Is it better to invest directly in overseas stocks?

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Investors need to give detailed disclosures of their foreign assets in the tax returns

Under exchange control regulations, resident Indians are permitted to draw foreign exchange up to $250,000 per year for various purposes, including overseas travel and investment. In recent times, a large number of investors have been tempted into investing in overseas listed stocks, given the lure of better returns, with the added benefit due to the depreciation of the Indian rupee vis-à-vis the foreign currency. Many banks and brokers offer this facility of investing directly in overseas stocks. Moreover, a large number of domestic mutual funds have recently launched fund of funds (FoF) or schemes that also invest in such foreign stocks. From a taxation perspective, is it better to invest directly in overseas stocks, or to invest through schemes offered by domestic mutual funds?

Even if one invests directly in foreign stocks, an investor would not get the benefit of the concessional tax treatment available for listed domestic equities, since such benefit is available for equities listed only on recognized stock exchanges (which effectively means only domestic stock exchanges recognized by the government). The benefits of reduced holding period to qualify as long-term assets after 1 year, and the concessional tax rates of 15% for short-term capital gains and 10% for long-term capital gains are restricted to equities listed on domestic stock exchanges. The holding period for foreign stocks to qualify as long term would be 2 years, and the rate of tax on long-term gains would be 20% and normal slab rates of tax for short-term capital gains.

FoF or a scheme floated by a domestic mutual fund, which normally invests either in overseas exchange-traded funds or in foreign stocks, would not qualify as an equity-oriented mutual fund, through its entire holding may be in equity or equity

underlying instruments, since 65% of its holding would not be in domestically listed equity shares or in funds investing 90% of their investments in such domestic equities. Such investments would also therefore not give the benefits of concessional tax rates of 10% or 15% available for equity-oriented mutual fund units. The holding period in such cases would be 3 years to qualify as long-term capital gains, while the rates of capital gains tax would be the same as for direct foreign equities.

While there is not much of a difference in the manner of taxation, other than a longer holding period for mutual fund units, the problem really lies in the detailed disclosures required to be made by a taxpayer in respect of his/her foreign assets in the tax returns. A taxpayer holding foreign assets has to mandatorily file a tax return, even if his/her income is below the taxable limit. There is a separate schedule FA to be filled up by a taxpayer, disclosing foreign assets and income on such assets. These details have to be given even if the shares were held for a day or two. The detailed disclosure is much more than that required to be given for domestic shares, where one is claiming benefit of the 10% rate.

Such disclosure is required irrespective of the taxpayer's income level, unlike domestic assets, where a limited disclosure is required of total cost of various types of assets, only if the taxable income exceeds ₹50 lakh. The worst part of this disclosure is that a failure to make a disclosure of any foreign asset could invite a penalty of ₹10 lakh under the Black Money Act! You cannot afford to make even a single mistake, and if you have dealt in numerous foreign stocks, you may spend more time filling up this schedule than you may spend on the rest of your tax return. The reason for this is that the tax authorities look upon all persons holding foreign assets as potential tax evaders, thanks to some taxpayers having been found to have held accounts in Switzerland and other tax havens. This is in spite of the fact that holding of foreign assets has been permitted for resident Indians for almost two decades now. It is also highly likely that your case may be picked up for verification by the tax department merely on account of your foreign assets, as a high-risk case, or that you may receive a notice from the investigation wing of the tax department seeking to cross-verify the information received by them from the foreign tax

authorities, with your tax returns. In order to claim credit for foreign tax deducted at source, you also have to file a separate form before you file your return.

The hassle and effort involved is at times not worth the extra return that you may earn by investing in foreign equities. Unless you are a large-scale investor and can either afford to hire an accountant or take time out yourself to keep tab of your various foreign scrips, you may be better off investing in schemes of domestic mutual funds that invest in foreign stocks, in which case no such detailed disclosures are required.

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