Association of Mutual Funds in India

BUDGET PROPOSALS FOR FY 2020-21

1. Request to introduce Debt Linked Savings Scheme (DLSS) to deepen the Indian Bond Market.		
Background	**Proposal**	**Justification**
Over the past decade, India has emerged as one of the key financial market 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. 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 livelier 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.	It is proposed to introduce **"Debt Linked Savings Scheme" (DLSS)** on the lines of Equity Linked Savings Scheme (ELSS) which would help channelize long-term savings of retail investors into corporate bond market and help in deepening the Indian Bond Market. At least 80% 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, as may be permitted by SEBI. It is further proposed that the investments upto INR1,50,000 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.	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 may not be equipped to fund such investments. If large borrowers are persuaded to raise funds from the market, it will increase bond 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. Therefore, 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. ***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.***

2. Mutual Fund Units should be notified as ‘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, Sec. 54EA and 54EB were withdrawn in the Union Budget 2000-01 and a new Section 54EC was introduced, whereby tax exemption on long-term capital gains is allowed 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, wherein the underlying investments are made into **‘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. 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. Alternatively, a new sub-section 54EF be introduced, wherein long-term capital gains from mutual funds can be reinvested in other mutual funds (on the same lines and rationale as 54EC for sale transactions in immovable property) and long-term capital gains can be saved by the investor.	With the ever-growing demand for housing and easy access to home loans and tax incentives on home loan repayments, consumers are attracted to real estate sector, as housing being a basic need, a residential property ranks high as a ‘desirable’ asset as compared to other assets among individual taxpayers. Most individuals liquidate their financial assets to purchase a residential property, with or without the aid of home loans. However, money once invested in immovable property using the sale proceeds from mutual funds or stocks rarely comes back into capital markets, as people prefer to reinvest the capital gains arising from sale of an immovable property to buy another property or in NHAI/REC bonds to avail of capital gains tax exemption u/Sec. 54 or 54F. Recognizing the need to channelize long term household savings into Capital Market, the Government has been taking various measures to encourage individual taxpayers to invest in capital markets via mutual funds, through tax incentives. However, consequent on withdrawal of Section 54EA and 54EB, the inflow of investments, which could have otherwise flowed into capital market, has altogether stopped. In order to channelize at least some of the gains from sale of immovable property into capital markets, it is recommended to broaden the list of the specified long-term assets under Sec. 54 EC by including mutual fund units with a lock in period of three years.

