



**Association of Mutual Funds in India**

**PROPOSALS  
FOR  
UNION BUDGET - FY 2022-23**



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

1. Request for Uniformity in Taxation on Listed Debt Securities and Debt Mutual Funds		
Background	Proposal	Justification
<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>	<p>The holding period for long term capital gains for direct investment in listed debt securities / and <b>Zero-Coupon Bonds (listed or unlisted)</b> and for investment through debt mutual funds should be harmonized and made uniform. This may be done by bringing the two at par in either by –</p> <p>(i) treating investments in non-equity oriented mutual fund schemes <b>which invest 65% or more in listed debt securities as long term</b>, if they are held for more than 12 months</p> <p>OR</p> <p>(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.</p>	<p>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.</p> <p>This parity between direct investments in a listed security (by corporates &amp; HNIs) and indirect investments made through mutual funds by retail investors would also prevent tax revenue leakage.</p>



## 2. Request for Uniform tax treatment on Capital Gains from Mutual Funds investments and ULIPs of Insurance companies

Background	Proposal	Justification
<ul style="list-style-type: none"> <li>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 <i>grandfathered</i>).</li> <li>However, the proceeds from ULIPs of Insurance companies (including early surrender / partial withdrawals), are exempted from income tax <i>under Section 10(10D) of Income Tax Act</i>, 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 products that invest in equity stocks, just like mutual funds, and with added advantage of tax deduction under Section 80C of the Income Tax Act on the premium paid.</li> <li><i>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.</i></li> <li>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.</li> </ul>	<p>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.</p>	<ul style="list-style-type: none"> <li>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.</li> <li>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 two lakh and fifty thousand rupees, which could be significant.</li> <li>SEBI, in its “Long Term Policy for Mutual Funds”, published a few years ago, had emphasized that <u>similar products should get similar tax treatment</u>, and the need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators.</li> <li>We have been highlighting about the tax arbitrage between Mutual Fund Schemes &amp; ULIPs in the past also and the need to bring about parity between the two.</li> <li>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.</li> </ul>



### 3. Need for parity in tax treatment in respect of Intra-scheme Switching of Units under MF Schemes

Background	Proposal	Justification
<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> <li>• 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, <b>not</b> subjected to any Capital Gains Tax.</li> <li>• However, switching of investment in Units within the same Mutual Fund scheme from Growth Option to Dividend Option (<i>or vice-versa</i>), and/or from Regular Plan to Direct Plan (<i>or vice-versa</i>) 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>i.e., even though there are no realized gains</i>, as the underlying securities/ portfolio remains unchanged within the scheme.</li> </ul> <p>Thus, there is disparity in tax treatment on switching of investment within a Mutual Fund scheme and within a ULIP of Insurance companies, <b>although both MF schemes and ULIPs invest in securities, and are investment products.</b></p>	<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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.</li> </ul>	<ol style="list-style-type: none"> <li>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.</li> <li>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:             <ul style="list-style-type: none"> <li>(i) <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)}.</i></li> <li>(ii) <i>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)}.</i></li> </ul> </li> <li>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.</li> <li>4. It may be added here that in the “<i>Long Term Policy for Mutual Funds</i>”, SEBI has emphasized the principle that <b>similar products should get similar tax treatment</b>, and the need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators. Thus, on this count too, 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.</li> </ol>



## B. Suggestions to mitigate hardship to retail taxpayers

<b>1. Increase in threshold limit of withholding tax (TDS) on Income distribution by Mutual Fund scheme</b>		
<b>Background</b>	<b>Proposal</b>	<b>Justification</b>
<p>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.</p>	<p>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.</p>	<p>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.</p> <p>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 last year's budget.</p> <p>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.</p>

<b>2. 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</b>		
<b>Background</b>	<b>Proposal</b>	<b>Justification</b>
<p>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.</p> <p>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%.</p>	<p>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%.</p>	<p>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.</p>



### 3. Request for partial modification of Equity Linked Saving Scheme (ELSS) to allow investment of any amount instead of multiples of ₹500

