



IVCA's Pre-Budget Presentation _ 2007 to Dr. Hasmukh Adhia, Secretary (Revenue)

22nd November 2016

Agenda

| # | Section |
|-----|--|
| I | Overview of AIF industry |
| II | Core principles |
| III | Key policy initiatives needed from MoF <ul style="list-style-type: none">- Critical roadblocks that significantly impact flow of capital- Other initiatives |

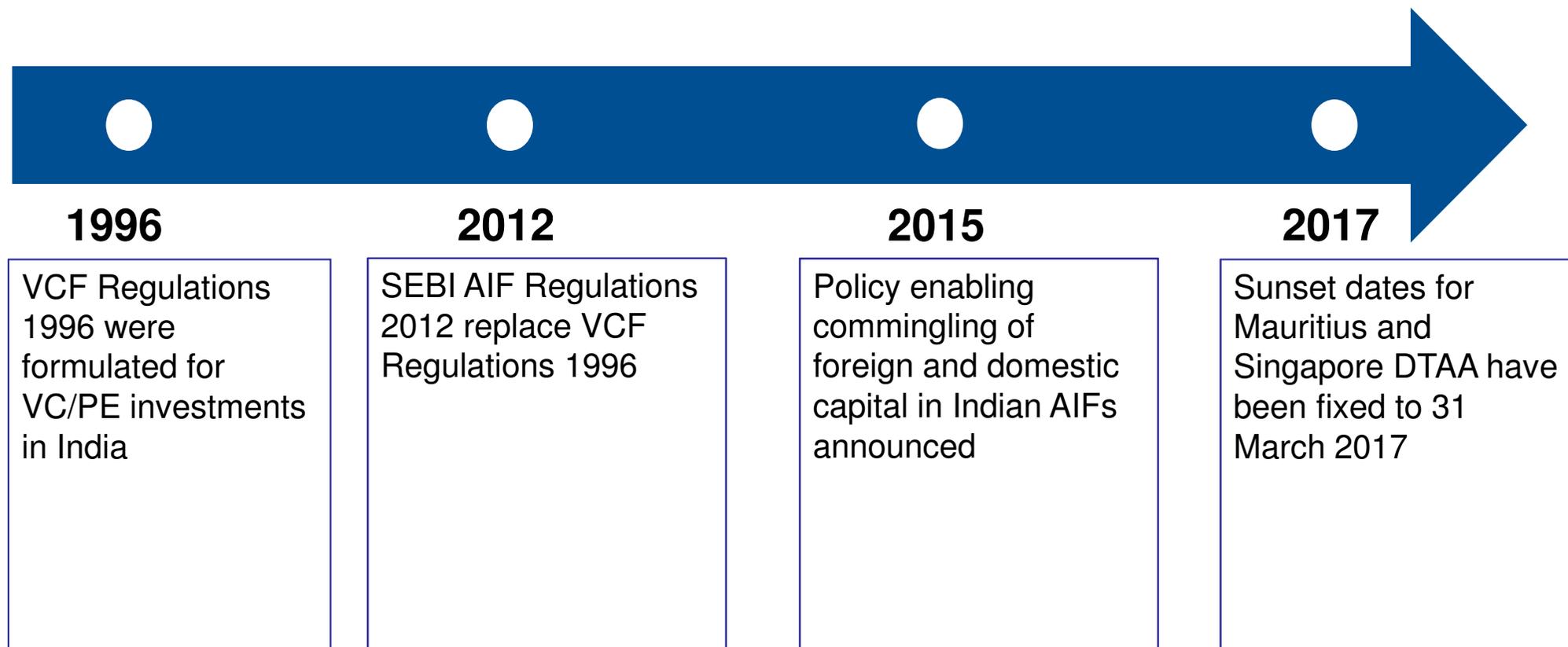
I. Overview of AIFs – Key messages

- 1 Transformation of VC/PEs to AIFs in India
- 2 AIFs* have invested more than USD 130 billion since 2001
- 3 AIF inflows are stable source of long term capital – better positioned to meet economy’s capital needs in the wake of recent demonetization and other progressive economic moves
- 4 AIF backed companies grow faster, generate more employment and pay more taxes
- 5 AIFs works closely with invested companies and are generally seen bringing in strong, formal position
- 6 However, clear and decisive roadmap for change is necessary to increase deployment by 4X by 2025



AIF investors across the globe are feeling very optimistic about India → ‘time to build confidence and capture the opportunity’

1. Transformation of VC/PEs to AIFs in India

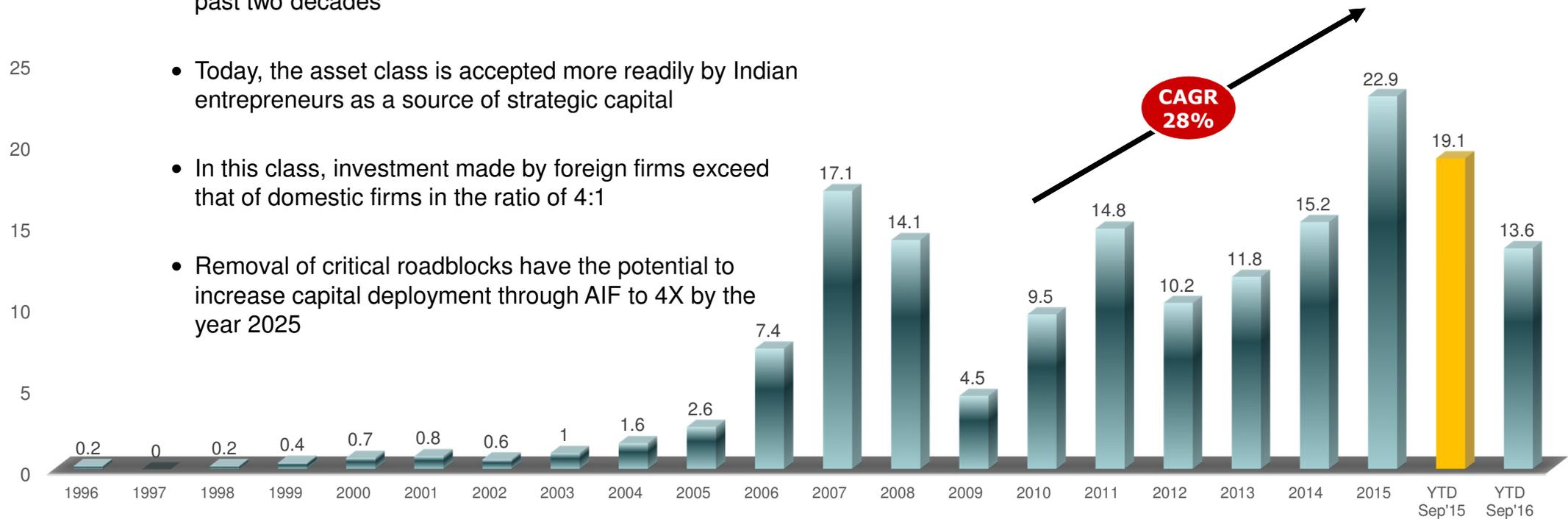


Going forward unified AIF has the potential to become the primary investment vehicle for both foreign and domestic capital

2. AIFs* have invested more than USD 130 billion since 2001

PE/VC deal value, India (\$B)

