Booklet on Taxation of Investments

The information furnished below outlines briefly the tax regulations which may be relevant to the investors and is based on relevant provisions of the Income-tax Act, 1961 ('Act') as amended by the Finance Act, 2020 and Chapter VII of Finance (No. 2) Act, 2004, i.e. Securities Transaction Tax ('STT') as at 11 May 2020. We do not make any representation regarding any legal interpretations. Since the information below is based on relevant provisions as at 11 May 2020, any subsequent changes in the said provisions could affect the tax benefits. The tax rates mentioned below relate to Financial Year 2020-21 (i.e. Assessment Year 2021-22).

The following information is provided for general information purposes only and applies to the portfolio. In view of the individual nature of tax benefits, each investor is advised to consult his or her own tax consultant with respect to the specific tax implications arising out of his or her participation in the scheme. Barclays accepts no responsibility for any tax consequences that may arise to the investor in reliance of information contained herein below.

Non-residents [including Foreign Portfolio Investors[1] ('FPI')] are entitled to be governed by the applicable Double Tax Avoidance Agreement ('DTAA'), which India has entered into with the country of residence of the non-resident, if it is more beneficial than the provisions of the Act. This would have to be considered on a case-to-case basis depending upon the relevant DTAA. Ordinarily, capital gains and interest income are taxable in India in the manner and at the rates prescribed under the relevant DTAA or the relevant rates applicable in India, whichever is more beneficial to the assessee.

According to section 90(4) of the Act, a non-resident shall not be entitled to claim treaty benefits, unless it obtains a Tax Residency Certificate ('TRC') of being a resident of his home country.

Furthermore, as per section 90(5) of the Act, a non-resident is also required to provide such other documents and information, in Form 10F.

The specific tax treatment would primarily depend on the type of the income and its characteristic / classification and have not been specifically dealt with hereunder. The note below captures the tax implications in case the securities held by investors are categorised as capital assets. We have not captured the scenario wherein the securities are categorised as business assets in the hands of investors. In case the securities are held as business

[1] As per Notification No. 9/2014 dated 22 January 2014, the Central Government has specified Foreign Portfolio Investors registered under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, as 'Foreign Institutional Investor' for the purposes of clause (a) of the Explanation to section 115AD of the Act.

assets, it is advisable to consult your professional tax advisor.

The following are the various income streams that can arise from securities held under the PMS:

- Dividend income on shares / income distributed on units;
- Interest income on debt securities; and
- Gains arising on sale of securities;
- Premium on redemption; and
- Proceeds on buy back of shares.

Dividend income

The dividend income shall be taxable in the hands of the investors under section 56 of the Act under the head 'Income from Other Sources' at the applicable rates. Further, the taxpayer can claim deduction of interest expenditure under section 57 of the Act against such dividend income, but capped up to 20% of such dividend income.

As per section 194 of the Act, the company declaring dividend would be required to deduct tax at the rate of 10% (in case of dividend payouts to resident shareholders). When dividend is distributed by a mutual fund to a resident investor, tax should be deducted at the rate of 10% under section 194K of the Act.

Further, such company/ mutual fund should deduct tax at the rates in force (in case of payment to non-resident shareholders, other than FPI), as per section 195 of the Act. For dividend payouts to FPIs, tax should be deducted at the rate of 20%.

As per the amended provisions, the dividend income (net of deductions, if any), whether declared or distributed by company/ mutual funds, shall be taxable at the following rates:

- Resident investors – Normal Rates as applicable.

- Non-resident investors - 20% under the Act. For FPIs, no deduction of expenditure should be allowed under section 57 of the Act. However, this rate shall be subject to the tax rate specified in the DTAA of the respective jurisdictions of the shareholders/ unitholders and subject to applicable conditions

Interest

Interest income arising on securities could be categorised 'Income from other sources' and subject to tax as follows:

- Resident investors - Normal rates as applicable.
- Non-resident investors (except FPIs) - 40% (plus applicable surcharge and health and education cess); and
- FPIs - 20% (plus applicable surcharge and health and education cess).