Background	Proposal	Justification
<p>Rule 3(a) of Equity Linked Savings Scheme, 2005 under Notification No.226/2005 dated Nov. 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.</p> <p>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 Mutual Funds and UTI. At that time the ELSS applications were typically collected by ‘Bankers to the Issue’ and it was common for investors to make their subscriptions by cash. The aforesaid Rule 3 (viz., amount to be invested in ELSS to be in multiples of ₹ 500) seems to have been introduced to facilitate acceptance of subscriptions in cash.</p> <p>Currently, mode of payment for mutual fund transactions predominantly happen via electronic mode or cheques. Hence, the requirement of multiples of ₹500 has lost its relevance.</p> <p>It is often observed that, while investing in ELSS, investors invest amounts which are not necessarily in multiples of ₹500/- since in most other mutual fund schemes, the investment / subscriptions are accepted in multiples of ₹1. However, due to requirement of investment 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 (which is completely avoidable)</p> <p>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. This results in avoidable rejection of application or partial refund of fractional amount which is not in multiples of ₹500.</p> <p>It is also pertinent to mention here that the growth / 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 growth in value of investment / redemption value thereof would typically be an odd amount (including a few paise) 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.</p>	<p>It is proposed to carry out partial modification of 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.</p>	<p>The challenges explained alongside often lead avoidable investor inconvenience, including the loss of investment opportunity / loss of income tax benefits, apart from additional operational work for mutual funds.</p> <p>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 as a result of the above change.</p>





## C. Suggestions to mitigate hardship to NRI taxpayers

1. Need to prescribe a uniform rate for deduction of Surcharge on TDS in respect of NRIs		
Background	Proposal	Justification
<p>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 &amp; 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, <i>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)</i> –</p> <ul style="list-style-type: none"> <li>→ 10% where total income exceeds ₹50 lakhs, but does not exceed ₹1 crore</li> <li>→ 15% where total income exceeds ₹1 crore but does not exceed ₹2 crore.</li> <li>→ 25% where total income exceeds ₹2 crore but does not exceed ₹5 crore.</li> <li>→ 37% on base tax where total income exceeds ₹5 crore.</li> </ul> <p>In addition, "Health and Education Cess" @4% is to be levied on aggregate of base tax and surcharge.</p> <p><b>Challenges faced by Mutual Funds</b></p> <p>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.</p> <p>NRI investors may choose to redeem his/her units through multiple transactions at different times throughout the year.</p> <p>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.</p> <p>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.</p> <p>A mutual fund would be regarded as an 'assessee in default' for any shortfall in TDS.</p> <p>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.</p>	<p>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.</p>	<p>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.</p> <p>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' &amp; 'Income from Other sources' (for dividend) in the income tax return.</p> <p>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.</p> <p>At the same time, it would also mitigate the hardship currently being faced by the mutual funds and the NRIs</p>





<p>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.</p> <p>From a tax-payer’s perspective, the plethora of tax rates, compounded with varied surcharge and cess rates leads to significant amount of confusion.</p> <p>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.</p> <p>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.</p>		
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2. Rate of TDS in Section 196A		
Background	Proposal	Justification
Section 196A specifies a TDS rate of 20%. This causes hardship, NRI investors who are otherwise eligible for a lower tax rate under DTAA. As a result, they suffer a TDS higher than the applicable tax rate.	It is suggested that the Section 196A be modified to include words “ <i>or at the rates in force</i> ” to help Mutual Funds to deduct TDS at 20% or lower in case of lower tax rate as per DTAA.	This will mitigate the hardship faced by NRI who would otherwise be required to claim a tax refund.

3. 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 could act 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.



<b>4. Request to permit Indexation benefits to Non-Resident Investors for investment in Debt Mutual Funds</b>		
<b>Background</b>	<b>Proposal</b>	<b>Justification</b>
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% <i>without indexation</i> 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 by way of a suitable amendment in law.	To bring parity in tax treatment by extending indexation benefits to all the categories of investors and encourage inflows from non-resident investors.



