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Indian Taxation Aspects of FIIs: A Critical Analysis

PUNEET SHARMA[1]

ABSTRACT

The Indian taxation system for Foreign Institutional Investors (FIIs) has been a subject of intensive scrutiny over the years. The tax laws governing FIIs were first introduced in the country in 1992, with the objective of promoting foreign investments in the Indian economy. The taxation system has undergone several changes since then, with a view to aligning it with the evolving global economic environment. This paper critically analyses the Indian taxation aspects of FIIs, examining the various tax implications that foreign investors face while investing in the Indian market. The paper evaluates the taxation rules governing the income earned by FIIs in the form of capital gains, dividends and interest, and assesses the impact of these rules on the flow of foreign investments into the country. The study finds that India's tax regulations on FIIs are complex and often ambiguous, leading to a lack of clarity and uncertainty in the minds of investors. The tax treatment of capital gains, dividends and interest earned by FIIs varies depending on the duration of investment and the type of security.

Keywords: *Foreign Institutional Investors (FIIs), Taxation of FIIs, Double tax avoidance treaty (DTAA).*

I. INTRODUCTION

Foreign institutional investors (FIIs) were first allowed into India's financial market on September 14, 1992 as a part of India's liberalisation reform action initiated in the early 1990s to recover from the effects of the Asian financial crisis. Given the importance of capital to any economy, the influx of foreign capital has emerged as a notable indicator of progress in both advanced and emerging economies. 'Because of the integration and growth of the global equity market, developing countries like India are becoming increasingly attractive investment destinations. This is because India is an emerging economy that is backed by strong government support and widespread faith in its financial administrative infrastructure.[2]

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[1] Author is a LL.M. Student at Maharashtra National Law University, Nagpur, India.

[2] Rashmi Perumal, Liberalisation of the law relating to Foreign Institutional Investment and its impact on economic development, LEGAL SERVICE INDIA.COM, (Mar. 28, 2023, 12:25 PM), https://www.legalservicesindia.com/article/689/Liberalisation-of-the-Law-relating-to-Foreign-Institutional-Investment-and-its-Impact-on-Economic-Development.html.

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Foreign Institutional Investors (FIIs) have been an important source of investment for India since the mid-1990s. They have played a vital role in the development of the Indian equity and debt markets by providing liquidity, sharing knowledge and expertise about global best practices, and bringing in diversified portfolios. However, the taxation of FIIs in India has been a matter of debate and controversy over the years. To understand the tax implications of FIIs in India, it is essential to have a brief overview of the regulatory framework and the history of their investment in India. The SEBI (Foreign Portfolio Investors) Regulations, 2014 govern the registration, operation, and monitoring of FIIs, also known as Foreign Portfolio Investors (FPIs) in India. FIIs invest in various securities such as equity, debt, and mutual funds, subject to various regulations and restrictions imposed by SEBI and the Reserve Bank of India (RBI).[3]

FIIs have been investing in India since the liberalization of the Indian economy in the early 1990s. Their contribution to the Indian capital markets has been significant, with major investments made in the sectors of banking, telecommunications, and infrastructure. The policy of the Indian government to attract foreign investment, deregulate various sectors, and provide a stable and predictable fiscal environment has encouraged FIIs to invest in India.[4]

The taxation of FIIs in India is complex, and has undergone several changes over the years. The tax laws in India relating to FIIs are governed by the Income Tax Act, 1961, and the Double Taxation Avoidance Agreements (DTAAs) signed between India and various countries. FIIs are considered non-resident entities for tax purposes, and are therefore subject to different tax rates and treatment than residents.[5]

The taxation of FIIs can be broadly categorized into three types – income tax, capital gains tax, and withholding tax. Income tax is levied on the income earned by FIIs from Indian sources such as interest, dividends, and capital gains. Capital gains tax is levied on the gains made by FIIs from the sale of securities. Withholding tax is deducted at source on payments made by Indian companies to FIIs, such as interest, dividends, and capital gains.[6]

II. UNDERSTANDING THE INDIAN CAPITAL MARKET

1. Stock Market

The stock market is a marketplace for buying and selling shares in publicly traded companies. It provides a mechanism for the orderly trading of stocks. Shares of publicly traded companies

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[3] *Ibid.*
[4] IBEF, https://www.ibef.org/economy/foreign-institutional-investors, (last visited Mar. 28, 2023).
[5] NSE, https://www.nseindia.com/invest/first-time-investor-income-tax-for-foreign-investors, (last visited April, 25, 2023)
[6] *Ibid.*

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are bought and sold on the stock market. After initial sales of securities in the primary market, these assets move to the secondary market, where they are traded between investors at the going market rate or at an agreed upon price. The regulatory body oversees the secondary market, sometimes known as the stock exchanges.[7] The Securities and Exchange Board of India is responsible for overseeing the country's stock market. Stock brokers are able to trade shares of companies and other securities on a stock exchange. Only shares of stock that are listed on an exchange can be bought and sold. Thus, it is the hub where investors can purchase and sell shares. Both the Bombay Stock Exchange and the National Stock Exchange are considered to be the most important stock exchanges in India.[8]

2. India's Main Stock Exchanges

When the East India Company started trading in loan stocks at the end of the 18th century, the Indian stock market took birth. By the time the 1830s rolled around, Bombay had begun dealing in bank and cotton press stocks. Around the middle of the 1950s, a group of twenty-two stock traders began meeting casually under a banyan tree in Horniman Circle Park, Bombay, and began trading with a combined capital of Re. 1 for each broker. The Native Share and Stockbrokers Association was an unofficial association formed by these brokers. In 1875, they legally formed into what is now known as the Bombay Stock Exchange (BSE).[9] Finally relocating to the now-famous BSE building on Dalal Street, the company did so in 1930. The majority of trading in India takes place on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The Bangalore Stock Exchange and the Madras Stock Exchange are two additional regional stock exchanges in addition to these two.[10]

a) National Stock Exchange (NSE)

In India, one can purchase and sell shares of publicly traded companies on the National Stock Exchange. The Mumbai-based company dates back to 1992. The NSE first opened for business on November 4, 1994, and its annual turnover quickly surpassed that of the BSE. The NIFTY 50 is its primary benchmark. Based on trading volume and market cap, it includes the 50 largest companies. Investors in India and around the world look to this index as a proxy for the health of the Indian Capital Market. The NSE's introduction of an electronic stock exchange triggered

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[7] James Chen, What is the Stock Market, What Does It Do and How Does It Work?, Investopedia, (April 2, 2023, 1:10 PM), https://www.investopedia.com/terms/s/stockmarket.asp.

[8] Securties and Exchange Board of India, https://www.sebi.gov.in/sebi_data/faqfiles/jan-2017/1485843476566.pdf, (last visited April 2, 2023).

