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Budget 2016: Alternative Investment Funds want parity on taxation

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The Alternative Investment Funds (AIF) sector, comprising private equity (PE) and venture capital (VC) entities, is expecting Budget 2016 to align the tax rate for listed and unlisted market transactions.

Currently, capital gains tax on investments in publicly listed companies are treated as long-term capital gains (LTCG) and taxed at zero per cent if held for over a year, and as short-term capital gains and taxed at 15 per cent if held for less than a year.

However, in an unlisted company (or start-up), while investments for over three years are considered long-term and attract a tax of 20 per cent, investments of less than three years fall under short-term capital gains and are taxed at 33 per cent.

CALLS FOR CHANGE

Align capital gains tax for listed and unlisted transactions

Empower AIFs to efficiently provide capital for start-ups

Amend pass-through rules to avoid excess or double taxation

Amend safe harbour rules in income tax for onshore fund managers of offshore private equity/venture capital firms

This, the AIF sector says, acts as a deterrent to investing in riskier assets.

According to Saurabh Srivastava, co-founder, Indian Angel Network, investments by AIFs and angel groups in unlisted companies carry a higher risk and the holdings are illliquid — an investor cannot pull out its money overnight. Unlisted companies also create jobs and contribute to economic growth, he adds.

At least, Securities and Exchange Board of India (Sebi)-registered Category-I AIFs need to be treated on a par with investors in the public market, he says. Category-I AIFs have positive spillover effects on the economy, and include VCs, small and medium enterprises funds, social venture funds and infrastructure funds, which are close ended. Moreover, it would end the discrimination against domestic funds, as foreign funds pay zero tax through treaties with Mauritius and other countries, the sector says.

Gopal Srinivasan, chairman and managing director of home-grown PE fund TVS Capital Funds, terms it a punitive tax rate. “It imposes a three-year hold period for private capital, which is patient, takes significant risks and remains illiquid, while the liquid and fickle public market investments are allowed to enjoy zero rates under LTCG for holding investment for just a year,” he says.

Srinivasan urged the government to empower AIFs to efficiently provide capital for start-ups to stand up, for companies to grow and go beyond.

Experts also want amendments to the pass-through rules enacted in last year’s Budget for taxation of AIFs, to make it more effective and avoid double taxation. The pass-through system ensures investors do not pay more tax than they would, had they made the investments directly themselves.

Subramaniam Krishnan, tax partner, EY, says tax deduction at source (TDS) rules for foreign investors investing in AIFs need to be aligned with tax treaty rates.

A TDS of 10 per cent is prescribed for all investors, irrespective of income.

Other suggestions include allowing tax pass-through for net losses incurred by AIFs, exemption from ‘angel tax’, and addressing concerns on the General Anti-Avoidance Rules due to take effect from April 1, 2017. Besides, amending the safe harbour rules for onshore fund managers of offshore PE/VC firms under Section 9A of the Income Tax Act would make it more effective, add experts. Currently, most fund managers of offshore funds manage their investments from offshore locations rather than from India, which results in our losing employment avenues and tax revenue.

According to Srivastava, these changes and recent measures of Sebi to enable more ease of doing business and a fund of Rs 10,000 crore would help investors perform better. Almost 90 per cent of VC money comes from abroad and can dry up, based on investor sentiment. Further, foreign capital prefers later stage risk. Hence, to ensure start-up funding, encouraging domestic sources of VC money is crucial, he adds.

PEs expect complete pass-through for income of AIFs

Renuka Ramnath, founder, managing director & chief executive officer, Multiples Alternate Asset Management, says she would like to see the Budget address issues for the private equity sector that will propel fund inflows into India, especially investments in growth sectors. This includes complete pass-through for income of Alternative Investment Funds, without distinguishing between business income and others. Also, no withholding tax on exempt income and no withholding tax for non-resident investors claiming treaty benefits will help inflow. Abatement of service tax on management fees charged for managing offshore investors is another sector’s key expectation. Last but not the least required is clarity or significant dilution on safe harbour rules, in order to promote investment management in India for offshore investors.