ICI Global

Keith Lawson
DEPUTY GENERAL COUNSEL – TAX LAW

110 Bishopsgate
19th Floor, Suites 19-06 and 19-07
London EC2N 4AY, UK
+44 (0) 207 961 0830
www.iciglobal.org

Suite 715–717, Level 7
Two Exchange Square
8 Connaught Place
Central, Hong Kong
+852 2168 0882

1401 H Street, NW
Suite 1200
Washington, DC 20005, USA
+001 202 326 5800
www.ici.org

+001 202 326 5832
MOBILE: +001 202 957 7226
lawson@ici.org

By Electronic Delivery

March 1, 2018

Shri Arun Jaitley
Honourable Finance Minister
Ministry of Finance
North Block
New Delhi – 110 001
India

Re: *Foreign Investment Funds' tax concerns with amendments proposed in the Finance Bill, 2018*

Honourable Finance Minister,

On behalf of our members, ICI Global[1] would like to bring to your attention two substantial concerns with proposals included in recent amendments that have been proposed in the Finance Bill, 2018.

First, we have substantial concerns with the proposed taxation under the new section 112A of previously exempt long-term capital gains (LTCGs). Our specific concerns, as explained below, are that:

1. The proposed 10 percent tax will discourage long-term investment in Indian securities;
2. The proposal will be even more harmful to Indian investment unless the securities transaction tax (STT) is abolished;
3. Foreign Portfolio Investors (FPIs) must be expressly covered by the step-up in the acquisition cost of long-term capital assets (LTCAs) and the exemption of Rs 100,000 of LTCGs;
4. FPIs must be expressly permitted to step-up the acquisition cost of LTCAs regardless of whether the FPI realizes either (i) an aggregate net long-term capital loss (LTCL) in an assessment year or (ii) an aggregate LTCG in an assessment year but has adequate brought-forward tax losses that are available for set-off fully against such LTCG; and
5. The cost-of-acquisition step-up may not be available for certain genuine transactions.

[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$30.0 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

Second, we have substantial concerns with the proposed expansion of the list of persons required to obtain a Permanent Account Number (PAN). Our specific concerns, as explained below, are that:

1. The proposed expansion, perhaps unintentionally, may cause every individual connected to a FPI group, including key personnel of the group, to seek tax registration in India;
2. Foreign nationals may not be willing to obtain Indian tax registration and divulge their personal details without having any personal income taxable in India;
3. No clarity is provided regarding either how compliance will be monitored or what would be the potential consequences to FPIs of non-compliance by their key personnel; and
4. No clarity is provided regarding whether an income-tax return filing form will require disclosure of such PAN details of key personnel.

Background

Many of the members of our organizations are large pedigreed fund houses that have made significant portfolio investments (*i.e.*, non-controlling investments) in Indian listed companies. Our members' investment funds are widely regarded by international peers as global leaders in terms of their approach to governance, investment policies, the scale of their assets, and their solid performance.

Our members are widely-held, hold a diversified portfolio of securities, and are subject to investor-protection regulations in the country in which they are established; these funds commonly are known as "collective investment vehicles" or "CIVs."[2] Interests in these funds may be purchased and sold by individual investors every day. These funds typically have tens or hundreds of thousands of investors (or more). These CIVs invest in Indian securities in their capacity as either Securities and Exchange Board of India (SEBI) registered Foreign Institutional Investors (FIIs) or FPIs under the SEBI (FPI) Regulations, 2014.

LTCG Concerns (An Introduction to Five Separate Concerns)

At the outset, we respectfully submit that our members are surprised with the Indian Government's proposal to impose a 10 percent tax[3] on LTCGs arising from transfer of certain specified LTCAs.[4] We believe that most of the reasons articulated in the memorandum to the Finance Bill, 2018 for introducing a tax on LTCGs are not entirely relevant in case of FPIs. More specifically, (i) FPIs are financial investors and do not undertake manufacturing activities in India, and (ii) the abusive use of tax arbitrage opportunities is not something that is usually associated with FPI investments.

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[2] We use the term "CIV" as it was used by the Organisation for Economic Co-Operation and Development (OECD) in its 2010 Report on "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" (the "CIV Report"). http://www.oecd.org/dataoecd/59/7/45359261.pdf.

