Other tax issues

Issue 1: Non-applicability of TCS and TDS provisions to an AIF in GIFT IFSC

Background

1. Section 206(1H) of the Act provides that a seller is required to collect tax at source (TCS) from buyer when he receives any consideration for sale of any 'goods' of the value or aggregate of such value exceeding INR 5 million in any tax year. The rate of TCS shall be 0.1% (1%, where PAN is not furnished by the buyer) of the sale consideration exceeding INR 5 million.

2. The term 'seller' is defined as a person whose total sales, gross receipts or turnover from the business carried on by him exceeds INR 100 million during the tax year immediately preceding the tax year in which the sale of goods is carried out.

3. Further, TCS provisions shall not be applicable where the buyer is liable to deduct taxes on the payment being made to the seller and has actually deducted such taxes.

4. Section 194Q of the Act provides that every person (whose total sales/ turnover/ gross receipts from business exceeds INR 100 million during the financial year immediately preceding the financial year under consideration), on purchase of goods, shall now be liable to deduct TDS at the rate of 0.1% (5% in case the seller does not have a PAN) on payments made to a resident seller of a sum exceeding INR 5 million. The said amendment is applicable from 1 July 2021.

5. However, TDS provisions shall not be applicable where:

   - Transaction is subject to TDS under any other provision of the Act; and
   - Transaction is subject to TCS under the provisions of the Act, other than TCS on sale of goods which was introduced from 1 October 2020 [section 206(1H) of the Act].

6. The said provisions have caused a lot of ambiguities. One of the key issues that emanate out of the provisions are the coverage of the term 'goods' as the same is not defined under the Act. If a person relies on Central Goods and Services Tax Act, 2017, then shares and securities may not be treated as 'goods'. However, there is a concern that the Indian Revenue authorities may rely on the definition as per the Sales of Goods Act, 1930 and contend that shares and securities will be covered within the definition of the term 'goods' for TCS and TDS purposes.

7. While the guidelines issued vide CBDT circulars[1] to exclude transactions in securities and commodities traded on recognised stock exchanges or cleared and settled through recognised clearing corporations from the ambit of TCS and TDS provisions was a welcome step to avoid the wide impact of this provision on stock market transactions, the question with regard to the off-market shares and securities transactions and transactions in unlisted shares and securities continues to remain and in fact has been magnified.

[1] Circular No. 17/2020 dated 29 September 2020 [For TCS] and Circular No. 13/2021 dated 30 June 2021 [For TDS]

8. Further, various press reports have noted that the TCS implications could also arise both at the time of issue as well as redemption of units by an AIF. In this regard, we wish to highlight that issue of units should not be regarded as 'sale' of units as it is a primary subscription of units in the AIF by an investor. Further, redemption of units at the time of distribution of proceeds would be consequent to an underlying transaction of sale/ income generated that would be separately already be covered in the tax net and reported by the AIF/ investors in their return of income. Further, redemption of units results in cancellation/ extinguishment/ destruction of the units and hence, should not be considered as 'sale' of units to be subjected to the provisions of TCS.

Recommendation

9. While the intent of introduction of the TCS and TDS provisions has typically been to facilitate tracking of transactions, this may end up increasing costs as well as the compliance burden and could be chaotic for AIFs to manage.

10. Circular 13 of 2021 clarifies that section 194Q of the Act shall not apply in case of purchase of goods from a seller who is wholly exempt from income tax under the Act, e.g. section 10 entities. Similarly, Section 206C(1H) will also not apply in cases where the buyer is wholly exempt from income tax under the Act. In this relation, we request that it is clarified that the TDS and TCS provisions should not apply to AIFs completely.

11. Notwithstanding the above request and where the same is not acceptable, similar to the FAQs on the Indian Stamp Act, 1899 Amendments and Rules made thereunder wherein it is clarified that redemption of mutual fund units are not subject to stamp duty (on the basis that the same is not a transfer nor an issue nor a sale), it should be clarified that issue and redemption of units by an AIF should not be regarded as 'sale' of goods.

Issue 2: Exemption for AIF in GIF IFSC from furnishing Form 15CA/ CB for distributions to non-resident investors

Background

1. As per section 195(6) read with Rule 37BB of the Rules, any person making a payment (whether or not the sum is chargeable to tax) to a non-resident is required to furnish Form 15CA and Form 15CB, wherever applicable.

2. Given this, it may be construed that the AIF in GIFT IFSC may be required to furnish Form 15CA and Form 15CB[2] for effecting each distribution to the non-resident investors and lenders. This will lead to an increase in compliance burden for the AIF in GIFT IFSC.

