KPMG

Foreign Portfolio Investors

January 2024

Regulatory updates – SEBI, RBI

SEBI released consultation paper on introduction of optional T+0 and optional instant settlement of trades

SEBI released consultation paper soliciting comments from stakeholders and public on introduction of the facility for clearing and settlement of funds and securities on T+0 and instant settlement cycle on **optional basis** in addition to the existing T+1 settlement cycle in secondary markets for equity cash segment. Comments to be provided by 12 January 2024.

The features of the mechanism are:

Particulars	Phase 1: Optional T+0 settlement cycle	Phase 2: Optional instant settlement cycle
Basic proposition	Settlement of funds and securities to be completed on the **same day**	Trade-by-trade **immediate settlement** (funds and securities)
Eligible investors	All clients excluding clients settling through custodians	All clients
Eligible securities	To begin with, it shall be made available in top 500 listed equity shares based on the market capitalisation. Exchange to create a separate series/group/scrip code	All securities under phase 1
Trading hours	9.15 a.m. to 1.30 p.m.	9.15 a.m. to 3.30 a.m.
Client code modification	Permitted	Not permitted
Risk management	Based on margin	Order level risk management system and mandatory prefunding of funds and securities
Obligation (for non-UPI clients and propitiatory)	Net obligation at member level across clients	Each trade settled separately
Funds settlement (for non-UPI clients and proprietary)	Pay-in and pay-out at member level with Clearing Corporation (CC)	Same as phase 1
Securities settlement	Early pay-in by 1.45 p.m.	Early pay-in mandatory before trading
	Securities pay-out to member pool account for non-UPI clients and proprietary. Pay-in validation will be done by CC	Same as phase 1
Settlement timelines	4.30 p.m.	As soon as possible

Benefits of the proposed mechanism:

For clients:

- Provide flexibility in terms of faster pay-out of the funds against the securities to the sellers and faster pay-out of securities against the funds to the buyers

  Better control over funds and securities by the investors.

For the securities market ecosystem:

- Shorter settlement cycle will free up capital in the securities market thereby enhancing the overall market efficiency

  Enhance the overall risk management of CCs as the trades are backed by upfront funds and securities.

Public comments also sought on the following:

- Should SEBI move towards a shorter settlement cycle in the form of instant settlement?
- Is the proposed mechanism a right step towards developing and increasing investor confidence in the securities markets?
- Any challenges and risks associated with the proposed mechanism apart from those highlighted in the consultation paper? If yes, to highlight the same along with possible mitigation measures
- Should the proposed mechanism be made available only for top 500 listed equity shares?
- Any other additional suggestions on the proposed mechanism.

Source: SEBI consultation paper dated 22 December 2023

Reserve Bank of India (Government Securities Lending) Directions, 2023 notified

To add depth and liquidity to the government securities market, and to aid efficient price discovery Reserve Bank of India (RBI) has notified RBI (Government Securities Lending) Directions, 2023 with effect from 27 December 2023. Key features of the directions are:

Government Securities Lending (GSL) transaction to refer to dealing in Government securities (G-Sec) involving lending of eligible G-Sec, for a fee, by the owner of those securities (the lender) to a borrower, on the collateral of other G-Sec, for a specified period of time, with an agreement that the borrower shall return to the lender the security borrowed and the latter shall return the security received as collateral to the former at the end of the agreed period.

Eligible securities

G-Sec issued by the central government excluding treasury bills to be eligible for lending/borrowing under a GSL transaction.

G-Sec issued by the central government including treasury bills and the state governments for collateral under a GSL transaction.

Securities obtained under repo transaction, including through Reserve Bank's Liquidity Adjustment Facility, or borrowed under another GSL transaction to be eligible to be lent or placed as collateral under a GSL transaction.

Eligible participants

Lenders of securities:

- An entity eligible to undertake repo transactions in G-Sec in terms of the Repurchase Transactions (Repo) (Reserve Bank) Directions, 2018 (such as any regulated entity, any listed corporate, any All-India Financial Institutions)
- Any other entity approved by RBI.

Borrowers of securities:

Entities that are eligible to undertake short sale transactions in terms of Short Sale (Reserve Bank) Directions, 2018 (such as scheduled commercial banks, primary dealers, urban co-operative banks etc.)

Source: RBI Notification No. RBI/2023-24/97 [FMRD.DIRD.No.05/14.03.061/2023-2024] dated 27 December 2023

RBI releases draft directions for bond forwards

The RBI, based on suggestions received on the need to introduce bond forwards in G-Sec, issued **draft** Reserve Bank of India (Bond Forwards) Directions, 2023.

The draft directions seek to enable market participants to manage their cash flows and interest rate risk. Comments are invited from stakeholders by **25 January 2024**. Key features of the draft are:

Applicability

These directions to apply to transactions in bond forwards undertaken in **Over-the-Counter (OTC)** markets in India.

