Association of Mutual Funds in India

PROPOSALS FOR

UNION BUDGET - FY 2023-24

Contents

I. Need to bring parity in tax treatment for investments in different financial sectors 4

1. Need for parity in tax treatment in respect of Intra-scheme Switching of Units under MF Schemes 4
2. Request for Uniformity in Taxation on Listed Debt Securities and Debt Mutual Funds 5
3. Request for Uniform tax treatment on Capital Gains from Mutual Fund investments and ULIPs of Insurance companies 6

II. Suggestions to mitigate hardship to retail taxpayers 7

1. Increase in threshold limit of withholding tax (TDS) on Income distribution by Mutual Fund scheme 7
2. Need to provide tax parity for consolidation of Options of Schemes similar consolidation of Scheme and Plan 7
3. Request for amendment to ELSS Rule 3A to permit ANY amount to be invested in the scheme, instead of in multiples of ₹500 8
4. Definition of Equity Oriented Funds to be revised to include Fund of Funds (FOF) investing in Index Funds 9
5. Taxability of long-term capital gains under section 112A of the Act 10
6. The rate of Surcharge applicable to dividend paid on equity mutual funds units to non-corporate assessee to be harmonized 10

III. Suggestions to mitigate hardship to NRI taxpayers 11

1. Need to prescribe a uniform rate for deduction of Surcharge on TDS in respect of NRIs 11
2. Request to reduce tax/TDS rate for NRIs on STCG from Debt Schemes from 30% to 15% 12
3. Request to permit Indexation benefits to Non-Resident Investors for investment in Debt Mutual Funds 12
4. Request for Clarity on TDS on payment to Non-Resident Investors under Sec. 196A 13

IV. Suggestions to deepen the capital market through Mutual Funds 14

1. Request to introduce Debt Linked Savings Scheme (DLSS) to help deepen the Indian Bond Market 14
2. All Mutual Funds should be allowed to launch pension-oriented MF schemes (MFLRS) with Uniform Tax Treatment as NPS 15
3. Mutual Fund Units should be notified as 'Specified Long-Term Assets' qualifying for exemption on LTCG under Sec. 54 EC 16
4. Suggestions w.r.t. Exchange Traded Funds (ETFs) 17
5. Gold ETFs and FoFs which invest 90% or more in Gold ETFs should be subjected to LTCG tax @ 10% instead 18
6. Request for Rationalization of Stamp Duty on various categories of ETFs 19

V. Proposals for Development of Mutual Fund industry 21

1. CPSE investment of surplus funds in Mutual Funds 21
2. Request to permit Insurance Companies to outsource the Fund Management activities to SEBI Registered MF AMCs 23

VI. Request for certain clarifications & Simplification of tax regime for ease of compliance 24

1. Amendment in definition of Equity-Oriented Fund in case of Fund of Funds scheme – Section 112A of the Income Tax Act 24
2. Need to further simplify Taxation provisions of offshore funds managed by Indian portfolio managers 25
3. Issues in provisions of the new Section 194R - Mutual Funds should be exempt from the provisions of section 194R 28
4. Challenges in claiming deductions under section 43B (in case payments are made after due date of filing tax audit report, but paid before filing of return) 29

I. Need to bring parity in tax treatment for investments in different financial sectors

<table>
<tr><th colspan="3">1. Need for parity in tax treatment in respect of Intra-scheme Switching of Units under MF Schemes</th></tr>
<tr><th>Background</th><th>Proposal</th><th>Justification</th></tr>
<tr><td>

- As per SEBI Mutual Funds Regulations, mutual funds offer 'Direct Plan' wherein investors can invest directly, i.e., without involving any distributor/agent and a "Regular Plan", wherein one can invest through a distributor/agent (who gets commission). Direct Plan and Regular Plan are part of the same mutual fund scheme, and have the same / common portfolio, but have different expense ratios (recurring expenses that is incurred by the MF). Direct Plan has lower expense ratio than Regular Plan, as there is no intermediary involved.
- Mutual Funds also provide "GROWTH" option and "DIVIDEND" option under a MF scheme. Under Growth Option, the income generated / earned remains invested in the scheme and is reflected in the appreciation in the NAV of Growth Option, whereas under Dividend Option, the income generated is paid/distributed to the unitholders.
- Under the current Tax regime, switching of investments to/from investment plans to another within the same Unit Linked Insurance Plan (ULIP) of insurance companies is not considered as a "Transfer" and hence, **<u>not</u>** subjected to any Capital Gains Tax.
- However, switching of investment in Units within the same Mutual Fund scheme from Growth Option to Dividend Option *(or vice-versa)*, and/or from Regular Plan to Direct Plan *(or vice-versa)* is considered a "Transfer" under Sec. 47 of the Income Tax Act, 1961 and is liable to capital gains tax, even though the amount invested remains in the mutual fund scheme, *i.e., <u>even though there are no realized gains</u>,* as the underlying securities/ portfolio remains unchanged within the scheme.

Thus, there is disparity between tax treatment on switching of investment within a Mutual Fund scheme and within a ULIP of Insurance companies, ***although both MF schemes and ULIPs invest in securities, and are investment products***.

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- It is proposed that Intra-Scheme Switches, i.e., switching of investment within the same mutual fund scheme is not regarded as a "Transfer" under Section 47 of the IT Act, 1961 and the same should be exempt from payment of capital gains tax.
- It is therefore requested that a new sub-section under Section 47 of the Income Tax Act, 1961 be inserted {on the lines of sub-sections 47(xviii) and 47(xix)}, so that Switching of Units from (a) Regular Plan to Direct Plan or vice-versa; and (b) Growth Option to Dividend Option or vice-versa, within the SAME scheme of a mutual fund are not regarded as transfer and hence, shall not be charged to capital gains.

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1. In respect of switching of Units within the same scheme of a Mutual Fund from Growth Option to Dividend Option or vice-versa, there is no realised gain, since the investment remains within the SAME mutual fund scheme, as the underlying securities/ portfolio remains unchanged.
2. As per extant provisions of Income Tax Act, 1961, the following transactions are not regarded as transfer and hence, shall not be charged to capital gains:
   (i) Transfer of units of a mutual fund pursuant to consolidation of two or more schemes of equity oriented mutual fund or of two or more schemes of a mutual fund other than equity oriented mutual fund {section 47 (xviii)}.
   (ii) Transfer of units of a mutual fund from one plan to another pursuant to consolidation of plans within scheme of mutual funds {section 47 (xix)}
3. Extending the above principle and rationale, it is only logical that a switch transaction from one Plan/Option to another Plan/Option within the same scheme of a Mutual Fund should also not be regarded as transfer and hence, not subjected to Capital Gains Tax.
4. It may be added here that in the "*Long Term Policy for Mutual Funds*", SEBI has emphasized the principle that **similar products should get similar tax treatment**, and the need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators. Thus, there is need to have uniformity in the tax treatment for "Switch" transaction in respect ULIPs and Mutual Fund Products to have a level playing field.

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2. Request for Uniformity in Taxation on Listed Debt Securities and Debt Mutual Funds		
Background	**Proposal**	**Justification**
Currently, the minimum holding period for Units of debt-oriented mutual funds (listed or unlisted) to qualify as Long-Term Capital Asset is 36 months. However, direct investments in a listed securities such as bonds/debentures, Government Securities, derivatives, etc. listed on a recognised stock exchange in India and Zero Coupon Bonds (listed or unlisted) the holding period to qualify as Long Term Capital Asset is only 12 months. In other words, the holding period for direct investment in a listed debenture to be treated as long term investment for capital gain tax purposes is 12 months; whereas, if the same investment is made through a Debt-oriented Mutual Fund scheme, the period of holding is increased to 36 months to be regarded as long-term investment for capital gain tax purposes, which is ironical. There is a also revenue leakage on account of the tax arbitrage especially in respect of investment in Zero Coupon Bonds, as many HNIs are understood to have shifted their debt investments to listed zero coupon bonds, and thus managed to reduce their tax liability from peak rate of 43% to 10 % under LTCG. Thus, there is a need for harmonizing the tax treatment on investments in debt oriented MFs and direct investments in debt securities. It is thus logical and fair to bring parity in holding period for capital gains tax purposes for direct investment in listed debt instruments and investment in such listed debt instruments through debt-oriented mutual fund schemes.	The holding period for long term capital gains for direct investment in listed debt securities / and Zero-Coupon Bonds (listed or unlisted) and for investment through debt mutual funds should be harmonized and made uniform. This may be done by bringing the two at par in by either – (i) treating investments in non-equity oriented mutual fund schemes **which invest 65% or more in listed debt securities as long term**, if they are held for more than 12 months; OR (ii) increasing the minimum holding period for direct investment in listed debt securities / and Zero-Coupon Bonds (listed or unlisted) to 36 months to qualify as Long-Term Capital Asset.	It is only logical and fair to bring parity in tax treatment for direct investment in listed debt securities and indirect investment in the same instruments through debt-oriented mutual fund schemes. This parity between direct investments in a listed security (by corporates & HNIs) and indirect investments made through mutual funds by retail investors would also prevent tax revenue leakage.