[9] Bizdom, The Story of Bombay Stock Exchange, TheBizdom, (April 2, 2023, 1:40 PM), https://www.thebizdom.in/the-story-of-bombay-stock-exchange/.

[10] Smriti Chand, History of Stock Exchange in India, YOURARTICLELIBRARY, (April 2, 2023, 2:10 PM 2023), https://www.yourarticlelibrary.com/stock-exchange/history-of-stock-exchange-in-india/23488.

a revolutionary change in India's financial markets. National Securities Depository Limited was established on November 8, 1996 as India's first electronic securities depository through a partnership between the National Stock Exchange of India and the 'Industrial Development Bank of India Limited (IDBL)' and the Unit Trust of India.[11] By the year 2000, the spot market had given way to rolling settlement, and derivative trading had entered the scene. Trading in equities derivatives was virtually monopolised by NSE.

The National Stock Exchange is a premier marketplace for companies preparing to list on a major exchange. Increased openness in trade matching and settlement is facilitated by the use of automated technologies and the high amount of trading activity. Just increasing awareness in the marketplace can increase trust among investors. Orders may be filled faster and more accurately with the help of modern technology, which in turn improves liquidity and correct pricing.[12]

b) Bombay Stock Exchange (BSE)

The Bombay Stock Exchange (BSE) is India's first and oldest stock exchange. Its doors first opened in Mumbai in 1875. Under BSE, BSE SENSEX is the most prominent index. The index tracks the success of the 30 largest, most liquid, and financially secure companies. Formerly called the Native Share and Stock Dealers' Association, this market was the first and largest of its kind in India. BSE is one of the world's largest exchanges, alongside the Nasdaq, NYSE, London Stock Exchange Group, Shanghai Stock Exchange and Japan Exchange Group, and it lists about 6,000 companies. The BSE replaced its open-floor trading method with an electronic one in 1995.[13] Electronic trading systems now predominate in the financial sector as a whole due to their superiority over older open-outcry trading methods in terms of accuracy, speed of execution, and efficiency. Stocks, stock options, stock futures, index futures, index options, and weekly options are just some of the securities listed by the BSE. The BSE has been instrumental in the expansion of India's business sector and the development of the country's capital markets, particularly the retail debt market. BSE now also offers services in the areas of clearing, settlement, and risk management inside the capital market.[14]

III. Participants in the Indian Stock Market Regulator

By revising and passing new regulations, regulatory authorities ensure that no broker or

[11] NSE, https://www.nseindia.com/national-stock-exchange/history-milestones, (last visited April 3, 2023)
[12] *Ibid.*
[13] James Chen, Bombay Stock Exchange (BSE): What It Is, How It Works, History, INVESTOPEDIA, (April 3, 2023, 3:35 PM), https://www.investopedia.com/terms/b/bombaystockexchange.asp.
[14] *Ibid.*

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organization is involved in fraudulent operations. The Securities Exchange Board of India is the regulatory body for the Indian stock exchange. The Securities and Exchange Board of established in 1988 and through SEBI Act, 1992 it was given statutory powers on 30 January 1992.[15]

a) Depositories

Investors' electronic shares, bonds, debentures government securities, and mutual fund units are held by depositories, which are financial institutions. Investors can open a depository account with a registered Depository Participant. They also offer services associated with trading dematerialized securities. The Securities and Exchange Board of India (SEBI) now recognises two Depositories in India.

CDSL (Central Depository Services Ltd) and

NSDL (National Securities Depository Ltd)[16]

b) Depository Participant

The depository's agent through which it interacts with investors and delivers depository services is known as a Depository Participant (DP). Depository participants were given the ability to store and trade dematerialized securities. The depository trust company (DP) holds and maintains investor accounts in securities and company accounts in securities issued.

c) Stock Brokers, Sub-Brokers, And Other Participating Traders

Stock Brokers and Traders who are Members of a Stock Exchange. They facilitate investors' purchase and sell trades in stock markets. Generally speaking, only stock exchanges' registered brokers may effect trades in the secondary market. Individuals, partnerships, and corporations are all eligible to become trading members of established stock exchanges.A sub-broker is a non-Stock Exchange member who works with a trading member or Stock Broker to complete stock transactions on behalf of investors. They make it easier for brokers to connect with more potential clients.[17]

d) Authorized Person

A stock broker or trading member may appoint an authorised person (an individual, partnership, business, LLP, or corporation) to act as an agent in communicating with investors located in

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[15] Ayush Jha , Sebi Act: Regulating and Monitoring Stock Market, GETLEGAL INDIA, (April 3, 2023, 5:10 PM), https://getlegalindia.com/sebi-act/.

[16] CLEARTAX, Depository Participant Registration, https://cleartax.in/s/depository-participant-registration, (last visited April 3, 2023).

[17] CHOICE, https://choiceindia.com/blog/role-of-broker-and-sub-broker-in-capital-market/, (last visited April 3, 2023).

different parts of the country. A stock broker is permitted to designate one or more authorised persons, provided that the stock exchange in question has given its express prior authorization for each such individual. The authorization and delegation of authority are limited to a specific part of the transaction at hand.[18]

e) Custodians

Financial organisations including banks, insurance firms, and international portfolio investors typically work with a Custodian, a third party that is responsible for safely storing their money and securities. A custodian's duties extend beyond simply storing securities safely; they also include settling trades and keeping track of corporate activity on their clients' behalf.[19]

f) Clearing Companies

When it comes to the Securities Market, Clearing Companies are crucial in ensuring the safety of investors' funds. Members of the Stock Exchange are held accountable for fulfilling their delivery obligations by clearing agencies. All transactions on the Stock Exchanges are guaranteed to be settled by these organisations, as they serve as a legal counter party to all deals. It can function either as a component of an exchange or independently.[20]

g) Clearing Banks

When it comes to communicating between clearing members and the clearing organisation, Clearing Bank plays a vital role. The clearing bank is the financial institution that all clearing members must have an account with. It is the clearing member's responsibility to ensure sufficient cash in its clearing bank account on the day of pay-in to cover its obligations resulting from stock exchange trades. On the day of the payout, the clearing member's account with the clearing bank is credited with the corresponding amount.[21]

h) Merchant Bankers

They act as issue managers, investment bankers, and lead managers, merchant banks are organisations that have registered with SEBI to perform these functions. Depository participants were given the ability to store and trade dematerialized securities. During a new offering of securities, they serve as the issuer's sole point of contact. They evaluate the issuer's demand for money, form a viable instrument, price the instrument, and oversee the entire issuance process

