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The Pulse

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Pulse is a quick guide to the ongoing tax and regulatory developments in India that are relevant to Foreign Portfolio Investors (FPIs). It highlights key components of changes, their impact on FPIs and the way forward. Our endeavor is to help you comprehend the changes easily and equip you with the requisite knowledge to assist you in staying ahead of the curve.

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Rationalisation of surcharge rate



The Indian tax law provides for separate rates of surcharge on the tax amount depending upon the type of taxpayer, it's residential status, the type of income it earns and the quantum of total taxable income. Due to different surcharge rates, the effective rate of tax is not the same across taxpayers. For instance, the effective rate of tax on short term capital gains arising from sale of listed equities on a total income of INR 20 million would be 15.91 percent/17.47 percent/17.94 percent for FPIs set up as a company / partnership / Trust, due to different surcharge rates.

Effective April 2020, the Indian tax law was amended to shift the taxation of dividends from the company distributing dividends to its shareholders. The tax rate for non-resident shareholders including FPIs on dividend income is 20 percent which is to be increased by the applicable surcharge and cess. While the surcharge rate on tax payable on dividends for corporates and partnerships is in line with the surcharge on capital gains, for other types of taxpayers, e.g., trusts, the surcharge rates on dividend tax can be as high as 37 percent where the income of a taxpayer exceeded INR 50 million. This meant that the highest effective tax rate on dividend income for a trust would be 28.496 percent, as against 21.84 percent for a company.

Acceding to the representations made by various stakeholders, in September 2020, the government amended the tax law whereby the maximum surcharge on dividend tax for non-corporate and non-partnership FPIs was capped at 15 percent. This has brought a significant tax relief reducing the highest effective tax rate from 28.496 percent to 23.92 percent for such FPIs.

It is pertinent to note that the above rationalisation in surcharge rates has been made only for FPIs and not for other taxpayers. As a result, other non-corporate and non-partnership taxpayers which are not FPIs, e.g., domestic funds, investors under Foreign Direct Investor route, would still be subjected to higher surcharge of 25 percent and 37 percent on the dividend tax.

Status of FPI	Particulars	Income <u><</u> INR 5M	Income > INR 5M < INR 10M	In come > INR 10M < INR 100M	In come > INR 100M
Corporate	Surcharge rate	NIL	NIL	2%	5%
	Effective dividend tax rate	20.8%	20.8%	21.216%	21.84%
Partnership Firm	Surcharge rate	NIL	NIL	12%	12%
	Effective dividend tax rate	20.8%	20.8%	23.296%	23.296%
Non-Corporate (including trusts, association of persons, in dividuals, artificial juridical persons)	Surcharge rate	NIL	10%	15%	15%
	Effective dividend tax rate	20.8%	22.88%	23.92%	23.92%

The table below provides the varying surcharge and effective dividend tax rates for different types of taxpayers:

GIFT IFSC – Emerging global fund jurisdiction



India has set up its first International Financial Services Center (IFSC) in the western state of Gujarat as part of the Gujarat International Finance Tec-City (GIFT). The GIFT IFSC is considered as an offshore jurisdiction under exchange control regulations and a host of financial services can be offered in IFSC encompassing capital markets, banking, insurance, asset management, and ancillary services. The Government of India has offered significant tax incentives for entities set up in IFSC including a 10 year tax holiday, exemption from Minimum Alternate Tax or MAT (for domestic companies that opt for the new corporate tax regime) and exemption from the Goods and Services Tax (GST). Additionally, there is no transaction tax levied on securities and commodities traded on the stock exchanges set up in the IFSC.