Any expense incurred to earn such interest (such as interest expense, etc.) should be available as a deduction subject to the provisions of the Act. However, FPIs are not eligible to claim deduction of expenditure incurred for earning the interest income.

Gains on transfer of securities

When the gains arising from sale of capital assets being securities are characterised as capital gains, the tax rate depends on the period of holding of the securities. Capital gains are computed by deducting from the sale consideration, the cost of acquisition and certain other expenses. The tax rates for securities are discussed below.

<u>Period of holding</u>
Capital assets are classified as long-term assets ('LTCA') or short-term assets ('STCA'), based on the period of holding of these assets. The period of holding of the asset is computed from the date of acquisition to the date of transfer. Depending on the period of holding for which the securities are held, the gains would be taxable as short-term capital gains ('STCG') or long-term capital gains ('LTCG').

Type of instrument	Resident Investor		Non Resident Investor Other than FPI	
	Long-term capital gains	Short-term capital gains	Long-term capital gains	Short-term capital gains
(i) Equity shares listed on a recognised stock exchange; (ii) To be listed equity shares to be sold through offer for sale; or (iii) Units of equity-oriented fund on which STT has been paid at the time of transfer & acquisition	10% (without indexation) Gains upto INR 1 lakh is exempt from tax	15%	10% Gains upto INR 1 lakh exempt from tax. (Refer Note 2)	15% (Refer Note 2)

of the above-mentioned instruments (Note 1)				
Listed bonds or listed debentures	10% (without indexation) (Note 5)	Normal rates	10% (without indexation) (Note 3)	Slab rates for non-resident individuals, 30% (in case of foreign non-corporates) / 40% (in case of foreign company)
Listed securities (other than units of mutual funds, listed equity shares, listed bonnds and debentures) and STT has not been paid	10% (without indexation), or 20% (with indexation), whichever is lower	Normal rates	10% (without indexation) (Note 3)	
Unlisted securities (other than unlisted bonds and unlisted debentures) (Note 6)	20% (with indexation)	Normal rates	10% on gains computed in INR (without indexation and foreign exchange fluctuation) (Note 4)	
Units of mutual fund (other than equity-oriented fund on which STT is paid)			20% (with indexation)	
Unlisted bonds or unlisted debentures			10% on gains computed in INR (without indexation and foreign exchange fluctuation)	

Nature of asset	STCA	LTCA
Listed securities (other than units), units of equity-oriented fund, units of UTI and Zero Coupon bonds	Held for not more than 12 months	Held for 12 months or more
Unlisted shares	Held for not more than 24 months	Held for 24 months or more
Other securities	Held for not more than 36 months	Held 36 months or more

<u>Taxation of capital gains</u>

Depending on the classification of capital gains, the investors would be chargeable to tax as per the Act as under:

- FPIs

Nature of Income	Tax rate for Foreign Portfolio Investors
STCG on transfer of listed equity shares or unit of an equity oriented fund on which Securities Transaction Tax ('STT') has been paid	15%
STCG on transfer of other securities	30% (without foreign exchange fluctuation)
LTCG on transfer of listed equity shares or unit of an equity oriented fund provided STT paid on transfer of such units and shares and on acquisition of shares exceeding INR 1 lakh	10% (without indexation and foreign exchange fluctuation)
LTCG on transfer of other securities (Note 6)	10% (without indexation and foreign exchange fluctuation)

The above-mentioned tax rates are exclusive of surcharge and health and education cess.

The above-mentioned tax rates would be subject to availability of DTAA benefits which may have to be separately evaluated by the tax consultants of the investors on a case-to-case basis.

In case, the investments are made by non-resident Indians, then such investors are entitled to be governed by the special tax provisions under Chapter XII-A of the Act and if such investors opt to be governed by these provisions, the same needs to be evaluated separately on a case-to-case basis.

Note 1: The cost of acquisition of equity shares or units of an equity oriented mutual funds acquired before 1 February 2018, shall be higher of:

- the actual cost of acquisition; and
- Lower of
    - Fair market value ('FMV') as on 31 January 2018, determined in the prescribed manner; and
    - Value of consideration received or accruing upon transfer.

