



Report submitted by Alternative Investment Policy Advisory Committee

1. To solicit the comments/views from public on suggestions pertaining to the third report submitted by Alternative Investment Policy Advisory Committee.

Background:

2. SEBI had constituted a standing committee 'Alternative Investment Policy Advisory Committee' (AIPAC) under chairmanship of Shri. N. R. Narayana Murthy in March 2015. AIPAC has submitted its third report to SEBI with various recommendations stated therein.

Public Comments:

3. In order to take into consideration the views of various stakeholders, public comments are solicited on the said report as placed at Annexure. Comments may be emailed on or before **February 19, 2018**, to **aif@sebi.gov.in** or sent by post, to:-

*Deputy General Manager
Division of Funds – I
Investment Management Department
Securities and Exchange Board of India
SEBI Bhavan
Plot No. C4-A, "G" Block,
Bandra Kurla Complex,
Bandra (East), Mumbai - 400 051*

4. Comments/ suggestions may be provided in the format given below:

Name of entity / person / intermediary/ Organization			
Sr. No.	Clause No.	Suggestions	Rationale

Issued on: January 19, 2018

The Alternative Investment Policy Advisory Committee

Third Report

■ 26th November, 2017 ■



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PREFACE

I am glad to note that the Government has implemented reform measures favourably affecting a large part of the Indian economy. It is widely accepted that the environment for business in India is improving. Various indicators show steady progress. Data from the Securities & Exchange Board of India (SEBI) shows that the number of Alternative Investment Funds (AIFs) has been rising each year, as have been the amounts invested by the AIFs. In addition, aggregate private equity and venture capital flows are touching record levels in India.

Reforms are a continuous process as the huge capital needs of India are a compelling force. I am happy that the Alternative Investment Policy Advisory Committee (AIPAC) has continued its work and addressed a wide range of reforms which are much needed.

This report covers reforms in a number of areas.

The taxation of SEBI-registered Category III Alternative Investment Funds has been analysed. In recent years, the Government has done much to reform and institute pass-through taxation of Categories I and II AIFs. The Committee will highly appreciate if the taxation of AIFs in Category III can now be addressed given that the present trust-based taxation approach is complex and ambiguous.

The Government took positive steps to introduce a new GST regime this year. In addition, the Government has shown prudence and flexibility by introducing changes in the GST regime commensurate with the needs of businesses. The GST regime also impacts the establishment of domestic AIFs in India, particularly those with overseas investors. Accordingly, the Committee has analysed the impact of GST on AIFs and has made a number of helpful reform suggestions aimed at attracting overseas investors.

Some of the previous recommendations have been the subject of discussion among Committee members and market participants at large. Taking this feedback into account, this report includes recommendations relating to the allocation of Corporate Social Responsibility (CSR) funds, created pursuant to the obligations under the Companies Act, 2013, to SEBI-regulated AIF Category I Social Venture Funds.

There has been a constant call to attract offshore fund managers (who invest in India, but operate from an offshore location), by encouraging them to shift their fund management and administration to India. In this context the Committee has made suggestions for a suitable tax and regulatory framework for the domiciliation of AIFs in International Financial Services Centers in India.

AIPAC members are open to further feedback and additional suggestions will be welcome.

I must thank the leadership and staff of SEBI which has played such a vital and helpful role in the work of AIPAC.

I sincerely thank all the AIPAC members and market participants who have made their invaluable contribution and burnt the midnight oil to prepare this in-depth report.

Thank you once again.

N.R. Narayana Murthy
Chairman
Alternative Investment Policy Advisory Committee

Alternative Investment Policy Advisory Committee: List of Members

Sr. No.	Name	Organization & Designation
1.	Mr. N.R. Narayana Murthy	Founder, Infosys Ltd.
2.	Mr. Sudarshan Sen	ED, Reserve Bank of India
3.	Shri. Rajesh Kumar Kedia	Director, CBDT, Ministry of Finance
4.	Shri. Nikhil Varma	Deputy Secretary, DEA, Ministry of Finance
5.	Shri Ajay Kumar Kapur	Deputy Managing Director, Small Industries Development Bank of India
6.	Mr. Sanjay Nayar	Member & CEO, KKR India Advisors Pvt. Ltd.
7.	Dr. Saurabh Srivastava	Founder, Indian Angel Network
8.	Mr. Devinjit Singh	Managing Director, The Carlyle Group, India
9.	Mr. Manish Chokhani	Senior Advisor, TPG Growth
10.	Mr. Gautam Mehra	Partner, PwC India and Leader, Tax & Regulatory Services
11.	Mr. Akshay Mansukhani	Partner, Malabar Investments
12.	Mr. Mani Iyer	Director, Incube Ventures Pvt. Ltd.
13.	Mr. Abid Hassan	Product Manager, Qplum
14.	Mr. K.E.C Rajakumar	Managing Director & CEO, Ascent Capital Advisors
15.	Mr. Sudhir Sethi	Founder Chairman & MD, IDG Ventures India
16.	Mr. Gopal Srinivasan	Chairman, IVCA, Chairman and MD, TVS Capital Funds Limited
17.	Mr. Manish Kejriwal	Managing Partner, Kedaara Capital Advisors LLP
18.	Mr. Arvind Mathur	Chairman, Private Equity Pro Partners
19.	Mr. Rajat Tandon	President, Indian Private Equity & Venture Capital Association (IVCA)
20.	Mr. Krishnamurthy Subramanian	Associate Professor of Finance, ISB
21.	Mr. Krishnan Subramaniam	Partner, Ernst & Young
22.	Ms. Nandita Agarwal Parker	Managing Partner, Karma Capital Management LLC
23.	Shri. Andrew Holland	CEO, Avendus Capital Alternate Strategies
24.	Shri. S.V. Murali Dhar Rao	Executive Director, SEBI
25.	Smt. Barnali Mukherjee	Chief General Manager, SEBI

Terms of reference of the Alternative Investment Policy Advisory Committee:

- i. To advise SEBI on issues related to the further development of the alternative investment and start-up ecosystem in India.
- ii. To advise SEBI on any hurdles that might hinder the development of the alternative investment industry under its purview.
- iii. To advise SEBI on any issues which need to be taken up with other regulators for development of the alternative investment industry.
- iv. Any other item relevant to alternative investment industry and development of the start-up ecosystem in India.

Acknowledgment

This report of the Alternative Investment Policy Advisory Committee (AIPAC) has been made possible with the support and contributions of many individuals.

The Committee would like to gratefully acknowledge the valuable support of SEBI and the contribution of its professionals G. Mahalingam, S.V. Murali Dhar Rao, Ananta Barua, Naveen Sharma, Dharmendra Jain and several other SEBI staff who helped convene the meetings of AIPAC.

The Committee also acknowledges the efforts, with thanks, the contribution of Gopal Srinivasan, Gautam Mehra, Subramaniam Krishnan, Nishith Desai, Tushar Sachade, Nehal Sampat, Tanuruh Gupta, S. Krishnakumar, Rahul Chakraborty, Pratik Ajmera, Vijay Morarka, Kumar Shah, Rahul Rishi, Siddharth Shah, Vivaik Sharma, Tejash Gangar, Bhakti B. Vaidya, Akshay Mansukhani, Rajat Tandon, Yogesh Arora and Rohit Nag.

Sincere thanks are due to IVCA and its members as well as the contribution of the members of The Impact Investors Council.

Finally, we thank Arvind Mathur for editing, producing and integrating the contents of all AIPAC reports in a common thread consistent with the terms of reference of AIPAC.

Chapter I

Introduction to the Alternative Investment Funds Industry

CHAPTER I

Introduction to the Alternative Investment Funds Industry

A. Introduction

1. Indian entrepreneurs need private equity and debt products to meet the capital needs of their growth, restructuring, turn around or start-up plans. The main providers of this form of capital are private equity and venture capital funds which are channeled through Alternative Investment Funds (AIFs). Given that such capital is in short supply in India, a favourable policy and regulatory environment is essential. AIFs are regulated by the Securities and Exchange Board of India (SEBI). Other government agencies which play an important role are the Ministry of Finance and sector regulators in the pension and insurance areas as well as the Reserve Bank of India.
2. This is the third report of the Alternative Investment Policy Advisory Committee. It covers a wide set of reforms needed in areas like Good & Service Tax (GST) and Category III AIFs. Some of the previous recommendations have been further elucidated in this report.
3. This chapter introduces the backdrop and current environment in which the AIF sector is functioning in India. Relevant data, which will help understand the trends influencing private equity and venture capital in India, are also presented.

B. Growth in SEBI-Registered Domestic Alternative Investment Funds

4. Table 1 shows that the number of all categories of AIFs increased by nearly 50% during the last 15 month period ended 30th September, 2017, reaching 374 funds. Category III AIFs have nearly doubled in number, reaching 67 funds. Category II AIFs have grown by 42% during the same period and stand at 199. Category I AIFs stood at 108, having risen by 21 per cent. This growth indicates the greater potential of AIFs in meeting India's capital and investment requirements.

Table 1: Number of Alternative Investment Funds Registered with SEBI

	30 th September, 2017	30 th June, 2016
Category I		
Infrastructure Fund	14	10
Social Venture Fund	12	7
Venture Capital Fund	74	54
SME Fund	8	8
Total of Category I	108	79
Category II	199	140
Category III	67	
Grand Total	374	253

5. Table 2 shows that the growth in funds raised over the 12-month period ended 30th September, 2017 has averaged 112 per cent across the three AIF categories. Funds raised by Category II and III AIFs have recorded annual growth rates of 112 per cent and 146 percent, respectively.

Table 2: Growth in Capital Raised by Domestic AIFs Registered with SEBI: 2017 versus 2016 (Rupees in crores)

Category	Funds raised (30 Sept, 2017)	Funds raised (30 Sept, 2016)	Absolute Rise Between 30 Sept, 2017 over 30 Sept, 2016	Percentage Rise Between 30 Sept, 2017 over 30 Sept, 2016
Category I				
Infrastructure Fund	4121.86	2323.91	1,797.95	77 %
Social Venture Fund	591.16	483.41	107.75	22%
Venture Capital Fund	3391.71	1915.31	1476.40	77%
SME Fund	175.51	170.79	4.72	2.7%
Total of Category I	8280.24	4893.42	3386.82	69.2%
Category II	37,303.05	17,544.12	19,758.93	112%
Category III	16,213.9	6,578.23	9,635.67	146%
Grand Total	61,797.19	29,015.77	32,782.19	112%

6. Table 3 shows the cumulative data for all categories of AIF's as of 30th September, 2017. It shows that the total amount of capital raised cumulatively by domestic AIFs is Indian Rupees 116,085 crores i.e. approximately US \$ 18 billion. This is a small but growing fraction (an estimated 15 percent) of the total private equity and venture capital invested in India when compared to the international private equity and venture capital invested in India. This has a significant policy implication in that policy measures need to be taken to grow the supply of domestic capital in AIFs to at least 50% of the total annual private equity & venture capital flows in the country i.e. at least trebling from current levels. Some of the policy measures recommended in this and previous AIPAC reports are steps in the direction of greater mobilization of domestic capital for investment through domestic AIFs.

**Table 3: Alternative Investment Funds: Cumulative net Data
as at the end of 30th September 2017**

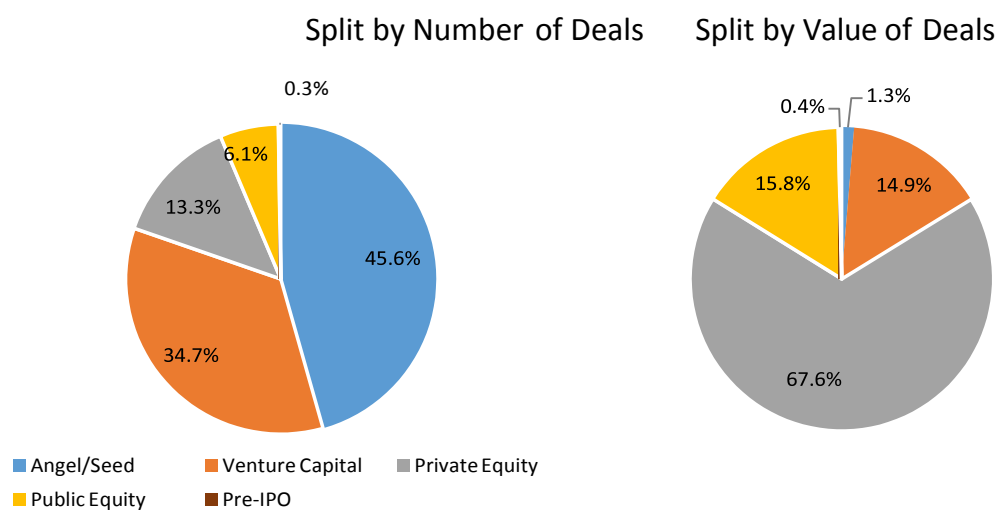
Category	Commitments raised (Rs in crores)	Funds raised (Rs in crores)	Investments made (Rs in crores)
Category I			
Infrastructure Fund	7102.59	4121.86	3493.06
Social Venture Fund	1048.96	591.16	500.03
Venture Capital Fund	14570.56	3391.71	2402.83
SME Fund	207.98	175.51	28.71
Category I Total	22930.09	8280.24	6424.63
Category II	70498.38	37303.05	23837.09
Category III	22656.58	16213.9	13227.33
Grand Total	116085.05	61797.19	43489.05

Indian Rupees 6,500 crores = \$ US 1 billion (approximate)

C. Private Equity & Venture Capital Investments in India from All Sources

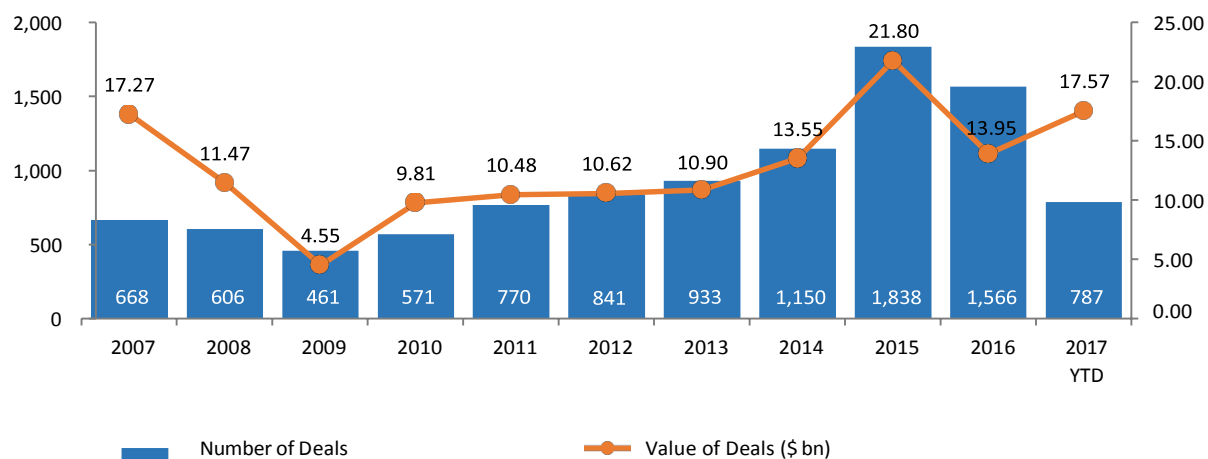
- The charts below show that private equity and venture capital is experiencing an upward momentum in 2017. Compared to \$ 13.95 billion invested during 2016, it has reached \$ 17.57 billion in the first ten months of 2017. Given the traction, it is expected that private equity and venture capital will be an estimated \$ 20 billion and may touch the record annual inflow of \$ 21.80 billion experienced in 2015.

India: Deal Type Split in 2017 YTD



2017 YTD: 31st October 2017: Source: VC Circle

Investments Overview



2017 YTD: 31st October 2017: Source: VC Circle

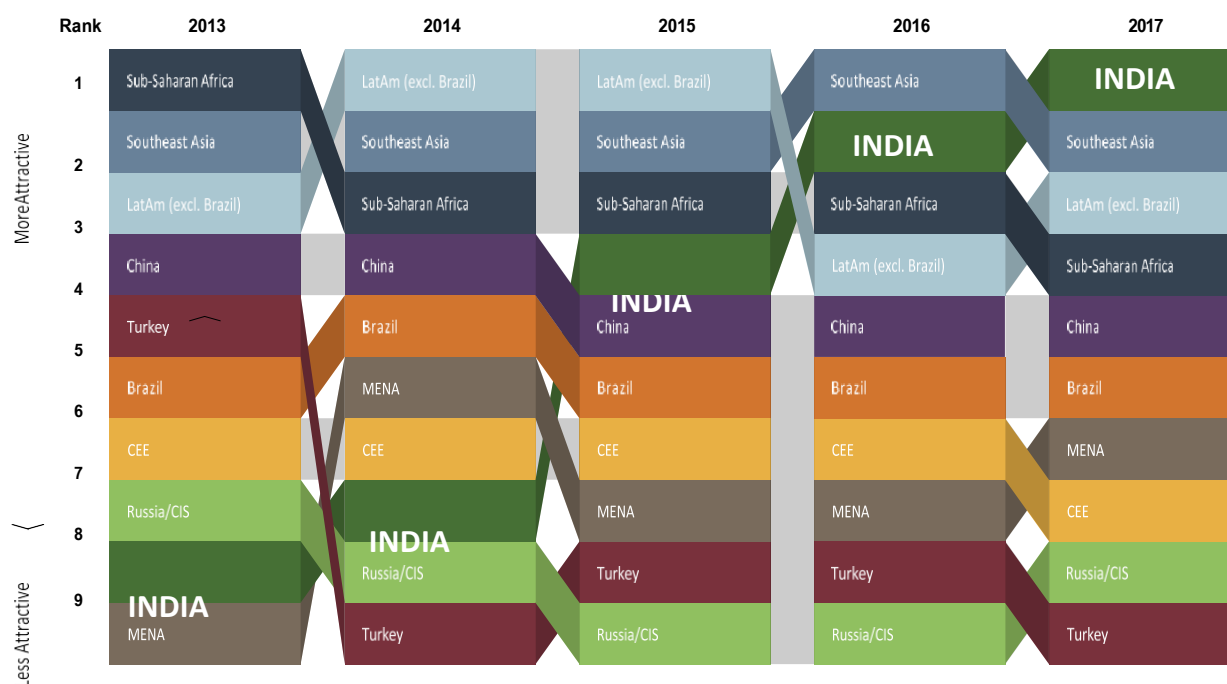
D. Global Limited Partner Survey, 2017 of the Emerging Markets Private Equity Association (EMPEA) Indicates Attractiveness of India

8. Global investors who invest in private equity and venture capital, referred to as limited partners, have indicated their preference for investing in India. 106 limited partners were surveyed by EMPEA in 2017.
9. Amongst 34 countries, India was ranked number one in 2017. In previous years India's rankings were: 2nd in 2016, 4th in 2015, 8th in 2014 and 9th in 2013.

Table 4: India's Ranking as an Investment Destination by Global Limited Partners

Year	Rank
2017	1st
2016	2nd
2015	4th
2014	8th
2013	9th

*The Attractiveness of Emerging Markets for GP Investment Over the Next 12 Months – LP Views
(Source: EMPEA)*



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Global Limited Partners Survey

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E. World Bank Survey on Doing Business

10. The momentum of capital flows is also reflected in India's 30 rung jump in terms of ease of doing business in India. While the advance is more than incremental, its significance lies in the fact that if the Government continues its reform process, its ease of doing business rank could rise further. Ultimately, this would make the investment environment attractive for both domestic and international institutions, entrepreneurs and corporations. Eventually this may lead to greater job creation and improve the standards of the conduct of business in India.
11. The World Bank report titled 'Doing Business 2018' mentioned a number of progressive regulatory reforms in India including the following:
 - (i) **Protecting minority investors**
India strengthened minority investor protections by increasing the remedies available in cases of prejudicial transactions between interested parties;
 - (ii) **Resolving insolvency**
India made resolving insolvency easier by adopting a new insolvency and bankruptcy code that introduced a reorganization procedure for corporate debtors and facilitated the continuation of the debtor's business during insolvency proceedings;
 - (iii) **Starting a Business**
India made starting a business faster by merging the applications for the Permanent Account Number (PAN) and the Tax Account Number (TAN) and by improving the online application system;and
 - (iv) **Paying Taxes**
India made paying taxes easier by requiring that payments be made electronically and introduced a set of administrative measures easing compliance with income tax laws.

Conclusion:

The positive economic trends affecting the investment climate in India, can pave the way for greater domestic and international flows of venture capital, private equity and alternative investments. AIPAC has made a number of recommendations in its previous reports as well as in this third AIPAC report to create a favourable environment for these capital flows. Ultimately such flows will lead to greater development and job creation in India.

Chapter - II

Executive Summary

Chapter II

Executive Summary

A. Introduction

1. This report makes recommendations to help grow the supply of risk capital in India in the form of private equity and venture capital through Alternative Investment Funds (AIFs). AIFs are a common pool of funds – managed by a fund manager- in which institutional and high net-worth individuals invest, typically on a long-term basis.

The areas covered are:

- (i) Reforms in the Government of India's Goods & Service Tax regime insofar as it impacts the growth of the AIF asset class in India;
- (ii) Promoting Alternative Investment Funds in India through International Financial Services Centers;
- (iii) Taxation of Alternative Investment Funds, including the taxation of AIFs which are registered as Category III AIFs with the Securities and Exchange Board of India (SEBI); and
- (iv) Some of the recommendations made in previous AIPAC reports particularly the application of CSR funds for impact investing, which delivers social benefits, through SEBI - registered Category I AIFs.

B. Recommendations relating to the Goods & Services Tax Regime Relating to Alternative Investment Funds

2. An AIF can include both domestic and foreign investors. The current GST framework encourages AIFs, which include foreign investors, to be domiciled offshore and not in India due to GST disincentives. The GST paid on fund management fees and other input services become an incremental cost to be borne by AIF investors. In the context of foreign investors, this, in effect, violates the taxing principle of destination-based consumption tax because the services rendered by a service provider to AIFs are ultimately for the benefit of the underlying investors. Hence, the services rendered to a domestic AIF, to the extent it has foreign investors, are effectively consumed outside India.
- (i) Recommendation: Considering the importance of venture capital and private equity capital, services rendered to an AIF should be chargeable to GST at a rate of 5%, where the majority of the investors of an AIF are foreign investors.

- (ii) Recommendation: Alternatively, investors in an AIF should be deemed to be the service recipients and where the foreign investment in an AIF exceeds 50%, the services received by an AIF should be considered as export of services and thereby be liable for zero rate of GST.
- (iii) Recommendation: Liability under section 89(1) of the Central Goods and Service Tax Act should not be extended to nominee or non-executive directors, especially where the appointment or nomination is made by AIFs.
- (iv) Recommendation: It should be clarified that GST is not applicable on distribution of share in income or profits to the general partner/fund manager or its employees.

C. Promoting AIFs with Foreign Limited Partners in International Financial Services Centers (IFSC)

3. The main benefits to India of an IFSC are:

- (i) Added inflow of investment capital which is much needed for India's economic growth, development and employment generation;
- (ii) Reduction of the loss of invisible earnings to other financial centers elsewhere in the globe because AIFs with foreign investors find it optimal to locate offshore;
- (iii) Bring fund management operations closer to portfolio companies for ease of conducting due diligence and portfolio monitoring;
- (iv) Leverage India's deep talent pool in professions like fund management, valuation, accountancy and law;
- (v) Provide India-based, overseas investors with a platform for international investment operations from India; and
- (vi) Enhance the development of Indian capital markets.

4. The current regulatory regime for the establishment of AIFs in an IFSC is restrictive and offers investment in limited products and sectors. The recommendations to create a favourable framework, for AIFs in an IFSC are divided into two parts i.e. tax reforms and regulatory reforms.