3. Request for Uniform tax treatment on Capital Gains from Mutual Fund investments and ULIPs of Insurance companies		
Background	**Proposal**	**Justification**
• Long-Term Capital Gains (LTCG) arising out of the sale of listed equity shares and Units of equity-oriented mutual fund schemes are now taxed at the rate of 10%, if the LTCG exceed ₹1 lakh in a financial year (gains upto January 31, 2018, being *grandfathered*). • However, the proceeds from ULIPs of Insurance companies (including early surrender / partial withdrawals), are exempted from income tax *under Section 10(10D) of Income Tax Act,* if the sum assured in a life insurance policy is at least 10 times the annual premium and withdrawn after a lock-in of 5 years, even though ULIPs are also investment productsthat invest in equity stocks, just like mutual funds, and with addedadvantage of tax deduction under Section 80C of the Income Tax Act on the premium paid. • *Finance Act 2021 removed the benefits of Section 10(10D) in case where the premium exceeds Rupees Two lakh and fifty thousand. However, still this is no parity of tax treatment between Mutual Fund Units and ULIPs.* • Thus, there is still a clear case of **tax arbitrage**, whereby ULIPs are not only placed at an advantageous position vis-à-vis Mutual Fund Schemes, but there is also a significant revenue leakage on capital gains from ULIPs, especially from HNI segment, which needs to be plugged, considering the potential loss to the exchequer if this loophole / arbitrage is continued.	It is proposed to bring parity in tax treatment in respect of capital gains on withdrawal of investments in ULIPs of Life Insurance companies and redemption of Mutual Funds Units, so as to bring about level playing field between ULIPs and MF schemes.	• Although ULIPs are considered as insurance products for tax purposes, ULIPs are essentially investment products that invest in securities like mutual funds, but with insurance benefit. • With high commissions and incentive structure prevailing in the life insurance sector – a point that the Sumit Bose Committee report (2015) had highlighted – and a lucrative tax arbitrage, there is a potential revenue leakage of LTCG tax of 10.4% on the gains from ULIPs upto a premium of ₹2,50,000, which could be significant. • SEBI, in its "Long Term Policy for Mutual Funds", published in 2014, had emphasized that similar products should get similar tax treatment, and the need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators. • MF industry has been highlighting about the tax arbitrage between Mutual Fund Schemes & ULIPs since past several yeasr and the need to bring about parity between the two. • While Finance Act 2021 has reduced this gap to some extent, it is requested to bring complete parity, so that there is a level playing field among the players in financial industry.

II. Suggestions to mitigate hardship to retail taxpayers

1. Increase in threshold limit of withholding tax (TDS) on Income distribution by Mutual Fund scheme		
Background / Issue	**Proposal**	**Justification**
Presently as per provision of section 194 K, withholding tax (TDS) is applicable on income distribution by Mutual fund scheme to resident investors, where the aggregate of the amounts of such income distribution exceeds ₹5,000. This has been causing hardship to small / retail investors. It is pertinent to mention here that the threshold limit for TDS on interest on bank FD was raised from ₹10,000 to ₹40,000 couple of years ago.	It is requested that the threshold limit for withholding tax (TDS) on income distribution (dividend) on mutual fund units be increased from ₹5,000 to ₹50,000 p.a.	The threshold limit of ₹5,000 for TDS on income (dividend) distribution on mutual fund units is too meagre and very low as compared to the threshold limit of ₹40,000 applicable on interest on bank FD. It is pertinent to mention here that the threshold limit for TDS on interest on time deposit was raised from ₹10,000 to ₹40,000 in the budget couple of years ago. Increasing the threshold limit to ₹50,000 would mitigate the hardship faced small retail investors, who would otherwise will have to claim the refund of TDS in the next AY.

2. Need to provide tax parity for consolidation of Options of Schemes similar consolidation of Scheme and Plan		
Background / Issue	**Proposal**	**Justification**
Mutual Funds offer various category of Schemes. Each Scheme offers 'Direct' Plan and 'Regular' Plan to the investors to invest directly (by themselves) or through a distributor. Further, each such Plan has "Options" such as Growth Option & Dividend Option depending on whether the investor wants capital appreciation or dividend income (and within Dividend Options, there may be Daily Dividend Option, Monthly Dividend Options, and so on). Currently, under the Income Tax Act Consolidation of Schemes {47(xviii), 49(2AD), and explanation 1 (i)(hd) to section 2(42A)} and Consolidation of plans –{47(xix), 49(2AF) and explanation 1 (i)(hg) to section 2(42A)} dealing with transaction not regarded as a transfer, cost of acquisition and period of holding respectively are specifically covered. However, Consolidation of "Options" within the same MF scheme are not covered, thus leaving ambiguity in taxation in case where Options were to be consolidated.	It is proposed to provide similar clarity for Consolidation of *Options* within a Mutual Fund Scheme as well.	This would bring parity in cases where a mutual fund intends to consolidate the '*Options*' within a Mutual Fund Scheme, and reduce the tax burden on unitholders.

3. Request for amendment to ELSS Rule 3A to permit ANY amount to be invested in the scheme, instead of in multiples of ₹500		
Background/Issue	**Proposal**	**Justification**
Rule 3(a) of Equity Linked Savings Scheme, 2005 under Notification No.226/2005 dated November 3, 2005 issued by the CBDT stipulates that the amount to be invested in an ELSS of a mutual fund shall be in multiples of ₹500, with a minimum of ₹500. It is observed that, investors investing in ELSS often invest amounts which are not in multiples of ₹500/- because in all other mutual fund schemes, the investment / subscriptions are accepted for any amount (subject to a defined minimum amount). Also, many investors choose to invest in ELSS by availing the "inter-scheme switch" facility available in Mutual Funds i.e., switching their investment from other mutual fund scheme/s to an ELSS fund. In such cases, investors invariably choose to switch-over / reinvest the entire amount of redemption proceeds from other mutual fund scheme to ELSS, which may not be in multiples of ₹500. However, due to requirement of investment to be made in multiples of ₹500 under ELSS, Mutual Funds are compelled to reject such applications which are not in multiples of ₹500 or have to make partial refund of fractional amount which is not in multiples of ₹500. The results in avoidable inconvenience to the investor, including the loss of investment opportunity / loss of income tax benefits, apart from additional operational work for mutual funds.	It is proposed to amend Rule 3 of Equity Linked Savings Scheme, 2005, deleting the stipulation that investments in ELSS should be multiples of ₹500 and permit investments of any amount, subject to a minimum of ₹500.	ELSS was originally notified in the year 1992, by providing tax rebate under section 88 of the Income Tax Act, 1961 for investments in ELSS floated by Unit Trust of India and other Mutual Funds. During that era, the ELSS applications were typically collected by 'Bankers to the Issue' and investors were allowed to make their subscriptions in cash at the designated bank branches. The aforesaid Rule 3 (viz., amount to be invested in ELSS to be in multiples of ₹ 500) facilitated acceptance of subscriptions in cash and reconciliations. However, in today's digital era, payment for mutual fund investments happening via electronic mode the requirement of multiples of ₹500 has lost its relevance. It is also pertinent to mention here that the growth in the value of ELSS investments is reflected in the scheme's NAV, which is rounded off upto two decimals. Thus, even if the initial contribution is made in multiples of ₹500, the market value / redemption value of the investment would typically be an odd amount (including a few paises) and never be a round amount. In short, the aforesaid requirement of multiple of ₹500 has no relevance in today's digital payment eco system. The proposed modification will help in mitigating the hardship to investors and mutual funds. It is also pertinent to mention here that there would not be any revenue loss by introduction of the proposed amendment.