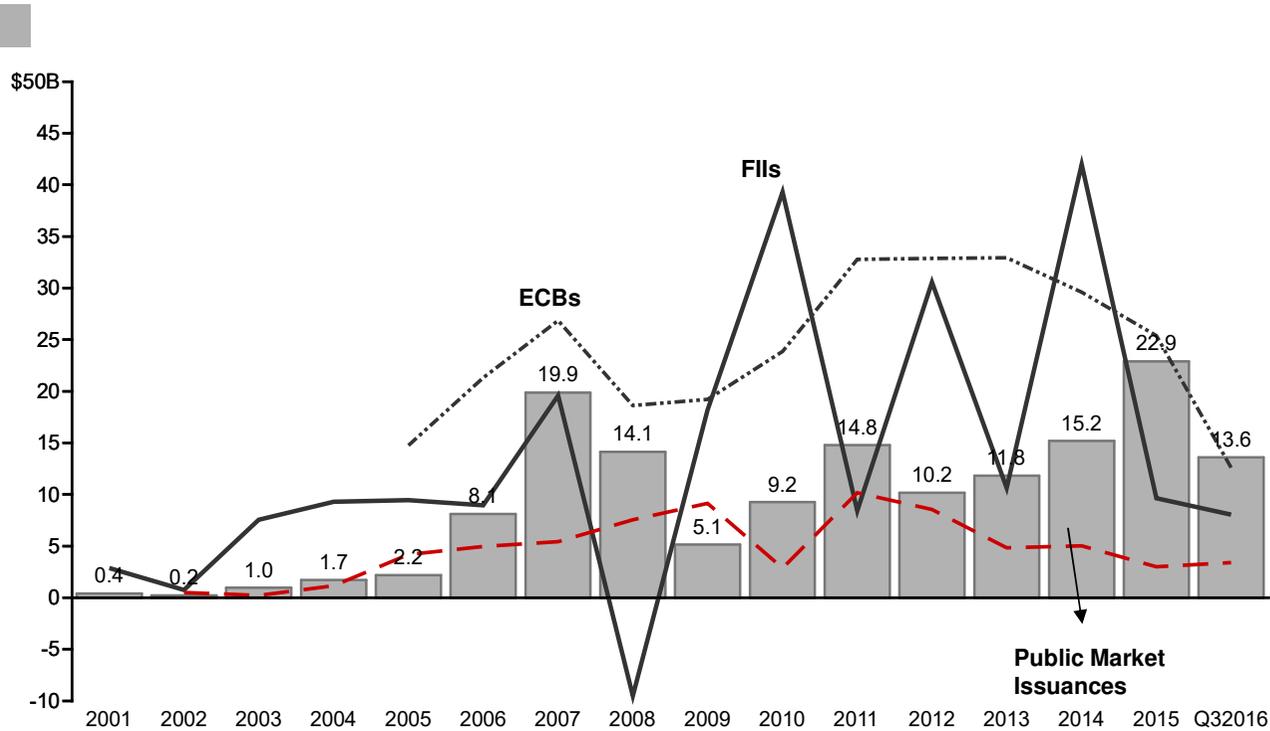
- VC/PEs in India as an asset class has evolved over the past two decades
- Today, the asset class is accepted more readily by Indian entrepreneurs as a source of strategic capital
- In this class, investment made by foreign firms exceed that of domestic firms in the ratio of 4:1
- Removal of critical roadblocks have the potential to increase capital deployment through AIF to 4X by the year 2025



*AIFs include VC, PE and other offshore funds

3. AIF inflows - a stable source of long term capital

AIF vs. ECB, FII and public market issuances in India (\$ Bn)



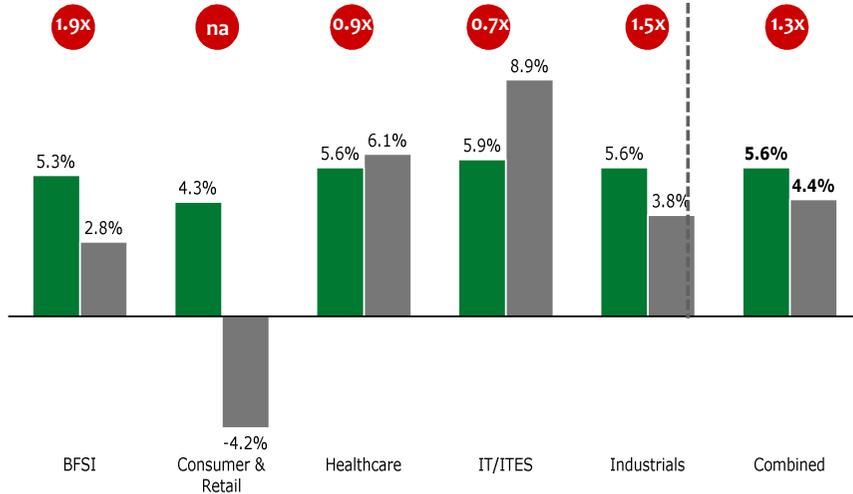
- PE capital inflows has been relatively less volatile across economic cycles
- PE provided about 2x the capital raised from IPO in the last 5 years

Even during the 2008 downturn, capital inflows from VCPEs were more reliable than those from other sources of equity funding (including Foreign Institutional investors)

4. AIFs add value by building better companies

AIF BACKED COMPANIES HAVE CREATED MORE JOBS

Employee count CAGR (2012-15)

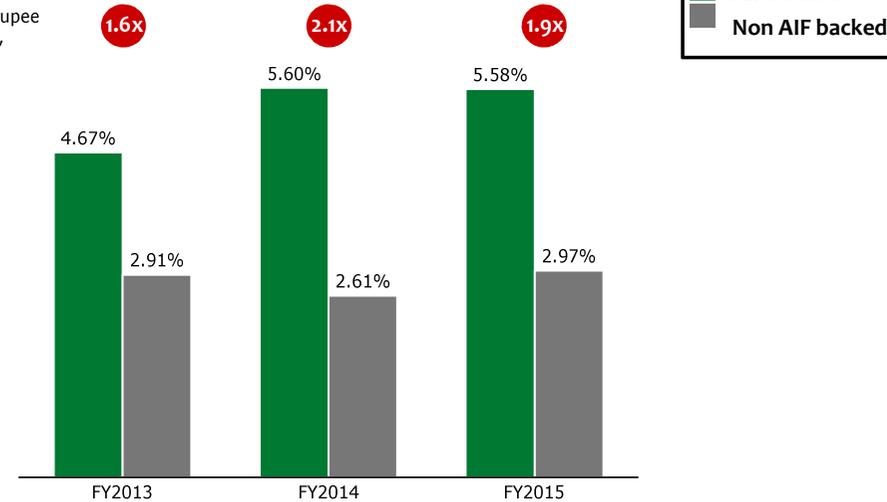


Note: Top 2500 publicly listed companies with reported data across 2012-2015 were considered for the analysis (Result included a total of 491 companies of which 35 were AIF backed companies)

Source: Bain PE/VC deals database, Capital IQ, Bain analysis

AIF BACKED COMPANIES HAVE PAID MORE TAX

For every rupee of revenue, taxes paid



Comparison between the VC/PE backed and the non VC/PE backed companies

AIF invested companies have created more jobs and paid more tax

5. AIFs works closely with invested companies and are generally seen bringing in strong, formal position of influence

| Affirmative Rights | AIF Shareholding <20% | AIF Shareholding = 20 - 50% | AIF Shareholding >50% |
|---|-----------------------|-----------------------------|-----------------------|
| Issue of shares/ Liquidation preferences/ Pricing | ✓ | ✓ | ✓ |
| Business Acquisition/ Setting up subsidiaries | ✓ | | ✓ |
| Strategic Financial Alliance | | ✓ | |
| Amalgamation/ Restructuring/Buy-back | ✓ | ✓ | ✓ |
| Amendment to AoA/MoA | | | ✓ |
| Variation of Rights | | | ✓ |
| Board representation | ✓ | | ✓ |
| Managerial appointment/ removal | | ✓ | ✓ |
| Related Party Transactions | ✓ | | ✓ |
| Liquidation | ✓ | ✓ | ✓ |
| Business Plan | | ✓ | ✓ |
| Dividend/Utilisation of surplus funds | | ✓ | ✓ |
| Sale/Investment in Undertaking/IPR | | ✓ | ✓ |
| Borrowings/ Mortgages/Guarantees | ✓ | ✓ | ✓ |

AIFs take significant share holder rights in unlisted companies they invest in

6. AIF: an important tool of Government policy

- **AIFs have become the most important tool of Government policy**
 - ✓ Center approves INR 10,000 crore fund-of-fund for Start ups
 - ✓ SIDBI has supported 95 funds, including 11 regional funds with an aggregate commitment of 2,576 crores
 - ✓ NIIF is being activated with a contribution of INR 20,000 crores to fund infrastructure projects
- **Given the thrust on AIF investments, Government has embarked on a reform oriented approach by introducing several path breaking initiatives as given below;**
 - ✓ Extending pass through to Category I and II AIFs
 - ✓ Aligning tax withholding rates for non-resident investors in AIFs to the final income-tax rates
 - ✓ Clarifying the applicability of 10% capital gains tax rate for private company shares
 - ✓ Reduced holding period of 2 years for unlisted shares
 - ✓ Providing instructions for capital gains treatment for listed and unlisted shares and securities
 - ✓ Introduction of rule for inclusion of conversion period in computing holding period of convertible debentures
 - ✓ Enabling the safe harbour for fund management through an approval mechanism
- **However, stability, consistency and clarity on certain critical issues necessary to create an investment friendly environment**

Clarity on these critical issues is fundamental to providing an impetus to AIF investment in India that is vital to the country's economic progress