In September 2020, the following tax reliefs were introduced for Category III Alternative Investment Funds (AIFs) set up in IFSC:

- Gains arising from transfer of Indian securities (except shares of Indian companies) are exempt from tax, to the extent such gains pertain to investments made by non-residents in the AIF
- All income arising from foreign securities and from transfer of foreign securities are exempt from tax, to the extent such income pertains to investments made by non-residents in the AIF
- Income from Indian securities, e.g., dividend, interest, etc., is taxable at 10 percent

• Investors in AIF are exempt from tax in respect of their investments in the AIF

In addition to tax incentives for the fund, the IFSC also offers significant tax incentives to asset managers which include the following:

- A 10-year tax holiday from corporate tax
- No MAT payable provided the Asset Management Company set up in IFSC opts for the new corporate tax regime
- No GST on fund management fees

With the introduction of the above tax reliefs, from the Indian tax standpoint, a fund set up in IFSC enjoys similar benefits as compared to a fund set up in certain popular fund jurisdictions such as Mauritius, Singapore, and Ireland, as can be seen in the below table:

	Comparison of fund jurisdictions from a taxation perspective						
	GIFT-IFSC	Mauritius	Singapore	Ireland			
Capital gains from transfer of shares of Indian companies	Taxable at Indian domestic tax rates	Taxable at Indian domestic tax rates	Taxable at Indian domestic tax rates	Taxable at Indian domestic tax rates			
Capital gains from transfer of other Indian securities	Not taxable (tax exemption provided in domestic tax law)	Not taxable under the treaty provided non- resident qualifies for treaty benefits	Not taxable under the treaty provided non- resident qualifies for treaty benefits	Not taxable under the treaty provided non- resident qualifies for treaty benefits			
Dividend from Indian shares	Taxable at 10% (plus applicable surcharge and cess)	Taxable at 15% under the treaty provided non-resident qualifies for treaty benefits	Taxable at 15% under the treaty provided non-resident qualifies for treaty benefits	Taxable at 10% under the treaty provided non-resident qualifier for treaty benefits			
 Interest from Indian securities: 1) Government securities 2) Corporate bonds where coupon is within 500 bps of base rate of State Bank of India 	Taxable at 10% (plus applicable surcharge and cess)	Taxable at 5%	Taxable at 5%	Taxable at 5%			
Interest from other Indian securities	Taxable at 10% (plus applicable surcharge and cess)	Taxable at 7.5% under the treaty provided non-resident qualifies for treaty benefits	Taxable at 15% under the treaty provided non-resident qualifies for treaty benefits	Taxable at 10% under the treaty provided non-resident qualifier for treaty benefits			
Income from foreign securities or from transfer of such foreign securities	Nottaxable	Not taxable (outside the purview of Indian tax)	Not taxable (outside the purview of Indian tax)	Not taxable (outside the purview of Indiar tax)			
Whether tax benefits subject to anti abuse rules under treaties	No	Yes	Yes including PPT	Yes including PPT			

The aforementioned tax incentives have generated interest amongst fund managers, particularly managing India focused funds, to explore setting up of investment funds to pool foreign money for inbound investments into India and to pool domestic money for outbound investments from India. Having said so, there are still some concerns (discussed below) which need to be addressed:

- 1) Investment manager to be located in GIFT IFSC: In the current regime, it is mandatory to have the investment manager of the fund located in GIFT-IFSC. Many international fund jurisdictions such as Mauritius, Ireland, Luxembourg do not insist upon the location of investment manager in the same jurisdiction. This flexibility has helped development of large-scale fund industry in these jurisdictions.
- 2) **Co-investment by Sponsor / Investment Manager**: In the current regime, it is mandatory for the Investment Manager or Sponsor of the fund located in GIFT-IFSC to maintain a continuing investment interest in the fund as follows:
 - Category I & II AIF: 2.5 percent of the corpus of the fund or USD 750,000, whichever is lower
 - Category III AIF: 5 percent of the corpus of the fund or USD 1,500,000, whichever is lower

The co-investment condition is likely to apply to all the schemes of an AIF set up in the GIFT-IFSC. As a result, each fund / scheme set up in GIFT-IFSC would need capital contribution by the Investment Manager or Sponsor of the fund.