[3] As noted below, the effective tax rate is higher than 10 percent because of the applicable surcharge (of 5 or 15 percent) and cess (of 4 percent).

[4] LTCAs, for section 112A purposes, would mean: (i) equity shares, (ii) units of equity oriented mutual funds and (iii) units of a business trust. Equity shares should be subjected to STT at the time of acquisition and transfer, except for those transactions that may be notified. Units of equity-oriented mutual funds and business trusts should be subjected to STT at the time of transfer.

Equally importantly, any tax on LTCGs is likely to discourage foreign investment; the resulting impact on the Indian securities markets will be negative.

We also are concerned about the lack of clarity regarding how the tax would be applied. This issue is critical to CIVs because they must value their portfolio securities every day to determine for their investors the per-share net asset value (NAV) of the CIV. More specifically, CIVs need to know every day the tax that would be due if the security were sold that day—as the tax liability reduces the value to the CIV's investors of that security. For example, if a security that trades for 20*x* was purchased for 10*x*, and is subject to a tax of 10%, the CIV would value the security at 19*x*—because tax of 1*x* (10% of the 10*x* unrealized gain) would be due if the security were sold.

CIVs today account for the short-term capital gains (STCGs) tax in valuing their Indian securities; once the tax no longer is due, because the long-term holding period has been reached, the security either is marked exempt in the system or moved to a separate accounting system.

The timing of these changes, consequently, also is problematic. Many CIVs will need to develop systems to apply the proposed Indian LTCG tax to their securities and to coordinate the long-term and short-term systems to determine the net tax liability on their entire portfolio of Indian securities.

Our specific concerns on the proposed amendment to tax LTCGs are as follows.

Part A: The proposed 10 percent tax will discourage long-term investment in Indian securities

The proposed tax rate of 10 percent on LTCGs (with STT paid), for three reasons, will discourage FPIs from making long-term investments in Indian securities. First, any tax on LTCGs reduces the net return from making a cross-border investment into India and, consequently, makes investment in other countries more attractive on a relative basis.[5] Second, the differential between the 10 percent tax rate on LTCGs and the 15 percent tax rate on STCGs, with STT paid, may not be a sufficient incentive to encourage long-term holdings. Third, the systems changes necessary for CIVs to value correctly their Indian securities will be costly and may not be operational by the proposed implementation date.

The Indian Government repeatedly has recognized the value to India of long-term investments by FPIs. In 1992-93, for example, the Government issued "Old Guidelines for Foreign Institutional Investors"[6] (the 'GOI Guidelines'); these guidelines operationalized the policy announcement in that year's Union Budget for allowing FIIs to invest in the Indian financial markets. The GOI Guidelines, among other things, had specified differential tax rates for taxing LTCGs and STCGs earned by FIIs. The GOI Guidelines specifically state that the rationale for prescribing differential tax rates for LTCGs and STCGs was to induce FIIs to retain their investments as long-term.

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[5] Importantly, the disincentive to foreign investment created by the proposed 10 percent tax is even higher because, as noted above, these transactions already are subject to other charges (in addition to STT). Specifically, FPI gains are subject to a surcharge (of 5 percent for corporate FPIs and 15 percent for non-corporate FTIs) and a health and education cess of 4 percent (increased from 3 percent). Thus, the pre-STT tax rates on LTCGs would be 10.92 percent for corporate FPIs and 11.96 percent for non-corporate FPIs. The pre-STT tax rates on STCGs would be 16.38 percent for corporate FPIs and 17.94 percent for non-corporate FPIs.

[6] Press Note dated September 14, 1992.

At present, capital gains earned by various categories of tax payers are taxed as follows:

Listed LTCAs	FPIs	Residents	Other non-residents
LTCGs (STT paid)	0%	0%	0%
LTCGs (non-STT paid)	10%	10% (without claiming indexation benefits)	20% (with indexation benefits) or 10% (without claiming indexation benefits)
STCGs (STT paid)	15%	15%	15%
STCGs (non-STT paid)	30%	30%	40%

As you will observe, LTCGs are (and have always been) taxed at a rate that is substantially lower than the tax rate applicable to STCGs. When the tax rates for STCGs (non-STT paid) and LTCGs (non-STT paid) are compared, for example, you see that the LTCG (non-STT paid) rate is (i) *one third* in case of FPIs and Indian tax residents and (ii) *one quarter to one half* in case of other Indian tax non-residents. The difference is even more pronounced for LTCGs (STT paid); specifically, whereas LTCGs (STT paid) are not taxable, STCGs (STT paid) are taxed at 15 percent.

