3 June 2020

Shri Pramod Chandra Mody
Chairman
Central Board of Direct Taxes
New Delhi

ASIFMA representation on taxability on interest and capital gains in government securities to be traded on International Central Securities Depositories

Dear Sir,

At the outset, Asia Securities Industry & Financial Markets Association (ASIFMA[1]) India Fixed Income Steering Committee applauds Central Government and the Reserve Bank of India for introducing Fully Accessible Route ('FAR') to enable a wider spectrum for non-residents to invest in Indian Government securities ('G-secs'). As per the circular[2], non-resident investors would invest in G-secs through International Central Securities Depositories ('ICSD'). FAR, if successful, would *inter-alia* help fill the headroom currently available in respect of outstanding stock of G-secs – *i.e.*, currently, only 3% of the outstanding stock of the G-secs has been utilized by FPIs out of the maximum limit of 6% permissible under the Medium-Term Framework.

Investors accessing a wide range of securities on ICSD platforms require standardization, including implementation of international best practices. Accordingly, in our view, additional tax measures would be required by Government of India ('GoI') to increase the attractiveness of the ICSD platform route for investment in G-secs.

To make the investment in G-secs both feasible and attractive under FAR (through ICSDs), we earnestly present the following recommendations. These measures are intended towards achieving additional liquidity from offshore investors to support further GoI issuances. Success of the ICSD platform for GoI issuances would help to further internationalize the Indian market and support the eventual inclusion of Indian Government bonds in the desired global indices.

[1] ASIFMA is an independent, regional trade association with over 135 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, professional and consulting firms, and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

[2] RBI/2019-20/200 A.P. (DIR Series) Circular No. 25 dated March 30,2020

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Our recommendations:

1. *Capital gains on transfer of Government Securities*

   Section 47(viib) of the Act provides that any transfer of government securities made outside India through an intermediary dealing in settlement of securities, by a non-resident to another non-resident should not be covered under the ambit of transfer (and hence would not be taxable). However, transfer made by non-resident to resident outside India may still be taxable in India.

   Recommendation

   It is to be noted that taxable transfer of Indian G- secs from non-resident to resident investors through an intermediary such as ICSD would act as a deterrent for non-resident investor to invest in Indian G-secs as it would significantly increase tax compliance (such as obtaining PAN, filing tax return) on such non-resident investors and pose operational challenges. Further, non-resident investors would not be able to post these G-secs as collateral, as in the event of default by counter parties, non-resident investors would not be able to sell the G-secs to resident investors without incurring capital gains tax. Such capital gains tax would make G-secs traded on ICSD platform illiquid, which would defeat the purpose of this scheme.

   In order to boost liquidity on the ICSD platform, it is recommended that Section 47(viib) of the Act be extended to cover transfer of government securities through an intermediary dealing in settlement of securities, by a non-resident to residents as well. This will enable consistent treatment of government securities traded through ICSD platforms irrespective of whether the non-residents transfer the securities to another non-resident or resident entities. Investments under the FAR, through ICSD is expected to be significant with the right tax outcome, especially in the current environment where new sources of capital are critical.

2. *Taxability of interest income*

   Where the total income of Foreign Portfolio Investors (FPIs) includes income by way of interest in respect of investment made in Government security, such interest would be taxed at the rate of 5% (plus applicable surcharge and cess) under section 115AD read with section 194LD of the Act. This is applicable in respect of interest receivable on or before 30 June 2023.

   However, no such specific rate has been prescribed in respect of income derived by non-residents (not being FPIs) from investment in INR denominated G-secs.

   Recommendation

   It is recommended that the beneficial rate of 5% (plus applicable cess and surcharge) be extended to interest income received by non residents (including foreign companies) from investment in G-secs made through an intermediary dealing in settlement of securities (i.e. ICSD). This would level the playing field for non residents not registered as FPIs, who wish to invest in these specified G-secs. This would attract a new set of non-resident investors to invest in Indian G-secs through the ICSD platform.

Further, we recommend that where the total income of a non-resident (including foreign companies), includes only interest income received from investment in Government securities made outside India through ICSD, there should not be a requirement to furnish return of income under section 139(1) of the Act, provided that appropriate taxes have been withheld at source. This would assuage unnecessary compliance burden on such investors.

3. *Exemption from the provisions of Representative Assessee*

Under FAR, non-residents would invest in government securities on the platform provided by ICSDs, also facilitated by local custodians. As per Section 163 of the Act, there is a risk that the counterparties or an agent to a transaction would be regarded as a Representative Assessee and would be required to discharge taxes on behalf of a non-resident, where such non-residents have not settled any applicable taxes.

Recommendation

It is to be noted that ICSDs are operators of the platform for the investors to trade in securities. Further, ICSDs are not the beneficial owner of the G-secs, instead they are just the nominees on behalf of the actual investors investing in G- secs. As an operator, ICSDs only run the platform and do not exercise any control over the activities of the investors utilizing the platform. Hence ICSDs are not the appropriate party to take on any responsibility for their clients' investments, including any ensuing liability towards the tax department. Accordingly, it would not be appropriate to make them liable as a representative assessee for non-resident investors.

In light of the above, we recommend that the provisions of section 163 of the Act should specifically provide an exemption to ICSDs and/ or local custodians/sub-custodians from the applicability of representative assessee provisions, for purposes of this FAR regime.

If you have any follow up comments or questions, please feel free to contact **Rebecca Weinrauch** (Executive Director – Head of Fixed Income, ASIFMA) at rweinrauch@asifma.org or **Patrick Pang** (Managing Director – Head of Compliance and Tax, ASIFMA) at ppang@asifma.org.

Yours sincerely,

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