Association of Mutual Funds in India

BUDGET PROPOSALS FOR FY 2018-19

1. Request for Clarification that the provisions of section 115BBDA are not applicable to Mutual Funds		
Background	**Proposal**	**Justification**
The Finance Act, 2017 amended the scope of section 115BBDA of the Act (which was earlier applicable only to resident Individuals, Hindu Undivided Families and Firms) to extend its applicability to a 'specified assessee', which has been defined to mean a person other than: a) A domestic company; b) A fund or institution referred to in sec. 10(23C) of the Act; or c) A trust or institution registered under section 12A or section 12AA of the Act. Mutual Funds have not been specifically included in the above list of persons to which the provisions of section 115BBDA of the Act do not apply. Section 10(23D) of the Income Tax Act provides that any income earned by a Mutual Fund registered under the SEBI Act, 1992 or the Regulations made thereunder, shall not be included in computing its **total income** of a previous year. Hence, the provisions of section 115BBDA of the Act, which are computational provisions, should not apply to dividend from domestic companies earned by Mutual Funds whose income is not included in the total income by virtue of section 10(23D) of the Act. Nonetheless, there is an apprehension that the position mentioned above may not be accepted by the assessing income tax officers in the field, in the absence of a specific exclusion for Mutual Funds in section 115BBDA of the Act, which may cause unintended and avoidable hardship to Mutual Funds if the assessing officers were to apply section 115BBDA of the Act, in assessing their total income.	In order to provide absolute clarity and to avoid any conflicting interpretations and thereby avoid any litigation/unintended hardship to Mutual Funds, it is requested that a clarificatory circular be issued to specify that the provisions of section 115BBDA of the Act are not applicable to dividends in excess of ₹10 lakhs received from domestic companies by Mutual Funds whose income is excluded from the total income under section 10(23D) of the Act. Alternatively, appropriate instructions be issued to income tax officers in the field advising them to take note of the above and frame the assessments of Mutual Funds, accordingly.	To provide absolute clarity and to avoid any conflicting interpretations, in the absence of such 'specific' exclusion to a Mutual Fund thereby avoiding any unintended hardship to Mutual Funds and litigation.

2. Introduce Debt Linked Savings Scheme (DLSS) to encourage Long-Term Household Savings into Bond Market.		
Background	**Proposal**	**Justification**
Over the past decade, India has emerged as one of the key markets in Asia. However, the Indian corporate bond market has remained comparatively small and shallow, which continues to impede companies needing access to low-cost finance. As per the data from Asia Securities Industry & Financial Markets Association (ASIFMA), the corporate bond markets of Malaysia, South Korea, Thailand, Singapore and China exceed that of India as a percentage of GDP. Historically, the responsibility of providing debt capital in India has largely rested with the banking sector. This has resulted in adverse outcomes, such as accumulation of non-performing assets of the banks, lack of discipline among large borrowers and inability of the banking sector to provide credit to small enterprises. Indian banks are currently in no position to expand their lending portfolios till they sort out the existing bad loans problem. Thus, there is a need for a vibrant bond market in India, to provide an alternative platform for raising debt finance and reduce dependence on the banking system. Several committees [such as the R.H. Patil committee (2005), Percy Mistry committee (2007) and Raghuram Rajan committee (2009)] studied various aspects of the issue and have made recommendations, but the progress has not been as desired. The heavy demands on bank funds by large companies, in effect, crowd out small enterprises from funding. India needs to eventually move to a financial system where large companies get most of their funds from the bond markets while banks focus on smaller enterprises.	It is proposed to introduce **"Debt Linked Savings Scheme" (DLSS)** on the lines of Equity Linked Savings Scheme, (ELSS), to channelize long-term savings of retail investors into corporate bond market which would help deepen the Indian Bond Market. At least 80 per cent of the funds collected under DLSS shall be invested in debentures and bonds of companies as permitted under SEBI Mutual Fund Regulations. Pending investment of the funds in the required manner, the funds may be invested in short-term money market instruments or other liquid instruments or both. It is further proposed that the investments upto ₹1,50,000 under DLSS be eligible for tax benefit under Chapter VI A, under a separate sub-Section and subject to a lock in period of 5 years (just like tax saving bank Fixed Deposits). CBDT may issue appropriate guidelines / notification in this regard as done in respect of ELSS.	To deepen the Indian Bond Market and strengthen the efforts taken by RBI and SEBI for increasing penetration in the corporate bond markets, it is expedient to channelize long-term savings of retail segment into corporate bond market through Mutual funds on the same lines as ELSS. In 1992, the Government had notified the Equity Linked Savings Scheme (ELSS) with a view to encourage investments in equity instruments. Over the years, ELSS has been an attractive investment option for retail investors. The introduction of DLSS will help small investors participate in bond markets at low costs and at a lower risk as compared to equity markets. This will also bring debt oriented mutual funds on par with tax saving bank fixed deposits, where deduction is available under Section 80C.

While it is highly unlikely that the corporate bond market will ever replace banks as the primary source of funding, experts agree that India needs a more lively corporate bond market. This can also play a part in disciplining companies that borrow heavily from banks to fund risky projects, because the borrowing costs would spike. While RBI & SEBI have taken the welcome steps in developing a vibrant corporate bond market in recent times, it is imperative that other stakeholders complement these efforts, considering the fact that with banks undertaking the much needed balance sheet repairs and a section of the corporate sector coming to terms with deleveraging, the onus of providing credit falls on the other players. The Government's plans to significantly increase investment in the infrastructure space will require massive funding and the banks are not suited to fund such investments. If large borrowers are pushed to raise funds from the market, it will increase issuance over time and attract more investors, which will also generate liquidity in the secondary market. A vibrant corporate bond market is also important from an external vulnerability point of view, as a dependence on local currency and markets will lower risks.		