Under the Union Budget proposal, the 10 percent tax on LTCGs (STT paid) will be *two thirds* of the tax rate applicable to STCGs (STT paid). By increasing the proximity between the tax rates for LTCGs and STCGs, FPIs will have less incentive to hold investments in Indian listed securities for a longer period of time; the result could be increased volatility in the Indian securities markets.

Our request

While we recognize India's sovereign right to tax income earned therein, and understand the need for tax revenues to support India's remarkable growth, we are concerned that the proposed tax will discourage longer term investments in Indian securities and could impact India negatively. Our investment-disincentive concern is heightened because these transactions also would be subject to a surcharge and cess. Thus, the proposal would increase the pre-STT effective tax rate on LTCGs from zero to either 10.92 (for corporate FPIs) or 11.96 percent (for non-corporate FPIs).

Our preferred position, consequently, would be for the LTCG proposal to be abandoned.

Second, if the proposal is not abandoned, its implementation should be delayed for one year—with respect to CIVs—so that systems can be developed to calculate every day the net after-tax value of the entire Indian securities portfolio. If a CIV cannot comply effectively with its securities-law valuation obligations, it might have no choice but to temporarily abandon the Indian market.

Finally, should the Government conclude that the tax must be imposed, we request that the tax rate on LTCGs (STT paid) be lowered—thereby increasing the long-term saving incentive. Specifically, we request that the Indian Government levy the tax on LTCGs (STT paid) under section 112A at a 5 percent rate; this rate would mirror the current one-third differential—for FPIs and Indian residents—with respect to LTCGs (non-STT paid) and STCGs (non-STT paid). A higher rate of 7.5 percent would mirror the current one-half differential—for other non-resident investors—with respect to LTCGs (non-STT paid) and STCGs (non-STT paid).

Part B: The proposal will be even more harmful to Indian investment unless the STT is abolished

We also are surprised that the Indian Government proposes to introduce a tax on LTCGs without abolishing the STT regime.[7] The STT regime was introduced in 2004 as one of the measures to simplify the tax regime applicable to securities transactions. The introduction of STT was accompanied by a reduction in the tax rates on LTCGs and STCGs arising from listed securities to 0 percent and 10 percent,[8] respectively. The Honourable Finance Minister had, at the time, called the new tax regime a win-win situation for all.

Introducing tax on LTCGs (STT paid) without abolishing the STT regime is inconsistent with the STT's purpose. Investors now will pay taxes (STT) on the purchase and sale transactions implemented on an Indian stock exchange, as well as on the associated capital gains. By increasing the high incidence of tax for investors, FPI trading on the Indian bourses will become more expensive and unattractive.

Our request

We request that the Indian Government abolish the STT if it introduces tax on LTCGs.

Part C: FPIs must be expressly covered by the step-up in the cost of acquisition of LTCAs under section 112A and the exemption of Rs 100,000 of LTCGs

Clarity is needed promptly, before the tax on LTCGs becomes effective, that FPIs are entitled to step-up the acquisition cost of their LTCAs. This January 31, 2018 step-up also should apply to securities acquired after January 31, 2017 (*i.e.,* less than one year before the 2018 step-up date) that ultimately satisfy the long-term holding period. Absent prompt clarification, substantial volatility may occur prior to April 1, 2018.

The proposed section 112A seeks to tax LTCGs (in excess of Rs 100,000) from the transfer of specified LTCAs at a tax rate of 10 percent; this proposed new section is intended to apply to all categories of tax payers, whether Indian tax residents or non-residents (including FPIs).