4. Definition of Equity Oriented Funds to be revised to include Fund of Funds (FOF) investing in Index Funds		
Background/Issue	**Proposal**	**Justification/Rationale**
A Fund of Funds (FOF) scheme of a Mutual Fund primarily invests in the units of other Mutual Fund schemes. At present, a FOF that invests predominantly in units of an Equity Oriented Funds (EOF) is NOT regarded as an EOF, because under current Income Tax regime, a FOF scheme structure shall be treated as an EOF only if: 1) a minimum of 90% of the total proceeds of such fund is invested in the units of EOFs; and 2) such EOFs also invest a minimum of 90% of their total proceeds in the equity shares of domestic companies listed on a recognised stock exchange. While FOFs that invest predominantly in units of an EOF meet the first criteria above, they fall short on the second criteria as the underlying EOFs by mandate have flexibility to invest between 65% to 100% in listed stocks of domestic companies. Thus, in theory they do not need to invest minimum 90% of total proceeds in listed stocks, although in practice, most of the EOFs do invest at least 90% in listed stocks. Consequently, despite FOFs investing in equity securities of domestic companies via EOFs, short term and long-term gains from these funds get taxed as non-equity oriented mutual fund schemes.	It is proposed that the definition of "Equity Oriented Funds" (EOF), be revised to include investment in Fund of Funds (FOF) schemes which invests a minimum of 90% of the corpus in units of Equity Oriented Mutual Fund Schemes, which in turn invest minimum 65% in equity shares of domestic companies listed on a recognised stock exchanges. Consequently, Redemption of units in FOF schemes investing 90% or more in EOF should be subjected to the same capital gains tax, as applicable to sale of listed equity securities or units of Equity Oriented Mutual Fund Schemes.	There is strong case for rationalisation of taxation between investments in Direct Equity, Equity Oriented Funds, and Fund of Funds investing in Equity Oriented Mutual Fund Schemes. The tax treatment should be the same in both the cases as the underlying portfolio of investments include domestic equities only. This will ensure that the intent of the law is not sacrificed.

5. Taxability of long-term capital gains under section 112A of the Act		
Background/Issue	**Proposal**	**Justification/Rationale**
Previously, long term capital gains (LTCG) from sale of equity shares / Units of equity oriented mutual fund were completely exempt from capital gains tax, if the shares / units were held for minimum one year. However, the exemption from capital gains tax on the LTCG arising from sale of equity shares or units of equity-oriented fund or units of a business trust was abolished in the Finance Act, 2018, while the holding period for LTCG was kept unchanged at 12 months. As per the current provisions of section 112A of the Act, long term capital gains (LTCG) arising from transfer of long-term capital assets in the nature of equity shares or units of equity-oriented fund or units of a business trust are subject to capital gains tax @ 10% (plus applicable surcharge and cess). The income tax is applicable/payable on LTCG in excess of ₹1,00,000 in a financial year.	It is requested that the LTCG on listed equity shares or units of equity oriented fund schemes be exempted from Capital Gains tax if the equity shares / Mutual Funds Units are held for at least 3 years by suitable amendments to section 112A, while other tax provisions under the said section may be otherwise continued as it is.	In case of debt investments, considering inflation of 5-6%, effective tax rate (post indexation) after 3 years or more may be lower than current taxability of long-term gains on Equity (10%). The above if considered will encourage long-term investments in equities and will help channelize more household savings in to the equity markets, thus helping the Indian economy.

6. The rate of Surcharge applicable to dividend paid on equity mutual funds units to non-corporate assessee (such as Individual, HUF, AOP, Body of Individuals and Artificial Juridical Person) to be harmonized		
Background	**Proposal**	**Justification**
The definition of "dividend" provided under section 2(22) of the Act is an inclusive definition, wherein the reference is made to distribution in various forms by a company and *does not cover distribution of income in respect of units of mutual funds.* Finance Act, 2020 has capped the surcharge rate on 'dividend income' on equity shares @ 15% in the hands of non-corporate taxpayers. However, there is no similar capping on the rates of surcharge in respect of income distribution from equity schemes of mutual fund. Consequently, MF investors are required to pay higher surcharge at rates ranging from 25% or 37%.	It is proposed that, similar to the cap of 15% on surcharge rate on dividend income earned by non-corporate assessee (including residents and Foreign Portfolio Investors) on equity shares, the surcharge rate on income distribution on Units from equity mutual funds schemes should also be capped at 15%.	It is logical and fair to bring parity in surcharge on TDS from dividend from equity shares and Units of equity oriented mutual fund schemes.

III. Suggestions to mitigate hardship to NRI taxpayers

<table>
<tr><th colspan="3">1. Need to prescribe a uniform rate for deduction of Surcharge on TDS in respect of NRIs</th></tr>
<tr><th>Background</th><th>Proposal</th><th>Justification</th></tr>
<tr><td>As per section 195 / 196A of the Income Tax Act, 1961 Mutual Funds are required to deduct tax at source (‘TDS’) from amount paid/credited to NRI investors (i) u/sec. 111A & 112A from the capital gains arising upon redemption of units; and (ii) u/sec, 56 on income distribution (dividends) paid/credited in respect of mutual units. In addition to TDS, surcharge need to be deducted at the following rates as applicable (as specified in Part II of the First Schedule to the Finance Act, 2020) –
→ 10% where total income exceeds ₹50 lakhs, but does not exceed ₹1 crore
→ 15% where total income exceeds ₹1 crore but does not exceed ₹2 crore.
→ 25% where total income exceeds ₹2 crore but does not exceed ₹5 crore.
→ 37% on base tax where total income exceeds ₹5 crore.
In addition, “Health and Education Cess” @4% is to be levied on aggregate of base tax and surcharge.
Challenges faced by Mutual Funds
Mutual Funds do not provide any guaranteed returns and as such, payment of dividend on mutual fund units is always subject to available distributable surplus. Moreover, a mutual fund may make the dividend payment multiple times during the financial year.
NRI investors may choose to redeem his/her units through multiple transactions at different times throughout the year.
Thus, in the context of mutual funds, neither the quantum of dividends nor the redemption amounts are known in advance, nor is it possible for a mutual fund to determine or even estimate the aggregate income likely to be paid to the NRI investor during the year in advance. In short, there is no way for mutual funds to know the income slab of the NRI investor, so as to determine the appropriate rate of Surcharge on the TDS to be applied at the time of making payment of dividend or redemption proceeds.
A mutual fund would be regarded as an ‘assessee in default’ for any shortfall in TDS.
Further, a mutual fund may also be regarded as representative assessee by the tax authorities. Hence there is an apprehension amongst mutual funds that they could be held liable in case of any shortfall in the Surcharge on TDS made in respect of NRI taxpayers at assessment stage.</td><td>It is proposed that the existing provisions w.r.t. Surcharge on TDS in respect of NRIs be amended and prescribe a uniform rate of Surcharge @10% on TDS in respect of dividend from mutual fund units u/S 56 to NRIs as well as the capital gains under Sec. 111A and Sec.112A arising upon redemption of mutual fund units in respect of NRIs, instead of slab-wise rate of Surcharge specified in Part II of the First Schedule to the Finance Act, 2020.</td><td>This will mitigate the hardship faced by NRI investors, eliminate the lack of uniformity amongst mutual funds in compliance of the TDS obligation and will also ease the TDS compliance burden for the mutual funds.
It is pertinent to mention here that, in any case, the actual /final applicable rate of Surcharge on Tax payable by a NRI assessee would depend entirely upon the final aggregate income of the NRI taxpayer under the heads ‘Income from Capital gains’ & ‘Income from Other sources’ (for dividend) in the income tax return.
Hence, rationalizing the rate of Surcharge on TDS by prescribing a flat rate (just like the flat rate for TDS itself) will facilitate ease of tax administration, without any loss of revenue to the Government.
At the same time, it would also mitigate the hardship currently being faced by the mutual funds and the NRIs</td></tr>
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It is pertinent to mention here that unlike mutual funds, companies typically make dividend payment annually, once a year. Further, payment of interest on Corporate Bonds have a fixed due date and fixed coupon rate, which is known in advance. In other words, corporates do not face the aforesaid challenges being faced by mutual funds. From a tax-payer's perspective, the plethora of tax rates, compounded with varied surcharge and cess rates leads to significant amount of confusion. In view of the aforesaid challenges, some mutual funds have been conservatively deducting the Surcharge on TDS at the maximum rate of 37% surcharge, irrespective of the amount of capital gain, while some are deducting the Surcharge at the applicable rate for the actual redemption amount paid for a given transaction. In short, there is a lack of uniformity in the rate of Surcharge on the TDS applied by various Mutual Fund houses. Consequently, there have been numerous complaints from NRI taxpayers who are demanding for a uniform rate of Surcharge on TDS to be applied across all mutual funds.		