## D. Suggestions to encourage deepening of capital market through Mutual Funds

1. Request to introduce Debt Linked Savings Scheme (DLSS) to help deepen the Indian Bond Market.		
Background	Proposal	Justification
<ul style="list-style-type: none"> <li>Over the past decade, India has emerged as one of the key financial market 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.</li> <li>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.</li> <li>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.</li> <li>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.</li> </ul>	<ul style="list-style-type: none"> <li>It is proposed to introduce “<b>Debt Linked Savings Scheme</b>” (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.</li> <li>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.</li> <li>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).</li> <li>CBDT may issue appropriate guidelines / notification in this regard as done in respect of ELSS.</li> </ul>	<ul style="list-style-type: none"> <li>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.</li> <li>A similar stimulus through introduction of DLSS would help channelize household savings into bond market and help deepen the bond market.</li> <li>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.</li> <li>This will also bring debt oriented mutual funds on par with tax saving bank fixed deposits, where deduction is available under Section 80C.</li> <li>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.</li> <li>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.</li> <li>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.</li> <li>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.</li> </ul>



## 2. All Mutual Funds should be allowed to launch pension-oriented MF schemes (MFLRS) with Uniform Tax Treatment as NPS

Background	Proposal	Justification
<p>Presently, there are three broad investment avenues for post-retirement pension income in India, namely:</p> <ol style="list-style-type: none"> <li>(i) National Pension System (NPS).</li> <li>(ii) Retirement /Pension schemes offered by Mutual Funds.</li> <li>(iii) Insurance-linked Pension Plans offered by Insurance companies.</li> </ol> <p>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.</p> <p>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.</p> <p>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).</p> <p>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.</p>	<ol style="list-style-type: none"> <li>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) &amp; 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.</li> <li>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.</li> <li>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.</li> <li>iv. Contributions made by employer should be allowed as an eligible ‘Business Expense’ under Section 36(1) (iv a) of Income Tax Act, 1961.</li> <li>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.</li> <li>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.</li> <li>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.</li> </ol>	<ul style="list-style-type: none"> <li>• 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,</li> <li>• It was also emphasized in the aforesaid Long Term Policy that <u>similar products should get similar tax treatment</u>, 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.</li> <li>• 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.</li> <li>• Allowing Mutual Funds to launch MFLRS would bring pension benefits to millions of Indians in unorganized sector.</li> <li>• 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.</li> <li>• 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.</li> <li>• 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).</li> </ul>



### 3. Mutual Fund Units should be notified as ‘Specified Long-Term Assets’ qualifying for exemption on LTCG under Sec. 54 EC

Background	Proposal	Justification
<p>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.</p> <p>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 &amp; REC.</p> <p>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.</p>	<p>It is proposed that, mutual fund units wherein the underlying investments are made into specified <i>infrastructure sub-sector</i> as may be notified by the Government of India, be also included in the list of the specified long-term assets under Sec. 54EC.</p> <p>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.</p> <p>Further, the aforesaid investment can have a lock in period of three years to be eligible for exemption under Sec. 54EC.</p>	<p>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.</p> <p>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.</p> <p>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..</p>



4. Suggestions w.r.t. Exchange Traded Funds (ETFs)		
Background	Proposal	Justification
<p>a. 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.</p>	<p><i>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.</i></p>	<p><i>To bring parity in tax treatment between listed debentures and listed debt ETF units.</i></p> <p><i>Reduction in the minimum period of holding for units of Debt ETFs to 12 months would boost the retail participation in Debt ETFs.</i></p>
<p>b. 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.</p>	<p>It is proposed to lower the minimum holding period for LTCG purposes in case of Gold &amp; 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</p>	<p>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.</p> <p>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.</p> <p>Gold ETFs &amp; 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.</p>





Background	Proposal	Justification
<p><b>c. Equity ETFs</b> 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 :</p> <ul style="list-style-type: none"> <li>• Fresh creation of units with AMC @ 0.005%</li> <li>• Underlying basket @ 0.015% (sell)</li> <li>• Purchasing ETFs on the exchange @ 0.015%</li> </ul>	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
<p><b>d. Debt ETFs (Bonds other than Government Securities):</b> Levy of Stamp Duty w.e.f. July 1, 2020 has resulted in increase in costs for Debt ETFs substantially as follows:</p> <ul style="list-style-type: none"> <li>• Fresh Creation of Units with AMC @ 0.005%, earlier 0%</li> <li>• Underlying Securities @0.0001% (Buy), earlier - 0%</li> <li>• While Purchasing ETFs on the SE @ 0.015%, earlier - 0.0005% (Buy &amp; Sell each)</li> </ul> <p>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.</p>	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.
<p><b>e. Debt ETFs (Government Securities):</b> Levy of Stamp Duty w.e.f. July 1, 2020 has resulted in increase in costs for G-Sec ETFs substantially as follows:</p> <ul style="list-style-type: none"> <li>• Fresh Creation of Units with AMC - 0.005%, earlier 0%</li> <li>• Underlying Securities - 0%, earlier - 0%:</li> <li>• While Purchasing ETFs on the SE - 0.015%, earlier - 0.0005% (Buy &amp; Sell each)</li> </ul> <p>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.</p>	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.
<p><b>f. STT implications</b> In the case of ETFs, STT applicable on intra-day square off is more than that applicable for delivery based trading</p>	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.





