NO RELAXATION ON FPI WITHHOLDING TAX

Firms stare at costlier borrowing

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Capital raising via debt could become expensive for India Inc once the concessional withholding tax rate of 5 per cent on interest income of foreign portfolio investors (FPIs) is increased to 20 per cent.

Since the central government, experts said, has not extended the concessional tax rate, FPIs may look to pass on the additional burden to portfolio companies. Stakeholders plan to approach the government on the issue. They are also seeking grandfathering of their existing investment.

"As most portfolio firms have tax-bearing contracts with FPIs, the tax burden can eventually fall on the borrower. This can significantly raise the cost of borrowing for corporations. It is expected that Indian companies will also request for an extension," said Suresh Swamy, partner, Price Waterhouse & Co.

FPIs were pinning hopes on an extension in the Budget. But, since there has been no announcement on the same, FPIs are planning to make a representation to the Central Board of Direct Taxation to request grandfathering of incomes on investments until June 2023, said experts.

With grandfathering, any lending done after June would be taxable at the higher rate but returns on earlier investments would be taxed at 5 per cent.

"FPIs have been hoping for an extension of the 5 per cent tax rate and representations were made before the Budget. Non-FPI investments in foreign currency loans, long-term bonds, and rupee- denominated bonds will be grandfathered because the higher rate will apply only to new borrowings raised after June 2023. However, FPIs won't get any grandfathering benefit and any interest payable on existing G-Secs and corporate bonds after June will not get the benefit of the 5 per cent rate," said Rajesh Gandhi, partner, Deloitte.

Interests from FPI investments in government securities and rupee-denominated corporate bonds are currently taxed at 5 per cent. Come June 2023, FPIs will face a tax rate of 20 per cent on these investments. The concessional tax was implemented in 2013 to bring inflows into the debt market amid the flight of offshore investors.

"Apart from the request for grandfathering, there may be representations to implement the higher tax in a staggered way over the period of the next three-four years," Swamy said.

In 2022, India witnessed outflows of nearly ₹1.33 trillion, of which ₹15,911 crore outflows were from the debt segment.

Certain FPIs do have the option to claim tax treaty benefits for bringing down the tax outgo. But, selecting a jurisdiction on only treaty benefits can lead to other complications like general anti-avoidance rules (GAAR).

For availing of the relief, the entity must be a resident in the country or have offices there and they should be the beneficial owners. GAAR is to check that investors do not use a tax-friendly country to only channel their money. Another option, experts said, is to look at investments through GIFT City IFSC, which can lower taxation to 10 per cent with some additional surcharges.

TAXING REGULATIONS

- **With no concessional tax,** FPIs may pass the burden to portfolio companies
- **FPIs can pass the outgo to companies** under tax-bearing contracts
- **FPIs may request for grandfathering on returns** till June 2023
- **Withholding tax to rise** to 20% from current 5%
- **Offshore investors will have option** to take tax treaty reliefs, IFSC route