

Mauritius-based FPIs get tax relief as tribunal rules mutual fund units are not shares



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This verdict will also positively impact FPIs based out of jurisdictions such as Singapore which have similarly worded tax treaties with India



Several marquee foreign portfolio investors (FPIs) such as Blackrock, Templeton Asset Management, Invesco and capital group, who have invested into India through Mauritius/Singapore route have received a shot in the arm in the form of a recent Delhi Income Tax Appellant Tribunal (ITAT) verdict. In a verdict delivered in late June involving Emerging India Focus Fund (foreign mutual fund), the tribunal ruled units of mutual funds are not shares and hence are eligible for tax exemption under India-Mauritius Double Tax Avoidance Agreement(DTAA). The tribunal hence opined sale of mutual fund units is not the same as sale of shares by foreign entities in India.

While the verdict is in a matter pertaining to India-Mauritius DTAA, tax experts say, it will also benefit Singapore based FPIs since India-Singapore treaty is similarly worded as India-Mauritius treaty.

As a result, Mauritius based FPIs who are mutual funds don't have to pay capital gains tax in India and claim treaty exemption. Until 2017, even capital gains accrued via sale of shares was exempt from capital gains tax in India, however post the renegotiation of India-Mauritius tax treaty shares became taxable. However, derivative market transactions from Mauritius continued to enjoy tax exemption even under the new treaty. The Emerging India Focus verdict now places even Mauritius based Mutual funds under the exemption bracket.

Tax experts say, the verdict will also have impact on foreign mutual funds coming from other jurisdictions like Singapore whose tax treaties with India are similarly worded.

“Under the Indian Laws, the shares and mutual fund both are different forms of securities and investment in both of them have significant differences in terms of the rights of investors, regulation, nature of return and taxability under the domestic laws. Equity Mutual Funds are merely a class of mutual funds. They may be treated along with equity shares for giving exemption or rate of taxation by virtue of section 10(38) or 112 of the Act, but for the DTAA the gain on sale of Equity Mutual funds cannot be said be out of alienation of ‘shares’.” Said a two-bench ITAT bench in their June 25 verdict.

“This clarification provides significant relief to foreign investors, as it confirms that mutual fund units enjoy independent treaty protection and are not to be clubbed with shares for tax purposes. Indian tax authorities cannot tax capital gains from mutual fund units as if they were shares just because mutual funds invest in shares. This ruling makes it clear that mutual fund units and shares are different, which should reduce disputes and legal cases.” Said Dhruv Chopra, Managing Partner at Dewan PN Chopra and Co.

In April this year, there was a similar verdict from Mumbai ITAT but it was pertaining to how mutual fund units owned by Non-Resident Indians(NRIs) should be treated. In the verdict, Mumbai ITAT took a similar interpretation as the Delhi ITAT order in Emerging India Focus Fund case.

“This verdict adds to the jurisprudence of tax certainty laid down by tax tribunals from across the country over the last decade - for non-resident funds/companies/family offices investing in Indian securities other than shares.” Said Himanshu Sinha, partner, Trilegal. “While the treaty doesn’t define the term ‘shares’ - even under domestic Indian laws, ‘shares’ and ‘units of a mutual fund’ are classes of assets with entirely different rights and obligations, and regulated under different companies and securities laws.”

Although the contribution of Mauritius to India’s FPI flows has dipped significantly over the last decade, the country continues to serve as a prominent jurisdiction for FPIs wanting to invest in India. Mauritius is the fifth largest source of FPI flows into India with FPIs from the island country owning assets worth Rs 3.85 lakh crore in India. There are currently 622 FPIs based out of Mauritius now.

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