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3. Uniform tax treatment in respect of investments in Mutual Funds Units and ULIPs of Life Insurance companies		
Background	**Proposal**	**Justification**
3 (a) Request for uniform tax treatment on Switching of Investments under Mutual Fund schemes and ULIPs of Insurance companies		
At present, "switching" of investment in Units **within the same scheme of a Mutual Fund** from Growth Option to Dividend Option or vice-versa, constitutes a "Transfer" under the current Income Tax regime and is liable to capital gains tax, even though the amount invested remains in the mutual fund scheme, **i.e., EVEN THOUGH THERE ARE NO REALISED GAINS**, since 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. Thus, there is a lack of uniformity in tax treatment on Switching of investment in Mutual Funds schemes and ULIPs of Insurance companies while both MF units and ULIPs invest in securities.	It is proposed that in case of **Intra-Scheme Switches** (i.e., switching of investment within the same scheme of a Mutual Fund) *is not regarded as a "Transfer" under Section 47 of the IT Act, 1961* and should be exempt from payment of capital gains tax.	1. In respect of switching of Units **within the same scheme of a Mutual Fund** from Growth Option to Dividend Option (or vice-versa) i.e., **THERE ARE NO REALISED GAINS**, since the investment remains within the mutual fund scheme, as the underlying securities/ portfolio remaining unchanged, being common for both Options. 2. 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
3 (b) Request for Uniform tax treatment on Capital Gains from Mutual Funds investments and ULIPs of Insurance companies		
Background	**Proposal**	**Justification**
As announced in last year's Union Budget, and passage of Finance Act, 2018, Long-Term Capital Gains (LTCG) arising out of the sale of listed equity shares and Units of equity-oriented mutual fund schemes are now taxed at the rate of 10%, if the LTCG exceed ₹1 lakh in a year, while all gains up to January 31, 2018 would be grandfathered. **The above provision has placed mutual funds at a great dis-advantage vis-à-vis ULIPs of Insurance companies,** as the proceeds from Unit Linked Insurance Plans (ULIPs) of Insurance companies (including partial withdrawals), continue to be exempted from income tax *under section 10(10d) of Income Tax Act,* even though they too are investment products that invest in equity stocks, just like mutual funds (with added advantage of tax deduction under Section 80C of the Income Tax Act on the premium paid). **Thus, there is a clear case of tax arbitrage, wherein ULIPs are now placed at an advantageous position vis-à-vis Mutual Fund Schemes.**	It is requested to reconsider the matter and exclude the mutual units of equity-oriented mutual fund schemes from the ambit of LTCG tax and maintain status-quo ante, insofar as LTCG from equity mutual fund schemes are concerned, keeping the interest of the retail investors and to ensure level playing field between equity mutual fund schemes and ULIPs.	In the interest of the retail investors, it is imperative to ensure level playing field between mutual fund schemes and ULIPs. Although ULIPs are treated as insurance plans for tax purposes, like mutual funds, ULIPs are also investment products that invest in securities, with an insurance wrapper. With high commissions and incentive structure prevailing in the life insurance sector, retail investors could be lured away by the insurance agents from equity mutual fund schemes and made to invest in ULIPs, as retail investors may not understand the distinction between a pure investment product like mutual funds and an insurance product with equity exposure. As a fall-out, this could also lead to mis-selling of ULIPs as investment products – a point that Sumit Bose Committee report had highlighted. It is also pertinent to highlight here that if a large number of investors shift from equity MF schemes to ULIPs, there will not be any additional tax revenue, since ULIP maturity proceeds are currently tax exempt, contrary to the assumed / potential additional revenue from the proposed LTCG tax on equity-oriented mutual fund schemes.

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3 (c) Request for removal of Tax Arbitrage between ULIPs & Equity MF Schemes on account of STT		
Background	**Proposal**	**Justification**
In 2004, the government had introduced the Securities Transaction Tax (STT), when LTCG Tax on sale of equity shares and equity-oriented mutual fund schemes was abolished. However, although LTCG on sale of listed equity shares and Units of equity-oriented mutual fund schemes has been re-introduced Finance Act, 2018, the STT has not been abolished. In respect of Equity Oriented Funds (EOF), the Mutual Funds are required to pay STT on every purchase or sale of securities. In addition, the unitholders are also required to pay the STT on the redemption value at the time of redemption of units. Thus, there is a double levy of STT for an investor investing in the equities through equity mutual fund scheme. And in respect of Exchange Traded Fund (ETF), the investor of the ETF has to pay STT on the purchase as well as sale of units in the ETF. **However, there is no STT levied on the withdrawal proceeds from ULIPs. Thus, on this count also mutual funds are placed at disadvantage vis-à-vis the ULIPs.**	It is proposed to abolish the STT levied at the time of redemption of Mutual Fund Units by the investor.	a) In SEBI's "Long Term Policy for Mutual Funds" published in Feb.2014, it has been emphasized that there was a need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators similar products should get similar tax treatment. b) ULIPs, which are investment products with an insurance wrapper. c) There is a need to ensure level playing field between mutual funds and insurance sector.
3 (d) Tax Arbitrage between ULIPs & Equity MF Schemes on account of DDT		
Background	**Proposal**	**Justification**
The Budget 2018 has also introduced a dividend distribution tax (DDT) of 10% for equity-oriented funds of mutual funds. In addition to DDT there is applicable Surcharge & Cess. While LTCG tax will be applicable for only those investors whose cumulative capital gains in a financial year exceed INR 1 lakh, DDT will be borne by equity-oriented mutual funds in respect of dividend distributed to **all investors**. While the Finance Minister said in his Budget speech that this will provide level playing field across growth-oriented funds and dividend distributing funds, *the move will result in mutual fund unitholders being subject to double taxation because of the cascading effect of DDT* – first when the mutual fund schemes receive the dividends from the companies, net of DDT, and again when the mutual funds pay dividend, net of DDT.	It is requested to abolish the DDT on dividend paid under equity-oriented mutual fund schemes maintaining status-quo ante, keeping the interest of the retail investors, and to have a level playing field and uniformity in taxation of investment in MF schemes and ULIPs of Insurance companies.	a. Keeping the interest of the retail investors in mind; and b. To have a level playing field and uniformity in taxation of investment in MF schemes and ULIPs of Insurance companies.