[18] NORTHEAST BROKING SERVICES LIMITED, https://www.northeastltd.com/authorised-person/, (last visited April 4, 2023).
[19] Adam Barone, Custodian: What It Means in Banking and Finance, IVESTOPEDIA, (April 4, 2023, 4:45 PM), https://www.investopedia.com/terms/c/custodian.asp.
[20] Shreya Tiwari, What is a Clearing House, INSIDER BY FINOLOGY, (April 4, 2023, 5:25 PM), https://insider.finology.in/stock-market/what-is-clearing-house.
[21] *Ibid.*

until the securities are traded on a stock exchange. They coordinate with various intermediaries in the issuing process, including registrars, brokers, banks, underwriters, and credit rating organisations.[22]

i) Underwriters

In the primary market, underwriters are intermediaries who agree to subscribe for any unsold shares of a security offering. Underwriters play a crucial role in the primary market, assuring issuers that they will purchase their securities if the public offering of those securities does not generate sufficient interest from investors. Hard underwriting refers to the IPO's early phases, when the underwriters offer their guarantee. Once pricing is finalised, a firm commitment is made, known as soft underwriting. The risk to the underwriter is typically limited by the placement of the transferred shares with other financial institutions. There is a provision in soft underwriting that allows the company to back out of the commitment if specific conditions occur. Rigid underwriting carries significantly more danger than flexible underwriting.[23]

j) Investors

Any person or organization (such a corporation or mutual fund) that puts money into an endeavor with the expectation of a return is considered an investor. Investors can use a wide variety of financial tools, such as stocks, commodities, bonds, mutual funds, ETFs, futures, options, foreign currency, silver, gold, retirement plans, and real estate, to reach their financial goals. Potential risks and potential returns are two factors that investors weigh when making investment decisions.[24] Shareholders and investors are the same people when it comes to publicly traded companies. They have the right to be treated fairly and equally, to vote and exercise voting rights, and to earn dividends and other benefits that are properly theirs as investors. Investors come in many shapes and sizes. Their risk appetites, financial resources, aesthetic preferences, and time horizons are all different. They may ride the ups and downs of various elements on a daily basis as they make investments in currencies, developing markets, or stocks.[25] Traders are people who purchase stocks with the intention of selling them within a year. They can be categorised as:

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[22] Julia Kagan, Merchant Bank: Functions, Services, and Examples, INVESTOPEDIA, (April 5, 2023, 12:23 PM), https://www.investopedia.com/terms/m/merchantbank.asp.

[23] Investopedia Team, What Does the Underwriter Do in a New Stock Offering?, INVESTOPEDIA, (April 5, 2023, 12:40 PM), https://www.investopedia.com/ask/answers/041415/what-does-underwriter-do-new-stock-offering.asp.

[24] Ali Hussain, What Does an Investor Do? What Are the Different Types?, INVESTOPEDIA, (April 5, 2023, 12:55 PM), https://www.investopedia.com/terms/i/investor.asp.

[25] *Ibid.*

- Retail Investors

Those who invest their own money in the stock market or in mutual funds or exchange traded funds that hold a variety of securities are considered retail investors. The vast majority of trades made by retail investors are conducted through either online or brick-and-mortar brokerage accounts. They are investing their own money, so they buy stocks and bonds. Professional portfolio and fund managers, such as those who manage a mutual fund or a pension fund, fall under the category of "institutional investors," which describes those who invest on a bigger scale.[26]

- Instituitional Investors

A firm or organisation that invests money on behalf of others is known as a "institutional investor." Investing options include mutual funds, pension plans, and insurance firms. Large blocks of stocks, bonds, or other securities are frequently traded by institutional investors. Certain laws may be less stringent for this group because they are seen as more sophisticated than the typical retail investor.

- Domestic Institutional Investors (DIIs)'

The term "domestic institutional investor" refers to a type of investor that is based in one country and primarily invests in the securities and other financial assets of that country. Institutional investment refers to money put into a country's economy or property by entities like banks, insurance companies, mutual fund companies, etc. These financial commitments are affected by both domestic economic and political developments. Institutional investors at home have an impact on the economy's net investment flows in addition to their international counterparts.[27]

- Foreign Institutional Investors (FIIs)

An FII is an investor or investment fund that is based in a nation other than the one in which it makes investments. In India, the phrase "foreign institutional investor" is used most frequently to describe foreign entities that have invested in the country's financial markets. Investors who put their money into foreign businesses and property. Companies and banks are two examples.[28]

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[26] Adam Hayes, Retail Investor: Definition, What They Do, and Market Impact, INVESTOPEDIA, (April 5, 2023, 1: 15 PM), https://www.investopedia.com/terms/r/retailinvestor.asp.

[27] THE ECONOMIC TIMES, https://economictimes.indiatimes.com/definition/domestic-institutional-investors-diis, (last visitedApril 6, 2023).

[28] James Chen, Foreign Institutional Investor (FII): Definition and Regulations, INVESTOPEDIA, (April 6, 2023, 5:35 PM), https://www.investopedia.com/terms/f/fii.asp.

IV. FIIS AND ITS REGULATORY FRAMEWORK

Institutional investors or investment funds that operate outside of their home nation are referred to as "foreign institutional investors" (FIIs). Insurance firms, hedge funds, pension funds, mutual funds and investment banks may all fall under this category. SEBI classifies as a Foreign Institutional Investor any domestic assets management company or domestic portfolio manager that is responsible for the management of money acquired, gathered, or brought into India from a location outside of India for the purpose of investing in India on behalf of a sub-account. When it comes to investing large sums of money, FII can be a crucial source of financing for developing economies. When these large investors buy stocks and other securities, the market is said to be in a bullish trend. They have a major impact on the sum of money flowing into the economy. Investment banks, mutual funds, mutual insurance companies, pension funds, and insurance firms are all examples of FIIs.[29]

(A) History and Registration Of FIIs

In 1993, India began to attract foreign portfolio investment in the form of FIIs after opening its stock market to outsiders the previous year, in September 1992. One of the most popular ways for international investors to invest in India. Initially, many FIIs were unable to invest in India due to the restrictions and conditions that were in place.[30] But, over time, in order to attract more investors, SEBI has simplified numerous conditions such as:

The ceiling for overall investment of FII was increased to 24% of the paidup capital of Indian business. To begin with, it welcomed non-natives. There was a rise in the buying of government bonds. Streamlined requirements for signing up.[31]

a. Registration Procedure

SEBI regulations outline the steps required to register as a FII. It stipulates that "no person shall buy, sell, or otherwise trade in securities as a Foreign Institutional Investors" unless such person has a certificate issued by the Board in accordance with the rules. Form A, as specified in the SEBI (FII) Regulations, 1995, must be used to apply for registration.[32]

The following are the eligibility requirements for an applicant seeking FII registration:

- Regulated by an appropriate foreign regulatory authority in the same capacity for which

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[29] *Ibid.*

[30] ANGELONE, https://www.angelone.in/knowledge-center/share-market/fiis-investment-may-increase-in-future, (last visited April 6, 2023)

[31] supra note 28, at 9.

