INVESTMENT COMPANY INSTITUTE

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Mr. Arbind Modi, IRS
Joint Secretary, Tax Policy & Legislative Division
Department of Revenue
Ministry of Finance
Government of India
North Block
New Delhi 110 001
India

RE: Impact of Proposed New Direct Tax Code on Foreign Institutional Investors

Dear Mr. Modi:

The Investment Company Institute,[1] on behalf of U.S. investment companies and their shareholders, respectfully requests that two provisions in the August 12 draft of a new Direct Taxes Code ("DTC") not be adopted. Specifically, the Institute is concerned about the potential impact on foreign institutional investors ("FIIs") of the proposals to increase the tax rate on capital gains and to override treaties. If these proposals are adopted, the willingness of FIIs to invest in India may be impacted negatively.

We understand that the draft DTC proposes to tax gains arising to non-residents (including FIIs) on the transfer of any investment asset, regardless of holding period, at a rate of 30 percent. Further, we understand that the DTC proposes that neither the DTC nor any Double Tax Avoidance Agreement ("DTAA") entered into between the government of India and the government of a foreign country will have preferential status. Thus, subsequent legislation will override (*i.e.,* apply instead of) a previously-negotiated treaty.

ICI members have expressed concern to us about these proposed changes and the effects such changes may have on their investments in India. While the change in the capital gains tax rate directly

[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 $11.2 trillion and serve over 93 million shareholders.

impacts all U.S. funds and other FIIs, the treaty override proposal also is problematic for the U.S. industry because it reflects a willingness on India's part to disregard negotiated assurances provided to investors – who strongly prefer stable rules for taxing investments.

The U.S. Fund Industry

Investment companies are extremely popular investing vehicles in the United States. The industry consists of over 8,000 mutual funds (that issue redeemable securities) and over 500 closed-end funds (the shares of which trade on stock exchanges). These funds have assets of over $11.2 trillion and are owned by over 93 million shareholders in over 50 million households. The overwhelming majority of these shareholders are resident in the United States.

U.S. funds (like funds organized in other countries) have made substantial investments in India because of the attractiveness of the Indian market relative to other potentially comparable markets. In general, funds decide to invest in India based upon the expected investment return of securities of Indian-domiciled companies (on an after-tax basis) relative to securities of companies domiciled in other markets.[2] One factor in making this determination is the anticipated stability of the tax rules applicable to FIIs' investments. Taxes imposed (or that may be imposed) by India, but not by other countries, affect the relative returns of investing in different markets.

Capital Gains Tax Rate Change Proposal

Any increase in the tax rate applied to gains on Indian securities will impact the relative attractiveness of Indian securities for FIIs because of the negative impact of the tax rate increase on after-tax returns. To the extent that demand by FIIs for Indian securities affects the market price at which these securities trade, the proposed tax increase would reduce the value of the Indian stock market.

Funds seek to invest in companies with above-average potential for capital appreciation. Thus, a 30 percent tax imposed by India on capital appreciation of Indian securities held by FIIs will impact most severely those stocks that are expected to increase most in value.

Because most countries do not tax the capital gains of foreign investors, the proposed Indian tax may impact investment decisions made by FIIs. If the DTC goes into effect with these proposals,

[2] The only type of fund that would not be concerned with such relative returns would be one with an objective of investing *exclusively* in India.

those U.S. funds investing in India (as will be the case for other U.S. institutional investors) may reduce their investment in India and increase their investment in other countries.[3]

Treaty Override Proposal

The proposed treaty override provision does not affect directly any investment that relies upon provisions of the income tax convention between India and the U.S. because, as you know, the convention's Article 13 does not provide a capital gains tax rate reduction. Nevertheless, this proposal concerns the U.S. industry because tax treaty overrides are relatively rare and introduce considerable tax uncertainty. Any country that overrides a treaty once presumably is more likely to override another treaty than a country that never has overridden a treaty. India's consideration of a treaty override thus introduces uncertainty that may impact negatively FII investment decisions.

* * *

Our members have made substantial investments in India because they view favorably India's strong economy and significant growth potential. These proposed changes to current law, however, are raising concerns about the relative attractiveness of the Indian market. If adopted, these changes may impact negatively the attractiveness of Indian company securities. Any significant reduction in demand by FIIs for these securities may impact negatively the Indian market unless an offsetting increase in demand arises from Indian investors. We urge, therefore, that these proposals not be adopted.

We appreciate your consideration of this matter. We would be pleased to discuss further this issue with you at your convenience. I can be reached by e-mail (at lawson@ici.org) or by telephone (at 001-202-326-5832).

Sincerely,

/s/ Keith Lawson

Keith Lawson
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[3] Citigroup reports that, as of June 2009, FIIs owned almost 23 percent of the BSE 500's securities (including American Depositary Receipts ("ADRs") and Global Depositary Receipts ("GDRs")) and over 13 percent of the BSE 500's securities (excluding ADRs and GDRs).