5. The requisite tax reforms to encourage the establishment of AIFs with foreign limited partners, namely, investors, in an IFSC are:

- (i) **Recommendation:** Exemption from tax for any income earned by an offshore investor, from offshore investments made outside India through an AIF in an IFSC;
 - (ii) **Recommendation:** Relaxation from filing return of income and obtaining a PAN number for offshore investors in an AIF in an IFSC, in respect of any income distributed by an AIF in an IFSC after deduction of tax at source; and
 - (iii) **Recommendation:** It should be recognized in the Income Tax Act, 1961 that an Eligible Investment Fund, which is domiciled in an IFSC in India, does not constitute a business connection in India.
6. The non-tax regulatory reforms needed in SEBI guidelines or regulations and RBI regulations to encourage AIFs with foreign limited partners to be domiciled in an IFSC are as follows:
- (i) **Recommendation:** Overseas investors be enable to invest in India through any route, including the Foreign Portfolio Investor(FPI), Foreign Direct Investment (FDI) and Foreign Venture Capital Investors (FVCI) routes, and be enabled to invest in LLPs;
 - (ii) **Recommendation:** Since AIFs domiciled in an IFSC will source funds from offshore investors, the current limits on overseas investments of SEBI-regulated domestic AIFs, which source funds from domestic investors, should not apply to IFSC-domiciled AIFs;
 - (iii) **Recommendation:** Domestic fund managers and sponsors should be permitted to manage AIFs domiciled in an IFSC; and
 - (iv) **Recommendation:** It is a good practice for fund managers, or fund sponsors, to invest in AIFs which they manage/sponsor. SEBI AIF regulations require such sponsor commitments as 'skin-in-the-game'. Accordingly, FEMA regulations should be amended to enable investment by a domestic fund manager or sponsor in an AIF domiciled in an IFSC.

D. Taxation of Alternative Investment Funds, including Category III AIFs

7. Substantial changes have been implemented in the Income-tax Act, 1961 (the Act) since the year 2015 which have addressed several tax issues faced by AIFs. However, from a tax perspective, the following sets of critical reforms are needed:
- a. A separate code for the taxation of Category III AIFs;
 - b. The treatment of significant costs, expenses and net losses of AIFs; and
 - c. A separate tax code for AIFs which has its units listed and traded on a stock exchange.

Summary of Recommendations for AIFs, including the Taxation of Category III AIFs

8. Recommendation: Implement an investor-level taxation approach for Category III AIFs. Under such a regime, investors of Category III AIFs shall pay tax on income/gains arising from investment in units of Category III AIFs. The recommended features of the investor-level taxation regime are:

- (i) Short term capital gains on transfer of units of an equity-oriented investment fund (whether by way of redemption or otherwise) to be taxed at the rate of 15%;
- (ii) Long term capital gains on transfer of units of an equity-oriented investment fund (whether by way of redemption or otherwise) to be exempt from income-tax;
- (iii) Any other long-term or short-term capital gains on transfer of units (whether by way of redemption or otherwise) of a Category III AIF, to be taxable at the applicable rates;
- (iv) Any income distributed by Category III AIFs out of income received by it (other than income of the nature which is exempt under section 10), shall be taxable in the hands of investors as Income from Other Sources at applicable rates (~30%)

For the above purpose, 'Equity-oriented investment fund' shall mean an investment fund: (i) which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the SEBI (AIF) Regulations 2012 made under the SEBI Act, 1992, and (ii) its investible funds are invested in equity shares of domestic companies amounting to more than sixty-five per cent of the total proceeds of such 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.

All the taxes on investors on redemption of units, or on the distribution of income would be paid by way of Tax Deducted at Source ('TDS') at the Fund level.

- (v) Category III AIFs shall not be subject to any tax on income or gains arising from their investment in underlying securities; and
- (vi) Any transfer of units pursuant to the consolidation of schemes of Category III AIFs should not be regarded as a transfer.

E. Recommendations applicable to all AIFs

9. The current tax regime for AIFs does not address the following:

- a. Significant costs incurred by an AIF are not factored in determining investors' tax liability; and
- b. Net losses incurred by AIFs are not available as a deduction to investors and may lapse, if not set-off by an AIF

10. Recommendation relating to the Deduction of Expenses

Allow the management fee incurred, from the date of the investment to the date of its divestment, to be capitalised as "cost of improvement". The management fee incurred to be calculated based on the management fee contractually payable to the AIF's investment manager at the annual rate applied to the actual cost of the investment.

11. Recommendation Relating to Net Losses

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

F. Taxation of AIFs which has its Units Listed on a Stock Exchange

12. The SEBI (AIF) Regulations 2012 allow the listing of the units of closed-ended AIFs on a stock exchange. All AIFs, except an open ended-Category III AIF, can be listed on a stock exchange. The Bombay Stock Exchange (BSE) has laid down the process and documentation required for the purpose of listing of AIFs.

13. Investors in AIFs have the intention of making long-term investments. The listing and trading of units of an AIF, enables exits by pre-listing investors and also provides a liquidity window to investors which invest post-listing. Given these exit and liquidity advantage of listed AIFs, they can be a significant catalyst for greater participation of investors in AIFs as an investment instrument.

14. While the present AIF Regulations, and the guidelines issued by BSE, enable listing of AIFs, subject to conditions, and given the liquidity advantages of listing, the current taxation policy for AIFs (i.e. pass-through taxation) is not conducive for listed AIFs.

Recommendations for the Taxation of Listed AIFs

15. It is recommended that a new taxation code be defined for listed AIFs as follows:

- (i) Exemption to listed AIFs for all streams of income earned by listed AIFs on its investments in Indian portfolio entities;
- (ii) Taxation of income (namely dividend and interest) on distributions by listed AIFs to investors in the hands of AIF investors
 - Dividend - Exempt from tax in the hands of the investor;
 - Interest – Resident investor at their respective tax rates, non-resident investors at 5%.
- (iii) Taxation of gains realized by investors of listed AIF's: The taxation of gains should be determined based on the difference between the cost of acquisition of the units and actual sale consideration/ redemption price in a sale/ transfer or redemption event, respectively. Taxation of gains should be determined on the following basis:
 - (a) Equity-oriented fund (an AIF in which at least 65% of the investible funds are invested in equity shares of domestic companies):
 - Short-term capital gains - at 15% with the sale/ redemption being liable to Securities Transaction Tax (STT), and
 - Long-term capital gains – Exempt from tax in the hands of the investor with the sale/ redemption being liable to STT.
 - (b) Debt-oriented fund (an AIF that is not an equity-oriented AIF)
 - Short-term capital gains at the maximum marginal rate; and
 - Long-term capital gains at 20% (in the case of residents) and at 10% (in the case of non-residents) [in the case of non-residents without indexation or foreign exchange fluctuation benefit].

G. Corporate Social Responsibility & Public Trust Recommendations

- (a) CSR and Public Trusts: Enable investments in SEBI Regulated Category I AIFs.

It is recommended that s.135 of the Companies Act 2013 and the related Schedule VII, be amended to enable investment by companies of Corporate Social Responsibility funds in SEBI-registered Category I Social Venture Funds, 'social business projects' and 'social enterprises'.

In the first AIPAC report, it was recommended that charitable and religious trusts be permitted to invest in AIFs. To enable this recommendation to be given effect, there is a need to expand the scope of eligible investments by public trusts. It is recommended that section 11(5) of the Income Tax Act, 1961 be amended to enable investments by such trusts in social businesses or social enterprises and not-for-profit companies, including SEBI-registered Category I Social Venture Funds.

(b) Category III Funds-of Funds

Category III Funds-of-Funds (FOF) should be allowed to invest in Category III AIFs. There should be an option for permissible leverage to be either at the FOF level, or at the level of the underlying individual portfolio of funds.

Chapter - III

GST Regime for SEBI-Registered Alternative Investment Funds

Chapter III

GST Regime for SEBI-Registered Alternative Investment Funds

A. Introduction

1. The Government of India has implemented a Goods & Services Tax (GST) regime. The Government has been flexible and responsive to the needs of businesses. Accordingly, it has made a series of amendments in the GST regime since its inception. This chapter outlines some of the additional GST reforms in order to:
 - (i) Align GST with the character of AIFs in which international i.e. non-resident, investors have invested in foreign currency and pay their proportionate share of fund management and operating expenses in foreign currency; and
 - (ii) Exempt nominee or non-executive directors from liability as is the case under other laws particularly, the Companies Act, 2013.

B. The GST Regime for Alternative Investment Funds

GST on Fund Management and other Services Received by Alternative Investment Funds

2. As discussed in an earlier report of AIPAC, the levy of GST on fund management and other services received by AIFs, may adversely impact the choice of domiciliation of AIFs as a pooling vehicle to raise foreign capital. The hurdles faced by the AIF asset class are summarised below:
 - (i) The taxing principle under the erstwhile service tax legislation continues under the new GST regime, i.e. GST is a destination-based consumption tax. Accordingly, GST is not levied on services consumed outside India which are regarded as export of services.
 - (ii) A domestic Alternative Investment Fund (AIF), in essence, represents a common pool of contributions made by its investors and therefore, should not be viewed as a distinct entity separate from its investors. Recognising the 'pooling' concept, the Income-tax law has accorded 'pass-through status' to Category I and Category II AIFs such that income is taxed, as if investments were made directly by investors. This, in essence, represents the taxing principle of managing and taxing AIFs.

- (iii) Under the GST regime, as in the previous service tax regime, there is no concept of 'pass through', and the services provided by fund managers and other service providers to AIFs are liable to GST. Since AIFs are only a pooling vehicle and do not provide any service, there is no output GST liability on AIFs. Hence, AIFs are not able to obtain any benefit of input credits. Consequently, the GST paid on fund management fees and other input services, becomes an incremental cost to be borne by investors.
- (iv) In the context of foreign investors, this, in effect, violates the taxing principle of destination-based consumption tax, because the services rendered by a service provider to AIFs are ultimately for the benefit of its underlying investors who include foreign investors as well. The services rendered to an AIF are effectively consumed outside India to the extent that there are foreign investors in a domestic AIF.
- (v) On the other hand, if a foreign investor makes a direct investment in a start-up or a growth portfolio company, he is not subject to service tax or GST liability. GST is also not applicable on fees and expenses for services provided by an overseas fund manager to an offshore pooling vehicle for investment in India, but which is domiciled outside India.
- (vi) Accordingly, the current GST framework encourages AIFs to be domiciled offshore, instead of onshore in India. Consider a simple example of a an India- domiciled AIF where all its investors are foreign investors. The AIF receives services which would generally be liable to GST at the rate of 18%. The India- domiciled AIF would not be eligible to claim a refund of such input GST. On the other hand, in a similar situation, if the pooling vehicle for investing in India, would be formed and domiciled offshore, then the services provided to such an offshore pooling vehicle would be regarded as export of services and would not be subject to GST. Accordingly, the service provider would be eligible to claim a refund of GST paid on any input services.
- (vii) The Government has progressively liberalized the foreign exchange regime by permitting foreign investments in domestic AIFs to encourage the conduct of asset management within India. Similarly, it has introduced safe harbour provisions in the income-tax law, recognizing the role of asset managers abroad and to facilitate their relocation to India. The Government is also making significant efforts to rationalise the safe harbor provisions, making it convenient for the fund managers to re-locate to India, especially in the case of India-focused funds. The levy of GST on domestic AIFs in which foreign investors have invested may, on the contrary, discourage such initiatives. The Government has been increasingly giving impetus to provide more clarity and certainty to the investor community and is trying to maintain consistency in the implementation of tax and regulatory laws. Exemption from GST to domestically-domiciled AIFs which have foreign investors, would provide much needed tax clarity to investors

in AIFs, bringing certainty on tax outcomes and ensure greater consistency in extending export-related incentives.

3. There are six principal benefits of domestic formation and domiciliation of AIFs in India with foreign investors i.e. limited partners:

- (i) When an offshore investor invests through an overseas fund domiciled outside India, the investment remains contingent till it is actually invested in the country. On the other hand, in a India-domiciled AIF structure, once an offshore investor commits the investment to a domestic AIF, the foreign pool of capital is effectively 'earmarked' and 'locked' for investment in India for the entire life of the AIF;
- (ii) The investment commitments, typically being long term in nature, spur investments and economic activity in the country, leading to the growth of portfolio companies and meet the investment needs of the Indian economy;
- (iii) The resultant growth of portfolio companies is also consistent with the larger 'Make in India' initiative of the Government;
- (iv) Growth of private equity investments accelerates employment opportunities in the Indian economy. These employment opportunities fit well with the Government's initiative of 'Skill India';
- (v) Companies with private equity investments are also more diligent in ensuring good corporate governance leading to greater investor confidence; and
- (vi) Internationally, countries like Singapore are recognized as well developed asset management hubs. India competes with such countries for domiciling funds and fund managers, especially India-focused funds and fund managers. On indirect taxes, Singapore provides benefits in the form of GST rebate to asset managers and thus, mitigates the effective tax cost. GST exemption to India-domiciled AIFs could encourage fund managers to re-locate to India.

Recommendation: Measures are needed to address the problem of the levy of GST on fund management fees and other fund operating and administration services fees as the effective added cost deters foreign investors from investing in India-domiciled onshore funds through the AIF platform and instead encourages them to remain offshore.

***GST on profit share distributed to General Partner (hereinafter referred as 'GP')/
Sponsor***

4. Typically, in an AIF structure, investors, or Limited Partners (LPs), act akin to 'sleeping' or 'dormant' partners in a partnership. The General Partner (GP- the investment or fund manager) acts like a 'working partner'. The gains earned by the partnership are usually divided between LPs and GPs. The distributions to GPs could also be viewed as a return on the investment committed by the GP to the Fund.
5. In the case of a partnership firm or LLP, the levy of GST is not attracted on distributions of profits by such partnership firm, or LLP, to its partners.
6. Globally, from an income-tax perspective, profits distributed in the hands of GPs are generally taxable in their hands as capital gains, being a return on investment earned by the fund, as shared between LPs and the fund's GP.

Recommendation: The issue of levy of GST on such profit sharing between Limited Partners and General Partners may lead to uncertainty. It should be clarified that GST is not applicable on distribution of share in income or profits to General Partners or their employees.

C. GST Liability of Directors

7. Under various Indian laws, directors of companies have the obligation and liability to ensure that the companies are compliant with the obligations under various laws. The Government has recognised and exempted a certain category of directors i.e. nominee or non-executive directors who are not involved in the day-to-day functioning of companies, from these obligations and related liabilities. These carve-outs are most relevant for alternative investment funds. This is because in order to protect the interest of their investors, AIFs frequently appoint their nominees as non-executive directors on the Board of portfolio companies.
8. Section 89(1) of the CGST Act casts joint and several liability on all directors of a private limited company which defaults in the payment of tax, interest or penalty. Such liability is, however, not triggered if the director proves that the non-recovery of taxes, interest or penalty cannot be attributed to any gross neglect, misfeasance or breach of duty on his part.
9. Nominee or non-executive directors, who merely represent the interest of a shareholder or his/her appointor, are also covered by the provision of section 89(1) of the CGST Act. It is submitted that nominee, or non-executive, directors of AIFs are merely engaged in a stewardship role and do not participate in the day-to-day activities or management of companies.

10. The Companies Act, 2013 is a good example of a carve-out from liability for non-executive directors. It is pertinent to note that the definition of 'officer in default' as per section 2(60) of the Companies Act, 2013, viz persons who shall be liable for penalty or imprisonment in the case of any contravention by the company, does not include non-executive directors, unless such non-executive director is aware of such contravention by virtue of receiving any proceedings of the Board, or participation in such proceedings without objecting to them, or where such contravention had taken place with his consent or connivance.
11. Additionally, section 149(12) of the Companies Act, 2013 states that the non-executive director shall be liable under the Companies Act, 2013, only in respect of acts of omission or commission by a company which has occurred with his knowledge, attributable through Board processes, and with his consent or connivance, or where such non-executive director has not acted diligently.

Recommendation: It is recommended that nominee and non-executive directors appointed by Alternative Investment Funds on the boards of their portfolio companies be excluded from the provisions of section 89(I) of the CGST Act.

Recommendation: GST Relating to Alternative Investing Funds

I. GST on fund management and other services availed by Alternative Investment Funds

- i. Considering the importance of the VCPE industry, services availed by an AIF should be chargeable to GST at a rate of 5%, where the majority of the investors of the AIF are foreign investors.
- ii. Alternatively, the investors in an AIF could be considered as service recipients and where the foreign investment in an AIF exceeds 50%, the services availed by an AIF should be considered as export of services and thereby be liable for zero rate of tax.

II. GST on profit share distributed to GP/ Sponsor

- iii. Distribution of share of profit or income to the GP or its employees should not be subjected to the levy of GST.

III. GST liability on directors in case of default by a private limited company

- iv. Liability under section 89(1) of the CGST Act should not be extended to the nominee/non executive directors, especially where appointment is made by AIFs.

Proposed Amendments:

I. GST on fund management and other services availed by Alternative Investment Funds

- A draft of the notifications to be issued under the Integrated Goods and Services Tax Act, 2017 ('IGST Act') and Central Goods and Services Tax Act, 2017 ('CGST Act')/ amendment to be made to the IGST Act to give effect to the above are set out as **Annexure 1**.

II. GST on profit share distributed to GP/ Sponsor

- v. A draft of the amendment to be made to CGST Act to give effect to the above is set out as **Annexure 2**.

III. GST liability on directors in case of default by a private limited company

- vi. Section 89(1) of the CGST Act could be amended as under:

"Notwithstanding anything contained in the Companies Act, 2013, where any tax, interest or penalty due from a private company in respect of any supply of goods or services or both for any period cannot be recovered, then, every person who was a director, other than a nominee/non-executive director appointed by an Alternative Investment Fund, of the private company during such period shall, jointly and severally, be liable for the payment of such tax, interest or penalty unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company."

Annexure 1

BILL NO_of 2017

The Integrated Goods and Service Tax Act Amendment Bill, 2017

Amendment of Section 16

- (i) After sub-section 1(b) of Section 16, the following shall be added:

(c) supply of goods or services or both to an Alternative Investment Fund

- (ii) After section 1 of 16, the following provisos shall be added:

Provided that the foreign investments in the Alternative Investment Funds shall be in accordance with the conditions prescribed in this regard.

- (iii) After sub-section 3 of Section 16, the following explanation shall be added:

Explanation: for the purpose of sub section 1 (c) of section 16:

- a. *Alternative Investment Fund shall have the meaning assigned to it under Regulation 2(1)(b) of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012*
- b. *Foreign investment shall mean investment by non-resident entity/person resident outside India in accordance with Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.*
- c. *Taxable supplies provided by the Associate (in the capacity of a Manager) to the Alternative Investment Fund shall also be covered under sub section 1(c) of Section 16.*

Procedure to be prescribed by way of Notification

(This Notification would have to be issued to give effect to sub section 1(c) of Section 16)

Conditions to be prescribed:

1. Alternative Investment Funds wherein the total foreign investments is more than 50% shall be eligible.
2. The split of domestic investments and foreign investments in the Alternative Investment Fund shall be monitored on a yearly basis, being financial year. Where, at the end of the financial year, the share of foreign investment is less than 50% of the total investment in the Alternative Investment Fund, the benefit of 'zero-rating' shall not be available for the financial year.
3. For new Alternative Investment Funds, which have not been in existence during the entire duration of the previous financial year, the monitoring shall be based on the foreign investment in the AIF as on the date of first closing.
4. The Alternative Investment Fund shall intimate the jurisdiction officer about its status at the time of first closing and at the beginning of each financial year, providing such details/ procedure to be followed as prescribed under the **Annexure**. If the Alternative Investment Fund is not registered, the responsibility of filing the declaration shall be with the Manager of the Alternative Investment Fund.
5. The Alternative Investment Fund should provide a copy of the intimation filed as per SI No. 1 of the **Annexure** to all its suppliers from whom it seeks to receive supplies at zero rate.

Annexure

The Alternative Investment Fund shall be required to fulfill the following procedure:

- (1) A statement evidencing split of investments between domestic and foreign investors in the Alternative Investment Fund shall be required to be filed with the jurisdictional officer;
- (2) The statement shall be submitted within 90 days of the end of the relevant financial year.

[TO BE PUBLISHED IN PART II, SECTION 3, SUB-SECTION (i) OF THE GAZETTE OF INDIA,
EXTRAORDINARY]

GOVERNMENT OF INDIA

MINISTRY OF FINANCE

(Department of Revenue)

Notification No. /2017-Central Tax (Rate)

New Delhi, the , 2017

G.S.R. (E).- In exercise of the powers conferred by sub-section (1) of section 9 of the Central Goods and Services Tax Act, 2017 (12 of 2017), the Central Government, on the recommendations of the Council, hereby notifies the rate of the central tax of:

(i) 2.5% in respect of goods supplied to Alternative Investment Fund on intra-State supplies of goods, the description of which is specified in Government of India, in the Ministry of Finance (Department of Revenue) Notification 1/2017 Central Tax (Rate), dt. 28-06-2017 and in satisfaction of conditions specified in Annexure.

Explanation - For the purposes of this Notification

- (a) Alternative Investment Fund shall have the meaning assigned to it under Regulation 2(1)(b) of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012.
- (b) Foreign investment shall mean investment by non-resident entity/person resident outside India in accordance with Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.
- (c) Taxable supplies provided by the Associate (in the capacity of a Manager) to the Alternative Investment Fund shall also be covered under for the purpose of this Notification.
- (d) Alternative Investment Funds wherein the total foreign investments is more than 50% shall be eligible.

The split of domestic investments and foreign investments in the Alternative Investment Fund shall be monitored on a yearly basis, being financial year. Where, at the end of the financial year, the share of foreign investment is less than 50% of the total investment in the Alternative Investment Fund, the rate 2.5% shall not be available for the financial year.

For new Alternative Investment Funds, which have not been in existence during the entire duration of the previous financial year, the monitoring shall be based on the foreign investment in the AIF as on the date of first closing.

- (e) The Alternative Investment Fund shall intimate the jurisdiction officer about its status at the time of first closing and at the beginning of each financial year, providing such details/ procedure to be followed as prescribed under the **Annexure**. If the Alternative Investment Fund is not registered, the responsibility of filing the declaration shall be with the Manager of the Alternative Investment Fund.
- (f) The Alternative Investment Fund should provide a copy of the intimation filed as per SI No. 1 of the **Annexure** to all its suppliers from whom it seeks to receive supplies at 2.5%.

2. This notification shall come into force with effect from the ___ day of ___, 2017.

[F.No. ___/___/2017-TRU]

(*****)

Under Secretary to the Government of India

Annexure

The Alternative Investment Fund shall be required to fulfill the following procedure:

- (1) A statement evidencing split of investments between domestic and foreign investors in the Alternative Investment Fund shall be required to be filed with the jurisdictional officer;
- (2) The statement shall be submitted within 90 days of the end of the relevant financial year.

[TO BE PUBLISHED IN PART II, SECTION 3, SUB-SECTION (i) OF THE GAZETTE OF INDIA, EXTRAORDINARY]
GOVERNMENT OF INDIA

MINISTRY OF FINANCE

(Department of Revenue)

Notification No. /2017-Integrated Tax (Rate)

New Delhi, the , 2017

G.S.R. (E).- In exercise of the powers conferred by sub-section (1) of section 5 of the Integrated Goods and Services Tax Act, 2017 (13 of 2017), the Central Government, on the recommendations of the Council, hereby notifies the rate of the central tax of:

(i) 5% in respect of goods supplied to Alternative Investment Fund on inter-State supplies of goods, the description of which is specified in Government of India, in the Ministry of Finance (Department of Revenue) Notification 1/2017 - Integrated Tax (Rate), dt. 28-06-2017 and in satisfaction of conditions specified in Annexure.

Explanation - For the purposes of this Notification

- (a) Alternative Investment Fund shall have the meaning assigned to it under Regulation 2(1)(b) of the Securities and Exchange Board of India(Alternative Investment Funds) Regulations, 2012.
- (b) Foreign investment shall mean investment by non-resident entity/person resident outside India in accordance with Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.
- (c) Taxable supplies provided by the Associate (in the capacity of a Manager) to the Alternative Investment Fund shall also be covered under for the purpose of this Notification.
- (d) Alternative Investment Funds wherein the total foreign investments is more than 50% shall be eligible.

The split of domestic investments and foreign investments in the Alternative Investment Fund shall be monitored on a yearly basis, being financial year. Where, at the end of the financial year, the share of foreign investment is less than 50% of the total investment in the Alternative Investment Fund, the rate 5% shall not be available for the financial year.

For new Alternative Investment Funds, which have not been in existence during the entire duration of the previous financial year, the monitoring shall be based on the foreign investment in the AIF as on the date of first closing.

(e) The Alternative Investment Fund shall intimate the jurisdiction officer about its status at the time of first closing and at the beginning of each financial year, providing such details/ procedure to be followed as prescribed under the **Annexure**. If the Alternative Investment Fund is not registered, the responsibility of filing the declaration shall be with the Manager of the Alternative Investment Fund.

(f) The Alternative Investment Fund should provide a copy of the intimation filed as per SI No. 1 of the **Annexure** to all its suppliers from whom it seeks to receive supplies at 5%.