## E. Proposals for Development of Mutual Fund industry

<b>1. Request to permit Insurance Companies to outsource the Fund Management activities to SEBI Registered MF AMCs</b>		
<b>Background</b>	<b>Proposal</b>	<b>Justification</b>
<p>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.</p> <p>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.</p>	<p>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 &amp; IRDA Regulations.</p>	<p>This would result in both MF &amp; 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.</p> <p>Hence the AMCs with Mutual Fund products never really compete or conflict with Insurance products.</p> <p>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.</p> <p>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.</p>



2. CPSE investment of surplus funds in Mutual Funds		
Background / Issue	Proposal	Justification
<p>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, <i>Maharatna, Navratna and Miniratna CPSEs</i> are permitted to invest their surplus funds in mutual funds subject to the following conditions –</p> <p>a) <i>They may invest only in debt-based schemes of public sector mutual funds.</i></p> <p>b) <i>Investment in mutual funds shall not exceed 30% of the available surplus funds of the concerned CPSE.</i></p> <p>c) <i>The mutual fund debt scheme should have –</i>  - <i>corpus amounting to at least ₹1000 Crore for the scheme at the time of investment, as per the latest published information; and</i>  - <i>been accorded highest mutual fund rating by any two of the Credit Rating Agencies registered with SEBI.</i></p> <p>d) <i>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.</i></p> <p>e) <i>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.</i></p> <p><i>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.</i></p> <p>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.</p>	<p>It is requested to –</p> <ol style="list-style-type: none"> <li>1. Revise the current DPE guidelines, and permit the Maharatna, Navratna and Miniratna CPSEs to invest their surplus fund in <u>any</u> SEBI registered Mutual Fund, irrespective of whether it is a public sector mutual fund or a private sector mutual fund;</li> <li>2. Enhance the current limit of 30% of available surplus funds for investments in mutual funds by CPSEs to 50% of available surplus funds;</li> <li>3. Not to stipulate any minimum corpus size in respect of the debt scheme as a pre-condition for investments by CPSEs;</li> <li>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.</li> <li>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.</li> </ol>	<p>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.</p> <p><b><i>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.</i></b></p> <p>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:</p> <ul style="list-style-type: none"> <li>• Currently, out of 44 active Mutual Funds registered with SEBI (including 2 Infrastructure Debt Funds), only 7 are PSU Mutual Funds.</li> <li>• 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).</li> </ul> <p>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%).</p> <p><b><i>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.</i></b></p>



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 to 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 any SEBI registered Mutual Funds, irrespective of whether it is a public sector mutual fund or private sector mutual fund.**