AIFs* have invested more than USD 130 billion since 2001, and can provide strong long term equity (and short term capital requirement) for >8% economic growth

**GDP growth @ 8%
needs \$60B+ AIF / VCPE capital**

More Foreign capital inflow by Indian asset managers increasing Foreign allocation

More domestic capital into the AIF asset class

AIFs as an instrument to pool domestic + foreign capital

- *Context: Unified AIFs have raised ~₹33,000 cr commitments in CY16 (greater than since inception)*
- *SEBI registered AIFs for CY 16 – 253 as against 167 AIFs in CY 15*

Certain & Consistent Tax regime

- Tax gains on unlisted shares as capital gains
- Extend "pass-through" tax status to all AIF categories
- Provide GST abatement, proportionate to foreign capital in AIF
- Apply GST band of 12% for services to AIFs

Continue to attract Overseas Investments through VCPE / AIFs

- Amend safe harbour provisions to facilitate onshoring of fund managers

Build strong domestic capital pool

- Smooth regulations for Insurers & PFRDA to invest in AIFs
- Encourage EPFO to invest ~3-5% in AIFs
- Exclude FPI holdings in determining ownership / control of AIFs of managers owned by Indian listed cos
- Clarity in investments of funds by government's FFS scheme

AIFs investment to be 3x in 3 years

*AIFs include VC, PE and other offshore funds

II. Core principles

Certainty, clarity and consistency in taxation

Ease of investing in India directly

Ease of managing offshore funds in India

Adopt global best practices and innovate “NEXT” (best) practices

Revenue neutrality

Given the above principles, we suggest the following policy initiatives would help to achieve the following key objectives:

- Make the AIF system work effectively as a primary investment vehicle to raise both domestic as well as foreign capital which could be allocated across various sub-categories of AIF ranging from venture capital, infrastructure, private equity, real estate, etc.
- Non-resident investors should continue to experience ease of doing business and ideally embrace the idea of managing offshore funds in India.

All the recommendations made are based on core principles

III. Key policy initiatives needed from MoF

I

Critical road blocks that needs removal to increase flow of stable long-term capital

II

Important initiatives, and a long term roadmap

I. Critical roadblocks which need to be removed to increase flow of capital

- a Tax gains on unlisted shares as capital gains
- b Amend safe harbour provisions to facilitate onshoring of fund managers
- c Extend "pass-through" tax status to all AIF categories
- d Provide GST abatement, proportionate to foreign capital in AIF
- e AIFs and AMC of AIFs to pay 12% service tax

II. Important initiatives, and a long term roadmap

| Long Term Growth | Clarifications | Policy |
|---|--|--|
| <ul style="list-style-type: none">1. STT based taxation of AIFs2. Listing of AIFs – taxation policy3. Extension of beneficial tax rate of 5% on interest income | <ul style="list-style-type: none">4. On taxation of convertible preference shares5. On indirect transfer rules for multi-layered structure6. On taxation of interest on Overseas Rupee Denominated Bonds | <ul style="list-style-type: none">7. Enable insurers and pension funds to invest in all AIFs8. Exclude FPI holdings in determining the ownership / control of AIFs managed by Indian listed companies |

I. Critical road blocks which need to be removed to increase the flow of stable capital

a. Tax gains on unlisted shares as capital gains

Issue

Characterisation of income from sale of securities as business income or capital gains has always been a vexed issue with no objective criteria

Rationale

- Category I and II AIFs predominantly invest in unlisted investee entities with a medium to long-term investment horizon (two to five years)
- The current tax code for AIFs could lead to unintended litigation on treatment of income at AIF level
- Given the intent of SEBI (AIF) Regulations is not to allow carrying on of business, the income earned by an AIF from its investment activity cannot be treated as business income
- CBDT clarification F.No.225/12.2016/ITA.II puts to rest controversy on capital gains treatment on transfer of unlisted shares, however does not apply where transfer is made along with control and management
- Decision of Chandigarh tribunal which was upheld by HC, is distinguishable from investments made by VCPE

Recommendation

- Income earned by Category I and II AIFs should be taxable as “capital gains” and not as “business income”
- The CBDT should issue a circular clarifying that in the case of SEBI registered AIF and other classes of investors as may be prescribed, the exception provided in the instruction of 2 May 2016 for transfer of unlisted shares along with control and management of underlying business should not apply. Resultantly, income arising from transfer of unlisted shares in such cases should be considered under the head “capital gains”

Exception on ‘transfer of shares along with control and management of underlying business’ (provided in the CBDT instruction) should be expressly removed at least in context of AIFs

b. Amend safe harbour provisions to facilitate onshoring of fund managers(1/3)

Issue

In the guidelines, look-through provision is restrictively worded since it suggests that only one level look through is permitted

Rationale

- The Guidelines provide for looking through specific entities (subject to conditions)
- In most VCPE funds, there may be few layers of pooling vehicles above the fund vehicle
- SEBI registered Foreign Portfolio Investors (FPIs)/Foreign Venture Capital Investors (FVCIs) are allowed to invest in India – detailed mechanism in place to track quality of investors and sectors

Recommendation

- Investor diversification conditions should not be applicable to SEBI registered FPIs or FVCIs
- The term ‘member’ be interpreted in a manner to include investors and beneficiaries

Exempt FPIs/FVCIs and expand the scope of the term ‘member’ in a manner to include investors and beneficiaries

b. Amend safe harbour provisions to facilitate onshoring of fund managers(2/3)

Issue

Fund is treated as controlling or managing a business in India if it holds directly or indirectly, more than 26% stake in an Indian entity

Rationale

- VCPE funds acquire controlling stake without any intention of controlling or managing business
- Conversion of convertible instruments may result in holding more than 26% stake
- Minority shareholder protection rights could give rise to control over investee company in certain cases
- Financial investors need to have control to protect investment

Recommendation

In order to promote the safe harbour for VCPE funds, it is recommended to delete the condition on control or management of business in India by way of holding directly or indirectly, more than 26% stake in an Indian entity

Control and management conditions in the safe harbour rule should be deleted

b. Amend safe harbour provisions to facilitate onshoring of fund managers(3/3)

Issue

Currently, no safe harbour to the Investment Manager of SEBI registered AIF or mutual fund managing fund activity in India

Rationale

- Currently only portfolio managers and investment advisors registered with SEBI are covered
- Intention is to promote fund management activity in India and attract additional foreign investment under the AIF route

Recommendation

CBDT should notify managers referred in SEBI (AIF) Regulations, 2012 and SEBI (Mutual Funds) Regulations, 1996, for the purposes of specified regulations in section 9A(8)(e) of the Act

Include manager of SEBI registered AIF or mutual fund as eligible fund manager

c. Uncertainty in taxation of income for Category III AIF(1/2)

Issue

- Uncertainty in tax treatment on income from securities held by Category III AIF

Rationale

- The current size of the Category III AIFs in India is an estimated INR 8,081 crores as of 30th September, 2016. This is much smaller than the approximately INR 100,000 crores invested under Portfolio Management Schemes
- Category III AIFs are a potential alternative source of funding for India's economic growth and development. They are attractive to large institutional investors such as sovereign wealth funds, pension funds, endowments, trusts and family offices. These AIFs aim to improve the quality of governance in portfolio companies, thereby bringing about improvements in their performance and enhanced efficiencies in their operations and lower cost of capital
- Category III AIFs which are formed as trusts therefore continue to be subject to taxation under the classical trust taxation regime of the Act. The classical trust taxation framework is complex to interpret and not specifically enacted to deal with the taxation of 'investment trusts'. There are certain interpretations of the provisions of the trust taxation framework which could potentially:
 - lead to the taxation of the income of such AIFs at a rate higher than the rates prescribed under the Act and
 - result in double taxation of income from investments made by such AIF i.e. taxation of same income in the hands of AIF as well as in the hands of the investors in such AIF.
- Such uncertainty on account of lack of clarity in taxation could make AIF commercially infeasible as an investment product and could adversely impact the presence of Category III AIF in the Indian capital market.
- A clear tax code for taxation of such AIFs based on the pass-through tax principle will be critical for its success

c. Uncertainty in taxation of income for Category III AIF(2/2)

Recommendation

- Complete pass-through for all streams of income from securities held by Category III AIFs which includes
 - Business income
 - Capital gains or
 - Income from other sources
- Tax withholding may be applicable on accrual/ distribution of income to resident investors in accordance with the provisions of Chapter XVII-B of the Act and non-resident investors in accordance with the tax rates under an applicable DTAA.