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

3. Request to permit Indexation benefits to Non-Resident Investors for investment in Debt Mutual Funds		
Background	**Proposal**	**Justification**
Section 112(1)(c)(iii) of the Act provides that long-term capital gains arising in the hands of non-residents from investments in unlisted securities (which includes unlisted debt mutual funds) will be taxed at 10% *without indexation* and foreign exchange fluctuation benefits. However, indexation benefits are available to resident investors investing in this category of mutual funds.	It is proposed that indexation benefits be extended to Non-Resident investors as well, by way of a suitable amendment to the Income Tax law.	To bring parity in tax treatment by extending indexation benefits to all the categories of investors and encourage inflows from non-resident investors.

4. Request for Clarity on TDS on payment to Non-Resident Investors under Sec. 196A		
Background	**Proposal**	**Justification**
Finance Act, 2020 abolished Dividend Distribution Tax from April 1, 2020, and section 194K was reintroduced requiring tax deduction at source (TDS) on payment of dividend / income distribution to residents. Also section 196A, which provides for TDS on income in respect of units paid to Non-Resident unitholders was revived. However, there is an ambiguity with respect to TDS by a mutual fund on capital gains upon redemption of mutual fund units to Non-Resident investors, inasmuch as hitherto, such redemption proceeds were subjected to deduction of tax at source under section 195 of the Act. The question that arises is, whether payment of such redemption proceeds continues to be subject to TDS under section 195, or is now covered within the ambit of section 196A, because of the words "any income in respect of units of a Mutual Fund" under the new section 196A. Prior to Finance Act, 2020, NRIs (excluding FPIs) were subject to TDS at the 'rates in force' on capital gains in accordance with provisions of section 195 of the Act. This provided a leeway to the Mutual Funds to withhold tax as per the rates provided under the Double Taxation Avoidance Agreement (DTAA) to the extent beneficial, subject to certain conditions. However, Section 196A specifies TDS rate of 20%. Consequently, Mutual Funds are now required to withhold tax as per section 196A of the Act which provides for a flat TDS rate of 20% (plus applicable surcharge and cess) on any income earned from Mutual Fund (i.e. dividend distributions and capital gains). This is causing hardship to NRI investors who are otherwise eligible for a lower tax rate under DTAA. As a result, they suffer a TDS higher that the applicable tax rate.	It is requested that the Section 196A be modified to include words "*or at the rates in force*" to help Mutual Funds to deduct TDS at 20% or lower in case of lower tax rate as per DTAA. It is also requested to clarify that provisions of section 196A are applicable to dividend/income distributions only adding a proviso as follows – "196A. (1) Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any income in respect of units of a Mutual Fund specified under clause (23D) of section 10 or from the specified company referred to in the Explanation to clause (35) of section 10 shall, at the time of credit of such income to the account of the payee or at the time of payment thereof by any mode, whichever is earlier, deduct income-tax thereon at the rate of twenty per cent. Provided that the provisions of this section shall not apply if the income is of the nature of capital gains. Further, this amendment may be made effective retrospectively from 1 April 2020.	Payment of redemption proceeds to non-residents was subjected to TDS under section 195 of the Act. There is no change in the tax treatment of redemption proceeds warranting a change in the obligation of TDS. CBDT had, vide Press Release dated February 4, 2020, clarified that a Mutual Fund shall be required to deduct TDS @ 10% only on dividend payment and no tax shall be required to be deducted by the Mutual Fund on income which is in the nature of capital gains. It is necessary for CBDT to issue a similar clarification that the provisions of section 196A shall not be applicable in case of any capital gains arising on sale of units of a mutual fund to non-resident investors. Consequently, the provisions of section 195 of the Act would apply in case of capital gains arising to non-residents. This will remove the ambiguity prevailing at present with respect to TDS on payment of redemption proceeds by a mutual fund to Non-Resident unitholders. This will also mitigate hardship faced by NRIs who would otherwise be required to claim a tax refund.

IV. Suggestions to deepen the capital market through Mutual Funds

<table>
<tr><th colspan="3">1. Request to introduce Debt Linked Savings Scheme (DLSS) to help deepen the Indian Bond Market.</th></tr>
<tr><th>Background</th><th>Proposal</th><th>Justification</th></tr>
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• Over the past decade, India has emerged as one of the key financial markets in Asia. However, the Indian corporate bond market has remained comparatively small and shallow, and there is a over-dependence on banks for finance, which hampers companies needing access to low-cost finance.

• Historically, the responsibility of providing debt capital in India has largely rested with the banking sector. This has resulted in adverse outcomes, such as accumulation of non-performing assets of the banks, lack of discipline among large borrowers and inability of the banking sector to provide credit to small enterprises.

• Indian banks are currently in no position to expand their lending portfolios till they sort out the existing bad loans problem, especially post Covid19 pandemic. The heavy demands on bank funds by large companies, in effect, crowd out small enterprises from funding.

• India needs to eventually move to a financial system where large companies get most of their funds from the bond markets, while banks focus on smaller enterprises. Hence, there is a need to provide a viable alternative platform for raising debt finance and reduce dependence on the banking system.
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• It is proposed to introduce “Debt Linked Savings Scheme” (DLSS) on the lines of Equity Linked Savings Scheme (ELSS) to channelize long-term savings of retail investors into higher credit rated debt instruments with appropriate tax benefits which will help in deepening the Indian Bond Market.

• At least 80% of the funds collected under DLSS shall be invested in debentures and bonds of companies as permitted under SEBI Mutual Fund Regulations. Pending investment of the funds in the required manner, the funds may be allowed to be deployed in money market instruments and other liquid instruments as permitted under SEBI MF Regulations.

• It is further proposed that the investments upto ₹1,50,000 under DLSS be eligible for tax benefit under a separate sub-Section and subject to a lock in period of 5 years (just like tax saving bank Fixed Deposits).

• CBDT may issue appropriate guidelines / notification in this regard as done in respect of ELSS.
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• In 1992, the Government had introduced the ELSS with a view to encourage retail investments in equity instruments.by providing tax benefits under the Income Tax Act, 1961 for investments in ELSS. Over the years, ELSS has been an attractive investment avenue for retail investors to invest in equities through mutual fund route with dual benefit of tax incentive and long-term capital growth.

• A similar stimulus through introduction of DLSS would help channelize household savings into bond market and help deepen the bond market.

• DLSS will provide an alternative fixed income option with tax breaks to retail investors and help retail investors to participate in bond markets at low costs and at a lower risk as compared to equity markets.

• This will also bring debt oriented mutual funds on par with tax saving bank fixed deposits, where deduction is available under Section 80C.

• The Government’s plans to significantly increase investment in the infrastructure space will require massive funding and the banks may not be equipped to fund such investments. DLSS will also help take away burden from the Government on higher cost of borrowing on small savings instruments.

• This can also play a part in disciplining companies that borrow heavily from banks to fund risky projects, because the borrowing costs would spike. If large borrowers are persuaded to raise funds from the bond market, it will increase bond issuance over time and attract more investors, which will also generate liquidity in the secondary market.

• A vibrant corporate bond market is also important from an external vulnerability point of view, as a dependence on local currency and markets will lower risks.