- 3) Investments by Indian citizens in a fund in GIFT-IFSC: Since the fund set up in GIFT-IFSC would also need to register as an FPI under SEBI (FPI) Regulations 2019, it would be subject to FPI restrictions which a domestic fund is not subject to. For instance, investments by Indian citizens residing abroad (Non-resident Indians NRIs and Overseas Citizens of India OCIs) would be subject to following restrictions:
 - Investment by a single NRI / OCI should be less than 25 percent of the corpus of the fund
 - Investment by all NRIs / OCIs taken together should be less than 50 percent of the corpus of the fund

Given that NRIs / OCIs are the primary target investors for funds set up by Indian fund managers, the Government could consider relaxing the above conditions for set up in GIFT-IFSC.

Clock is ticking: Investment restriction for Indian citizens and persons of Indian origin



Investment in FPIs by Indian citizens and persons of Indian origin are subject to following conditions:

- Investments by a single RI / NRI / OCI in the fund should be less than 25 percent corpus of the fund
- Investments by all RIs / NRIs / OCIs taken together should be less than 50 percent corpus of the fund
- RIs are permitted to invest in an FPI provided:
 - Such investments are made under the Liberalised Remittance Scheme (LRS); and
 - Indian assets represent less than 50 percent of the global assets of such FPI

The above conditions were introduced in the Operational Guidelines issued by SEBI in November 2019 and the existing FPIs (at the time of issuance of Operational Guidelines) were given time until 31 December 2020 to comply with the above conditions and new FPIs set up post issuance of the said Operational Guidelines get two years (from the date of registration) to comply.

In case an FPI is not able to comply with the above conditions by the stipulated timelines, it would not be permitted to purchase any securities post the stipulated timeline and would need to dispose its Indian holdings within 6 months, post the stipulated timeline.

It is interesting to note that while NRIs / OCIs are free to invest in India under the FDI, FVCI and NRI-PIS routes, they need to comply with the above limits while investing through the FPI route. Further, though the Hon'ble Finance Minister of India proposed merger of NRI-PIS and FPI routes in her Budget speech last year, such a merger is yet to be effected and it is not clear whether the above restrictions (on investments by NRIs / OCIs in FPIs) would be removed after merger of the two routes.

Key tax updates



Return filing deadlines

India follows a tax year that runs from April to March and the tax returns are required to be filed by 31 July / 31 October / 30 November for different types of taxpayers. Considering the COVID-19 situation, Indian authorities have extended the tax return filing timelines for the income earned in financial year 2019-20 as follows:

Type of FPI	Original timeline	Extended timeline
FPIs that have international transactions triggering transfer pricing compliances	30 November 2020	31 January 2021
Corporate FPIs where transfer pricing compliances are not triggered	31 October 2020	31 January 2021
Non-corporate FPIs where transfer pricing compliances are not triggere	d 31 July 2020	31 December 2020

Faceless Assessment Scheme

The Central Board of Direct Taxes (CBDT) had first initiated paperless assessment in October 2015 in case of select non-corporate taxpayers. In August 2018, the CBDT mandated e-proceedings for all regular assessments with certain exceptions. In September 2019, the CBDT introduced E-assessment Scheme 2019 to eliminate personal interaction between taxpayer and the tax department. In September 2020, the e-assessment scheme 2019 was incorporated into the tax law itself with its name changed to "Faceless Assessment Scheme, 2019" and its scope expanded significantly.

