

**FOREIGN PORTFOLIO INVESTORS**  
SERVICE OFFERING



## Overview

Under the Securities and Exchange Board of India ('SEBI') (Foreign Portfolio Investors) Regulations, 2014, a single route for Foreign Portfolio Investors ('FPIs') has been created by merging the erstwhile Foreign Institutional Investor, sub-accounts and Qualified Foreign Investor regimes with common market entry, investment monitoring and reporting norms.

Designated Depository Participants ('DDPs') are authorized to grant registration to eligible FPIs under one of the following three categories:

Category	Eligible Applicants
I	<ul style="list-style-type: none"> <li>Governments, Government/Government-related agencies, sovereign wealth funds</li> <li>International or multilateral organizations or agencies</li> </ul>
II	<ul style="list-style-type: none"> <li>Appropriately regulated<sup>1</sup> broad-based funds<sup>2</sup></li> <li>Appropriately regulated persons</li> <li>Broad-based Funds not appropriately regulated (with an appropriately regulated investment manager)</li> <li>University Funds and Pension Funds</li> <li>University-related endowments already registered as FPIs</li> </ul>
III	Residuary category, to include: <ul style="list-style-type: none"> <li>Corporate bodies</li> <li>Trusts</li> <li>Individuals and family offices</li> <li>Charitable societies, charitable trusts, foundations</li> <li>Endowments</li> </ul>








The registration granted by the DDPs is permanent unless suspended or cancelled by SEBI or surrendered by the FPI. FPIs or global custodians (acting on behalf of FPIs) are required to appoint an Indian custodian of securities before making any investments in Indian securities.

FPIs are also required to open a foreign currency and rupee-denominated account in India with a bank authorized by the Reserve Bank of India prior to making investments in India. The investments by FPIs are permitted only through stock brokers registered with SEBI<sup>3</sup>.

FPIs are permitted to make investments in the following securities (subject to conditions):

- Listed (including to-be-listed) shares, debentures, warrants of Indian companies
- Listed or unlisted units of domestic Mutual Funds and Collective Investment Scheme

- Non-convertible debentures ('NCDs')/bonds issued by Non-Banking Finance Company categorized as Infrastructure Finance Companies and Infrastructure companies
- Security receipts issued by Asset Reconstruction Companies
- Perpetual debt instruments and debt capital instruments
- Rupee-denominated bonds or units issued by Infrastructure Debt Funds
- Indian Depository Receipts
- Exchange-traded derivatives
- Commercial Papers
- Rupee-denominated credit-enhanced bonds
- Dated government securities and Treasury bills
- Category III Alternative Investment Funds, Real Estate Investment Trusts, and Infrastructure Investment Trusts
- Securitized debt instruments
- Unlisted NCDs/bonds

Category I and II<sup>4</sup> FPIs are permitted to issue Offshore Derivative Instruments ('ODIs').

FPIs are also permitted to freely repatriate their capital after ensuring that appropriate Indian income-tax is paid on income/gains. As of 31 March 2018, more than 9,200<sup>5</sup> FPIs have registered with SEBI.

1. An applicant will be considered as "appropriately regulated" if it is regulated or supervised by the securities market regulator or the banking regulator of the foreign jurisdiction concerned, in the same capacity in which it proposes to make investments in India.

2. "Broad-based fund" shall mean a Fund, established or incorporated outside India, that has at least 20 investors (direct as well as indirect), with no investor holding more than 49% of the shares or units of the Fund. If the broad-based fund has an institutional investor that holds more than 49% of the shares or units in the fund, then such an institutional investor must itself be a broad-based fund.

3. Transaction in securities shall be only through registered stock brokers except in certain prescribed cases.

4. Broad-based funds not appropriately regulated (with an appropriately regulated investment manager) shall not issue ODIs. Also, such ODIs shall not be issued to resident Indians or non-resident Indians and to entities that are beneficially owned by resident Indians or non-resident Indians.