AMFI

3. Alignment of Tax Treatment for Retirement / Pension Schemes of Mutual Funds and National Pension System		
Background	**Proposal**	**Justification**
Retirement planning has become very important due to longer life expectancy owing to improved medical and healthcare. There's a significant increase in ageing population today, with no social security to fall back on. It is critical for individuals to accumulate sufficient funds that can sustain over long post-retirement life for healthcare needs and expenses (which could deplete one's lifetime savings in case of critical illness). Hence, one has to plan to build the retirement corpus to help meet the regular income or any contingency post retirement. India, like most of the developing economies, does not have a universal social security system and the pension system has largely catered to the organized segment of the labor force. While, till recently, public sector and government employees typically had a three-fold structure comprising provident fund, gratuity and pension schemes, the bulk of the private sector (with the exception of few major corporates) had access only to provident funds, a defined-contribution, fully funded benefit program providing lump sum benefits at the time of retirement. The Employees' Provident Fund (EPF) is the largest benefit program operating in India. Reflecting this state of affairs, the significance of pension funds in the Indian financial sector has been rather limited. In recognition of the possibility of an unsustainable fiscal burden in the future, the Government of India moved from a defined-benefit pension system to a defined-contribution pension system, with the introduction of the "New Pension System" (NPS) in January 2004.	• As in the case of NPS, investment in Retirement Benefit / Pension Schemes offered by Mutual Funds upto ₹150,000 should also be allowed tax exemption under Sec. 80CCD of Income Tax Act, 1961, instead of Sec. 80C, with E-E-E status i.e., subscription being eligible for tax exemption, any accrued income being tax-exempt, and withdrawal also being exempted from tax. • Where matching contributions are made by an employer, the total of Employer's and Employee's contributions should be taken into account for the purpose of calculating tax benefits under Sec. 80 CCD. • Further, the contributions made by an employer should be allowed as an eligible 'Business Expense' under Section 36(1) (iva) of the I.T.Act. • Likewise, contributions made by the employer up to 10% of salary should be not taxable in the hands of employee, as in respect of section 17(1)(viii) read with the Section 80CCD of the IT Act.	• Empirically, tax incentives are pivotal in channelising long-term savings. For example, the mutual fund industry in the United States (U.S.) witnessed exponential growth when tax incentives were announced for retirement savings. • Contractual savings systems have been improved, but pension funds in India are still in their infancy. In terms of size, India's pension funds stood at 0.3 percent of its GDP, as against China's 1 percent or Brazil's 13 percent (Source: OECD, 2015). • With a large ageing population and increased longevity and growing health care needs and medical expenditure in an inflationary environment, there is strong need to provide the individuals a long term pension product that could provide a decent pension which could beat the inflation. Considering that India's population is around 1.34 billion in which the share of the old (i.e., 60 years and above) is around 10 percent, pension funds in India have, in principle, a large potential - both as a social security measure as well as means to providing a depth to the financial markets, in both debt and equity market segments. • Going forward, pension funds will emerge as sources of funds in infrastructure and other projects with long gestation period, as well as for providing depth to the equity market (perhaps looking for absorbing stocks arising out of disinvestment program of the government)

Presently, there are three broad investment avenues for post-retirement pension income in India, namely :

(i) National Pension System (NPS).
(ii) Retirement /Pension schemes offered by Mutual Funds;
(iii) Insurance-linked Pension Plans offered by Insurance companies.

While NPS is eligible for tax exemptions under section 80CCD exclusively, Mutual Fund Pension Schemes qualify for tax benefit under Sec.80C, which is rather over-crowded with several other financial products such as EPF, PPF, NPS, Life Insurance Premia, ULIP, Tax Saving FDs, Home Loan repayment etc.

Moreover, currently each Mutual Fund Pension Scheme needs to be Notified by CBDT on a case-by-case basis involving a long and painful bureaucratic process for being eligible for tax benefit u/Section 80C.

SEBI, in its "**Long Term Policy for Mutual Funds**" (2014) has emphasized the principle that <u>similar products should get similar tax treatment,</u> and the need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators and has stressed the need for restructuring of tax incentive for Mutual Funds schemes, ELSS and Mutual Fund Pension schemes.

Thus, there is very strong case for extending the exemption under Sec. 80CCD of Income Tax Act, 1961 for investments in Retirement Benefit / Pension Schemes offered by Mutual Funds (instead of Sec.80C) so as to bring parity of tax treatment for the pension schemes and ensure level playing field.

- The switches of MFLRP investments between mutual funds should not be treated as transfer and may be exempted from capital gain tax.

It is further recommended that CBDT, in consultation with SEBI may notify the guidelines giving the framework for Mutual Funds to launch MFLRP, which shall be eligible for deduction under Section 80CCD (as done in respect of ELSS), obviating the need for each Mutual Fund to apply to CBDT individually to notify its MFLRP for being eligible for tax benefit u/Sec.80CCD, obviating a long bureaucratic process that exists at present.

- Thus, there is a huge scope for growth in India's retirement benefits market owing to low existing coverage and a large workforce in the unorganized sector, vast majority of which has no retirement benefits. NPS provides one such avenue, albeit with limited reach. **Mutual funds could provide an appropriate alternative, given the maturity of the mutual fund industry in India and their distribution reach. This could be better achieved by aligning the tax treatment of mutual fund retirement products / MFLRP with NPS.**
- Market-linked retirement planning has been one of the turning points for high-quality retirement savings across the world. Investors have a choice in the scheme selection and flexibility.
- SEBI, in its "Long Term Policy for Mutual Funds" released in Feb. 2014, had proposed that Mutual Funds be allowed to launch pension plans, namely, Mutual Fund Linked Retirement Plan' (**MFLRP**) which would be eligible for tax benefits akin to 401(k) Plan of the U.S.
- For the growth of securities market, it is imperative to channelize long-term savings into the securities market. A long-term product like MFLRP can play a very significant role in channelizing household savings into the securities market and bring greater depth. Such depth brought by the domestic institutions would help in curbing the volatility in the capital markets and would reduce reliance on the FIIs.