d. Provide GST abatement, proportionate to foreign capital invested in AIFs

Issue

Consumption based service tax not met for foreign investors

Rationale

- Presently, services whose place of supply is in India are subject to effective service tax at 15%
- Management fees/ other fees are subject to service tax, as fund is viewed as distinct entity separate from its investors
- Services provided to service recipients outside India qualify as 'export' and exempt from service tax, subject to certain conditions
- Fund in essence is pooling vehicle for investors (including foreign investors)

Recommendation

- Foreign investors in AIF be regarded as service recipient
- Proportionate management fees/other fees should then qualify as 'export' and be exempted from service tax

Foreign investors in the AIF be deemed as service recipients and services by fund/ fund manager would accordingly qualify as 'export' and exempt from service tax

e. AIFs and AMC of AIFs to pay 12% service tax

Issue

AIFs do not have any output indirect tax liability. Hence any service tax/ GST paid on all input services is ultimately a cost to the AIF

Rationale

- AIFs do not have any output indirect tax liability, hence any service tax/ GST paid on all input services is ultimately a cost to the AIF.
- From an income-tax standpoint, the investors in AIFs are not allowed a tax deduction for most of the expenses incurred by the AIFs. Consequently, the cost of investing in AIFs will significantly increase if the GST rate is fixed at a level higher than the present service tax rate of 15%
- Considering the important financial intermediation role performed by AIFs in channelizing investments into seed capital, early stage and growth companies, services to AIFs should be chargeable at a lower rate

Recommendation

- Fund management and distributor services to AIFs should be chargeable to GST at the rate of 12%

Foreign investors in the AIF be deemed as service recipients and services by fund/ fund manager would accordingly qualify as 'export' and exempt from service tax

II. Important initiatives, and a long term roadmap

II. Other initiatives

1 Clarification on investments by AIF

- A. Pass through tax status to be extended to net losses incurred at AIF level
- B. Exemption for AIFs from (a) Section 56(2)(viib) on issue of shares at a value higher than fair market value and (b) Section 56(2)(viiia) on purchase of shares at a value lower than fair market value
- C. Remove tax compliance of filing annual return for foreign investors in AIF
- D. Allow management expenses for AIF investments as 'cost of improvement'

2 STT based tax system for AIF

- Investments by AIF in unlisted shares should be taxed similar to tax on investment in listed securities

3 Listing of AIFs – taxation policy

- Exempt listed AIF from tax on its income
- Taxation is a combination of distribution tax on income distributions and capital gains tax on unit redemptions/ transfers

II. Other initiatives

- 4 Clarification on taxation of convertible preference shares
- 5 Clarification on indirect transfer rules for multi-layered structure
- 6 Clarification on taxation of interest on Overseas Rupee Denominated Bonds
- 7 Extension of beneficial tax rate of 5% on interest from bonds and government securities
- 8 Enable insurers and pension funds to invest in Category II AIFs
- 9 Exclude FPI holdings in determining the ownership / control of AIFs managed by Indian listed companies

1 (a) . Pass through tax status to be extended to net losses incurred at AIF level

Issue

Pass through tax status to be extended to net losses incurred at AIF level

Rationale

- Category I and II AIFs are close ended funds - tenure would not exceed 10 years
- Unabsorbed losses would not be utilised if incurred towards end of fund life, thus investors are not taxed on the 'real income'
- In line with the pass through for losses provided to investors in securitization trusts, the pass through of losses should also be extended to investors in AIF

Recommendation

As such, a pass through tax regime should not distinguish between gains and losses. Therefore, similar to the pass through for net income, net losses incurred by all the categories of AIFs, under any head of income, should also be allowed to be passed on to the investors.

Amend Section 115 UB to allow net losses incurred at the AIF level

1 (b). Exemption from section 56

Issue

Exemption for AIFs from (a) Section 56(2)(viib) on issue of shares at a value higher than fair market value and (b) Section 56(2)(viiia) on purchase of shares at a value lower than fair market value (FMV)

Rationale

- AIFs, being institutional investors, hold a fiduciary responsibility to invest in transactions on an arm's length basis, and given that they are subject to supervision of SEBI and have investor reporting obligations.
- It is reasonable to assume that the price for acquisition / subscription is determined on a reasonable basis, considering all factors associated with the investee companies' and sector's past performance and future potential.
- Thus, the transaction entered into by AIFs can be assumed to be in compliance with FMV principles and hence the rigour of section 56(2)(viiia) and 56(2)(viib) should not be applicable to AIFs.

Recommendation

All AIFs and their investee companies should be exempted from the rigor of Sections 56(2)(viiia) and 56(2)(viib) of the Act.

Amendment/ notification exempting investment funds from section 56(2)(vii)(a) and section 56(2)(vii)(b)

1 (c). Remove tax compliance of filing annual return for foreign investors in AIF

Issue

AIFs are required to with-hold taxes on accrual/distribution of income to investors and foreign investors are required to file Return of Income (RoI) resulting in increased compliance burden

Rationale

- The entire liability of non-resident investors in the AIF is being deducted at source by the AIF
- Despite this, these investors are required to file RoI. This additional compliance will discourage several non-resident investors from making direct investments in India and thereby, diluting the effectiveness of the aforesaid policy initiative

Recommendation

Foreign investors in AIF to be exempted from filing of RoI for any income arising from AIF, so long as applicable taxes are deducted at AIF level

Amend section 115 UB of the Act to introduce relaxation from the requirement of filing the return of income by non-resident unit holders of AIF

I (d). Allow management expenses for AIF investments as ‘cost of improvement’

Issue

Currently, there is no provision for capitalizing expenses related to the management and improvement of the operations of the investee company

Rationale

- AIFs/investors spend a significant amount of time working closely with unlisted businesses to enhance the value of the investment.
- Currently, there is no provision for capitalizing expenses related to the management and improvement of the capital asset during the holding period of the security.
- This means in effect that AIFs/investors have to write off the management fees as expenses, which means that they are not available to be offset against capital gains that may eventually result from the investment.

Recommendation

- Option 1 - Allow expenditure capital in nature towards improvement of the capital asset be capitalised as “cost of improvement”
- Option 2: Allow a standard deduction of 3% of cost of acquisition of capital asset irrespective of the actual expenditure incurred.

Amendment to allow deduction of expenses incurred by AIF for management and improvement of the operations of investee company

2. STT based tax system for AIF

Rationale

Securities Transaction Tax (STT) was introduced in 2004 to:

- replace the LTCG tax on listed securities
- shore up revenue from stock transactions and to create a level playing field for all participants in the stock market
- simplify the tax treatment on transaction in securities leading to a significant reduction in litigation

As a long-term approach to align taxation of AIFs and other forms of collective investment vehicles, an STT approach may be considered. This approach would

- Eliminate tax arbitrage and hence, attract more capital in AIFs
- Simplify tax administration of AIFs and reduce revenue compliance gaps
- Ease of operations – pave the way for VCPE funds to domicile in India
- Discourage ‘treaty shopping’ – development of local financial hubs

Recommendation

- Introduce STT at an appropriate rate on all distributions (gross) of AIFs and eliminate any withholding of tax. After STT, income from AIFs should be tax free to investors
- VCPE funds have a complete audit trail. The audit trail and full information on investments/distributions to be provided to tax authorities

Tried and tested approach of STT in listed securities and mutual funds should be extended to VCPE funds

3.Listing of AIFs – taxation policy

Rationale

- AIFs units can be listed except an open ended-Category III AIF
- Different set of investors at the time of realisation and distribution of income
- **Current tax policy:**
 - Category I and II AIFs are provided a ‘pass-through’ tax status for the income earned (except for business income). Such AIFs are also required to withhold tax at 10% (in case of resident investors) and at rates in force (in case of non-resident investors) on any income paid or credited to the investors
 - Category III AIFs not provided a specific tax ‘pass-through’ and governed by complex trust taxation provision
- This may create significant anomalies – for example, deduction of tax at source for investors who may not be investor sat the time of actual distribution

Recommendation

Define unit based taxation regime for listed AIFs where

- the AIF is exempt from tax on its income and
- the taxation is a combination of distribution tax on income distributions and capital gains tax on unit redemptions/ transfers

Introduce unit based taxation regime for listed AIFs (similar to mutual funds)

4. Clarification on taxation of convertible preference shares

Issue

Currently, there is no specific exemption for conversion of preference shares into equity shares from 'transfer' thereby resulting in capital gains at the time of conversion

Rationale

- Circular dated 12 May 1964 provides that where one type of share is converted into another type of share, there is, in fact, no 'transfer' of a capital asset within the meaning of section 2(47) of the Income-tax Act, 1961.
- However, when such newly converted share is actually transferred at a later date, the cost of acquisition of such share for the purposes of computing the capital gains shall be calculated with reference to the cost of acquisition of the original share of stock from which it is derived.