• Therefore, to deepen the Indian Bond market and strengthen the efforts taken by RBI and SEBI for increasing penetration in the corporate bond markets, it is expedient to channelize long-term savings of retail segment into corporate bond market through Mutual funds on the same lines as ELSS.
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2. All Mutual Funds should be allowed to launch pension-oriented MF schemes (MFLRS) with Uniform Tax Treatment as NPS		
Background	**Proposal**	**Justification**
Presently, there are three broad investment avenues for post-retirement pension income in India, namely: (i) National Pension System (NPS). (ii) Retirement /Pension schemes offered by Mutual Funds. (iii) Insurance-linked Pension Plans offered by Insurance companies. While NPS is eligible for tax exemptions under Section 80CCD, Mutual Fund schemes which are similar in nature, i.e., which are retirement/pension oriented, AND which are specifically notified by CBDT, qualify for tax benefit under Sec. 80C.Currently, each Mutual Fund Pension Scheme needs to be Notified by CBDT for being eligible for tax benefit u/Section 80C on a case-by-case basis involving a lengthy time consuming process. Thus, presently only a handful of Mutual Fund Retirement Benefit / Pension Schemes WHICH HAVE BEEN SPECIFICALLY NOTIFIED BY CBDT qualify for tax benefit under Sec.80C. It may be recalled that in the 'Key Features of Budget 2014-2015' there was an announcement under 'Financial Sector - Capital Market' about "UNIFORM TAX TREATMENT FOR PENSION FUND AND MUTUAL FUND LINKED RETIREMENT PLAN" (on Page 12 of the Budget Highlights document). This implied that Indian Mutual Funds would be able to launch Mutual Fund Linked Retirement Scheme (MFLRSP) which would be eligible for the same tax concessions available to NPS. However, there was no reference to this in the actual Finance Bill, disappointing the Mutual Fund industry.	i. It is proposed that all SEBI registered Mutual Funds should be allowed to launch pension-oriented MF schemes, namely, 'Mutual Fund Linked Retirement Scheme' (MFLRS), with similar tax benefits as applicable to NPS under Sec. 80CCD (1) & 80CCD (1B) of Income Tax Act, 1961, with Exempt-Exempt-Exempt (E-E-E) status on the principle of similar tax treatment for similar products. ii. In other words, it is also proposed that the tax treatment for NPS and Retirement/Pension oriented schemes launched by Mutual Funds should be aligned by bringing the latter also under Sec. 80CCD of IT Act, 1961, considering that the characteristics of both are similar. iii. Where matching contributions are made by an employer, the total of Employer's and Employee's contributions should be taken into account for calculating tax benefits. iv. Contributions made by employer should be allowed as an eligible 'Business Expense' under Section 36(1) (iv a) of Income Tax Act,1961. v. Likewise, contributions made by the employer to MFLRS Schemes up to 10% of salary should be deductible in the hands of employee, as in respect of Section 80 CCD (2) of the Income Tax Act, 1961. vi. Withdrawals made from MFLRS should be exempt from income tax upto the limits specified for tax- exempt withdrawals from NPS as in section 10(12A) and 10(12B) of the Income Tax Act, 1961. vii. It is also requested that CBDT, in consultation with SEBI, should issue appropriate guidelines / notification in this regard as has been done in respect of ELSS, obviating the need for each Mutual Fund to apply individually to CBDT to notify its MFLRP as being eligible for tax benefit u/Sec.80CCD.	• SEBI, in its "Long Term Policy for Mutual Funds" published a few years ago , had proposed that Mutual Funds be allowed to launch pension plans, namely, Mutual Fund Linked Retirement Plan' (**MFLRP**) akin to *401(k) Plan* in the U.S. which would be eligible for tax benefits, • It was also emphasized in the aforesaid Long Term Policy that similar products should get similar tax treatment, and the need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators and the need for restructuring of tax incentive for Mutual Fund Pension schemes. • Thus, there is very strong case for bringing Mutual Funds Retirement Benefit / Pension Schemes under Sec. 80CCD instead of Sec.80C to bring parity of tax treatment for the pension schemes and ensure level playing field. • Allowing Mutual Funds to launch MFLRS would bring pension benefits to millions of Indians in unorganized sector. • Empirically, tax incentives are pivotal in channelising long-term savings. For example, the mutual fund industry in the United States witnessed exponential growth when tax incentives were announced for retirement savings. Market-linked retirement planning has been one of the turning points for high-quality retirement savings across the world. Investors have a choice in the scheme selection and flexibility. • A long-term product like MFLRS can play a catalytical role in channelizing household savings into securities market and bring greater depth. Such depth brought by the domestic institutions would help in balancing the volatility in the markets and would reduce reliance on the FPIs. • Going forward, pension funds will emerge as sources of funds in infrastructure and other projects with long gestation period, as well as for providing depth to the equity market (perhaps looking for absorbing stocks arising out of disinvestment program of the government).

3. Mutual Fund Units should be notified as 'Specified Long-Term Assets' qualifying for exemption on LTCG under Sec. 54 EC		
Background	**Proposal**	**Justification**
In 1996, Sections 54EA and 54EB were introduced under the Income Tax Act, 1961 that allowed capital gains tax exemption for investments in specified assets, including mutual fund units, with a view to channelize investment into priority sectors of the economy and to give impetus to the capital markets. However, Sec. 54EA and 54EB were withdrawn in the Union Budget 2000-01 and a new Section 54EC was introduced, whereby tax exemption on long-term capital gains is allowed only if the gains are invested in specified long-term assets that are redeemable after three years, namely, the bonds issued by the NHAI & REC. After withdrawal of Section 54EA and 54EB in 2000, the inflow of Long-Term Capital Gains from sale of property, which would have otherwise flowed into capital market has practically stopped.	It is proposed that, mutual fund units wherein the underlying investments are made into specified *infrastructure sub-sector* as may be notified by the Government of India, be also included in the list of the specified long-term assets under Sec. 54EC. While the underlying investment could be made in securities in infrastructure sub-sector as specified above, the mutual fund itself could be equity-oriented scheme or debt-oriented scheme. Further, the aforesaid investment can have a lock in period of three years to be eligible for exemption under Sec. 54EC.	The Government's plans to significantly increase investment in the infrastructure space will require massive funding and the banks may not be equipped to fund such investments and bonds issued by REC or NHAI may be inadequate. Investment in the specified mutual fund schemes can provide an alternative investment avenue in addition to existing options to the investors and also provide an option to earn market related returns. It will also help ease the burden cost of borrowing for infrastructure funding on the Government. Tax benefit under Sec. 54 EC for investment in the specified mutual fund scheme will help channelize the gains from sale of immovable property into capital markets through mutual fund route and bring greater depth to capital markets.

4. Suggestions w.r.t. Exchange Traded Funds (ETFs)		
Background	**Proposal**	**Justification**
i. Currently, the minimum holding period in respect of listed securities for being considered as long term investment for capital gain tax purposes is 12 months, whereas, for Debt-oriented Mutual Fund scheme including ETFs, it is 36 months, even though units of Debt ETFs are also listed on stock exchanges and "Units" are also securities as per SCRA.	Considering that units of Debt ETFs are also securities as per SCRA and are also listed on the exchanges, it is proposed the minimum period of holding for units of Debt ETFs for being considered as long-term investment for capital gain tax purposes be pegged at 12 months at par with listed securities.	To bring parity in tax treatment between listed debentures and listed debt ETF units. Reduction in the minimum period of holding for units of Debt ETFs to 12 months would boost the retail participation in Debt ETFs.
i. Currently, a Gold ETF and Gold Linked MF Scheme are treated as "Other than Equity Oriented Funds" for income tax purposes. Consequently, the minimum period of holding for being considered as long-term investment for capital gain tax purposes in respect of Units of Gold ETF is 3 years attracting LTCG tax @20% with indexation, while the Short Term Capital Gains is taxed at the marginal rate of taxation applicable to the assessee.	It is proposed to lower the minimum holding period for LTCG purposes in case of Gold & Silver ETFs from 3 years to 1 year, as in the case of listed debt securities, as the units are listed on the stock exchanges	The launch of Sovereign Gold Bonds (SGB) has made Gold ETF and Gold Linked MF Scheme less attractive resulting in lack of interest in Gold ETFs / and Gold Linked MF Scheme. From liquidity perspective, Gold ETFs are superior as compared to SGB, as Gold ETFs provide continuous liquidity to investors. Lowering the holding period in resp. of Gold ETFs for LTCG purposes from 3 years to 1 year will provide an incentive to retail investors to invest in Gold ETF and help expand retail investments in ETFs. Gold ETFs & Commodity ETFs are globally popular with over $100 billion in AUMs. In India, Gold ETFs are now a decade old, functioning seamlessly on the stock exchanges. ETFs are globally accepted as a preferred route for commodity investments. A favourable tax regime would go a long way in making gold and silver ETFs popular among retail investors and encourage investors to move away from physical commodity and improve adoption of Commodity ETFs.

5. Gold ETFs and FoFs which invest 90% or more in Gold ETFs should be subjected to LTCG tax @ 10% instead		
Background/Issue	**Proposal**	**Justification/Rationale**
i. Request for Tax treatment to Gold ETFs and Fund of Funds that invest 90% or more in units of Gold ETFs Gold ETFs and Fund of Funds that invest 90% or more in units of Gold ETFs are currently subject to capital gains tax which is in line with other gold investment avenues as follows – a) Short term capital gains taxed at marginal tax rate for holding period up to 3 years; b) Long term capital gains tax @ 20% with indexation benefit for holding period of more than 3 years.	To encourage retail investors to invest in gold through mutual fund route rather than buying physical gold, it is proposed that Gold ETFs and Fund of Funds which invest 90% or more in Units of Gold ETFs should be subjected to Long Term Capital Gains tax @ 10% instead of @ 20% with indexation benefit (as may be applicable) OR the holding period to avail Long Term Capital Gains taxation in respect of Units of Gold ETFs be reduced from existing period of 3 years to 1 year.	A preferential tax treatment to financial gold offerings like Gold ETFs and Fund of Funds that invest 90% or more of their corpus in units of Gold ETFs will promote the category as a gold investment avenue over other fiscally inefficient avenues like physical gold and gold jewellery. This move will be in line with the Government's agenda to discourage savings and investments in physical gold/jewellery and boost the financialization of gold holdings. Such incentives are prevalent in other countries like the UK where investment gold does not attract VAT which is charged on non-investment gold at the rate of 20%.