The CBDT issued a notification dated 1 October 2018, wherein the list of transactions has been specified in respect of which the provision of sub-clause (a) of clause (iii) of sub-section (1) of section 112A of the Act shall not apply.

Note 2: Without considering indexation and foreign exchange fluctuation benefit.

Note 3: Based on judicial precedents, non-residents may avail the concessional tax rate (as mentioned above). However, the possibility of Indian Revenue Authorities disregarding the said position and applying a tax rate of 20% (plus applicable surcharge and health and education cess) cannot be ruled out.

Note 4: In the case of units of an investment fund, tax rate of 10% without indexation shall apply provided the units are treated as 'securities' as defined under the Securities Contracts (Regulation Act, 1956), which should be the case. If, however, units are not treated as 'securities', 20% shall apply, with indexation benefit.

Note 5: The risk of considering the tax rate of 20% (plus applicable surcharge and health and education cess) by the Revenue Authorities cannot be ruled out.

Note 6: As per section 50CA of the Act, where the consideration received or accruing on account of transfer of unlisted shares is less than the fair market value of such share, determined in the prescribed manner, the fair value as determined should be deemed to be the full value of consideration for the purpose of computing capital gains.

DTAA Benefits for Non-Resident Investors

As per Section 90(2) of the Act, the provisions of the Act would apply to the extent they are more beneficial than the provisions of the DTAA between India and the country of residence of the non-resident investor (subject to General Anti Avoidance Rules provisions discussed below and to the extent of availability of DTAA benefits to the non-resident investors). As per the Finance Act, 2020, section 90(1) is amended to provide that the Central Government may enter into DTAA *inter-alia* for granting relief in respect of income tax, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit of residents of any other country or territory).

Having said the above, it may be noted that no assurance can be provided that the DTAA benefits will be available to the non-resident investors or the terms of the DTAA will not be subject to amendment or re-interpretation in the future. This chapter does not discuss the tax implications applicable to the non-residents under a beneficial DTAA, which would need to be analysed separately based on the specific facts.

The taxability of such income of the non-resident investors, in the absence of DTAA benefits or from a country with which India has no DTAA, would be as per the provisions of the Act.

Tax Residency Certificate ('TRC')

In order to claim DTAA benefits, the non-resident investor has to obtain the TRC as issued by the relevant authorities of its home jurisdiction. Further, the non-resident investor shall be required to furnish such other information or document as may be prescribed. In this connection, the CBDT *vide* its notification dated 1 August 2013 has prescribed certain information in Form No. 10F to be produced along with the TRC, if the same does not form part of the TRC.

The tax authorities may grant DTAA benefit (after verifying the TRC) based on the facts of each case.

Capital Losses

Losses under the head capital gains cannot be set off against income under any other head. Furthermore, within the head capital gains, losses arising from the transfer of long-term capital assets cannot be adjusted against gains arising from the transfer of a short-term capital asset. However, losses arising from the transfer of short-term capital assets can be adjusted against gains arising from the transfer of either a long-term or a short-term capital asset.

Unabsorbed long-term capital loss can be carried forward and set off against the long-term capital gains arising in any of the subsequent eight assessment year. Unabsorbed short-term capital loss can be carried forward and set off against the income under the head capital gains in any of the subsequent eight assessment years.

Premium on redemption

There are no specific provisions contained in the Act, with regard to the characterization of the premium received on redemption of debentures. Considering the fact that the securities are held as a capital asset, premium on redemption of securities can either be treated as 'interest' or as 'capital gains'. The characterisation of premium on redemption of securities as interest or a capital gains is to be decided based on factors surrounding the relevant case. Taxability of 'interest' and 'capital gains' in the hands of resident and non-resident unitholders has been provided above.

Additional income-tax on buy-back of shares

Under section 115QA of the Act, an additional income-tax is levied in the hands of companies at the rate of 20% (plus applicable surcharge and cess) on distributions by such companies made to its shareholders in the form of buy-back of shares. The corresponding income in the hands of the shareholders would be exempt from tax under section 10(34A) of the Act.

