

Foreign funds sidestep tax havens

Overseas investors making fresh investments into India directly from home countries

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Overseas funds investing in India from Mauritius and Singapore are either winding down or stopping fresh investments from the regions, in favour of home countries such as the US and the UK or even regions such as the Cayman Islands, Ireland, and Luxembourg.

India had renegotiated its tax treaties with Mauritius and Singapore in 2016. Based on the new arrangement, Indian equities acquired prior to April 1, 2017, were grandfathered and granted capital gains tax exemption. Shares acquired on or after this period, and sold before April 1, 2019, had to pay concessional tax at 50 per cent of the domestic rate.

Many long-only equity funds from Mauritius and Singapore continued to operate from these regions during this transition phase, given the grandfathering clause still applied. Now that the transition period has ended, there is no add-on benefit in operating from these countries, unless the fund invests in derivatives or debt instruments, said experts.

"If the fund is a pure long-only fund, Mauritius or Singapore are no different from, say, the US or the UK. The funds do not want to incur the additional cost for the Mauritius or Singapore entity, if it brings no additional benefit," said a person familiar with the matter.

Equity investments on or after April 1, 2019,

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will be taxed 10 per cent for investments greater than one year, and at 15 per cent for those below a year. Many funds are making fresh investments directly from the US or Europe. Out of the 271 new fund registrations since January 1, 2019, one-third has come from the US and another 25 per cent from Cayman, Ireland, and Luxembourg, accord-

TOP 10 COUNTRIES INVESTING INTO INDIA

Country	Assets under custody (₹ trillion)
US	10.93
Mauritius	4.58
Luxembourg	3.26
Singapore	3.10
UK	1.51
Ireland	1.15
Japan	1.13
Canada	1.03
Netherlands	0.77
Norway	0.75

*As of March 2019

Source: NSDL

ing to PRIME Database. Mauritius and Singapore constitute 12 per cent of new fund registrations.

"Some of the long-only funds from Mauritius and Singapore have been looking at folding into the parent structure, though several funds continue to use Mauritius due to regulatory ease and lower operational costs," said Rajesh Gandhi, partner, Deloitte India. "In certain situations, funds could also consider setting up a parallel structure elsewhere and slowly wind down the existing structures in Mauritius or Singapore."

Another reason for moving away from

Mauritius and Singapore, according to experts, is that the structure will be tested by tax authorities from a GAAR (general anti-avoidance rule) perspective, where the fund will have to prove it has substance to claim treaty benefits. "The likelihood of investors coming from these jurisdictions purely for tax reasons is very low," said Anish Thacker, partner, EY India.

According to him, existing closed-ended funds in Mauritius and Singapore, with grandfathered positions, will continue to hold their positions till they find the right time to liquidate these, as will open-ended funds where tax may not be a key driver.

Gandhi believes it may not be easy to shift Indian investments between different jurisdictions, given off-market transfer of listed securities is not allowed except in the case of multiple investment manager (MIM) structures. "Shifting through the market route involves significant costs and is therefore, highly inconvenient," he said. MIM structures allow multiple FPI registrations. Funds that desire to invest in Indian debt or derivative instruments may continue to look at Mauritius or Singapore as preferred jurisdictions as the treaties still do not permit India to tax gains arising from transfer of these instruments. Debt investors have to pay tax on the interest portion, but the tax treaties provide for a concessional rate of tax, subject to satisfaction of the beneficial owner test.

"The requirements to show that investment from these jurisdictions was not for the main purpose of obtaining a tax benefit or establishing beneficial ownership of the income by the funds, still remain key considerations for these funds," said Thacker.