Recommendation

Conversion of preference shares into equity shares should be exempt. Also, the period of holding of preference shares (pre-conversion) should be included in the holding period of equity shares received on conversion

Issue clarification to provide that conversion of preference shares into equity shares shall not be regarded as a transfer and hence exempt from tax and notify conversion period to be included in determining holding period of equity shares

5. Clarification on indirect transfer rules for multi-layered structure — (1/2)

Issue

Indirect transfer rules apply where the value of the shares of the foreign company is substantially derived from Indian assets held, directly or indirectly

Rationale

- India-centric offshore funds by design have more than 50% Indian assets and therefore are subject to ambiguity on indirect transfer related taxation
- In multi-layered structure, gains can be subject to indirect transfer tax at multiple levels especially in cases of repatriation on part / full exit
- Gains on sale of stake in LP for providing liquidity by facilitating secondary transfers can be subject to indirect transfer tax

Recommendation

- Clarify that indirect transfer provisions should not be applicable where -
- transfer/ redemption is directly or indirectly in consequence of or by reason of transfer of capital assets situated in India; or
 - transfer/ redemption of share or interest does not alter the ownership of the transferor in the transferee.

Clarification that the indirect transfer provisions should not be applicable in specific circumstances

5. Clarification on indirect transfer rules for multi-layered structure — (2/2)

Issue

Extremely onerous obligation on the Indian concern to report the transaction of sale of units/ shares by investors in the off-shore funds

Rationale

- VCPE funds have multiple Indian concerns in or through which they holds India assets. Also, the Indian concerns may be held through various immediate/intermediate holding entities.
- The provisions of Rule 114DB will require that such compliance is done by each concern on a duplicated or overlapping basis

Recommendation

- Reporting obligation should be complied either by the Indian concern or the transferor or transferee of the share of, or interest in the foreign company/ entity
- Simplify reporting obligation – report only base information such as details of transferor, transferee, subject matter of transfer and its valuation

Simplify reporting obligation to be complied either by the Indian concern or the transferor or transferee of the share of, or interest in the foreign company/ entity

6. Clarification on taxation of interest on Overseas Rupee Denominated Bonds

Issue

- No specific amendment for withholding of interest income from RDBs inspite of the CBDT press release dated 29 October 2015
- As per section 194LC of the Act, concessional tax rate of 5% on interest income from foreign currency loan or long-term bond is applicable where such loan is received only before 1 July 2017

Rationale

- The CBDT press release dated 29 October 2015 inter-alia provided for a withholding tax rate of 5% on interest income earned by non-resident from RDBs. However, the Finance Act, 2016 is silent on the same.
- Given that the lower rate of withholding only in respect of interest from foreign currency loan or long-term bond is expiring on 30 June 2017 and the same is gaining importance lately, there is a requirement to extend the said period

Recommendation

- Specific amendment in section 194LC of the Act to provide for withholding at concessional rate of 5% on such RDBs
- Amendment be made in section 194LC of the Act to provide concessional tax rate of 5% on interest income from foreign currency loan or long-term bond by another five years i.e. i.e. till 1 July 2022

Amendment to provide for withholding at a concessional tax rate of 5% on RDBs for non-residents

7. Extension of beneficial tax rate of 5% on interest from bonds and government securities

Issue

As per section 194LD of the Act, concessional withholding tax rate of 5% on interest income from rupee denominated bond and government securities before 1 July 2017

Rationale

- The lower rate of withholding shall apply only where the interest in respect of the above investments is paid to the FPI only between 01 July 2013 and 01 July 2017
- The intent behind providing a concessional rate of taxation under section 194LD of the Act was to provide broad based incentive and encourage greater off-shore investment in the debt market by FPIs – Press Release dated 20 May 2013.

Recommendation

Debentures issued by Indian companies should also be eligible for a concessional withholding tax rate of 5% under section 194LD of the Act.

Further, appropriate amendment should be made under section 194LD of the Act such that the lower rate of withholding tax is extended by another five years i.e. till 1 July 2022.

Amendment to provide for concessional tax rate of 5% on interest from bonds and government securities

8. Enable Insurance Companies & Pension Funds to Invest in all AIFs

Issue

Insurance companies & pension funds are have not yet begun investing in AIFs in a significant manner

Rationale

- They are potentially the largest investors in in all Categories of AIFs
- CAT II AIFs are the largest category of AIFs which provide capital to a much wider range of industries than CAT I or III AIFs and the opportunity to invest in these industries should not be denied to insurance companies and pension funds

Recommendation

Both IRDA and PFRDA should issue notifications enabling investment in all categories of AIFs, including Category II.

IRDA & PFRDA TO ISSUE CLEAR NOTIFICATIONS TO ENABLE INVESTMENTS IN CAT II AIFs

9.Exclude FPI holdings in determining the ownership / control of AIF Fund Managers/Sponsors

Issue

- RBI Notification dated 15 November, 2015 requires foreign owned and controlled fund managers or their sponsors/affiliates to comply with ownership caps under FDI Policy with respect to their downstream investments in portfolio companies. The test of Indian ownership of fund managers/ sponsors/ their listed affiliates does not exclude the shareholding of Foreign Portfolio Investors. This has the unintended effect of restricting the portfolio investments of many fund managers whose affiliates have large FPI holdings.

Rationale

- IRDA rightly permits the exclusion of the shareholdings of Foreign Portfolio Investors (FPIs) in determining Indian ownership and control.
- A similar method of computing Indian ownership should be adopted by RBI in determining the Indian ownership of fund managers or their listed sponsors/affiliates.
- Several highly experienced domestic fund managers are adversely affected.

Recommendation For Amendment in RBI Notification

The shareholding of Foreign Portfolio Investors should be excluded in computing the foreign ownership of the listed parents/affiliates/sponsors of the fund managers of AIFs. A suitable Explanation should be introduced in the relevant RBI Notification.

Amend RBI Notification to exclude shareholdings of FPIs in listed parents/affiliates of domestic fund managers

Proposed notifications – critical issues

A. Certainty on treatment for taxation of gains on sale of unlisted shares as capital gains

Proposed circular

Subject: Partial modification of the instruction F.no. 225/ 12/ 2016/ ITA.II dated 2nd May 2016 regarding consistency in taxability of income/loss arising from transfer of unlisted shares under Income-tax Act - regarding

1. Regarding characterization of income from transfer of unlisted shares, the Central Board of Direct Taxes, issued instruction F. no. 225/ 12/ 2016/ ITA.II dated 2nd May 2016 wherein with a view to avoid disputes/litigation, maintain a uniform approach, it was clarified that any income arising from transfer of unlisted shares was to be treated as capital gains irrespective of the period of holding of such assets. However, it was also, inter alia, clarified that the aforesaid treatment would not apply in the case where transfer of unlisted shares is made along with the control and management of underlying business.
2. The Board has since received representations on the treatment of unlisted shares and securities held by Alternative Investment Funds (AIFs), Venture Capital Funds (VCFs) and Foreign Venture Capital Investors (FVCIs) registered with the Securities and Exchange Board of India. Considering the representations, it is clarified that the conditions in clause 3(iii) of the aforesaid instruction would not be applicable on transfer of unlisted shares and securities held by SEBI registered AIFs, VCFs and FVCIs.
3. The above may be brought to the notice of all for necessary compliance.

Xxxxxx

XXXXXXXXXXXX

Copy to:

1. XXXXXXXX
2. XXXXXXXX

B. Making fund management safe harbour provisions effective — (1/3)

Proposed amendment

Rule 10V - Guidelines for application of section 9A.-

- (3) A fund shall not be denied the benefit of being an eligible fund for the purposes of section 9A, if, -
- (c) that fund is registered as a Category I or a Category II Foreign Portfolio Investor in accordance with the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 or Foreign Venture Capital Investor in accordance with the Securities and Exchange Board of India (Foreign Venture Capital Investors) Regulations, 2000.*

B. Making fund management safe harbour provisions effective — (2/3)

Proposed amendment

Section 9A(3)

~~*k) The fund shall not carry on or control and manage, directly or indirectly, any business in India or from India*~~

Rule 10V. Guidelines for application of section 9A

~~*(4) For the purposes of clause (k) of sub-section (3) of section 9A, a fund shall be said to be controlling or managing a business carried out by any entity, if the fund directly or indirectly holds such rights in, or in relation to, the entity, which results in the fund holding the share capital or a voting power or an interest exceeding twenty six per cent. of the total share capital of, or as the case may be, total voting power or total interest in, the entity*~~

B. Making fund management safe harbour provisions effective — (3/3)

Proposed notification

SECTION 9A OF THE INCOME-TAX ACT, 1961 - CERTAIN ACTIVITIES NOT TO CONSTITUTE BUSINESS CONNECTION IN INDIA - SPECIFIED REGULATIONS UNDER SECTION 9A(9)(e)

NOTIFICATION NO. -----

In exercise of the powers conferred by clause (e) of sub-section 9 of section 9A of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby notifies the following regulations made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) as 'specified regulations':

1. Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and
2. Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012.