In fact, in the 'Key Features of Budget 2014-2015' there was an announcement under 'Financial Sector - Capital Market' about *"**UNIFORM TAX TREATMENT FOR PENSION FUND AND MUTUAL FUND LINKED RETIREMENT PLAN**"* (on Page 12 of the Budget Highlights document). This implied that Indian Mutual Funds would be able to launch Mutual Fund Linked Retirement Plans (MFLRP) which would be eligible for the same tax concessions available to NPS. However, there was no reference to this either in the budget speech of the Finance Minister, nor in the Budget, disappointing a vast number of retail investors and the Mutual Fund industry.		• Allowing Mutual Funds to launch MFLRP would help investors gain from the expertise of a large talent pool of asset managers who are already managing the existing funds of mutual funds efficiently with the support of research and analyst teams. • It is pertinent to mention here that Mutual Fund asset managers also have experience in managing long term fund of EPF and NPS. Mutual Funds could play a meaningful role during the 'Accumulation Phase' of retirement planning in addition to that of the providers of the NPS, EPF and PPF. • A majority of NPS subscribers are from government and organized sector. Hence, MFLRP could target individuals <u>who are not subscribers to NPS</u> especially those from the unorganized sector and provide them an option to save for the long term, coupled with tax benefits.

4. Request to include Mutual Fund Units among the Specified Long-Term Assets qualifying for exemption on Long-Term Capital Gains under Sec. 54 EC		
Background	**Proposal**	**Justification**
In 1996, Sections 54EA and 54EB were introduced under the Income Tax Act, 1961 with a view to channelize investment into priority sectors of the economy and to give impetus to the capital markets. Under the provisions of Sec. 54EA and 54EB, capital gains arising from the transfer of a long-term capital asset on or after 01-10- 1996, were exempted from capital gains tax if the amount of net consideration (Section 54EA) or the amount of capital gain (Section 54EB) was invested in certain specified assets, including mutual fund units, redeemable after a period of three years. (cf: Notification No. 10248 [F. No. 142/58/96-TPL], dated 19-12-1996). However, the aforesaid exemption under Sec. 54EA and 54EB was withdrawn in the Union Budget 2000-01 and a new Section 54EC was introduced, whereby tax exemption on long-term capital gains is now available only if the gains are invested in specified long-term assets (currently in bonds issued by the NHAI & REC) that are redeemable after three years. Under Sec. 54, long term capital gains arising to an individual or HUF from the sale of a residential property are exempt from capital gains tax, if the gains are invested in a new residential property either bought within two years or constructed within three years from date of transfer of existing property. In case of buying a new property, the exemption is available even if it is bought within one year before the date of transfer.	It is proposed that, mutual fund units that are redeemable after three years, <u>wherein the underlying investments are made into equity or debt of 'infrastructure sub-sector' as specified by RBI Master Circular in line with 'Master List of Infrastructure sub-sectors' notified by the Government of India, be also included in the list of the specified long-term assets under Sec. 54EC.</u> While the underlying investment will be made in securities in infrastructure sub-sector as specified above, the mutual fund itself could be equity oriented scheme or debt oriented scheme, based on investors' choice and risk appetite. The investment shall have a lock in period of three years to be eligible for exemption under Sec. 54EC.	Recognizing the need to channelize long term household savings into the Capital Market, the Government has been taking various measures to encourage individual tax payers to invest in capital markets via mutual funds, through tax incentives u/Sec. 88 / 80C / 54EA / 54EB etc. However, consequent on withdrawal of the benefit of capital gains tax exemption under Section 54EA and 54EB, the inflow of investments, which could have otherwise flowed into capital market, has altogether stopped and hence there is a need to re-introduce capital gains tax exemption for investment in mutual fund units, so as to incentivize investment in capital markets. With the ever growing demand for residential property and easy access to home loans with tax incentives on home loan repayments, the boom in real estate sector has been a continuing phenomenon. Housing being a basic need, a residential property ranks high & 'a must have' or 'desirable' asset when compared to various other assets and is rightly preferred over other assets. Most individuals liquidate their financial assets to purchase a residential property with or without the aid of home loans. **Money once invested in immovable property using the sale proceeds from mutual funds or stocks never comes back into capital markets, as people invariably reinvest the capital gains arising from sale of an immovable property to buy another property & avail of capital gains tax exemption u/Sec. 54 or 54F.** ***Thus, the flight of money from financial markets capital into real estate sectors has become an irreversible phenomenon.*** Thus, in order to reverse this one-way phenomenon and to channelize at least some of the gains from sale of immovable property into capital markets, it is expedient to broaden the list of the specified long-term assets under Sec. 54 EC by including mutual fund units under both equity oriented or non-equity schemes (based on investors' choice and risk appetite) - with a lock in period of three years.

5. Mutual Fund Units to be notified for as Long-Term Specified Assets for exemption on Long-Term Capital Gains under Sec. 54 EE		
Background	**Proposal**	**Justification**
In the Finance Act 2017, a new Section 54EE has been inserted in the Income-tax Act, 1961 to provide exemption from capital gains tax, if the long term capital gains proceeds are invested in units of specified fund, as may be notified by the Central Government. "Long term specified assets" means unit or units, issued before April 1, 2019 of such fund as may be notified by the Central Government in this behalf. The investment in the units of the specified fund shall be allowed up to ₹ 50 lakhs, subject to a lock in period of three years.	It is recommended that Units issued by Mutual Funds that are registered with SEBI, having a lock-in for three years may be notified as "Long term specified assets" under Section 54EE. Further, the investments in mutual fund units could be permitted in both equity oriented or debt oriented funds, based on investors' choice & risk appetite, with a lock in period of three years.	In 1996, the Government had introduced Sections 54EA and 54EB of the Income Tax Act, 1961, with a view to channelize investment into priority sectors of the economy and to give impetus to the capital markets. Under the provisions of these sections capital gains arising from the transfer of a long-term capital asset on or after 1st October, 1996, were exempted from capital gains tax if the amount of net consideration (Section 54EA) or the amount of capital gain (Section 54EB) was invested in certain specified assets, including mutual fund units, redeemable after a period of three years. (Notification No. 10248 [F. No. 142/58/96-TPL], dated 19-12-1996). However, the said Sections 54EA and 54EB were withdrawn in the Union Budget 2000-01. Hence, notifying the mutual fund units as Long term specified assets under Section 54EE would encourage individual tax payers to invest in capital markets via mutual funds, and help to channelize long term household savings into Capital Market.

