

GAAR proposal will be a dampner for FIIs and other strategic investors: Mahesh Kumar, Nishith Desai Associates

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Mahesh Kumar, Senior Associate, Nishith Desai Associates, in an interview with ET Now, gives the legal perspective on GAAR issue. Excerpts:-

ET Now: There is an FII view saying that money is absolutely needed and the ambiguity needs to be cleared? The question mark is what if the ambiguity gets cleared in a way that FIIs do not like? This becomes a done deal and it is applicable to FII investments routed through all routes as well.

Mahesh Kumar: I completely agree that the GAAR proposal is going to be a real dampener. It is going to really affect strategies on not only FIIs but other strategic investors. It is going to have a serious impact on all sorts of transactions whether they are mergers and acquisitions or domestic transactions and for that matter even Indians investing globally. The impact of the GAAR provisions can be very wide. They are going to create immense uncertainty in the country and especially at a time when India needs foreign capital. At a time when we need to meet huge public expenditure and we need to provide a stimulus to capital formation in the country, this is definitely not the right time to introduce such a move.

ET Now: The question mark really is that how likely is it that the tax will be claimed with a retrospective affect on historical transactions as well because that is something that will really dampen sentiments for FII investors?

Mahesh Kumar: Yes, so the proposal in the budget is that the GAAR provisions will apply from April 1, 2012 onwards. The idea is to make it prospective but it is not as simple as that because the GAAR provisions essentially apply to arrangements and even a step in an arrangement. Potentially even if it is an arrangement that exists today but that may lead to a transaction, say a divestment or sell out sometime in the future, post April 1, 2012, this potentially can still be covered which is something completely contradictory to what the standing committee of parliament has even suggested. It is very elaborate report where you have said that there should grandfathering of existing structures because taxpayers have planned their affairs and invested whether through Mauritius or Singapore. They have understood the law, they have invested in a certain manner, you cannot penalise them for something that has happened in the past. It is unconstitutional as well.

ET Now: Just to stretch that point forward and bring in some more clarity on P-notes, investments of profits made through P-notes will be subject to tax and even investments routed through companies in Mauritius probably will be taxed. Is there any reason to believe that these kind of investments will be subject to short term as well as long term capital gains tax?

Mahesh Kumar: Potentially it can be subject to either of them. GAAR allows the tax department to deny a tax benefit which is probably allowed under law. To deny tax benefit in cases where based on near perception, it is considered that an arrangement say whether it is a P-note or whether it is a fund structure through Mauritius or Singapore. The mere perception that the object was to avoid Indian tax. So they are able to deny this tax benefit it would result in long term as well as short term capital gains tax.

ET Now: There was a note which said that it is also likely that representation would be made to exempt FIIs from this, as the key objective of this law is to avoid Vodafone type cases. Do you think that could be a possibility that FII investments could be exempt but there will be specific cases so that a Vodafone type of case does not happen again? Could that be the main objective and therefore, could this respite be given?

Mahesh Kumar: One thing is the Vodafone type cases where you have share transfers at an offshore level. The other thing is the use of some of these holding company jurisdictions such as Mauritius and Singapore. The GAAR proposal, potentially targets both. Both the use of intermediary jurisdictions such as Mauritius or Singapore as well as Vodafone type situations where you have share transfers at an offshore level. In addition to GAAR, they have also proposed to introduce these retrospective amendment which seems to overrule Supreme Court's decision in Vodafone and tax such offshore share transfers. I hope that at least in the case of the FIIs and pension funds, insurance companies, people making genuine investments in India to avoid situation of double taxation in both India whether in the US or in the UK, it is necessary to provide some sort of exemption of portfolio investors at least.