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Mr. Raman Chopra
Director (TPL-II)
Central Board of Direct Taxes (CBDT)
Room No.147-E
North Block
New Delhi 110 001
India

Kind attention: The Honourable Members of the A.P. Shah Committee

RE: *CIV Industry Coalition Letter to Shah Committee on MAT Issue*

Dear Mr. Chopra:

The undersigned are associations representing the investment funds industry in some 33 jurisdictions worldwide. We jointly are submitting this letter to request that the Committee on Direct Tax Matters headed by Justice A.P. Shah (the Shah Committee) urge the Finance Minister to announce that the minimum alternate tax (MAT) does not apply retrospectively to foreign institutional investors (FIIs). The negative impact – on collective investment vehicles (CIVs) and the Indian markets – of the present uncertainty regarding potential tax liabilities for past periods is substantial.

Background – The CIV Industry

CIVs are widely-held, hold a diversified portfolio of securities, and are subject to investor-protection regulation in the country in which they are established. These investment pools provide valuable, non-controlling, capital that supports and enhances economic growth. CIVs invest heavily in India. For example, US and European CIVs held more than $132 billion in Indian equity holdings and more than $9 billion in Indian bonds as of the end of 2014. CIVs in many other countries such as Japan, Canada, Hong Kong, and Australia also invest in Indian equity and bonds.

The typical CIV, being widely-held, will have tens (sometimes hundreds) of thousands of individual investors. Because CIV interests generally may be purchased and sold every day, both the CIV's investor base and each investor's proportionate interest in the CIV change constantly. These changes make it impossible for a CIV to determine the amount of tax that should be charged retrospectively to each individual who was an investor when the CIV received income, realized gains, or made distributions.

CIV interests typically are purchased and sold at net asset value (NAV), which is calculated by determining the value of a CIV's assets and liabilities and dividing by the number of CIV interests outstanding. If a potential tax liability is large, as it would be if MAT applies, tax certainty becomes particularly important. Tax certainty helps ensure that investors purchase and sell CIV interests at the correct price.

The CIV Industry's Understanding of the MAT's Inapplicability to FIIs

The CIV industry has understood, since FIIs first were permitted to invest in the Indian markets in 1993, that their India-sourced income is taxed only under Section 115AD of the Indian Tax Code. This section was added at that time to provide FIIs with a concessional basis of taxation.

The tax imposed by Section 115AD on FFIs is clear. FIIs are exempt from tax on long-term capital gains realized on Indian listed securities that are sold on a recognized stock exchange and for which a securities transaction tax is paid. If these securities are sold before the long-term holding period requirement has been satisfied, the gains are taxed at a 15% rate. Gains on other Indian securities are taxed at 10% (the long-term rate) or 30% (the short-term rate). Dividends paid on Indian securities are exempt from tax. Interest paid on Indian securities presently is taxed at either a 5% concessional rate or at 20%.

The MAT, in contrast, clearly is intended to apply only to Indian domestic corporations and those foreign companies that have a physical presence (*e.g.,* branch or project office) in India. This intention is illustrated by the requirement that the corporation prepare a separate set of financial statements, including P&L Account and Balance Sheet, pursuant to the Indian Companies Act or another Indian law; these financial statements must reflect the various activities the corporation conducts in India.

Indian tax professionals retained by CIVs uniformly have advised CIVs that their tax liability is based solely on Section 115AD – even though the MAT has been in effect for almost 20 years. Until quite recently, moreover, Indian tax assessors that routinely audited CIVs extensively never asserted MAT – despite the MAT rate of 18.5% being much higher than the otherwise generally-applicable rates.

To the CIV industry, it is obvious why MAT was not asserted. First, as CIVs are not doing business in India, they are not subject to the Indian Companies Act (or any other Indian law) that mandates that they prepare the requisite financial statements. Second, were the MAT applicable, all of the concessionary tax provisions enacted to encourage FII investment would have been meaningless.

The confidence of investors in India will be undermined if it transpires that CIVs should have been filing financial statements under laws that do not apply to them and paying tax under a provision designed almost 20 years ago to apply to domestic corporations and foreign companies with Indian offices.

Impact of MAT Assertions on CIVs

The negative impact of these MAT assertions on CIVs cannot be overstated. The totally-unexpected potential tax liabilities for the open years are extraordinarily large. Every CIV must follow the issue closely and revisit constantly the question of whether to post a reserve on its books for any MAT that might become due. Any reserve posted by a CIV will reduce the CIV's NAV and therefore be borne by those investors in the CIV today irrespective of whether they were investors when the taxable income arose.

The Present Situation is Problematic for the Indian Markets and Should Be Resolved Promptly

Tax uncertainty can have a negative impact on FII investment. The recent MAT liability assertions are particularly problematic for investor confidence. First, the amounts potentially at issue are extremely large; the fact that only some assessments have been issued does not negate the impact should all open years be pursued. Second, the length of time – almost 20 years – between when the MAT was enacted and when it was first asserted against FIIs raises uncertainty in the investment environment in India. The Honorable Finance Minister has stated on numerous occasions that the new Indian government will provide FIIs with the requisite tax certainty. Unfortunately, these MAT assertions are viewed by investors as more consistent with the tax uncertainty that prevailed under the prior government. The market reaction, we understand, has not been favorable for either Indian companies or the FIIs that have maintained their Indian investments.

Conclusion

We urge the Shah Committee, pursuant to its advisory mandate, to recommend to the Finance Minister that he announce promptly that the MAT does not apply to FIIs.

* * *

Please feel free to contact the representatives at the associations signing this letter, at your convenience, for additional information.

Sincerely,

Financial Services Council (FSC)

Per: "*Carla Hoorweg*"
Title: Senior Policy Manager

The Investment Funds Institute of Canada (IFIC)

Per: "*Joanne De Laurentiis*"
Title: President & CEO

European Fund and Asset Management Association (EFAMA)

Per: "*Peter De Proft*"
Title: Director General

French Asset Management Association (AFG)

Per: "*Pierre Bollon*"
Title: Director General

German Investment Funds Association (BVI)

Per: "*Thomas Richter*"
Title: Chief Executive Officer

Hong Kong Investment Funds Association (HKIFA)

Per: "*Sally Wong*"
Title: Chief Executive Officer

Irish Funds Industry Association

Per: "*Pat Lardner*"
Title: Chief Executive

Italian Association of Investment Management Companies (Assogestioni)

Per: "*Fabio Galli*"
Title: Director General

The Investment Trusts Association, Japan (JITA)

Per: "*Fumio Inui*"
Title: Vice Chairman

Association of the Luxembourg Fund Industry (ALFI)

Per: "*Camille Thommes*"
Title: Director General

Per: "*Marc-Andre Bechet*"
Title: Director Legal & Tax

Federation of Investment Managers Malaysia (FIMM)

Per: "*En. Nazaruddin*"
Title: Chief Executive Officer

Swedish Investment Funds Association (Fondbolagens förening)

Per: "*Pia Nilsson*"
Title: CEO

The Investment Association

Per: "*Jorge Morley-Smith*"
Title: Director, Head of Tax

Investment Company Institute (ICI)

Per: "*Paul Schott Stevens*"
Title: President and CEO

ICI Global

Per: "*Keith Lawson*"
Title: Deputy General Counsel - Tax Law