6. Taxation on Listed Debt Securities and Debt Mutual Funds to be aligned.		
Background	**Proposal**	**Justification**
In his 2014 Budget Speech, the Finance Minister had mentioned that investment in debt securities, either directly or through Mutual Funds should be at par for retail investors, at the same time acknowledging that retail participation in debt Mutual Funds was limited. The amendments made in the Finance Act, 2014 unfortunately did not completely address the disparity and retained the difference between tax treatment of direct and indirect investment into debt securities. The changes the Finance Act, 2014 has increased the holding period for non-equity oriented Mutual Funds (MFs) from more than 12 months to more than 36 months for being eligible for long term capital gains. However, a direct investment in a listed debenture, if held for more than 12 months, is treated as long term investment, whereas, if the said investment was made through a Debt-oriented Mutual Fund scheme, the period of holding is increased to 36 months for it to be regarded as long-term investment. Thus, there is a need for harmonizing the tax treatment on investments in debt-oriented MFs and direct investments in debt securities.	The holding period for long term capital gains between direct investment in listed debt securities and through debt mutual funds should be harmonized and made uniform. This may be done by bringing the two at par by treating investments in non-equity oriented mutual fund schemes **which invest 65% or more in listed debt securities as long term**, if they are held for more than 12 months, on similar lines of Equity Oriented Funds (wherein a fund is treated as Equity oriented fund if it invests 65% or more in equities).	There is a need to bring parity between direct investment in listed debt instruments and investment through debt-oriented mutual fund schemes.

<table>
<tr><th colspan="3">7. Definition of Equity Oriented Funds (EOF) to be expanded to include investment by Fund of Funds Schemes in EOF</th></tr>
<tr><th>Background</th><th>Proposal</th><th>Justification</th></tr>
<tr>
<td>• A Fund of Funds (FOF) scheme of a Mutual Fund primarily invests in the units of another Mutual Fund scheme.
• An FOF investing in Equity Oriented Funds (EOF) takes exposure to listed equity securities through the EOF in which it invests.
• At present, where a FOF invests predominantly in units of an Equity Oriented Funds (EOF), the FOF is NOT treated as an EOF because under current Income Tax regime, definition of an EOF only specifies investment in listed equity securities of domestic companies.
• Consequently, in case of FOFs investing in equity securities of domestic companies via EOFs, there is dual levy of Dividend Distribution Tax (DDT), viz., when the domestic companies distribute dividends to their shareholders and again, when the FOF distributes the dividends to its unit-holders.</td>
<td>• It is proposed that the definition of “Equity Oriented Funds” (EOF), be revised to include investment in Fund of Funds (FOF) schemes which invest predominantly i.e., 65% or more, in units of Equity Oriented Mutual Fund Schemes.
• Consequently -
a) the income distributed by such funds be <u>exempted from </u>‘tax on distributed income’ under section 115R of the Act; and
b) redemption of units in FOF schemes investing predominantly i.e., 65% or more in EOF be subjected to the same capital gains tax, as applicable to sale of listed equity securities / units of Equity Oriented Mutual Fund Schemes.</td>
<td>• There is strong case for rationalisation of taxation between Direct Equity, EOF and Equity Oriented Fund of Funds.
• Hence the Tax treatment in respect of FOF schemes investing in predominantly in EOFs should be at par with EOFs. Accordingly, FOFs investing 65% or more of their corpus in EOF should be regarded as EOFs.
• To ensure that the intent of the law is not sacrificed, the minimum allocation of an FOF to its target fund(s) investing in the dominant asset class may be set at a higher level, say 90% for such eligibility. In the absence of such higher allocation, an FoF investing more than 65% in funds that invest at least 65% in equities may attract equity taxation while theoretically investing merely 42.25% in equities.</td>
</tr>
</table>

8. Removal of Double Taxation of STT on Equity Oriented Funds and Exchange Traded Funds		
Background	**Proposal**	**Justification**
• As per current Tax laws, in respect of Equity Oriented Funds (EOF), the Mutual Funds are required to pay Securities Transaction Tax (STT) on sale of securities. • In addition, the unit-holders (Investors) are also required to pay the STT on the redemption value at the time of redemption of units. • Thus, there is clearly a double levy of STT for an investor investing in the equity markets through the mutual fund route, i.e., via an EOF. • Where the EOF is an Exchange Traded Fund (ETF), listed on a stock exchange, the investor of the ETF pays STT on the purchase and sale of units in the ETF. • Similarly, there is multiple levy of STT when the following events occur: - Units are purchased from / sold to Authorised Participants; - Underlying securities are transferred by / to Authorised Participants; - Units surrendered by AP to the mutual fund are redeemed.	It is proposed that the incidence of STT being paid by the Mutual Funds on sale of equity shares in respect of MF schemes should either be abolished altogether or levied only at the time of redemption by the investor.	• The double levy of STT on EOFs/ETFs, adversely impacts the returns in the hands of the investors and could act as a deterrent from investing in mutual funds, which, in fact, are a more appropriate platform for retail investors to participate in the capital markets. • To encourage retail participation and deepening of capital markets, the double levy of STT on EOF/ETF should be removed. • As provided in case of New Pension Scheme (NPS) by the Finance Act, 2009, the incidence of STT being paid by the Mutual Funds on sale of equity shares in respect of MF schemes needs to be abolished, since Mutual Funds are ‘pass through vehicles’