2. This notification shall come into force with effect from the ___ day of ___, 2017.

[F.No. ___/___/2017-TRU]

(*****)

Under Secretary to the Government of India

Annexure

The Alternative Investment Fund shall be required to fulfill the following procedure:

- (1) A statement evidencing split of investments between domestic and foreign investors in the Alternative Investment Fund shall be required to be filed with the jurisdictional officer;
- (2) The statement shall be submitted within 90 days of the end of the relevant financial year.

[TO BE PUBLISHED IN PART II, SECTION 3, SUB-SECTION (i) OF THE GAZETTE OF INDIA,
EXTRAORDINARY]

GOVERNMENT OF INDIA

MINISTRY OF FINANCE

(Department of Revenue)

Notification No. 11/2017-Central Tax (Rate)

New Delhi, the 28th June, 2017

G.S.R. (E).- In exercise of the powers conferred by sub-section (1) of section 9 of the Central Goods and Services Tax Act, 2017 (12 of 2017), the Central Government, on the recommendations of the Council, hereby makes the following amendments in the notification of the Government of India, in the Ministry of Finance (Department of Revenue), No.11/2017-Central Tax (Rate), dated the 28th June, 2017 published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i), *vide* number G.S.R. 673(E) dated the 28th June, 2017, namely:-

2. In the said notification, -

- (i) In Sr. no (15), Chapter 9971, after entry (v) in Column (3), the following entry shall be inserted, namely: -

Sr. No.	Chapter, Section, Heading, Group or Service Code (Tariff)	Description of Services	Rate (per cent.)	Condition
(1)	(2)	(3)	(4)	(5)
15	9971	(vi) Taxable supplies received by Alternative Investment Funds	2.5	(i) Alternative Investment Funds wherein the total foreign investments is more than 50% shall be eligible. The split of domestic investments and foreign investments in the Alternative Investment Fund shall be monitored on a yearly basis, being financial year. Where, at the end of the financial year, the share of foreign

				<p>investment is less than 50% of the total investment in the Alternative Investment Fund, the rate specified in column (4) shall not be available for the financial year.</p> <p>For new Alternative Investment Funds, which have not been in existence during the entire duration of the previous financial year, the monitoring shall be based on the foreign investment in the AIF as on the date of first closing.</p> <p>(ii) The Alternative Investment Fund shall intimate the jurisdiction officer about its status at the time of first closing and at the beginning of each financial year, providing such details/ procedure to be followed as prescribed under the Annexure. If the Alternative Investment Fund is not registered, the responsibility of filing the declaration shall be with the Manager of the Alternative Investment Fund.</p> <p>(iii) The Alternative Investment Fund should provide a copy of the intimation filed as per SI No. 1 of the Annexure to all its suppliers from whom it seeks to receive supplies at the rate specified on column (4).</p>

(iii) In para 4, after SI No (viii), the following explanation shall be inserted

- (ix) Alternative Investment Fund shall have the meaning assigned to it under Regulation 2(1)(b) of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012
- (x) Foreign investment shall mean investment by non-resident entity/person resident outside India in accordance with Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.
- (xi) Taxable supplies provided by the Associate (in the capacity of a Manager) to the Alternative Investment Fund shall also be covered under Entry (vi) in SI No (15) of the table.

[F.No. [REDACTED]/[REDACTED]/2017-TRU]

(*****)

Under Secretary to the Government of India

Annexure

The Alternative Investment Fund shall be required to fulfill the following procedure:

- (1) A statement evidencing split of investments between domestic and foreign investors in the Alternative Investment Fund shall be required to be filed with the jurisdictional officer;
- (2) The statement shall be submitted within 90 days of the end of the relevant financial year.

[TO BE PUBLISHED IN PART II, SECTION 3, SUB-SECTION (i) OF THE GAZETTE OF INDIA,
EXTRAORDINARY]

GOVERNMENT OF INDIA

MINISTRY OF FINANCE

(Department of Revenue)

Notification No. 8/2017-Integrated Tax (Rate)

New Delhi, the 28th June, 2017

G.S.R. (E).- In exercise of the powers conferred by sub-section (1) of section 5 of the Integrated Goods and Services Tax Act, 2017 (13 of 2017), the Central Government, on the recommendations of the Council, hereby makes the following amendments in the notification of the Government of India, in the Ministry of Finance (Department of Revenue), No.8/2017-Integrated Tax (Rate), dated the 28th June, 2017 published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i), *vide* number G.S.R. 673(E) dated the 28th June, 2017, namely:-

2. In the said notification,-

In Sl no (15), Chapter 9971, after entry (v) in Column (3), the following entry shall be inserted, namely:-

Sl. No.	Chapter, Section, Heading, Group or Service Code (Tariff)	Description of Services	Rate (per cent.)	Condition
(1)	(2)	(3)	(4)	(5)
15	9971	(vi) Taxable supplies received by Alternative Investment Funds	5	(i) Alternative Investment Funds wherein the total foreign investments is more than 50% shall be eligible. The split of domestic investments and foreign investments in the Alternative Investment Fund shall be monitored on a yearly basis, being financial year. Where, at the end of the financial year, the share of foreign investment is less than 50% of the total investment in the Alternative Investment

				<p>Fund, the rate specified in column (4) shall not be available for the financial year.</p> <p>For new Alternative Investment Funds, which have not been in existence during the entire duration of the previous financial year, the monitoring shall be based on the foreign investment in the AIF as on the date of first closing.</p> <p>(ii) The Alternative Investment Fund shall intimate the jurisdiction officer about its status at the time of first closing and at the beginning of each financial year, providing such details/ procedure to be followed as prescribed under the Annexure. If the Alternative Investment Fund is not registered, the responsibility of filing the declaration shall be with the Manager of the Alternative Investment Fund.</p> <p>(iii) The Alternative Investment Fund should provide a copy of the intimation filed as per SI No. 1 of the Annexure to all its suppliers from whom it seeks to receive supplies at the rate specified on column (4).</p>
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(iv) In para 4, after SI No (viii), the following explanation shall be inserted

- (ix) Alternative Investment Fund shall have the meaning assigned to it under Regulation 2(1)(b) of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012
- (x) Foreign investment shall mean investment by non-resident entity/person resident outside India in accordance with Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.
- (xi) Taxable supplies provided by the Associate (in the capacity of a Manager) to the Alternative Investment Fund shall also be covered under Entry (vi) in SI No (15) of the table.

[F.No. [REDACTED]/[REDACTED]/2017-TRU]

(*****)

Under Secretary to the Government of India

Annexure

The Alternative Investment Fund shall be required to fulfill the following procedure:

- (1) A statement evidencing split of investments between domestic and foreign investors in the Alternative Investment Fund shall be required to be filed with the jurisdictional officer
- (2) The statement shall be submitted within 90 days of the end of the relevant financial year.

Annexure 2

BILL NO_of 2017

The Central Goods and Service Tax Act Amendment Bill, 2017

Amendment to Schedule III

(i) After entry 6, the following entry shall be added:

7. Share in income or profits distributed by an Alternative Investment Fund to its Sponsor, Fund Manager, any employee of the Sponsor or Fund Manager or to any other person

Chapter IV

India: Alternative Investment Funds in International Financial Services Centers

Chapter IV

India: Alternative Investment Funds in International Financial Services Centers

A. Introduction

1. An International Financial Services Centre (IFSC) is an area which enables the inflow of capital by providing a package of services to investment managers. This requires a conducive regulatory framework and easy access to the requisite talent pool of professional fund managers, bankers, lawyers, technologists and accountants.
2. The main benefits to India of an IFSC are:
 - (i) Added inflow of capital which is much needed for India's economic growth, development and employment generation;
 - (ii) Reduction in the loss of invisible earnings to other financial centers elsewhere in the globe;
 - (iii) Proximity of fund management functions to portfolio companies in India for ease of due diligence, portfolio monitoring and fund administration;
 - (iv) Leveraging India's deep talent pool in professions like fund management, accountancy and law;
 - (v) Provide a platform for global investing to India-based, overseas investors; and
 - (vi) Enhance the development of Indian capital markets.
3. The world has witnessed the growth of international financial hubs such as London, New York, Hong Kong, Singapore and Dubai. The time is ripe now to examine and recommend the measures needed to enhance the flows of capital through an IFSC in India. For example, according to a recent Global Limited Partner survey conducted by the Emerging Markets Private Equity Association (EMPEA), India is seen as one of the most attractive economies for allocating capital commitments. In addition, India is one of the fastest growing economies in the world. It is regarded as one of the most attractive destinations for foreign investment. India's attractiveness has also been enhanced by the Government's move to create an environment in which there is ease of doing business. Several countries across the world have successfully established such centers by instituting a favourable and stable regulatory environment.

4. In recognition of the benefits of IFSCs, the Government of India (“GoI”) notified India’s first IFSC in Gujarat at the Gandhinagar Fin-Tech City and followed up with relevant tax and regulatory amendments to activate its functioning. International financial centres benefit from a low burden of regulation and prove extremely attractive for offshore investors and funds as they are driven by lighter regulatory requirements, world class infrastructure, and ease in doing business, rather than the perceived tax benefits. Given India’s commitment to the Organization for Economic Cooperation and Development’s ‘G20 Base Erosion and Profit Shifting’ project, the GoI aims to promote its IFSC as a global financial services hub with minimal tax arbitrage vis-à-vis its domestic and other global markets.
5. The promotion and development of the IFSC is a priority for GOI. The current regulatory regime designed to promote Alternative Investment Funds in IFSCs has in-built regulatory restrictions which need to be addressed in order to open doors for offshore funds. This chapter addresses reforms in the Income Tax Act, 1961 and SEBI regulations governing AIFs and Foreign Portfolio Investors (FPI) in IFSCs.
6. The origins of IFSCs in India lie in **Section 18 in The Special Economic Zones Act, 2005 which states that:**

Setting up of International Financial Services Centre. —

- i. The Central Government may approve the setting up of an International Financial Services Centre in a Special Economic Zone and prescribe the requirements for setting up and operation of such Centre: Provided that the Central Government shall approve only one International Financial Services Centre in a Special Economic Zone.
 - ii. The Central Government may, subject to such guidelines as may be framed by the Reserve Bank, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority and such other concerned authorities, as it deems fit, prescribe the requirements for setting up and the terms and conditions of the operation of Units in an International Financial Services Centre.
7. One of the most significant, growing and stable class of capital in recent years in India has been venture capital and private equity. These capital flows are regulated domestically as pooled investment vehicles known as Alternative Investment Funds under SEBI’s Alternative Investment Fund Regulations, 2012.
 8. The current regulatory regime for AIFs in an IFSC is restrictive and offers investment in limited products/sectors. The recommendations listed in this chapter need to be implemented to realise the benefits highlighted above and to provide a suitable

regulatory regime for offshore investors / AIFs in an IFSC which make inbound as well as outbound investments. The remainder of this chapter is divided into the following two parts:

- (i) PART A: The Tax Environment
- (ii) PART B: The Regulatory Framework

B. PART A: The Tax Environment for an IFSC in India

The tax issues to be addressed for setting up Alternative Investment Funds in an International Financial Services Centre ('IFSC') are addressed in this section. Three sets of tax amendments are recommended:

- (a) exemption of specified income;
- (b) exemption from filing return of income; and
- (c) safe harbour for India-based fund managers.

I. Recommendation: Exemption from tax for any income earned by offshore investors (overseas investors in entities domiciled in an IFSC) from offshore investments made outside India, through SEBI-registered AIFs domiciled in an IFSC.

9. Indian tax laws follow source-based taxation, wherein any income earned by a non-resident is taxable in India, if such income is –
 - a. Received, or deemed to be received, in India; or
 - b. Accrues or arises, or is deemed to accrue or arise, in India.
10. Accordingly, any income earned by a foreign investor, from an investment made in an offshore jurisdiction through an AIF set up in an IFSC, is taxable in India. (For example, any income earned by a US investor from making investment in the Korean market through an AIF / company set in an IFSC in India would be taxable in India.) Such unfavorable tax treatment, relative to other other IFSCs abroad, may deter global fund managers from domiciling an AIF i.e. a pooling vehicle in an IFSC in India.
11. However, if a similar transaction is undertaken through a fund set up in an offshore jurisdiction e.g. Singapore, then any income earned by a US investor from an investment in the Korean market (made through a fund domiciled in Singapore), the income may not be subject to any tax in Singapore.
12. Given the above and with a view to encouraging offshore investment by foreign investors through AIFs set up and domiciled in an IFSC in India, any income earned from such a transaction should be exempted from tax in India.

II. Recommendation: Relaxation from filing return of income and obtaining PAN number for offshore investors in an AIF in IFSC

13. Currently, Category I and II AIFs have been provided tax pass-through status for capital gains under Indian income tax laws. While distributing any income to its investors, an Indian AIF is required to withhold taxes at the applicable rates depending on the jurisdiction of the investor and remit such taxes to the Government of India.
14. Further, Indian income tax laws also require the unit holders i.e. the investors, to obtain tax registration (i.e. to obtain a Permanent Account Number-PAN- and disclose income by filing a Return of Income ('RoI') in India.
15. Collection of tax revenue is effected by the above withholding requirement in the hands of the AIF, resulting in no tax revenue leakage for the Government of India.
16. The need to obtain tax registrations and filing of a RoI by the unitholder requires an investor to go through the rigours of compliance in India. While this approach may be required for the domestic market, an IFSC regime should be more investor-friendly in terms of compliance requirements.
17. In order to encourage foreign investors to directly invest via an IFSC-domiciled AIF, without worrying about the complications of Indian tax compliance, the Government of India should exempt foreign investors from obtaining a PAN number and the requirement to file a tax return in India, in respect of any income distributed by an AIF in an IFSC after deduction of tax at source.
18. Where such foreign investor earns any other income from India, he should be subject to the above compliance requirements.

III. Recommendation: The IT Act should recognise that an Eligible Investment Fund which is domiciled in an IFSC does not constitute a business connection in India by virtue of such domiciliation.

19. The Central Board of Direct Taxes (CBDT) issued a notification on 15th March, 2016 prescribing Rules for application of section 9A of the Income-tax Act, 1961 (the Act) dealing with taxation of offshore funds in India¹.
20. Section 9A of the Act encapsulates safe harbour provisions whereby an 'eligible investment fund' shall not be regarded as a tax resident in India merely because an 'eligible fund manager' undertaking fund management activities on its behalf is located in India. Benefits under the safe harbour provisions are subject to compliance with

¹ Fund management activities - Safe Harbour Rules prescribed

[https://www.pwc.in/assets/pdfs/news-alert-](https://www.pwc.in/assets/pdfs/news-alert-tax/2016/pwc_news_alert_17_march_2016_fund_management_activities-safe_harbour_rules_prescribed.pdf)

[tax/2016/pwc_news_alert_17_march_2016_fund_management_activities-safe_harbour_rules_prescribed.pdf](https://www.pwc.in/assets/pdfs/news-alert-tax/2016/pwc_news_alert_17_march_2016_fund_management_activities-safe_harbour_rules_prescribed.pdf)

certain conditions. The CBDT has issued detailed Rules for the application of such safe harbour provisions.

- 21.** It is recommended that this safe harbour be extended to include Eligible Investment Funds domiciled i.e. established in an IFSC. The specific wording of the recommended amendments to s. *Section* 9A (2) and 9A(3) of the IT Act is given below.

Proposed Amendments to Implement the IFSC Recommendations

- 1. Exemption from tax of any income earned by an offshore investor from offshore investments made through a Fund domiciled in an IFSC*
22. In order to treat an AIF set up in an IFSC on par with a fund, i.e. a pooling vehicle set up in an offshore jurisdiction, and encourage offshore investments by a foreign investor through a fund i.e. an AIF set up in an IFSC in India, any income arising from such investments should be exempted from tax in India.

Suggested Amendments:

It is recommended to insert the following proviso in section 5(2) of the Income-tax Act, 1961

“Provided that in the case of a non-resident, being an unit holder in an Alternative Investment Fund set up in an International Financial Services Center in India, the income referred to in sub-section (2) above, shall not include any income, to the extent, derived from any investment made by such Alternative Investment Fund outside India.

Explanation 3.- For the purpose of this proviso, an Alternative Investment Fund means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012 and Securities and Exchange Board of India (International Financial Services Centres) Guidelines, 2015 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992).

II. Exemption from filing return of income and obtaining PAN number for offshore investors in an AIF in IFSC

23. In order to encourage foreign investors to directly come into the IFSC without worrying about the complications of Indian tax compliance the Government of India should exempt offshore investors from obtaining a PAN number and the filing of tax returns in India, in respect of any income distributed by an AIF in an IFSC after deduction of tax at source.

Suggested Amendments:

A. Exemption from obtaining Permanent Account Number

It is recommended to issue the following notification pursuant to powers conferred in clause (d) to sub-section (8) of section 139A of the Income-tax Act, 1961

SECTION 139A OF THE INCOME-TAX ACT, 1961 – EXEMPTION FOR INVESTORS IN AN ALTERNATIVE INVESTMENT FUND SET UP IN AN INTERNATIONAL FINANCIAL SERVICES CENTRE

NOTIFICATION NO. S.O. _(E) [NO. XXX—201X (F. NO._-_-_-)], DATED XX-XX- 201X

In exercise of the powers conferred by clause (d) to sub-section (8) of section 139A of the Income-tax Act, 1961 (XX of 1961), the Central Government hereby specifies that the requirement to obtain a permanent account number shall not apply in respect of the following class or classes of persons, namely:

- (a) a non-resident, not being a company, or
- (b) a foreign company

which earns income only from investments made in an Alternative Investment Fund set up in an International Financial Services Centre.

B. Exemption from filing Return of Income

It is recommended to insert the following sub clause (iv) in clause (a) of sub-section (1) in section 115A of the Income-tax Act, 1961

"(iv) income received in respect of units, purchased in foreign currency, of an Alternative Investment Fund set up in an International Financial Services Centre;"

- III. Recommendation: The IT Act to be amended to recognize that Eligible Investment Funds which are domiciled in an IFSC do not constitute a business connection in India.

Recommended Amendments to Safe Harbor Provisions of the IT Act, 1961

Section 9A(2) of the IT Act recommended to be amended as follows:

“Notwithstanding anything contained in section 6, an eligible investment fund shall not be said to be resident in India for the purpose of that section merely because the eligible fund manager including a portfolio manager incorporated or established in an International Financial Services Centre, undertaking fund management activities on its behalf, is situated in India.”

Section 9A(3) of the IT Act recommended to be amended as follows:

“The eligible investment fund referred to in sub-section (1), means a fund established or incorporated or registered outside India, including a fund established or incorporated in an International Financial Services Centre, which collects funds from its members for investing it for their benefit and fulfils the following conditions, namely:— ...”

The following proviso will be inserted in Regulation 9A(3):

“Provided further that the conditions specified in sub-clauses (a), (b), (d), (h), (j), (k) and (l) shall be deemed to be fulfilled in case of funds established or incorporated in an International Financial Services Centre.”

C. PART B: The Regulatory Environment for AIFs in an IFSC in India

24. Two sets of regulations under the regulatory authority of SEBI will require enabling amendments, or SEBI may issue equivalent guidelines, for helping grow AIFs domiciled in IFSCs. These are mainly the AIF and FPI regulations. In addition, certain consequential FEMA amendments are also needed.
25. The changes are briefly described below followed by boxes and a matrix indicating the suggested amendments (see also the Matrix at the end of this report).
- (i) Overseas investors to be enabled to invest in India through any route including the FPI, FDI and FVCI routes and ability to invest in LLPs.
 - (ii) Since IFSC- domiciled AIFs will source funds from offshore investors, the current limits on overseas investments of SEBI-regulated AIFs should not apply to AIFs domiciled in IFSCs;
 - (iii) Domestic fund managers/sponsors should be permitted to manage AIFs domiciled in an IFSC; and
 - (iv) It is good practice for fund managers or fund sponsors to invest in AIFs which they manage/sponsor. SEBI AIF regulations require such sponsor commitments as skin-in-the-game. Accordingly, FEMA regulations should enable investment by a domestic fund manager/sponsor to invest in an AIF which they manage which is domiciled in an IFSC.

Proposed Recommendations

I. Investment Avenues for AIFs in IFSCs

26. Currently, offshore funds/investors invest in listed as well as unlisted securities² in the Indian market through the FDI route, the FPI route or the FVCI route.
27. Considering the above, in order to ensure that AIF's in IFSCs are treated on par with the offshore funds / investors with respect to the permissible investment avenues for making investments into India, an AIF in an IFSC should be permitted to invest in India under all the permissible investment avenues.
28. Further, an AIF in an IFSC should also be allowed to participate in the capital of a Limited Liability Partnership incorporated in India.

² including interests in limited liability partnerships

29. Considering the above, specific amendments should be made in the regulations to expand the available investment products for an AIF set up in an IFSC.

Suggested Amendments:

SEBI Impact

It is recommended that the following amendments are made to the Circular No. SEBI/HO/MRD/DSA/CIR/P/2017/45 of SEBI dated May 23, 2017.

Clause 22 (3) of SEBI (IFSC) Guidelines, 2015 is to be amended and read as follows:

"Any alternative investment fund or mutual fund operating in IFSC shall be permitted to invest in the following:

- a) Securities which are listed in IFSC;
- b) Securities issued by companies incorporated in IFSC;
- c) Securities issued by companies incorporated in India or companies belonging to foreign jurisdiction. subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and Government of India from time to time;**and**
- d) Capital of limited liability partnerships incorporated in India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and Government of India from time to time."

~~Further, it is clarified that such portfolio manager, alternative investment fund or mutual fund shall invest in India through the foreign portfolio investor route~~

~~Such alternative investment fund or mutual fund shall obtain registration, where necessary, under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014.~~

~~Further, it is clarified that the Circular No. CIR/IMD/DF/7/2015 dated /1 October 2015 issued by the Board on 'Guidelines on overseas investments and other issues / clarifications for AIFs/VCFs' shall not apply to an AIF set up in an IFSC."~~

FEMA Impact

The following proviso needs to be inserted in Regulation 26 of the Foreign Exchange Management (Transfer or issue of Foreign Security) Regulations, 2004:

"Provided that nothing contained in this regulation shall apply to an AIF set up in an IFSC."

II. The Sponsor and Manager of an AIF in an IFSC

30. Considering the regulatory requirements for a Sponsor/Manager, the SEBI IFSC guidelines should be relaxed to permit a Sponsor / Manager of an existing AIF in India to act as a Sponsor / Manager of an AIF in an IFSC by setting up a branch, or a company, or a limited liability partnership in an IFSC or by way of direct investment from India.

Suggested Amendments:

It is recommended to insert the following clause clause 22.7 in Chapter VI – Funds of the SEBI (International Financial Services Centres) Guidelines, 2015:

“22.7 The Sponsor / Manager of an Alternative Investment Fund in IFSC shall be in compliance with the provisions of this clause -

a) A Sponsor / Manager of an Alternative Investment Fund in India may act as a Sponsor / Manager of an Alternative Investment Fund set up in the IFSC by–

- i) directly investing from India, outside IFSC; or**
- ii) setting up a branch in the IFSC; or**
- iii) incorporating a company or limited liability partnership in the IFSC**

subject to any guidelines, regulations issued by the Reserve Bank of India from time to time.

b) In other cases, such a Sponsor / Manager shall need to incorporate a company or limited liability partnership in the IFSC.”

III. The Sponsor / Manager Commitment

- 31.** The following amendments need to be made in the relevant Foreign Exchange Management Regulations issued by RBI.

Scenario 1 – Domestic Sponsor / Manager in India to act as a Sponsor / Manager for an AIF in an IFSC

Suggested Amendments:

The following regulation needs to be inserted in the Foreign Exchange Management (Transfer or issue of Foreign Security) Regulations, 2004:

“6D. General permission for investment in Alternative Investment Funds in International Financial Service Centre

Notwithstanding anything contained in Regulation 7, any person resident in India may invest in an Alternative Investment Fund set up in an International Financial Service Centre provided such investment is made in its capacity as a Sponsor / Manager of the Alternative Investment Fund.”

Scenario 2 - Domestic Sponsor / Manager in India to act as a Sponsor / Manager for an AIF in IFSC by setting up a branch in IFSC

- 32.** To liberalise remittance of funds by the Sponsor/ Manager in India to its branch in an IFSC, the Reserve Bank of India should amend the Foreign Exchange Management

(Foreign Currency Accounts by a Person Resident In India) Regulations, 2015 to specifically permit such remittances.

Suggested Amendments:

- It is recommended to amend clause (B) of Regulation 5 of the Foreign Exchange Management (Foreign Currency Accounts By a Person Resident In India) Regulations, 2015 by inserting the following clause (iii) under clause (b) to the first proviso as follows::

“(iii) Nothing contained in clause (i) and (ii) above shall apply to any remittance made to the branch, which is a Sponsor / Manager of an Alternative Investment Fund in an International Financial Services Centre.”

