TAXATION OF INVESTMENT FUND & ITS INVESTORS

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Investment funds pool resources from the investors and invest in new companies, social ventures, infrastructure and other areas which Government consider as socially or economically desirable. Investment Fund means Category I or Category II Alternative Investment Fund approved by SEBI **or registered under IFSC Act, 2019**.

Salient Features of New Taxation Rules are as under:

1. **Income from "Profits and Gains of Business or Profession" of Investment Fund shall be taxable in hands of Investment Fund. The proportional income under the head "Profits and Gains of Business or Profession" of investment fund accruing or arising to unitholder shall be exempt in hands of unitholder under section 10(23FBB).**

2. **Any income of Investment Fund other than under the head "Profits and Gains of Business or Profession" shall be exempt in hands of Investment Fund under section 10(23FBA). The proportional income other than "Profits and Gains of Business or Profession" of investment fund accruing or arising to unitholders shall be taxable in hands of unitholder.**

3. Any income of investment fund which is exempt under section 10 shall continue to remain exempt in the hands of Investment Fund and its unitholders.

4. The total income of Investment Fund shall be taxable at normal rates applicable to a firm/ company, in case Investment fund is a firm / company.

5. If Investment Fund is not a firm/ company, then its income shall be taxable at **Maximum Marginal Rate**.

6. Investment Fund is required to deduct TDS @ 10% on distribution made by it to its resident unitholder if such distribution is taxable in the hands of unitholder. **The rates of TDS shall be as per section 195 where unitholder is a non-resident or foreign company.**

7. **Example:** Investment Fund derives following income:

Income from other sources – Interest	₹ 200 lakhs
Capital Gains	₹ 300 Lakhs

The above incomes are exempt in the hands of Investment Fund. If Investment Fund distributes ₹ 500 Lakhs to unitholders, then ₹ 500 Lakhs is taxable in hands of unitholders. Investment Fund has to deduct TDS @ 10% on such distribution and at rates in force under section 195 where payment is made to non-resident or foreign company.

Suppose, there are 2 unitholders, then, ₹ 250 Lakhs is taxable in hands of each unitholder.

8. Suppose in above case, the Investment Fund distributes only ₹ 400 Lakhs, then, it shall be deemed that ₹ 500 Lakh has been distributed. ₹ 250 Lakhs is taxable in hands of each unitholder. Investment Trust shall deduct TDS @10% on ₹ 500 Lakhs. (Resident unitholder)

When ₹ 100 Lakhs is distributed in next previous year, then 100 lakhs shall not be taxable in the hands of unitholder in the next previous year and no TDS shall be deducted on such ₹ 100 lakh. **[Section 115UB(6) and Explanation 2 to Section 115UB]**

9. **The income received by the investment fund would be exempt from TDS requirement.**

10. It shall be mandatory for the investment fund to file its return of income. The investment fund shall also provide to the prescribed income-tax authority (15th June) and the investors (30th June), the details of various components of income, etc. for the purposes of the scheme.

INCOMES OF INVESTMENT FUND

	INCOME UNDER THE HEAD	IN HANDS OF INVESTMENT FUND	IN HANDS OF UNIT HOLDERS
1.	**Profits and Gains of Business or Profession**	Taxable	Exempt
2.	**Capital Gains**	Exempt	Taxable in hands of unit holders
3.	**Income from other sources** **Note:** It may be noted that Investment Fund cannot invest in immoveable property and therefore there is no question of Income under the head House Property.	Exempt	Taxable in hands of unit holders

LOSSES OF INVESTMENT FUND

STEP 1: COMPUTE THE LOSS OF THE INVESTMENT FUND ASSUMING THAT ALL INCOMES OF INVESTMENT FUND ARE TAXABLE IN HANDS OF INVESTMENT FUND AND ASSUMING THAT EXEMPTION UNDER SECTION 10(23FBA) IS NOT AVAILABLE.

STEP 2: AFTER SETTING OFF THE LOSSES AGAINST INCOMES AS PER CHAPTER VI, IF THERE IS A LOSS THEN SUCH LOSS SHALL BE TREATED IN FOLLOWING MANNER:

	LOSS UNDER THE HEAD	IN HANDS OF INVESTMENT FUND	IN HANDS OF UNIT HOLDERS
1.	**Profits and Gains of Business or Profession**	Shall be carried forward by Investment Fund	Shall not be allocated to the unit holders
2.	**Capital Gains or Income from other sources**		
	I *Units are held by unit holder for at least 12 months as on 31st march of the previous year to which the loss relates*	Loss shall not be carried forward by Investment Fund	Loss shall be allocated to the unit holder as per section 115UB(1) and the unit holder can set off and carry forward such loss as per provisions of chapter VI
	II *Units are held by unit holder for less than 12 months as on 31st March of the previous year to which the loss relates*	Loss shall be carried forward by Investment Fund **(ICAI takes contrary view → Loss shall lapse)**	Loss shall not be allocated to unit holders. Unit holder cannot set off or carry forward such loss

