April 3, 2012

The Honorable Pranab Mukherjee
Union Minister
Ministry of Finance
North Block
New Delhi 110001
India


Dear Minister Mukherjee:

The Investment Company Institute (“ICI”)¹ and ICI Global² urge that the impact on foreign investment funds of (1) the indirect transfer provision and (2) the General Anti-Avoidance Rule (“GAAR”) in the proposed Finance Bill be clarified promptly. We urge further than any changes that are enacted apply only to new investments.

These two provisions apparently were drafted in response to very specific and narrow concerns. The proposed legislative language, however, is sufficiently ambiguous that the provisions may call into question the tax treatment, widely viewed as settled, of common transactions engaged in by highly-regulated, publicly-available investment funds. Moreover, these ambiguities reinforce a lingering concern that Indian tax policy, particularly when applied to existing investments, can be less consistent than the policies of other capital-seeking locations.

The specific suggestions made below are intended to strengthen investor confidence and enhance the stability of the Indian capital markets. Our prior experiences with Indian tax matters

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¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (“ETFs”), and unit investment trusts (“UITs”). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.3 trillion and serve over 90 million shareholders.

² ICI Global is the global association of regulated funds publicly offered to investors in leading jurisdictions worldwide. ICIG seeks to advance the common interests and promote public understanding of global investment funds, their managers, and investors. Members of ICIG manage total assets in excess of US $1 trillion.
suggests that the provisions’ effects, which we describe below, are unintended. Prompt clarification, through public statements and amended legislative language, will benefit investors and the markets.

*The Indirect Transfer Provision*

The first provision, apparently designed to reverse retroactively the decision of the Indian Supreme Court in the *Vodafone* case, could have extremely broad and negative effects. One industry concern is that the provision would permit Indian authorities, subject to the statute of limitations, to assert tax against any non-Indian investor who sold shares of a non-Indian fund investing in India. The industry’s concern would be even greater if tax were asserted against a non-Indian investor who held only a small interest in a publicly-available fund, even one investing exclusively in India, that held only small, non-controlling interests (e.g., less than 10 percent) in individual Indian companies.

Although the indirect transfer provision apparently is intended to address situations in which a non-Indian investor sells a controlling interest in a non-Indian holding company that owns a controlling interest in an Indian company, the provision is not so limited. The simplest way to address this concern would be to state precisely those transactions that the provision is intended to cover. We recommend this approach.

Alternatively, a list of excepted transactions could be provided. One such alternative, a *de minimis* exception applicable to the fund itself, could be crafted based upon the 10-percent investment limit that applies to foreign institutional investors. Another alternative approach would be to except from the provision’s application transfers of shares of publicly-available investment funds.

*The General Anti-Avoidance Rule*

The second provision, to enact the GAAR, also could have extremely broad and negative effects. We understand that one potential use of the GAAR would be to permit Indian authorities to assert capital gains tax against investors resident in countries with which India, by treaty, provides a tax exemption. The GAAR, which we understand would place the burden of proof on the investor, could be used for innumerable other purposes as well.

Cross-border investors place great emphasis on legal certainty; such certainty includes the well-established practice of countries overriding treaties in only the absolutely rarest of circumstances. Investor confidence is diminished if a country’s tax laws, including the treatment provided by carefully-negotiated and mutually-ratified treaties, is uncertain.

To the extent that certain types of investors, or the residency requirements of any specific country with which India has an income tax treaty, are viewed as problematic, a narrowly-crafted solution should be advanced. If a GAAR (despite its broad scope and its potentially negative impact on
investment and capital formation) is to be enacted, the provision should allow for treaty overrides only prospectively, after a transition period, for new investments.

The Investment Fund Industry’s Need for Certainty

The investment fund industry is unique in that (1) the typical fund values its assets daily and (2) the typical fund’s interests (e.g., shares) generally are purchased and sold each day based upon the fund’s net asset value. Uncertainty regarding the tax treatment of a fund’s investments creates uncertainty regarding fund asset values and the price at which the fund’s interests should trade.

The investment fund industry’s need for tax certainty illustrates quite clearly the very negative impact on investor confidence of legislation that applies, whether retroactively or prospectively, to existing investments. Funds must evaluate constantly the valuations of their portfolio securities and the benefits of continuing to hold them. The possibility of incurring unexpected tax can affect valuation considerations and reduce investor demand for Indian securities. Reduced demand, in turn, could reduce securities prices and harm Indian companies and their investors.

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A strong signal is needed that the indirect transfer provision and the GAAR will not impact the settled expectations of investment funds holding Indian securities. If existing law, including the application of ratified treaties, is to be changed, the changes should be targeted narrowly to the specific concerns sought to be addressed. Moreover, any such changes should apply only to new investments.

We appreciate greatly your attention to this serious matter. If there is any additional information that we can provide, please contact me (at lawson@ici.org or 001-202-326-5832).

Sincerely,

/s/ Keith Lawson

Keith Lawson
Senior Counsel – Tax Law

cc: R.S. Gujral, Finance Secretary/Revenue Secretary, Ministry of Finance
    Ashutosh Dikshit, Joint Secretary (TPL–I), CBDT
    Sunil Gupta, Joint Secretary (TPL–II), CBDT
    U.K. Sinha, Chairman, Securities and Exchange Board of India
    Banashri Bose Harrison, Minister-Commerce, Embassy of India, Washington D.C.