Scenario 3 - Domestic Sponsor / Manager in India to incorporate a Company / Limited Liability Partnership in IFSC and act as a Sponsor / Manager for an AIF in IFSC

Suggested Amendments:

It is recommended to amend sub-regulation 7 of the Foreign Exchange Management (Transfer or issue of Foreign Security) Regulations, 2004 by inserting the following proviso after clause (2) as follows:

“Provided that nothing contained in clause 1) and 2) above shall apply to any investment made by a person resident in India in a company or limited liability partnership, incorporated in an International Financial Services Centre, to act as a Sponsor / Manager for an Alternative Investment Fund in such centre.”

33. Leverage at the Fund level of AIFs in an IFSC

SEBI may consider relaxing the leverage restrictions on AIF's domiciled in an IFSC subject to appropriate safeguards. Some examples of the leverage restrictions in other regimes are given below:

The Alternative Investment Fund Managers Directive (AIFMD)

Any AIFM, managing one or more AIF using leverage, will have to provide the competent authorities of its home Member State regular information concerning its leverage.

The concerned Member State regulator will inform the ESMA of the leverage limits disclosed and the latter may decide to limit the level of leverage used if it considers

that the leverage employed by an AIFM may pose a substantial risk to the stability and integrity of the financial system.

While funds that comply as Alternative Investment Funds (under the Alternative Investment Fund Managers Directive regime) are not subject to leverage restrictions, nevertheless additional reporting is required from them if they employ leverage more than 3x their assets.

Singapore

In Singapore, private funds offered through private placement, or to accredited or institutional investors, are not restricted in the use or extent of their borrowing/leverage at the fund level, provided they disclose the information to the investors in the fund. Only funds offered to the retail public (such as REITs in Singapore) are restricted in their use of leverage.

IFSC: Matrix of Regulatory Changes in SEBI's Foreign Portfolio Investors(FPI) and AIF Regulations/Guidelines

CURRENT REGIME	RECOMMENDED AMENDMENTS
Recommended Amendments for FPIs	
SEBI (International Financial Services Centre) Guidelines, 2015 Chapter III, Guideline 8 Any recognised entity or entities desirous of operating in IFSC as an intermediary, <u>may form a company to provide such financial services relating to securities market</u> , as permitted by the Board.	Guideline 8 may be amended as follows: "Any recognised entity or entities desirous of operating in IFSC as an intermediary, <u>may form a company, limited liability partnership or a trust</u> to provide such financial services relating to securities market, as permitted by the Board."
SEBI (Foreign Portfolio Investors) Regulations, 2014 Definitions - Regulation 2	The following should be inserted as Regulation 2(ia): <u>"International Financial Services Centre" or "IFSC" shall have the same meaning as assigned to it in clause (q) of section 2 of the Special Economic Zones Act, 2005"</u>
SEBI (Foreign Portfolio Investors) Regulations, 2014 Eligibility criteria of foreign portfolio	The following proviso should be included after Regulation 4: <u>"Provided that the eligibility requirements under sub-clause (a), (b), (c), (d) and (f) shall</u>

CURRENT REGIME	RECOMMENDED AMENDMENTS
<p>investor</p> <p>Regulations 4 - The designated depository participant shall not consider an application for grant of certificate of registration as a foreign portfolio investor unless the applicant satisfies the following conditions namely, -</p> <p>(a) the applicant is a person not resident in India;</p> <p>(b) the applicant is resident of a country whose securities market regulator is a signatory to International Organization of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with the Board;</p> <p>(c) the applicant being a bank, is a resident of a country whose central bank is a member of Bank for International Settlements;</p> <p>(d) the applicant is not resident in a country identified in the public statement of Financial Action Task Force as:</p> <p style="padding-left: 40px;">(i) a jurisdiction having a strategic Anti- Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or</p> <p style="padding-left: 40px;">(ii) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies;</p> <p>(e) the applicant is not a non-resident Indian;</p> <p>(f) the applicant is legally permitted to invest in securities outside the country of its incorporation or establishment or place of business;</p> <p>(g) the applicant is authorized by its Memorandum of Association and Articles of</p>	<p><u>be deemed to be fulfilled in the case the applicant is established or incorporated in an International Finance Services Centre."</u></p>

CURRENT REGIME	RECOMMENDED AMENDMENTS
<p>Association or equivalent document(s) or the agreement to invest on its own behalf or on behalf of its clients;</p> <p>(h) the applicant has sufficient experience, good track record, is professionally competent, financially sound and has a generally good reputation of fairness and integrity;</p> <p>(i) the grant of certificate to the applicant is in the interest of the development of the securities market;</p> <p>(j) the applicant is a fit and proper person based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008; and</p> <p>(k) any other criteria specified by the Board from time to time.</p>	
<p>SEBI (Foreign Portfolio Investors) Regulations, 2014</p> <p>Categories of foreign portfolio investor</p> <p>Regulation 5- An applicant shall seek registration as a foreign portfolio investor in one of the categories mentioned hereunder or any other category as may be specified by the Board from time to time:</p> <p>(b) "Category II foreign portfolio investor" which shall include:</p> <p>(i) appropriately regulated broad based funds such as mutual funds, investment trusts, insurance/reinsurance companies;</p> <p>(ii) appropriately regulated persons such as banks, asset management companies, investment managers/ advisors, portfolio manager;</p> <p>(iii) broad based funds that are not appropriately regulated but whose investment manager is appropriately regulated:</p>	<p>Explanation 1 and 2 of Regulation 5 should be amended as follows:</p> <p><i>"Explanation 1- For the purposes of this clause, an applicant seeking registration as a foreign portfolio investor shall be considered to be "appropriately regulated" if it is regulated or supervised by the securities market regulator or the banking regulator, of the concerned foreign jurisdiction, in the same capacity in which it proposes to make investments in India, <u>provided that an applicant established in an International Financial Services Centre will be deemed to be "appropriately regulated" for the purposes of these Regulations.</u></i></p> <p><i>Explanation 2-</i></p> <p>A) For the purposes of this clause, "broad based fund" shall mean a fund, established or incorporated outside India <u>or in an International Financial Services Centre</u>, which has at least twenty investors, with no investor holding more than forty-nine per</p>

CURRENT REGIME	RECOMMENDED AMENDMENTS
<p>Provided that the investment manager of such broad-based fund is itself registered as Category II foreign portfolio investor:</p> <p>Provided further that the investment manager undertakes that it shall be responsible and liable for all acts of commission and omission of all its underlying broad-based funds and other deeds and things done by such broad-based funds under these regulations.</p> <p><i>Explanation 1</i>-For the purposes of this clause, an applicant seeking registration as a foreign portfolio investor shall be considered to be "appropriately regulated" if it is regulated or supervised by the securities market regulator or the banking regulator of the concerned foreign jurisdiction, in the same capacity in which it proposes to make investments in India.</p> <p>Explanation 2-</p> <p>A) For the purposes of this clause, "broad based fund" shall mean a fund, established or incorporated outside India, which has at least twenty investors, with no investor holding more than forty-nine per cent of the shares or units of the fund:</p> <p>Provided that if the broad-based fund has an institutional investor who holds more than forty-nine per cent of the shares or units in the fund, then such institutional investor must itself be a broad based fund.</p> <p>B) For the purpose of clause, A of this Explanation, for ascertaining the number of investors in a fund, direct investors as well as underlying investors shall be considered.</p> <p>C) For the purpose of clause B of this Explanation, only investors of entities which have been set up for the sole purpose of pooling funds and making investments, shall be considered for the purpose of determining underlying investors.</p>	<p>cent of the shares or units of the fund:"</p>
SEBI (Foreign Portfolio Investors)	Explanation 1 of Regulation 32(1) should be

CURRENT REGIME	RECOMMENDED AMENDMENTS
<p>Regulations, 2014</p> <p>Regulation 32 (1)- All designated depository participants who have been granted approval by the Board shall -</p> <p>(a) comply with the provisions of these regulations, as far as they may apply, circulars issued thereunder and any other terms and conditions specified by the Board from time to time;</p> <p>(b) forthwith inform the Board in writing, if any information or particulars previously submitted to the Board are found to be false or misleading, in any material respect;</p> <p>(c) forthwith inform the Board in writing, if there is any material change in the information previously furnished by him to the Board;</p> <p>(d) furnish such information, record or documents to the Board and Reserve Bank of India, as may be required, in relation to his activities as a designated depository participant;</p> <p>(e) ensure that only registered foreign portfolio investors are allowed to invest in securities market;</p> <p>(f) ensure that foreign portfolio investor does not have opaque structure(s):</p> <p>Explanation 1.- For the purposes of this clause, "opaque structure" shall mean any structure such as protected cell company, segregated cell company or equivalent, where the details of the ultimate beneficial owners are not accessible or where the beneficial owners are ring fenced from each other or where the beneficial owners are ring fenced with regard to enforcement: Provided that the foreign portfolio investor satisfying the following criteria shall not be treated as having opaque structure:</p> <p>(i) the applicant is regulated in its home</p>	<p>amended as follows:</p> <p><i>"Explanation 1.- For the purposes of this clause, "opaque structure" shall mean any structure such as protected cell company, segregated cell company or equivalent, where the details of the ultimate beneficial owners are not accessible or where the beneficial owners are ring fenced from each other or where the beneficial owners are ring fenced with regard to enforcement: Provided that the foreign portfolio investor satisfying the following criteria shall not be treated as having opaque structure:</i></p> <p>(i) the applicant is regulated in its home jurisdiction</p> <p><u><i>Provided if the applicant is established in an International Financial Services Centre, it will be deemed to be regulated in its home jurisdiction;</i></u></p> <p>(ii) each fund or sub fund in the applicant satisfies broad based criteria, and</p> <p>(iii) the applicant gives an undertaking to provide information regarding its beneficial owners as and when Board seeks this information."</p>

CURRENT REGIME	RECOMMENDED AMENDMENTS
<p>jurisdiction</p> <p>(ii) each fund or sub fund in the applicant satisfies broad based criteria, and</p> <p>(iii) the applicant gives an undertaking to provide information regarding its beneficial owners as and when Board seeks this information.</p> <p>Explanation 2.- For the purposes of Explanation 1, the definition of ultimate beneficial owner shall be as provided under the Master circular on Anti Money Laundering Standards or Combating the Financing of Terrorism, issued by the Board from time to time.</p> <p>(g) have adequate systems to ensure that in case of jointly held depository accounts, each of the joint holders meet the requirements specified for foreign portfolio investors and shall perform KYC due diligence for each of the joint holders;</p> <p>(h) in case of any penalty, pending litigations or proceedings, findings of inspections or investigations for which action may have been taken or is in the process of being taken by any regulator against a designated depository participant, the designated depository participant shall bring such information forthwith, to the attention of the Board, depositories and stock exchanges;</p> <p>(i) be guided by the relevant circular on Anti-Money Laundering or Combating the Financing of Terrorism specified by the Board from time to time.</p>	
Recommendations for Amendments to SEBI AIF Regulations	
<p>SEBI (Alternative Investment Fund) Regulations, 2012</p> <ul style="list-style-type: none"> General Investment Conditions- Regulation 15(a) <p>Alternative Investment Fund may invest in securities of companies incorporated outside India subject to such conditions or</p>	<p>A circular must be issued by SEBI clarifying that SEBI circular dated 1 October 2015 will not apply to alternative investment funds established or incorporated in an International Financial Services Centre and they shall be permitted to invest outside India freely, without requiring any regulatory approvals from SEBI or RBI.</p>

CURRENT REGIME	RECOMMENDED AMENDMENTS
<p>guidelines that may be stipulated or issued by the Reserve Bank of India and the Board from time to time</p> <ul style="list-style-type: none"> SEBI Circular dated 1 October 2015 <p>Re: Guidelines on overseas investments and other issues/clarifications for AIFs/VCFs</p> <p>The circular <i>inter alia</i> provides the following:</p> <ol style="list-style-type: none"> AIFs may invest in equity and equity linked instruments only of offshore venture capital undertakings, subject to overall limit of USD 500 million (combined limit for AIFs and Venture Capital Funds); AIFs desirous of making investments in offshore venture capital undertakings shall submit their proposal for investment (in the attached format at Annexure) to SEBI for prior approval; Investments would be made only in those companies which have an Indian connection (e.g. company which has a front office overseas, while back office operations are in India); Such investments shall not exceed 25% of the investible funds of the scheme of the AIF; and The allocation of investment limits would be done on 'first come first serve' basis, depending on the availability in the overall limit of USD 500 million. 	

Further suggestions for reform in SEBI AIFs regulations/guidelines are contained in the detailed matrix at the end of this report.

Chapter V

India: Taxation of Alternative Investment Funds

Chapter V

India: Taxation of Alternative Investment Funds

A. Introduction

1. During the past few years, the Central Board of Direct Taxes (CBDT) has adopted measures to improve the tax environment for Alternative Investment Funds in India. This chapter lists some of the tax measures which the Government has recently implemented for Alternative Investment Funds. The Government has recognised the principle of pass-through taxation of AIFs under which investors are taxed and not the fund pooling vehicle. Accordingly, the principle of pass-through taxation has been applied to AIF Categories I & II.

2. This chapter makes three sets of recommendations as follows:

Firstly, it recommends further refinements in the taxation of AIFs to enable deduction of expenses and pass-through of net losses;

Secondly, it recommends a regime for AIFs listed on stock exchanges which have the unique characteristic of a frequently changing pool of unitholders i.e. investors; and

Finally, it recommends investor-level taxation for Category III AIFs which are currently taxed under an ambiguous trust taxation regime.

B. Summary of Recent Tax Reforms Impacting Alternative Investment Funds

3. Characterisation of income arising from the transfer of listed shares and securities

The treatment of investment exit gains (whether taxable as business income or capital gains) has been a matter of litigation. There have been several judicial pronouncements on whether gains from transactions in securities should be taxed as “business profits” or as “capital gains”. However, these pronouncements, while laying down guiding principles, have been driven by the facts and circumstances of each case.

The Central Board of Direct Taxes (CBDT) issued Circular 6 of 2016 dated February 29, 2016 in respect of treatment of surplus arising on the transfer of listed shares/ securities with a view to reduce litigation and maintain consistency in approach. The Circular states that:

- Where the assessee itself treats listed shares/securities as ‘stock in trade’, irrespective of the period of holding, income from transfer to be treated as business income; and
- In the case of listed shares/securities held for more than 12 months period immediately preceding date of transfer, the tax authorities shall not dispute the stand taken by assessee of treating such income as capital gains. However, this stand once taken shall remain applicable in subsequent years also; and
- In all other cases, guidance under existing CBDT circulars shall apply.

The aforesaid principles shall not apply in cases where genuineness of transaction itself is in dispute.

4. Characterisation of income as 'capital gains' from transfer of unlisted shares held by Category I and II Alternative Investment Funds (AIFs)

The CBDT issued an instruction dated 2 May 2016 clarifying that the income arising from transfer of unlisted shares will be treated as 'capital gains' irrespective of the period of holding except in the following situations where the Assessing Officer would take an appropriate view:

- the genuineness of transactions in unlisted shares itself is questionable;
- the transfer of unlisted shares is related to issue pertaining to the lifting of the corporate veil;
- the transfer of unlisted shares is made along with the control and management of underlying business

Further, the CBDT has issued a clarification that the exception regarding transfer of unlisted shares along with 'control and management of the underlying business' would not be applicable to SEBI registered Category I AIFs and Category II AIFs.

5. Inclusion of the pre-conversion period in determining the holding period for convertible debentures

The CBDT, in its notification dated 17 March 2016, has stated that in the case of a capital asset being shares or debentures acquired by way of conversion of bonds, debentures, debenture-stock or deposit certificates, the period for which such bonds, debentures, debenture-stock or deposit certificates are held prior to its conversion would be included while determining the period of holding of such shares or debentures.

6. Tax neutrality for conversion of the preference shares and inclusion of the pre-conversion period in determining the holding period

The Finance Act, 2017 introduced section 47(xb) in the Income-tax Act, 1961 (the Act) to provide that the conversion of preference shares into equity shares will not be regarded as transfer under the Act. Hence, no capital gains would arise in the hands of the investors on conversion of convertible preference shares of a company into equity shares of that company.

Further, at the time of transfer of the equity shares received on conversion, the cost of acquisition of the convertible preference shares would be deemed to be the cost of acquisition of such equity shares. While computing the period of holding of the equity shares, the period for which the preference shares were held by the investor prior to the conversion shall also be included.

7. Clarification in the law on the applicability of 10% long-term capital gains tax to foreign investors investing in shares of private limited companies

Section 112(1)(c) of the Act provided a concessional tax rate of 10% on long term capital gains earned from transfer of unlisted securities in the hands of the non-residents

However, the manner in which the term ‘unlisted securities’ had been defined in the Act led to the unintentional consequence of the 10% concessional tax rate not being applicable to long-term gains on transfer of shares of private limited companies

Section 112 of the Act has been amended to clarify that the concessional tax rate of 10% is applicable to long-term capital gains arising from transfer of shares of private limited companies in the hands of non-resident investors.

8. Tax withholding for foreign investors in AIFs at ‘rates in force’

Section 194LBB of the Act has been amended to provide that tax deduction at source on accrual/ distribution of income to non-resident investors eligible for beneficial taxation provisions under an applicable Double Taxation Avoidance Agreement (DTAA) will be on the basis of the DTAA or domestic tax law provision, whichever is more beneficial to the investor.

9. No tax withholding for exempt domestic investors in AIFs

Section 197 of the Act which provides a mechanism whereby, the Assessing Officer upon application by the assessee, issues a nil withholding / lower withholding certificate did not include section 194LBB of the Act.

Section 197 of the Act has been amended so as to enable investors in AIFs to obtain a NIL/ reduced tax withholding certificate on investment proceeds, subject to conditions in the said section.

10. Exclusion for Category I and II AIFs in the notification for exemption on long-term capital gains on transfer of listed equity shares

The Finance Act, 2017 amended s. 10(38) of the Act to provide that such exemption will be available only if STT has been paid, both, at the time of sale and purchase of securities except in certain acquisitions.

CBDT’s notification dated 5 June 2017 *inter alia* provided that the acquisition of listed equity shares by a Category I and II AIFs will be eligible to claim benefit of section 10(38) of the Act even if securities transaction tax has not been paid at the time of acquisition of such shares.

C. Taxation of Alternative Investment Funds (AIFs): Deduction of Expenses & Pass through of Net Losses

11. A substantial majority of AIFs raise capital commitments from investors to form a pool of capital to be invested based on an investment thesis. In this mode of fund raising, investors place substantial reliance on the AIF’s investment manager.

12. The AIF’s investment manager has the fiduciary responsibility to originate, evaluate,

select, invest, monitor and disinvest the AIF's portfolio. An AIF requires significant fiduciary and management role and oversight of the business of the AIF's portfolio entities. This stewardship role generates substantial value for all stakeholders.

13. Substantial changes have been implemented in the Income-tax Act, 1961 (the Act) since the year 2015 that have addressed several tax issues faced by AIFs. However, from a tax perspective, the following two critical issues need to be addressed:

Significant costs incurred by the AIF are not factored in determining the investors' tax liability

14. Typically, an AIF would incur 15-20% of the investors' capital commitments towards fees payable to the investment manager, bankers, advisers, lawyers, accountants, administrators, and other service providers. Therefore, the amount actually invested by the AIF stands reduced by this amount and only 80-85% of the investor's capital commitments are actually invested. Commercially, the investor's gain on their investment is net of all expenses incurred by the AIF.
15. The main income stream of an AIF that makes investment in equity/ equity linked securities is gains on sale of investments, while it could also earn income in the form of interest or dividend. The Act provides for a mechanism for computation of income under the 'capital gains' head. As per the provisions of the Act, capital gains/losses are to be computed by reducing from the sale consideration:
 - the cost of acquisition of the asset transferred;
 - the cost of any improvement thereto; and
 - any expenditure incurred wholly and exclusively in connection with the transfer of the asset.
16. Several expenses of an AIF viz. investment management fee, service providers' fee for investments that are not consummated, administration expenses of the AIF are incurred even if there are no acquisition or exit during a particular period. Under the tax law, such expenses may not be included in the cost of acquisition/improvement of the asset or treated as an expenditure incurred for transfer of that asset for computing capital gains. This means in effect that the AIFs have to write-off the expenses, which means that neither the AIF nor their investors are able to offset the expenses against income/gains that may eventually result from the investment leading to an incongruence in the gains commercially derived by the investors (net of expenses) vs gains treated as taxable (gross of expenses). This issue is now further exacerbated by the fact that a number of services sought by AIFs are liable to goods and services tax at the rate of 18% (increased from 15% under the service tax regime).

Recommendation: Deduction of Expenses

Option 1: Allow management fee incurred from the date of the investment to the date of its divestment to be capitalised as –cost of improvement. The management fee incurred may be calculated based on the management fee contractually payable to the AIF’s investment manager at the annual rate applied to the actual cost of the investment.

Proposed Amendment

Modify section 55 (1)(b)(2)(ii) of the Act to read as under:

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

Notification required

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

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

Net losses incurred by AIFs are not available to investors and may lapse if not set-off by the AIF

17. Investors in AIFs could have chosen to directly invest in portfolio companies of their own accord. Conceptually, pooling vehicles are formed to derive two advantages; (a) to engage experienced professionals for investment management; and (b) to achieve economies of scale.
18. Tax implications play an important role for the investor to choose one form of investing over the other i.e. pooling vehicle vs. direct investing. An efficient tax system for AIFs would ensure that an investor in a pooling vehicle should have the same (or better) tax outcome in comparison with direct investment with the objective of driving investor preference towards professional fund management. Should investors suffer extra tax as a result of investing in an AIF vis-à-vis direct investment that would serve as a disincentive for investment in an AIF.
19. The present tax regime for Category I and II AIFs provides for pass-through of income earned by the AIF, however losses are retained at the fund level, and are not passed on to the investors. Typically, an AIF’s tenure would be 8-10 years from its launch. Practically, it is observed that in a fund, usually the profitable investments of the fund are first sold, while the relatively lesser performing investments may be sold towards the end of the fund’s life.
20. Based on the current provisions of the Act and the sequence of exits, practically, where Category I and II AIFs incur net losses on investments towards the end of its life or has unabsorbed losses, which cannot be utilised by the AIF, such losses would lapse. The investors would in this scenario also be taxed on an amount that would be greater than the “real” income derived by them from their total investment in the AIF. For an investor who has committed capital to an AIF and remained invested in the AIF for its full tenure,

Recommendation: Pass through of Net Losses

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

Proposed Amendment

115UB. (1) Notwithstanding anything contained in any other provisions of this Act and subject to the provisions of this Chapter, any income accruing or arising to, or received by, a person, being a unit holder of an investment fund, out of investments made in the investment fund, shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person had the investments made by the investment fund been made directly by him.

~~(2) Where in any previous year, the net result of computation of total income of the investment fund [without giving effect to the provisions of clause (23FBA) of section 10] is a loss under any head of income and such loss cannot be or is not wholly set off against income under any other head of income of the said previous year, then,—~~

~~(i) such loss shall be allowed to be carried forward and it shall be set off by the investment fund in accordance with the provisions of Chapter VI; and~~

~~(ii) such loss shall be ignored for the purposes of sub-section (1).~~

(3) The income paid or credited by the investment fund shall be deemed to be of the same nature and in the same proportion in the hands of the person referred to in sub-section (1), as if it had been received by, or had accrued or arisen to, the investment fund during the previous year ~~subject to the provisions of sub-section (2).~~

(4) The total income of the investment fund shall be charged to tax—

(i) at the rate or rates as specified in the Finance Act of the relevant year, where such fund is a company or a firm; or

(ii) at maximum marginal rate in any other case.

(5) The provisions of Chapter XII-D or Chapter XII-E shall not apply to the income paid by an investment fund under this Chapter.

(6) The income accruing or arising to, or received by, the investment fund, during a previous year, if not paid or credited to the person referred to in sub-section (1), ~~shall subject to the provisions of sub-section (2),~~ be deemed to have been credited to the account of the said person on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year.