SECTION 194LBB: INCOME IN RESPECT OF UNITS OF INVESTMENT FUND

Where any income, **other than that proportion of income which is in nature of P/G/B/P**, is payable to a unit holder in respect of units of an investment fund, the person responsible for making the payment shall, at the time of credit of such income to the account of payee or at the time of payment thereof, whichever is earlier, deduct income-tax thereon:

(i) **at the rate of 10%, where the payee is a resident;**

(ii) **at the rates in force, where the payee is a non-resident or a foreign company.**

Illustration:
The broad features of the above regime can be explained through the following Examples. For simplicity, it is assumed that the investment fund has ten unit holders each having one unit and the income from investment in the investment fund is the only income of the unit holder and the figures are for previous year 31.3.2023.

Example 1:
If in a previous year, the income stream of the investment fund consists of:

Income by way of capital gains	₹ 800 lakhs
Income from other sources	₹ 200 lakhs

Then:

Total Income of the investment fund	NIL
Total income of the unit holders	₹ 1,000 lakhs

Total income of a unit holder	₹ 100 lakhs

Break up:

Chargeable under the head "Capital gain"	₹ 80 lakhs
Chargeable under the head "Income from other sources"	₹ 20 lakhs

Investment fund shall deduct TDS @ 10% on ₹ 1,000 lakhs.

Example 2:
If in Example 1, the income stream of investment fund consists of:

Business income	₹ 100 lakhs
Income by way of capital gains	₹ 700 lakhs
Income from other sources	₹ 200 lakhs

Then:

Total Income of the investment fund	₹ 100 lakhs

(Tax shall be charged at applicable rate if investment fund is a company or a firm, else at maximum marginal rate)

Income arising to a unit holder which is exempt in hands of unitholders	₹ 100 lakhs
Income of unit holder which is exempt	₹ 10 lakhs
Total income chargeable in the hands of unit holders	₹ 900 lakhs
Total income of each unit holder (chargeable to tax)	₹ 90 lakhs

Break up:

Chargeable under the head "Capital gain"	₹ 70 lakhs
Chargeable under the head "Income from other sources"	₹ 20 lakhs

Example 3:
If the income stream of the investment fund consists of:

Business Loss	₹ 100 lakhs
Capital gains Loss	₹ 300 lakhs
Income from other sources	₹ 500 lakhs

Then:
The business loss of ₹ 100 is set off against Income from other sources whereas Capital gain loss cannot be set off. The result is:

Total Income of the investment fund	NIL
Total income of the unit holders	₹ 400 lakhs
Total income of a unit holder	₹ 40 lakhs

(Chargeable under the head "Income from other sources")

Now let us say that 8 unit holders are holding units for more than 12 months as on 31.3.2023 and 2 unit holders are holding units for less than 12 months as on 31.3.2023.

Now out of the loss of ₹ 300 lakhs under the head Capital Gains, loss of ₹ 30 lakhs each shall be allocated to eight unit holders who held units for more than 12 months. The loss shall be treated as loss of unit holders under the head Capital Gains.

The loss of ₹ 60 lakhs related to two unit holders who held units for less than 12 months shall be carried forward by Investment Fund only and not by unit holders.

Example 4:
Investment Trust receives following incomes:

P/G/B/P	₹ 200 lakhs
Tax-free interest from companies	₹ 300 lakhs
Capital Gains Long Term	₹ 400 lakhs
Total	**₹ 900 lakhs**

Let's say there are 4 unit holders holding 25% units each. Discuss the Tax treatment in the hands of Investment trust as well as in the hands of unit holders.

Tax Treatment in the Hands of Investment Trust

- Income of ₹ 200 lakhs under the head P/G/B/P is taxable.
- ₹ 700 lakhs is exempt under section 10(23FBA).
- Entire Income of investment trust except income under the head P/G/B/P is exempt under section 10(23FBA).

Tax Treatment in the Hands of Each Unitholder

Proportionate Share of Income	**Amount**	**Taxability**
P/G/B/P	₹ 50 lakhs	₹ 50 lakh is exempt in hands of unitholder under section 10(23FBB)
Tax-free interest from companies	₹ 75 lakhs	₹ 75 lakhs interest shall also be exempt in hands of the unitholders under section 10.
Long Term Capital Gains	₹ 100 lakhs	Long Term Capital Gains of ₹ 100 lakhs shall be taxable in hands of unitholder @ 20%/10% under section 112/ section 112A.

Note: Tax Deduction at Source - Investment Trust will deduct TDS @ 10% on + ₹ 100 lakhs if unitholder is a resident.