5. <https://www.fpi.nsdl.co.in/Reports/RegisteredFPIISAFPI.aspx>

## Taxation of FPIs

While the Indian tax laws for FPIs are still evolving, the Indian Government is making considerable efforts towards creating a favorable tax environment for FPIs.

Income earned by FPIs can be broadly categorized into gains from the transfer of securities, interest and dividend income. Income arising as a result of the transfer of securities are characterized as 'capital gains', whereas dividends and interest income are characterized as 'income from other sources'.

The Income-tax Act, 1961 (the 'Act') prescribes a separate concessional tax regime for FPIs. The tax rates applicable to an FPI are tabulated below:

Nature of income	Tax rates <sup>6</sup>
Dividends declared, distributed and paid by an Indian company <sup>7</sup>	Nil
Interest on securities	5% <sup>8</sup> /20%
Income in respect of securities (other than interest)	20%
Short-term capital gains <sup>9</sup> on transfer of securities being equity shares, units of equity-oriented funds, or units of business trusts that are subject to Securities Transaction Tax ('STT') <sup>10</sup>	15%
Other short-term capital gains (i.e. derivatives, bonds, debentures, and off-market <sup>11</sup> transactions in respect of securities being equity shares, units of equity-oriented funds, or units of a business trust)	30%
Long-term capital gains	10%
Any other income	40%

The above rates are subject to tax treaty relief, as applicable.

### \*Long-Term Capital Gains

With effect from 1 April 2018<sup>12</sup>, long-term capital gains on transfer of equity shares (where STT is paid on acquisition and transfer), or units of equity-oriented fund or units of business trusts (where STT is paid on transfer) is taxable at the rate of 10%<sup>13</sup> on such amount exceeding Rs 1 lakh (approximately USD 1,500).

The cost of acquisition for computing long-term capital gains on the abovementioned investments acquired prior to 1 February 2018, shall be the higher of:

- The actual cost; or
- The lower of:
  - The fair market value<sup>14</sup> of such asset as on 31 January 2018; or
  - The consideration received upon the transfer of such capital asset

A few illustrations computing such long-term capital gains are as under:

Particulars	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Purchased on 1 April 2017	100	100	100	100
Fair Market Value as on 31 January 2018	90	140	180	80
Sale on 1 April 2018	80	160	160	160
<b>Taxable long-term capital gains/(loss)</b>	<b>(20)</b>	<b>20</b>	<b>-</b>	<b>60</b>

The gains/losses from the transfer of securities is determined on the basis of the 'First-in First-out' method.

6. The tax rates are further increased by the applicable surcharge, and health and education cess.

7. The Indian Company is liable to pay dividend distribution tax.

8. The Act prescribes a concessional rate of 5% tax in case of interest income earned from a rupee-denominated bond or a government security if such interest is payable during the period 1 June 2013 to 30 June 2020 (subject to the rate of interest of the rupee-denominated bond not exceeding a rate specified by the Central Government). Any other interest on securities is chargeable to tax at the rate of 20%.

9. In the case of listed securities, gains arising from transfer of such securities held for up to 12 months are regarded as short-term capital gains. Gains from the transfer of listed securities held for more than 12 months are regarded as long-term capital gains. In the case of unlisted shares, the period of holding is increased to 24 months. In case of other securities, the period of holding is increased to 36 months.

10. STT is a tax payable in India on the value of securities transacted through a recognized stock exchange.

11. Off-market transactions are transactions that are not executed through a recognized stock exchange in India.

12. Long-term capital gains earned in such cases prior to 1 April 2018 are exempt from tax.

13. This rate is further increased by the applicable surcharge, and health and education cess.

14. The determination of the fair market value has been prescribed under the provisions of the Act, such as (i) in case of listed securities, the highest price quoted on the stock exchange, and (ii) in case of unlisted units, the net assets value of the unit.

### Manner of discharging taxes

Typically, any payments made to a non-resident are subject to withholding tax.

However, there is no withholding tax on capital gains earned by FPIs. Tax on such income earned by FPIs must be discharged by way of advance tax prior to the repatriation of such income or before the specified due dates, whichever is earlier. Any other income earned by the FPIs would be subject to withholding tax at the applicable rates.