In this context, it is pertinent to mention here that the Bonus paid in ULIPs by insurance companies, *which is akin to payment of dividend in mutual funds*, is not subject to DDT or any levy (nor subject to any capital gains tax). It may be reiterated here that ULIPs are primarily investment products of insurance companies with the wrapper of insurance cover. Thus, there is a clear case of tax arbitrage, wherein ULIPs are now placed at an advantageous position vis-à-vis Mutual Fund Schemes. Retail mutual fund investors who need or seek regular income, especially retired individuals, typically opt for Dividend Option. Following the above Budget proposal to levy DDT on dividend paid by equity MFs schemes, many retail investors are now seeking to shift their investments from Dividend Option to Growth Option. However, unlike in respect of ULIPs, intra-scheme switching of investments in mutual funds (i.e., switching from Dividend Option to Growth Option) within a same mutual fund scheme is regarded as "Transfer" under the current Income Tax regime. And hence, the same is liable to capital gains tax, even though the original investment as also the underlying securities remains within the same scheme/portfolio. **Thus, on this count also there is a tax arbitrage putting mutual fund investors at disadvantage.**		
While on the subject of DDT, it is also pertinent to mention here that since companies need to deduct DDT when they pay dividends to shareholders, mutual funds receive dividends on their equity holdings, receive a lesser amount, net of DDT. When the same mutual funds declare dividends in MF scheme, they are once again require to levy DDT 10% (as per Finance Act, 2018). Further, there is additional tax on dividends over INR10 lacs, in respect of individual investors. **Thus, the same dividend is being taxed at 3 levels, and needs to be eliminated.**	It is recommended to abolish the Dividend Distribution Tax, when mutual funds declare dividends in their respective funds to the extent of dividends received by them from the companies to eliminate double taxation.	To eliminate double taxation, in the interest of individual taxpayers.

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4. Uniform Tax Treatment for Retirement / Pension Schemes of Mutual Funds and NPS		
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. Recognizing the potential unsustainable fiscal burden in future, in January 2004, the Govt. of India introduced the New Pension System (NPS), replacing the Defined-Benefit system with Defined-Contribution system. 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	i. As in the case of NPS, investment in Retirement Benefit / Pension Schemes offered by Mutual Funds upto ₹150,000 should also be allowed tax deduction under Sec. Sec 80CCD (1) of Income Tax Act, 1961 (instead of Sec. 80C), within the overall ceiling of ₹1.5 lakhs under Sec 80 CCE, with E-E-E status. ii. Likewise, the additional deduction for investment up to ₹ 50,000 under section 80CCD (1B) (presently available to NPS subscribers should be extended to investment in Mutual Fund Retirement Benefit / Pension Schemes, over and above the deduction of ₹ 1.5 lakh under section 80C of Income Tax Act,1961. iii. 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. iv. Further, the contributions made by an employer should be allowed as an eligible 'Business Expense' under Section 36(1) (iva) of Income Tax Act,1961. v. Likewise, contributions made by the employer to Mutual Funds' Retirement Benefit / Pension Schemes up to 10% of salary	• 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) • 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*