Proposed notifications – Other initiatives

1. a) Pass through tax status to be extended to net losses incurred at AIF level

Proposed amendment

Section 115UB

- (2) Where in any previous year, a person, being a unit holder of an investment fund, transfers the units to another person (excluding transfers referred to in section 47) and the net result of computation of total income of the investment fund [without giving effect to the provisions of clause (23FBA) of Section 10] is a loss under any head of income and such loss cannot be or is not wholly set-off against income under any other head of income of the said previous year, then—
- (i) ~~such loss shall be allowed to be carried forward and it shall be set off by the investment fund in accordance with the provisions of Chapter VI; and~~
 - (ii) such loss shall be ignored for the purposes of sub-section (1) in respect of transferor/transferee of such units.

1. b) Exemption from section 56

Proposed amendment

Proposed Amendment in section 56(2)(viia)

After first proviso to section 56(2)(viia) add the following proviso -

Further provided that this clause shall not apply to any such property received by an investment fund

Amend Explanation to section 56(2)(viia) as under –

For the purpose of this clause -

(a) "fair market value" of a property, being shares of a company not being a company in which the public are substantially interested, shall have the meaning assigned to it in the Explanation to clause (vii).

(b) "Investment Fund" shall have the meaning assigned to it in clause (a) of the Explanation 1 to Section 115UB.

Proposed notification exempting Investment Funds from section 56(2)(vii)(b)

In exercise of the powers conferred by the clause (ii) of the proviso to clause (viib) of sub-section (2) of section 56 of the Income-tax Act, 1961 (43 of 1961), the Central Government, hereby notifies the 'classes of persons' for the purposes of the said clause as being the 'Investment Fund' who makes any consideration exceeding the face value for issues of shares of a company.

Explanation. – For the purposes of this notification, "Investment Fund" shall have the meaning assigned to it in clause (a) of the Explanation 1 to section 115UB

1. c) Remove tax compliance of filing annual return for foreign investors in AIF

Proposed amendment

115UB. (8) It shall not be necessary for an assessee referred to in sub-section (1) to furnish under sub-section (1) of section 139 a return of his or its income if –

- a) The assessee is a non-resident (not being a company) or a foreign company
- b) his or its total income in respect of which he or it is assessable under this Act during the previous year consisted only of income referred to in sub-section (1); and
- c) The tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income

1. d) Allow management expenses for AIF investments as ‘cost of improvement’

Proposed amendment

- (a) Option 1: Where expenditure capital in nature towards improvement of the capital asset is to be capitalized as “cost of improvement”

Modify section 55 (1)(b)(1)(ii) of the Act to read as under:

“in any other case, means all expenditure of a capital nature incurred in making any additions or alterations ‘*or improvement*’ to the capital asset by the assessee after it became his property, and, where the capital asset became the property of the assessee by any of the modes specified in sub- section (1) of] section 49, by the previous owner, but does not include any expenditure which is deductible in computing the income chargeable under the head...”

Notification required:

“Improvement expenditure” for a capital asset would include expenditure of a capital nature in relation to:

- *Management Advisory*
- *Legal and Professional*
- *Administrative expense directly identifiable to capital asset.*

1. d) Allow management expenses for AIF investments as ‘cost of improvement’

Proposed amendment

- (b) Option 2: Allow a standard deduction of 3% of cost of acquisition of capital asset irrespective of the actual expenditure incurred

Section 48: Mode of computation.

8. The income chargeable under the head “Capital gains” shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :—

- (i) expenditure incurred wholly and exclusively in connection with such transfer;
- (ii) the cost of acquisition of the asset and the cost of any improvement thereto:

(iii) a sum equal to three per cent of the cost of acquisition of the asset where asset is in the nature of securities of an unlisted company or units in a mutual fund/AIF

2. Illustration – Levy of STT on investments and distributions—(1/6)

Tax collected if STT was levied on VCPE investments (Projected taxes collected over a 15 year period)

| | | | |
|--|-------------------|---------------------|---------------------|
| STT on investment | | 0.25% | |
| STT on distribution | | 0.25% | |
| STT on short term capital gains | | 1.00% | |
| Capital Invested per year(USD million) as per actuals for FY2015 | | 15,000 | |
| Average Holding period for an Investment (years) | | 5 | |
| Average Return on Investment | | 170% | |
| (USD million) | STT on Investment | STT on Distribution | Total Tax collected |
| Year 1 | 38 | 83 | 120 |
| Year 2 | 38 | 83 | 120 |
| Year 3 | 38 | 83 | 120 |
| Year 4 | 38 | 83 | 120 |
| Year 5 | 38 | 83 | 120 |
| Year 6 | 38 | 83 | 120 |
| Year 7 | 38 | 83 | 120 |
| Year 8 | 38 | 83 | 120 |
| Year 9 | 38 | 83 | 120 |
| Year 10 | 38 | 83 | 120 |
| Year 11 | 38 | 83 | 120 |
| Year 12 | 38 | 83 | 120 |
| Year 13 | 38 | 83 | 120 |
| Year 14 | 38 | 83 | 120 |
| Year 15 | 38 | 83 | 120 |
| Total tax | | | 1806 |

Assumptions:

1. USD 15 billion PEVC investments per year (same as in 2015)
2. The fund will hold the investment for 5 years and divest it after.
3. An average multiple of 1.7x on realization of exit
4. STT is levied both during investment and distribution
5. STT on short term gains is at 1.0% (gross); assumed 10% of total distributions

2. STT based tax system for AIF— (2/6)

Proposed amendment

Amendment 1

Distributions by AIF to be treated as a taxable transaction liable to STT

Amendments required in the Finance Act 2004 (Chapter VII):

Amending the Chapter VII of Finance (No. 2) Act, 2004 to include distribution from Investment Funds as a taxable transaction in securities:

Definitions

A) In section 97 of the Finance (No.2) Act, 2004, insert the following definition as sub-section (1):

“Investment Fund” shall have the meaning assigned to it in clause (a) of the explanation to section 115UB of the Income-tax Act, 1961”

B) In section 97 re-insert the current sub-section (1) defining Appellate Tribunal as sub-section (1A)

C) In sub-section 13, after sub-clause (b), the following sub-clauses shall be inserted:

“(c) purchase of a unit in an Investment Fund

(d) any distribution made on sale or redemption of a unit in an Investment Fund”

(e) any distribution made otherwise by an Investment fund”

2. STT based tax system for AIF— (3/6)

Proposed amendment

Charge of STT

D) In section 98 of the Finance (No. 2) Act, 2004, in the Table, after serial number 7 and the corresponding entries thereto, the following shall be inserted, namely:--

| Sl. No. | Taxable Securities Transaction | Rate | Payable by |
|---------|---|-----------|-------------|
| (1) | (2) | (3) | (4) |
| "8 | (a) Purchase of an unit of an Investment Fund | _ percent | Purchaser |
| | (b) Distribution of income representing long term capital gains, made to an unit holder by an Investment Fund on redemption or otherwise | _ percent | Unit holder |
| | (c) Distribution of income other than long term capital gains, made by an Investment Fund on redemption or otherwise | _ percent | Unit holder |
| | (d) Sale of an unit of an Investment Fund being a long term capital asset, to any person other than the Investment Fund in which such units are held | _ percent | Seller |
| | (e) Sale of an unit of an Investment Fund being a short term capital asset, to any person other than the Investment Fund in which such units are held | _ percent | Seller |

2. STT based tax system for AIF— (4/6)

Proposed amendment

Value of taxable securities transaction

E) In Section 99 of the Finance (No.2) Act, 2004, after sub-clause (b) insert the following clauses -

“(ba) in the case of purchase of units of an Investment Fund, the price at which such units are purchased;

(bb) in the case of distribution on account of redemption of units of an Investment Fund, such amounts as are distributed to the unit holder including the principal amount redeemed;

(bc) in the case of distribution by an Investment Fund other than the distribution referred in clause (bb) above, the amounts so distributed to the unit holder;

(bd) in the case of sale of units of an Investment Fund by the unit holder to any person other than the Investment Fund in which such units are held, the price at which such units are sold”

Collection and Recovery of STT

F) In Section 100 insert the following sub-section (2B) after sub-section(2A)

“The prescribed person in the case of every Investment Fund shall collect the securities transaction tax from every person who purchases or sells or redeems the unit of an Investment Fund”.

