



## SHOULD FOREIGN PORTFOLIO INVESTORS BE WORRIED ABOUT MAT?

### **Background**

Minimum Alternate Tax (“**MAT**”) is a tax levied under the Income-tax Act, 1961 (“**IT Act**”) on the book profit of a company where the overall tax paid by the company is less than 18.5% of the book profit. Generally speaking, in the case of non-resident entities who do not have a permanent establishment in India, Indian courts have held that MAT is not applicable as such entities do not maintain their books and records under Indian company law.

### **Putting FPIs on the MAT**

In the *Castleton* case, in 2012, the Authority for Advance Rulings (“**AAR**”) upheld the levy of MAT on Foreign Portfolio Investors (“**FPIs**”) even where their long term capital gains were not taxable in India. While deciding *Castleton*, the AAR disregarded the ruling in the case of *Bank of Tokyo Mitsubishi* (“**BTM**”) passed in 2010, where it was held that MAT could not be levied on foreign companies who did not have a place of business in India.

Armed with the *Castleton* ruling, the Indian tax authorities (“**ITA**”) have served notices on foreign institutional investors (“**FIIIs**”) and FPIs over unpaid MAT for previous years. This notwithstanding that, the Indian government through its Finance Bill, 2015, has proposed to specifically exempt long term capital gains arising to FPIs from the ambit of MAT provisions; the ITA’s argument being that the proposed law will only be applicable prospectively from April 1, 2015.

Press reports suggest that the ITA have sent notices to around ninety (90) FPIs, and this may extend to about six thousand (6,000) FPIs with a total tax demand of approximately INR40,000 crore (roughly US\$6 billion).

### **Should FIIs and FPIs be worried?**

Legislative intent behind the introduction of MAT back in 1987 was to make it applicable to companies who, because they availed of benefits and tax incentives, did not pay significant income tax although they had high book profits. Moreover, MAT was only intended to be applied to Indian companies who maintained their books and records in India. There was never any intention to make this provision applicable to foreign companies. In any event, this intent of the legislature has not been captured specifically in the IT Act.

Given the outcry, the chairperson of the Central Board of Direct Taxes stepped in and stated that FIIs and FPIs who are domiciled in countries that have signed double taxation avoidance treaties with India (like Singapore and Mauritius) will be exempt from MAT. This statement, although not documented in the form of a circular or notification, does come as a big relief to investors.

But the question is, what if the ITA go into the substance over form issue in respect of funds investing through Mauritius and disregard their Mauritius residence status! Or, what happens to non-resident



entities like companies, private equity funds and venture capital funds who have invested in India on a long term basis through non-treaty protected countries?

As things stand, some FPIs are moving the Bombay High Court seeking an order to quash the MAT notices issued by the ITA and to decide on the applicability of MAT provisions. Some FPIs are also planning to become a party in the ongoing *Castleton* case in the Supreme Court. Based on BTM ruling, which is prior in point of time, it appears that the FPIs do stand a chance in their case. Needless to say, India's Supreme Court will be the final deciding authority.

The need of the hour is clarity at a conceptual level on the applicability of MAT to foreign companies having no place of business in India. Generally speaking, non-residents are taxed on incomes such as royalty, fees for technical services, interest, dividend, commission, etc., on a gross basis. The attempt of the ITA to levy MAT on them is not only contrary to the aforesaid taxation policy, but can also be counter-productive to India's growth.

In the meantime, all FII's, FPIs and funds investing through Mauritius must assess their substance in Mauritius. If they fall short on this count, immediate remedial steps should be taken.