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CBDT Press Release - Frequently Asked Questions on Qualified Foreign Investor regime

The Securities Exchange Board of India had introduced the qualified foreign investors (QFIs) regime in 2011 in order to widen the investor base for foreign investment in the secondary market.

In order to clarify the taxation of QFIs and the responsibility of qualified depository participants (QDPs), the Central Board of Direct Taxes (CBDT) has issued a Press Release[1]. The questions addressed pertain to the requirement of obtaining permanent account number (PAN), filing returns, manner of computation of gains/income, set-off of losses, applicability of treaty benefits, obligation to deduct tax at source, etc.

In all, the CBDT has addressed 26 questions. These have been grouped subject-wise and summarised in this document.

Requirement of PAN

QFIs are required to obtain a PAN card. QDPs can facilitate QFIs in this process. In case QFIs does not have a PAN card, it would be subject to a higher rate of withholding tax and the concessional rates of tax under the Indian domestic law or tax treaties would not be available.

[1] Press Release on 26 December 2012

Characterisation of income

The income earned by QFIs is to be characterised as 'business income' or 'capital gains' depending upon a number of factors as specified in the earlier circular[2] issued by CBDT in this regard.

Manner of computation of tax by QDPs

- QDPs need to ensure that broker engaged by it for undertaking QFIs transactions withholds and deposits the tax on gains earned by QFIs failing which QDPs need to withhold and deposit the tax at source.

- The withholding tax on income earned by QFIs needs to be computed on settlement basis and not on transaction basis. In other words, tax needs to be withheld by QDPs at the time of credit of proceeds to QFIs account.

- Further, loss of the current year available at the time of withholding tax can be set-off. However, withheld taxes once affected cannot be reduced by the deductor even if there is a loss in subsequent transactions.

- However, the earlier year's losses cannot be considered by QDPs while computing tax on current year's income of QFIs.

- The losses arising on transactions on which securities transaction tax (STT) is paid can be set-off only against the profits arising from transactions on which STT is paid.

- Further, expenses like brokerage fees can be deducted while computing the income of QFIs. However, the deductibility of other expenses to depend upon the fact whether the income is characterised as 'business income' or 'capital gains'.

- The benefits of tax treaties can be considered by QDPs while computing withholding tax liability.

- QDPs to *prima facie* rely on tax residency certificate (TRC) provided by QFIs for the purpose of beneficial rates of tax as per applicable tax treaty. However, the Press Release further states that as per the tax laws[3] , TRC is a necessary but not a sufficient condition for claiming tax treaty benefits.

- As QDPs are liable to withhold taxes, it can approach tax authorities by making the application as prescribed under the law[4] if there is complexity in determining the income of the QFIs and tax liability thereon. Else, in normal situations, it can compute the gains and the taxes itself or by taking assistance of a Chartered Accountant.

- Also, the requirement of certificate from a Chartered Accountant is only in the context of remittance outside India and not for computing withholding tax liability.

Liability to withhold tax by QDPs in certain cases

In case of income earned by QFIs from investments in mutual fund units, as distribution of profits, since the mutual fund pays the dividend distribution tax before paying off the profits to the unit holders, the withholding tax liability of QDPs may not arise. In case of sale or redemption of units, QDPs to be required to withhold taxes, if the buyer has not withheld tax. Similarly, in case of open offer or buy back arrangements, if the purchaser of shares is making the payment of sale consideration directly to the QFIs then he is liable to withhold tax else QDPs to be

[2] Circular no. 4/2007 dated 15 June 2007

[3] Section 90 and 90A of the Income-tax Act, 1961
[4] Section 195(2) of the Income-tax Act, 1961

liable to withhold tax, if QDPs are crediting the sum or making the payment to QFIs account.

QDPs to be treated as “representative assessee”

QDPs have been assigned the responsibility to act as single point contact for all purposes including tax on behalf of QFIs. QDPs need to submit a declaration that they have no objection to being treated as representative assessee/agent of QFIs.

Since the QDPs are to be treated as the representative assessee\agent of QFIs and also a withholder of taxes, QDPs are to be liable for any short withholding or non-withholding of tax liable to be paid by QFIs even in case where QFIs ceases to be the client of QDPs.

Also, in case where tax treaty benefits are later disallowed by the tax authorities, QDPs would be responsible for any short fall of tax liability.

Filing of tax returns for claim of tax refunds and carry forward losses by QFIs

QFIs can claim refund of (excess) taxes paid and also carry forward the losses to subsequent years for set-off by filing the loss returns within the statutory time limit.

Conclusion

The clarifications issued by the CBDT reiterate the obligations of the QFIs to obtain tax registration and file the annual tax return with the Indian tax authorities in certain cases. No specific exemption from filing tax returns by QFIs has been provided for.

Further, onerous obligations have been cast on QDPs to ensure tax payments and be accountable to the government to make good any loss of revenue.

The requirements relating to withholding of tax such as filing of quarterly withholding tax returns and issuance of withholding certificates by QDPs have not been specifically touched upon.

Also, a situation where the QFIs have invested in debt instruments and the payer has withheld tax has not been dealt with.

Overall, clarity and certainty on the manner of computation of tax laws specifically with respect to set off of losses would be of some relief to QFIs/QDPs.

The FAQs expressly carry a disclaimer that it cannot be used in a court of law to interpret any circular, rules, regulations, statutes etc., one way or the other and are intended to only provide a generic understanding.

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