[32] Form -A, Securities And Exchange Board Of India (Foreign Institutional Investors) Regulations, 1995

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SEBI registration is sought.

- Permission from the RBI in accordance with the Foreign Exchange Management Act of 1999 (FEMA).
- Legally permitted to invest in foreign securities or their subsidiaries.
- A proven track record, professional expertise, and financial stability.
- The applicant must be physically active and healthy.[33]

b. Eligible Securities

A foreign institutional investor (FII) can only invest in the following types of securities:

- Securities on the primary market and the secondary market, such as shares and debentures of unlisted, soon-to-be-listed, or recognized stock exchange-listed companies.
- Bonds from the government.
- Commercial paper.
- Security Receipts.
- Derivatives, like futures and options, are traded on a well-known stock exchange.
- Units of schemes floated by domestic mutual funds, such as Unit Trust of India[34]

(B) Investments by FIIS

There are two ways to invest for FIIs.

- Investing in stock (Equity Investment)

  Up to 30% of the money could be put into debt instruments. This means that 70% of the money could be put into equity-related instruments.

- 100% Debt (Debt instruments)

  Only debt securities can be bought with the money.

a. Equity Investment Route

While taking the equity option, FIIs might put their money into the following:

- Shares that are not yet listed, or are not yet scheduled to be listed, on a major stock

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[33] OIFC, https://www.mea.gov.in/images/pdf/OIFCPublication2009GuidebookonFDIforOI.pdf, (last visited April 7, 2023)

[34] supra note 2, at 1.

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exchange.

- Mutual fund shares from domestic companies, including those listed on exchanges, as well as those from the Unit Trust of India.
- Warrants

b. 100% Debt Route

The following instruments are available to FIIs for investment if they choose the Debt Route:

- Debentures (Non-convertible, Partially convertible)
- Bonds
- Government bonds with a specific maturity date
- Treasury Bills
- Additional Debt Market Instruments. Note that 100% debt investments are not open to international companies or individuals.[35]

(C) Legal Limitations/ Pros. And Cons. Of Foreign Institutional Investments

Foreign Institutional Investors are subject to a number of rules and regulations. Foreign institutional investors (FIIs) are typically restricted from investing more than 24% of the paid-up capital of an Indian company. However, a special resolution and board approval are required for FII investments in excess of 24%. Foreign institutional investors are limited to investing no more than 20% of the paid-up capital of Indian public-sector banks. However, in the case of specific corporations that have obtained shareholder approval for the same, the 24% limit may be raised to 30%.[36]

Subject to the overall limit of 24% on investments by all FIIs, NRIs, and OCBs, any FII or sub-account of a FII has been permitted to invest up to 10% of the equity of any one company.

For foreign institutional investors, the maximum amount that can be invested in the debt securities on their account and sub-account is governed by SEBI's stipulated requirements, which may be mandatory. An investment in a company that is subject to the Security and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, or in a company that has issued securities subject to that Act.

Compliance with these caps is checked every day by the Reserve Bank of India, which sets daily

[35] Manoj Singh, An Introduction to the Indian Stock Market, INVESTOPEDIA, (April 7, 2023, 12:30 PM), https://www.investopedia.com/articles/stocks/09/indian-stock-market.asp.
[36] Shivangi Ghosh, The legality of Foreign Institutional Investment in India, IPLEADERS, (April 7, 2023, 12:50 PM), https://blog.ipleaders.in/legality-foreign-institutional-investment india.

cutoffs at 2% below the maximum investment. This will allow it to provide the Indian firm receiving the investment with some warnings before allowing the last 2% to be purchased.[37]

There are two agencies with the authority to regulate FII—the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI)—but since they have different provisions, it is necessary to establish a third agency—one that reports to both RBI and SEBI—in order to effectively oversee the capital funds.

- **Advantages and disadvantages of the legal clauses**

a. **Advantages**

Increased capital availability

As a result of the influx of capital, the growth rate of the host country improves, which benefits output and employment.

An attitude of healthy competition is fostered

It fosters a competitive and growth-oriented atmosphere for both sides, which is beneficial to the relationship. Certain countries' economy make them attractive investment options.

Improved Business

When foreign institutional investors expand and improve corporate governance by solving problems at a company's operations, the firm is better able to reach its objectives.[38]

b. **Disadvantages**

Shortage of Funds

If a country's economy is struggling, investors may pull their money out of the market suddenly, creating instability that's difficult for authorities to manage.

Inflation

The increased demand for the rupee caused by the large influx of capital from overseas institutional investors has led to the RBI injecting large amounts of money into the market. Inflation is caused by the resulting surplus of cash.

Negative effects on exports

Because of the influx of foreign institutional investors, the currency has appreciated, making exports more expensive and reducing demand, which in turn reduces supply and weakens

[37] Ibid.
[38] Id.

competitiveness.[39]

(D) Foreign institutional investment in india: rules & regulations

Meaning and Terminologies under SEBI regulations for FIIs

- An institution that is not based in India but plans to invest in the Indian securities market is considered a foreign institutional investor.
- To qualify as a sub-account under these rules, an individual must be located outside of India and on behalf of whom a foreign FIIs investment in India institutional investor is offering to make investments in India.
- FIIs, sub-account FIIs, and QFIs who have paid their registration fees in accordance with the Securities and Exchange Board of India (Foreign Institutional Investors) Rules, 1995 and who hold a valid certificate of registration till the end registration block.[40]
- Qualified Foreign Investor a person who has opened an account of dematerialized with a qualified depository participant (QDP) as a QFI.[41]
- An Investment Manager is a company or other organisation that manages or advises on investments on behalf of clients or beneficiaries. Foreign Exchange Management Act of 1999 definitions of "person," "Non-Resident Alien," and "Resident Indian" were also taken into account (FEMA)[42]
- SEBI's guidelines are presented in the form of a number of different updated regulations and revisions to those regulations. Shown below is a condensed version of such a timeline for regulations.

a. Timeline of SEBI regulations and amendments regarding FIIs

- The initial set of FII regulations were released on October 15th, 1993, and stipulated a 5-year validity period for both SEBI registration and RBI general approvals under FERA.
- Securities and Exchange Board of India (foreign institutional investors) regulations, 1995 (December 1995) : procedure for FIIs as well as Sub-account to get register with SEBI Responsibility of FIIs
- The Securities and Exchange Board of India (SEBI) amended its 1995 FIIs regulations in 1996–97 to permit a wider range of foreign institutions with at least five years of track