6.	Request for Rationalization of Stamp Duty on various categories of ETFs		
	Background	**Proposal**	**Justification**
ii.	**Equity ETFs** Levy of Stamp Duty w.e.f. July 1, 2020 has resulted in Equity ETFs being subjected to levy of Stamp Duty at multiple stages as follows : • Fresh creation of units with AMC @ 0.005% • Underlying basket @ 0.015% (sell) • Purchasing ETFs on the exchange @ 0.015%	Stamp Duty should be rationalised and levied only once instead of being paid on multiple legs for the same units that are issued	To avoid levy of Stamp Duty at multiple stages for the same units that are issued
iii.	**Debt ETFs (Bonds other than Government Securities):** Levy of Stamp Duty w.e.f. July 1, 2020 has resulted in increase in costs for Debt ETFs substantially as follows: • Fresh Creation of Units with AMC @ 0.005%, earlier 0% • Underlying Securities @0.0001% (Buy), earlier - 0% • While Purchasing ETFs on the SE @ 0.015%, earlier - 0.0005% (Buy & Sell each) This has resulted in lower returns for listed debt securities. In addition, for ETFs, the stamp duty is being levied on multiple legs for the same units, resulting in increase in stamp duty on two legs of ETF by almost 20 times as compared to earlier regime before 2020. This additional stamp duty leads to reduced returns in the hands of debt investors where returns are relatively lesser as compared to equities.	Stamp Duty should be rationalised and levied only once instead of being paid on multiple legs for the same units that are issued	To avoid levy of Stamp Duty at multiple stages for the same units that are issued Same should be rationalised as, now there is no differentiation in stamp duty on the exchange whether equity or debt.
iv.	**Debt ETFs (Government Securities):** Levy of Stamp Duty w.e.f. July 1, 2020 has resulted in increase in costs for G-Sec ETFs substantially as follows: • Fresh Creation of Units with AMC - 0.005%, earlier 0% • Underlying Securities - 0%, earlier - 0%: • While Purchasing ETFs on the SE - 0.015%, earlier - 0.0005% (Buy & Sell each) This has resulted in lower returns for listed debt securities. In addition, for ETFs, the stamp duty is being levied on multiple legs for the same units, resulting in increase in stamp duty on two legs of ETF by almost 20 times as compared to earlier regime before 2020. This additional stamp duty leads to reduced returns in the hands of debt investors where returns are relatively lesser as compared to equities.	Stamp Duty should be rationalised and levied only once instead of being paid on multiple legs for the same units that are issued	To avoid levy of Stamp Duty at multiple stages for the same units that are issued. Same should be rationalised as now there is no differentiation in stamp duty on the exchange whether equity or debt.
v.	**STT implications** In the case of ETFs, STT applicable on intra-day square off is more than that applicable for delivery-based trading	The principle for applicability of STT on units of ETFs and on equity stocks should be made similar.	In Equity stocks, STT on non-delivery transactions is 0.025% and for delivery is 0.1% whereas for ETFs, STT on non-delivery transactions is 0.025% and for delivery it is 0.001%, which is an anomaly, as STT on intra-day should be lesser as compared to delivery trades helping improve liquidity.

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V. Proposals for Development of Mutual Fund industry

1. CPSE investment of surplus funds in Mutual Funds		
Background / Issue	**Proposal**	**Justification**
As per the extant DPE guidelines regarding investment of surplus funds by the CPSEs vide Office Memorandum F. No. DPE/18/(1)/2012-Fin dated May 8, 2017, *Maharatna, Navratna and Miniratna CPSEs* are permitted to invest their surplus funds in mutual funds subject to the following conditions – a) *They may invest only in debt-based schemes of* ***public sector mutual funds****.* b) *Investment in mutual funds shall not exceed 30% of the available surplus funds of the concerned CPSE.* c) *The mutual fund debt scheme should have –* - *corpus amounting to at least ₹1000 Crore for the scheme at the time of investment, as per the latest published information; and* - *been accorded highest mutual fund rating by any two of the Credit Rating Agencies registered with SEBI.* d) *The period of maturity, including cases of residual maturity, of any instrument of investment shall not exceed one year from the date of investment. However, in the case of term deposits with banks and GOI securities, it may be up to three years from the date of investment.* e) *If any statutory guidelines have been issued by the sectoral regulatory authority such as RBI, SEBI etc., on investment of surplus funds, the DPE guidelines will be applicable to CPSEs only to the extent that the same are not contrary to the guidelines laid down by such regulatory authority.* *Since investment in debt schemes of mutual funds are subject to market risks, the track-record of the scheme shall be taken into account for taking investment decisions.* Although the revised guidelines have covered the 'Maharatna CPSEs', there is continued restriction on the CPSEs to invest their surplus funds of only in public sector mutual funds, as result of which the lack of level playing field between the public sector and private sector mutual funds continues to prevail in this regard.	It is requested to – 1. Revise the current DPE guidelines, and permit the Maharatna, Navratna and Miniratna CPSEs to invest their surplus fund in ***any*** SEBI registered Mutual Fund, irrespective of whether it is a public sector mutual fund or a private sector mutual fund; 2. Enhance the current limit of 30% of available surplus funds for investments in mutual funds by CPSEs to 50% of available surplus funds; 3. Not to stipulate any minimum corpus size in respect of the debt scheme as a pre-condition for investments by CPSEs; 4. Instead of the debt scheme requiring rating by any two separate Credit Rating Agencies, rating of only one SEBI-registered Credit Rating Agency may be accepted as adequate. 5. The period of maturity, including residual maturity in respect of debt mutual fund schemes may also be permitted / extended upto three years from the date of investment, in line with the extant provisions for deployment of surplus funds in term deposits with banks and GOI securities.	The current investment restrictions on CPSEs is rather monopolistic and restrictive, as it denies good investment opportunity to the CPSEs who are compelled to invest their surplus funds only in public sector Mutual Funds, thereby losing competitive opportunity to invest in private sector Mutual Funds with good track record. In turn, this prevents healthy competition and level playing field amongst various MF players. ***The DPE Guidelines also imply that PSU Mutual Funds are safer and / or more capable to manage the funds of CPSEs, although, all Mutual Funds operate under the same regulatory framework and operate in the same competitive environment.*** Over the years, private sector mutual funds have steadily overtaken the PSU mutual funds, both in terms of Assets Under Management (AUM) and number of investor accounts, which is evident in the factual data presented below: • Currently, out of 44 active Mutual Funds registered with SEBI (including 2 Infrastructure Debt Funds), only 7 are PSU Mutual Funds. • As on November 30, 2021, the aggregate AUM of the Indian Mutual Funds was ₹ 37,33,702 crore, out of which, the AUM of PSU Mutual Funds was ₹ 690,671 crore (i.e., about 18.50% of the aggregate Industry AUM), while the AUM of other non-PSU Mutual Funds was ₹30,43,031 lakh crore (i.e. 81.50% of the Industry AUM). In terms of investor folios (accounts), as on November 30, 2021 the PSU Mutual Funds had an aggregate of around 1.71 crore folios (14.60%), while private sector funds had 9.99 crore folios (85.40%). ***The above data clearly indicates the level of trust, credibility and track record which the private sector mutual funds have built over the last two decades.***