## F. Request for Clarifications from CBDT

1. Applicability of TCS on sale of “Goods” [section 206C(1H)] and purchase of goods vide provisions of section 194Q – Unintended impact on mutual funds		
Background	Proposal	Justification
<p>As per section 194Q &amp; section 206C(1H) of the Act buyer and seller of goods are required to deduct/collect a sum equal to 0.1 per cent of the consideration as TDS and TCS.</p> <p>As per the memorandum to the Finance Bill, 2020, the intent of introducing TCS was to widen and deepen the tax net to levy TCS (collection of tax at source) on sale of goods above a specified limit. The Income-tax Act does not define the term goods but the intent of introducing this provision does not seem to be to cover mutual fund transactions and also, any transaction of purchase and sale of securities by Mutual Funds, (i.e. 1. units of mutual fund &amp; 2. purchase and sale of securities by a mutual fund)</p> <p>AMFI had made a few representations to CBDT. CBDT had issued a few clarifications stating transactions in securities (which would include mutual fund units) through recognized stock exchanges and payment by an investor to a mutual fund (whose income is exempt) for subscription of units are exempt from the purview of Section 194Q. It further clarified that receipt by an investor from a mutual fund (whose income is exempt) for redemption of units shall be exempt from the provisions of Section 206C(1H).</p> <p>However, it may be possibly interpreted that the provisions of Sec 194Q and 206C(1H) are applicable for the below transactions</p> <ol style="list-style-type: none"> <li>1. transaction in unlisted securities and transaction in securities not cleared and settled on recognized clearing corporation or stock exchange \</li> <li>2. payment by a mutual fund to an investor for redemption of units (under Section 194Q), and receipt by a mutual fund from an investor for subscription of units (under Section 206C(1H)).</li> </ol>	<p>It would be prudent to issue a clarification for non-applicability of section 194Q &amp; 206C(1H) of the Act for the below transactions:</p> <ol style="list-style-type: none"> <li>1. transaction in unlisted securities and transaction in securities not cleared and settled on recognized clearing corporation or stock exchange.</li> <li>2. transaction in subscription and repurchase of mutual fund units by the unit holders</li> </ol>	<ol style="list-style-type: none"> <li>a. Intent to implement these provisions was to cover goods and not securities. The applicability will lead to double taxation in some cases. Non-resident Investor: In case these provisions are made applicable to mutual fund units then on issue of mutual fund units (i.e. purchase by investor from the MF), as per section 206C(1H) - TCS may have to be collected by the seller i.e. mutual fund from non-resident investors. Subsequently, at the time of redemption of such units by the non-resident (i.e. sale by investor to MF), the capital gain is currently subject to TDS u/s 195. Therefore, the non-resident investors are subject to taxation under provisions of both TCS as well as TDS. Resident Investor: In case these provisions are made applicable to mutual fund units then it would also lead to double taxation for resident investors as the investors shall be subject to taxation u/s 206C(1H) for TCS on issue of mutual fund units (i.e. purchase by investor from the MF) and also u/s 194Q for TDS at the time of repurchase of such units (i.e. sale by investor to MF)</li> <li>b. Transactions in mutual fund units with the mutual fund entity is same in nature as transactions that are put through stock exchanges resulting into non-parity</li> <li>c. Income earned by Mutual Funds are exempt under section 10(23D) of the Income Tax Act</li> <li>d. Mutual Funds are highly regulated. Audit trail for mutual fund transactions is very well established and</li> <li>e. The CBDT, on February 24, 2020, had clarified that that under the proposed section, 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. Had the intention been to levy TDS on redemption of mutual fund units, a direct provision to that extent would be explicitly included rather than levy of TDS under section 194Q. Levy of TDS/ TCS shall cause undue and unintended burden and hardship on the investors/unitholders in Mutual Funds.</li> </ol>



## 2. Request for Clarity on TDS on payment to Non-Resident Investors under Sec. 196A

Background	Proposal	Justification
<p>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.</p> <p>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.</p> <p>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.</p> <p>Prior to Finance Act, 2020, non-resident investors (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.</p> <p>However, 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).</p>	<p>It is requested to clarify that provisions of section 196A are applicable to dividend/income distributions only adding a proviso as follows –</p> <p>“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.</p> <p>Provided that the provisions of this section shall not apply if the income is of the nature of capital gains.</p> <p>This amendment should be effective from 1 April 2020.</p>	<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>