9. Exemption from Dividend Distribution Tax (DDT) in respect of Tax-exempt Institutional Investors		
Background	**Proposal**	**Justification**
The Finance Act, 2013 introduced a new Section 115TA relating to Tax on Distributed Income by Securitisation Trusts. The proviso to Section 115TA states that Dividend Distribution Tax (DDT) will not be charged when the income is distributed by a Securitization Trust to a person in whose case, the income, irrespective of its nature and the source, is not chargeable to tax under the Income Tax Act.	It is proposed that on the same analogy as per proviso to Section 115TA, Tax-exempt institutional investors such as EPFO, NPS, Insurance Companies, non-profit Section 8 companies etc. or Pass-through vehicles who invest on behalf of their investors / contributors/ policyholders in Mutual Funds schemes or Infrastructure Debt Funds of Mutual Funds, should be exempt from Dividend Distribution Tax under section 115R of the Income Tax Act.	• Although pre-tax returns from Debt Mutual Fund schemes or Infrastructure Debt Funds are competitive, due to the levy of DDT u/S. 115R, the post-DDT returns adversely impacts the net returns for the investors. This acts as a deterrent for Tax-exempt institutional investors from investing in mutual fund schemes and MF-IDFs, due to the disparity in the tax treatment of income earned from MFs / MF-IDFs vis-a-vis other interest-bearing financial instruments. • While waiving DDT in respect of Tax-exempt institutional investors would not affect the Government’s revenue, it would eliminate arbitrage between incomes earned from MFs / MF-IDFs vis-à-vis other interest-bearing financial instruments.

10. Rationalisation of Tax treatment of Infrastructure Debt Funds of Mutual Funds and Infrastructure Debt Funds of NBFCs		
Background	**Proposal**	**Justification**
• Currently, Mutual Funds as well as Non-Banking Finance Companies (NBFCs) are permitted to set up Infrastructure Debt Funds (IDFs) under the purview of respective Regulations of SEBI and RBI. • The income of a Mutual Fund is exempt under section 10(23D) of Income Tax Act, 1961. Similarly, the income of an IDF set up as an NBFC is also exempt, but under section 10(47). • The income from NBFC-IDF is in the form of interest, whereas the income from MF-IDF is in the form of dividend. • The interest paid by NBFC-IDF attracts TDS @10% for Resident Investors, whereas the dividend distributed by MF-IDF is subject to Dividend Distribution Tax (DDT) under section 115R of the IT Act @ 25% for Individuals & HUFs and 30% for others (plus applicable surcharge) • **The levy of DDT adversely impacts the net returns from MF-IDF, due to the disparity in the tax treatment of income earned from IDFs of NBFCs vis-à-vis IDFs of MFs.**	It is recommended that Tax-exempt institutional investors in Infrastructure Debt Funds of Mutual Funds be exempt from Dividend Distribution Tax under section 115R of the Income Tax Act.	• In its "**Long Term Policy for Mutual Funds**", SEBI has emphasised the principle that **similar products should get similar tax treatment**, and the need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators. • The investors in IDF of an NBFC and IDF of a Mutual Fund are primarily the same and mostly Tax-Exempt Institutional Investors such as, EPFO, NPS, Insurance Companies, Section 25 companies etc. or pass through vehicles who invest on behalf of their investors /contributors /policyholders . • In order to attract and encourage investment through Mutual Fund-IDFs, it is necessary to bring parity in the treatment of income received under both the routes.

11. Rationalisation of tax treatment on Switching of Investments under Mutual Funds v/s ULIPs of Insurance companies		
Background	**Proposal**	**Justification**
• Currently, **Intra-Scheme Switch transactions**, i.e., switching of investment in Units from Growth Option to Dividend Option (or vice-versa) **within the same scheme of a Mutual Fund** constitutes a "Transfer" under the current Income Tax regime and is liable to capital gains tax, even though the investment remains within the mutual fund scheme, i.e., the underlying securities/ portfolio remaining unchanged, being common for both Options. • However, the switches to/from various investment plans of the same Unit Linked Insurance Plan (ULIP) of insurance companies does not constitute transfer and is not subjected to Capital Gains Tax.	To have a level playing field and uniformity in taxation of investment in Mutual Funds schemes and ULIPs of Insurance companies, it is proposed that in case of **Intra-Scheme Switches (switching of investment within the same scheme of a Mutual Fund) be also not regarded as a "Transfer" under Section 47 of the IT Act, 1961** and be exempt from payment of capital gains tax.	In its "**Long Term Policy for Mutual Funds**", SEBI has emphasised the principle that **similar products should get similar tax treatment**, and the need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators. Thus, there is need to have uniformity in the tax treatment for "Switch" transaction in respect Insurance products and Mutual Fund Products to have a level playing field

12. Threshold Limit in Equity Oriented Mutual Fund schemes to be lowered from 65% to 50%		
Background	**Proposal**	**Justification**
As per the Income Tax Act, 1961, an "equity oriented fund" means a fund— (i) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than **sixty-five per cent** of the total proceeds of such fund; and (ii) which has been set up under a scheme of a Mutual Fund: Provided that the percentage of equity shareholding of the fund shall be computed with reference to the annual average of the monthly averages of the opening and closing figures. Previously, **this threshold limit was fifty percent** and the same was revised to sixty-five per cent w.e.f. 1-6-2006, by the Finance Act, 2006.	It is proposed that the threshold limit of 65% be reverted to 50% which was prevailing before June 2006 and accordingly, the definition of "Equity Oriented Funds" be revised as follows: An "equity oriented fund" means a fund— (i) where the investible funds are invested by way of equity shares or equity related instruments of domestic companies to the extent of more than **fifty per cent** of the total proceeds of such fund; and (ii) which has been set up under a scheme of a Mutual Fund: Provided that the percentage of equity shareholding of the fund shall be computed with reference to the annual average of the monthly averages of the opening and closing figures.	For the growth of capital markets, it is imperative to channelize long-term savings of retail investors into capital markets. Mutual funds are ideal vehicles for retail investors create wealth over long term. The "Make in India" initiative of the Prime Minister is expected to boost the economy in a big way and bring prosperity to the capital markets. It is therefore expedient to encourage and incentivize the retail investors to participate in equity markets through Mutual Funds and reap the benefit expected from the "Make in India" initiative. However, mutual fund products have still remained 'push' products. Of a population of over 1.34 billion, barely 18 million persons have invested in mutual funds, as there is a perception that mutual funds are rather risky (as all mutual fund advertisements are required carry a mandatory message that Mutual Funds are subject to "Market Risk". Reducing the threshold limit of equities from 65% to 50% for being regarded as 'equity oriented fund' would ensure that asset allocation products with **equitable risks** are also promoted leading to penetration of debt markets and promotion of real balanced portfolios and encourage more number of investors with lower risk appetite to invest in mutual funds.