Deemed income on investment in securities

Section 56(2)(x) of the Act provides that if any assessee receives any property (including securities) without consideration or for inadequate consideration in excess of INR 50,000 as compared to the fair market value, fair market value in excess of such consideration shall be taxable in the hands of the recipient as 'Income from Other Sources'. The above rates would be subject to availability of benefits under the tax treaty, if any in case of non-resident assessee.

The CBDT has issued rules with revised mechanism for computation of FMV for the purpose of section 56(2)(x) of the Act.

Accordingly, such other income should be chargeable to tax (i) at the rate of 30% (plus applicable rates of surcharge and cess) in case of resident investors (assuming highest slab rate for resident individual) (ii) at the rate of 40% (plus applicable rates of surcharge and cess) in case of foreign companies (ii) at the rate of 30% (plus applicable rates of surcharge and cess) in case of non-resident firms/LLPs.

Shares subscribed at a premium

In case, a resident subscribes to the shares of an Indian closely held company at a premium and the total consideration for subscription exceeds the face value of such shares, the difference between the total consideration for subscription and fair market value of such shares would be considered as income from other sources. The same would be subject to tax in the hands of the portfolio company under section 56(2)(viib) of the Act.

For the above purposes, the FMV of shares would be determined as per detailed rules prescribed or as may be substantiated by the Company to the satisfaction of the tax officer based on the value of assets and liabilities, whichever is higher.

Minimum Alternate tax ('MAT')

As per the Act, if the income-tax payable on total income by any company is less than 15% (excluding applicable surcharge and health and education cess) of its book profits, the company will be required to pay MAT which will be deemed to be 15% of such book profits (excluding applicable surcharge and health and education cess).

Further, MAT provisions shall not be applicable to a foreign company if such company is a resident of a country or a specified territory with which India has a DTAA and the company does not have a PE in India.

Also, MAT provisions are not applicable if the company is a resident of a country or a specified territory with which India does not have a DTAA, but the company is not required to seek registration under any law in relation to companies.

In case where the domestic company opts to be taxed as per the rates and manner prescribed under section 115BAA and 115BAB of the Act, then MAT provisions shall not be applicable to such domestic companies.

Alternate Minimum Tax ('AMT')

The Act provides for levy of AMT on non-corporate tax payers if the tax amount calculated at the rate of 18.5% (plus applicable surcharge and health and education cess) of the adjusted total income, as the case may be, is higher than the regular income-tax payable under the normal provisions of the Act. Such provisions are not applicable if the adjusted total income does not exceed INR 20 lakhs.

Further the above provisions are not applicable in case of a person who exercises the option referred to in section 115BAC or section 115BAD of the Act.

Securities Transaction Tax ('STT')

STT is chargeable in respect of taxable securities transaction as per the rates applicable from time to time.

Dividend Stripping

Losses arising from sale/transfer/redemption of securities and units acquired up to 3 months prior to the record date (for entitlement of dividends) and sold within 3 months in case of securities and within 9 months in case of units after such date will be disallowed to the extent of dividend/income distribution on such securities/units, which has been claimed exempt by the investor.

Bonus Stripping

In case of units purchased within a period of 3 months prior to the record date (for entitlement of bonus units) and sold/transferred/redeemed within 9 months after such date, the loss arising on transfer of original units shall be ignored for the purpose of computing the income chargeable to tax. The loss so ignored shall be deemed as cost of acquisition of such bonus units.

Special provisions relating to derivatives

The Finance Act, 2005 has inserted clause (d) in the proviso to section 43(5) of the Act to provide that specified derivative transactions would not be deemed to be "speculative transactions". Accordingly, the amount received / paid on settlement of the contract for such derivative transactions would not be regarded as speculation gain/ loss. Such receipt/ payment would normally be treated as business income/ loss. Deviation, if any would depend on the specific facts and circumstances attributable to each investor. Depending upon accounting regulations applicable, each investor may choose to record gains or losses on account of market valuation of outstanding derivative contracts at the tax year-end. Taxability / allowability of tax deduction of such gains / losses would depend upon facts and circumstances attributable to each investor read with relevant legal provisions / clarifications issued by Government of India[2].

