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Global Tax Alert

India poised to enact tax increase affecting non-corporate foreign investors in Indian securities

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The new Indian budget[1] would increase the tax rates applicable to, *inter alia*, non-Indian investors, other than entities deemed to be "companies" or "partnership firms" under Indian law, that have invested in public and non-public Indian securities.[2] The rate increase would be retroactive to 1 April 2019, and the amount of the increase would be between 2.29% and 6.86% (at maximum rates, depending upon the security and holding period). The budget has been passed by both Houses of India's Parliament. It is awaiting approval by the President of India.

The budget would not change the tax rates applicable to non-Indian funds deemed to be "companies" or "partnership firms" under the Indian tax law.

Background

Under current law, non-Indian investors that are "non-corporates," i.e., not regarded as "companies" or "partnership firms" for Indian tax purposes, are subject to Indian capital gains tax on the sale of Indian securities.[3] For example, US business trusts, investment trusts, common trust funds, group trusts, and charitable trusts and foundations might be "non-corporates" for this purpose. However, determining whether a non-Indian entity is a "non-corporate" for this purpose requires reviewing its constituting documents and legal status. The current maximum tax rates for such "non-corporates" are:

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	Maximum rate
Long-term capital gains on sales of equity and debt securities	11.96%
Short-term capital gains on sales of equities on Indian exchanges (and therefore subject to securities transaction tax)	17.94%
Short-term capital gains on sales of debt securities and off-exchange sales of equity securities	35.88%

Pending change

The Indian budget would increase the capital gains tax rate[4] for such "non-corporates" as follows:

	Maximum rate
Long-term capital gains on sales of equity and debt securities	14.25%
Short-term capital gains on sales of equities on Indian exchanges (and therefore subject to securities transaction tax)	21.37%
Short-term capital gains on sales of debt securities and off-exchange sales of equity securities	42.74%

To reiterate, this change, if enacted into law, would be retroactive to 1 April 2019.

Implications

The increased tax rates could apply to a wide range of foreign investors that are regarded as "non-corporates" for Indian tax purposes and, while the definition of "non-corporates" would not change as a result of the provisions in the budget, the disparity between the tax rates for corporates and non-corporates has widened. These potentially could include US business trusts, investment trusts, common trust funds, group trusts, and charitable trusts and foundations. The characterization of a fund for Indian tax purposes needs to be evaluated (or re-evaluated) in detail based on its constituting documents and legal status. Although the budget will not become law until it has been approved by the President of India, potentially affected investors should evaluate the possible implications and consider its effects on the net asset value of Indian securities – including the fact that if the budget becomes law, it will be retroactive to 1 April 2019.

Endnotes

1. More precisely, the Finance (No. 2) Bill, 2019.
2. The changes discussed here are also applicable to certain Indian-resident investors, but this will not be discussed.
3. Funds treated as "companies" or "partnership funds" are subject to a different set of Indian tax rules. These rules will not be discussed here. Also, this Tax Alert will not discuss Indian taxation of interest income on Indian debt securities.
4. Technically speaking, the Indian tax under discussion here comprises a "base" tax, a surcharge and a "cess." The budget would increase the rate of the surcharge. All rates discussed in this Tax Alert are overall rates comprising all three components.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP (United States), Wealth and Asset Management, New York

- Joseph Bianco joseph.bianco@ey.com

Ernst & Young LLP (United States), International Tax and Transaction Services/Financial Services Organization, Boston

- Matthew S. Blum matt.blum@ey.com

Ernst & Young LLP (United States), India Tax Desk – Global Tax Desk Network, New York

- Roshan Samuel roshan.samuel1@ey.com

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