13. Compliance under Sec.195(6) of the Income Tax Act, 1961 and Rule 37BB of the Income Tax Rules, 1962		
Issue	**Proposal**	**Justification for proposal**
As per Section 195(6), a person responsible for paying any sum to a non-resident individual is required to furnish information in Form 15 CA and 15CB (prescribed under Rule 37BB). • As per section 195(6) of the Income Tax Act, 1961 ("the Act") : *"The person responsible for paying to a non-resident, not being a company, or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall furnish the information relating to payment of such sum, in such form and manner, as may be prescribed"* • As per Sec. 271-I of the Act which has come into effect from 01-06-2015, "*If a person, who is required to furnish information under sub-section (6) of section 195, fails to furnish such information; or furnishes inaccurate information, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of one lakh rupees.*" (Prior to the amendment by the Finance Act, 2015 section 195(1) of the Act required an Indian payer making payment to non-resident or foreign company to furnish the prescribed details in Form Nos. 15CA and 15CB <u>only in respect of sum chargeable to tax</u> under the provisions of the Act. Finance Act, 2015 has amended the provision of section 195(6) of the Act w.e.f. June 1, 2015). Rule 37BB of the Income Tax Rules, 1962 ("the Rules") provides that any person responsible for paying to non-resident, not being a company, or to a foreign company, any sum chargeable to tax under the provisions of the Act shall furnish information in Form Nos. 15CA and 15CB. Further, <u>Form Nos. 15CA and 15CB also indicate the information required to be furnished only in respect to payments which are chargeable to tax.</u>	It is proposed that: Payments made by mutual funds which are not chargeable to tax under the provisions of Income Tax Act be included in the Specified List under Rule 37BB (3)(ii); and Mutual Funds/AMCs be permitted to submit the requisite information under section 195(6) of the Income Tax Act, 1961 in respect of payments made to NR investors which is chargeable under the provisions of the Income Tax Act on an annual basis along with the Annual Information Report.	Submission of the prescribed Form Nos. 15CA and 15CB on a daily basis is operationally impractical. There is no foreign remittance involved in respect of dividend/ redemption payments, as the same is credited to their NRE or NRO bank accounts in India and not remitted overseas. Thus, the banks would be eventually filing the Form 15 CA/ 15 CB, in case the amounts credited to NRE bank accounts is repatriated overseas. Further, Dividend from Mutual fund units is completely tax free in the hands of the investors. The Annual Information Report (AIR) of Mutual Funds/AMCs submitted to the Income Tax Department contains the details of all mutual fund transactions of Rs.2 lakh and above, in respect of all customers, including NRI clients.

Implications for the Mutual Fund Industry : a. *The amended provisions are applicable to all payments made to NRIs, **whether taxable or not**;* b. *Mode of reporting is filing of Forms 15CA and Form 15CB certified by a CA ;* c. *Frequency of reporting is prior to or immediately upon payment or accrual in the books of the mutual fund; and* d. *Failure to furnish such information or furnishing inaccurate information attracts penalty one lakh rupees.* Redemption and dividend payments to NRI investors in respect of Mutual Fund units are credited to their NRE or NRO bank accounts in India and not remitted overseas. **In other words, there is no foreign remittance involved in respect of redemption or dividend payment made to NRI investors by Mutual Funds/AMCs.** Unlike the interest on bank deposits, which is typically booked once a calendar quarter, mutual fund transactions take place every working day. Further, investors are also given an option to reinvest the dividend amount in the scheme and the dividend amount in such cases is reinvested at source in the same scheme, and not remitted to the NRI investors' bank accounts. Since *reporting* Form 15CA and Form 15CB (certified by a CA) has to be done *prior to or immediately upon payment or accrual in the books of the mutual fund, the Mutual Funds are required to* submit the Form 15CA and Form 15CB (certified by a CA) <u>practically on every working day, which</u> is operationally difficult / impractical, and that too on such a massive scale**.**		