3. The operations of GIFT IFSC are at a very nascent stage and it is only recently that they have started picking up scale. At this juncture, exemption from such compliances which would require substantial time and processes of the IFSC unit would be very critical especially given that the distribution of income to the non resident investors in and AIF and interest payment to lenders is exempt from income-tax.

Recommendation

4. In order to avoid onerous compliance burden on the AIF in GIFT IFSC, remittance of any income from the AIF in GIFT IFSC to non-resident investors and lenders should not be subject to compliance from a Form 15CA/ CB perspective.

5. Arrangements in the form of quarterly/ yearly undertakings with the custody banks in GIFT IFSC may be considered for effecting such remittances to meet with the reporting requirements, if any.

[2] Form 15CA is a declaration from the remitter detailing the information with regard to the payment being made to a non-resident and Form 15CB is a certificate from an independent chartered accountant certifying the taxability of the proposed payment being made to the non-resident

Issue 3: Rationalisation of MAT rate for units set-up in the GIFT IFSC

Background

1. As per section 80LA of the Act, income of a unit in a GIFT IFSC from its approved business is entitled to a tax holiday of 100% of such income for any 10 consecutive years [at the taxpayer's option], out of 15 years, beginning from the year in which permission was obtained.

2. The present tax concession granted to the IFSC units is lower than what other jurisdictions provide. Dubai provides a tax holiday for 50 years; Labuan has a concessional tax rate of 3% and Singapore grants concessional rate ranging from 5% to 13.5%.

3. The GIFT IFSC unit claiming tax holiday is subject to MAT at 9 percent (plus applicable surcharge and cess) on their book profits. The MAT provision increases the effective tax rate (despite no headline tax considering the tax holiday).

Recommendation

4. It is recommended that the MAT rate applicable to units in the GIFT IFSC be reduced from 9% of the book profits to 5% of the book profits [similar to the MAT rate reduction implemented for Indian corporates]. Further, MAT credit carry forward should also be extended to 20 years.

Issue 4: Relax the condition of "convertible foreign exchange" under MAT/ AMT provisions

Background

1. As per section 115JB(4) read with section 115JC(7) of the Act, where the assessee, is a unit located in a GIFT IFSC and derives its income solely in convertible foreign exchange, MAT/AMT rate shall apply at concessional rate of 9% instead of 15%.

2. GIFT IFSC unit may invest in Indian securities and may earn dividend and interest income which may be paid to its India bank account in Indian rupees.

3. This may result in such units not being able to meet the condition of deriving income solely in foreign exchange. In such a situation, they may have to pay MAT at the full rate instead of the concessional tax rate provided for GIFT IFSC units.

Recommendation

4. The condition of deriving income “solely” in convertible foreign exchange should be relaxed. If a GIFT IFSC unit earns rupee income from permitted business activities as per IFSCA Regulations, it should not result in the unit being subjected to a higher MAT/ AMT.

Issue 5: Clarity on attribution mechanism for income earned by Category III AIF located in GIFT IFSC

Background

1. Category III AIFs in IFSC are subject to fund level taxation under section 115AD of the Act. Further, any income accruing or arising to or received from the Category III AIF in IFSC or on transfer of its units is exempt from tax in the hands of investors.

2. Section 10(4D) and section 115AD of the Act provides for exemption/ lower tax rates on certain incomes earned by Category III AIF in GIFT IFSC, only to the extent of income that is attributable to units held by non-residents, calculated in the prescribed manner. The computation mechanism for attributing income to the resident and non-resident investors for the purpose of taxation for Category III AIF in GIFT IFSC is yet to be prescribed under the Act.

Recommendation

3. While the new taxation framework for Category III AIFs domiciled in the GIFT IFSC is comparable to taxation regime of Offshore Funds, there is a need to provide clarity on the attribution mechanism for taxing the income earned by the Category III AIF in GIFT IFSC.

Issue 6: Extend the current tax laws of AIFs registered with SEBI to AIFs registered with IFSCA

Background

1. The current Act provides for a specific tax regime for AIFs which are registered with SEBI.

2. Since the IFSCA Act is now enacted, AIFs set-up in GIFT IFSC shall receive the approval from the IFSCA and not SEBI.

3. This may create certain confusion and uncertainty for the AIFs setup in GIFT IFSC as to determine whether the specified tax regime under the Act shall be extended to such AIFs.

Recommendation

4. In order to avoid confusion and uncertainty, it is recommended to extend the specific tax laws for SEBI registered AIFs to AIFs registered with IFSCA as well.

Issue 7: Non-applicability of debt concentration norms for an AIF in GIFT IFSC

Background

1. FPI investment in debt securities could be made under the general investment route or Voluntary Retention Route (VRR).