D. Taxation of Alternative Investment Funds (AIFs) Listed on a Stock Exchange

21. The SEBI (AIF) Regulations, allow the listing of the units of closed- ended AIFs on a stock exchange i.e. all AIFs, except an open ended-Category III AIF, can be listed on a stock exchange. The Bombay Stock Exchange (BSE) and the National Stock Exchange have laid down the process and documentation required for the purpose of listing of AIFs.
22. Investors in AIFs have the intention of making long-term investments. The listing and trading of units of an AIF, enables exits by pre-listing investors and also provides a liquidity window to investors which invest post-listing. Given this liquidity advantage of listed AIFs, they can be a significant catalyst for greater participation of investors in AIFs as an investment instrument.
23. While the present AIF Regulations and the guidelines issued by BSE enable listing of AIFs subject to conditions, and the advantages of listing are obvious, the current taxation policy for AIFs (i.e. pass-through taxation) is not conducive to an AIF listed on a stock exchange.
24. In case the units of the AIFs are listed on a stock exchange, on account of trading of units, the composition of the pool of investors may change from time to time during any financial year. It may very likely be the case that the set of investors at the time of investment by the AIF may be different from those at the time of earning of the income/ gains by the AIF, which, in turn, may differ from those when the AIF distributes such income/gains to the investors. This is illustrated below:
 - Mr. A, a resident in India, subscribed to a unit of a Category II AIF on 20 December 2016 which was subsequently listed on Bombay Stock Exchange.
 - The AIF has subscribed to a debenture of INR 100 of A Ltd on 30 December 2016 and received interest of INR 10 from such investment on 7 March 2017. Given that the AIF has to withhold tax at the time of accrual of income to the unitholder, the AIF withheld tax at 10% on interest on debenture in the hands

of Mr. A. However, the interest was not actually distributed to Mr. A.

- Mr. A sold the unit of AIF to Mr. B, on 8 March 2017. On 15 March 2017, the interest of INR 10 was distributed to Mr. B as Mr. B held that unit of the AIF. Thus, while the tax was withheld in the hands of Mr. A, the income is distributed to Mr. B, who could be required to discharge tax on it.
 - Further, if the AIF transfers the investment in debenture of A Ltd on 2 January 2020 for INR 200, long-term capital gains (as period of holding exceeds 3 years) would arise in the hands of AIF, which would be passed on to Mr B. Mr B has held the units of the AIF for a period of less than 3 years, and shall ideally qualify the gains as short-term capital gains taxable at 30% (excluding surcharge and education cess). However, given the pass-through mechanism under the Act for Category II AIFs, the gains on transfer of units is based on the period of holding of the underlying asset i.e. debentures and shall accordingly, qualify as long-term capital gains, taxable at 20% (excluding surcharge and education cess).
 - In a scenario where Mr B had acquired the units of the AIF at INR 250, at the time of sale of the debenture for INR 200, while economically, Mr B would have a loss on the investment, because of pass-through treatment, there would be a capital gain taxable in his hand.
25. Accordingly, the current tax policy for AIFs in the context of an AIF listed on a stock exchange, or in the case of the secondary transfer of units of an AIF, may create significant anomalies for AIFs and its investors. In this scenario, a pass-through tax system is unable to achieve the intended consequences.
26. It is evident from the above illustrations that the listing of AIFs on stock exchanges will necessitate a distinct tax framework that is based on taxation at the unit level that will ensure that investors in units are taxed on their realised gains and the tax attributes are linked to their cost of acquisition and period of holding of the AIF's units.
27. A regulatory and tax framework for listed AIFs can lead to a significant increase in the capital inflows from listed AIFs investing in Indian private and public markets and pave the way for much greater contribution by listed AIFs to the country's economic growth and development.

Recommendation: Taxation of Listed AIFs

Define a new taxation code for **listed AIFs** as follows:

- i. Exemption to the listed AIFs for all streams of income earned by the AIF on its investments in Indian portfolio entities.
- ii. Taxation of income (viz. dividend and interest) on distribution by the listed AIF to its investors in the hands of the AIF's investors
 - Dividend - Exempt from tax in the hands of the investor;
 - Interest – Resident investor at their respective tax rates, Non-resident investors at 5%.
- iii Taxation of gains actually realized by the listed AIF's investors. The taxation of gains should be determined based on the difference between the cost of acquisition of the units and actual sale consideration/ redemption price in a sale/ transfer or redemption event respectively. Taxation of gains determined should be on the following basis:
 - iv Equity-oriented fund (an AIF in which at least 65% of the investible funds are invested in equity shares of domestic companies)
 - Short-term capital gains - at 15% with the sale/ redemption being liable to Securities Transaction Tax (STT)
 - Long-term capital gains – Exempt from tax in the hands of the investor with the sale/ redemption being liable to STT
 - v. Debt-oriented fund (an AIF that is not an equity oriented AIF)
 - Short-term capital gains at maximum marginal rate
 - Long-term capital gains at 20% (in case of residents) and at 10% (in case of non-residents) [in the case of non-resident without indexation or foreign exchange fluctuation benefit].

Proposed Amendments:

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

Insert new section 10(23DBA)

10(23DBA) subject to the provisions of Chapter XII-FB, any income of alternative investment fund

Explanation – For the purposes of this clause, -

- “alternative investment fund” means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I, Category II or Category III Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992), whose units are listed on a recognized stock exchange ;
-

- (a) "recognised stock exchange" shall have the meaning assigned to it in clause (ii) of Explanation 1 to clause (d) of sub-section (5) of section 43.

Amendment 2: Tax on income distributed by listed AIFs

Insert new section 115UBA

Tax on distributed income to unit holders.

Section 115UBA

(1) Notwithstanding anything contained in any other provisions of this Act, income distributed by an alternative investment fund referred to in 10(23DBA) being in the nature of interest or dividend to its unit holders shall be taxable in the hands of the unit holder as it had been received by, or accrued to, the investment fund.

(2) The provisions of Chapter XII-D or Chapter XII-E shall not apply to the income paid by an investment fund under this Chapter.

(3) Any person responsible for making payment of the income distributed on behalf of an investment fund to a unit holder shall furnish a statement to the unit holder and the prescribed authority, within such time and in such form and manner as may be prescribed, giving the details of the nature of the income paid during the previous year and such other details as may be prescribed.

Explanation 1.—For the purposes of this Chapter, "unit" means beneficial interest of an investor in the investment fund or a scheme of the investment fund and shall include shares or partnership interests.

Amendment 3: Withholding on distribution

Insert new section 194LBDA in the Act

Section 194LBDA

(1) Where any income referred to in sub-section (1) of section 115UBA is payable by an alternative investment fund to its unit holder in respect of units of an investment fund, the person responsible for making the payment shall at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, deduct income-tax thereon -

- (i) at the rates in force, where the payee is a resident;
- (ii) at the rate of five per cent, where the payee is a non-resident (not being a company) or a foreign company.

Provided also that no such deduction shall be made in respect of any dividends referred to in section 115-O.

Explanation.—For the purposes of this section,—

- (a) "unit" shall have the meaning assigned to it in clause (c) of the Explanation 1 to section 115UBA;
- (b) "alternative investment fund" " shall mean an alternative investment fund as specified in clause (23DBA) of section 10.

Amendment 4: Tax rates in case of non-resident

115A. (1) Where the total income of—

(a) a non-resident (not being a company) or of a foreign company, includes any income by way of—

....

(iiad) distributed income being interest referred to in sub-section (1) of section 194LBDA;

Amendment 5: Amendments to section 2(42A), section 10(38), section 111A and 112 of the Act

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

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

Explanation 5 - "equity oriented alternative investment fund" shall have the meaning assigned to it in the Explanation to clause (38) of section 10.

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

Explanation.—For the purposes of this clause,—

(d) "equity oriented investment fund" means an alternative investment fund—

(i) where the investible funds are invested by way of 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 an alternative investment fund as specified under clause (23DBA) of section 10:

Provided that the percentage of shareholding of the fund shall be computed with reference to the annual average of the monthly averages of the opening and closing figures.

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

Explanation.—For the purposes of this section,—

(a) "equity oriented investment fund" shall have the meaning assigned to it in the Explanation to clause (38) of section 10.

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

Provided that where the tax payable in respect of any income arising from the transfer of a long-term capital asset, being listed securities (other than a unit) or zero coupon bond or unit of an alternative investment fund specified in clause (23DBA) of section 10, exceeds ten per cent of the amount of capital gains before giving effect to the provisions of the second proviso to section 48, then, such excess shall be ignored for the purpose of computing the tax payable by the assessee :

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

E. Proposed Separate Tax Regime for Category III AIFs: Investor-Level Taxation

Background of existing complications in the taxation of Category III AIFs

28. Unlike Category I and II AIFs, tax pass-through status has not been accorded to Category III AIFs. Section 10(23FBA) read with Section 115UB of the Act provides tax pass-through for any income (other than business income) earned by Category I and II AIFs.

29. In accordance with the SEBI (AIF) Regulations 2012, Category III AIFs invest in long term or short-term listed instruments and may employ diverse or complex trading strategies by investing in listed or unlisted derivatives. Category III AIFs could have the following features:

- It may be possible for Category III AIFs to maintain two sets of portfolios viz. a trading portfolio for short-term trading gains and an investment portfolio with a view to earn long term appreciation;
- Category III AIFs may be open-ended or closed ended; and
- Category III AIFs are generally set-up as trusts due to operational complications involved in other forms of entities.

The above characteristics lead to significant complexity under the current provisions of the Income Tax Act since there is no specific tax regime or guidance on the taxation of Category III AIF and their investors.

30. Category III AIFs are therefore governed by complex trust taxation provisions under the Act which were introduced in the law in the year 1961 for taxation of private and family trusts.

31. Under the trust taxation provisions, the taxation of Category III AIF depends upon whether a Category III AIF is set up as either a determinate trust or an indeterminate trust.

1. If the trust is regarded as an indeterminate trust – the entire income is taxable at the maximum marginal rate (~35.535%); and
2. If the trust is regarded as a determinate trust and if the income includes business income, the whole of the income becomes taxable at the maximum marginal rate.

32. A trust can be regarded as a determinate trust if:

- (i) the beneficiaries (i.e. investors in the context of Category III AIFs) are expressly stated and identifiable as on the date of the trust deed; and
- (ii) their individual shares are expressly stated and ascertainable as on the date of the trust deed.

A strict technical interpretation of the above definition of determinate trust renders any AIF, which cannot ascertain and name all its investors (present and future) at the time of inception, as an indeterminate trust.

33. The Karnataka High Court³ in the context of an investment fund, stated the following principles for a trust to be determinate:

- All that is necessary is that the beneficiaries should be identifiable based on the provisions of the trust deed, and it was not necessary that the beneficiaries should be specifically named in the trust deed. In the present case, the trust deed clearly laid down that beneficiaries meant the persons, each of whom had made, or agreed to make, contributions to the trust in accordance with the contribution agreement.
- It is not necessary that the trust deed should actually prescribe the percentage share of the beneficiaries in order for the trust to be determinate. It is enough that the share of the beneficiaries is capable of being determined based on the provision/ formula as on the date of the trust deed.
- If the trust deed authorises the addition of further contributors to the trust at different points in time in addition to the initial contributors, it would not make the beneficiaries unknown or their shares indeterminate.

No clarity on taxation of investors of Category III AIFs

34. A trust is not a separate legal entity. A trustee is assessed to tax on income arising to the trust since he receives such income on behalf of the beneficiaries of the trust.

Double Taxation: There are no express provisions under the Act which provide that once the income arising at the trust level is assessed to tax in the hands of the trustee, it cannot be assessed again in the hands of the beneficiaries (investors). Further section 166 of the Act [which overrides the above regime of trust taxation i.e. sections 161 to 164 discussed above] provides that nothing can prevent the tax authorities to directly assess the beneficiaries (investors) of the Category III AIF trust for the income arising at the trust level or recover the tax arising on such income from them.

35. Further, there are no provisions in the Act which allows credit of tax paid by the trustee to the beneficiaries (investors) in the trust. Hence, there are clouds of doubts in relation to taxability of income distributed by the trust to its investors, by way of redemption or otherwise, and there is no assurance under the Act that the income which gets taxed at the trust level will not get doubly taxed in the hands of the investors when distributed.

1. ³ India Advantage Fund-VII ITA No. 191/2015

Rationale for proposed changes to the tax regime of Category III AIFs

29. The rationale for the proposed tax regime is to provide clarity in the taxation for Category III AIFs. It will help promote the Government's objective of 'ease of doing business in India' and provide the required depth in Indian capital markets. Capital invested in Category III AIFs has increased rapidly in recent years and is expected to grow further in the coming years. The capital invested in Category III AIFs is growing at increasing rate compared to other categories of AIFs. This is because Category III AIFs serve the following vital functions in the capital markets:

- (i) risk management for investors;
- (ii) hedging long positions in investments;
- (iii) flexible and a wide range of investment strategies which meet the diverse needs of various investors, including institutions and high-net worth individuals;
- (iv) stewardship role by potentially influencing the quality of corporate governance in portfolio companies;
- (v) lend greater sophistication to the capital markets; and
- (vi) provide exits to other investment funds such as Category 1 & Category II AIFs.

30. The lack of clarity in the taxation of Category III AIFs handicaps their growth and management as described below:

- . (i) Clarity to foreign asset managers which setup open-ended hedge funds in offshore jurisdictions for investing in India under the FPI route are not handicapped by the uncertainty of taxation surrounding the domestic SEBI-registered Category III AIFs;
- (ii) There is complete certainty to Foreign Portfolio Investors (FPI) with respect to the characterization of income. The regulatory framework for FPIs is similar to the regulatory framework for AIFs, with 'investment in securities' being the common factor. CBDT Circulars have been issued for providing certainty with respect to characterisation of income on the transfer of securities (listed and unlisted). There is no clarity for short term capital gains arising from the transfer of listed securities unlike for FPIs;
- (iii) The uncertainty of taxation is also leading to the reduction of opportunities to domestic fund managers and professionals and in some cases leads to 'brain drain' to offshore jurisdictions, besides a narrowing of investment opportunities for domestic investors. Clarity and certainty in the taxation of Category III AIFs will provide a competitive edge to domestic fund managers and will improve the prospects of an appropriate risk-return profile of these pooled investment vehicles.

Recommendation: Implement an Investor-Level Taxation Regime for Category III AIFs

31. In an investor-level tax regime, investors of Category III AIFs shall pay tax on income / gains arising from investment in units of Category III AIFs.

32. The features of the recommended investor-level regime for Category III AIFs are:

- (i) Short term capital gains on transfer of units (whether by way of redemption or otherwise) of equity-oriented investment fund to be taxed at the rate of 15%;
- (ii) Long term capital gains on transfer of units (whether by way of redemption or otherwise) of equity-oriented investment fund to be exempt from tax;
- (iii) Any other long term or short-term capital gains on transfer of units (whether by way of redemption or otherwise) of a Category III AIF, to be taxable at applicable rates;
- (iv) Any income distributed by a Category III AIF out of income received by it (other than income of the nature which is exempt under section 10) shall be taxable in the hands of investors as Income from Other Sources at applicable rates (~30%);
- (v) All of the above tax on investors would be paid by way of Tax Deducted at Source ('TDS') at the fund level;
- (vi) Category III AIFs shall not be subject to any tax on income / gains arising from their investments in underlying securities; and
- (vii) Any transfer of units pursuant to the consolidation of schemes of Category III AIFs should not be regarded as a transfer.

'Equity oriented investment fund' means an investment fund, which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the SEBI (AIF) Regulations 2012 made under the SEBI Act, 1992, whose investible funds are invested in equity shares of domestic companies to the extent of more than sixty-five per cent of the total proceeds of such 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.

33. The draft of the proposed amendments to be made under the IT Act for Category III AIFs are presented in the following boxes for consideration.

Investor-based taxation for Category III AIFs

Suggested amendments in the Act to give effect to the recommendation

Proposed Amendments:

Section 2(14)

Capital Asset means –

(a) property of any kind held by an assessee, whether or not connected with his business or profession;

(b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992;

(c) any units issued by an investment fund

Explanation 2: For the purposes of this clause-

(a) the expression “Foreign Institutional Investor” shall have the meaning assigned to it in clause (a) of the Explanation to section 115AD;

(b) the expression “securities” shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulations) Act, 1956 (42 of 1956);

(c) the expression “investment fund” shall have the meaning assigned to it in the Explanation to clause (23DB) of section 10

Section 2(42A)

“short term capital asset” means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer:

Provided that in the case of a security (other than a unit) listed in a recognised stock exchange in India or a unit of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963) or a unit of an equity oriented fund or a unit of an equity oriented investment fund or a zero coupon bond, the provisions of this clause shall have effect as if for the words “thirty-six months”, the words “twelve months” had been substituted:

Explanation 5. – For the purposes of this clause, the expression “equity oriented investment fund” shall

have the meaning assigned to it in the Explanation below clause (38B) of section 10

Section 56

(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from Other Sources", namely: -

(ie) any income distributed by an investment fund

Explanation: For the purposes of this clause, the term "investment fund" shall have the meaning assigned to it in clause (23DB) of section 10

Section 111B

(1) Where the total income of an assessee includes income chargeable under the head "Capital Gains", arising from the transfer of a short-term capital asset, being a unit of an equity oriented investment fund, the tax payable by the assessee on the total income shall be the aggregate of -

(i) the amount of income-tax calculated on such short-term capital gains at the rate of fifteen per cent; and

(ii) the amount of income-tax payable on the balance amount of the total income as if such balance amount were the total income of the assessee

Provided that in the case of an individual or a Hindu undivided family, being a resident, where the total income as reduced by such short term capital gains is below the maximum amount which is not chargeable to income-tax, then, such short term capital gains shall be reduced by the amount by which the total income so reduced falls short of the maximum amount which is not chargeable to income-tax and the tax on the balance of such short-term capital gains shall be computed at the rate of fifteen per cent.

(2) Where the gross total income of an assessee includes any short-term capital gains referred to in sub-section (1), the deduction under Chapter VI-A shall be allowed from the gross total income as reduced by such capital gains.

Explanation. - For the purposes of this section, the expression "equity oriented investment fund" shall have the meaning assigned to it in the Explanation below clause (38B) of section 10.

Insertion of new section 194LBD

(1) Where any income is payable to a unitholder in respect of units of the investment fund, the person responsible for making the payment or distribution shall, at the time of payment or distribution thereof in cash or by issue of cheque or draft or by any other mode, deduct income-tax thereon at the following rates:

- a. on the income of the nature referred to in section 111B at the rate of fifteen per cent;
- b. on the income distributed by an investment fund other than income distributed by equity oriented investment fund referred to in clause (38B) of section 10, at the rate of thirty per cent;

- c. *on the income arising on redemption of a long-term capital asset being a unit of an investment fund other than equity oriented investment fund, at the rate of twenty percent; and*
- d. *on the income arising on redemption of a short-term capital asset being a unit of an investment fund other than equity oriented investment fund, at the rate of thirty per cent.*

Provided that where the payee is a non-resident (not being a company) or a foreign company, deduction of tax shall be made in respect of any income at the rates in force

Explanation – For the purposes of this section -

- (i) *the expression “equity oriented investment fund” shall have the meaning assigned to it in the Explanation below clause (38B) of section 10*
- (ii) *the expression “investment fund” shall have the meaning assigned to it in the Explanation to clause (23DB) of section 10*

Section 196

Notwithstanding anything contained in the foregoing provisions of this Chapter, no deduction of tax shall be made by any person from any sums payable to –

- (i) *the Government, or*
- (ii) *the Reserve Bank of India or*
- (iii) *a corporation established by or under a Central Act which is, under any law for the time being in force, exempt from income-tax on its income or*
- (iv) *a Mutual Fund specified under clause (23D) of section 10, or*
- (v) *an Investment Fund specified under clause (23DB) of section 10,*

where such sum is payable to it by way of interest or dividend in respect of any securities or shares owned by it or in which it has full beneficial interest, or any other income accruing or arising to it

Section 10(23DB)

Any income of an investment fund.

Explanation: For the purposes of this clause, ‘investment fund’ shall mean a fund which has been granted a certificate of registration as a category III Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations 2012, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992)

Section 10(38A)

Any income arising from the transfer, either by way of redemption or otherwise, of a long term capital asset being a unit of an equity oriented investment fund

Section 10(38B)

Any income distributed by an equity oriented investment fund to its unitholder, out of the income arising to the investment fund which is of the nature specified in clause (34) or clause (34A) or clause (35) or clause (38) of section 10

Explanation - For the purposes of clause (38A) and clause (38B) of section 10, the expression "equity oriented investment fund" means an Investment Fund referred to it in the Explanation to clause (23DB) of section 10 and whose investible funds are invested by way of equity shares of domestic companies to the extent of more than sixty five per cent of the total proceeds of such 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

Chapter VI

Alternative Investment Funds

Part A: SEBI Registered Social Venture Funds

Part B: Category III Funds- of-Funds

Part A: India: SEBI-registered Social Venture Funds- Category I Alternative Investment Fund (AIF) Pooling Vehicles

ACKGROUND

1. The Union Finance Minister in his union budget speech this year had emphasized the need for enhancing expenditure in priority areas of farm, rural sector, social sector, employment generation and focus on vulnerable sections of the society. The Government of India has put investment in these sectors as one of the core elements of its socio-economic progress. In recent past, the government has created major financial institutions with a focus on investments to provide financial support to improve the viability of government projects with special focus on energy, water, sanitation, communication, and social and commercial infrastructure. While majority of earlier investment projects focussed on debt financing for such initiatives, the requirements are equally critical for equity financing. Further, the role of the government in being able to influence policies play a major role in re-energizing the social sector investments.

B. CONSTRUCTIVELY ENGAGING INDUSTRY-LED PRIVATE INVESTMENT

2. With insufficient public sector and philanthropic resources available to address chronic social challenges, private sector capital is emerging as a powerful tool to create economic opportunities for underserved communities. Further, targeting CSR pool in a focused and more sustainable manner can help tackle our existing financing gap for SME enterprises and organizations focused on social innovations and outcomes. We need to harness CSR led innovation and entrepreneurial spirit and create a vibrant ecosystem to engage with them to spur impact investments in India.

C. LATENT DEMAND AND DESIRE

3. The idea is to allow CSR funds to be invested in SEBI-regulated alternative investment vehicles, which would be dedicated to sectoral allocation and would provide investments into social start-ups, social enterprises and MSMEs. The objective is to maximize socio-economic impact mainly through investment in projects through debt and equity that have the potential to achieve certain social outcomes, including government's social welfare programs and missions. It can catalyze impact investing in social startups, MSMEs and create employment and livelihood for thousands of people over the years. The objective is to provide impact investing which supports socially or economically beneficial organizations in disadvantaged communities that generally cannot attract efficient financing through traditional market mechanisms. The mission is to invigorate local communities and provide them with avenues to economic self-sufficiency, while producing positive social impact.
4. Thus, instead of spending directly or opting to pour funds into government programs, funds could be allowed to be invested in social impact funds or other instruments managed by a group of experts. Impact investing is a targeted intention to create positive social impact in conjunction with social dividends and muted financial-returns.
5. Impact investing is always done through externalizing the responsibility to another legal entity, an investment fund. The argument here is that funds can be sustainable and continuously reinvested. Funds can either be managed by individual companies or pooled together into one fund. The latter argument of pooled funds allows for economies of scale, including appropriate collation of expertise and research under one roof. CSR funds can be used for equity, grants, or loans in local communities via patient capital impact investing. Funds can also be used to create or invest in local community development financial institutions. The options are plenty and allow for growth of social enterprises and/or programs already working in the development sector without recreating the wheel.
6. The advantages of channelling CSR funds through Category I AIF pooled vehicles are:

- (i) The fund manager acts as a fiduciary on behalf of its investors playing an important fiduciary and stewardship role;
- (ii) The fund manager is mandated to apply professional investing and monitoring skills;
- (iii) Investors in AIFs are typically high-calibre entities with business acumen such as HNIs, family offices, family foundations and pension funds;
- (iv) The fund manager provides frequent reports on portfolio companies to its investment committee;
- (v) The fund manager typically invests in and builds a portfolio of sustainable social projects, or social enterprises, consistent with the aims of CSR funds as enunciated in the Companies Act 2013;
- (vi) AIFs are registered and regulated by a Government regulatory authority i.e. SEBI under its AIF Regulations, 2012;
- (vii) AIF pooling vehicles are well-accepted as a sound and valid instrument by investors in many countries as channels for investing impact funds in order to achieve social good; and
- (viii) Finally, the pooling of funds in AIFs enables the leveraging of funds invested by any single investor.