Under the updated scheme the assessment will be coordinated by the National Faceless Assessment Center (NFAC) which will communicate with the taxpayer and various other units within the tax department including assessment unit, technical unit and review unit for completion of assessment proceedings. The taxpayer needs to provide information / documents / evidences

sought for by NFAC within the stipulated timeline failing which the assessment maybe completed on a best judgement basis by the authorities. After completion of assessment queries, the NFAC will issue the final assessment order to the taxpayer if the order is not prejudicial to the interest of taxpayer; otherwise NFAC will issue a show cause notice to the taxpayer giving him an opportunity of being heard. In case of FPIs, after completion of all such proceedings, if the assessment order is still preju dicial to the interest of taxpayer, NFAC will issue a draft assessment order which can be appealed against by FPI taxpayers before the Dispute Resolution Panel (DRP). In such cases, the final assessment order will be issued by NFAC based on the directions of DRP. After completion of assessment, all the electronic records of the case shall be transferred by NFAC to the jurisdictional Assessing Officer.

The faceless assessment scheme is a step towards strengthening the resolve made by the Government under the 'Transparent Taxation – Honoring the Honest' platform. Having said so, with the implementation of this scheme, taxpayers (and their representatives) would not have an opportunity to personally meet / speak to the tax authorities to explain the positions adopted by the taxpayers or explain certain important aspects relevant for the tax return. It is hoped that the tax authorities would duly consider the submissions made by the taxpayers in faceless assessment proceedings and would not mechanically disregard the submissions to complete the assessments in favor of Revenue.

Recent tax rulings



Brought forward capital losses need not be set-off / adjusted against current year exempted capital gains under tax treaty

Goldman Sachs Investments (Mauritius) Ltd. vs. Deputy Commissioner of Income Tax, (International Taxation), [2020] 120 taxmann.com 23 (Mumbai - Trib.), ITAT Mumbai

A Mauritian company (taxpayer) was registered as a Foreign Institutional Investor (FII) in India. During the Financial Year (FY) 2012-13, it earned short term capital gains which were claimed as not taxable in India under Article 13 of the India-Mauritius tax treaty. Also, the taxpayer had losses brought forward from past years as well which were carried forward in the return of FY 2012-13. During the course of audit proceedings, the Assessing Officer (AO) did not allow the carry forward of past year losses) on the grounds that the term 'income' or 'profits and gains' included losses as well. Since the 'capital gains' derived by the taxpa yer were not taxable in India by virtue of the India-Mauritius tax treaty, 'capital losses' also were not to be included in the total income of the taxpayer and therefore the losses were not eligible to be carried forward. The taxpayer filed objections against the AO's order with the Dispute Resolution Panel (DRP). Though the DRP allowed carry forward of past year losses, it held that such losses should be offset against gains for the current year and only remaining losses (if any) should be carried forward to subsequent years.

Aggrieved, the taxpayer filed an appeal before the Mumbai Income Tax Appellate Tribunal (ITAT) which ruled in favor of the taxpayer. The following observations of the ITAT are noteworthy:

- Since the capital gains earned by the taxpayer were exempt under the India-Mauritius tax treaty, there would not be any occasion for seeking an adjustment of brought forward losses against such exempt income. Accordingly, the brought forward losses were rightly carried forward by the taxpayer to subsequent years.
- It is for the taxpayer to examine whether the provisions of the Income Tax Act (ITA) or tax treaty are beneficial to it, based on its precise factual position and applicable legal provisions.

• In any case, a tax treaty cannot be thrust upon a taxpayer. In case the taxpayer does not opt for the tax treaty in a particular year, it would not be precluded from availing the benefits of the said treaty in the subsequent years.

Accordingly, the ITAT held that the brought forward losses need not be adjusted against the exempt capital gains of the current year and were eligible to be carried forward to subsequent years.