Importantly, section 112A provides a step-up in the cost of acquisition of the aforesaid LTCAs held by taxpayers as on January 31, 2018 to be higher of: (i) actual cost of acquisition, and (ii) the lower of (a) highest prevailing price on the stock exchanges as on January 31, 2018 (NAV in case of unlisted units) or (b) the sale consideration, for computing LTCGs under section 112A.

Our primary concern is that a tax technical reading of the proposed section 112A and the corresponding amendment in the extant section 115AD (which is a specific provision applicable to FPIs) could lead to an interpretation that the step-up in the cost of acquisition of LTCAs acquired prior to February 1, 2018 will not be available to FPIs. This is because the proviso proposed to be inserted in section 115AD[9] draws reference to the LTCAs prescribed in section 112A and not the

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[7] STT will need to be paid (i) on acquisition and transfer in case of equity shares (other than notified transactions), and (ii) on transfer in case of units of equity-oriented mutual funds and business trusts.

[8] The tax rate on STCGs (STT paid) has subsequently been increased to 15 percent.

[9] Proposed proviso to section 115AD(1)(iii).

LTCGs that are to be computed after considering the step-up in the cost of acquisition prescribed in section 112A. This issue is unique to FPIs considering that a separate taxing code exists in the case of FPIs in the Indian tax laws (*i.e.*, section 115AD), and does not arise in the case of other categories of taxpayers.

We also believe that FPIs could be denied the marginal benefit of Rs 100,000. A tax technical reading of the proposed proviso to section 115AD(1)(iii) could lead to an interpretation that LTCGs arising from transfer of LTCAs in excess of Rs 100,000 are taxable under section 115AD(1)(iii). This is because the aforesaid proposed proviso levies tax on income arising from transfer of LTCAs referred to in section 112A and not the LTCGs referred to in section 112A. While the Press Release and FAQs dated February 4, 2018 issued by the Indian Government clarify that this is not the intent of the Indian Government, the proposed amendment to section 115AD could lead one to believe otherwise.

We understand that the Indian Government does not intend to discriminate between FPIs and other categories of taxpayers. This intention has been clarified both in the recent Press Release and FAQs of the Central Board of Direct Taxes[10] ('CBDT') and by you during interviews with some Indian business news channels. Specifically, we understand that the step-up in the cost of acquisition for LTCAs acquired prior to February 1, 2018 should be available to all categories of tax payers (whether Indian tax residents or non-residents, including FPIs). We thank you for this. However, we respectfully submit that a Press Release and FAQs do not have legal sanctity and do not resolve the ambiguity created by the proposed language in section 115AD.

Our request

We request that the proposal be amended so that it is unequivocally clear that FPIs are eligible to claim the step-up in the cost of acquisition under section 112A and that FPIs will be conferred with the benefit of being taxed only on LTCGs exceeding Rs 100,000. More specifically, we request that you could consider rewording the proposed amendment in section 115AD on lines similar to one of the existing provisos in section 115AD, relating to STCGs. The said proviso draws reference to the *"short-term capital gains referred to in section 111A"* rather than to short-term capital assets (STCAs) referred to in section 111A, that give rise to the STCGs. Hence, we request you to kindly reword the proposed amendment as follows:

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Provided *that the amount of income-tax calculated on the income by way of long-term capital gains referred to in section 112A exceeding one lakh rupees, shall be at the rate of ten per cent"*

Part D: The step-up in the cost of acquisition of LTCAs under section 112A should specifically be available when a taxpayer realizes either (i) an aggregate net LTCL in an assessment year or (ii) an aggregate net LTCG in an assessment year but can fully offset those gains with brought forward tax losses

CIVs need certainty that the acquisition cost step-up for LTCAs is provided whether transfer of LTCAs gives rise to an aggregate net LTCG or an aggregate net LTCL. Without this certainty, a CIV would not know until an assessment year ends whether the step-up in acquisition cost would

[10] Press Release and FAQs dated February 4, 2018.

apply to any security with net unrealized gain. Consequently, the CIV would be unable to accurately value its securities every day and compute the NAV for its shares.