### 3. Compliance under Sec.195(6) of the Income Tax Act, 1961 and Rule 37BB of the Income Tax Rules, 1962

Background	Proposal	Justification
<p>As per Section 195(6), a person responsible for paying any sum to a non-resident individual is required to furnish information in Form 15 CA and 15CB (prescribed under Rule 37BB).</p> <ul style="list-style-type: none"> <li>As per section 195(6) of the Income Tax Act, 1961 (“the Act”) :  <i>“The person responsible for paying to a non-resident, not being a company, or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall furnish the information relating to payment of such sum, in such form and manner, as may be prescribed”</i></li> <li>As per Sec. 271-I of the Act which has come into effect from 01-06-2015,  <i>“If a person, who is required to furnish information under sub-section (6) of section 195, fails to furnish such information; or furnishes inaccurate information, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of one lakh rupees.”</i></li> </ul> <p>(Prior to the amendment by the Finance Act, 2015 section 195(1) of the Act required an Indian payer making payment to non-resident or foreign company to furnish the prescribed details in Form Nos. 15CA and 15CB <u>only in respect of sum chargeable to tax</u> under the provisions of the Act. Finance Act, 2015 has amended the provision of section 195(6) of the Act w.e.f. June 1, 2015).</p> <p>Rule 37BB of the Income Tax Rules, 1962 (“the Rules”) provides that any person responsible for paying to non-resident, not being a company, or to a foreign company, any sum chargeable to tax under the provisions of the Act shall furnish information in Form Nos. 15CA and 15CB. Further, <u>Form Nos. 15CA and 15CB also indicate the information required to be furnished only in respect to payments which are chargeable to tax.</u></p> <p>Implications for the Mutual Fund Industry:</p> <ol style="list-style-type: none"> <li>The amended provisions are applicable to all payments made to NRIs, <b>whether taxable or not;</b></li> <li>Mode of reporting is filing of Forms 15CA and Form 15CB certified by a CA ;</li> <li>Frequency of reporting is prior to or immediately upon payment or accrual in the books of the mutual fund; and</li> <li>Failure to furnish such information or furnishing inaccurate information attracts penalty one lakh rupees.</li> </ol>	<p>It is proposed that:</p> <p>Payments made by mutual funds which are not chargeable to tax under the provisions of Income Tax Act be included in the Specified List under Rule 37BB (3) (ii); and Mutual Funds/AMCs be permitted to submit the requisite information under section 195(6) of the Income Tax Act, 1961 in respect of payments made to non-resident investors which is chargeable under the provisions of the Income Tax Act <u>on an annual basis</u> under the Statement of Financial Transactions.</p>	<p>Submission of the prescribed Form Nos. 15CA and 15CB on a daily basis is operationally impractical.</p> <p>There is no foreign remittance involved in respect of dividend/ redemption payments, as the same is credited to their NRE or NRO bank accounts in India and not remitted overseas. Thus, the banks would be eventually filing the Form 15 CA/ 15 CB, in case the amounts credited to NRE bank accounts is repatriated overseas.</p> <p>The Statement of Financial Transactions of Mutual Funds/AMCs submitted to the Income Tax Department contains the details of all mutual fund transactions of ₹10 lakh and above, in respect of all customers, including NRI clients.</p>





Redemption and dividend payments to NRI investors in respect of Mutual Fund units are credited to their NRE or NRO bank accounts in India and not remitted overseas.

**In other words, there is no foreign remittance involved in respect of redemption or dividend payment made to NRI investors by Mutual Funds/AMCs.**

Unlike the interest on bank deposits, which is typically booked once a calendar quarter, mutual fund transactions take place every working day. Further, investors are also given an option to reinvest the dividend amount in the scheme and the dividend amount in such cases is reinvested at source in the same scheme, and not remitted to the NRI investors' bank accounts.

Since *reporting* Form 15CA and Form 15CB (certified by a CA) has to be done *prior to or immediately upon payment or accrual in the books of the mutual fund, the Mutual Funds are required to submit the Form 15CA and Form 15CB (certified by a CA) practically on every working day, which is operationally difficult / impractical,* and that too on such a massive scale.





<b>4. Amendment in definition of equity oriented fund in case of fund of fund scheme – Section 112A of the Income Tax Act</b>		
<b>Background/Issue</b>	<b>Proposal</b>	<b>Justification/Rationale</b>
<p>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</p>	<p>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.</p>	<p>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:</p> <p style="text-align: center;"><i>“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.”</i></p> <p>Thus, the SEBI regulations allow FoFs to invest in more than one fund.</p> <p>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.</p> <p>3) Thus, it could be clarified that “fund of fund” could invest in more than one equity oriented fund schemes.</p>



**5. Need to further simplify Taxation provisions of offshore funds managed by Indian portfolio managers**

Background / Issue	Proposal	Justification
<p>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, <i>subject to fulfilment of the prescribed conditions.</i></p> <p>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.</p>	<p>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.</p> <p>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.</p>	<p>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.</p>

**4 (a) Participation of residents in the Fund – Sec. 9A(3)(c)**

Background / Issue	Proposal	Justification
<p>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.</p>	<p>Section 9A(3)(c) should be amended as under:  <b><i>“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”</i></b></p> <p>Alternatively, section 9A(3)(c) should be amended as under:  <b><i>“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”.</i></b></p>	<ul style="list-style-type: none"> <li>• Practical challenges for retail funds to monitor indirect participation of persons resident in India, especially on continuous basis.</li> <li>• 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.</li> </ul>