S. No.	Suggested Changes	Rationale
	Restriction on Investment by Companies using CSR Funds	
1.	<p>The Ministry of Corporate Affairs may consider issuing a circular/notification modifying section 135 and Schedule VII of the Companies Act to effectuate the following:</p> <p>Section 135. Corporate Social Responsibility:</p> <p>(1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.</p> <p>(2) The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.</p>	<p>The Alternative Investment Funds (Regulation), 2012 ("AIF Regulation") can play an enabling role for the spread of CSR activities in India. The AIF Regulation may have a far-reaching effect as it can harmonize a considerable pool of CSR fund created pursuant to the CSR provision and facilitate investment of such CSR funds towards social ventures at a sustainable cost.</p> <p>Allowing companies to invest their CSR funds in social ventures will also enable scalability and social impact.</p>

	<p>(3) The Corporate Social Responsibility Committee shall, —</p> <p>(a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;</p> <p>(b) recommend the amount of expenditure or investment to be incurred on the activities referred to in clause (a); and (c) monitor the Corporate Social Responsibility Policy of the company from time to time.</p> <p>(4) The Board of every company referred to in sub-section (1) shall, —</p> <p>(a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and</p> <p>(b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.</p> <p>(5) The Board of every company referred to in sub-section (1), shall ensure that the company spends or invests, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.</p> <p>Provided that the company shall give preference to the local area and areas around it where it operates, for spending/investing the amount earmarked for Corporate Social Responsibility activities:</p> <p>Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending/investing the amount.</p> <p>“Further, in exercise of the powers conferred under sub-section (1) of section 467 of the Companies Act,</p>	
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	<p>the Central Government hereby makes the following amendments to Schedule VII of the said Act, namely:-</p> <p>In Schedule VII, after items (i) to (x) and the entries relating thereto, the following items and entries shall be inserted, namely: -</p> <p>“ (xi) social business projects”</p> <p>“ (xii) social enterprise”</p> <p>“(xiii) social venture or social venture fund as defined under SEBI (Alternative Investment Funds) Regulation, 2012”</p>	
2.	Broadening the Scope of Eligible Investments by Public Trusts	
	<p>Amendment required in Section 11(5) of the Income-tax Act, 1961 (“ITA”)</p> <p>Section 11(5): the forms and modes of investing or depositing the money referred</p> <p>Additional clauses allowing wider permissible modes of investment by public trusts under Section 11(5) of ITA. The ITA should amend section 11(5) to effectuate the following:</p> <p>“(iva) investment in any security of a social business or a social enterprise”</p> <p>“(ivaa) investment in the security of a <i>not-for-profit</i> company</p> <p>Explanation- In this clause, a <i>not-for-profit</i> company means a company set up under Section 8 of the Companies Act”</p> <p>“(ivaaa) investment in social venture fund</p> <p><i>Explanation-</i> In this clause, a “social venture fund” means an Alternative Investment Fund [set up under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012]] which invests primarily in securities or units of social</p>	<p>Under the ITA in order to be eligible for tax benefits, the funds of the trust have to be invested in specified instruments. Thus, a large majority of charitable trusts can only invest in eligible and safe instruments like RBI bonds and cannot invest in securities like stocks. In certain cases, these trusts own stakes in various companies as part of a bequest or legacy and enjoy tax exemptions. While such trusts continue to hold shares in the company, they are not allowed to put in fresh money into subscribing additional shares of the company. As far as shares in companies are concerned, these are not part of the eligible investments by a charitable trust. In case the holdings of the trust are not as per ITA, then the trust</p>

	ventures and which satisfies social performance norms laid down by the fund and whose investors may agree to receive restricted or muted returns.”	becomes ineligible for tax benefits. In a situation when shares are given to a trust, it has a period of up to a year to dispose of them and remain eligible for availing of tax benefits. Further, a newly set up trust can only make grants to a social enterprise but is not allowed to hold equity in such social enterprises. In order to spur financial innovation in social sector, public trusts should be allowed to invest in recognized social enterprises and profits on such investments may be subject to tax.
3.	Include “Social Enterprises” as a separate category in the AIF Regulation	
	<p>Section 2(u) of the AIF Regulations may be amended as follows:</p> <p>A “social venture” is defined as a “non-profit venture” or a “social enterprise”.</p> <p>“Non-profit venture” means a trust, society or company formed with the purpose of promoting</p>	The AIF Regulations currently highlight only such Social Ventures which are charitable in nature, with the exception of micro-finance institutions. However, there is a wide range of businesses engaged in agriculture,

	<p>social welfare or solving social problems or providing social benefits and includes,</p> <ul style="list-style-type: none"> (i) public charitable trusts registered with Charity Commissioner; (ii) societies registered for charitable purposes; (iii) company registered under Section 8 of the Companies Ac. <p>“Social Enterprise” means a trust, society or company or limited liability partnership which satisfies all of the conditions below:</p> <ul style="list-style-type: none"> i) It has the achievement of positive social impact as a primary objective under its memorandum and articles of association ii) It carries on a business in the areas of agriculture, affordable healthcare, affordable education, affordable housing, financial inclusion, last mile delivery of goods and services to under privileged beneficiaries, renewable energy, water and sanitation, livelihoods, or any other area as may be notified by the Government for priority sector lending, but does not carry on business in the areas of Real estate other than affordable housing, Infrastructure, Tobacco, Alcohol, Weapons or Wildlife. iii) It focuses primarily on promoting the social welfare of, or providing social benefits to, Specified Beneficiaries, who may act as producers, consumers, suppliers or employees in relation to the Social Enterprise. For the purpose of this provision, Specified Beneficiaries shall be persons with annual household incomes of less than a threshold prescribed annually by the investment committee of the SEBI-registered Category! social venture funds making the investment or be individuals with physical disabilities. 	<p>healthcare, low cost housing etc. which are for-profit entities with a primarily social motive.</p> <p>Recognizing such social enterprises as “social ventures” for the purpose of the AIF Regulations would enable investors to contribute capital to these socially beneficial activities.</p> <p>The proposed definition specifies conditions as to sectors, beneficiaries and social impact objective, to ensure that social businesses are the primary recipients of such funding.</p> <p>Moreover, explicitly highlighting for-profit social ventures or social enterprises will attract more capital, which allows India to bridge the social sector investment gaps.</p>
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Chapter VI Part B: India: SEBI CATEGORY III AIFs: FUNDS-of-FUNDS

A. Background

I. Restriction on fund-of-funds structure for category III AIFs

- As per the SEBI (AIF) Regulations, Category I AIFs are permitted to invest in the units of other category I AIFs of the same Sub-Category, and Category II AIFs are permitted to invest in units of other Category I AIFs (of any sub-category) and other Category II AIFs. However, as per Regulations 18(b) of the SEBI (AIF) Regulations, Category III AIFs are permitted to invest only in units of other Category I AIFs or category II AIFs. There is no provision permitting Category III AIFs to invest in units of other Category III AIFs.

II. Lack of diversification in case of a fund-of-funds structure for category III AIFs

- Category III AIFs are typically funds which employ complex strategies and raise investments from sophisticated investors, such as financial institutions and high net worth individuals. Such investors are required to make a minimum capital commitment of INR 1 crore, which may be a substantial amount for many such investors. For some investors, investment in AIFs may be a novelty. In order to increase investor participation, a category III AIF may be organized as a fund-of-funds structure which provides investors with an opportunity to invest in different strategies.
- Under the current regime, a Category III AIF gets the advantages of a fund-of-funds structure, only with respect to investment in units of Category I AIF or Category II AIFs. This limits the investment strategy of the Category III AIF to be diversified into a PE/VC structure only. If a category III AIF is permitted to invest in units of other Category III AIFs, the investors will be able to take advantage of diversified complex fund strategies as well.
- For example, when a Category III AIF employs a strategy to invest in derivatives or complex or structured products, it will provide investors with diversified exposure if it is permitted to invest in units of other Category III AIFs which employ the same strategy.

III. Concerns with over-leveraging in case of Category III AIFs investing in units of other category III AIFs

- There could be certain concerns with respect to over leveraging in case of a fund of funds structure where a Category III AIF invests in units of other Category III AIFs. This could more easily be addressed by limiting employment of leverage to only one

level of such fund of funds structure. Accordingly, the AIF Regulations may be amended to clarify that where a Category III AIF invests in the units of other Category III AIFs, leverage can only be undertaken by one of the funds so as to ensure that both the Category III AIFs do not assume leverage.

- Alternatively, for the purpose of determining the leverage for regulation purposes, the same shall be computed on a consolidated basis.

Rationale for providing the recommendations

Advantages of a fund-of-funds structure for AIFs

- Investing in a fund-of-funds structure allows investors to access diversified portfolios with different underlying assets, which may be difficult to access through individual investment in AIFs. Investing in a fund of funds provides risk diversified exposure to investors, compared to investing directly in securities or units of a single fund.
- In a fund-of-funds structure, investors benefit from diverse managerial experience. A manager of a fund of funds, will identify other managers of an AIF who have vast experience and a good track record in managing pools of money. The due diligence of the manager of a fund of funds, provides the investors with expert investment managerial services, thereby mitigating certain investment risks.

Proposed Recommendations

In order to allow investors to realise the benefits of a fund-of-funds structure for a Category III AIF investing in units of other category III AIFs, it is recommended that Regulation 18(b) of AIF Regulations should be amended to include investment into units of other Category III AIFs.

Suggested amendment in the AIF Regulations to give effect to the above recommendation

Regulation 18(b):

Fund of Category III Alternative Investment Funds may invest in units of Category I or Category II Alternative Investment Funds or Category III Alternative Investment Funds:

Provided that they invest solely in such units and shall not invest in units of other Fund-of-Funds.:-

Provided further that a Category III Alternative Investment Fund which itself employs leverage, may invest in units of only such other Category III AIFs which do not employ any leverage.

Chapter VII

An Alternative View of Taxation &
Promoting Onshore Fund Management
in India

VII

An Alternative View of Taxation & Promoting Onshore Fund Management in India

A. Introduction

1. This chapter recommends a Securities Transaction Tax regime for various categories of Alternative Investments. It describes the difficulties arising from the current tax regime and which confront all the key players in the AIF ecosystem, namely investors in funds, the Alternative Investment Funds and the revenue authorities. The chapter also provides cogent reasons for the need for a suitable STT regime for hedge funds- which fall under Category III Alternative Investment Funds of SEBI AIF regulations. The chapter includes the justification and rationale for the proposed recommendations and includes draft amendments for consideration by the relevant Government authorities. In essence, the chapter recommends a complete revamp in the manner in which AIFs and their investors are taxed in India.

B. Recommendation I: Introduction of Securities Transaction Tax ("STT") for Category I and Category II AIF

2. It is imperative that the existing uncertainties on the tax treatment of Alternative Investment Funds are removed and a stable and tax regime be prescribed. While the revenue authorities could try and remove the uncertainties by issuing clarifications and continue with the existing tax regime that may not completely eliminate the uncertainties and administrative difficulties. The tax treatment needs to be completely revamped.
3. A simplified regime of taxation of investors in mutual funds has significantly helped in the growth of mutual funds with minimal issues and litigation. AIFs, like mutual funds, pool capital raised from investors which is invested in accordance with some stated investment criteria. Given the similarities in the structure of mutual funds and AIFs, a similar tax regime i.e. Securities Transaction Tax (STT) should apply to transactions in units of AIFs.
4. The simplified regime for private equity and venture capital funds, as is the case of Foreign Portfolio Investors (FPIs) who invest in listed securities and are subject to Securities Transaction Tax, would provide great impetus to the growth of the alternatives fund management industry i.e. AIFs. Experience has shown that some of the key advantages of the Securities Transaction Tax regime are ease of compliance and reduction in tax litigation.

5. To harmonize the taxation of mutual funds and Investment Funds and to simplify tax compliance of both the investors as well as the Investment Funds, it is proposed to bring Investment Funds (i.e. Alternative Investment Funds) under the ambit of STT.
6. It is recommended that, in lieu of the current tax regime, investors in Alternative Investment Funds should be made liable to pay STT which would be collected at three transaction stages i.e. firstly, at the time of entry, at which point the investor purchases units, secondly, when income is distributed during the unit holding period, and, finally, when the investor exits by the transfer of units. Thus, it is recommended that the Government should institute a regime under which, STT would apply at the following points in the AIF transaction cycle:
 - Point A: Investor invests in the Fund.
 - Point B: Fund distributes income / redeems units to investors.
 - Point C: Investor transfers units of the Fund.
7. In short, it is recommended that investors in Alternative Investment Funds should be made liable to pay STT at various points in the transaction cycle, as mentioned above, and consequently income arising to investors, whether on distributions / redemption / transfer of units should be exempted from tax in their hands.

C. Rationale and Justification

8. While AIFs have provided much needed long term and stable private capital, the tax and regulatory environment in which they operate has become more and more complex and litigation prone. On the contrary, the tax treatment of Foreign Portfolio investors, investing in listed securities, has tended towards greater certainty. For instance, two Government clarifications have provided much needed certainty to Foreign Portfolio Investors (previously known as Foreign Institutional Investors i.e. FIIs). These are: (i) the income earned by FIIs to be treated as capital gains; and (ii) clarification on the applicability of MAT to FIIs. These clarifications have gone a long way in providing certainty to Foreign Portfolio investors. In contrast the tax treatment of income earned by SEBI registered VCFs and AIFs has seen a chequered history and has been anything other than certain.
9. In addition to the complexities surrounding the withholding and tax treatment of domestic investors, foreign investors have also been having to deal with stringent scrutiny of relief / benefits under Double Taxation Avoidance Agreements. These difficulties have discouraged Fund Managers from setting up Indian pooled and domiciled funds. Instead capital is pooled and domiciled outside India, and invested in India under the Foreign Direct Investment (FDI) route. Investments under the FDI route are not subject to any of the restrictions and difficulties mentioned in the next section.

10. The introduction of a Securities Transaction Tax ("STT") can help alleviate the concerns. The implementation of a STT-based tax regime for AIFs gains paramount importance after the negotiation of the DTAA with jurisdictions such as Mauritius and Singapore. If implemented, an STT regime for private equity and venture capital funds, including AIFs, could yield STT tax revenues of \$1.8 billion during the next 15 years (see Appendix 1)
11. The specific difficulties arising from the current tax regime for venture capital and private equity funds, their investors and the revenue authorities are given below.

a) Difficulties Faced by Alternative Investment Funds

12. **Lack of parity on withholding tax provisions for residents and non-residents**: Resident investors suffer a 10 percent withholding tax on gross distributions made by AIFs which includes distribution of income in the nature of gains from the sale of listed company's shares held for more than one year (which is exempt from tax), dividend income (which is exempt from tax) etc. However, withholding from distributions made to non-resident investors shall be made at the rates in force (including rates applicable on account of a tax treaty). Hence, there is a lack of parity in the treatment given to residents and non-resident investors thereby discouraging domestic investments.
13. **Blockage of resident investors funds due to withholding requirement of 10 percent even in respect of exempt income**: Resident investors suffer TDS on all income distributed by the Fund thereby resulting in tax on exempt income as well. Resident investors are left with no option but to claim the TDS as a refund by filing a return of income. Refund claims of the investors are blocked until the refund is paid thereby lowering the return on capital on investments from the Fund.
14. **Administrative inconvenience for the Funds**: In order to realize refund claims and complete assessment proceedings Fund would need to continue to exist for notwithstanding the fact that most funds are established with a limited life.
15. **Compliance burden on the Funds**: The tax related compliance requirements of Funds has not been reduced over the years. The Fund is still required to file a return of income and in addition is required to submit Forms 64A and 64B detailing the income distributed by the Fund. This is in addition to the requirement of submitting TDS returns on income distributed to the Fund which is otherwise not required to be done by other assesses.

b) Difficulties Faced by Investors

16. **Claim of refund and return filing requirement**: Most non-resident investors would have no other business activity other than participating in a VC / PE fund. Despite this, they will be required to file in India return of income irrespective of whether they have taxable income or not. This could act as a deterrent to large institutional investors.
17. **Stress on working capital of investors**: Blocked tax deducted at source claims on exempt income creates unnecessary stress on working capital.
18. **High withholding tax rate**: The 10 per cent withholding tax rate is high considering that the actual tax payable by the investors could be less. A high withholding tax rate would reduce the effective Internal Rate of Return to the investors as the excess tax deducted would have to be claimed as a refund, the grant of which is delayed.

c) Difficulties Faced by Revenue Authorities

19. **Burden on Revenue Authorities**: Increased scrutiny of returns filed by the PE/VC Funds and in the investors towards income and TDS adds to the administrative burden of the revenue authorities of scrutinizing returns containing exempt income;
20. Administering tax credits and ensuring that the Form 26AS credits match with the credits claimed by the investors adds to the existing reconciliation of mismatches between TDS claims and Form 26AS;
21. **Revenue leakage** on account of interest on refunds which was never to be charged;
22. **Litigation**: Increase in litigation leading to poor tax collection and inefficient utilization of tax authorities in dealing into such litigation.

Proposed Amendments

Amendment – 1: Distributions by AIFs to be treated as a taxable transaction in securities liable to STT

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

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

Definitions

A) In section 97 of the Finance (No.2) Act, 2004, -

Insert the following definition as sub-section (1):

– Investment Fund¹¹ shall have the meaning assigned to it in clause (a) of the explanation to section 115UB of the Income-tax Act, 1961¹¹

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

C) In section 97 of the Finance (No. 2) Act, 2004, –

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

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

(d) any distribution made on sale or redemption of a unit in an Investment Fund¹¹

(d) any distribution made otherwise by an Investment fund¹¹

Charge of Securities Transaction Tax

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

Sl. No.	Taxable Securities Transaction	Rate ⁴	Payable by
(1)	(2)	(3)	(4)
"8	(a) Purchase of a unit of an Investment Fund	0.25%	the purchase
	(b) Distribution of income representing long term capital gains, made to a unit holder by an Investment Fund on redemption or otherwise	0.25%	the unit holder
	(c) Distribution of income other than long term capital gains, made by an Investment Fund on redemption or otherwise	1%	the unit holder
	(d) Sale of a unit of an Investment Fund being a long-term capital asset, to any person other than the Investment Fund in which such units are held	0.25%	the seller
	(e) Sale of a unit of an Investment Fund being a short-term capital asset, to any person other than the Investment Fund in which such units are held	1%	the seller

Value of taxable securities transaction

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

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

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

(bc) in the case of distribution by an Investment fund other than the distribution

⁴Or such other rate as may be appropriate

referred in clause (bb) above, the amounts so distributed to the unit holder;

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

Collection and Recovery of Securities Transaction Tax,

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

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

Recognised stock exchange or Investment Fund or Mutual Fund to furnish prescribed return

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

–Prescribed person in the case of every Investment Fund

Amendment – 2: Amendments required in the Income Tax Act, 1961

i) Exempting the income from Investment Fund (AIF) under section 10:

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

–(38A) any distribution received by an assessee, being a unitholder of an Investment fund referred to in Explanation to section 10(23FBA), either on redemption or otherwise and where such distribution is chargeable to securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004.

(38B) any income received by an assessee, being a unitholder of an Investment fund referred to in Explanation to section 10(23FBA), on sale of units in an Investment Fund to any person other than the Investment Fund in which such units are held and where such sale is chargeable to securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004.

Other Consequential Amendments

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

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

– Provided further that in the case of share or other securities of a company (not being a share listed in a recognised stock exchange) held by an Investment Fund or a unit

of an Investment Fund specified under clause (23FBA) of section 10, the provisions of this clause shall have effect as if for the words "thirty-six months", the words "Twenty four months" had been substituted

B) Amending Section 115UB

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

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

(9) It shall not be necessary for an assessee being a unit holder of an investment fund to furnish under sub-section (1) of section 139 a return of his or its income if:

- a) His or its total income in respect of which he or it is assessable under this Act, during the previous year consisted only of distributions from an investment fund, chargeable to securities transaction tax under Chapter VII of the Finance (no.2) Act, 2014

C) Avoiding redundant exemptions in section 10

In Section 10 of the Income-tax Act, -

- (a) for clause (23FBA), the following clause shall be substituted, namely: -

—(23FBA) any income of an investment fund;

Explanation. —For the purposes of this clause, the expression —Investment fund shall have the same meaning as assigned to it in clause (a) of the Explanation 1 to section 11UB

- (b) clause (23FBB) shall be omitted: -

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

In Section 194LBB of the Income-tax Act, the first paragraph shall be numbered as sub-section

(1) and after sub-section (1) so numbered, the following sub-section shall be inserted, namely: -

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

- E) Exempting a portfolio company from the tax on share premium amount when invested by an Investment Fund (AIF) (as is the case when invested by a venture fund)

In section 56 of the Income-tax Act, in sub-section (1), in clause (viib), after clause (ii) of

the Proviso, the following clause shall be inserted, namely-

(iii) by a company from an Investment fund referred to in Explanation to section 10(23FBA)

A separate provision to be added in section 194 LBB of the Income Tax Act, 1961 to clarify that the TDS is not applicable for income earned by the Fund which is exempted from Tax liability.

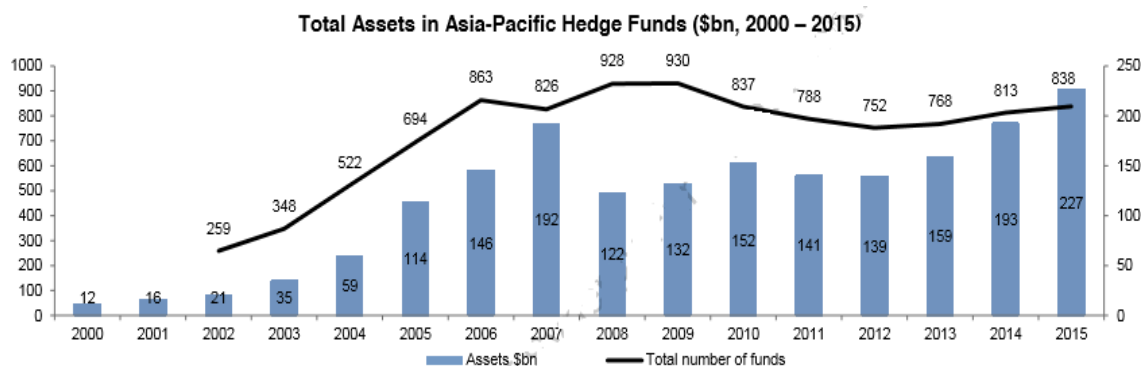
C: Recommendation 2: Introduction of Securities Transaction Tax (“STT”) for Category III Alternative Investment Funds

23. Category III **Alternative Investment Funds** include hedge funds under SEBI AIF regulations. In India the hedge fund industry has not yet developed to its full potential due to various factors, including the lack of certainty in taxation. A transformative change on the taxation front can greatly facilitate their growth. A fair, transparent and enabling tax regime could result in India’s hedge fund industry potentially growing at 20% per annum from its current low base. Ultimately their assets under management could surpass \$25 Billion or INR 166,750 crores in 10 years.

24. The rationale and advantages of the STT regime have been amplified in the earlier section. In order to simplify and bring ease of compliance and remove ambiguity in taxes, the introduction of the STT regime (on entry and redemption for each investor) will ensure smooth payment and collection of taxes. This proposal will ensure stable cash flows for the government and since they are source based, it represents a superior tax policy, which is a win-win for the fund manager, the investors and the Government.

Justification for Developing the Hedge Fund Industry in India & Alternative Investment Funds in the Indian Context

25. The current size of the AIF Category III Funds in India is an estimated INR3,816 crores as of 30th June, 2016. This is much smaller than the approximately Rs. 100,000 crores invested under Portfolio Management Schemes (PMS). The global hedge fund industry has \$3 Trillion in assets under management as of 2015 (Asia Hedge and HFR Global Hedge Fund surveys). From 2007 to 2015, China’s equity hedge fund assets under management have risen from an estimated USD13.5 Billion to USD45 Billion in 2015, taking China’s market share from 6% in 2007 to 18% in 2015 in the Asia-Pac hedge fund industry. During this period, the share of India’s equity hedge funds declined from 5% to 2% today. The Chinese hedge fund industry has also grown strongly at a roughly 19% compounded rate since 2007.



26. Hong Kong and Singapore, which have zero capital gains tax, have experienced tremendous growth in the hedge fund and financial services industry. Currently, Indian AIFs are at a nascent stage with potential to grow larger. Consequently, the taxes collected can rise if the tax structure is simplified and made fair by implementing an STT regime for Category III AIFs.

27. Securities Transaction Tax, which is source based taxation, has the potential of leading to an exponential growth of this industry in India in line with international jurisdictions such as Singapore, Hong Kong, US and the UK.

