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Dear Mr. Chopra,

EFAMA comments to the Committee on Direct Taxes in relation to the application of Minimum Alternate Tax to FIIs and FPIs for financial years before 1st April 2015

EFAMA¹ as the representative European association for the European asset management industry, has welcomed the creation of the Committee on Direct Taxes entrusted of the issue of the application of the Minimum Alternate Tax (“MAT”) to Foreign Institutional Investors (“FIIs”) and Foreign Portfolio Investors (“FPIs”) for tax years before 1st April 2015. EFAMA has been closely following these discussions since its beginning and welcomed the invitation of the Committee to industry associations to present views on this matter.

Upon the announcement of the Indian Budget Law for the tax year 2015 – 2016, the Indian government has confirmed that MAT does not apply to FIIs/FPIs as from 1st April 2015. However, for the period before 1st April 2015, Indian Tax Authorities intend to apply MAT to FIIs and FPIs. Accordingly, further to the notices already issued end of 2014, Tax Offices have continued to issue notices to FIIs/FPIs.

EFAMA has therefore welcomed the decision of the Indian Central Board of Direct Taxes dated 11 May not to enforce any coercive action for the recovery of demand already raised and to put on hold the issuance of further notices until the recently appointed Committee on Direct Taxes examines the issue.

EFAMA strongly believes that MAT should not apply to all type of income earned and capital gains realised by European investment funds investing in Indian securities through the FIIs/FPIs regime for the period before 1st April 2015 nor to all types of income earned and capital gains realised after that date.

¹ EFAMA is the representative association for the European investment management industry. EFAMA represents through its 26 member associations and 63 corporate members almost EUR 19 trillion in assets under management of which EUR 12.7 trillion managed by 55,600 investment funds at end March 2015. Just over 29,300 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 26,300 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit www.efama.org.

EFAMA has already expressed its views and deep concern in relation to the application of the MAT for the period before 1st April 2015 through two letters sent to The Honorary Jayant Sinha, respectively on 26 February 2015 and 30 April 2015, a copy of which is attached to this letter. These letters, in particular the one dated 30 April, illustrate EFAMA serious concerns and describe the significant impact of the application of the MAT to FIIs and FPIs and, consequently, on the European investment fund industry. Please find here below an overview of EFAMA representations in this respect.

FIIs/FPIs have relied on the longstanding practice of the Indian Tax Authorities. European investment funds investing in Indian listed securities have been taxed in line with the provisions of Section 115AD since its introduction in the Indian Income Tax Act 1961. For the past 20 years, the MAT has never been applied to FIIs and FPIs and this has created reliance in the market and contributed to the growth of foreign investment in India. The sudden modification of the Indian Tax Authorities' position on MAT has been received as an overhaul and a serious concern for the European investment funds industry.

The retrospective application of MAT creates a serious legal uncertainty. The application of MAT has, from a practical point of view, all the adverse consequences of a retroactive measure and creates many legal and practical implementation issues to which no answer has been provided.

It is unclear how MAT would be applied to foreign FIIs and FPIs, in particular given that its provisions would conflict with the existing specific tax regime applicable to FIIs/FPIs under Section 115AD of Income Tax Act. The retrospective application of MAT would also not be in line with the long-standing commitment of the Indian Government to provide a tax policy which is stable and certain and would impair the confidence of foreign investors in the Indian market

FIIs and FPIs do not hold a place of business in India and do not earn business income

We understand the MAT was designed to have Indian and foreign companies carrying on business in India pay a minimum tax on the basis of a profit and loss account computing their Indian business income.

European investment funds investing in India do not hold a place of business in India and do not earn "business income" as defined under the Income Tax Act of 1961. Most of European investment funds under the FII/FPI regime limit their investment to Indian listed securities² and their earnings are purely of financial nature (*i.e.* dividend, interest and capital gains) and may not fall under the category of "Business Income" but rather qualify as "Capital gains". "Capital gains", we understand, is also the qualification retained by the Indian Government to confirm the exemption from MAT to FIIs and FPIs as from 1st April 2015.

EFAMA would also like to outline the **technical elements** of crucial importance which show the complex and far-reaching implications the retrospective application of MAT would have.

²In particular it is the case for Undertakings for Collective Investments in Transferable Securities ("UCITS") as defined under the Directive 2009/65/EC of the European Parliament and of the EU Council of 13 July 2009

The preparation of profit and loss accounts for European investment funds is a highly complicated accounting challenge, the results of which are, at best, estimates and which will create the risk of introducing vast divergence across the industry.

European investment funds generally have diversified portfolios invested in several countries and the preparation of profit and loss accounts would need to consider the following elements:

- the profit and loss accounts to be provided could relate to a period covering up to 7 years (the applicable statute of limitation for taxes in India);
- Over this 7 years period, some investment funds potentially subject to the MAT have been liquidated or restructured and wound up;
- the profit and loss accounts should cover the relevant Indian tax years going from 1st April N to 31 March N+1, where European investment funds most commonly close their financial years either on 31 December, 30 June, or 30 September;
- the preparation of such profit and loss accounts implies that investment funds have to allocate the income/gains and related expenses to their investment in India.

For global portfolios, the allocation of expenses occurs at portfolio or investment fund level and not at an asset level, while for daily net asset value funds, daily calculations incorporate an allocation of expenses at a portfolio or corporate entity level.

Producing an asset based accounting system would be complex and would, at best, only be an estimate containing a number of variables that could create a vast divergence across the industry in terms of “book profits” per Indian asset.

EFAMA therefore wants to stress that it is not accurate to state that it would be easy for investment funds to carve out profit and loss accounts.

The impact of the MAT on the Net Asset Value (“NAV”) would put investment funds in a difficult position towards their investors

Most of European investment funds determine their NAV on a daily basis. Tax provisions included in NAVs are assessed on the basis of tax laws and practices applied in each country of investment at the time they arise and a (re-)assessment of previous years will create the need for a specific tax provisions. In accordance with the general principle of prudence, liabilities should be accounted for as soon as they are ascertained, however on the current grounds, it is impossible to compute and account for reliable tax provisions.

If the figure of INR 40,000 Crores taxes (equivalent to approx. EUR 6 billion) that has been reported on several occasions in the press is accurate, tax provisions could reach very significant amounts to be accounted for at once in relation to all past years, where no faulty behavior is to be attributed to European investment funds as taxpayers in India.

The retrospective application of the MAT would trigger additional costs for FIIs and FPIs in relation to the preparation of profit and loss accounts, professional advisory fees and fees related to the filing of legal complaints in front of Indian Courts.

The impact of the MAT on the Indian Market

The discussions around a retroactive application of the MAT is already damaging the efforts made by the Indian authorities for many years to attract foreign investors and boost the Indian Stock Market. There is a serious risk that foreign investment funds consider that investing in India through the FIIs/FPIs status has now become extremely uncertain.

EFAMA very much appreciates to have been given the opportunity to convey its views and concerns to this Committee. We remain at your disposal to further discuss these with you.

Yours sincerely,



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Appendices:

- (i) EFAMA letter dated 26 February 2015
- (ii) EFAMA letter dated 30 April 2015

Copy:

(i) The Honorary Jayant Sinha

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