[39] *Id.*
[40] Securities And Exchange Board Of India (Foreign Institutional Investors) Regulations, 1995.
[41] SEBI, Investment by Qualified Foreign Investors (QFI) in Indian equity shares, Circular, January 13, 2012.
[42] The Foreign Exchange Management Act, 1999, § 2.

record to qualify as FIIs. The overall ceiling of foreign investment, which includes other FIIs, NRIs, and OCBs, was set at 24%; this limit can be increased from 24% to 30% with the consent of the company's shareholders. FIIs may invest 100% of their portfolios in debt instruments with prior authorisation from SEBI; FIIs may invest in unlisted securities and proprietary funds. It is considered to be an element of the overall cap on commercial borrowing from outside sources and consists of both corporate debt instruments and government debt securities. Both SEBI and the Reserve Bank of India made efforts to streamline the FII registration process.[43]

- ‘The SEBI (Foreign Institutional Investors) Regulations’, 1995 Amendment (30th June 1998) : Provided the revised procedure of registration of sub-accounts of registered FIIs[44]
- SEBI (Foreign Institutional Investors) Rules, 1995 Amendment (18th May 1998) allows FIIs to invest in Treasury Bills through the debt channel and the equity route, where they can spend up to 30% in debt instruments.[45]
- According to the SEBI (Foreign Institutional Investors) Regulations, 1995 Amendment (29th February 2000), deemed Foreign Institutional Investor (FII) status is granted to Indian portfolio managers and approved asset management companies whose registered portfolio managers manage foreign funds, including sub-accounts. Sub-accounts of FIIs are open to investments from foreign companies and high net worth individuals.[46]
- Guidelines for disinvestment by FIIs and their sub-account in the event that a FII either does not wish to renew their FIIs investment in India registration or fails to make an application for renewal were established by the Securities and Exchange Board of India (Foreign Institutional Investors) (Amendment) Regulations, 2001 (13th February 2001).[47]
- Foreign institutional investors were required to report daily transaction data per Regulation 16 (2) (b) of the Securities and Exchange Board of India (Foreign Institutional Investors) Rules, 1995 (19th July 2002 Circular No. FITTC/FIIs/04/2002).[48]

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[43] Foreign Institutional Investment, Changes to the SEBI (Foreign Institutional Investors) Regulations, 1995, https://www.sebi.gov.in/sebi_data/commondocs/pt1b5_h.html, (last visited April 10, 2023).
[44] SEBI, Revised procedure for grant of registration of sub-accounts of registered Foreign Institutional Investors, Press Release, https://www.sebi.gov.in/media/press-releases/aug-1998/revised-procedure-for-grant-of-registration-of-sub-accounts-of-registered-fiis_19195.html, (last visited April 10, 2023).
[45] on May 18, 1998 by the Securities and Exchange Board of India (Foreign Institutional Investors) (Second Amendment) Regulations, 1998 vide No. S.O. 417(E).
[46] on February 29, 2000 by the Securities and Exchange Board of India (Foreign Institutional Investors) (Amendment) Regulations, 2000 vide No. S.O.180(E).
[47] on February 13, 2001 by the Securities and Exchange Board of India (Foreign Institutional Investors) (Amendment) Regulations, 2001 vide No. S.O. 128(E)

- The Securities and Exchange Board of India (SEBI) (Amendment) Rules, 2002 (December 2002) streamlined the FII registration process.
- Securities and Exchange Board of India (Foreign Institutional Investors) (Amendment) Regulations, 2004 (19th February 2004): Provided precise guidelines for FII to Issuance of Offshore Derivative Instruments by them.[49]
- Foreign institutional investor (FII) registration fees were lowered as of June 26, 2006 under the Securities and Exchange Board of India (FII) (Amendment) Rules, 2006.
- Updated the "Form A" Application Form for Award of Certificate of Registration as Foreign Institutional Investor in accordance with the Securities and Exchange Board of India (Foreign Institutional Investors) (Second Amendment) Rules, 2006 (21st August 2006). (FIIs)
- An Asset Management Company, investment manager, advisor, or institutional portfolio manager established and/or owned by a non resident Indian (NRI) is eligible to be registered as a FII under the terms of the Securities and Exchange Board of India (Foreign Institutional Investors) (Amendment) Regulations, 2008 (22nd May 2008), which stipulate the Know Your Client (KYC) procedure for FIIs and their Subaccounts.[50]
- The Securities and Exchange Board of India (Introduced new class of foreign investor Foreign Portfolio Investor merging Introducing Portfolio Investors) Rules, 2014 were published. They govern FIIs, QFIs, and sub-accounts of FIIs. In addition, we've included some registration requirements for FPIs. established criteria for QFI, defined qualified depository participant, know your customer norms for offshore derivative instruments issued by FPIs, mandated that all FPIs get a Permanent Account Number from the Income Tax Department, and allowed SEBI to appoint one or more individuals either on its own initiative or in response to a complaint or information. Form A, Application for Registration as a Foreign Portfolio Investor, is made available.[51]
- The Securities and Exchange Board of India (Foreign Portfolio Investors) (Amendment) Rules, 2016 were published on July 8th, 2016; they state that FPI clearance is needed before transferring offshore derivative instruments created on its behalf.

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[49] SEBI, Issuance of Offshore Derivative Instruments by Registered Foreign Investors (FIIs), https://www.sebi.gov.in/legal/circulars/feb-2004/issuance-of-offshore-derivative-instruments-by-registered-foreign-institutional-investors-fii-_9575.html, (last visited April 12, 2023)

[50] Securities And Exchange Board Of India Notification Mumbai, the 22nd May, 2008, Securities and Exchange Board of India (Foreign Institutional Investors) (Amendment) Regulations, 2008

[51] Securities Exchange Board of India Nitification, Mumbai 7th January 2014, Securities and Exchange Board of India(Foreign Portfolio Investors) Regulations, 2014.

- The Securities and Exchange Board of India (SEBI) (Third Amendment) Regulations, 2017 (25th May 2017):Announced that FPIs shall not be issued to, nor shall offshore derivative instruments be transferred to, resident Indians or non-resident Indians who are beneficially owned by resident Indians or non-resident Indians. Funds from Institutional Investors in India
- The SEBI (Foreign Portfolio Investors) (Fourth Amendment) Rules 2017 (20th July 2017) informed FPIs that they were required to collect a regulatory charge from each subscriber of an offshore derivative instrument issued by them and remit it to SEBI for a period of three years.
- The Securities and Exchange Board of India (Foreign Portfolio Investors) (Third Amendment) Rules, 2018 were updated on December 31 with the introduction of the phrase "Investment Manager."

