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Bond Street ignored in surcharge relief

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Mumbai: After the government's decision to roll back the higher surcharge on capital gains, financial markets are grappling with a new question: Is bond the missing piece in the finance ministry's latest communique?

The question has now come to the fore after Tuesday's intra-day rally in thebond market, triggered by the Reserve Bank of India's announcement to transfer surplus capital to the government.

To encourage investment in the capital market, the government has withdrawn the extra surcharge on tax payable on transfer of certain assets. These are listedequity shares, unit of equity-oriented mutual funds and units of a business trust. For foreign investors, the lower surcharge was extended to capital gains from derivative deals as well.

But the list spelt out by the Central Board of Direct Taxes (CBDT) in a press release dated August 24 excludes bonds. "However, FPIs have also made substantial investments in Indian debt securities (corporate bonds, non-convertible debentures and government securities), and gains arising out of their transfer are also taxable in India in accordance with Section 115AD," said Subramaniam Krishnan, tax partner (private equity & financial services), EY India.

Details Awaited

"The press release does not clarify whether non-corporate FPIs shall be charged the enhanced surcharge on such gains," said
Krishnan. (The particular section in the Income Tax Act deals with capital gains as well as income of FPIs.) Since January FPIs have invested ?26,753 crore in debt. While FPIs do invest in unlisted bonds, bulk of their debt exposure is to listed securities. As against this, net equity investment by FPIs during the period was ?51,589 crore.

The CBDT also sends out a signal that the rollback of the additional surcharge shall only apply to “capital gains”. Thus, on the income earned by FPIs that is not capital gains in nature such as interest on debt securities or on pass through interest income earned from investments in units of a business trust — the enhanced surcharge shall continue to apply, said Krishnan.

RBI payout to govt

The transfer of capital and higher dividend by RBI came as a positive surprise for bond houses. Since RBI balance sheet is tilted more towards domestic assets (which fetches higher return), many in the market think that central bank’s payout to the Centre would be higher in future compared to earlier years.
RBI’s earnings are primarily from return on government of India bonds, interest earned by lending to banks in the repo window, and returns generated (which are significantly lower) from foreign securities. The higher earnings in 2018-19 were due to substantial open market operations (OMO) conducted by RBI — almost Rs 3 lakh crore.
This involved buying bond from banks and bond houses to infuse liquidity in the system and continuous repo lending to inject liquidity in the money market.

As against 2018-19 numbers, RBI’s earnings in 2019-20 could be comparatively lower with OMO levels expected to come down and the market having entered a reverse repo mode — which means the central bank has to pay interest to banks to borrow from them in order to mop up extra liquidity in the system.

Even as the market bets on the next interest rate cut and analysts estimate the possible payout next year amid softening bond yields, tax experts and fund advisers are awaiting the detailed wording of the proposed amendment to incorporate the recent changes in the tax law.

“The circular does not seem to have covered all the instruments and focuses largely on improving sentiment. However, the fine print is important and it remains to be seen whether other instruments like bonds are included as and when the CBDT directive is converted into law,” said Richie Sancheti, head, investment funds at law firm Nishith Desai Associates.

Senior chartered accountant Dilip Lakhani is of the view that the exclusion of bonds is not an oversight by the apex tax body. “The intention of the government was clearly to arrest the steep fall in listed stock prices and hence, it chose to retain the higher surcharge on other securities like unlisted shares and bonds,” he said.

The CBDT spokesperson did not comment on the matter.