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. 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.	should be deductible in the hands of employee, as in respect of Section 80CCD(2) of the Income Tax Act, 1961. vi. Withdrawals made by the investor/ employee from Retirement Benefit / Pension Schemes offered by Mutual Funds should be exempt from income tax upto the limits specified for tax- exempt withdrawals from NPS as in section 10(12A) and 10(12B) of the Income Tax Act, 1961. vii. The switches of MFLRP investments between mutual funds should not be treated as transfer and may be exempted from capital gain tax. viii. It is further recommended that CBDT, in consultation with SEBI, should NOTIFY the guidelines giving the framework for Mutual Funds to launch MFLRP, which will be eligible for tax benefit 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 as being eligible for tax benefit u/Sec.80CCD, avoiding a long bureaucratic process that exists at present.	*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* in the U.S. • For the growth of capital market, it is imperative to channelize long-term savings into the securities market. A long-term product like MFLRP can play a catalytical role in channelizing household savings into securities market and bring greater depth. Such depth brought by the domestic institutions would help in balancing the volatility in the markets and would reduce reliance on the FIIs. • 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.

5. Request to abolish Capital Gains tax on Switching of Units in the Same scheme of Mutual Funds

Background	Proposal	Justification
• As per extant SEBI Mutual Funds Regulations, mutual funds offer 'Direct Plan' (wherein investors may invest directly, i.e., without routing the investment through any distributor/agent) and a Regular Plan, wherein one may invest in mutual fund schemes through a mutual fund distributor/agent. Direct Plan has lower expense ratio than Regular Plan, as there is no distributor/agent involved, and hence there is saving in terms of distribution cost/commissions, which is added back to the returns of the scheme. Direct Plan and Regular Plan are part of the same mutual fund scheme, and have the same / common portfolio, but have different expense ratios (recurring expenses that is incurred by the mutual fund scheme). • Mutual Funds also provide "GROWTH" option and "DIVIDEND" option. Under Growth Option, no dividends are declared/paid, and the income generated / earned remains invested in the scheme / option and will be reflected in the appreciation in the NAV of growth option. Under Dividend Option, the income generated / earned in the scheme / option is paid. Further, the unitholders may switch their Units from Growth Option to Dividend Option (and vice-versa) as per their needs / financial planning. • As per current Income Tax provisions, switching of Units from Growth Option to Dividend Option (or vice-versa) or from a Regular Plan to a Direct Plan (or vice-versa) <u>within a mutual fund scheme</u> *is subjected to capital gains tax, even though there is no monetary transaction involved, either on the part of the investor or on the part of the mutual fund w.r.t. the underlying securities of the scheme.* In a switch transaction whether from Growth Option to Dividend Option (or vice-versa) or from a Regular Plan to a Direct Plan (or vice-versa) within the scheme, the amount of investment remains within the same scheme, i.e., there is no change in the underlying securities and scheme's portfolio being common for both Growth & Dividend Options, remains unchanged.	It is submitted that switch transactions within the same mutual fund scheme should not be regarded as transfer and hence, should not be charged to capital gains tax. It is therefore requested that suitable amendments be made in extant Income Tax rules by inserting a new sub-section under Section 47 of the Income Tax Act, 1961 *{on the lines of sub-sections 47(xviii) and 47(xix)}* so that Switching of Units from (a) Regular Plan to Direct Plan or vice-versa; and (b) Growth Option to Dividend Option or vice-versa, within the SAME scheme of a mutual fund shall not be regarded as transfer and hence, shall not be charged to capital gains.	In a switch transaction from Regular Plan to Growth Plan (or vice-versa) or from Growth Option to Dividend Option (or vice-versa), within a scheme of a mutual fund, there is no inflow or outflow of money involved and the amount of investment made by the unitholder remains within the same scheme as there is no change in the underlying securities, i.e., scheme's portfolio remains unchanged, being common for both the Plans and Options. As per extant provisions of Income Tax Act, 1961, the following transactions are not be regarded as transfer and hence, shall not be charged to capital gains: *(i) Transfer of units of a mutual fund pursuant to consolidation of two or more schemes of equity oriented mutual fund or of two or more schemes of a mutual fund other than equity oriented mutual fund {section 47 (xviii)}.* *(ii) Transfer of units of a mutual fund from one plan to another pursuant to consolidation of plans within scheme of mutual funds {section 47 (xix)}* **Extending the same principle and rationale, it follows that a switch transaction from one Plan/Option to another Plan/Option within the same scheme of a Mutual Fund should also not be regarded as transfer and hence, not subjected to Capital Gains Tax.** It may be added here that switch transactions to/from various investment plans of the same Unit Linked Insurance Plan (ULIP) of life insurance companies are not regarded as transfer and hence, not subjected to Capital Gains Tax.