The specific concern is that Section 112A, as drafted, could be read to limit the acquisition step-up to assessment years during which the aggregate net result of the computation of capital gains is a LTCG—after giving the benefit of all set-off of tax loss provisions that are codified in the Indian Income-tax Act, 1961 ('Act')—and *"tax is payable"* by the taxpayer. Said another way, the concern is that the step-up benefit would not be available if (i) a taxpayer realizes a net LTCL on assets referred to in section 112A for the assessment year, or (ii) a taxpayer realizes a net LTCG on assets referred to in section 112A for the assessment year but such taxpayer has adequate brought forward tax losses that are available for set-off fully against such LTCG.

The concern arises because the proposed amendments are being introduced in the new section 112A in Chapter XII of the Act, which deals with "*Determination of tax in certain special cases.*" This Chapter, as you would appreciate, prescribes concessional tax rates in certain special cases and does not purport to deal with *"Computation of Total Income."* The mode of computation of total income is dealt with in Chapter IV of the Act, most specifically in sections 45 to 55A that relate to computation of Capital Gains. The mode of set-off, or carry forward and set-off provisions is *inter alia* dealt with in Chapter VI of the Act, which addresses the issue of *"Aggregation of Income and Set-off or Carry Forward of Loss,"* most specifically in sections 70 to 80 of the Act.

Hence, the provisions of section 112A of the Act technically would get invoked when a taxpayer has realized an aggregate net LTCG—as computed under sections 45 to 55A of the Act and after giving effect to the set-off of losses benefit provisions that are codified in sections 70, 71, and 74 of the Act—that would result in a *"tax payable"* by the taxpayer. *"Tax payable"* is to be determined in accordance with the provisions of the new section 112A, which confers the cost step-up benefit.

The following two examples illustrate our concern:

Illustration 1:

Say FPI A has invested in equity shares of two different listed companies on April 1, 2000. FPI A sells the equity shares of both the companies after April 1, 2018 (say on July 1, 2018). If FPI A were to compute the LTCGs/LTCLs in accordance with sections 48 to 55A and section 70 of the Act—and if step-up did not apply because of the resulting net loss—the calculation would be as follows:

Particulars	Security A (Rs)	Security B (Rs)
Original cost (A)	100	1000
Fair market value as on January 31, 2018 (B)	500	2000
Sale price as on July 1, 2018 (C)	600	400

LTCGs/(LTCLs) [without considering a step-up in the cost of acquisition] D = (C) – (A)	500	(600)
Aggregate Net LTCGs/(LTCLs)	**(100)**	

In this example, FPI A's sales of Security A and Security B give rise to net LTCLs; consequently, no *"tax is payable"* on the LTCLs by FPI A. If step-up were permitted, the LTCG on Security A would be 100 and the net aggregate LTCL would be (500).

If step-up were available only so long the FPI had an aggregate net LTCG in the assessment year—which could not be determined until the end of that year—the acquisition cost of security A, the unrealized capital gain on the sale date, and the tax that would reduce the value of security A would depend in part on the net gain or loss on the other securities sold. Specifically, the acquisition cost of security A would be either 100 (no step-up) or 500 (step-up), the capital gain on the sale date would be either 500 (no step-up) or 100 (step-up), and the tax that would reduce the value of security A (assuming a 10% long-term capital gains rate) would be either 50 (no step-up) or 10 (step-up) or zero (because the FPI has an aggregate net LTCL for the assessment year).

If the benefits of acquisition cost step-up are available irrespective of the aggregate net LTCG or LTCL for the assessment year, the LTCLs would be computed as follows:

Particulars	Security A (Rs)	Security B (Rs)
Sale price	600	400
Less: acquisition cost (per section 112A)	500 -- The FMV on January 31, 2018	1000 -- The original cost of acquisition
LTCGs/(LTCLs)	100	(600)
Aggregate Net LTCGs/(LTCLs)	**(500)**	

By providing acquisition cost step-up, the CIV will know every day that the acquisition cost of Security A is: (i) 500—if the security can be sold for at least 500; (ii) the expected sales price—if the security can be sold for between 100 and 500; and (iii) 100—if the security can be sold for only less than 100. The LTCG tax that would be due would be known every day that security A can be sold for at least 500. No tax would be due if the security could be sold for between 100 and 500. Loss would be realized if the security could be sold only for less than 100.

