India Finance News

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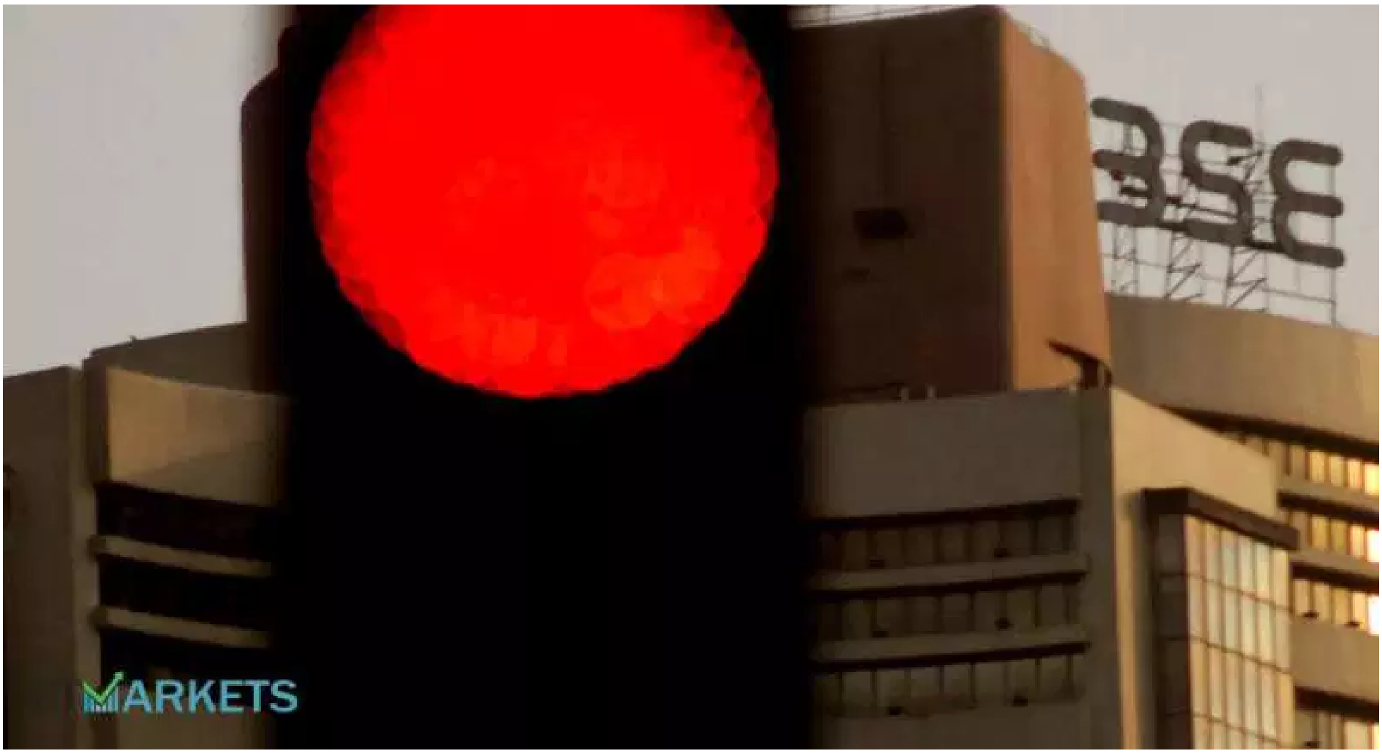
Double whammy: Falling rupee adds to FPIs' woes



The recent drop in the rupee to record lows has dealt a double blow to foreign portfolio investors (FPIs). While the depreciating rupee has eroded the value of their holdings in dollar terms, the government's move in the recent Budget to tax capital gains made by foreigners in the domestic stock market on rupeedenominated returns has added to their woes.

Until last financial year, foreigners paid tax on capital gains based on dollar returns. This was allowed only for stock market transactions under a special provision in the Income Tax Act . The government quietly withdrew this benefit in this Budget while reintroducing the long-term capital gains (LTCG) tax in the Union Budget. Now, foreign investors have to calculate capital gains based on how much they have earned in rupee terms.

Then, overseas investors didn't oppose the move because of the rupee's strength against dollar earlier this year. But, with the Indian currency falling 16 per cent so far in 2018, capital gains tax on rupeebased returns would be steeper.

"Finance Act 2018 has taken away the benefit of neutralisation of foreign currency fluctuation on the sale of listed securities. This has gained significance in recent times for FPIs in light of sharp strengthening of the US Dollar," said Amit Singhania, partner of Shardul Amarchand Mangaldas.

Foreign investors have sold Indian shares worth $1.3 billion or roughly Rs 9,600 crore in September and $1.8 billion or about Rs 13,400 crore in October so far.

A chunk of this selling has been in blue-chip stocks. Consider this: a foreign investor 'A' had bought 10,000 shares of Tata Consultancy Services (TCS) at Rs 1,200 a piece a year ago for Rs 1.2 crore. Since the exchange rate was Rs 64 per dollar back then, the total purchase cost would have been $187,500. Now assume 'A' is selling off these shares to book profits now. TCS shares are currently trading at Rs 2,044 apiece; the total sales proceeds would be Rs 2.04 crore. This is equal to $275,992 at the current exchange rate. So, if A could pay capital gains in dollar terms, he would pay 10 per cent of the $88,492 gains made, which is $8,849.

Under the new tax rule, if capital gains are calculated based on rupee gains, the total capital appreciation would be Rs 84 lakh. Hence, the total tax outgo would be Rs 8.4 lakh or $11,342. In this case, the rupeebased capital gains tax is nearly 30 per cent higher than the dollar gain.

"Global asset allocators compare returns in their local currency and on post-tax basis. It is relevant that the original tax provisions that allow computing capital gains in their home currency is restored, especially in the current phase when rupee is sliding," said Richie Sancheti of Nishith Desai Associates.

Experts said the government had decided to discontinue the benefit of currency fluctuation for FPIs since an incentivised rate of capital gains tax was being offered in listed securities. As per the latest rules, selling of any stock held for less than a year will be subject to short-term capital gains tax; while the ones held more than a year are subject to long-term capital gains tax. Short-term capital gains tax on stocks and equity mutual funds is charged at a rate of 15 per cent, while it is 10 per cent for the long-term.

Source: Economic Times