6. Request for Uniformity in Taxation on Listed Debt Securities and Debt Mutual Funds		
Background	**Proposal**	**Justification**
In his 2014 Budget Speech, the Hon'ble 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 Finance Act, 2014 increased the holding period for non-equity oriented Mutual Funds (MFs) from 'more than 12 months' to 'more than 36 months' for being regarded as long term capital gains. However, a direct investment in a listed debenture, if held for more than 12 months, is still 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).	It is only logical and fair to bring parity in direct investment in listed debt instruments and investment in listed debt instruments through debt-oriented mutual fund schemes.

7. Request for lowering of DDT on Debt Mutual Fund Schemes		
Background	**Proposal**	**Justification**
The DDT in debt mutual funds was introduced to reduce the arbitrage between bank fixed deposit and debt funds. mutual fund schemes that invest less than 65% of the corpus in equity are categorised as non-equity funds and they are taxed as applicable on debt mutual funds. India's combined effective tax rate was among the highest globally. After the tax cut, the effective tax rate for all domestic companies has been reduced to 25.17%.	It is proposed that the DDT on Debt Schemes should be lowered and at least brought at par with the Corporate Tax rate of 22% (as against the current rate of 25% for individual and 30% for Corporates, plus applicable Surcharge + Cess)	Since dividends are distributed out of the gains made by a mutual fund, a higher DDT reduces the post-tax dividend available to investors. Lesser DDT will attract fresh flows into Debt mutual fund schemes especially from retirees and can help inflow stable money into bond market through mutual fund route. It is only fair and just to bring parity in the DDT rate in line with the Corporate Tax rate of 22%

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<tr><th colspan="3">8. Request to eliminate Double Taxation of STT on Equity Oriented Funds and Exchange Traded Funds</th></tr>
<tr><th>Background</th><th>Proposal</th><th>Justification</th></tr>
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As per current Tax laws, in respect of Equity Oriented Funds, the Mutual Funds are required to pay Securities Transaction Tax (STT) on every purchase and sale of securities. In addition, the investors are also levied STT on the redemption value at the time of redemption of units. Thus, there is a double levy of STT for an investor investing in the equities through equity mutual fund scheme.
Where the Equity Oriented Fund is an Exchange Traded Fund (ETF), listed on a stock exchange, the investor of the ETF has to pay STT on the purchase and sale of units in the ETF. In respect of ETFs, there is multiple levy of STT in respect of the following scenarios:
<ol type="a">
When the Units are purchased from or sold to an Authorised Participant;
When the underlying securities are transferred by or to an Authorised Participant;
When the Units surrendered by an Authorised Participant to the Mutual Fund for redemption.

The double levy of STT on Equity Oriented Funds / ETFs adversely impacts the returns in the hands of the investors and needs to be eliminated.