14. Securitisation Trust		
Background	**Proposal**	**Justification**
• The Finance Act 2013 rolled out a special taxation regime to facilitate the securitization process, in respect of income of securitization entities set up as a "Trust" from the activity of securitization of assets. The income of these *Special Purpose Vehicles* (SPV) set up as trusts are exempted from taxation whose activities are regulated either by SEBI or RBI. • There have been several challenges as regards SPVs set up as "Trusts". The Income Tax officers in certain cases have contended that a trust set up as a securitization Special Purpose Vehicle (SPV) was not a valid trust and constituted as Association of Persons (AOP) and cannot avail of 'Pass Through' status for taxation. • This is notwithstanding the fact that such trusts have been set up in compliance with the Guidelines of Securitization of Standard Assets issues by Reserve Bank of India.	It is proposed that the words 'Securitisation Trust' in Section 115TA of the Income-tax Act be replaced by **'Securitisation Special Purpose Vehicle'**, which is regarded as a securitization special purpose vehicle either under the guidelines on securitization brought out by the Reserve Bank of India or the Securities and Exchange Board of India. **It is also proposed that in the Explanation in Chapter XII-EA the words "which fulfills such conditions, as may be prescribed" may be deleted.**	The RBI guideline clause 5(ix) defines a SPV to mean a company, trust or other entity constituted for a specific purpose. This clearly highlights and accepts other forms of SPV other than trusts.
• In the current ongoing litigation, the Income Tax Department has challenged the structure of "Trust" and has contended this as an Association of Person (AOP) by citing procedural issues in the formation of the Trust. If this view is ultimately upheld, section 115 TCA of the Act is feared to not become applicable (*which provides for the income accruing or arising to an investor of a securitisation trust out of investments made in the securitisation trust shall be taxable in the same manner as if it would be the income of the person had the investments made by the securitisation trust, been made directly*. This is because, if the view expressed by the CIT(A), that the income from the originator is not income of the 'securitisation trust', but that of the ' AOP' of the PTC holders' then. Consequently, the taxation of the whole of the income (including income receivable by mutual funds) would be taxed at 'full rates'. This would obviously not be in the interest of the mutual funds. • As per the Explanation in Chapter XII-EA, CBDT was to prescribe the eligibility conditions for a trust to qualify as a Securitisation Trust. The requirement was originally introduced in the year 2013-14. However, CBDT is yet to prescribe the conditions. This leaves ambiguity about the tax treatment in respect of securitization trust already formed under RBI guidelines, and uncertainty in the event CBDT prescribes some conditions with retrospective effect.	For clarity and removal of doubt and avoidance of litigation, conditions to be fulfilled by a securitization trust may please be prescribed.	Section 115TCA introduced by the Finance Act, 2016 specify the provisions on the taxation treatment of investors in a Securitization Trust to increase penetration in the securitization market. This cannot be achieved as the current tax provisions lack clarity on the eligibility of a securitisation trust. As there has been avoidable litigation regarding the securitisation trust formed earlier, the conditions under section 115TC may be prescribed with prospective applicability.

15. Safe Harbour for investment management activities of Offshore funds in India		
Section 9A of the Income-tax Act, 1961 prescribes 13 conditions that need to be fulfilled by the offshore fund, and 4 conditions that need to be fulfilled by the India-based Fund Manager, for the offshore fund to qualify for exemption from a business connection risk and the risk of having a Permanent Establishment (PE) under the Act. The conditions are rather stringent and difficult to fulfil or open to interpretation. Mentioned below are some of the clauses that need to be reviewed and relaxed:		
Issue	**Proposal**	**Justification for proposal**
i. One of the conditions stipulated in clause 4b of Sec.9A is that the Indian AMC should be registered as a fund manager or an investment advisor in accordance with the specified regulations. "Specified Regulations" has been defined to include SEBI (Portfolio Managers) Regulations, 1993 or the SEBI (Investment Regulations, 2013, or such other regulations made under the SEBI Act, 1992 which may be notified by the Central Government under this clause. However, the above definition does not include SEBI (Mutual Funds) Regulations, 1996. Consequently, Indian AMCs who are only managing SEBI registered Mutual Funds under the SEBI (Mutual Funds) Regulations, 1996 will face challenges while seeking approval from the Central Board of Direct Taxes (CBDT) regarding its eligibility for the purposes of Section 9A.	It is recommended that the definition of "Specified Regulations" should be revised to include Securities and Exchange Board of India (Mutual Funds) Regulations, 1996. Till the time the above amendment is effected in Section 9A, the CBDT may issue a notification to include SEBI (Mutual Funds) Regulations, 1992 under "Specified Regulations".	"Specified Regulations" has been defined to include SEBI (Portfolio Managers) Regulations, 1993 or the SEBI (Investment Advisers) Regulations, 2013, or such other regulations made under the SEBI Act, 1992. As SEBI (Mutual Funds) Regulations, 1996 were framed under the SEBI Act, 1992, the same meets the criteria "such other regulations made under the SEBI Act, 1992." All Indian AMCs managing mutual funds registered with SEBI are permitted to manage offshore funds under Regulation 24B of SEBI (Mutual Funds) Regulations, 1996. Since SEBI (Mutual Funds) Regulations, 1996 has not been specifically included in the list of "Specified Regulations", Indian AMCs which are only managing Mutual Funds under the SEBI (Mutual Funds) Regulations, 1996, and have not registered under SEBI (Portfolio Managers) Regulations, 1993 etc. could face unintended challenges / avoidable delay in obtaining approval from the CBDT regarding its eligibility for the purposes of Section 9A.
ii. "Corpus" is defined as the total amount raised for the purpose of investment by the eligible investment fund as on a particular date	"Corpus" may be defined as the Net Asset Value of the eligible investment fund as on a particular date	The current definition will not take into account the mark-to-market gains or losses of the eligible investment fund.. Investment restrictions as per 9A(3)(h) and restrictions placed under 9A(3)(c) and 9A(3)(j) should include the MTM gains/losses and therefore cannot be based on the original amount raised. It may also be noted that Open ended funds will have ongoing subscriptions and redemption.