As foreign investment deals in foreign exchange FIIs need to deals with RBI too. But time to time these compliances were liberalised by the government.

V. Taxable aspects of FIIs in India

Foreign Institutional Investors (FIIs) have played a significant role in the growth of the Indian economy. They have been investing in various sectors of the Indian economy, including equity, debt, and other financial instruments. However, the taxation of FIIs in India has been a contentious issue for a long time. The Indian government has been trying to strike a balance between attracting foreign investment and ensuring that the tax system is fair and equitable.

Many individuals are under the impression that FIIs do not pay taxes in India. That is not the case. Typically, FIIs register their funds with nations that have a Double Taxation Avoidance Agreement (DTAA) with India. This prevents them from paying tax twice, i.e. in their country of origin and in the country in which they invest. However, taxes must be paid. If the taxes have already been paid at one point, then they are exempt from paying taxes twice on the same income.[52]

1. Taxation of FIIs in India

The taxation of FIIs in India is governed by the Income Tax Act, 1961. The FIIs are subject to tax on their income from Indian sources. The income of FIIs from Indian sources includes dividends, interest, capital gains, and other income. The tax rate applicable to FIIs depends on

[52] Aditi Sharma, Do FIIs pay taxes in India and what are the rates of taxes applicable to FIIs?, INVESTORQ, (April 21, 2023, 4:20 PM), https://www.investorq.com/question/do-fiis-pay-taxes-in-india-and-what-are-the-rates-of-taxes-applicable-to-fiis-(last visited 21st April 2023)

the nature of the income and the country of residence of the FII.[53]

a) **Dividend Income:**

The dividend income received by FIIs from Indian companies is subject to a dividend distribution tax (DDT) of 20%. The TDS rate for non-resident Indians is 20% and is governed by any applicable Double Taxation Avoidance Agreements (DTAA). Due to any favorable agreements with the nation of residence, NRIs may benefit from lower tax deductions. [54]

b) **Interest Income:**

The interest income received by FIIs from Indian sources is subject to tax at the rate of 20%. The tax is deducted at source by the Indian company or the Indian government agency that pays the interest. The FII can claim credit for the tax deducted at source against its tax liability in its home country.

c) **Capital Gains**

Capital gains arise when an FII sells its investments in Indian securities or mutual funds. The gains can be classified as short-term or long-term depending on the holding period of the investment. If the holding period is less than 12 months, the gains are classified as short-term capital gains (STCG), and if the holding period is more than 12 months, the gains are classified as long-term capital gains (LTCG).

The taxation of these capital gains is different for STCG and LTCG. For STCG, the gains are taxed at the rate of 15%, while for LTCG, the gains are taxed at the rate of 10% (without indexation) or 20% (with indexation). Indexation refers to adjusting the purchase price of the asset for inflation.[55]

d) **Other Income:**

The other income earned by FIIs from Indian sources, such as rental income, is subject to tax at the rate of 30%. The tax is deducted at source by the Indian company or the Indian government agency that pays the income.[56]

e) **Tax Treaty Benefits:**

FIIs can avail of the benefits of the tax treaties between India and their home country. The tax

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[53] NSE, https://www.nseindia.com/invest/first-time-investor-income-tax-for-foreign-investors, (last visited April 21, 2023)

[54] IND MONEY, https://www.indmoney.com/articles/mutual-funds/taxation-on-dividends, (last visited April 21, 2023)

[55] NSE, Income Tax for Foreign Investors, https://www.nseindia.com/invest/first-time-investor-income-tax-for-foreign-investors, (last visited 26th April 2023)

[56] Arinjay Jain, §115AD of Income tax act – Tax on Income of Foreign Institutional Investors, SORTINGTAX, (April 26, 2023, 4:15 PM), https://sortingtax.com/section-115ad-of-income-tax-act/.

treaties provide for a lower tax rate or exemption from tax on certain types of income. The FIIs can claim credit for the tax paid in India against their tax liability in their home country. This has been criticized as it results in a higher administrative burden on the FIIs. The FIIs have to comply with the tax laws of both India and their home country, which increases the compliance costs.[57]

VI. Taxation regulations related to FIIs

Section 115AD - Foreign Investor Income Tax

Tax on income of Foreign Institutional Investors from securities or capital gains resulting from their transfer is the subject of Section 115AD of the Income Tax Act of 1961. The amended provision of Section 115AD became applicable for the assessment year 2022-23 beginning with the financial year 2021-22. In addition, a number of provisions apply under Section 115AD of the Income Tax Act. The present article provides a summary of Section 115AD of the Income Tax Act.[58]

Amendment to Section 115AD

Section 115AD and Section 115AD (2) of the Income Tax Act, 2021 have been amended to include the phrase "Investment Division of an offshore banking unit" as of January 4, 2022.

The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 includes a new Section 115AD (1) that takes effect on January 4, 2022. With retroactive effect to January 4, 2022, the Finance Act, 2021 added subsection 1B to section 115AD.

Effective January 4, 2022, the Finance Act, 2021 includes the justification for an offshore banking unit's Investment Division. As of January 4, 2022, the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 amended the definition of "security," "permanent establishment," and "specified fund".[59]

Section 115AD (1) of the Income Tax Act

The foreign institutional investors' total income consists of income from securities and income from long-term or short-term capital gains from the sale of securities. If the following are included in the total income of a specified fund or investment branch of an offshore banking unit or Foreign Institutional Investor:

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[57] Ektha Surana, What is Double Taxation Avoidance Agreement (DTAA)? How NRIs can Claim Benefits Under DTAA, CLEARTAX, (April 26, 2023, 4:27 PM), https://cleartax.in/s/how-nris-can-claim-benefits-under-dtaa.
[58] NAVI, https://navi.com/blog/section-115ad-of-the-income-tax-, (last visited April 26, 2023)
[59] B MARKETS, https://www.bajajfinservmarkets.in/markets-insights/income-tax/section-115ad.html, (last visited April 27, 2023)

a) The income received from securities other than those referred to in Section 115AB, or

b).The income from short-term or long-term capital gains resulting from the sale of these securities.[60]

The income tax amount calculated with respect to any securities referred to in clause (a) and included in the total income, if any, At the rate of 20% for Foreign Institutional Investors, in the case of a specified fund or investment subdivision of an offshore banking unit, the tax rate is 10%.