Illustration 2:

Say FPI A has invested in equity shares of two different listed companies on April 1, 2000, and FPI A has brought forward short-term capital losses (STCL) or LTCL amounting to Rs 200 that are available to it for set-off purposes. FPI A sells the equity shares of both the companies after April 1, 2018 (say on July 1, 2018). FPI A would then compute the LTCGs/LTCLs in accordance with sections 48 to 55A and sections 70, 71 and 74 of the Act, as follows:

Particulars	Security A (Rs)	Security B (Rs)
Original cost (A)	100	1000
Fair market value as on January 31, 2018 (B)	500	2000
Sale price as on July 1, 2018 (C)	600	650
LTCGs/(LTCLs) [without considering a step-up in the cost of acquisition] D = (C) – (A)	500	(350)
Net LTCGs/(LTCLs)	**150**	
Less: Brought forward STCL/LTCL available for set-off benefit	**(200)**	
Aggregate Net LTCGs/(LTCLs)	**0**	

In this example, FPI A's sales of Security A and Security B give rise to net LTCGs. But, since FPI A has adequate STCLs/LTCLs available for set-off purposes, no *"tax is payable"* on the net LTCGs realized by FPI A.

If step-up were available only so long the FPI had an aggregate net LTCG in the assessment year that exceeded the brought forward STCL/LTCL available for set-off benefit —which could not be determined until the end of that year—the acquisition cost of security A, the unrealized capital gain on the sale date, and the tax that would reduce the value of security A would depend in part on the net gain or loss on the other securities sold.

If the benefits of acquisition cost step-up are available, the LTCLs would be computed as follows:

Particulars	**Security A (Rs)**	**Security B (Rs)**
Sale price	600	650
Less: acquisition cost (per section 112A)	500 -- The FMV on January 31, 2018	1000 -- The original cost of acquisition
LTCGs/(LTCLs)	100	(350)
Net LTCGs/(LTCLs)	**(250)**	

By providing acquisition cost step-up, the CIV will know every day that the acquisition cost of Security A is: (i) 500—if the security can be sold for at least 500; (ii) the expected sales price—if the security can be sold for between 100 and 500; and (iii) 100—if the security can be sold for only less than 100. Subject to the adjustment of brought forward tax losses, the LTCG tax that would be due would be known every day that security A can be sold for at least 500; no tax would be due if the security could be sold for between 100 and 500. Loss would be realized if the security could be sold only for less than 100.

Conclusion

Clearly, for FPIs organized as CIVs to calculate correctly every day the value of their securities, FPIs must be eligible every day—without regard to the overall net gain or loss position of the portfolio—to apply section 112A's acquisition cost step-up. If the ability to utilize the step-up is predicated on whether or not a fund has net capital gains (step-up applies) or losses (step-up does not apply), the cost of developing and utilizing systems to track the overall net gain or loss provision and turn on or off the step-up in valuing a large portfolio of securities each day would be overwhelming.

The Indian Government, we submit, did not intend to craft a step-up rule that prevents CIVs from valuing correctly their portfolio securities every day. A tax technical reading of section 112A, however, could lead one to interpret otherwise.

Our request

We request the Indian Government to consider moving the provisions relating to step-up in the cost of acquisition in section 112A, to section 55(2), which specifically defines the term "*cost of acquisition*" for the purposes of computing Capital Gains. This change would ensure that section 112A would deal only with the tax rate applicable to LTCGs from transfer of LTCAs; the computation mechanism for determining capital gains would continue to be in accordance with sections 48 to 55A and end the aforesaid ambiguity. Alternatively, the Government may issue a clarification to this effect by way of a circular; our strong preference, however, would be for the aforesaid clarity to be provided for in the Act.

Part E: The cost-of-acquisition step-up may not be available for certain genuine transactions

Clarity also is needed regarding the intention to grandfather the accretion in value of the prescribed LTCAs that have been acquired prior to February 1, 2018. This Indian Government's intention, we understand, is to be achieved by providing a step-up in the cost of acquisition of the specified LTCAs acquired by the taxpayers prior to that date, to be computed in the prescribed manner.