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It is proposed to abolish the incidence of STT at the time of –
(i) redemption of Units by the investor in an Equity Oriented mutual fund scheme; and
(ii) sale of units in an Equity Oriented ETF on a stock exchange.
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In 2004, the Government had introduced the STT when LTCG Tax on sale of equity shares and equity-oriented mutual fund schemes was abolished. However, although LTCG on sale of listed equity shares and Units of equity-oriented mutual fund schemes was re-introduced in the Finance Act, 2018, the STT has not been abolished.
There is clear case of double levy of STT for an investor investing in the equities through equity mutual fund scheme, which needs to be eliminated. This would encourage retail participation in equity schemes and ETFs.

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9. Definition of Equity Oriented Funds (EOF) to be revised to include Equity Oriented "Fund of Funds"		
Background	**Proposal**	**Justification**
• A Fund of Funds (FOF) scheme of a Mutual Fund primarily invests in the units of other Mutual Fund schemes. • An FOF investing in Equity Oriented Funds (EOF) takes exposure to listed equity securities through the EOF in which it invests. • At present, a FOF that invests predominantly in units of an Equity Oriented Funds (EOF) is NOT regarded as an EOF, because under current Income Tax regime, definition of an EOF only specifies investment in **listed equity securities of domestic companies only**. • Consequently, in respect 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 unitholders.	• 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, say 65% or more, in units of Equity Oriented Mutual Fund Schemes. • Consequently - a) the income distributed by such funds may 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.	• 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.

10. Request to reduce holding period of Long-Term Capital Gold ETF		
Background/ Issue	**Proposal**	**Justification/ Rationale**
Currently, a Gold Exchange Traded Fund (ETF) and Gold Linked MF Scheme are classified / treated as "*Other than Equity Oriented Funds*" Consequently, the Units under Gold ETF and and Gold Linked MF Scheme need to be held 3 years for Long Term Capital Gains (LTCG) purposes (& taxed at 20% with indexation), while the Short Term Capital Gains is taxed at the marginal rate of taxation applicable to the assessee.	In order to make Gold and Commodity ETFs more attractive, it is proposed to lower the holding period for LTCG purposes from 3 years to 1 year, as in the case of listed debt securities.	Lowering the holding period for LTCG purposes to 1 year will provide an incentive to retail investors to invest in Gold and Commodity ETFs and help expand retail investments The launch of Sovereign Gold Bonds (SGB) have made Gold ETFs less attractive resulting in lack of interest in Gold ETFs over the last 2-3 years. From liquidity perspective, Gold ETFs are superior as compared to SGB, as Gold ETFs provide continuous liquidity to investors. Gold ETFs & Commodity ETFs are globally popular with over $100 billion in AUMs. In India, Gold ETFs are now a decade old functioning seamlessly on the stock exchanges. ETFs are globally accepted as a preferred route for commodity investments. A favorable tax regime would go a long way in making ETFs popular among retail investors.

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11. Threshold Limit in Equity Oriented Mutual Fund schemes to be restored 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.** The threshold limit 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 government 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 individuals 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.**

12. TDS on Redemption amount payable to NRIs		
Background	**Proposal**	**Justification**
At present, Short Term Capital Gains (STCG) from redemption of Units by Non-Resident Indians (NRIs) is subject to TDS @ 30% in respect of Debt Schemes and TDS @15% in respect of Equity Schemes.	It is proposed that the rate of TDS for NRIs on STCG from Debt Schemes be reduced from 30% to 15% at par with TDS rate for Equity Schemes.	With yields coming down, such a high rate of TDS could act as a deterrent for NRI investors to invest in Debt MFs schemes, considering that Interest earned on NRE and FCNR Accounts (savings or fixed deposit) are exempt from tax for NRIs. Aligning (lowering) the TDS rate for debt mutual fund schemes with that of equity schemes will encourage NRIs to invest in debt schemes as an asset class, which in turn will help in deepening the bond market segment.

13. Request for Uniformity in 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 had 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.

14. 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.

