



C-7, Pashchimi Marg, Vasant Vihar, New Delhi - 110057

24th August 2012

Dr. Poonam Kishore Saxena
Chairperson
Central Board of Direct Taxes
Department of Revenue
Ministry of Finance
North Block, New Delhi – 110 001

Dear Madam,

SUB: REPRESENTATION FOR CLARIFICATION IN THE SCOPE OF SECTION 112(1)(c) OF THE INCOME TAX ACT, 1961 IN CONNECTION WITH TAXATION OF LONG TERM CAPITAL GAINS ARISING TO NON-RESIDENTS

The Finance Act, 2012 has amended Section 112(1)(c) of the Income Tax Act, 1961 ('the Act'). The amendment provides for taxation in the hands of non-residents (including foreign company) of gains arising on transfer of long term capital asset being unlisted securities at the rate of ten per cent. The amendment has sought to provide tax relief for all non-resident investors by reducing the rate of long-term capital gain arising from transfer of 'unlisted security' from 20 per cent to a concessional rate of 10 per cent.

The intention behind this amendment is clearly to provide the benefit of 10 per cent tax rate to all non-resident investors, specifically including private equity ('PE') investors. This intention has been clearly spelt out in the opening remarks made by the then Finance Minister Shri Pranab Mukherjee at the beginning of the discussion on the Finance Bill 2012. It is a well-known fact that a majority of the PE investors would invest in companies which are organized as private companies under the Companies Act, 1956. This is due to the fact that these companies are initially set up by entrepreneurs with the shares being held by such entrepreneurs and their family / friends, PE investors then provide funding to such companies by infusing share capital.



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While the aforesaid amendment was hailed as a welcome step by the entire private equity ('PE') and Venture Capital ('VC') industry, one unintended issue has arisen due to the manner in which the amendment has been legislated.

Issue:

The amendment made in s. 112(1)(c) is as under:

"s. 112(1) Where the total income of an assessee includes any income, arising from transfer of a long-term capital asset, which is chargeable under the head 'Capital gains', the tax payable by the assessee on the total income shall be aggregate of –

- (a) in the case of an.....
- (b)
- (c) in the case of a non-resident (not being a company) or a foreign company, -
 - i. the amount of income-tax payable on the total income as reduced by the amount of such long-term capital, had the total income as so reduced been its total income; and
 - ii. *the amount of income-tax calculated on long term capital gains [except where such gains arises from transfer of capital asset referred to in sub-clause (iii)] at the rate of twenty per cent; and*
 - iii. *the amount of income-tax on long-term capital gains arising from transfer of a capital asset, being unlisted securities, calculated at the rate of ten per cent on the capital gains in respect of such asset as computed without giving effect to the first and second proviso to section 48.*

Currently, the Explanation to section 112(1) of the Act defines 'unlisted securities' as under:

"Explanation –

(ab) "unlisted securities" means securities other than listed securities."

Further, the expression "listed securities" has been defined vide the same Explanation to mean securities which are listed on any recognized stock exchange in India.

The expression "securities" has been defined as under:

"Explanation –



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(a) the expression ‘Securities’ shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulations) Act, 1956 (32 of 1956)”

Hence, in order to determine the universe of ‘securities’ to which this amendment applies, we need to refer to the said definition under the Securities Contracts (Regulations) Act, 1956 (“SCRA”).

The relevant extract of the expression ‘securities’ as defined in SCRA is as under:

“Section 2(h) - Securities include –

- (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate¹;*
- (ii)*

A technical reading of the aforesaid definition of securities may lead to an interpretation that the definition of ‘securities’ would be limited to “marketable securities”. This is because the words ‘other marketable securities of a like nature’ are of a general nature and hence, it may apply to all preceding words, namely, ‘shares, scrips, stocks, bonds, debentures and debenture stock’. The definition of ‘securities’ may, therefore, possibly exclude from its purview shares in a private limited company.

If the aforesaid interpretation is adopted as per SCRA itself, it would lead to an inadvertent consequence of limiting the benefit of concessional rate of ten per cent under section 112(1)(c) of the Act to long term capital gains which arise on transfer of only marketable securities i.e. of unlisted company being public company and **not private company**. However, we believe that restricting the scope of the section only to securities held by non-residents in public companies cannot be the intention of the legislature.

As mentioned above, PE funds including VC funds in India primarily invest in private limited companies. Such investments by PE and VC funds not only provides much needed long term capital but add value for the investee companies by way of access to technical / financial / business expertise. VC funds promote new and innovative business models and processes by providing financial backing to innovative ideas.

¹ (emphasis supplied)



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Given the general operating standards of PE and VC funds, higher corporate governance standards and international best practices is facilitated by the funds. As you would appreciate, such PE and VC funds play a pivotal role in fostering economic growth of India.

In order to ensure certainty and avoid undue litigation, on behalf of the PE and VC fund industry, we would like to present to you our request on the aforesaid issue:

Request

To clarify by way of necessary amendment / clarification that long term capital gains arising to non-residents would be subject to concessional tax rate of 10 per cent under section 112(1)(c) on transfer of securities including the following:

“shares, scrips, stocks, bonds, debentures, debenture stock, warrants, units or other securities of like nature issued by a private company, public company, any other body corporate and includes other securities as specified in Section 2(h) of SCRA”

We would be delighted to discuss the above with you. If you have any questions / need any clarifications, please do revert to us.

Thank you.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Mahendra Swarup'.

For Indian Venture Capital Association of India
Mahendra Swarup
President - IVCA