Rationale for a Vibrant Hedge Funds Industry

28. There is a strong rationale for developing a vibrant hedge funds industry in India. The rationale for this is the several benefits associated with a hedge fund industry which are explained below:

- **Alternative source of funding:** Hedge funds are a potential alternative source of funding for India's economic growth and development. They are attractive to large institutional investors such as sovereign wealth funds, pension funds, endowments, trusts and family offices. Hedge funds typically start their corpus with proprietary capital of the fund manager. This 'skin-in-the-business', brings about a natural alignment of interest between the fund manager and fund investors;
- **Counterweight to Volatile International Capital Flows:** The creation of a large domestic institutional AIF industry, including hedge funds, would act as a counterweight to volatile foreign portfolio flows and contribute to stability in the Indian equity market. Domestic AIFs can lower the help impact of speculative activity. Daily trading in equity derivatives is 20x the daily trading volume in the cash segment;
- **Superior Governance:** Hedge funds strategies include activist investment strategies which aim to improve the quality of governance in portfolio companies, thereby bringing about improvements in their performance and enhanced efficiencies in their operations;

- **Diversity of Investment Strategies Meets the Investment & Risk Management Needs of Investors:** Hedge funds play a critical role by offering a wide array of investment strategies, thus increasing the number of participating investors and enlarging pools of capital available. For investors, hedge funds also serve a risk-management role, since their returns can be uncorrelated to those in equity markets. Markets work best when investors draw on a diverse set of strategies and securities to manage risk. Private pools of regulated capital provide valuable liquidity to financial markets under normal conditions and especially during periods of market stress and downturns;
- **Price Discovery:** The variety of investing strategies that hedge funds employ, strengthen capital markets by improving opportunities for price discovery. “Short selling contributes to the market’s process of finding correct prices and its valuable to have hedge funds do this,” said Jeremy Seigel, Prof of Finance at Wharton School of Business. “By buying irrationally cheap assets and selling irrationally expensive ones, they shift market prices until irrationalities disappear, thus ultimately facilitating the efficient allocation of the world’s capital.” ;
- **Lower Cost of Capital:** Countries with highly developed hedge fund industry have seen more efficient capital markets and a much **lower cost of capital**. This is desirable as India currently suffers from high cost of capital (double digit across sectors) and a high equity risk premium; and
- **Job Creation:** A strong hedge fund ecosystem will help create many jobs within the financial industry. This will lead to high value job creation in the financial services industry in India. The diagram below shows the areas in the hedge fund eco-system where jobs will increase as the hedge fund industry grows.



The Proposed Securities Transaction Tax on Category III AIFs: Collection Stages

29. To simplify tax compliance by investors and category III AIFs, it is recommended that category III AIFs are brought under the ambit of STT. Further, the investors of the category III AIFs should be made liable to pay STT on the distribution made by the category III AIFs to the investors and consequently such distributions should be exempted from tax in the hands of the investors.

30. It is recommended that STT be collected at 5 stages of the typical Category III AIF investment transaction cycle, in lieu of the current tax regime covering AIFs, as follows:

- Point A: Investor invests in the Fund.
- Point B: Fund buys securities, equity and derivatives over the course of the year.
- Point C: Fund sells securities pay STT on both equities and derivatives.
- Point D: Transaction-Fund distributes income to investors.
- Point E: Transaction-Investor redeems money / transfers units of the Fund.

31. In addition to the above, a 15% service tax on brokerage amount is also paid, as also an incremental service tax on the asset management fees paid out to the domestic fund manager.

32. In this manner the government collects the tax on the entire gain made by the fund when the investor redeems his or her investment from the fund.

33. It is important to highlight that in category III AIFs, the money received by such AIFs would be invested in underlying listed securities. As per the current law, such AIFs would be subject to STT for transacting in listed securities. Further, considering the volume involved at the category III AIF level, there is already a good amount of STT liability created at the time of transacting in underlying listed securities. The proposed rates of STT are over and above the STT that a category III AIF would otherwise pay for transacting in listed securities.

34. Additionally, there are also funds which are registered as CATIII AIFs and which adopt a 'long' strategy for investment in listed securities. A significant portion of their income is in the nature of long term capital gains which is otherwise exempt under existing tax law. Since investors earning long term capital gains would otherwise not have paid any income-tax at the time of disposing the listed securities, it is proposed not to levy any STT at the time of distribution of such income.

Proposed Amendments

Amendment – 1: Amendments required in the Finance Act 2004 (Chapter VII – Securities Transaction Tax):

**Distributions by AIFs to be treated as a taxable transaction in securities
liable to STT**

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

Definitions

- A) In section 97 of the Finance (No.2) Act, 2004, after sub-section (3A), the following definition shall be inserted:

“(3B) “CAT III Investment Fund” shall have the meaning assigned to it in the Explanation to Section 10(23FBAA) of the Income-tax Act, 1961”

- B) In section 97 of the Finance (No. 2) Act, 2004, in sub-section 13, after sub-clause (b), the following sub-clauses shall be inserted:

*“(c) purchase of an unit in a CAT III Investment Fund; or
(d) any distribution made on redemption of an unit in a CAT III Investment Fund; or
(e) any distribution made otherwise by a CAT III Investment Fund; or
(f) sale of an unit in a CAT III Investment Fund”*

Charge of Securities Transaction Tax

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

Sl. No.	Taxable Securities Transaction	Rate	Payable by
(1)	(2)	(3)	(4)
“8	a) Purchase of an unit of a CAT III Investment Fund	0.05%	the purchaser
	b) Distribution representing long term capital gains as referred to in Section 10(38) of the Income-tax Act, 1956, made by a CAT III Investment Fund on redemption or otherwise	Nil	-
	c) Distribution other than referred to in clause b above, made by a CAT III Investment Fund on redemption or otherwise	0.25%	the unit holder
	d) Sale of an unit of a CAT III Investment Fund being a long term capital asset, to any person other than the CAT III Investment Fund in which such units are held	0.05%	the seller
	e) Sale of an unit of a CAT III Investment Fund being a short term capital asset, to any person other than the Investment Fund in which such	0.25%	the seller

Value of taxable securities transaction

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

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

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

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

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

Collection and Recovery of Securities Transaction Tax,

E) In section 100 insert the following sub-section (2C) after sub-section (2B)

“(2C) The prescribed person in the case of every CAT III Investment Fund shall collect the securities transaction tax from every person purchases or sells or redeems the unit of a CAT III Investment Fund”

Recognised stock exchange or Investment Fund or Mutual Fund to furnish prescribed return

F) In sub-section (1) of section 101 - insert the following words after the words –every recognised stock exchange –

“or prescribed person in the case of every CAT III Investment Fund”

Amendment – 2: Amendments required in the Income Tax Act, 1961

Exempting the income from CAT III Investment Fund under section 10:

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

“(38A) any distribution received by an assessee, being a unitholder of a CAT III Investment Fund as referred to in Explanation to section 10(23FBAA), either on redemption or otherwise and where such distribution is chargeable to securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004.

(38B) any income received by an assessee, being a unitholder of a CAT III Investment Fund referred to in Explanation to section 10(23FBAA), on sale of units in a CAT III Investment Fund to any person other than the CAT III Investment Fund in which such units are held and where such sale is

chargeable to securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004.”

Exempting the income of CAT III Investment Fund under section 10:

In Section 10 of the Income-tax Act, after clause (23FBB), the following clauses shall be inserted, namely: -

“(23FBAA) any income of a CAT III Investment Fund;

Explanation.—For the purposes of this clause, “CAT III Investment Fund” means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992);”

Other consequential amendments:

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

In sub-section 42(A) of Section 2 of the Income-tax Act, insert the following proviso after the second proviso-

“Provided further that in the case of share or other securities of a company (not being a share listed in a recognised stock exchange) held by a CAT III Investment Fund or a unit of a CAT III Investment Fund specified under clause (38A) of section 10, the provisions of this clause shall have effect as if for the words "thirty-six months", the words "Twenty-four months" had been substituted”

- B) Exemption from filing return of income

Notification providing exemption from filing return of income by a Category III Alternative Investment Fund

MINISTRY OF FINANCE
(Department of Revenue)
(CENTRAL BOARD OF DIRECT TAXES)
NOTIFICATION
New Delhi, the_____, 2016
No. [●]
INCOME-TAX

S.O. 1703(E). —In exercise of the powers conferred by the proviso to sub- section (1) of section 139 of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby notifies that it shall not be necessary for an assessee being a unit holder of a Category III Alternative Investment fund as defined under clause

(23FBAA) of section 10 of the said Act to furnish under sub-section (1) of section 139 a return of his or its income if:

- His or its total income in respect of which he or it is assessable under this Act, during the previous year consisted only of distributions from a Category III Alternative Investment Fund as defined in explanation to clause (23FBAA) of section 10, chargeable to securities transaction tax under Chapter VII of the Finance (no.2) Act, 2014

This notification shall come into force from the date of its publication in the Official Gazette.

Appendix 1

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

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

Year 11	38	83	120
Year 12	38	83	120
Year 13	38	83	120
Year 14	38	83	120
Year 15	38	83	120
Total tax			1806

Assumptions:

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

Chapter VIII

Matrix of Recommendations of the 3rd Report of AIPAC

Chapter VIII

Matrix of Recommendations of the 3rd Report of AIPAC

A. Promoting AIFs in International Financial Service Centre (IFSCs)

B. Goods & Services Tax (GST)

C. Taxation of Category III AIFs: Investor-based Taxation

D. Taxation of AIFs Listed on a Stock Exchange

E. AIF Taxation: Deductibility of Costs & Net Losses

F. Social Venture Funds & CSR

Recommendations of the Third AIPAC Report

A. PROPOSED AMENDMENTS IN SEBI REGULATIONS FOR THE PROMOTION OF IFSCs **Alternatively, equivalent guidelines may be considered by SEBI**

CURRENT REGIME	PROPOSED AMENDMENTS
Key relaxation expected for FPIs	
SEBI (International Financial Services Centre) Guidelines, 2015 Chapter III, Guideline 8 Any recognised entity or entities desirous of operating in IFSC as an intermediary, <u>may form a company to provide such financial services relating to securities market</u> , as permitted by the Board.	Guideline 8 may be amended as follows: "Any recognised entity or entities desirous of operating in IFSC as an intermediary, <u>may form a company, limited liability partnership or a trust</u> to provide such financial services relating to securities market, as permitted by the Board."
SEBI (Foreign Portfolio Investors) Regulations, 2014 Definitions - Regulation 2	The following should be inserted as Regulation 2(ia): <u>"International Financial Services Centre" or "IFSC" shall have the same meaning as assigned to it in clause (q) of section 2 of the Special Economic Zones Act, 2005"</u>
SEBI (Foreign Portfolio Investors) Regulations, 2014 Eligibility criteria of foreign portfolio investor Regulations 4 - The designated depository participant shall not consider an application for grant of certificate of registration as a foreign portfolio investor unless the applicant satisfies the following conditions namely, - (a) the applicant is a person not resident in India; (b) the applicant is resident of a country whose securities market regulator is a signatory to International Organization of Securities Commission's Multilateral	The following proviso should be included after Regulation 4: <u>"Provided that the eligibility requirements under sub-clause (a), (b), (c), (d) and (f) shall be deemed to be fulfilled in the case the applicant is established or incorporated in an International Finance Services Centre."</u>

CURRENT REGIME	PROPOSED AMENDMENTS
<p>Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with the Board;</p> <p>(c) the applicant being a bank, is a resident of a country whose central bank is a member of Bank for International Settlements;</p> <p>(d) the applicant is not resident in a country identified in the public statement of Financial Action Task Force as:</p> <p>(i) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or</p> <p>(ii) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies;</p> <p>(e) the applicant is not a non-resident Indian;</p> <p>(f) the applicant is legally permitted to invest in securities outside the country of its incorporation or establishment or place of business;</p> <p>(g) the applicant is authorized by its Memorandum of Association and Articles of Association or equivalent document(s) or the agreement to invest on its own behalf or on behalf of its clients;</p> <p>(h) the applicant has sufficient experience, good track record, is professionally competent, financially sound and has a generally good reputation of fairness and integrity;</p> <p>(i) the grant of certificate to the applicant is in the interest of the development of the securities market;</p> <p>(j) the applicant is a fit and proper person</p>	

CURRENT REGIME	PROPOSED AMENDMENTS
<p>based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008; and</p> <p>(k) any other criteria specified by the Board from time to time.</p>	
<p>SEBI (Foreign Portfolio Investors) Regulations, 2014</p> <p>Categories of foreign portfolio investor</p> <p>Regulation 5- An applicant shall seek registration as a foreign portfolio investor in one of the categories mentioned hereunder or any other category as may be specified by the Board from time to time:</p> <p>(b) "Category II foreign portfolio investor" which shall include:</p> <p>(i) appropriately regulated broad based funds such as mutual funds, investment trusts, insurance/reinsurance companies;</p> <p>(ii) appropriately regulated persons such as banks, asset management companies, investment managers/ advisors, portfolio manager;</p> <p>(iii) broad based funds that are not appropriately regulated but whose investment manager is appropriately regulated:</p> <p>Provided that the investment manager of such broad-based fund is itself registered as Category II foreign portfolio investor:</p> <p>Provided further that the investment manager undertakes that it shall be responsible and liable for all acts of commission and omission of all its underlying broad-based funds and other deeds and things done by such broad based funds under these regulations.</p> <p><i>Explanation 1</i>-For the purposes of this clause, an applicant seeking registration as a foreign portfolio investor shall be</p>	<p>Explanation 1 and 2 of Regulation 5 should be amended as follows:</p> <p><i>"Explanation 1-</i> For the purposes of this clause, an applicant seeking registration as a foreign portfolio investor shall be considered to be "appropriately regulated" if it is regulated or supervised by the securities market regulator or the banking regulator, of the concerned foreign jurisdiction, in the same capacity in which it proposes to make investments in India, <u>provided that an applicant established in an International Financial Services Centre will be deemed to be "appropriately regulated" for the purposes of these Regulations.</u></p> <p><i>Explanation 2-</i></p> <p>A) For the purposes of this clause, "broad based fund" shall mean a fund, established or incorporated outside India <u>or in an International Financial Services Centre</u>, which has at least twenty investors, with no investor holding more than forty-nine per cent of the shares or units of the fund:"</p>

CURRENT REGIME	PROPOSED AMENDMENTS
<p>considered to be "appropriately regulated" if it is regulated or supervised by the securities market regulator or the banking regulator of the concerned foreign jurisdiction, in the same capacity in which it proposes to make investments in India.</p> <p>Explanation 2-</p> <p>A) For the purposes of this clause, "broad based fund" shall mean a fund, established or incorporated outside India, which has at least twenty investors, with no investor holding more than forty-nine per cent of the shares or units of the fund:</p> <p>Provided that if the broad-based fund has an institutional investor, who holds more than forty nine per cent of the shares or units in the fund, then such institutional investor must itself be a broad based fund.</p> <p>B) For the purpose of clause, A of this Explanation, for ascertaining the number of investors in a fund, direct investors as well as underlying investors shall be considered.</p> <p>C) For the purpose of clause B of this Explanation, only investors of entities which have been set up for the sole purpose of pooling funds and making investments, shall be considered for the purpose of determining underlying investors.</p>	
<p>SEBI (Foreign Portfolio Investors) Regulations, 2014</p> <p>Regulation 32 (1)- All designated depository participants who have been granted approval by the Board shall -</p> <p>(a) comply with the provisions of these regulations, as far as they may apply, circulars issued thereunder, and any other terms and conditions specified by the Board from time to time;</p> <p>(b) forthwith inform the Board in writing, if any information or particulars previously submitted to the Board are found to be</p>	<p>Explanation 1 of Regulation 32(1) should be amended as follows:</p> <p><i>"Explanation 1.-</i> For the purposes of this clause, "opaque structure" shall mean any structure such as protected cell company, segregated cell company or equivalent, where the details of the ultimate beneficial owners are not accessible or where the beneficial owners are ring fenced from each other or where the beneficial owners are ring fenced with regard to enforcement: Provided that the foreign portfolio investor satisfying the following criteria shall not be treated as having opaque structure:</p>

CURRENT REGIME	PROPOSED AMENDMENTS
<p>false or misleading, in any material respect;</p> <p>(c) forthwith inform the Board in writing, if there is any material change in the information previously furnished by him to the Board;</p> <p>(d) furnish such information, record or documents to the Board and Reserve Bank of India, as may be required, in relation to his activities as a designated depository participant;</p> <p>(e) ensure that only registered foreign portfolio investors are allowed to invest in securities market;</p> <p>(f) ensure that foreign portfolio investor does not have opaque structure(s):</p> <p>Explanation 1.- For the purposes of this clause, "opaque structure" shall mean any structure such as protected cell company, segregated cell company or equivalent, where the details of the ultimate beneficial owners are not accessible or where the beneficial owners are ring fenced from each other or where the beneficial owners are ring fenced with regard to enforcement: Provided that the foreign portfolio investor satisfying the following criteria shall not be treated as having opaque structure:</p> <p>(i) the applicant is regulated in its home jurisdiction</p> <p>(ii) each fund or sub fund in the applicant satisfies broad based criteria, and</p> <p>(iii) the applicant gives an undertaking to provide information regarding its beneficial owners as and when Board seeks this information.</p> <p>Explanation 2.- For the purposes of Explanation 1, the definition of ultimate beneficial owner shall be as provided under the Master circular on Anti Money Laundering Standards or Combating the Financing of Terrorism, issued by the Board from time to time.</p>	<p>(i) the applicant is regulated in its home jurisdiction</p> <p><u>Provided if the applicant is established in an International Financial Services Centre, it will be deemed to be regulated in its home jurisdiction;</u></p> <p>(ii) each fund or sub fund in the applicant satisfies broad based criteria, and</p> <p>(iii) the applicant gives an undertaking to provide information regarding its beneficial owners as and when Board seeks this information."</p>

CURRENT REGIME	PROPOSED AMENDMENTS
<p>(g) have adequate systems to ensure that in case of jointly held depository accounts, each of the joint holders meet the requirements specified for foreign portfolio investors and shall perform KYC due diligence for each of the joint holders;</p> <p>(h) in case of any penalty, pending litigations or proceedings, findings of inspections or investigations for which action may have been taken or is in the process of being taken by any regulator against a designated depository participant, the designated depository participant shall bring such information forthwith, to the attention of the Board, depositories and stock exchanges;</p> <p>(i) be guided by the relevant circular on Anti-Money Laundering or Combating the Financing of Terrorism specified by the Board from time to time.</p>	
Key relaxations expected for AIFs	
<p>SEBI (Alternative Investment Fund) Regulations, 2012</p> <ul style="list-style-type: none"> Registration of Alternative Investment Funds-Regulation 3(4)(b) <p>Category II "Alternative Investment Fund" which does not fall in Category I and III and which does not undertake leverage or borrowing other than to meet day-to-day operational requirements and as permitted in these regulations</p> <ul style="list-style-type: none"> Conditions for Category I Alternative Investment Funds-Regulation 16(1)(c) <p>Category I Alternative Investment Funds shall not borrow funds directly or indirectly or engage in any leverage except for meeting temporary funding requirements for not more than thirty days, on not more than four occasions in a year and not more than ten percent of the investable funds.</p>	<ul style="list-style-type: none"> The following should be inserted in Regulation 3(4)(b): <i><u>"Nothing in this sub-clause shall apply to a Category II Alternative Investment Fund established or incorporated in an International Financial Services Centre."</u></i> The following should be inserted in Regulation 16(1)(c): <i><u>"Nothing in this sub-clause shall apply to a Category I Alternative Investment Fund established or incorporated in an International Financial Services Centre."</u></i> SEBI may consider relaxation on maximum leverage IFCS-domiciled AIFs subject to adequate safe guard such as private placement of fund unit only with credited investor and additional reporting requirements.

CURRENT REGIME	PROPOSED AMENDMENTS
<ul style="list-style-type: none"> Conditions for Category II Alternative Investment Funds-Regulation 17(1)(c) <p>Category II Alternative Investment Funds may not borrow funds directly or indirectly and shall not engage in leverage except for meeting temporary funding requirements for not more than thirty days, not more than four occasions in a year and not more than ten percent of the investable funds;</p>	
<p>SEBI (Alternative Investment Fund) Regulations, 2012</p> <ul style="list-style-type: none"> General Investment Conditions-Regulation 15(a) <p>Alternative Investment Fund may invest in securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and the Board from time to time</p> <ul style="list-style-type: none"> SEBI Circular dated 1 October 2015 <p>Re: Guidelines on overseas investments and other issues/clarifications for AIFs/VCFs</p> <p>The circular <i>inter alia</i> provides the following:</p> <ul style="list-style-type: none"> f) AIFs may invest in equity and equity linked instruments only of offshore venture capital undertakings, subject to overall limit of USD 500 million (combined limit for AIFs and Venture Capital Funds); g) AIFs desirous of making investments in offshore venture capital undertakings shall submit their proposal for investment (in the attached format at Annexure) to SEBI for prior approval; h) Investments would be made only 	<p>A circular must be issued by SEBI clarifying that SEBI circular dated 1 October 2015 will not apply to alternative investment funds established or incorporated in an International Financial Services Centre and they shall be permitted to invest outside India freely, without requiring any regulatory approvals from SEBI or RBI.</p>

CURRENT REGIME	PROPOSED AMENDMENTS
<p>in those companies which have an Indian connection (e.g. company which has a front office overseas, while back office operations are in India);</p> <p>i) Such investments shall not exceed 25% of the investible funds of the scheme of the AIF; and</p> <p>j) The allocation of investment limits would be done on 'first come first serve' basis, depending on the availability in the overall limit of USD 500 million.</p>	

SEBI-IFSC: AIFs: CONSIDERATION FOR GUIDELINE / REGULATIONS	
Clarity on applicability of existing SEBI AIF regulations to IFSC	<p>It is recommended to insert the following proviso under clause 3(1) of Chapter II of the SEBI (Alternative Investment Fund) Regulations, 2012:</p> <p>“Provided further that this regulation shall apply to an alternative investment fund set up in an International Financial Services Centre, as modified by the Securities and Exchange Board of India (International Financial Services Centres) Guidelines, 2015, amended from time to time.”</p>
Investment Avenues for AIFs in IFSC	
<p>Currently, offshore funds / investors invest in the listed as well as the unlisted securities⁵ in the Indian market through FDI route, FPI route or FVCI route.</p> <p>Considering the above, in order to ensure that AIF's in IFSC are treated on par with the offshore funds / investors with respect to the permissible investment avenues for making investments into India, an AIF in IFSC should be permitted to invest into India under all the permissible investment avenues.</p> <p>Further, an AIF in IFSC should also be allowed to participate in the capital of a Limited Liability Partnership incorporated in India.</p>	<p>Suggested Amendments:</p> <p>SEBI Impact</p> <p>It is recommended that the following amendments are made to the Circular No. SEBI/HO/MRD/DSA/CIR/P/2017/45 of SEBI dated May 23, 2017.</p> <p>Clause 22 (3) of SEBI (IFSC) Guidelines, 2015 is to be amended and read as follows:</p> <p>"Any alternative investment fund or mutual fund operating in IFSC shall be permitted to invest in the following:</p> <p>a) Securities which are listed in IFSC; b) Securities issued by companies incorporated in IFSC;</p> <p>c) Securities issued by companies incorporated in India or companies belonging to foreign jurisdiction. subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and Government of India from time to time; and</p>

	<p>d) Capital of limited liability partnerships incorporated in India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and Government of India from time to time."</p> <p>Further, it is clarified that such portfolio manager, alternative investment fund or mutual fund shall invest in India through the foreign portfolio investor route</p> <p>Such alternative investment fund or mutual fund shall obtain registration, where necessary, under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014.</p> <p>Further, it is clarified that the Circular No. CIR/IMD/DF/7/2015 dated /1 October 2015 issued by the Board on 'Guidelines on overseas investments and other issues / clarifications for AIFs/VCFs' shall not apply to an AIF set up in an IFSC."</p> <p>FEMA Impact The following proviso needs to be inserted in Regulation 26 of the Foreign Exchange Management (Transfer or issue of Foreign Security) Regulations, 2004:</p> <p>"Provided that nothing contained in this regulation shall apply to an AIF set up in an IFSC."</p>
<p>SEBI IFSC guidelines should be relaxed to permit a Sponsor / Manager of an existing AIF in India to act as a Sponsor / Manager of an AIF in IFSC by setting up a branch or a company in the IFSC. Further, the Investment</p>	<p>Suggested Amendments:</p> <p>It is recommended to insert the following clause clause 22.7 and</p>

