IDR's – Tax Angle

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Introduction

The Ministry of Corporate Affairs of the Government of India, in exercise of powers available with it under section 642 read with section 605A had prescribed the Companies (Issue of Indian Depository Receipts) Rules, 2004 (IDR Rules) vide notification number GSR 131(E) dated February 23, 2004.

IDR stands for Indian Depository Receipts. An Indian Depository Receipt is a way for a foreign company to raise money in India. The foreign company deposits its shares with a custodian, and then the custodian issues depository receipts based on these shares.

Standard Chartered PLC became the first global company to file for an issue of Indian depository receipts in India.

Under the current tax provisions of the Income Tax Act, 1961 put IDRs at a distinct disadvantage when compared with other common stocks.

Dividends

Dividend received from IDR will be assessed as income in the hands of Investors & thereby it is a taxable income. Investors don't need to pay any dividend taxes on other common stocks in India. The dividend taxes are paid by the company itself, and then the investor doesn't have to pay any tax on it. Of course there is discrimination with regard to dividend tax rates as when domestic companies pay DDT (u/s115O) @ 15% (plus surcharge were applicable & education cess) where as the investors will be paying tax at the normal rate @ 30%.

Capital Gains

Next up, Short Term Capital Gains. On Indian stocks which are listed & liable to STT, the short term capital gains is charged at 15%(S.111A), however in the case of IDRs, the short term capital gains will be charged at normal rate @ 30%*. Similarly, there are no long term capital gains on stocks in India which are listed & liable to STT [S.10(38)], but in the case of IDRs – investors will need to pay 20 per cent or 10 per cent on long-term gains according as the benefit of cost-inflation index is claimed or not while computing the cost of shares sold (Proviso to S.112).

Loss arising on sale of Indian stocks satisfying conditions of S.10(38) is not eligible for set off against taxable gains under S.70 or carry forward and set off under S.74 but in case of IDRs it is eligible for set off against taxable gains under S.70 and carry forward and set off under S.74.

Conclusion

That is a pretty significant hit right there, when compared with other stocks. The other thing about this is that these IDRs will not attract any Securities Transaction Tax (STT), which is a good thing, but that isn't that big a deal.