### Filing of return of income

FPIs are required to file an annual income-tax return with the Indian Revenue authorities ('IRA'), reporting their India-sourced income to tax.

**Permanent Account Number ('PAN')** FPIs are identified through a PAN, which must be obtained at the time of FPI's registration in India. A PAN is also required for FPIs to open a bank and securities account in India to invest in the domestic capital markets.

### Non-applicability of Minimum Alternate Tax ('MAT') provisions to FPIs

Companies are chargeable to tax on the basis of income computed under the normal tax provisions, or on book profits (i.e. MAT) at the rate of 18.5%, whichever is higher. As per the Act, the MAT provisions do not apply to foreign companies unless: (i) they have a permanent establishment ('PE') in India; or (ii) they are required to be registered in India under the prevailing Company Law provisions.

### General Anti-Avoidance Rules ('GAAR')

GAAR has the effect of invalidating an arrangement that has been entered into by a taxpayer for the purpose of obtaining a tax benefit. GAAR overrides benefits availed under any tax treaty.

GAAR is effective from 1 April 2017. Income arising out of transfer of investments acquired before 1 April 2017 are grandfathered. FPIs that do not claim any benefits under a tax treaty are exempt from the application of GAAR. Investments in ODIs are also exempt from GAAR.

While the GAAR provisions are effective from 1 April 2017, the

IRA in several instances in the past have questioned the substance of a transaction/arrangement and alleged that the transaction/arrangement is a colorable device, established merely for the purpose of tax avoidance.

In this regard, the Indian courts have held that tax planning is legitimate provided it is within the framework of the law. However, a colorable device, established only for the purpose of obtaining a certain tax benefit, cannot be a part of tax planning.

### Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ('MLI')

The MLI was signed by over 65<sup>15</sup> countries on 7 June 2017. The measures adopted by MLI attempt to prevent tax treaty abuse, improve dispute resolution, prevent artificial avoidance of PE.

The MLI shall apply to specific tax treaties only once the same has 'entered into force'. MLI shall enter into force as follows:

- *For the first five countries that ratify the MLI*  
1<sup>st</sup> day of the month following the expiry of 3 calendar months after the deposit of the 5th instrument of ratification, acceptance or approval
- *For countries that ratify subsequently*  
1<sup>st</sup> day of the month following the expiry of 3 calendar months after the deposit of the 5th instrument of ratification, acceptance or approval

Once the MLI has entered into force, the MLI will have effect (i.e. will apply to specific tax treaties) at different points of time with respect to (i) taxes withheld at source and (ii) all other taxes:

- *For withholding taxes*  
To credits/payments that occur in the taxable year beginning after the Trigger date
- *For other taxes*  
To the taxable year beginning after the expiry of 6 months from the Trigger date

**Trigger date** = 30 days after the completion of internal procedures is notified by both contracting states.

As per Article 7(1) of the MLI, the benefits under a tax treaty may be denied if it is reasonable to conclude (having regard to all facts and circumstances), that obtaining tax benefit was 'one of the principal purposes' of any arrangement or transaction that resulted directly or indirectly in that benefit.

The tax treaty benefit may not be denied if it can be established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the tax treaty.

### Indirect Transfer

In 2012, indirect transfer provisions were introduced in the Act to bring within the purview of the Indian taxation regime, an overseas transfer of shares/interest in a foreign entity deriving substantial value from assets in India. The provisions have been made applicable to the transfer of shares in a foreign entity where the value of assets in India exceeds INR 100mn and such assets represent at least 50% of the value of all the assets of such foreign entity.

Exemptions from the application of these provisions have been granted to small shareholders (not having rights of management or control and not holding directly/indirectly share capital in excess of 5%) and business re-organizations subject to specified conditions (such as continuity in shareholding and non-taxability in an overseas jurisdiction).

Exemption has been provided to Category I and II FPIs from the applicability of indirect transfer provisions. However, the indirect transfer provisions would apply to Category III FPI.