Exceptions to indirect transfer provisions introduced by Finance Act, 2015 are applicable retrospectively

Augustus Capital PTE Ltd Vs. The Dy.C.I.T, Circle 1(1), International Taxation, New Delhi (ITA No. 8084/DEL/2018), ITAT New Delhi

A Singapore company (taxpayer) made investments in another Singapore company (S Co.) which in turn held certain investments in India. During fiscal year 2014-15, the taxpayer sold its entire investment in S Co. to an Indian company and was of the view that the said transaction was not taxable in India since the taxpayer held less than 5 percent in S Co. Under the amended indirect transfer provisions effective 1 April 2016, a person who has held less than 5 percent shares / interest in the foreign entity, is outside the ambit of the indirect transfer tax. The AO however, rejected the claim of the taxpayer on the basis that the small shareholder exemption was introduced in the indirect transfer tax effective 1 April 2016 and therefore such exemption would not be available for fiscal year 2014-15. The taxpayer then proceeded to file objections before the DRP; however, the DRP also upheld the AO's order.

Aggrieved, the taxpayer filed an appeal before the Delhi ITAT wherein the ITAT held as follows:

- The charging provision (i.e. Explanation 5 to Section 9(1)(i)) of the ITA is applicable retrospectively with effect from 1 April 1962 and the same has been expressly provided for in the law
- Because of certain ambiguities and apprehensions in the aforesaid provision, Explanations 6 and 7 were added to Section 9(1)(i) of the Act to by the Finance Act of 2015, to inter-alia exempt small shareholders from indirect transfer provisions
- Since the charging provision has been given a retrospective effect and the explanations have been inserted in furtherance of the object of the charging provisions, they cannot be read in isolation and have to be tagged with the charging section

Accordingly, the ITAT ruled that the exemption to small shareholders and other exceptions to indirect transfer provisions (inserted vide Finance Act 2015) are applicable retrospectively (from 1 April 1962) and therefore sale of investments by taxpayer in S Co. would not be taxable in India.

Income from different streams may be offered at tax at different rates beneficial to the taxpayer Director of Income Tax, International Taxation v. IBM World Trade Corporation [2020] 120 taxmann.com 151 (Karnataka), High Court of Karnataka

During FY 2007-08, a foreign company (taxpayer) was in receipt of royalty pursuant to various agreements that were entered before as well as after 1 June 2005. Since the then Income tax law provided for different tax rates based on the time period as to when the agreements had been entered, the royalty so received was offered to tax, as follows:

- In respect of agreements entered on or after 1 June 2005: As per the ITA, since the then tax rate under the ITA was favourable
- In respect of agreements entered before 1 June 2005: As per the relevant tax treaty, since the tax rate under the treaty was favourable

In respect of the agreements entered on or after 1 June 2005, the tax officer did not accept the tax determined as per the ITA and levied the tax at a uniform rate in accordance with the tax treaty for all the agreements. On appeal, the Commissioner (Appeals) upheld the order of the tax officer holding that income which was assessable could not be split to find out whether the provisions of the ITA were beneficial or whether the provisions of treaty were beneficial; and that the taxpayer had to either opt

for provisions of treaty or provisions of the ITA. Aggrieved by the order of the Commissioner (Appeals), the taxpayer further appealed to the Tribunal wherein the Tribunal held as follows:

- The ITA prescribes separate tax rates for royalty income based on the time period of entering into the agreement and to this effect, separate clauses have been provided in the ITA
- Each of the clauses are mutually exclusive and independent of each other and create a charge of income-tax under section 4 of the ITA
- Accordingly, the taxpayer is to compute tax on its income under each of the clauses separately
- The contracts or agreements being source of income, had been entered on different dates and the statute recognises such differentiation and provides for separate tax rates for each stream
- Since the provisions under which the royalty income is taxable are different, the taxpayer is justified in offering the royalty income arising under two different contracts at two rates one under the ITA and one under the treaty, whichever is more beneficial to it

The above decision of the ITAT has also been upheld by the High Court of Karnataka, thereby allowing the taxpayer to apply provisions of the ITA or treaty with respect to income from different contracts / transactions even though they would fall under the same head of income.