2. Under the FPI route, minimum average maturity should be of 1 year. Further, short-term investments by an FPI should not exceed 30% of the total investment of that FPI in that category at any point of time. Short-term investments mean investments with residual maturity up to 1 year. Under the VRR route, minimum retention period is of 3 years, or as decided by RBI for each allotment by tap or auction.

3. Under the normal FPI route, investment by any FPI, including investments by related FPIs, shall not exceed 50% of any issue of a corporate bond (condition not applicable in case of exempted securities). Under the VRR route, FPIs can invest in the entire bond portfolio [except in the case of where the demand for more than 100% of amount offered].

4. In case of unlisted NCDs, there is end use-restriction in relation to investment in real estate business, capital market and purchase of land.

Recommendation

5. Considering the practical difficulty in recognizing 'Short-term investments' by an FPI [since investment held for more than 1 year – can become 'short term in the year of redemption thus qualifying as 'Short term investments'] and appropriate regulations of the fund by the GIFT IFSC, it is recommended that minimum maturity condition should not apply for debt investment by the AIF (licensed as FPIs) in GIFT IFSC. Alternatively, minimum retention period should be relaxed for investments by the AIF in GIFT IFSC.

6. To bring parity with the VRR route (except in cases of where the demand for more than 100% of amount offered), it is recommended that Single/ Group investor-wise limits in corporate bonds should not apply even under the general route (i.e. non-VRR) since it becomes unviable to enter into private debt deals where there is requirement of multiple unrelated investors.

7. Considering that AIF in the GIFT IFSC is regulated by the IFSCA, it is suggested that the end use restrictions should not apply where NCDs/ debt instruments of an Indian entity/ IFSC entity/ overseas entity are subscribed by AIF based in the IFSC (licensed as FPIs).

Issue 8: Relaxation for NRI investment in Category III AIFs

Background

1. As per SEBI FPI Regulations, 2019 read with its Operating Guidelines (cumulatively referred to as 'FPI Regulations'), an application for grant of certificate of registration as an FPI shall not be provided to an NRI/ OCI. NRIs/ OCIs can be constituents of the applicant provided they meet conditions specified by SEBI from time to time.

Recommendation

2. The operations of IFSC are at a very nascent stage. At this juncture, lifting the conditions/ restrictions with regard to investment by NRIs/ OCIs in the Category III AIF in GIFT IFSC (even where the same is considered as an FPI) would be very critical to determine the success of the GIFT IFSC and open avenues for NRI investments in AIF in GIFT IFSC.

Issue 9: A separate tax chapter for GIFT IFSC related provisions

Background

1. Currently, IFSC related sections are scattered at various places in the Act.

2. Taxpayers find it difficult to trace, refer and interpret them.

Recommendation

3. For ease of reference and simplicity of the tax law, it is recommended that a separate chapter should be provided within the Act consolidating all the relevant GIFT IFSC related provisions at one place.

Issue 10: Relaxation from requirement for the AIF to have office space in GIFT IFSC

Background

1. Currently, an AIF requires office space in GIFT IFSC in order to obtain approval from SEZ Authority (Development Commissioner).

2. Post the submission of the SEZ application, Unit Approval Committee meeting also reviews the fulfilment of requirement of the office space within 15 to 30 days of application, post which the final Letter of Approval (LOA) is received from the office of Development Commissioner.

3. Given that AIF is a passive investment vehicle and managed by a Manager, generally, as a global practice, AIF does not require separate office space.

Recommendation

4. In line with the global practice for offshore funds and domestic AIFs, the AIF in GIFT IFSC should not be mandated to obtain separate office space in GIFT IFSC.

Issue 11: Relaxation from requirement of locating the Investment Manager in GIFT IFSC

Background

1. Currently, as per the Operating Guidelines for AIFs in GIFT IFSC dated 26 November 2018, a Sponsor / Manager of an existing AIF in India may act as a Sponsor / Manager of an AIF set up in the IFSC by –

   - setting up a branch in the GIFT IFSC; or
   - incorporating a company or limited liability partnership in the GIFT IFSC.

2. However, Sponsor / Manager to be set up in GIFT IFSC is required to incorporate a company or limited liability partnership in the GIFT IFSC.

3. This creates a hurdle for many offshore fund managers to set-up AIFs in GIFT IFSC as they would have to move or redomicile their entire operations, personnel from offshore jurisdictions to GIFT IFSC.

4. Given that there is relaxation on the domicile of the Fund Manager in many jurisdictions such as Mauritius, Ireland, Luxembourg etc., to manage funds set-up in those jurisdictions, a similar benefit should be extended to manage an AIF set-up in GIFT IFSC.

Recommendation

5. In line with the global practice for offshore fund managers to operate from their home or other jurisdictions, AIF in GIFT IFSC should be allowed to be managed by Manager from outside GIFT IFSC.