# **Funds** Hotline

April 15, 2020

## INDIAN GOVERNMENT ORDER GETS MAURITIUS FPIS BACK IN ACTION

The Government of India has issued an Order[1], confirming that Mauritius would be regarded as an eligible country for the purpose of registration as Category I Foreign Portfolio Investor ("**FPI**") under the SEBI (Foreign Portfolio Investors) Regulations, 2019 ("**FPI Regulations**"). This is an extremely welcome move as it puts Mauritius based FPIs at par with those set up in FATF member jurisdictions (like Singapore).

Mauritius however continues to remain in the 'grey list' issued by the Financial Action Task Force ("**FATF**"), which triggered Indian intermediaries to consider Mauritius as a 'high risk jurisdiction'. This, in turn, imposes a stricter KYC and beneficial ownership identification standards on such Mauritius based FPIs than those applicable to other Category I FPIs.

### BACKGROUND

By and large, investment funds from FATF member countries are eligible to register as Category I FPIs whereas investment funds based out of non-FATF member countries are eligible to register as Category II FPIs (unless the investment manager of such fund is from an FATF member country and is registered as a Category I FPI).

Accordingly, a Mauritius based fund, unless appropriately managed by a manager as above, could generally get registered as a Category II FPI.

As a precursor to the Order, SEBI had issued a circular on April 07, 2020 amending the FPI Regulations whereby it allowed applicants from a jurisdiction which may not be a member country of FATF but "*from any country specified by the Central Government by an order or by way of an agreement or treaty with other sovereign Governments…*", to be considered eligible for a Category I FPI license. With the Order, Mauritius is the first country that has been so identified.

### ISSUES: BUCKET A (FOR ALL CATEGORY II FPIS)

In case of a Category II FPI, all the ultimate beneficial owners are required to share their proof of identity as part of the KYC process, which requirement otherwise does not apply to ultimate beneficial owners of a Category I FPI.

Eligibility criteria for subscription to offshore derivative instruments has, under Reg. 21(1) of the FPI Regulations, been modified to refer to persons that are either registered as, or are eligible to be registered as, Category I FPIs. Category II FPIs are therefore barred to access such synthetic products.

The Indian Income-tax Act, 1961 provides for taxability of income arising from transfer of offshore shares and interests in a foreign entity that derive value substantially from underlying assets in India and thus constitute indirect transfer of Indian shares. However, the Indian Income-tax Act, 1961 exempted investments held in Category I FPIs and Category II FPIs from the applicability of indirect transfer provisions. In September 2019, SEBI rationalized the categories of FPIs, with most sub-categories of Category I FPIs and Category II FPIs being grouped together as Category I FPIs under the FPI Regulations. With this change, the Finance Act 2020 made an amendment to the Income-tax Act, 1961 to exempt the applicability of indirect transfer provisions to investments held directly or indirectly in (only) Category I FPIs. However, the Finance Act 2020 provided for a grandfathering of the exemption with respect to investments held in Category I FPIs or Category II FPIs prior to September 2019. This was especially pertinent for Category II FPIs which could not be reclassified as Category I FPIs under the FPI Regulations 2019, such as Mauritius-based funds with Mauritius-based investment managers.

### ISSUES: BUCKET B (FOR MAURITIUS BASED FPIS)

On February 21, 2020, the FATF released a publication titled "Jurisdictions under Increased Monitoring" ("**FATF Release**"), whereby Mauritius was added to such list, generally referred to as the 'grey list'.

As per the guidance in the FATF Release and on the FATF website, jurisdictions identified as being subject to increased monitoring, are the ones actively working with the FATF to address strategic deficiencies in their regimes to counter money laundering.

The FATF Release states that when the FATF places a jurisdiction under such a 'grey list', it means the country has committed to resolve swiftly the identified strategic deficiencies within agreed timeframes, besides being subject to increased monitoring. The FATF Release accordingly identified areas wherein Mauritius may still have deficiencies and is expected to improve as per the action plan formulated in such regard.

SEBI in its circular dated February 25, 2020, endorsed FATF's findings, and issued a guidance to market intermediaries to consider this information in their risk analysis. Accordingly, intermediaries are entitled to apply lower materiality threshold of 10% for identification of beneficial ownership (instead of the 25% threshold that otherwise applies to companies based in Mauritius).

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Mauritius has been the jurisdiction of choice when India focused funds are being set up as it has legal framework which is conducive to fund formations and operations. Mauritius also has a robust ecosystem of administrators, banking operations and other ecosystem enablers comparable to other leading international financial centres.

Under the India-Mauritius tax treaty, India has a source-based right to tax gains arising from the alienation of shares only, and not capital assets other than shares (such as debentures and derivatives). In case such transfers are characterized as capital gains, the gains should be taxable only in Mauritius. In respect of interest income, provided the beneficial owner of interest income is a resident of Mauritius, tax chargeable in India should not exceed 7.5% of the gross interest paid. Of course, Mauritius funds may still need to cross the hurdles of the General Anti Avoidance Rule ("GAAR") to be eligible for lower rates of tax under the India-Mauritius tax treaty.

The Order is timely and helpful in easing the Bucket A issues of both existing Mauritius based FPIs or those considering setting platform in Mauritius to leverage the efficiencies it offers.

Bucket B concerns however continue to exist. We understand from a guidance issued by Financial Services Commission (Mauritius' financial services and securities regulator) that the FSC, during this 'increased monitoring' phase, will continue to actively work with FATF to address the remaining action items to resolve the same swiftly within or before the agreed timelines.

– Richie Sancheti, Kishore Joshi, Nandini Pathak & Parul Jain

You can direct your queries or comments to the authors

[1] Order dated April 13, 2020 issued by Department of Economic Affairs (DEA), Ministry of Finance, Government of India




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