Foreigners to pay LTCG tax on par with local investors

ENS ECONOMIC BUREAU @ Mumbai

THE budget has taken away the lower capital gains tax rate that foreign funds (foreign portfolio investors) enjoyed over the locals by bringing them on par with the latter who are taxed at 12.5%. Foreign investors were paying only 10% in capital gains on their profits made from sale of listed bonds, debentures, preference shares, and unlisted securities. The goal is to make the tax rate for non-residents the same as the rate for residents.

Announcing the changes, the finance minister said in her budget speech that the revised long-term capital gains tax (LTCG) for foreign portfolio investors will be 12.5% from April 1, 2026 and not from this April, which is when budget proposals get kicked in.

The new rate will align the tax rate for FPIs with the rate for listed shares and equity-oriented mutual funds and will apply to the assessment year 2026-27 and beyond.

According to Sunil Gidwani, a partner at tax consultancy Nangia Andersen, last year when the LTCG tax rates were changed for residents, the tax rates for FPIs on shares, equity MFs and business trusts were also changed to 12.5% but LTCG on other assets such as G-secs, bonds and NCDs were left out for them, perhaps inadvertently, and continued to be taxed at 10%. This is sought to be corrected."

FPI tax on gains from bonds, debentures brought on par with listed equities

Ashley Coutinho
Mumbai

The Budget has raised the tax on long-term capital gains (LTCG) for listed bonds, debentures and listed preference shares to 12.5 per cent from 10 per cent for foreign institutional investors in line with listed shares and equity oriented mutual funds.

"It was seen that while the rates of taxation in the case of specified fund or FIIs in case of long-term gains referred to in Section 112A have been brought to parity with the rates applicable for residents, the rate of income tax calculated on the income by way of long term capital gains not referred to in Section 112A were retained at 10 per cent vide Finance Act, 2024," the Budget document said.

Section 112A provides for LTCG tax on the sale of listed equity shares, equity-oriented mutual funds and business trust. The rate of tax on these listed securities was raised to 12.5 per cent from July 23, 2024 for gains exceeding ₹1.25 lakh.

Sunil Gidwani, Partner, Nangia Andersen, said: "Last year when the LTCG tax rates were changed for residents, the tax rates for FPIs on shares, equity mutual funds and business trusts were changed to 12.5 per cent, too. But LTCG on other assets such as G-secs, bonds and NCDs were left out, perhaps inadvertently, and continued to be taxed at 10 per cent. This is sought to be corrected."

[BOOST FOR AIFs]

Securities reclassified as capital assets

KHUSHBOO TIWARI
Mumbai, 1 February

Finance Minister Nirmala Sitharaman announced tax relief for Alternative Investment Funds (AIFs) in categories I and II in her Budget speech, reclassifying securities as capital assets. This change brings AIFs on par with Foreign Portfolio Investors (FPIs).

"Category I and Category II AIFs are undertaking investments in infrastructure and other such sectors. I propose to provide certainty of taxation to these entities on the gains from securities," FM Nirmala Sitharaman said in the Budget announcements.

AIFs are pooled investment vehicles catering to institutional investors and ultra-high-net-worth individuals, investing in various asset classes, including startups and real estate. With this amendment, the sale of securities by AIFs will be taxed as capital gains, rather than business income, reducing the compliance burden.

According to tax experts, this move could lower the tax outgo from over 30 per cent to the rates applicable on capital gains.

The CBDT had earlier issued clarification on treatment of income sale of securities as capital gains. This is now proposed to be codified to treat securities held by CAT I & II AIFs classified as a capital asset," explained Sunil Gidwani, Partner, Nangia Andersen.

Category II AIFs, the largest segment, have over ₹9.76 trillion commitments and ₹3.44 trillion funds raised. Industry experts believe this move will ease business for fund managers and investors, attracting long-term institutional capital.

Gopal Jain, Gaja Capital, noted, "By clarifying the tax treatment, the government has eliminated ambiguity, reinforced investor confidence, and reduced potential litigation."

This uniform treatment of capital gains taxation will enhance India's private capital industry competitiveness, encouraging investments in high-growth sectors, said experts.

Impact of the budget on FS sector

"From a financial sector perspective, clearly the focus of this year's budget is on the GIFT city and investment management along with some initiatives to ease business and facilitate transactions in equity asset class.

Last several years have witnessed new enabling regulations introduced by the GIFT city regulator (IFSCA) immediately followed by tax exemptions introduced by the ministry of finance to ensure parity with other international financial service centers.

While the tax holiday for business profits for units in IFSC is open ended, certain types of income and transactions have an exemption expiring this year. These tax exemptions are extended till March 31, 2030 on income such as capital gains tax on sell and withholding tax on lease rentals of aircraft and ships, dividend, interest for foreign shareholder etc.

Safe harbour regime for offshore funds managed from India has been rationalized further to ensure that more fund managers avail of the regime without exposing offshore funds to any additional tax in India.

Investors in AIF I and II are taxed directly on income earned by the Fund as capital gains, dividend or interest. The CBDT has earlier issued clarification on treatment of income sale of securities as capital gains. This is now proposed to be codified to treat securities held by CAT I & II AIFs classified as a capital asset. This means that all gains emanating from the sale of securities will be treated as "Capital gains" & not "Business Income". This brings AIFs at par with FPIs.

Provisions relating to Tax Collection at Source (TCS) are changed to exclude shares and hence will not attract TCS henceforth.

Currently offshore funds can relocate to IFSC in a tax neutral manner. IFSC recently extended its fund management regulations to Retail Funds and ETFs. The regime for relocation of offshore funds in a tax neutral manner has been extended to Retail Funds and ETFS."

Sunil Gidwani

Partner- Financial Sector, Nangia Andersen LLP

EXPERT OPINION

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Sunil Gidwani

Partner- Nangia Andersen LLP

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Impact of the budget on FS sectorFrom a financial sector perspective, clearly the focus of this year's budget is on the GIFT city and investment management along with some initiatives to ease business and facilitate transactions in equity asset class. Last several years have witnessed new enabling regulations introduced by the GIFT city regulator (IFSCA) immediately followed by tax exemptions introduced by the ministry of finance to ensure parity with other international financial service centers. While the tax holiday for business profits for units in IFSC is open ended, certain types of income and transactions have an exemption expiring this year. These tax exemptions are extended till March 31, 2030 on income such as capital gains tax on sell and withholding tax on lease rentals of aircraft and ships, dividend, interest for foreign shareholder etc. Safe harbour regime for offshore funds managed from India has been rationalized further to ensure that more fund managers avail of the regime without exposing offshore funds to any additional tax in India. Investors in AIF I and II are taxed directly on income earned by the Fund as capital gains, dividend or interest. The CBDT has earlier issued clarification on treatment of income sale of securities as capital gains. This is now proposed to be codified to treat securities held by CAT I & II AIFs classified as a capital asset. This means that all gains emanating from the sale of securities will be treated as "Capital gains" & not "Business Income". This brings AIFs at par with FPIs.Provisions relating to Tax Collection at Source (TCS) are changed to exclude shares and hence will not attract TCS henceforth.