15. Request for clarifications in case of creation of segregated portfolio in mutual fund schemes

Background	Proposal	Justification
In order to ensure fair treatment to all mutual fund investors in case of an adverse credit event (such as downgrade in credit rating to 'below investment grade'), and to deal with liquidity risk, SEBI has, vide circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018 permitted creation of segregated portfolio of debt and money market instruments by Mutual Fund schemes, whereby all existing unitholders in the affected scheme as on the day of the credit event shall be allotted equal number of units in the segregated portfolio as held in the main portfolio. *{Note: Creation of a segregated portfolio (also known as "side-pocketing") is a mechanism wherein the mutual fund isolates / segregates the stressed, illiquid asset from the rest of the holdings in the scheme's portfolio and the unitholders in the scheme are allotted units of the side-pocket, in the same ratio as the investment in the parent scheme. Units of the side-pocket are not redeemable, while the units in the main/original scheme portfolio are redeemable as usual. Thus, instead of redemption being suspended in the entire scheme, only the side pocketed portion is frozen until the market conditions improve, and the stressed asset could be sold at price that better reflects its intrinsic value. This prevents the stressed assets from adversely impacting the returns generated by the rest of the holdings in the scheme's portfolio. The segregated portfolio shall have different NAV}.* In the above context, it is expedient to have clarity with regard to the capital gains tax treatment upon the sale of Units in the (a) Main scheme (with healthy portfolio) and (b) the segregated portfolio (containing stressed assets) in the hands of the unitholder. In the absence of an amendment in the Income Tax Act, (a) the holding period with respect to the sale of segregated units shall be reckoned from the date of segregation instead of the original date of acquisition of units in the Main scheme; and (b) the cost of acquisition of Units in the Main scheme and Segregated portfolio will be taken as the original cost of acquisition instead of the proportionate cost as determined on the date of segregation for Main scheme and for Segregated portfolio as shown in the illustration appended below. Both would be incorrect and unfair to the unitholder.	It is requested that suitable clarifications should be issued with regard to the treatment of the Units allotted consequent on segregation of portfolio of a mutual fund scheme in the hands of the unitholder for the capital gains tax purposes that – a. The allotment of units in a segregated portfolio of a mutual fund scheme is not a Transfer under section 47 of the Income Tax Act; b. The period of holding of such units shall be reckoned from the date of investment by the investor {with suitable explanation under section 2(42A)}; and c. The cost of acquisition in case of Main scheme and Segregated portfolio shall be the proportionate cost as determined on the date of segregation for the purposes of section 49.	Segregation of portfolio or side-pocketing is essentially splitting the investments into two buckets, similar to demerger. Creation of segregated portfolio is driven by the trustees to protect the interest of the investors, under certain adverse circumstances of rating downgrade / credit default, in accordance with SEBI guidelines. For an assessee, capital gains tax liability on investment in mutual fund units arises only on redemption or transfer of the units. In the case of side-pocketing, the number of units remains unchanged — only the NAV of the units of the Main scheme reduces to the extent of the portfolio segregated from the main portfolio. Therefore, there is no Transfer or Redemption of the units held by the investor. As per the current provisions of Income Tax Act, 1961, Units allotted to an assessee pursuant to consolidation of two or more schemes and plans of a mutual fund as referred to in sections 47(xviii) and 47(xix) respectively, shall not be regarded as Transfer and hence, shall not be charged to capital gains. Further, the period of holding of such units shall include the period for which the unit or units in the consolidating scheme of the mutual fund were held by the assessee. It is thus clear that consolidation of mutual fund schemes/plans shall not qualify as transfer and the period of holding includes the total period. On the same logic and rationale, the period of holding of segregated units should include the total period of holding in the Main Scheme i.e., from the date of investment by the investor. Lastly, applying the same principle as applicable in respect of demergers, the cost of acquisition of Units of the Main scheme and the segregated portfolio should be the proportionate cost thereof as determined on the date of segregation, since the aforesaid SEBI circular dated December 28, 2018 clealry mandates that all existing unitholders in the affected scheme as on the day of the credit event shall be allotted equal number of units in the segregated portfolio as held in the main portfolio.

