By Electronic Delivery

13 July 2020

The Secretary Economic Affairs
Department of Economic Affairs
Ministry of Finance
North Block
New Delhi – 110 001
India

Re: *Finance Act, 2020: Impacting the competitiveness of the Indian capital markets globally. Urgent request to remove the anomaly regarding 15 percent cap on the income-tax surcharge on dividend income earned by non-corporate and non-firm Foreign Portfolio Investors (FPIs) in India.*

Dear Sir,

ICI Global[1] requests the removal of an anomaly regarding the application of the 15 percent cap on the income-tax surcharge to dividend income earned by non-corporate and non-firm FPIs in India.[2] This request is made on behalf of our US regulated fund members that have invested approximately US$90 billion in Indian equity securities. This change is necessary to maintain the competitiveness of the Indian capital markets globally.

The Finance Act, 2020 ("the Finance Act") made several important changes to the Income-tax Act, 1961 relating to taxation of dividend distributions by Indian companies. First, the Act removed the dividend distribution tax applied to Indian companies and instead now taxes dividends in the hands of shareholders. Second, the Finance Act levied a surcharge on the income-tax on dividends.

The anomaly of concern involves how the surcharge cap is applied to shareholders that are non-corporate and non-firm FPIs; this anomaly is of particular concern to the almost 85 percent of US funds that are organized in trust form. Specifically, while the surcharge on dividends received by these

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[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$31.3 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.

[2] This anomaly was legislated through the Finance Act, 2020, effective 1 April 2020.

FPIs has been capped at 15 percent in one part of the Finance Act,[3] the cap is not mentioned in the corresponding, related provisions of the Finance Act.[4]

This unintended anomaly is creating the following issues for our members that are organized as trusts and treated in India as non-corporate and non-firm FPIs:

1. Taxes are being withheld at source,[5] by Indian corporates on the dividends that they pay, at tax rates of 26%[6] and 28.496%[7] rather than at the intended tax rate of 23.92%.[8]

2. If tax is withheld at a lower rate on a dividend, because the monetary threshold limit of INR 20 million has not been met for *that* dividend, the fund nevertheless must pay advance tax in India on its aggregated Indian sourced dividend income at the above-mentioned higher rates rather than at the intended tax rate of 23.92%.

3. A fund may have practical difficulties in getting the 25% maximum tax rate benefit that is provided by Article 10 (Dividends) of the India-US tax treaty. Specifically, if the fund has current year capital losses or brought forward tax losses, the fund may have no other tax liability against which the excess taxes paid on dividend income can be offset. To recover the treaty benefit, the fund will need to make a tax refund claim in its annual income-tax return —which, while pending, may impair cash flow for the fund.

The excess tax paid by the almost 85% of the US funds that are organized as trusts reduces the competitiveness of an industry that invests US$90 billion in India; as a consequence, the Indian capital markets are less attractive globally. While we understand that application of the maximum surcharge rate to non-corporate and non-firm FPIs was unintended, as evidenced by Part II and Part III of the First Schedule to the Finance Act, it is having a significant negative impact on US funds.

We, therefore, request that this anomaly be removed by amending the following provisions of the Finance Act impacting non-corporate and non-firm FPIs:

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[3] *See* Part II (i.e., tax deduction at source), and Part III (i.e., advance tax) of the First Schedule to the Finance Act, 2020.

[4] *See* sections 2(6) and 2(9) of the Finance Act, 2020.

[5] Under section 196D of the Income-tax Act, 1961.

[6] The 26% rate applies when the FPI's taxable income ranges between INR 20 million and INR 50 million and the 25% Surcharge and the 4% Health and Education Cess are applied.

[7] The 28.496% rate applies when the FPI's taxable income exceeds INR 50 million and the 37% Surcharge and the 4% Health and Education Cess are applied.

[8] The 23.92% rate is determined by capping the Surcharge at 15% and applying the 4% Health and Education Cess.

(i) Section 2(6)(a)(iii) and section 2(6)(a)(iv), relating to withholding tax; and

(ii) Section 2(9)(aa)(iii), section 2(9)(aa)(iv), and section 2(9)(aa)(v), relating to advance tax.

In the interim, till a legislative amendment is made, we request that a clarification be provided on this issue through a circular issued by the CBDT.

If we can provide you with any additional information, please do not hesitate to contact me and Russell Gaitonde, our Indian tax advisor, at your convenience.

With kind regard on behalf of the regulated funds industry,

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cc: The Additional Secretary (Financial Markets), Department of Economic Affairs, Ministry of Finance
Mr. Keith Lawson, Deputy General Counsel, Tax Law, ICI Global
Mr. Russell Gaitonde, Partner, Deloitte Haskins & Sells LLP, Mumbai