4 (b) Minimum corpus of the fund – Sec. 9A(3)(j)		
<p>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.</p> <p>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.</p>	<p>Section 9A(3)(j) should be amended as under:</p> <p>(j) The monthly average of the corpus of the fund shall not be less than one hundred crore rupees:</p> <p>Provided that if the fund has <b><u>started operations</u></b> 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 <b><u>started the operations</u></b>.</p>	<p>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 “<b><u>operation of the fund</u></b>” while having a carve out for contribution by the eligible fund manager.</p>
4 (c) Investment diversification condition – Sec. 9A(3)(e), 9A(3)(f) and 9A(3)(g)		
<p>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.</p> <p>Category II FPI not only includes family offices, individuals, corporate bodies, but also include appropriately regulated funds not eligible as Category I FPI. Exemption from diversification conditions has been restricted only to Category I FPIs.</p> <p>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.</p>	<p>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)</p>	<ul style="list-style-type: none"> <li>• The change will seriously impact regulated broad-based funds domiciled in non-FATF member countries</li> <li>• 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.</li> <li>• 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.</li> </ul>
4 (d) Connected person condition – Sec. 9A(4)(a)		
<p>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.</p>	<p>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</p>	<p>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.</p>



<b>4 (e) Profits entitled to fund manager - 9A(4)(d)</b>		
<p>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.</p>	<p>It is recommended to delete Section 9A(4)(d)</p>	<p>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.</p> <p>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.</p>
<b>4(f) Definition of “Corpus” – 9A(9)(c )</b>		
<p>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 of 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.</p>	<p>It is recommended that the term "corpus" should be defined as <i>“The total net asset value of the eligible investment fund as on a particular date”</i></p>	<p>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.</p>



6. Need to provide tax parity for consolidation of Options of Schemes similar consolidation of Scheme and Plan		
Background / Issue	Proposal	Justification
<p>Mutual Funds offer various category of Schemes. Each Scheme offers ‘Direct’ and ‘Regular’ Plans to the investors to invest directly (by themselves) or through a distributor.</p> <p>Further, each such Plan has “Options” such as Growth Option &amp; 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).</p> <p>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.</p> <p>However, Consolidation of Option are not covered thus leaving ambiguity in taxation in case where Option were to be consolidated.</p>	<p>It is proposed to provide similar clarity for Consolidation of <i>Options</i> within a Mutual Fund Scheme as well.</p>	<p>This would bring parity in cases where a mutual fund intends to consolidate the ‘<i>Options</i>’ within a Mutual Fund Scheme, and reduce the tax burden on unitholders.</p>

7. Facility to allow payment by way of ‘Debit Card powered by RuPay’ should not be mandatory for mutual fund investments		
<p>In terms of Section 269SU of the Act read with Rule 119AA of the Income Tax Rules, 961 (‘Rules’) with effect from January 1, 2020 every person with a business where the total sales, turnover or gross receipts from business exceeds Rs. 50 Crores during the immediately preceding previous year has to provide digital modes for acceptance of payment.</p> <p>Rule 119AA of Income Tax Rules prescribes the following digital modes:</p> <ol style="list-style-type: none"> <li>1. Debit Card powered by RuPay</li> <li>2. Unified Payments Interface (UPI) (BHIM-UPI)</li> <li>3. Unified Payments Interface Quick Response Code (UPI QR Code) (BHIM-UPI QR Code).</li> </ol> <p>As per section 271DB, failure to provide such facility, shall make the taxpayer liable to pay a penalty of ₹ 5000, for every day during which such failure continues. It is, however, provided that no such penalty shall be imposable if it is proved that there were good and sufficient reasons for such failure.</p>	<p>It is requested that providing a facility to make payment by way of ‘Debit Card powered by RuPay’ should not be mandatory for a mutual fund and accordingly, penalty under section 271DB should not be applicable in the case of mutual funds.</p>	<p>Mutual Funds do not accept third party payments to prevent money laundering. Where payment is accepted from investors through Debit card, the source of funds cannot be identified. This results in a breach of the PMLA norms. It may also lead to tax evasion.</p> <p>Hence, acceptance of payment through "<i>Debit Card powered by RuPay</i>" should not be made mandatory for mutual fund investments</p> <p>This should be suitably clarified by CBDT by way of an amendment in the Income Tax Rules / circular.</p>