Further, the Government is expected to notify the nature of acquisitions of equity shares without payment of STT, which would be covered by section 112A. In the Press Release and FAQs dated February 4, 2018 that were issued by the CBDT, it has been specified that the notification issued last year for the purpose of section 10(38)[11] will be reiterated for the purpose of section 112A. Given that, acquisition of equity shares by way of corporate reorganizations such as mergers, demergers, stock-split, consolidations, etc., acquired without payment of STT should be covered within the ambit of section 112A. This is a welcome move.

We are concerned, however, that the receipt of new or additional equity shares pursuant to the corporate reorganizations mentioned above (which are beyond the control of FPIs) after January 31, 2018, on the basis of investments in equity shares held as on January 31, 2018, may be denied the step-up in the cost of acquisition at the time of computing capital gains under section 112A. This result, we submit, would occur because the scope of the step-up in acquisition cost contained in section 112A is restricted, *inter alia*, to equity shares acquired prior to February 1, 2018. Hence, the issue that merits consideration is whether an investor who has acquired equity shares in an Indian company prior to February 1, 2018, but such shares change shape and form on or after February 1, 2018 by virtue of a corporate reorganization such as a merger, demerger, stock-split, consolidation etc., would also qualify for the step-up in acquisition cost benefit ascribed in section 112A?

Further, section 112A does not prescribe the methodology for determining the cost of acquisition for unlisted securities acquired prior to February 1, 2018 and that are subsequently listed on an Indian stock exchange.

For better understanding of our concerns, we have illustrated below a hypothetical scenario to highlight the anomaly in section 112A which could result in denial of step-up in the acquisition costs in certain genuine cases.

- Let us assume that FPI A held shares in a listed company X Ltd as on January 31, 2018. The relevant details are:

Particulars	Details
Date of acquisition of equity shares	April 1, 2000
Original Cost of Acquisition	Rs 100
Highest price prevailing on a stock exchange on January 31, 2018	Rs 500

[11] Notification No 43/2017 dated June 5, 2017.

- X Ltd undergoes a tax neutral merger into another listed company (Y Ltd) on say April 15, 2018 pursuant to which shares in Y Ltd are allotted to FPI A. As per the Indian tax laws, investment in shares in Y Ltd will be regarded as being held by FPI A since April 1, 2000 (*i.e.*, the date on which FPI A had acquired the original shares in X Ltd). The cost of acquisition of the equity shares in Y Ltd will be the same as the original equity shares held by FPI A in X Ltd (*i.e.*, Rs 100).

- Now, if FPI A were to sell the shares received in Y Ltd on June 1, 2018 for say Rs 600, it would realize a profit by way of LTCGs amounting to Rs 500 (*i.e.*, Rs 600 – Rs 100). However, FPI A may not be eligible to claim a step-up in the cost of acquisition since the language contained in section 112A only accords grandfathering benefits to LTCAs acquired prior to February 1, 2018; in the instant case, the shares in Y Ltd were acquired on April 15, 2018 (*i.e.*, not prior to February 1, 2018).

- Consequently, the cost of acquisition of shares in Y Ltd will be regarded as Rs 100 (being the original cost of acquisition of shares in X Ltd). Hence, FPI A could be denied the grandfathering benefits and will be required to pay tax on Rs 500 (*i.e.,* Rs 600 – Rs100).

- If the aforesaid merger would not have been implemented, and FPI A would have sold the shares in X Ltd on say June 1, 2018 for Rs 600 (being the prevalent market price at that time) on the floor of a stock exchange, it would have been eligible to claim a step-up in the cost of acquisition and consequently, realize LTCGs of only Rs 100 (Rs 600 – Rs 500).

<u>Our request</u>

We request that Indian Government, through an administrative circular, specifically notify the following types of genuine transactions in which taxpayers (including FPIs) shall be eligible to adopt the step-up in the cost of acquisition of the original shares, for the capital gains to be computed on equity shares that have been received after January 31, 2018, as a consequence of the original investment:

- Equity shares acquired due to a stock split or on consolidation;
- Equity shares acquired pursuant to a corporate reorganization of Indian companies such as merger or demerger of Indian companies;
- Equity shares acquired on a free of transfer basis (without incurring STT), pursuant to an overseas fund reorganization, which has been approved by SEBI; and
- Equity shares that are held by a FPI in an unlisted Indian company that is subsequently listed on a recognized stock exchange in India.