Narration		Main Scheme	Segregated (stressed) portfolio
Date of original acquisition	A	01-04-2019	
Purchase price of original Acquisition (₹)	B	10.00	
Date of Segregation	C	01-09-2019	01-09-2019
NAV (pre segregation) (₹)	D	20.00	
NAV (post segregation) (₹)	E	18.00	2.00
<u>Sale of Unit in Main Scheme</u> (with healthy portfolio)			
Date of sale	F	01-01-2020	-
Sale Price	G	21.00	
Cost of Acquisition (based on the proportion of NAV post segregation) (₹)	H	9.00	1.00
Capital Gain (₹)	I = G - H	12.00	
Period of holding (days)	J = F - A	275	
<u>Sale of Unit in Segregated Portfolio</u> (containing stressed assets)			
Date of sale	K	-	01-01-2021
Sale Price	L	-	3.00
Cost of Acquisition (based on the proportion of NAV post segregation) (₹)	M = H	-	1.00
Capital Gain (₹)	N = L - H	-	2.00
Period of holding (days)	O = K - A	-	641

<u>Notes</u>:

In the absence of an amendment in the Income Tax Act, (a) the holding period with respect to the sale of segregated units will be reckoned from the date of segregation, instead of the original date of investment / acquisition of units by the assessee in the Main scheme; and (b) the cost of acquisition in case of Main scheme and Segregated portfolio will be taken as the original cost of acquisition (₹10.00) instead of the proportionate cost as determined on the date of segregation i.e., ₹9.00 for Main scheme and ₹1.00 for Segregated portfolio, *both of which would be incorrect and not fair to the unitholder.*

16. Compliance under Sec.195(6) of the Income Tax Act, 1961 and Rule 37BB of the Income Tax Rules, 1962

Background	Proposal	Justification
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> 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.*	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.

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) practically on every working day, which is operationally difficult / impractical, and that too on such a massive scale**.**		

17. Request to accord pass- through status to Category III AIFs for Income Tax Purposes		
Background/ Issue	**Specific Budget Proposal**	**Justification/ Rationale**
Chapter XII-B of the Income Tax Act is currently applicable only to Category I and II AIF, but not to Category III AIFs. Consequently, Category III AIFs are NOT considered as Pass-through vehicles, even though they are de-facto pass-through vehicles. This should also be extended to Category III AIF	It is proposed that the Category III AIF should also be given pass-through status for income tax purpose, as done in respect of Category I & II AIFs. In this regard, the definition of Investment Fund u/s 115UB of Income Tax Act may be amended to include Category III Alternative Investment Fund.	With the recent increase in surcharge tax rates proposed in Finance Budget II 2019, it becomes imperative to extend "pass-through" status for AIF CAT III Funds as the AIF Funds are pooled investment vehicles consisting of investors of varied taxable income slabs. In a subsequent amendment, the Government corrected the unintended consequence of tax surcharge applied to FPIs. However, the aforesaid amendment did not include Domestic Trusts such as CAT III AIF in its scope and thus the investors of CAT III AIF still have to bear a higher tax incidence compared to the other investors in similar product category. For instance, each fund may consist investors in one of the below taxable income slabs: • Upto INR 5 million • INR 5 million to INR 10 million • INR 10 million to INR 20 million • INR 20 million to INR 50 million • Above INR 50 million The surcharge rates for each of the above income slabs vary. However, at a fund level the total income would be more than INR 50 mln and hence surcharge at the highest rate would get applied which would adversely impact investors with lower taxable income with no provision to claim the excess tax paid. A "pass-through" status will ensure equitability and fairness in tax treatment. While the rate of tax may be decided based on the nature of income, a pass-through status will not affect the revenue of the government. It is submitted that the investment strategy need not be a consideration for determining the pass-through status. Even if it has to be considered, Cat-III AIF making 65% investments in listed equities through the stock exchange platform may be considered at par with Cat-I and II AIF for taxation purpose.