Further, the condition that the mutual fund debt scheme should have a corpus of at least ₹1000 Crore at the time of investment is restrictive and against the interest of smaller or newer mutual funds. It is also felt that requirement that the mutual fund scheme should have highest rating by any two of the Credit Rating Agencies (CRA) is not warranted, and it should be sufficient if a debt scheme has the requisite rating from one CRA. The restriction on the period of maturity of the investment, including residual maturity not exceed one year is also rather restrictive, as the CPSEs will not be able to invest in longer duration schemes especially fixed maturity plans with three-year maturity, which are designed to provide tax efficiency to the investors on account of indexation benefits.		Considering the performance of mutual funds vis-à-vis other alternate investment avenues and the fact that mutual funds provide better liquidity, especially in respect of open ended schemes, there is also a strong case for enhancing the existing prescribed limit of surplus funds which CPSEs could invest in mutual funds having equity investments, as it will help the CPSE to get better returns and liquidity. It is also pertinent to mention here that PSU Banks and Financial Institutions themselves do not differentiate between private sector and public sector Mutual Funds and make their investment decisions based on track record and returns rather than on ownership structure. Further, the PSEs do not differentiate between private-sector banks and public-sector banks, when they invest in bank deposits, nor is there any restriction imposed on them to carry on banking activities only with PSU Banks. In SEBI's "**Long Term Policy for Mutual Funds in India**", it has been recommended at para 3.8.6 that ALL CPSEs should be allowed in invest surplus funds in mutual funds and be allowed to choose from any / all SEBI registered mutual funds (irrespective of whether a mutual fund is sponsored by a Public-Sector enterprise or otherwise). **Thus, there is a very strong case for allowing CPSEs to invest their surplus fund in <u>any</u> SEBI registered Mutual Funds, irrespective of whether it is a public sector mutual fund or private sector mutual fund.**

2. Request to permit Insurance Companies to outsource the Fund Management activities to SEBI Registered MF AMCs		
Background	**Proposal**	**Justification**
The global practice adopted by the Insurance industry abroad is that of open architecture of fund management. In this regime, insurance companies create appropriate products and utilize the services of professional asset managers in discharging its investment management function. This process is widely followed to optimize the investment expertise domiciled with asset management industry. Insurance companies provide full disclosure of the AMC engaged by them in providing asset management / advisory services.	It is recommended that all IRDA-registered Insurance companies be permitted to outsource the Fund Management activities to SEBI Registered Mutual Fund Asset Management Companies (AMCs) and the AMCs be permitted to provide Fund Management / Asset Management services to the Insurance companies by appropriate amendments to relevant SEBI & IRDA Regulations.	This would result in both MF & Insurance industries complementing each other in accessing households with financial products which could be simple investment products manufactured by the Asset Management industries or Insurance products which could bundle an element of investment. Hence the AMCs with Mutual Fund products never really compete or conflict with Insurance products. There is an urgent need for the Indian regulatory regime to recognize that investors could choose an Insurance product of an insurance company with the full knowledge that the investment management function thereof is managed by an AMC which has been chosen by the insurance provider. This would, in fact, provide the insurance policy buyer multiple options on choosing insurance products with different asset managers. It would also bring about optimization of cost across both industries.

VI. Request for certain clarifications & Simplification of tax regime for ease of compliance

1. Amendment in definition of Equity-Oriented Fund in case of Fund of Funds scheme – Section 112A of the Income Tax Act		
Background/Issue	**Proposal**	**Justification/Rationale**
Definition of equity-oriented fund in case of fund of fund scheme under Section 112A of the Income Tax Act is not clear as to investments in multiple funds	The words "another fund" provided in the Explanation (a) to section 112A of the Income Tax Act should be replaced with "other funds" from the date of insertion of the Explanation.	1) "Equity-oriented fund" defined in the explanation to section 112A of the Act should be a fund set-up under a scheme of mutual fund under section 10(23D) of the Act. Further, section 10(23D) of the Act, inter alia, refers to mutual fund registered under SEBI Act, 1992 or regulations made thereunder. Regulation 2(ma) of SEBI (Mutual Funds) Regulations, 1996 defines "fund of fund scheme" as follows: *"2 (ma) Fund of funds scheme means a mutual fund scheme that invests primarily in other schemes of the same mutual fund or other mutual funds."* Thus, the SEBI regulations allow FoFs to invest in more than one fund. 2) A "fund of funds" is a mutual fund which invests in the schemes of other mutual funds rather than directly investment in shares, bonds, etc. The basic objective of a "fund of funds" is to offer greater diversification and/ or flexibility than traditional mutual funds. If a "fund of fund" is investing only in schemes of one mutual fund the basic objective of investing through "fund of funds" may be defeated. 3) Thus, it should be clarified that "Fund of Funds" could invest in more than one equity oriented fund schemes.

2. Need to further simplify Taxation provisions of offshore funds managed by Indian portfolio managers		
Background / Issue	**Proposal**	**Justification**
India continues to be an important investment destination despite the recent economic slowdown. Many of the India focused overseas funds typically have a structure where the investment manager is based outside India and is supported by an investment adviser based in India. To encourage the fund management activities of offshore funds from India, a "Safe Harbour" regime for onshore management of offshore funds, section 9A was introduced in the Income-tax Act in the year 2015, which provided that the presence of a fund manager/an investment adviser in India would not constitute business connection, permanent establishment or a tax residence for the offshore funds in India, *subject to fulfilment of the prescribed conditions*. However, some of the conditions were quite onerous in nature, e.g., one of the conditions to qualify for the Safe Harbour was for the eligible fund manager to receive an arm's length remuneration, and for the transaction between the eligible investment fund and eligible fund manager to be deemed an international transaction, subject to transfer pricing provisions. Although Finance Act, 2019 has removed the above requirement, replacing it with a minimum fee to be prescribed by CBDT and CBDT has since notified the amendment to Rule 10V, the Indian fund management industry has not been able to take advantage of the safe harbour provisions in section 9A due to the requirements still being too onerous or generally impractical for investment funds. Consequently, only a handful of offshore funds have availed of the safe harbour benefit.	It is requested that the onerous conditions under Section 9A of the Act, be further to simplified to encourage fund management activity from India and provide safe harbour in respect of offshore funds, as detailed below. It is also suggested that some or all the conditions relating to safe harbour need to be deleted for Portfolio Managers/ Advisors operating from the International Financial Services Centre (IFSC), GIFT city, Gujarat.	Creating a tax environment which encourages Indian portfolio managers to manage global mandates from India rather than from abroad will bring economies of scale, more jobs and help develop India as a regional financial center.
2 (a) Participation of residents in the Fund – Sec. 9A(3)(c)		
The condition with regard to aggregate participation or investment in the fund, directly or indirectly, by persons resident in India to not exceed five percent of the corpus of the fund, is difficult to monitor especially in case of indirect participation.	Section 9A(3)(c) should be amended as under: ***"The aggregate participation or investment in the fund, directly or indirectly, by persons resident in India shall not exceed the threshold prescribed by the Securities and Exchange Board of India in this regard"*** Alternatively, section 9A(3)(c) should be amended as under: ***"The aggregate direct participation or investment in the fund, by person resident in India does not exceed five percent of the corpus of the fund".***	• Practical challenges for retail funds to monitor indirect participation of persons resident in India, especially on continuous basis. • Given that KYC requirements under the SEBI FPI Regulations 2019 have a threshold for identification of beneficial owners, there is a relative disadvantage on marketability of FPIs availing safe harbour regime vis-à-vis FPIs not availing safe harbour regime.

2 (b) Minimum corpus of the fund – Sec. 9A(3)(j)		
There is a requirement that the monthly average of the corpus of the fund shall not be less than one hundred crore rupees, which makes it difficult for some of the new funds to satisfy especially in Covid times. Further, the Proviso to the Section provides a relaxation that if the fund has been established or incorporated in the previous year, the corpus of the fund shall not be less than one hundred crore rupees at the end of a period of twelve months from the last day of the month of its establishment or incorporation.	Section 9A(3)(j) should be amended as under: (j) The monthly average of the corpus of the fund shall not be less than one hundred crore rupees: Provided that if the fund has ***started operations*** in the previous year, the corpus of fund shall not be less than one hundred crore rupees at the end of a period of twelve months from the last day of the month when it ***started the operations***.	New funds require time to build track record for performance in which scenario the minimum corpus of hundred crore rupees may not be achieved. Further, Section 9A(3)(c) dealing with participation of persons resident in India has reference of "***operation of the fund***" while having a carve out for contribution by the eligible fund manager.
2 (c) Investment diversification condition – Sec. 9A(3)(e), 9A(3)(f) and 9A(3)(g)		
Earlier, Category I and Category II FPIs registered under the erstwhile regulations were exempt from diversification conditions. SEBI (FPI) Regulations, 2019 has re-categorised funds based on the country of domicile and the regulated status in that country. Category II FPI not only includes family offices, individuals, corporate bodes, but also include appropriately regulated funds not eligible as Category I FPI. Exemption from diversification conditions has been restricted only to Category I FPIs. However, funds that fall under Category II FPI that are appropriately regulated but not eligible for registration as a Category I FPI are required to satisfy diversification conditions and which are very onerous.	Diversification conditions specified under clause (e), (f) and (g) of section 9A should not be applicable to a Category II FPIs (except individuals, corporate bodies and family offices)	• The change will seriously impact regulated broad-based funds domiciled in non-FATF member countries • Operational Guidelines under SEBI (FPI) Regulations, 2019, treat appropriately regulated funds under Category II FPI at par with Category I FPIs for the purpose of KYC declarations, exemptions and limits such as margining of trades, position limits in certain derivative contracts. • Similarly, under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, "Qualified institutional buyer" status has been granted to Category I FPIs as well as to appropriately regulated funds registered as Category II FPI. •
2 (d) Connected person condition – Sec. 9A(4)(a)		
In case the eligible fund and the eligible fund manager are regarded as 'connected persons', then it would not be possible for any fund to satisfy the aforesaid condition.	It is recommended to delete Section 9A(4)(a) or introduce an objective definition of 'connected persons' relevant in the context of fund management industry	The definition of 'connected persons' is taken from section 102(4) of the Income tax Act, 1961. The definition of 'connected persons' provided in section 102(4) of the Act is subjective and very wide.