Bond forwards to mean derivative contracts in which one counterparty (buyer) agrees to buy a specific debt instrument from another counterparty (seller) on a specified future date and at a price determined at the time of the contract.

Transactions in bond forwards to be undertaken on **central government and state government** securities.

Eligible market participants

- A resident; and
- A non-resident, who is eligible to invest in government securities under the Foreign Exchange Management (Debt Instruments) Regulations, 2019.

Users

Various entities including FPI to be eligible to undertake transactions in bond forwards. Directions for FPIs for participation in bond forwards to be issued separately.

Settlement of trades

- Bond forwards to be physically settled, or cash settled
- The settlement of physically settled bond forwards to be through approved clearing agency
- Bond forwards which are cash settled, to be settled bilaterally or through approved clearing agency
- Market participants allowed to exit their position in bond forwards by unwinding the position with the original counterparty or assigning the position to any other eligible market participant through novation[1]
- The settlement basis and market conventions for bond forwards to be specified by The Fixed Income Money Market and Derivatives Association of India (FIMMDA), in consultation with market participants.

Source: RBI Press Release 2023-2024/1557 dated 28 December 2023

Income-tax – case laws, notification

Tax treaty benefit allowed on sale of shares based on Tax Residency Certificate (TRC)

The assessee is a company incorporated in Mauritius. It is a tax resident of Mauritius and holds a valid TRC. In AY 2016-17, the company filed return of income declaring long-term capital loss.

The AO initiated re-assessment proceedings and calculated Long-Term Capital Gain (LTCG) (without giving benefit of foreign exchange fluctuation and indexation on the sale of shares). Further, the AO denied the tax treaty benefits holding the taxpayer is a paper company.

On appeal, ITAT observed that the Mauritian company had a valid TRC and category 1 global business licence. The company had furnished various evidence to establish its residential status and bank statements reflecting details of investments made in foreign currency, foreign inward remittance certificate, etc.

ITAT, in view of the Central Board of Direct Taxes (CBDT) circular no. 789, dated April 13, 2000, and the supreme court's ruling in the case of Union of India Vs. Azadi Bachao Andolan, held that "once the assessee holds a valid TRC, the departmental authorities cannot go behind it to question residential status."

ITAT further stated that though the AO has the authority to dispute the residential status of the assessee merely on the strength of TRC, however, it is incumbent upon the AO to make proper inquiry and to establish the fact that the party claiming benefit and holding the TRC is a shell/conduit company.

Accordingly, ITAT allowed the benefit of Article 13(4) of India-Mauritius tax treaty and held that the LTCG was not taxable in India.

Source: CPI India Ltd. v. ACIT, ITA No.382/Del/2023 (Delhi ITAT) dated 21 November 2023

[1] Novation is the replacement of a contract between two counterparties to an OTC derivatives transaction (the transferor, who steps out of the existing contract, and the remaining party) with a new contract between the remaining party and a third party (the transferee). The transferee becomes the new counterparty to the remaining party.

Market Watch – press articles-select extracts

SEBI streamlines regulations for accredited investor registration

"The market regulator said that accreditation agencies will be able to grant certification solely based on the Know-Your-Customer (KYC) and financial information of the applicants. As KYC registration agencies (KRAs) act as accreditation agencies, they will now be able to access KYC documents from the database for this certification."

Source: Business Standard, Khushboo Tiwari, 18 December 2023

After getting FPI 'Visa' for D-Street, Russians move to open GIFT shops

"Just a few months after half a dozen Russian institutions were permitted by the Indian capital market regulator to trade as foreign portfolio investors (FPIs) on local stock exchanges, three Russian entities are learnt to have applied for different licences with the GIFT City authorities.

Two of these units would be set up as 'fund management entities' and another as a 'brokerage' once they get the go-ahead from the International Financial Services Centres Authority (IFSCA), the unified regulator for services, products, and institutions in GIFT City, two persons told ET."

Source: The Economic Times, Sugata Ghosh, 4 December 2023

Maharashtra GST department slaps tax notices on custodians to FPIs

"The Maharashtra Goods and Services Tax (GST) department has sent notices to several banks on the taxability of custodial services provided by them to foreign portfolio investors (FPIs), said people in the know.

The state GST authorities have taken the stand that the custodial services provided by the SEBI-registered custodian banks do not qualify as zero-rated supplies for the purpose of exports."

Source: Business Line, Ashley Coutinho, 1 December 2023

FPI Statistics – FPI portal, NSDL

Parameters	Current month	Earlier month	Changes
Net Equity inflows during Dec 2023(in USD million)	7,968	1,084	
Net Debt inflows during Dec 2023(in USD million)	1,706	1,879	
Total FPIs registered as on 1 Jan 2024	11,143	11,166	-23
AUC of FPIs at end of Nov 2023(in USD million)	732,538	684,293	48,246

Source: NSDL FPI Monitor

KPMG in India contact:

Sunil Badala
Deputy Head of Tax
National Head Tax - BFSI
KPMG in India
E: sunilbadala@kpmg.com

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