Foreign portfolio investors: Destination India

October 2024

Indian economy

India is the world's fifth largest economy by gross domestic product (GDP)[1] and with a projected growth of 6.8%,[2] it is one of the fastest growing developing economies.

This exponential growth is attributable to factors such as:

- strong macroeconomic fundamentals due to controlled fiscal and current account deficits
- demographic advantage
- deeply embedded digital revolution across the country
- government-driven enablers, such as Production Linked Incentive (PLI) schemes
- an independent judiciary and autonomous democratic institutions.

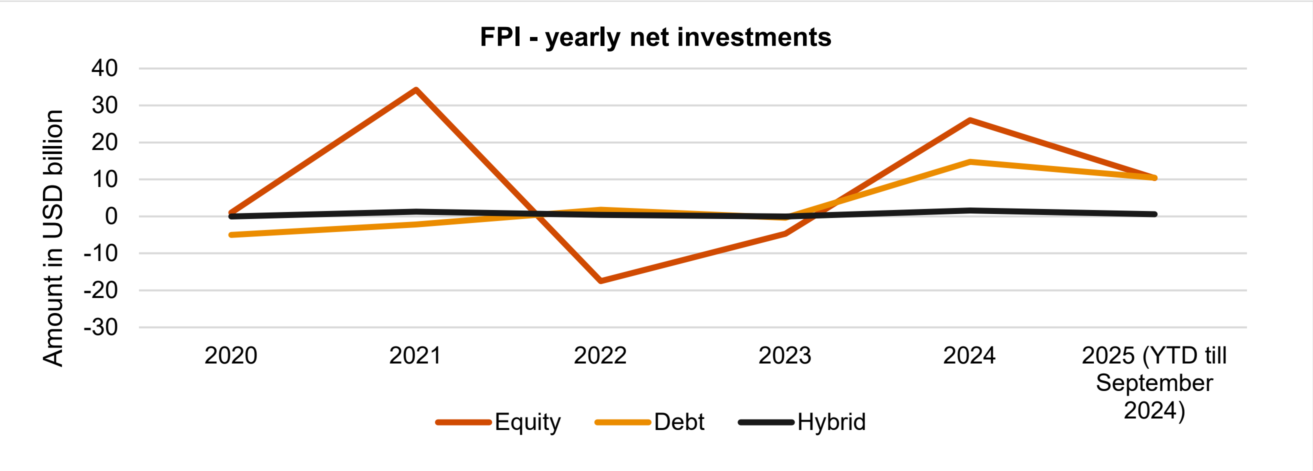
India remains one of the largest recipients of foreign investments categorised, from a regulatory perspective, into the following baskets:

- foreign direct investment (FDI)
- foreign portfolio investment (FPI)
- foreign venture capital investment (FVCI).

Foreign portfolio investors

FPIs play a crucial role in India's financial landscape as they help deepen the Indian capital markets for listed securities, bonds, derivatives, etc. Given India's robust growth prospects, foreign portfolio investors have continued to show confidence in Indian markets despite the uncertain global macroeconomic backdrop. Besides the cash equities segment, these investors are actively investing in the debt market due to the attractive yield offered by Indian debt securities.

Trends in FPI[3]



[1] Forbes India - The top 10 largest economies in the world in 2024 - https://www.forbesindia.com/article/explainers/top-10- largest-economies-in-the-world/86159/1
[2] IMF - World Economic Outlook Growth Projections - https://www.imf.org/en/Publications/WEO/Issues/2024/04/16/world-economic-outlook-april-2024
[3] NSDL FPI Monitor

Regulatory framework

The Securities and Exchange Board of India (SEBI) is the securities market regulator in India. It has issued the SEBI (Foreign Portfolio Investors) Regulations, 2019, and operational guidelines which govern FPIs.

Eligibility criteria for registering as a foreign portfolio investor

01	The applicant should not be a resident in India or non-resident Indian.
02	The applicant should be a resident of a country: • whose securities market regulator is a signatory to the International Organization of Securities Commissions' (IOSCO) Multilateral memorandum of understanding (MOU) or the bilateral MOU with SEBI • whose central bank is a member of the Bank for International Settlements • against whom the Financial Action Task Force (FATF) has not issued any warnings.
03	The applicant can also be incorporated or established in the International Financial Services Centre (IFSC).
04	The applicant must be a 'fit and proper' person as prescribed.