2 (e) Profits entitled to fund manager - 9A(4)(d)		
There could be challenges to apply the condition in certain situations such as (a) post redemption, the overall gain has turned into losses for the fund at the financial year end, (b) period for calculating performance profits not aligned with the financial year (as calculated on a calendar year) and (c) Multi share class vehicle.	It is recommended to delete Section 9A(4)(d)	As long as there are inflows into India which would mean more revenue coming into the country, there should not be any requirement to cap the fees at 20% of profits. Further, section 9A(3)(m) read with Income Tax Rules 10V now prescribes minimum remuneration with the intention of increasing revenue flow to India. Section 9A(4)(d), on the other hand, puts a restriction on the amount of fee to be charged by the fund manager to the overseas fund.
2 (f) Definition of "Corpus" – 9A (9)(c)		
Currently the definition of "corpus" means the total amount of funds raised for the purpose of investment by the eligible investment fund as on a particular date. Open ended fund witness inflows and outflows on daily/weekly/monthly frequency based on the structure if each fund and as a result the corpus keeps changing on daily/weekly/monthly basis, respectively. Therefore, for such funds it is not correct to link restrictions to the collection on a particular date.	It is recommended that the term "corpus" should be defined as "*The total net asset value of the eligible investment fund as on a particular date*"	As most public retail funds are open ended allowing subscription and redemption on a daily/weekly/monthly basis, net asset value is a better barometer for monitoring any restriction.

<table>
<tr><th colspan="3">3. Issues in provisions of the new Section 194R - Mutual Funds should be exempt from the provisions of section 194R</th></tr>
<tr><th>Background/ Issue</th><th>Proposal</th><th>Justification/ Rationale</th></tr>
<tr><td>Finance Act, 2022 (FA 2022) has introduced Section 194R of the Income-tax Act, 1961, wherein tax deducted at source (TDS) at the rate of 10% would be applied on benefit/perquisite provided to a resident carrying on business or profession in case value of benefit or perquisite provided to such resident exceeds ₹ 20,000 in a year with effect from July 1, 2022. Further, this provision is applicable even in cases where benefit/ perquisite is provided in cash or in kind.

Although FAQs have been issued by the tax authorities, clarifying the applicability of section 194R in some of the cases, the provision of section 194R or FAQs have not defined the term benefit/ perquisite.

In case the investor/ lender of money writes-off any receivable from the investee/ creditor, the AO may treat that the investor/ lender has provided benefit/ perquisite to the investee/ creditor and therefore such write-off amount might be liable to TDS under section 194R.</td><td>In order to avoid undue hardship and loss that may arise to the investor/ lender (i.e., the MFs), the write-off of any receivable from the investee/ creditor by the investor/ lender should be kept outside the purview of section 194R and suitable amendment should be made in section 194R.

(In short, mutual funds should be exempted from the provisions of section 194R as they provide service to general retail public, similar to banks and insurance companies.</td><td>Mutual Funds invest in debenture of company/s (i.e., investee) which may turn insolvent/ bad and therefore the MF/AMC may not be able to recover the money from the investee company. This may be treated as benefit/ perquisite provided by MF/ AMC to investee company.

As investee/ creditor is already in default, it will be difficult for the AMC to recover the amount from such investee and therefore investor/ lender (i.e., the MF) would be required to pay TDS on its behalf. This will further increase the loss to be borne by the investor/ lender (the MF) and would cause undue hardship to the investor/ lender (the MF).

One Time Settlement (OTS) towards defaulted Non-Convertible Debentures (NCDs) and loans are recognized in financial market and are resorted to only when the borrower is unable to repay the NCD dues or service the loan taken from the lenders. There are rulings (including that of the Supreme Court') to the effect that loan waiver ought not to be regarded as perquisite or income.

In view of non-inclusion of SEBI registered Mutual Funds, Alternative Investment funds and SEBI approved Asset Management Companies under Q1 in the guidelines issued vide circular 18 of 2022 dated September 13, 2022, MFs and AMCs would be expected to assume such settlements to be giving rise to a taxable benefit or perquisite to the borrower concerned and ensure compliance with TDS obligations under section 194R.

Given that the settlement of NCD maturity proceeds and/or loans are under distress and MFs / AIFs/ AMCs are having to forego a substantial portion of their principal and interest, the requirement of TDS under section 194R effectively compounds the issue and increases the stress with the following implications –
• The borrower is unlikely to discharge any tax on the OTS “benefit” — he may well apply the ruling of the Supreme Court and other courts and claim he has not received any taxable benefit; Therefore, he is unlikely to pay any advance tax on the same, nor is he likely to reimburse any TDS to the MFs, AIFs or AMCs.
• The TDS would, therefore, have to be borne by the MFs, AIFs or AMCs which will again be reckoned as additional perquisite.
• Credit for such TDS would reflect in the tax credit statement (in Form 26AS) of the delinquent borrower, enabling him to take credit of the same. This will be tantamount to incentivizing delinquencies and should be pre-empted.</td></tr>
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<table>
<tr><td colspan="3">4. Challenges in claiming deductions under section 43B (in case payments are made after due date of filing tax audit report, but paid before filing of return)</td></tr>
<tr><th>Background/Issue</th><th>Proposal</th><th>Justification/Rationale</th></tr>
<tr><td><u>Section 44AB and Section 43B</u>
1) Finance Act, 2020 (FA 2020) has extended the due date for filing return of income for taxpayers (which are subject to tax audit) where transfer pricing provisions do not apply from 30 September to 31 October. However, due date for furnishing tax audit report under section 44AB remains 30 September.
2) Also, where transfer pricing provisions apply, due date for furnishing tax audit report has been advanced from 30 November to 31 October whereas due date for furnishing return of income remains unchanged (i.e. 30 November).
3) As per section 43B of the Act, the deduction in respect of specified sum of the nature referred to in section 43B (i.e. payment of bonus etc.) is deductible only if paid before due date of filing of return of income.</td><td>1) In order to avoid the mismatch of claim made under section 43B of the Act between the Income-tax return and tax audit report, the due date of filing tax audit report should be the same as due date of filing of income tax return as it was available in the earlier regime of income tax laws. Thus, the due date of filing both tax audit report and tax return should be 31st October (or 30th November for transfer pricing cases).
2) Alternatively, suitable amendment should be carried out in section 43B of the Act to align the time limit prescribed under the proviso to section 43B of the Act with the time limit of filing tax audit report under section 44AB of the Act.</td><td>1) Where payment of any specified sum of the nature referred to in section 43B of Income-tax Act, 1961 (the Act) is made by the taxpayer after filing of tax audit report but before filing return of income (i.e. payments of bonus, etc. made in the month of November before filing of income tax return, whereas the tax audit report is required to be filed by 31 October), such payments, which otherwise are eligible for deduction under section 43B of the Act, would not be reported in the tax audit report as deductible under section 43B, since the tax audit report would have been filed prior to making this payment.
2) Once the income-tax return is filed electronically, the same is processed by the centralized processing center (CPC) whereby the data inputted in the income-tax return is electronically mapped and verified with tax audit report filed with the Revenue Authorities. Introducing a gap of one month between due dates for tax audit report and tax returns will substantially increase such cases of mismatch as the deductible amounts paid after tax audit report will not be verifiable by CPC. This would cause hardship to bona fide taxpayers, resulting into disallowance of genuine deductible amounts and consequential frivolous demands on the taxpayers.</td></tr>
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