of the eligible investment fund or a connected person of the fund;
- (ii) the person is registered as a fund manager or investment advisor in accordance with the specified regulations;
- (iii) the person is acting in the ordinary course of his business as a fund manager;
- (iv) the person along with his connected persons shall not be entitled, directly or indirectly, to more than twenty percent of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through such fund manager.



Annexure 2

Capital Gains

| | Corporate Taxpayer | | | Non-Corporate Taxpayer | |
|---|-----------------------------|--|-------------------------------------|------------------------------|------------------------------------|
| | Total Income (upto Rs10 mn) | Total Income (Exceeding Rs10mn but up to Rs. 100 mn) | Total Income (Exceeding Rs. 100 mn) | Total Income (upto Rs. 10mm) | Total Income (Exceeding Rs. 10 mm) |
| Transfer of equity shares, units of equity oriented fund chargeable to Securities Transaction Tax (STT) | | | | | |
| Short-term capital gains | 15.45% | 15.759% | 16.2225% | 15.45% | 17.304% |
| Long-term capital gains | Exempt | Exempt | Exempt | Exempt | Exempt |
| Transfer of securities not chargeable to STT | | | | | |
| Short-term capital gains | 30.90% | 31.518% | 32.445% | 30.90% | 34.608% |
| Long-term capital gains | 10.30% | 10.506% | 10.815% | 10.30% | 11.536% |
| Long-term capital gains (on transfer of units of Mutual funds, other than equity oriented funds) | 20.60% | 21.012% | 21.63% | 20.60% | 23.072% |

Dividend / Interest Income

| | Corporate Taxpayer | | | Non-Corporate Taxpayer | |
|---|-----------------------------|--|-------------------------------------|------------------------------|------------------------------------|
| | Total Income (upto Rs10 mn) | Total Income (Exceeding Rs10mn but up to Rs100 mn) | Total Income (Exceeding Rs. 100 mn) | Total Income (upto Rs. 10mm) | Total Income (Exceeding Rs. 10 mm) |
| Dividend from Indian Companies | Exempt | Exempt | Exempt | Exempt | Exempt |
| Interest on Govt. bonds and certain corporate bonds* upto June 30, 2017 | 5.15% | 5.253% | 5.4075% | 5.15% | 5.768% |
| Income from Securities (excluding above) | 20.6% | 21.012% | 21.63% | 20.6% | 23.072% |

*Rate of Interest on corporate bonds should be within 500 bps of the applicable base rate of State Bank of India

Note 1: Tax rates for Corporate taxpayers are inclusive of surcharge on tax amount @ 2.0% exceeding Rs.10mn but upto Rs. 100mn, above 100 mn the rate of surcharge will be 5% and cess @ 3% on tax + surcharge

Note 2: Tax rates for Non-Corporate tax payers are inclusive of surcharge @ 12% on tax amount only where the income exceeds Rs. 10mm and cess @ 3% on tax + surcharge



Securities Transaction tax (STT)

| Taxable transaction | Rate | Payable by |
|--|--------|--------------------|
| Purchase / sale of equity shares on stock exchanges | 0.1% | Purchaser / Seller |
| Sale of equity oriented mutual fund units on stock exchanges / Redemption of equity oriented mutual fund units | 0.001% | Seller |
| Sale of options | 0.017% | Seller |
| Exercise of options | 0.125% | Purchaser |
| Sale of futures | 0.01% | Seller |
| Sale of unlisted equity shares under an offer for sale to the public included in an initial public offer and such shares are subsequently listed on a stock exchange | 0.2% | Seller |

Note: Securities transaction tax is levied by the stock exchanges and is included in the settlement price of the transaction.



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