Overview of foreign portfolio investor categories

Category I

- Foreign governments and government-related investors
- International and multilateral organisations
- Pension and university funds
- Banks, brokers, asset managers and other appropriately regulated entities
- Other entities where the investment manager is from a FATF member country and registered as a Category I FPI
- Entities that are at least 75% owned by a Category I FPI

Category II

- Regulated funds from a non-FATF member country
- Endowments, foundations and charitable organisations\
- Corporate bodies, family offices, individuals and unregulated funds in the form of limited partnerships and trusts
- Appropriately regulated entities investing on behalf of clients

FPI registration process

1. User registration
2. User registration authorisation by the designated depository participant (DDP)
3. User login in the Common Application Form (CAF) – online to capture details
4. Upload documents and submit online to DDP
5. Sign and send CAF to DDP
6. CAF review and registration by DDP
7. DDP sends the Permanent Account Number (PAN) generation request to Income-tax Department (ITD)
8. PAN allotment by ITD

Ecosystem for FPIs

Ecosystem for FPIs		
Stockbroker	Reserve Bank of India	Tax consultant
Stock exchange	SEBI	
Clearing corporations	IFSC Authority (IFSCA)	Tax authorities
Depositories	Custodian and authorised dealer bank	
Clearing members		

Permitted investment avenues for FPIs

Equity and other securities

- Listed shares or 'to be listed' shares
- Exchange-traded derivatives (stock, index, currency, and commodity)
- Units of mutual funds
- Indian depositary receipts
- Units of real estate trusts (REITs), infrastructure investment trusts (InvITs) and Category III alternative investment funds (AIFs)
- Commodity derivatives (non-agricultural)
- Offshore debt instruments
- Convertible notes issued by Indian

Debt instrument

- Dated government securities and treasury bills
- Listed and unlisted non-convertible debentures (NCDs), and commercial papers
- Units of specified debt-oriented mutual funds
- Securitised debt instruments and security receipts
- Listed non-convertible/redeemable preference shares
- Rupee-denominated bonds/units issued by infrastructure debt funds
- Municipal bonds
- Debt securities issued by REITs and InvITs

Clubbing of investment limits

Aggregate holdings in equity shares of any Indian company by an FPI and its 'investor group' should not exceed 10% of the total paid-up equity capital on a fully diluted basis of the company. Multiple entities registered as FPIs shall be treated as part of same investor group and the investment limit of all such FPIs shall be clubbed where such entities:

have common ownership of more than 50% or have common control

The clubbing provisions do not apply to FPIs which are:

- appropriately regulated public retail funds*
- public retail funds where the majority stake is owned by an appropriately regulated public retail fund on a look-through basis or investment managers of such FPIs are appropriately regulated.

*Public retail funds include:

1. mutual funds or unit trusts which are open for subscription to retail investors, and which do not have specific investor type requirements, like accredited investors
2. insurance companies where a segregated portfolio with one-to-one correlation with a single investor is not maintained
3. pension funds.

Reporting requirements

Reporting of beneficial owners (BOs): Any person holding more than 10% shares, capital or profits of the company, or 10% beneficial ownership of a trust shall be treated as a BO. FPIs to intimate such BOs to the DDP and/or SEBI.

Additional disclosures: To mitigate the concerns around concentrated investments by FPIs in a single investee company or corporate group, and the threshold for the identification of the BOs, some objectively identified FPIs to provide specified granular information of persons to SEBI.

Recent regulatory updates:

- T+0 rolling settlement cycle
- Relaxed timelines for disclosure of material change(s)
- Exemption provided from additional disclosures if investments are in a company with no identified promotors within the prescribed thresholds
- Flexibility to FPIs dealing with securities after the expiry of registration
- Flexibility for increased contribution by non-resident Indians (NRIs), overseas citizens of India (OCIs), and Indian resident (RI) Individuals in the corpus of certain FPIs based out of an IFSC in India and regulated by the IFSCA, subject to the certain conditions

On the cards:

- Modification of the additional disclosure requirement prescribing a risk-based threshold for the disclosure of investors
- Simplified registration process for FPIs

Tax framework for FPIs

Securities Transaction Tax (STT)

The STT is required to be paid for dealings in Indian securities which are purchased or sold on Indian stock exchanges. The STT is collected by the respective stock exchange at the time of trade. The STT rates are as follows:

Taxable securities transaction	STT rate	Payable by
Purchase or sale of equity shares	0.1 %	Purchaser and seller
Sale of futures	0.0125 % / 0.02%*	Seller
Sale of options	0.0625 % / 0.1%*	Seller
Sale of options, where exercised	0.125 %	Purchaser
Sale of a unit of an equity-oriented fund to the mutual fund	0.001 %	Seller