Advance tax instalment obligations

It will be the responsibility of the client to meet the advance tax obligation instalments payable on the due dates prescribed under the Act.

General Anti-Avoidance Rules ('GAAR')

The Finance Act, 2012, introduced General Anti-Avoidance provisions pursuant to which the tax authorities are empowered to negate any impermissible avoidance arrangement and consequently deny tax benefit claimed by the taxpayer or enhance the tax liability in relation to income earned from such arrangement/transaction. An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit and it –

- Creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;
- Results, directly or indirectly, in the misuse, or abuse, of the provisions of the Act;
- Lacks commercial substance or is deemed to lack commercial substance; or
- Is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes

The GAAR provisions are applicable for income of the financial year 2017-18 and subsequent years.

Denial of tax treaty benefit to non-resident investors

In case, the DTAA benefits are denied to a particular non-resident investor, the particular investor shall have to pay higher taxes as per the Act.

Disallowance under Section 14A of the Act

The provisions of section 14A of the Act, aims to disallow any expenditure which are incurred for earning exempt income. The tax authorities may in this regard, disallow a particular expense in fully or partially claiming that the same is incurred for the purpose of earning exempt income. There are plethora of decisions on the applicability of Section 14A of the Act, in a particular situation.

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[2] For example, CBDT has issued an instruction (Instruction No. 03/2010, dated 23-3-2010) in connection with allowing losses on account of forex derivatives.

Withholding at a higher rate

The income tax provisions provide that where a recipient of income (which is subject to withholding tax) does not have a Permanent Account Number, then tax is required to be deducted by the payer at higher of the following i.e. rates specified in relevant provisions of the Act, or rates in force or at 20%. However, this provision of the Act shall not apply in respect of payments in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset to a non-resident, subject to furnishing of certain details and documents. As per Rule 37BC of the Income-tax Rules, 1962, the following details and documents are prescribed:

- Name, e-mail id, contact number of the recipient of income;
- Address of the recipient of income;
- Tax residency certificate; and
- Tax identification number of the of the recipient of income and in case no such number is available, then a unique number on the basis of which such person]can be identified by the Government of that country or the specified territory of which he claims to be a resident.

Multilateral Convention to implement Tax Treaty related measures to prevent Base Erosion and Profit Shifting

The Organisation of Economic Co-operation and Development ('OECD') released the Multilateral Convention to implement DTAA related measures to prevent Base Erosion and Profit Shifting ('MLI'). The MLI, amongst others, includes a "principal purpose test", wherein DTAA benefits can be denied if one of the principal purpose of an arrangement or a transaction was to, directly or indirectly, obtain tax benefit. The MLI has also expanded the scope of PE to include agent (excluding an independent agent) playing principal role, leading to routine conclusion of contracts without material modification. For this purpose, an agent is not considered independent if it acts exclusively or almost exclusively on behalf of one or more closely related enterprises. India has been an active participant in the entire discussion and its involvement in the BEPS project has been intensive. In a ceremony held in Paris on 7 June 2017, various countries including India, signed the MLIs.

Recently, the Union Cabinet of India issued a press release dated 12 June 2019 approving the ratification of the MLI to implement DTAA related measures to prevent BEPS. The application of MLI to a DTAA is dependent on ratification as well as positions adopted by both the countries signing a DTAA.

On June 25, 2019, India has taken the final step for implementation of MLI by depositing its instrument of ratification with the OECD. The MLI entered into force from 1 October 2019 and operational with effect from the financial year beginning from 1 April 2020 in respect of certain treaties signed by India.

Once MLI evolves and is implemented in future, one would need to analyse its impact at that point in time on the existing DTAA that India has entered into with other countries. There is limited guidance or jurisprudence at present on how the above will be interpreted by the Revenue authorities and applied.

Indirect Tax implication on Investment Advisory Fees

Investment Advisory Fees provided are subject to indirect tax levy of Goods and Service Tax (GST) except wherein it meets the condition to qualify as export of service. The rate of GST applicable on investment advisory service is 18% (i.e. for service within the same state - SGST: 9% and CGST: 9%, otherwise IGST: 18%).