Recognised Stock Exchange or Investment Fund or Mutual Fund to furnish prescribed return

G) In sub-section (1) of Section 101 - insert the following words after the words “every recognised stock exchange” –

“Prescribed person in the case of every Investment Fund”

2. STT based tax system for AIF— (5/6)

Proposed amendment

Amendment 2:

On treating the transactions of investment in and distribution from an Investment Funds liable to STT, any distribution made by the AIF should be totally exempt from tax

Exempting the income from Investment Fund under section 10 of the Act:

In Section 10 of the Act, after clause (38), the following clause shall be inserted, namely:-

“(38A) any distribution received by an assessee, being a unit holder of an Investment Fund referred to in Explanation to Section 10(23FBA), either on redemption or otherwise and where such distribution is chargeable to Securities Transaction Tax under Chapter VII of the Finance (No. 2) Act,2004.

(38B) any income received by an assessee, being a unit holder of an Investment Fund referred to in Explanation to Section 10(23FBA), on sale of units in an Investment Fund to any person other than the Investment Fund, in which such units are held and where such sale is chargeable to Securities Transaction Tax under Chapter VII of the Finance (No. 2) Act,2004

Other consequential amendments:

Amending the period of holding in the securities held in and by an Investment Fund

In sub-section 42(A) of the Act, insert the following proviso after the second proviso-

“Provided further that in the case of share or other securities of a company (not being a share listed in a recognized stock exchange) held by an Investment Fund or a unit of an Investment Fund specified under clause (23FBA) of Section 10, the provisions of this clause shall have effect as if for the words "thirty-six months", the words "twelve months" had been substituted”.

2. STT based tax system for AIF— (6/6)

Proposed amendment

Other consequential amendments (contd.):

In Section 10 of the Act-

Amend clause (23FBA) as follows:

~~any income of an investment fund other than income chargeable under the head “Profits and gains of business or profession.”~~

Delete clause (23FBB).

Amending Section 115UB

In Section 115UB of the IT Act, after sub-section (7), the following sub-section shall be inserted, namely:-

~~“(8) Nothing contained in sub-sections (1) to (7) shall apply to any distributions by an Investment fund, where the distribution from such an Investment Fund is chargeable to securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004”~~

Avoiding the needless Tax Deduction at Source by Investment Funds (Section 194LBB)

In Section 194LBB of the Act, the first paragraph shall be numbered as sub-section (1) and after sub-section (1) so numbered, the following sub-section shall be inserted, namely:-

~~“(2) Nothing contained in sub-section (1) shall apply to distributions by an Investment fund, where such distribution is chargeable to securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004~~

3. Listing of AIFs – taxation policy — (1/4)

Proposed amendment

Amendment 1: Income of the listed AIFs to be exempt from tax

Insert new section 10(23DB)

10(23DB) subject to the provisions of Chapter XII-FB, any income of an investment fund listed on a recognized stock exchange.

Explanation – For the purposes of this clause, -

- (a) “investment fund” shall have the meaning assigned to it in clause (a) of the Explanation 1 to section 115UB.
- (b) “recognised stock exchange” shall have the meaning assigned to it in clause (ii) of the Explanation 1 to clause (d) of sub-section (5) of section 43.

Amendment 2: Income of the investors in listed AIFs to be exempt from tax

Insert new section 10(23DC)

10(23DC) any distributed income, referred to in section 115UBA, received by a unit holder from the investment fund listed on a recognized stock exchange

Explanation – For the purposes of this clause, -

- (a) “investment fund” shall have the meaning assigned to it in clause (a) of the Explanation 1 to section 115UB.
- (b) “recognised stock exchange” shall have the meaning assigned to it in clause (ii) of the Explanation 1 to clause (d) of sub-section (5) of section 43.

3. Listing of AIFs – taxation policy — (2/4)

Proposed amendment

Amendment 3: Tax on income distributed by listed AIFs

Insert new section 115UBA

Tax on distributed income to unit holders.

115UBA.

(1) Notwithstanding anything contained in any other provision of this Act, any amount of income distributed by the investment fund listed on a recognized stock exchange to its unit holders shall be chargeable to tax and such investment fund shall be liable to pay additional income-tax on such distributed income at the rate of thirty per cent.

Provided that nothing contained in this sub-section shall apply in respect of any income distributed to a unit holder of an equity oriented investment fund in respect of any distribution made from such fund.

Explanation – For the purpose of this sub-section,-

1. “equity oriented investment fund” means a fund where the investible funds are invested by way of equity shares or equity linked instruments to the extent of more than sixty five percent of the corpus of the investment fund.
2. “corpus” and “equity linked instruments” shall have the meaning assigned to it in clause (h) and clause (j) of Regulation 2 of the Securities and Exchange Board of India (Alternative Investment Fund) Regulation, 2012, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992).

(2) The person responsible for making payment of the income distributed by the investment fund, as the case may be, shall be liable to pay tax to the credit of the Central Government within fourteen days from the date of distribution or payment of such income, whichever is earlier.

3. Listing of AIFs – taxation policy— (3/4)

Proposed amendment

Amendment 3: Tax on income distributed by listed AIFs

(3) The tax on distributed income so paid by the investment fund shall be treated as the final payment of tax in respect of the amount distributed or paid and no further credit therefor shall be claimed by the investment fund or by any other person in respect of the amount of tax so paid.

(4) No deduction under any other provision of this Act shall be allowed to the investment fund or the unit-holders in respect of the amount which has been charged to tax under sub-section (1) or the tax thereon

(5) Where the person responsible for making payment of the income distributed by the investment fund, fails to pay the whole or any part of the tax referred to in sub-section (1), within the time allowed under sub-section (2) of that section, he or it shall be liable to pay simple interest at the rate of one per cent every month or part thereof on the amount of such tax for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

(6) If any person responsible for making payment of the income distributed by the investment fund, does not pay tax, as is referred to in sub-section (1), then, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of this Act for the collection and recovery of income-tax shall apply.

Amendment 4: Amendments to section 2(42A), section 10(38) and section 111A of the Act

Section 2(42A) “short term capital asset” means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of transfer

3. Listing of AIFs – taxation policy — (4/4)

Proposed amendment

Provided that in the case of 23[a security (other than a unit) listed in a recognized stock exchange in India] or a unit of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963) or 24[a unit of an equity oriented fund] or a zero coupon bond **or units of an investment fund listed on a recognized stock exchange**, the provisions of this clause shall have effect as if for the words "thirty-six months", the words "twelve months" had been substituted.

Section 10(38) any income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund [or a unit of a business trust] **or a unit of an investment fund listed on a recognized stock exchange** where-

Section 111A – Where the total income of an assessee includes any income chargeable under the head “Capital gains”, arising from the transfer of a short-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust **or a unit of an investment fund listed on a recognized stock exchange**, and-

Appropriate amendments must be made in Chapter VII of the Finance (No. 2) Act, 2004 to introduce STT rates on transactions executed on the stock exchange.

Amendment 5: Amendment to MAT provisions

Amend Explanation 2 to section 115JB of the Act

Explanation 2 – For the purpose of clause (a) of Explanation 1, the amount of income-tax shall include- any tax on distributed profits under section 115-O or on distributed income under section 115R or **on distributed income under section 115UBA**

4. Clarification on taxation of convertible preference shares — (1/3)

Proposed amendment

Amendment 1: Exemption on conversion

Section 47(x) - any transfer by way of conversion of **preference shares**, bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company

Amendment 2: Inclusion of period of holding preference shares (pre-conversion)

Option 1:

This will require the following amendment in Rule 8AA:

8AA. (1) *The period for which any capital asset, other than the capital assets mentioned in clause (i) of the Explanation 1 to clause (42A) of section 2 of the Act, is held by an assessee, shall be determined in accordance with the provisions of this rule.*
(2) *In the case of a capital asset, being a share or debenture of a company, which becomes the property of the assessee in the circumstances mentioned in clause (x) of section 47 of the Act, there shall be included the period for which the **preference shares**, bond, debenture, debenture-stock or deposit certificate, as the case may be, was held by the assessee prior to the conversion.*

4. Clarification on taxation of convertible preference shares — (2/3)

Proposed amendment

Option 2: Proposed clarification:

This will require clarification in the CBDT circular dated 12 May 1964. The relevant extract of the aforesaid circular along with the proposed clarification is as follows:

F. No. 12/1/64 – IT (AI)
GOVERNMENT OF INDIA
MINISTRY OF FINANCE
(DEPARTMENT OF REVENUE AND COMPANY LAW)
NEW DELHI, the 12th MAY, 1964.