### Fund Management in India (Section 9A of the Act)

Typically, the presence of a fund manager in India increased the risk of the offshore fund constituting a business connection/tax presence in India.

Consequently, it exposed the risk of the profits of the offshore fund being subject to tax in India, to the extent attributable to the business connection/operations carried out in India.

<sup>15</sup> As on 13 April 2018, 78 countries are signatories to the MLI.

The Act was amended (vide introduction of section 9A) to encourage fund management activities in India – by providing that having an eligible manager in India should not create a tax presence (business connection) for the eligible fund in India or result in the eligible fund being considered a tax resident in India under the domestic ‘place of effective management’ rule, subject to certain prescribed conditions.

FPI Funds having fund manager in India and satisfying the section 9A conditions may not be considered as a tax resident of India (and may continue to avail the tax treaty benefits, where applicable).

ODIs prohibited from being issued against derivatives for speculative purpose.

Effective 7 July 2017, an FPI shall not be allowed to issue ODIs with derivative as underlying, except where the derivative positions are being taken by the ODI-issuing FPI for hedging the equity shares held by it, on a one-to-one basis.

In the case of the existing ODIs issued by the FPIs with derivatives as underlying (not for purpose of hedging the equity shares held by it), the ODI-issuing FPI has to liquidate such ODIs latest by the date of maturity of the ODI instrument or by 31 December, 2020, whichever is earlier. However, ODI-issuing FPIs should endeavor to liquidate such ODI instruments prior to said timeline.

## IFSC

### Overview

International Financial Service Centre (‘IFSC’) is a notified financial zone in India, where, *inter alia*, overseas investors can undertake transactions, that are generally carried on outside of India by overseas financial institutions, in foreign currency.

Transactions undertaken in the IFSC are not subject to:

- Securities Transaction Tax;
- Commodities Transaction Tax;
- Goods and Services Tax; and
- Stamp duty.

Currently, the following securities are permitted to be listed on a stock exchange of the IFSC:

- Equity share
- Depository receipt
- Debt securities
- Currency and interest rate derivatives
- Index-based derivatives
- Non-agricultural commodity derivatives
- Derivatives of an Indian company
- All categories of exchange-traded products as available for trading in stock exchanges in Financial Action Task Force/ International Organization of Securities Commissions compliant jurisdictions

- Rupee-denominated bonds issued overseas (Masala bonds)

Currently, two stock exchanges operate in IFSC: India INX and NSE IFSC. These stock exchanges offer trading in the following products:

- Stock derivatives<sup>16</sup>
- Index derivatives
- Commodity futures<sup>17</sup>
- Currency derivatives<sup>18</sup>

A SEBI-registered FPI is eligible to invest in an IFSC without providing for any additional documentation or requiring any prior approval. Also, the FPIs need not have physical presence in the IFSC. Thus, FPIs can transact on the recognized stock exchange (i.e., BSE and NSE) in India as well as on the IFSC stock exchanges. FPIs are required to ensure clear segregation of funds and securities.

### Taxation

Every FPI investing in an IFSC is required to hold a PAN. Further, an FPI is required to file its annual income-tax return in India in respect of the investments undertaken in the IFSC as well as investments undertaken in the domestic tariff area during the relevant tax year.

In the IFSC, FPIs shall earn income from transfer of securities, interest, and dividend income.

Gains arising to FPIs from transfer of securities in the IFSC should be characterized as ‘Capital Gains’ and shall be taxed at the following rates:

Sr. No.	Type of income	Tax rates <sup>19</sup>
1.	Short-term capital gains (on specified securities <sup>20</sup> )	Exempt
2.	Short-term capital gains (on equity shares)	15%
3.	Other short-term capital gains	30%/40%
4.	Long-term capital gains (on specified securities <sup>20</sup> )	Exempt
5.	Long-term capital gains (on equity shares)	10%
6.	Other long-term capital gains	10%/20%

FPIs shall be eligible to claim benefits of the relevant tax treaty on the income it earns in IFSC. Hence, the above tax rates are subject to the provisions of the relevant tax treaty.