(*) As per the Finance (No. 2) Act, 2024, the revised rates are applicable with effect from 1 October 2024

Income tax

- Any security held by a foreign portfolio investor is treated as a 'capital asset'. Thus, any income arising from the transfer of such security by a foreign portfolio investor is in the nature of 'capital gains'.
- Foreign portfolio investors may earn the following streams of income:
  - capital gains, or income on the transfer of capital assets; and
  - income from other sources, such as dividend and interest income.
- Foreign portfolio investors are required to compute their tax liability on income in Indian rupees and are obligated to discharge taxes on income prior to the repatriation of the proceeds out of India.
- Classification of capital assets:

Nature of asset	Short-term capital asset	Long-term capital asset
All listed securities in a recognised stock exchange in India	Held for not more than 12 months	Held for more than 12 months
For assets other than those specified above	Held for not more than 24 months	Held for more than 24 months

- Overview of tax rates: *#
  - Long-term capital gains: 10%^ or 12.5%^^
  - Short-term capital gains: 20%^^ % or 30%
  - Income in respect of securities – includes dividends and interest: 20%

^ For listed equities (not subject to STT), debt securities or units of mutual funds (other than equity oriented).

^^ For listed equities or equity oriented mutual funds (subject to STT) as per the Finance (No. 2) Act, 2024, applicable with effect from 23 July 2024

* In addition, applicable surcharge (ranges from 2%–37%), and health and education cess (4%) are leviable.

The above indicated base tax rates are subject to the applicability of the respective country's Double Taxation Avoidance Agreement (DTAA) with India. This is subject to the fulfilment of the prescribed conditions under anti-avoidance rules and any conditions applicable under the respective treaties.

Key tax compliance requirements

- Obtaining a Tax Identification Number in India
- Obtaining the computation from an appointed India tax consultant on the tax payable on gains or income
- Payment of taxes before the remittance of funds or on a quarterly basis via advance taxes, whichever is earlier
- Filing annual tax returns in India – 31 July, 31 October, or 30 November (as applicable)
- Tax audit by Revenue authoritie

General Anti-avoidance Rules (GAAR)

A foreign portfolio investor is eligible to avail the benefits of the DTAA of the respective country it is a resident of and with which India has a DTAA.

The provisions of the DTAA prevail over the provisions of the Indian tax laws to the extent that the DTAA provisions are beneficial.

- GAAR provisions are codified to counter aggressive tax planning arrangements and would get triggered if the 'main purpose' is obtaining tax benefit and any of the specified conditions are met.
- Threshold provided for tax benefit on aggregate basis > USD 363,000 (approximately) in a year.

Opportunities in Gujarat International Finance Tec-city (GIFT) IFSC

GIFT IFSC is a specialised hub strategically designed to cater to clients venturing into cross border financial activities. It offers a comprehensive suite of financial services coupled with world-class infrastructure facilities and highly skilled workforce.

- The IFSC assumes a pivotal role in the global finance landscape by ensuring regulatory adherence, providing tax advantages and enabling ease of doing business.
- The current ecosystem spans the entire spectrum of financial services, encompassing banking, capital markets, insurance, fund management, global distribution of financial products and other ancillary services.
- In a forward-looking approach, initiatives are underway to facilitate the direct listing of Indian securities on IFSC stock exchanges.
- Entities establishing a presence in the GIFT IFSC benefit from preferential direct and indirect tax treatment, complemented by state subsidies.

Benefits for Category III AIFs and Retail Funds in GIFT IFSC

Tax is paid at the fund level; that is, the taxes are to be paid by the IFSC AIF. FPI tax principles will apply and investments are treated as capital assets.

The IFSCA AIF can avail exemption from tax on income from:

- transfer of securities (other than shares of an Indian company), including debt, derivatives, offshore securities, mutual funds and securities listed on IFSC
- securities issued by a non-resident (not being a permanent establishment) with no accrual of income in India
- securitisation trust chargeable under the head Profit and Gains of Business or Profession (PGBP).
- any income received by investors from the IFSC AIF or on transfer of units of such AIF is exempt in the investors' hands.
- Overseas transfer provisions are not applicable if the IFSC AIF is registered as a Category I FPI under the SEBI (Foreign Portfolio Investors) Regulations, 2019.

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