The calculated income tax amount on the income from short-term capital gains referred to in clause (b), if any, included in the total income at a rate of 30%, provided that the income tax amount on the income from short-term capital gains referred to in section 111A is at a rate of 15%.[61] The income tax amount calculated by way of long-term capital gains referred to in clause (b), if any, shall be included in the total income at the rate of 10%, provided that in the case of income obtained from the transfer of a long-term capital asset referred to in section 112A, 10% income tax shall be calculated if such income exceeds Rs. 1 Lakh. The amount of income tax to which the specified fund or FII would have been subject if its total income had been reduced by the amount of income described in clauses (a) and (b).[62]

- **Section 115AD(1A**) of the Income Tax Act is a relevant provision to consider. The Income Tax Act's Section 115AD(1A) provision will not be applicable to the income attributable to units held by an NRI (who is not a permanent establishment of a non-resident in India) in a specified fund, as determined by the prescribed method.[63]
- The provision outlined in Section 115AD(1B) of the Income Tax Act is of relevance in this context - **Section 115AD(1B)** of the Income Tax Act is applicable to the investment division of an offshore banking unit in relation to accountable income, notwithstanding the provisions contained in subsection (1) of Section 115AD of the Income Tax Act.[64]

According to **Section 115AD(2)** of the Income Tax Act, it can be inferred that the application of Section 115AD (2) of the Income Tax Act is applicable in two distinct scenarios:

In the event that the entirety of revenue generated by an investment sector of an offshore banking entity or foreign institutional investor pertains solely to the income derived from securities specified in clause (a) of subsection (1) of Section 115AD, the entity will not be eligible for

[60] Income Tax Act, 1961, § 115AD (1),
[61] Ibid.
[62] CLEARTAX, https://cleartax.in/s/long-term-capital-gains-on-shares, (last visited April 29, 2023)
[63] Income Tax Act, 1961, § 115AD (1).
[64] Income Tax Act, 1961, § 115AD(1B).

income tax deductions under Sections 28 to 44C or clause (i) or clause (iii) of Section 57 or those under Chapter VI-A.[65]

According to **Section 115AD(3)** of the Income Tax Act, it is stipulated that the exclusion of the first and second provisos to Section 48 is applicable to the calculation of capital gains arising from the transfer of securities mentioned in clause (b) of subsection (1) of Section 115AD of the Income Tax Act and provides an explanation of the Foreign Institutional Investor, which pertains to the investment division of offshore banking unit securities and specified fund.[66]

VII. Exemptions for FIIs in IT Act, 1961

- **Section 194LBB**: The income arising from investments in a business trust, by a FII, FPI or NRIs is exempt from tax. This exemption is available only on income arising on or after 1st April 2016. Since such income is tax-exempt in their hands, no TDS will be taken from payments made to the government, the RBI, mutual funds, or corporations established under the Act.
- **Section 10(23FE)**: This section exempts income arising to a registered FII from trading in specified securities in a recognized stock exchange from taxation. The Finance Act of 2020, among other things, inserted clause (23FE) in section 10 of the Income-tax Act of 1961 to provide for exemption for wholly owned subsidiaries of Abu Dhabi Investment Authority (ADIA), sovereign wealth funds (SWF), and pension funds (PF) [these are referred to as "specified persons" herein] on dividend, interest, and long-term capital gains arising from infrastructure investment in India during the period beginning with 01 January 2020 and ending on 31 March 2024.[67]
- **Section 196D**: This section provides that any income received by way of interest or any other sum or capital gains by a registered FII from a specified security or a venture capital undertaking is exempt from tax.No tax deduction shall be made from any income by means of capital gains resulting from the transfer of securities mentioned in section 115AD that is payable to a Foreign Institutional Investor. No deduction shall be made from any income that is exempt under clause (4D) of section 10.[68]

[65] Income Tax Act, 1961, § 115AD (2).
[66] Income Tax Act, 1961, § 115AD(3).
[67] TAXGURU, https://taxguru.in/income-tax/guidelines-clause-23fe-section-10-income-tax-act.html, (last visited April 30, 2023).
[68] Income Tax Act, 1961, § 196D, Income Tax Act, 1961.

VIII. DOUBLE TAXATION AVOIDANCE AGREEMENTS (DTAA)

Double Taxation Avoidance Agreements (DTAA) are an important aspect of international tax law and are essential for promoting cross-border trade and investments. Under these agreements, the tax authorities of two countries agree to avoid the double taxation of the same income or capital. In the case of foreign institutional investors (FIIs) in India, DTAA has become a critical issue as several tax disputes have arisen in recent years.[69]

(A) DTAA and FIIs in India:

India has entered into DTAA with over 80 countries worldwide, including the United States, the United Kingdom, Singapore, and Mauritius. These agreements provide a mechanism for FIIs to avoid double taxation on their investments in India. However, DTAA has also been the subject of several controversies, especially in the context of the tax treatment of capital gains earned by FIIs.[70]

The primary source of conflict arises from the interpretation of Article 13(4) of the India-Mauritius DTAA. The capital gains arising from the sale of shares in an Indian company by a Mauritian resident shall only be taxable in Mauritius and not in India. This provision has been a subject of significant debate and has led to a rise in the number of structures used by investors to route their investments through Mauritius to avoid Indian taxes.[71] The Indian government has enacted several measures to curb the misuse of the treaty, including the imposition of a General Anti-Avoidance Rule (GAAR) and the revision of the DTAA with Mauritius.[72]

On August 10, 2016, the Indian government notified a protocol (the "India-Mauritius Protocol") revising a 33-year-old tax treaty with Mauritius (the "India-Mauritius Treaty") that exempted the investors from capital gains tax on investments in India. The exemption encouraged international money and corporations to channel investments into India via Mauritius, hampering India's efforts to enhance tax income. India now has the ability to tax capital gains on transfers of Indian shares purchased on or after 1 April 2017 under the India-Mauritius

[69] Dr. Rajkumar Adukia, Double Tax Avoidance Agreements and Taxation, TAXGURU, (April 30, 2023, 5:12 PM), https://taxguru.in/income-tax/double-tax-avoidance-agreements-taxation.html.

[70] BANKBAZAAR, Double Taxation Avoidance Agreement, https://www.bankbazaar.com/tax/double-taxation-avoidanceagreement.html#:~:text=For%20NRIs%20who%20are%20working,India%20has%20this%20agreement%20with., (last visited April 30, 2023).

[71] Abhishek, The Double Tax Avoidance Agreement between India and Mauritius, LEGAL SERVICE INDIA.COM, (April 30, 2023, 7:12 PM), https://www.legalservicesindia.com/article/1195/The-Double-Tax-Avoidance-Agreement-between-India-and Mauritius.html.

[72] Dhruv Gandhi and Gaurav Bhawnani, GAAR to Override DTAAs: Can the Constitution or Limitation of Benefits Clauses Prevent this Menace?, NUJS LAW REVVIEW,(May 2, 2023, 7:12 PM) http://nujslawreview.org/wp-content/uploads/2017/06/10-2-Dhruva-Gandhi-Gaurav-Bhawnani-%E2%80%93-GAAR-to-Override-DTAAs_-Can-the-Constitution-or-Limitation-of-Benefits-Clauses-Prevent-this-Menace.pdf.