16. As of 18 April 2018, stock derivatives of 107 and 109 Indian companies are being traded on India INX and NSE IFSC, respectively

17. Gold, Silver, Copper, and Brent Crude Oil

18. Currently, currency pairs (not involving INR) are being traded

19. The tax rates are further increased by the applicable surcharge, and health and education cess

20. ‘Specified securities’ mean derivatives, rupee-denominated bonds, or Global Depository Receipts

## How we can assist

### Advisory services

We advise on the tax and regulatory framework that govern the investments of FPIs in India, broadly covering the following:

- An overview of the regulatory framework governing FPIs
- Eligibility criteria for registration with DDPs
- Process of registration including applying and liaising with DDPs to obtain registration
- Assistance in analyzing suitable jurisdictions for setting up Funds for investment in India and provide assistance in implementing the identified investment structure
- Advising on whether the FPI is eligible to claim the relevant tax treaty benefits, given amongst other things, GAAR provisions
- In the case of Fund reorganizations undertaken outside India (e.g. mergers, conversions, liquidations), advice on the Indian income-tax implications (including the implications of indirect transfer provisions)
- Analysis of the permanent establishment exposure for the FPI

- Assist in preparing the Indian tax chapter of the Private Placement Memorandum or a similar document of the FPI

### Registration with the IRA

Every FPI is required to obtain a PAN prior to opening a dematerialized account with its custodian. We assist FPIs in obtaining a PAN from the IRA.

### Ongoing tax compliance

FPIs are required to discharge their tax liability prior to the remittance of funds from India.

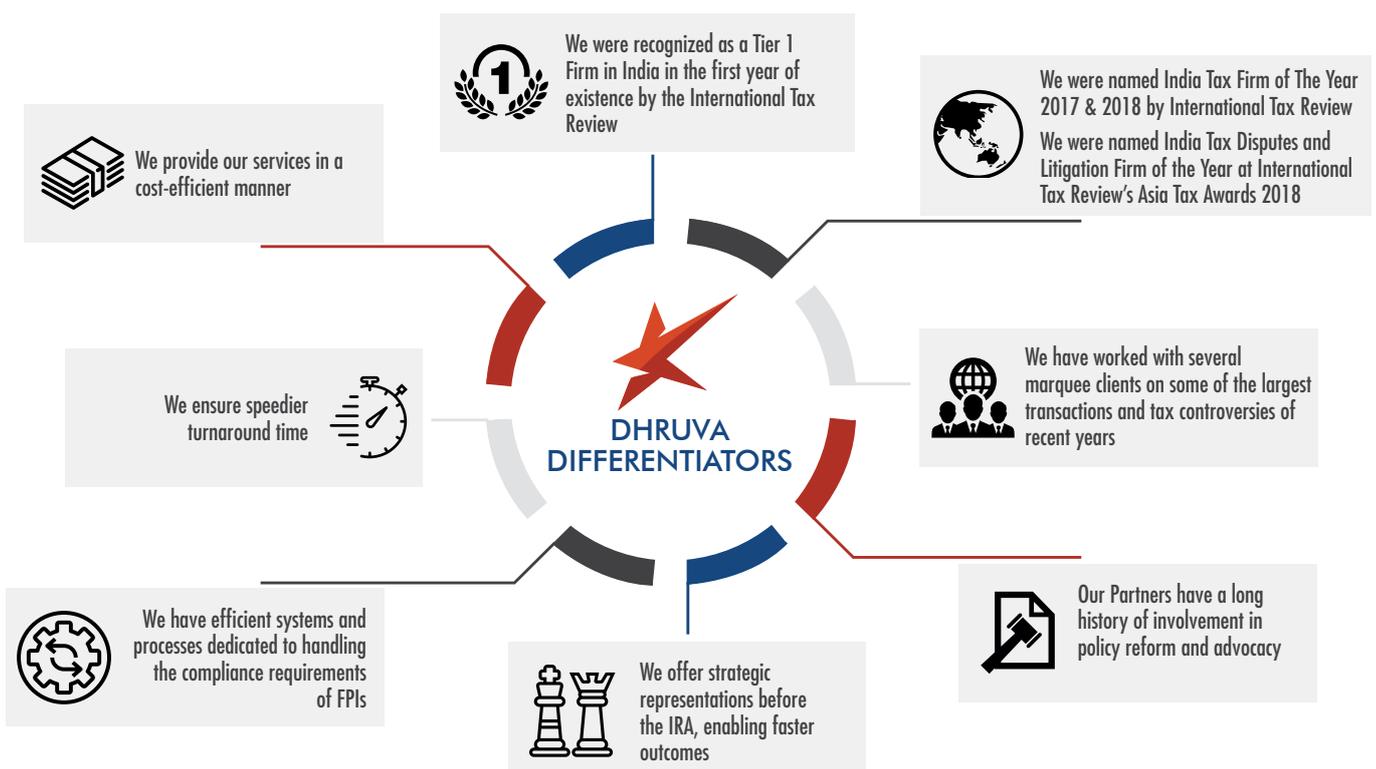
Our services will broadly cover the following:

