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Gift City route to foreign equities promises security

Depository receipts created by the exchange will be kept in the investor's own demat account

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TAXATION NORMS FOR FOREIGN EQUITIES

- Long-term capital gains will be subject to tax @ 10% under Section 112A of the IT Act on capital gain exceeding ₹1 lakh
- Short-term capital gains will be subject to tax @ 15% under Section 111A
- Investments in IFSC are exempted from securities transaction tax, nonetheless concessional tax rates under Section 112A and 111A will apply
- Long-term capital losses will only be set off against long-term capital gains, while short-term capital losses will be set off against both short-term and long-term capital gains
- Dividend income will be subject to tax in the hands of the shareholder at the applicable slab rates

Source: RSM India

Indian investors will soon be able to invest in international stocks via the National Stock Exchange's (NSE) subsidiary exchange in GIFT City (an international financial services centre) called NSE International Exchange. The BSE also plans to offer a similar facility through its GIFT City arm called India International Exchange. Currently, Indian investors can invest in international equities via mutual funds, and in foreign stocks and exchange traded funds (ETFs) through domestic brokers or through platforms like Globalise, Vested, etc that have tie-ups with foreign brokers.

Modus operandi

Large Indian brokerages will set up subsidiaries in GIFT City and become members of the international exchanges being set up by the leading Indian exchanges. Investors will have to open an account with these subsidiaries of brokerages.

They will also have to open a demat account in GIFT City. National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) are setting up subsidiaries in GIFT City for this purpose.

Investors will have to transfer funds via the liberalised remittance scheme (LRS) route, which has an annual limit of $250,000. "They will have to request their local bank branch to transfer fund through the LRS route to a designated foreign currency bank account. They will also have to fill up a FEMA (Foreign Exchange Management Act) declaration form for fund transfer," says V Balasubramaniam, managing director and chief executive officer, India INX (India International Exchange)

Invest via the depository receipt route

Indian investors will invest in depository receipts (DRs), which are certificates representing stocks. NSE's GIFT City arm will begin by offering DRs for the top 50 US stocks. Market makers will buy these stocks in the US and place them with a custodial bank account. The latter will create DRs against them, which the market makers will offer to investors on the exchange in GIFT City.

Greater security

The DRs will be kept in the investor's demat account. Currently, when an investor buys international equities through an Indian broker or a platform (which has a tie-up with a US broker), the securities are held by the US broker in an omnibus account. "Having the DRs in the investor's own demat account is safer. The risk in keeping stocks with a US broker is that if the latter goes bankrupt, investors could have a difficult time retrieving their securities," says Ravi Varanasi, president and chief business development officer, NSE.

Each DR will represent a small fraction of a US stock. "Fractionalisation will enable investors to buy shares of several companies and build a diversified portfolio with even a small sum," says Varanasi. Using DRs allows fractionalisation to be done by the exchange, rather than by the broker.

Costs are an issue in direct international investing. While the brokerage fee may not be high, other associated costs, such as remittance fee and foreign exchange markup, make this an expensive proposition, especially if the amount being invested is small. "We are working with a few banks to bring these costs down significantly," says Varanasi.

Investing via the NSE or BSE platform will also offer investors the comfort of dealing with a familiar entity.

Limited offerings

In the initial stages, the menu of products available on NSE's platform will be limited to the 50 largest US stocks and a few ETFs. The platforms, on the other hand, offer a larger bouquet. "With a US brokerage account, investors can invest in over 4,000 stocks and ETFs available on the US exchanges," says Viraj Nanda, co-founder and CEO, Globalise. He adds that direct accounts also give investors immediate access to US initial public offerings.

Once the DRs start trading, investors will have to check how closely they track the prices of their underlying stocks. "Trading directly on the US exchanges offers pricing efficiency," says Nanda.

Remember that the LRS route does not allow investing in derivatives or margin trading.

Who should go direct?

Portfolios of most Indian investors have a heavy home bias. "The Indian market accounts for barely 3-4 per cent of global market cap. Indian investors should invest in international equities to access the balance 96-97 per cent," says Pratik Oswal, head-passive funds, Motilal Oswal Asset Management Company. Investing in a market like the US also gives investors access to an asset with a low correlation to Indian equities. It also provides a hedge against the rupee's tendency to depreciate against the US dollar.

Financial planners say retail investors should take the mutual fund route for international exposure, at least initially. "Mutual funds offer diversification. An active fund offers the advantage of professional fund management. And if you invest via an index fund, you get the benefit of low cost," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisers. If retail investors take the direct route, they should begin with ETFs.

Only investors who have built well-diversified fund portfolios should consider investing in foreign equities directly, provided they have the time, the ability to evaluate stocks, and if they can overcome the information gap vis-à-vis foreign stocks.

Direct investors should adopt a buy-and-hold strategy. "If they trade, then the costs associated with international investing could make this route expensive," says Dhawan. Investing systematically may also be difficult due to this factor.

DRs will be treated as international assets. "They will have to be reported as foreign assets while filing income-tax returns," says Dhawan. No additional compliance is required while filing tax returns if you invest in international funds. They just get treated as debt funds for tax purposes.

Once NSE and BSE's Gift City platforms announce their cost structures, investors will be in a position to take an informed decision on whether to take this route.