Agreement.[73]

In the Case **MIH India (Mauritius) Limited, Mauritius v. ACIT Circle[74]** , the Delhi Bench of the Income-tax Appellate Tribunal ("Delhi Tribunal") held that Capital gains income earned by a Mauritius tax resident from the sale of shares of an Indian company is not taxable in India under the pre-amended Article 13(4) of the double taxation avoidance agreement between India and Mauritius (the "Mauritius DTAA").

Contextual information

Among other things, the Contracting State in which the alienator resides is the only one subject to taxation on the gain from the alienation of any property under Article 13(4) of the Mauritius DTAA. As of April 1, 2017, India would be able to tax capital gains from the sale of shares in an Indian resident company acquired on or after May 10, 2016 as per the amendment to the Double Taxation Avoidance Agreement (DTAA) with Mauritius. This announcement was made in a press release issued by India's Central Board of Direct Taxes ("CBDT") on May 10, 2016. However, the provision states that transfers of shares acquired prior to April 1, 2017 (i.e., the "pre-amended period") will not be subject to capital gains tax.

Another aspect of the DTAA that has impacted FIIs in India is the branch profits tax. The India-United States DTAA provides that a tax may be levied on the profits of a foreign enterprise operating in India through a permanent establishment or branch office. This provision has been a point of contention, with several FIIs challenging the imposition of branch profits tax by Indian tax authorities.[75]

(B) Analysis of DTAA related to FIIs in India:

The impact of DTAA on FIIs in India can be analyzed by examining the legal framework governing the tax treatment of FIIs in India, the provisions of relevant DTAA, and the impact of DTAA on tax revenue.

- **Legal framework:**

Under Indian tax law, FIIs are generally subject to a withholding tax on their income from investments in India. The rate of tax varies based on the type of investment, with a lower rate of tax for investments made through debt instruments. However, the tax implications of

[73] Squire Patton Boggs, Updates on India’s Tax Treaties With Mauritius and Its Impact on the India-Singapore Tax Treaty, https://www.squirepattonboggs.com/~/media/files/insights/publications/2016/10/updates-on-indias-tax-treaties-with-mauritius-and-its-impact-on-the-india-singapore-tax-, (last visited May 2, 2023).
[74] Case No. SA 138/DEL/2022.
[75] INCOME TAX DEPARTMENT, https://incometaxindia.gov.in/dtaa/108690000000000099.htm, (last visited May 3, 2023).

investing through equity shares are more complex, with the tax treatment dependent on the period of holding and the nature of the gains. In the case of short-term capital gains (less than 12 months), FIIs are subject to a tax rate of 15%, while long-term capital gains are taxed at a rate of 10%.[76]

- **Provisions of DTAA:**

DTAA generally provides for a mechanism for the avoidance of double taxation by allowing the FIIs to claim credits for taxes paid in India against tax liabilities in their home country. The applicable rate of tax is also determined by DTAA, which may be lower than the rate prescribed under Indian tax law. For example, the DTAA with Singapore provides for a lower tax rate of 10% for short-term capital gains as compared to the 15% rate prescribed under Indian tax law.[77]

- **Revision of DTAA with Mauritius:**

The Indian government revised the DTAA with Mauritius in 2016 to introduce a source-based taxation system for capital gains arising from the transfer of shares in an Indian company. Under the revised treaty, capital gains arising from the sale of shares after 1 April 2017 are taxable in India if the company's value is primarily derived from Indian assets.

In India, the Central Government has been authorized to enter into double tax avoidance agreements (also known as tax treaties) with foreign countries under Section 90 of the Income Tax Act.[78]

IX. Conclusion

The Indian stock market opened to FIIs (Foreign Institutional Investors) on September 14th, 1992. Foreign institutional investors (FIIs) have had regulations placed upon them since October 15th, 1993. According to the rules laid down, FIIs have to register with both SEBI and the RBI. Initially, FIIs were only allowed a maximum 24% stake in the total market, with a 5% cap on any one firm. With the exception of sectors with higher overall limits on foreign investment, these ceilings have been raised to 10% for single foreign portfolio investors in each company. Whenever there was a change in the requirements for FPIs and DDPs to meet KYC standards, SEBI released new recommendations. By consolidating FIIs, QFIs, and the FII sub-account in June 2014, SEBI created a new category of foreign investors known as Foreign

[76] Dhruva, Foreign Portfolio Investors, DHRUVAADVISORS, (May 3, 2023, 6:12 PM). https://www.dhruvaadvisors.com/insights/files/Foreign-Portfolio-Investors-2022.pdf.

[77] Shrey Sharma, Double Taxation Avoidance Agreements with special reference to DTAA between India and Singapore, TAXGURU, (May 3, 2023, 7:18 PM), https://taxguru.in/income-tax/dtaas-special-reference-dtaa-india-singapore.html.

[78] Income Tax Act, 1961, § 90.

Portfolio Investors (FPIs). As of the 2017–18 fiscal year, there were 9,136 FIIs registered with SEBI in India. Since FIIs were allowed to participate in India, the Indian equities market, debt market, and overall investment have all grown at CAGRs of 26.05%, 33.08%, and 27.43%, respectively, through the end of the latest fiscal year 2018-19. In 2016–17, FII turnover accounted for 21% of NSE and BSE's combined turnover and 13% of NSE's F&O turnover.The taxable aspects of FIIs in India have become a critical issue in recent years, with significant tax disputes arising due to the interpretation of relevant tax laws and DTAA. While the Indian government has taken several measures to address the issues arising from the tax treatment of FIIs, more comprehensive reforms may be necessary to create a more equitable and transparent tax regime. One of the major sources of controversy in this regard is the interpretation of Article 13(4) of the India-Mauritius DTAA, which provides for the tax treatment of capital gains earned by Mauritian residents in India. While the recent revision of the treaty has addressed some of the issues arising from tax avoidance through treaty shopping, there is still a need for more comprehensive reforms to prevent the misuse of the treaty. Another issue that has impacted the tax treatment of FIIs in India is the imposition of branch profits tax, which has been challenged by several foreign enterprises operating in India. The Indian government may need to review its tax laws to create a more conducive environment for foreign investors, while also ensuring that tax revenues are protected.

Furthermore, the introduction of a source-based taxation system and the imposition of a minimum threshold for tax treaty benefits are potential reforms that could address the concerns arising from tax avoidance and create a more predictable and transparent tax regime for FIIs in India. In summary, while the Indian government has made several efforts to address the issues arising from the taxable aspects of FIIs, there is still a need for more comprehensive reforms to create a more sustainable and equitable tax regime.

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