...

From Shri G. R. Desai,
 Deputy Secretary to Govt. of India

To All Commissioners of Income Tax

Sir,

Sub:- Conversion of one kind of shares of the Company into another kind – Capital gains and bonus tax – Finance Act, 1964

Attention is invited to Section 12 of the Finance Act, 1964, which introduces new sub-section (2) in section 45 of the Income-tax Act, 1961, so as to provide for the charging of tax on capital gains on allotment of shares by a company by way of bonus. Section 14 of the Finance Act, 1964 introduces a new sub-clause (v) in

4. Clarification on taxation of convertible preference shares — (3/3)

Proposed amendment

sub-section (2) of section 55 of the Income-tax Act, 1961, laying down the method for determining the cost of acquisition of a new share which becomes the property of the assessee on conversion of one type of share into another type of share. A question has been raised whether the transaction of conversion of one type of share into another attracts the capital gains tax under section 45(1) or the bonus tax of 12.5% or the capital gains tax on the issue of bonus shares under section 45(2). The position in this regard is as follows:

- i. Where one type of share is converted into another type of share (including conversion of debentures into equity shares), there is, in fact, no 'transfer' of a capital asset within the meaning of section 2(47) of the Income-tax Act, 1961. Hence, any profits derived from such conversion are not liable to capital gains tax under section 45(1) of the Income-tax Act. However, when such newly converted share is actually transferred at a later date, the cost of acquisition of such share for the purposes of computing the capital gains shall be calculated with reference to the cost of acquisition of the original share of stock from which it is derived.

In determining the holding period of the newly converted share at the time of transfer, the period for which the share was held before the conversion, should also be included

5. Clarification on indirect transfer rules for multi-layered structure

Proposed amendment

Furnishing of information or documents by transferor or transferee or an Indian concern in certain cases.

285A. Where any share of, or interest in, a company or an entity registered or incorporated outside India derives, directly or indirectly, its value substantially from the assets located in India, as referred to in Explanation 5 to clause (i) of sub-section (1) of section 9, and such company or, as the case may be, entity, holds, directly or indirectly, such assets in India through, or in, an Indian concern, then, **the transferor or transferee of the share of, or interest in, a company or an entity registered or incorporated outside India or the** Indian concern shall, for the purposes of determination of any income accruing or arising in India under clause (i) of sub-section (1) of section 9, furnish within the prescribed period to the prescribed income-tax authority the information or documents, in such manner, as may be prescribed

[Penalty for failure to furnish information or document under section 285A

271GA. If any Indian concern **or the transferor or transferee**, which is required to furnish any information or document under section 285A, fails to do so, the income-tax authority, as may be prescribed under the said section, may direct that such Indian concern **or the transferor or transferee** shall pay, by way of penalty,—

- (i) a sum equal to two per cent of the value of the transaction in respect of which such failure has taken place, if such transaction had the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern;
- (ii) a sum of five hundred thousand rupees in any other case.

6. Clarification on Taxation of interest on Overseas Rupee Denominated Bonds — (1/2)

Proposed amendment

Section 115A(1)(a) of the Act should be amended to provide for chargeability of the interest income from RDBs by inserting clause (iiad) and amending clause (BA) as follows:

- (1) Where the total income of—
 - (a) a non-resident (not being a company) or of a foreign company, includes any income by way of—
.....
(iiad) for the avoidance of doubt, interest received from offshore Rupee Denominated Bonds issued by Indian corporates or providing lending in Indian Rupees to Indian corporates under the Indian Rupee Denominated External Commercial Borrowing route of Reserve Bank of India; or
.....
- the income-tax payable shall be aggregate of –
.....
- (BA) the amount of income-tax calculated on the amount of income by way of interest referred to in sub-clause (ia) or sub-clause (iaa) or sub-clause (iab) or sub-clause (iac) or sub-clause (iad), if any, included in the total income, at the rate of five per cent;

6. Clarification on Taxation of interest on Overseas Rupee Denominated Bonds — (2/2)

Proposed amendment

The following clauses should also be inserted in Part II of First Schedule of the Finance Act for providing rate of withholding tax:

| Clause | Inclusion recommended | Rate of income-tax |
|--------------|---|--------------------|
| 1(b)(ii)(AA) | <i>On income by way of interest received from offshore Rupee Denominated Bonds issued by Indian corporates or providing lending in Indian Rupees to Indian corporates under the Indian Rupee Denominated External Commercial Borrowing route of the Reserve Bank of India</i> | 5 % |
| 2(b)(iiia) | <i>On income by way of interest received from offshore Rupee Denominated Bonds issued by Indian corporates or providing lending in Indian Rupees to Indian corporates under the Indian Rupee Denominated External Commercial Borrowing route of the Reserve Bank of India</i> | 5 % |

Alternatively, the following clause may be inserted after clause (b) of Explanation to Section 194LC of the Act:

“(c) ‘Monies borrowed in foreign currency’ will include rupee denominated bonds issued overseas in accordance with the guidelines issued under External Commercial Borrowings Policy framed by RBI”

7. Extension of beneficial tax rate of 5% on interest income

Proposed amendment

194LC(2) The interest referred to ..in respect of monies borrowed by it in foreign currency from a source outside India,—

(a) under a loan agreement at any time on or after the 1st day of July, 2012 but before 1 July 2022; or

(b)

(c) by way of issue of any long-term bond including long-term infrastructure bond at any time on or after the 1st day of October, 2014 but before the 1 July 2022,...

7. Extension of beneficial tax rate of 5% on interest income

Proposed amendment

194LD (2) The income by way of interest referred to in sub-section (1) shall be the interest payable on or after the 1st day of June, 2013 but before the 1 July 2022 in respect of investment made by the payee in

“Explanation.—For the purpose of this section,—

(c)

(d) For the removal of doubts, it is hereby clarified that the term ‘rupee denominated bond of an Indian company’ includes and has always included debentures issued by such an Indian company.”

9. Amendment in RBI Notification for Ownership Test for Indian Owned & Controlled Fund Managers/Sponsors/Affiliates

**Proposed
amendment in RBI
Notification Dated
15-Nov-2015**

“4. Downstream investment by an Investment Vehicle shall be regarded as foreign investment if either the Sponsor or the Manager or the Investment Manager is not Indian ‘owned and controlled’ as defined in Regulation 14 of the principal Regulations.

Provided that for sponsors or managers or investment managers organized in a form other than companies or LLPs, SEBI shall determine whether the sponsor or manager or investment manager is foreign owned and controlled.

Explanation 1: Subject to Explanation 1A below, Ownership and control is clearly determined as per the extant FDI policy. AIF is a pooled investment vehicle. ‘Control’ of the AIF should be in the hands of ‘sponsors’ and ‘managers/investment managers’, with the general exclusion to others. In case the ‘sponsors and ‘managers/investment managers’ of the AIF are individuals, for the treatment of downstream investment by such AIF as domestic, ‘sponsors’ and ‘managers/investment managers’ should be resident Indian citizens.

Explanation 1A: For purposes of determining level of foreign ownership of the Sponsor or the manager or investment manager of an AIF referred to above, account need not be taken of the holdings of equity in an Indian promoter company of such Sponsor or the manager or investment manager which is held by foreign institutional investors or foreign portfolio investors or non-resident Indians under the portfolio investment scheme unless these shares are held by the foreign promoters of the applicant and their subsidiaries and nominees, and Indian mutual funds to the extent the investment of foreign institutional investors and Indian mutual funds are within the approved limits laid down by the Securities and Exchange Board of India under its rules, regulations or guidelines issued from time to time.

Explanation 2: The extent of foreign investment in the corpus of the Investment Vehicle will not be a factor to determine as to whether downstream investment of the Investment Vehicle concerned is foreign investment or not.”