Budget just made international mutual funds more attractive

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With Finance Minister Nirmala Sitharaman announcing an increase in the threshold for tax collected at source (TCS) on remittances under RBI's Liberalized Remittance Scheme (LRS) from Rs 7 lakh to Rs 10 lakh, mutual fund experts believe this will reduce the upfront tax burden for investors remitting funds abroad.

"It reduces the upfront tax burden for investors remitting funds abroad. While this change doesn't impact the performance of international mutual funds, they remain a key component of a diversified portfolio. Irrespective of short-term returns, international funds offer geographic diversification and can act as a hedge against currency fluctuations. With the rupee on a depreciating trend, such exposure becomes even more relevant, as it can help investors benefit from currency gains alongside global market opportunities, enhancing long-term portfolio resilience," said Sagar Shinde, VP of Research at Fisdom.

In the last Budget announcement in July 2024, the Finance Minister shocked investors with a change in the capital gains structure but provided relief to those investing in international funds. The holding period for equity FoFs, overseas FoFs (international funds), and gold mutual funds was reduced from more than 36 months to more than 24 months, along with a change in the LTCG tax rate to 12.5% (down from being taxed as per the tax slab rate), while the STCG tax rate remained unchanged.

"The mutual fund industry is still awaiting the government's approval to allow investments in international stocks directly. Until then, investing through mutual funds in India will have to wait. If an investor wants to invest in international funds, the only available route is via LRS. However, investing directly in international stocks comes with higher risk, and proper research is essential. In contrast, with international fund-of-funds, the role of managing risk is taken on by the fund managers," he adds.

The market regulator SEBI has instructed mutual funds to stop fresh subscriptions in overseas ETFs effective from April 1, 2024, as the $1 billion investment limit is nearing breach. Mutual fund investors have long avoided investing in international funds primarily due to the high tax structure and the limits set by the RBI on overall investments into these funds.

Another expert believes that increasing the limit could help investors better manage cash flows when investing in international ETFs, mutual funds, and stocks.

While this TCS was adjustable against other taxes, it created a cash flow challenge that has now been eased to a certain extent. However, investors looking to invest internationally should keep in mind that valuations across many global markets, especially in the US, are at a significant premium compared to their long-term averages and will depend on strong corporate earnings growth for US businesses. Therefore, when using this route, investors may wish to invest in a staggered manner and have a 7-10 year investment horizon," recommends Vishal Dhawan, CEO of Plan Ahead Wealth Advisors, a wealth management firm in Mumbai.

One should always consider their risk appetite, investment horizon, and goals before making any investment decisions.