iii.	The aggregate participation or investment in the fund, directly or indirectly, by persons resident in India does not exceed 5% of the corpus of the fund {9A(3)(c)}	Seed capital invested directly or indirectly by the eligible Indian fund manager should be exempt from this clause	The eligible Indian fund manager or the wholly owned offshore subsidiary of the eligible Indian fund manager may be required to put seed capital while setting up the fund in order to show "skin in the game" or create a performance track record.
iv.	The fund shall not invest more than 20% of its corpus in any entity {9A(3)(h)}	Passive breaches should be exempt and provided 90 days within which the same shall be rebalanced or rectified, similar to relaxation offered under Rule 10V(3)(a)(i)	The threshold of 20% could get breached without any action by the fund manage, viz., redemptions or MTM losses.
v.	The monthly average of the corpus of the fund shall not be less than Rs 100 crores {9A(3)(j)}	Passive breaches should be exempt and provided 90 days within which the same shall be rebalanced or rectified, similar to relaxation offered under Rule 10V(3)(a)(i)	The threshold of 20% could get breached without any action by the fund manager viz. redemptions or MTM losses
vi.	No business connection of the offshore fund in India and no person acting on its' behalf {9A(3)(l)}	Suitable clarification/ amendment may be issued that: - outsourcing a part of the back office / support functions of the fund manager (such as fund administration, fund accounting etc.), to an outsourcing entity in India (which is a group entity of the fund manager), or - appointment of banker, custodian or broker in India by the fund or fund manager would not result in non-fulfilment of this condition.	'Business connection' is a broad term and its meaning has to be derived from various provisions of the Act and judicial pronouncements. In the absence of clear guidelines as to when an eligible fund would be considered as constituting a business connection in India, any activity of an eligible fund may become subject matter of scrutiny on whether it constitutes a business connection in India or not. Also, any person having relation with an eligible fund such as sub-advisor, co-fund managers may be deemed to be acting on behalf of the fund constituting business connection in India, in the absence of clear guidelines. Therefore, it is important to clarify situations with detailed examples on when an eligible fund or any person acting on behalf of an eligible fund would be considered as constituting a business connection in India.
vii.	Remuneration paid to fund manager is a) not less than the arm's length price {9A(3)(m)}; and b) restricted to maximum of 20% of profits of the fund {9A(4)(d)}	The condition of maximum 20% of profits should be restricted to performance based fees or profit sharing arrangements and not to fixed management fees. This may be clarified in clause 12 of Rule 10V.	This is already being tested in Transfer Pricing assessments. In the event of a loss suffered by the fund, the eligible fund manager will not be able to charge even the fixed management fee which was determined before the investment management activity was commenced.

16. Parity in tax treatment of all three categories of Foreign Portfolio Investors		
Issue	Proposal	Justification for the Proposal
• Section 9 of the Act deals with cases of income which are deemed to accrue or arise in India. Sub-section (1) of the said section creates a legal fiction that certain incomes shall be deemed to accrue or arise in India. Clause (i) of said sub-section (1) provides a set of circumstances in which income accruing or arising, directly or indirectly, is taxable in India. The said clause provides that all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India shall be deemed to accrue or arise in India. • Finance Act, 2012 inserted certain clarificatory amendment in provisions of section 9 and included explanation 5 in section 9(1)(i) w.e.f. 1st April 1962 clarifying that an asset or capital asset, being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India. • Further, in order to address various concerns raised by stakeholders, clarificatory amendment to Explanation 5 made by Finance Act 2017, states that Explanation 5 shall not apply to any asset or capital asset mentioned therein being investment held by non-resident, directly or indirectly, in a Foreign Institutional Investor, as referred to in clause (a) of the Explanation to section 115AD, and registered as Category-I or Category II Foreign Portfolio Investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 made under the Securities and Exchange Board of India Act, 1992, as these entities are regulated and broad based. The said clarificatory amendment is applicable w.e.f. AY 2012-13.	It is proposed to bring Category III FPIs under the clarificatory amendment to Explanation 5 by which indirect transfer provisions are relaxed for Category I and II fund vide clarification to Explanation 5 to section 9(1)(i) of the Income Tax Act vide amendment in Finance bill 2017	This proposal would eliminate risk of possible double taxation on account of indirect transfer in certain jurisdictions. It will result in uniformity by alignment of tax treatment of all the three categories of FPIs. It will also result in reduction of compliance burden on taxpayer which requires him to ensure withholding tax provisions on indirect transfer of Category III foreign portfolio investment. This will be helpful for the taxpayer in the light of compliance requirements under various statues and reforms

<table>
<tr><th colspan="3">17. Alternate Investment Funds – The tax at marginal rates should be harmonized to avoid differential treatment when investing through AIF</th></tr>
<tr><th>Background</th><th>Proposal</th><th>Justification</th></tr>
<tr><td>SEBI has introduced SEBI (Alternative Investment Funds) Regulations, 2012 as per which –

▪ Category I AIF Includes venture capital funds, SME Funds, social venture funds, infrastructure funds etc.
▪ Category II AIF - Which does not fall in Category I and III and which does not undertake leverage or borrowings generally.
▪ Category III fund - Any fund which employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives.

Under extant tax laws, while Category I & II AIF enjoy pass through status for tax purposes, the income of Category III AIF is taxable at Scheme level, which is inequitable.

Further, CBDT has issued a circular no. 13/2014 on July 28, 2014 clarifying that taxation of “AIF” would have status of non-charitable trusts under the Income Tax Act 1961 and clarifies that in the situation where the Trust deed either does not have name of the investors or does not specify their beneficial interest, then provision of sub section (1) of section would come into play and the entire income of the fund shall become liable to taxed at the Maximum Marginal Rate (MMR) of income tax in the hands of the trustees of such AIFs in capacity as “Representative Assessee” further also clarified that in such case, provision of section 166 of the Act need not be invoked in the hands of investor, as corresponding income has already been taxed in the hands of the “Representative Assessee”.</td><td>Category III AIF should also be given pass- through status for income tax purpose, as in respect of Category I & II AIF.</td><td>• To harmonise the tax treatment of investments made directly and through the AIF mechanism.

• Essentially the tax treatment for investments should be the same irrespective of whether an investor invests directly or through an AIF.

• This will result in uniformity and alignment of tax treatment in respect of all three categories of AIFs

• Fund will have to compute and pay advance tax. Refund situations will create challenges in terms of accounting and distributing the same amongst investors, who may have exited the funds.

• AIF would be subject to tax assessment, which generally happens with a lag of 4 to 5 years. The assessment could result in additional tax demand, penalties, etc. depending on the interpretation and assessment of the assessing officer at that point in time. This will result in challenges of apportioning the additional tax demand and recovery of the same from investors, who may have already exited the fund. In case AIF suffers losses, it is highly unlikely that the investor will be able to claim set off of losses against other gains taxed in his hands.

• The current taxation regime renders the domestic AIF Category III (AIF-III) industry at a disadvantage to foreign AIFs or India focused hedge funds operating outside India and domiciled in tax favorable jurisdictions. Hence, this may lead to headwinds in the growth of the domestic AIF-III industry.</td></tr>
</table>