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The Honorable Shri Arun Jaitley
Government of India
Minister of Finance, North Block
New Delhi, India

19th August, 2014

Honourable Minister Shri Arun Jaitley,

Subject: Appeal to accord Pass-through status to SEBI-registered Alternative Investment Funds (AIFs) and save the demise of VCF/AIFs

SEBI-registered Venture Capital Funds (VCFs)/AIFs & Foreign Venture Capital Investors (FVCIs)have contributed Rs 83,000 cr as Private Equity (PE) investments to a large number of Indian companies at different stages of evolution, averaging about 9000 cr per year.

Unlike many other sources of capital, such as Foreign Portfolio Investment or IPO markets, private equity (administered through Venture Capital Fund (VCF)/AIF and FVCI) is a steady source of long term (generally 5-7 years) capital, mainly to provide scarce equity capital to SME businesses in India.

In 2012, the erstwhile VCF regulations were substituted with AIF regulations, but due to coordination gaps between SEBI/RBI/CBDT at the time of the promulgation of the AIF regulations, the "pass-through" status of the erstwhile VCFs was not grand-fathered for all types of AIFs.

A "pass-through" [u/s 10 (23 FB) read with 115 U, the IT Act, 1961] status for different types of AIFs does not result in any tax leakage, or revenue loss, to the exchequer and therefore, it is not a concession. Further, AIFs can be asked to provide details of their income and list of beneficiaries in Form 64. Under section 115 U all beneficiaries of AIFs income, are liable to pay tax on income received, based on their tax status.

In the absence of pass-through status for AIF's, pooling of Funds in India is not feasible as Indian Investors as well as FVCIs shy away from investing through a taxable AIF vehicle which compromises their tax status e.g. no capital gains tax for FVCI coming from DTT nations, or reduced tax liability for institutions such as LIC etc.

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In the absence of a pass-through status for all AIFs, various AIFs had adopted a determinate trust structure to ensure taxpass-through. However, a recent CBDT circular No 13 dated 28th July 2014, in the context of charitable trusts, has issued clarifications on determinate trusts, whereby, all existing AIFs structured as determinate trusts may lose their pass-through status, unless a pass-through status is explicitly provided to AIFs. In the absence of a pass-through status, future AIFs will not be feasible.

The recent clarification from CBDT seeks to have the names and beneficial interest of all the contributors of a determinate trust upfront, at the time of forming the Trust/AIF. It is nearly impossible to achieve this as seeking commitments for a registered AIF from prospective investors is a time drawn process, often spread over 12-18 months, post which the final list of contributors and their beneficial interests are known.

In view of the above reality, and to avoid the demise of AIFs/VCFs it is sincerely requested to accord tax pass-through status to all SEBI registered AIFs to encourage the formation of domestic pools of capital.

A pass-through status [u/s 10 (23FB) read with 115 U] for AIFs and widening the scope of the recent clarification issued to Foreign Portfolio Investments (relating to Business Income vs Capital gains and the non-applicability of permanent establishment to managers of FPI vehicles) to AIFs/VCFs will increase the size of the capital of AIF/VCFs manifold.

We look forward to an expeditious and favourable action and save AIFs/VCFs which have not only provided capital, but have contributed in improving corporate governance, creating jobs and generating increased tax revenues for the exchequer, through direct and indirect tax contribution by their portfolio companies.

Thanking you

Yours Sincerely,

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