- Maintenance of details of purchase and sale transactions effected by the FPI and computation of the capital gains earned on a year-to-date basis
- Advice on the implications of corporate action events applicable to the securities held by the FPI and alternative tax positions that may be adopted
- Alteration of the holding statements/historical cost data on account of corporate actions, where required
- Provision of itemized reports on holdings/capital gains (sub-fund/fund-wise)

- Computation of the tax payable by the FPI, which would include evaluation of, *inter alia*, the following:

- tax rates prescribed in the Act or the provisions of a tax treaty as applicable to the FPI, whichever are more beneficial
- dividend-stripping transactions
- bonus-stripping transactions
- payment of advance tax and credit for taxes withheld, if any

- Assistance in the issuance of certificates of tax liability to enable the discharge of tax liability prior to the remittance of funds
- Assistance in obtaining a digital signature certificate required for the purpose of signing the return of income
- Preparation and filing of annual returns of income with the IRA
- Representation before the IRA in the case that the return of income is selected for an audit.



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Our dedicated team of experts, led by our Partners, have in-depth knowledge as well as practical experience with issues relating to FPI investments.

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## About Dhruva

Dhruva Advisors LLP is a tax and regulatory services firm, working with some of the largest multinational and Indian corporate groups. Its brings a unique blend of experience, having worked for the largest investors in India, advising on the largest transactions and on several of the largest litigation cases in the tax space. We also work closely with the Government on policy issues and with our clients on advocacy matters.

Key differentiators:

- Strategic approach to complex problems
- In-depth, specialised and robust advice
- Strong track record of designing and implementing pioneering solutions
- Trailblazers in tax controversy management
- Long history of involvement in policy reform
- Technical depth and quality

We believe in thinking out of the box, handholding our clients in implementing complex solutions and working towards achieving results. We have offices in Mumbai, Ahmedabad, Bengaluru, Delhi, Pune, Singapore, Dubai, Bahrain and USA. We advise clients across multiple sectors including financial services, IT and IT-enabled services (ITES), real estate and infrastructure, telecommunications, oil and gas, pharmaceuticals, chemicals, consumer goods, power, as well as media and entertainment.

Dhruva Advisors is a member of the WTS Alliance, a global network of selected firms represented in more than 100 countries worldwide.

## Our recognitions

- Dhruva Advisors has been named "India Tax Firm of the Year" at International Tax Review's Asia Tax Awards for both 2017 and 2018
- Dhruva Advisors has been named India Disputes and Litigation Firm of the Year 2018 at ITR's Asia Tax Awards, 2018
- Dhruva Advisors has been consistently recognized as a Tier 1 Firm in the International Tax Review's World Tax Guide to the world's leading tax firms.
- Dhruva Advisors was named the Best Newcomer of the Year 2016 - ASIA by International Tax Review

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