The above list is not exhaustive. We request the Indian Government to also notify any other genuine receipt/acquisition of equity shares by FPIs after January 31, 2018 (based on original holdings acquired prior to February 1, 2018) which should be covered within the ambit of the grandfathering provisions under section 112A. We additionally request the Indian Government to notify the valuation mechanism that should be adopted in case of unquoted shares held as on January 31, 2018. Lastly, we also request the Indian Government to seek prior comments of stakeholders on the notification that it may issue on this matter. This could be done by the Indian Government issuing a draft notification and putting it out for public comments, before the Indian

Government finalizes the notification, as was done last year in case of the notification issued under section 10(38).

PAN Concerns

We also have substantial concerns with the proposal to expand the requirement to obtain a PAN. Proposed clause (vi) to section 139A(1) would require certain key individuals[12] of an entity that has entered into a financial transaction exceeding Rs 250,000 during a financial year to obtain a PAN. As drafted, the proposed clause would extend the PAN requirement to all categories of taxpayers, whether Indian tax residents or non-residents (including FPIs).

First, we are concerned with the breadth of the key individual definition and, consequently, the requirement to obtain Indian tax registration. An FPI may have many persons, for example, "competent to act on behalf of" a principal officer.

This requirement likely will cause administrative hardship, and increase compliance costs, for FPIs and their key personnel. Even more importantly, foreign nationals will be extremely reluctant to divulge their personal details when they do not have any personal income tax liability in India. These privacy concerns could cause FPIs to abandon the Indian markets completely.

In our view, the proposal goes far beyond what is necessary to achieve what we understand is the Indian Government's intention. Specifically, linking financial transactions undertaken by non-individual entities with the natural persons responsible for those entities' affairs is not necessary or relevant when the entity is an FPI.

Importantly, FPIs do not present any risk of tax leakage. All FPI transactions on the Indian bourses must be undertaken through SEBI-registered stockbrokers. Details of these transactions are reported to and maintained by a local custodian in India that, in turn, reports the details to the National Securities Depository Limited (NSDL). The tax liability, if any, on capital gains arising on transactions implemented by FPIs needs to be discharged, by an FPI, prior to remitting sale proceeds from India. Without a risk of tax leakage, there is no reason for non-resident individuals competent to act on behalf of a FPI to obtain a PAN.

Second, we are concerned with the lack of clarity regarding how any unintended noncompliance would be monitored by the Indian Government and what penalties might be imposed. When these uncertainties are combined with the privacy concerns discussed above, the possibility for an adverse impact on the Indian markets cannot be discounted.

Our request

We request a carte-blanche statutory exemption for key personnel associated with FPIs from obtaining a PAN in India under the proposed section 139A(1)(vi). Alternatively, the Government could clarify this exemption by way of a circular; our strong preference, however, would be for the

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[12] A "key individual" would include the managing director, director, partner, trustee, author, founder, karta, chief executive officer, principal officer or office bearer of the person referred to in clause (v) or any person competent to act on behalf of the person referred to in clause (v).

aforesaid clarity to be provided for in the Act. In either event, any remedy short of a complete exemption will not be sufficient to address the industry's substantial concerns with this proposal.

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If the Indian Government would like to better understand any aspect relating to our requests, please do not hesitate to contact Mr. Keith Lawson, the Deputy General Counsel - Tax Law for the Investment Company Institute and ICI Global (lawson@ici.org or 1-202-326-5832). You also may contact our Indian tax advisor: Mr. Russell Gaitonde, Senior Director at Deloitte Touche Tohmatsu India LLP. Russell is based in Mumbai and is contactable at +91-22-6135 7045 or +91-98192 84801.

Thank you.

Yours faithfully,

Keith Lawson
Deputy General Counsel – Tax Law

Copy to:

Dr Hasmukh Adhia
Secretary (Revenue)
Ministry of Finance
Department of Revenue
Room No 128 – A, North Block
New Delhi – 110 001

Mr. Sushil Chandra
Chairperson
Central Board of Direct Taxes
Ministry of Finance
Department of Revenue
Room No 150, North Block
New Delhi – 110 001