Manager shall be permitted to obtain investment advisory services from an entity set up outside IFSC.	<p>22.8 in Chapter VI – Funds of the SEBI (International Financial Services Centers) Guidelines, 2015:</p> <p>“22.7 The Sponsor / Manager of an Alternative Investment Fund in IFSC shall be in compliance with the provisions of this clause -</p> <p>a) A Sponsor / Manager of an Alternative Investment Fund in India may act as a Sponsor / Manager of an Alternative Investment Fund set up in the IFSC by –</p> <ul style="list-style-type: none"> i) setting up a branch in the IFSC; or ii) incorporating a company in the IFSC <p>subject to any guidelines, regulations issued by the Reserve Bank of India from time to time.</p> <p>b) In other cases, such a Sponsor / Manager shall need to incorporate a company or limited liability partnership in the IFSC.</p> <p>22.8 The Manager of an Alternative Investment Fund in IFSC may obtain advisory services from an entity set up outside IFSC.”</p>
Sponsor / Manager commitment	<p>Scenario 1 - Domestic Sponsor / Manager in India to act as a Sponsor / Manager for an AIF in IFSC by setting up a branch in IFSC</p> <p>To liberalise remittance of fund by the Sponsor/ Manager in India to its branch in IFSC, the Reserve Bank of India should amend the Foreign Exchange Management</p>

	<p>(Foreign Currency Accounts By a Person Resident In India) Regulations, 2015 to specifically permit such remittances.</p> <p>Suggested Amendments:</p> <p>It is recommended to amend clause (B) of Regulation 5 of the Foreign Exchange Management (Foreign Currency Accounts By a Person Resident In India) Regulations, 2015 by inserting the following clause (iii) under clause (b) to the first proviso as follows:</p> <p>“(iii) Nothing contained in clause (i) and (ii) above shall apply to any remittance made to the branch, which is a Sponsor / Manager of an Alternative Investment Fund in an International Financial Services Centre.”</p> <p>Scenario 2 - Domestic Sponsor / Manager in India to incorporate a Company in IFSC and act as a Sponsor / Manager for an AIF in IFSC</p> <p>Suggested Amendments</p> <p>It is recommended to amend sub-regulation 7 of the Foreign Exchange Management (Transfer or issue of Foreign Security) Regulations, 2004 by inserting the following proviso after clause (2) as follows:</p> <p>“Provided that nothing contained in clause 1) and 2) above shall apply to any investment made by a person resident in India in a company or limited liability partnership, incorporated in an International Financial Services Centre, to act as a Sponsor /</p>
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	Manager for an Alternative Investment Fund in such center.”
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MOF-CBDT – Recommendations relating to IFSC-AIFs	
<p>Income Tax Act, 1961</p> <p><i>Certain activities not to constitute business connection in India</i></p> <p>Section 9A (2) -</p> <p>(2) Notwithstanding anything contained in section 6, an eligible investment fund shall not be said to be resident in India for the purpose of that section merely because the eligible fund manager, undertaking fund management activities on its behalf, is situated in India</p>	<p>Regulation 9A (2) should be amended as follows:</p> <p>“Notwithstanding anything contained in section 6, an eligible investment fund shall not be said to be resident in India for the purpose of that section merely because the eligible fund manager <u>including a portfolio manager incorporated or established in an International Financial Services Centre</u>, undertaking fund management activities on its behalf, is situated in India.”</p> <ul style="list-style-type: none"> Regulation 9A (3) should be amended as follows: <p>“The eligible investment fund referred to in sub-section (1), means a fund established or incorporated or registered outside India, <u>including a fund established or incorporated in an International Financial Services Centre</u>, which collects funds from its members for investing it for their benefit and fulfils the following conditions, namely: —...”</p> The following proviso will be inserted in Regulation 9A (3): <p><u>“Provided further that the conditions specified in sub-clauses (a), (b), (d), (h), (j), (k) and (l) shall be deemed to be fulfilled in case of funds established or incorporated in an International Financial Services Centre.”</u></p>
<p>Exemption from tax for any income earned by an offshore investor from offshore investments made through a Fund in IFSC</p>	<p>Currently, Category I and II AIFs have been provided tax pass through status for capital gains under the Indian income tax laws. However, while distributing any income to its investors, an AIF is required to withhold taxes at the applicable rates based on the jurisdiction of the investor and remit such taxes to the Government of India.</p> <p>Further, the Indian income tax laws also require the unit holders to obtain tax registration (i.e. to obtain PAN) and disclose such income by filing of a Return of Income (“RoI”) in India.</p> <p>In a way, collection of tax revenue is met by the above withholding requirement in the hands of the AIF resulting in no tax revenue leakage for the Government of India.</p> <p>The need to obtain tax registrations and filing of a RoI by the unit holder requires an investor to go through the rigours of compliances in India. While this approach may be required for the domestic market, an IFSC regime should be more investor friendly in terms of compliance requirements.</p>

	<p>Hence, in order to encourage foreign investors to directly come into the IFSC without worrying about the hassle of Indian tax compliances, the Government of India should exempt the foreign investors from obtaining PAN number and filing of tax return in India, in respect of any income distributed by an AIF in IFSC after deduction of tax at source.</p> <p>However, where such foreign investor earns any other income from India, such foreign investor should be subject to the above compliances.</p>
	<p>Suggested Amendments:</p> <p>It is recommended to insert the following proviso in section 5(2) of the Income-tax Act, 1961</p> <p>“Provided that in the case of a non-resident, being an unit holder in an Alternative Investment Fund set up in an International Financial Services Center in India, the income referred to in sub-section (2) above, shall not include any income, to the extent, derived from any investment made by such Alternative Investment Fund outside India.</p> <p>Explanation 3.- For the purpose of this proviso, an Alternative Investment Fund means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012 and Securities and Exchange Board of India (International Financial Services Centers) Guidelines, 2015 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992).</p>
<p>Exemption from filing return of income and obtaining PAN number for offshore investors in an AIF in IFSC</p> <p>In order to encourage foreign investors to directly come into the IFSC without worrying about the hassle of Indian tax compliances, the Government of India</p>	<p>Suggested Amendments:</p> <p>Exemption from obtaining Permanent Account Number It is recommended to issue the following notification pursuant to powers conferred in clause (d) to sub-section (8) of section 139A of the Income-tax Act, 1961</p> <p>SECTION 139A OF THE INCOME-TAX ACT, 1961 – EXEMPTION FOR INVESTORS IN AN ALTERNATIVE INVESTMENT FUND SET UP IN AN INTERNATIONAL FINANCIAL SERVICES CENTRE NOTIFICATION NO. S.O. _(E) [NO. XXX—201X (F. NO. __-__-__)], DATED XX-XX-201X In exercise of the powers conferred by clause (d) to sub-section (8) of section 139A of the Income-tax Act, 1961 (XX of 1961), the Central Government hereby specifies that the requirement to obtain a permanent account number shall not apply in respect of the following class or classes of persons, namely:</p>

<p>should exempt the offshore investors from obtaining PAN number and filing of tax return in India, in respect of any income distributed by an AIF in IFSC after deduction of tax at source.</p>	<p>(a) a non-resident, not being a company, or</p> <p>(b) a foreign company</p> <p>which earns income only from investments made in an Alternative Investment Fund set up in an International Financial Services Centre.</p> <p>Exemption from filing Return of Income</p> <p>It is recommended to insert the following sub clause (iv) in clause (a) of sub-section (1) in section 115A of the Income-tax Act, 1961</p> <p>"(iv) income received in respect of units, purchased in foreign currency, of an Alternative Investment Fund set up in an International Financial Services Centre;"</p>
MOF-CBDT/CBEC	
<p>B. GST- Related Recommendations</p> <p>I. GST exemption on management services and other services</p>	<p>GST exemption on management services and other services availed by AIF</p> <p>Considering the importance of the VCPE industry, it is recommended that services availed by an AIF should be chargeable to a rate at 5% slab under the GST regime, where majority of the investors of AIF are non-residents. This would boost the investments in AIFs which will in turn provide an impetus to the investments in the seed capital, early stage and growth</p>

availed by AIF	<p>companies.</p> <p>Alternatively, the investors in an AIF could be considered as service recipients and where the foreign investment in an AIF exceeds 50%, the services availed by an AIF should be considered as export of services and thereby be liable for zero rate of tax.</p>
II. GST liability on directors in case of default by a private limited company	<p>GST liability on directors in case of default by a private limited company</p> <p>Personal liability under section 89(1) of the CGST Act should not be extended to the nominee/non-executive directors, especially where appointment is made by AIFs. Accordingly, section 89(1) of the CGST Act should be amended as under (changes highlighted in bold font below):</p> <p>Notwithstanding anything contained in the Companies Act, 2013 where any tax, interest or penalty due from a private company in respect of any supply of goods or services or both for any period cannot be recovered, then, every person who was a director, other than a nominee/nonexecutive director appointed by an Alternative Investment Fund of the private company during such period shall, jointly and severally, be liable for the payment of such tax, interest or penalty unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company."</p>
III. GST on distribution of profit share to the GP/ Sponsor	<p>To provide certainty on levy of GST on distribution of profit share to the GP/ Sponsor, it should be clarified that distribution of profit share to the GP/Sponsor shall not be subjected to the levy of GST.</p>

\MOF-CBDT	
C. Investor-based Taxation for Category III AIFs	<p>Investor based taxation for Category III AIFs <u>Suggested amendments in the Act to give effect to the recommendation</u></p> <hr/> <p>Proposed Amendments:</p> <p><u>Section 2(14)</u></p> <p><i>Capital Asset means –</i></p> <p><i>(a) property of any kind held by an assessee, whether or not connected with his business or profession;</i></p> <p><i>(b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992;</i></p> <p><i>(c) any units issued by an investment fund</i></p> <p><i>Explanation 2: For the purposes of this clause-</i></p> <p><i>(a) the expression “Foreign Institutional Investor” shall have the meaning assigned to it in clause (a) of the Explanation to section 115AD;</i></p> <p><i>(b) the expression “securities” shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulations) Act, 1956 (42 of 1956);</i></p> <p><i>(c) the expression “investment fund” shall have the meaning assigned to it in the Explanation to clause (23DB) of section 10</i></p> <p><u>Section 2(42A)</u></p> <p><i>“short term capital asset” means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer:</i></p> <p><i>Provided that in the case of a security (other than a unit) listed in a</i></p>

recognised stock exchange in India or a unit of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963) or a unit of an equity oriented fund or **a unit of an equity oriented investment fund** or a zero-coupon bond, the provisions of this clause shall have effect as if for the words "thirty-six months", the words "twelve months" had been substituted:

Explanation 5. – For the purposes of this clause, the expression "equity oriented investment fund" shall have the meaning assigned to it in the Explanation below clause (38B) of section 10

Section 56

(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from Other Sources", namely:-

(ie) any income distributed by an investment fund

Explanation: For the purposes of this clause, the term "investment fund" shall have the meaning assigned to it in clause (23DB) of section 10

Section 111B

(1) Where the total income of an assessee includes income chargeable under the head "Capital Gains", arising from the transfer of a short-term capital asset, being a unit of an equity oriented investment fund, the tax payable by the assessee on the total income shall be the aggregate of -

(i) the amount of income-tax calculated on such short-term capital gains at the rate of fifteen per cent; and

(ii) the amount of income-tax payable on the balance amount of the total income as if such balance amount were the total income of the assessee

Provided that in the case of an individual or a Hindu undivided family, being a resident, where the total income as reduced by such short term capital gains is below the maximum amount which is not chargeable to income-tax, then, such short term capital gains shall be reduced by the amount by which the total income so reduced falls short of the maximum amount which is not chargeable to income-tax and the tax on the balance

of such short-term capital gains shall be computed at the rate of fifteen per cent.

(2) Where the gross total income of an assessee includes any short-term capital gains referred to in sub-section (1), the deduction under Chapter VI-A shall be allowed from the gross total income as reduced by such capital gains.

Explanation. - For the purposes of this section, the expression "equity oriented investment fund" shall have the meaning assigned to it in the Explanation below clause (38B) of section 10.

Insertion of new section 194LBD

(1) Where any income is payable to a unitholder in respect of units of the investment fund, the person responsible for making the payment or distribution shall, at the time of payment or distribution thereof in cash or by issue of cheque or draft or by any other mode, deduct income-tax thereon at the following rates:

- e. on the income of the nature referred to in section 111B at the rate of fifteen per cent;*
- f. on the income distributed by an investment fund other than income distributed by equity oriented investment fund referred to in clause (38B) of section 10, at the rate of thirty per cent;*
- g. on the income arising on redemption of a long-term capital asset being a unit of an investment fund other than equity oriented investment fund, at the rate of twenty per cent; and*
- h. on the income arising on redemption of a short-term capital asset being a unit of an investment fund other than equity oriented investment fund, at the rate of thirty per cent.*

Provided that where the payee is a non-resident (not being a company) or a foreign company, deduction of tax shall be made in respect of any income at the rates in force

Explanation – For the purposes of this section -

- (iii) the expression "equity oriented investment fund" shall have the meaning assigned to it in the Explanation below clause (38B) of*

section 10

- (iv) *the expression “investment fund” shall have the meaning assigned to it in the Explanation to clause (23DB) of section 10 and*

Section 196

Notwithstanding anything contained in the foregoing provisions of this Chapter, no deduction of tax shall be made by any person from any sums payable to –

(i) the Government, or

(ii) the Reserve Bank of India or

(iii) a corporation established by or under a Central Act which is, under any law for the time being in force, exempt from income-tax on its income or

(iv) a Mutual Fund specified under clause (23D) of section 10, or

(v) an Investment Fund specified under clause (23DB) of section 10,

where such sum is payable to it by way of interest or dividend in respect of any securities or shares owned by it or in which it has full beneficial interest, or any other income accruing or arising to it

Section 10(23DB)

Any income of an investment fund.

Explanation: For the purposes of this clause, ‘investment fund’ shall mean a fund which has been granted a certificate of registration as a category III Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations 2012, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992)

Section 10(38A)

Any income arising from the transfer, either by way of redemption or

	<p><i>otherwise, of a long-term capital asset being a unit of an equity oriented investment fund</i></p> <p><u>Section 10(38B)</u></p> <p><i>Any income distributed by an equity oriented investment fund to its unitholder, out of the income arising to the investment fund which is of the nature specified in clause (34) or clause (34A) or clause (35) or clause (38) of section 10</i></p> <p><i>Explanation - For the purposes of clause (38A) and clause (38B) of section 10, the expression "equity oriented investment fund" means an Investment Fund referred to it in the Explanation to clause (23DB) of section 10 and whose investible funds are invested by way of equity shares of domestic companies to the extent of more than sixty-five per cent of the total proceeds of such fund:</i></p> <p><i>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</i></p>
MOF-CBDT	
<p>D. Suggested New Tax Code for Listed AIFs</p> <p>SEBI has taken the progressive measure to enable listing of AIFs. However, the related tax regime needs to be enunciated. The current pass-through tax system cannot cater to listing of AIFs and secondary transactions in units of listed AIFs</p>	<p>TAXATION of Listed AIFs</p> <p>A new tax code for AIFs could be modelled along the following features:</p> <p>Exemption to the AIF for all streams of income earned by the AIF on its investments in portfolio entities</p> <p>Taxation of income (viz dividend and interest) distribution by the AIF to its investors in the hands of the AIF's investors</p> <p>Dividend - Exempt from tax in the hands of the investor</p> <p>Interest – Domestic investor at their respective tax rates, Non-resident investors at 5%</p> <p>Taxation of gains actually realized by the AIF's investors either on unit redemption by the AIF or on secondary transfer by a unit holder to another</p>

	<p>unit holder or third party**</p> <p><u>Equity Oriented Fund:</u></p> <p>Short-term capital gains @ 15% with the sale/ redemption being liable to STT</p> <p>Long-term capital gains – Exempt from tax in the hands of the investor with the sale/ redemption being liable to STT</p> <p><u>Debt Oriented Fund:</u></p> <p>Short-term capital gains @ Maximum Marginal Rate</p> <p>Long-term capital gains @ 20% for domestic investors, 10% for non-resident investors</p>
MOF-CBDT	
<p>E. Important Pending Recommendations from Previous AIPAC Reports</p> <p>AIF Taxation- Recognition of Costs & Net Losses</p> <p>These recommendations need to be implemented on an expeditious basis in order to make the current pass through tax regime more efficient.</p>	<ul style="list-style-type: none"> • The following critical issues are yet to be addressed in the tax law: <p>Significant costs incurred by the AIF are not factored in determining the investors' tax liability</p> <p>Net losses incurred by AIFs are not available to investors and may lapse if not set-off by the AIF</p> <p>Recommendations</p> <ul style="list-style-type: none"> • Allowing a deduction for management fee and expenses in determining taxable gains <p>Allow management fee incurred from the date of the investment to the date of its divestment to be capitalised as “cost of improvement”. The management fee incurred may be calculated based on the management fee contractually payable to the AIF’s investment manager at the annual rate applied to the actual cost of the investment.</p> <ul style="list-style-type: none"> • Allow pass through for net losses incurred by AIFs <p>(The related draft amendments are given in Section C of Chapter V of this report)</p>

S. No.	Suggested Changes: CSR in Companies Act 2013
4.	Restriction on investment by Companies using CSR funds
F. Ministry of Corporate Affairs: Social Venture Funds & CSR	<p>The Ministry of Corporate Affairs may consider issuing a circular/notification modifying section 135 and Schedule VII of the Companies Act to effectuate the following:</p> <p>Section 135. Corporate Social Responsibility:</p> <p>(1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.</p> <p>(2) The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.</p> <p>(3) The Corporate Social Responsibility Committee shall, —</p> <p>(a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;</p> <p>(b) recommend the amount of expenditure <u>or investment to be</u> incurred on the activities referred to in clause (a); and (c) monitor the Corporate Social Responsibility Policy of the company from time to time.</p> <p>(4) The Board of every company referred to in sub-section (1) shall, —</p> <p>(a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and</p> <p>(b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.</p> <p>(5) The Board of every company referred to in sub-section (1), shall ensure that the company spends or invests, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.</p> <p>Provided that the company shall give preference to the local area and areas around it where it operates, for spending/investing the amount earmarked for Corporate Social Responsibility activities:</p> <p style="text-align: center;">129</p> <p>Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134,</p>

	<p>specify the reasons for not spending/investing the amount.</p> <p>“Further, in exercise of the powers conferred under sub-section (1) of section 467 of the Companies Act, the Central Government hereby makes the following amendments to Schedule VII of the said Act, namely: -</p> <p>In Schedule VII, after items (i) to (x) and the entries relating thereto, the following items and entries shall be inserted, namely: -</p> <p>“(xi) social business projects” “(xii) social enterprise” “(xiii) social venture or social venture fund as defined under SEBI (Alternative Investment Funds) Regulation, 2012”</p>
5.	IT Act, 1961: Widening the Scope of Eligible Investments by Public Trusts
MoF CBDT	<p>Additional clauses allowing wider permissible modes of investment by public trusts under Section 11(5) of ITA. The ITA should amend section 11(5) to effectuate the following:</p> <p>“(iva) investment in any security of a social business or a social enterprise” “(ivaa) investment in the security of a <i>not-for-profit</i> company</p> <p>Explanation- In this clause, a <i>not-for-profit</i> company means a company set up under Section 8 of the Companies Act”</p> <p>“(ivaaa) investment in social venture fund</p> <p><i>Explanation-</i> In this clause, a “social venture fund” means an Alternative Investment Fund [set up under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012] which invests primarily in securities or units of social ventures and which satisfies social performance norms laid down by the fund and whose investors may agree to receive restricted or muted returns.”</p>

6.	<p>include “Social Enterprises” as a separate category in the AIF Regulation</p>
SEBI-AIF Regulations	<p>Section 2(u) of the AIF Regulations may be amended as follows:</p> <p>A “social venture” is defined as a “non-profit venture” or a “social enterprise”.</p> <p>“Non-profit venture” means a trust, society or company formed with the purpose of promoting social welfare or solving social problems or providing social benefits and includes,</p> <ul style="list-style-type: none"> (i) public charitable trusts registered with Charity Commissioner; (ii) societies registered for charitable purposes; (iii) company registered under Section 8 of the Companies Act. <p>“Social Enterprise” means a trust, society or company or limited liability partnership which satisfies all of the conditions below:</p> <ul style="list-style-type: none"> i) It has the achievement of positive social impact as a primary objective under its memorandum and articles of association. ii) It carries on a business in the areas of agriculture, affordable healthcare, affordable education, affordable housing, financial inclusion, renewable energy, water and sanitation, livelihoods, or any other area as may be notified by the Government for priority sector lending, but does not carry on business in the areas of Real estate other than affordable housing, Infrastructure, Tobacco, Alcohol, Weapons or Wildlife. iii) It focuses primarily on promoting the social welfare of, or providing social benefits to, Specified Beneficiaries, who may act as producers, consumers, suppliers or employees in relation to the Social Enterprise. For the purpose of this provision, Specified Beneficiaries shall be persons with annual household incomes of less than a threshold prescribed annually by the investment committee of the SEBI-registered social venture fund making the investment or be individuals with physical disabilities.

Abbreviations

AIF	<i>Alternative Investment Fund</i>	IIT	<i>Infrastructure Investment Trust</i>
AI	<i>Accredited Investor</i>	IT Act	<i>Income Tax Act, 1961</i>
AIFM	<i>Alternative Investment Fund Manager</i>	IRDA	<i>Insurance Regulatory & Development Authority</i>
AIFMD	<i>Alternative Investment Fund Manager Directive</i>	IRR	<i>Internal Rate of Return</i>
AIPAC	<i>Alternative Investment Funds Policy Advisory Committee</i>	LACS	<i>One Lac = 100 Thousand</i>
AUM	<i>Assets Under Management</i>	LP	<i>Limited Partner</i>
BSE	<i>Bombay Stock Exchange</i>	LLP	<i>Limited Liability Partnership</i>
CBDT	<i>Central Board of Direct Taxes</i>	LTCG	<i>Long-term Capital Gains Tax</i>
CCD	<i>Compulsorily Convertible Debentures</i>	MCA	<i>Model Contribution Agreement</i>
CCPS	<i>Compulsorily Convertible Preference Shares</i>	MMPCV	<i>Mid-Market Permanent Capital Vehicle</i>
CGST	<i>Central Goods and Service Tax</i>	NR	<i>Non-resident</i>
Crore	<i>1 Crore = 10 million = 100 Lakhs</i>	NRI	<i>Non-resident Indian</i>
DDT	<i>Dividend Distribution Tax</i>	NRE	<i>Non-Resident External bank account</i>
DTAA	<i>Double Tax Avoidance Agreement</i>	NRO	<i>Non-Resident (Ordinary) bank Ac</i>
DII	<i>Domestic Institutional Investor</i>	PE	<i>Private Equity</i>
EIF	<i>Eligible Investment Fund</i>	PFRDA	<i>Pension Fund Regulatory Development Authority</i>
ETF	<i>Exchange Traded Fund</i>	PIO	<i>Person of Indian Origin</i>
ESMA	<i>European Securities and Markets Authority</i>	PLCC	<i>The ratio of contributions to date measured against committed capital</i>
ESOP	<i>Employee Stock Option Plan</i>	PPM	<i>Private Placement Memorandum</i>
FA	<i>Finance Act</i>	QIB	<i>Qualified Institutional Buyer</i>
FCNR	<i>Foreign Currency Non-Resident bank account</i>	QIP	<i>Qualified Institutional Placement</i>
FDI	<i>Foreign Direct Investments</i>	RBI	<i>Reserve Bank of India</i>
FEMA	<i>Foreign Exchange Management Act</i>	ROI	<i>Return of Income</i>
FMV	<i>Fair Market Value</i>	REIT	<i>Real Estate Investment Trust</i>
FOF	<i>Fund-of-Funds</i>	RVPI	<i>Residual Value to Paid-In Capital</i>
FPI	<i>Foreign Portfolio Investor</i>	SEBI	<i>The Securities Exchange Board of India</i>
FVCI	<i>Foreign Venture Capital Investor</i>	SEC	<i>Securities & Exchange Commission</i>
GDR	<i>Global Depository Receipt</i>	STCG	<i>Short-term Capital Gains Tax</i>
GIFT	<i>Gujarat International Finance Tec-City</i>	STT	<i>Securities Transaction Tax</i>
GP	<i>General Partner</i>	SVF	<i>Social Venture Funds</i>
GST	<i>Goods & Services Tax</i>	TDS	<i>Tax Deducted at Source</i>
HUF	<i>Hindu Undivided Family</i>	TISPRO	<i>Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations 2000</i>
IAC	<i>Investor Advisory Committee</i>	TVPI	<i>Total Value to Paid-In Capital</i>
IFSC	<i>International Financial Services Centre</i>	VC	<i>Venture Capital</i>
		VCF	<i>Venture Capital Fund</i>