Other notable tax rulings

Rights under an agreement are a capital asset and income from relinquishing such rights are taxable as capital gains

Chandrashekar Naganagouda Patil v. Deputy Commissioner of Income Tax, Circle 6(2)(1), Bangalore [2020] 117 taxmann.com 520 (Bangalore - Trib.), ITAT Bangalore

A taxpayer entered into an agreement to purchase a vacant site (property) in India and paid a certain amount as an advance to the vendor. As per the terms of the agreement, the taxpayer had a right to transfer the property to another party and accordingly, the taxpayer nominated a third party to purchase the property for a consideration. In the return of income filed by the taxpayer, it offered the income to tax as income from capital gains. However, the AO assessed the income as that from other sources, on the basis that the taxpayer did not have any right over the property, except a right to get refund of advance paid. The taxpayer appealed to the Commissioner (Appeals); however, the AO's order was upheld. On a further appeal to the ITAT, it was held that the act of giving up a right in an agreement amounted to relinquishment of a capital asset and accordingly, the amount had rightly been offered to tax as income from capital gains.

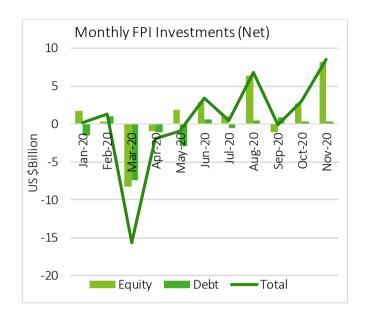
If the amount of refund issued does not include interest due payable on amount refunded, the authorities would be liable to pay interest on short fall

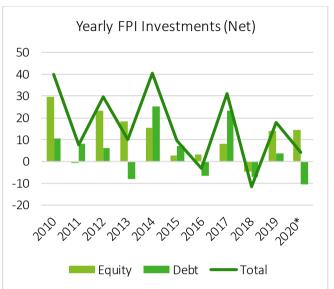
Commissioner of Income Tax v. Syndicate Bank [2020] 120 taxmann.com 227 (Karnataka), High Court of Karnataka

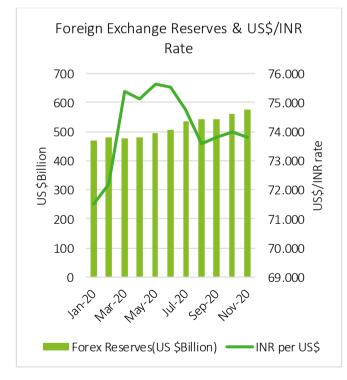
A taxpayer had filed an appeal with the Commissioner (Appeals) in respect of a return of income filed by it for a particular year. While disposing the appeal, the Commissioner granted interest to the taxpayer on the excess taxes paid. The AO however did not grant the said interest to the taxpayer and filed an appeal against the same. In this regard, the High Court held as follows:

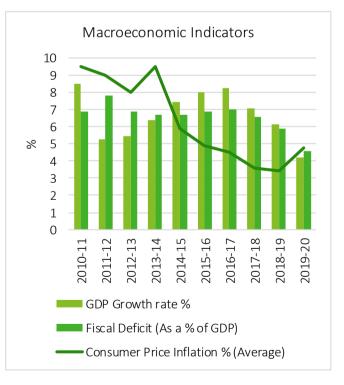
- The language of section 244A of the ITA is clear and unambiguous. The section speaks of the interest on refund due to a taxpayer and the same is to be calculated on the amount due to such a taxpayer
- In previous judicial decisions, it has been held that the authorities are liable to pay interest on the amount of interest. Further, in the phrase 'refund of amount due to the taxpayer', the interest component will also partake the character of amount due under section 244A of the ITA i.e. while calculating the amount due to a taxpayer, along with the additional taxes paid, the interest due also has to be taken into consideration
- Accordingly, when an order of refund is issued, the same should include interest payable on the amount, which is refunded. If the refund does not include interest due payable on the amount refunded, the authorities would be liable to pay interest on the short fall. This does not amount to payment of interest on interest.

Key trends at a glance









* Up to 30 November 2020

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