



**Association of Mutual Funds in India**

**PROPOSALS FOR  
UNION BUDGET - FY 2024-25**



# Contents

<b>DIRECT TAX PROPOSALS</b> .....	<b>3</b>
1. Request for Tax Concessions in Debt Mutual Funds.....	4
2. Request to amend the definition of Equity Oriented Funds to include Fund of Funds investing in Equity Oriented Funds.....	5
3. All Mutual Funds should be allowed to launch pension-oriented MF schemes (MFLRS) with Uniform Tax Treatment as NPS.....	8
4. Mutual Fund Units should be notified as ‘Specified Long-Term Assets’ qualifying for exemption on LTCG under Sec. 54 EC.....	10
5. Request for Parity in Taxation on gold and Gold ETF Mutual Funds.....	10
6. Need to further simplify Taxation provisions of offshore funds managed by Indian Portfolio Managers .....	11
7. Request for extending the exemption provided for mutual funds under section 10(23D) to CDMDF.....	14
8. Request to prescribe a uniform rate for deduction of Surcharge on TDS in respect of NRIs .....	17
9. Increase in threshold limit of withholding tax (TDS) on Income distribution by Mutual Fund scheme .....	19
10. Taxability of long-term capital gains under section 112A of the Act.....	19
11. Request for amendment to ELSS Rule 3A to permit <i>any</i> amount to be invested in the scheme, instead of in multiples of ₹500.....	20
12. Request to introduce Debt Linked Savings Scheme (DLSS) to help deepen the Indian Bond Market. ....	21
13. Request for relaxation to the mutual funds in case of deduction of TDS for inoperative PAN cases.....	22
<b>INDIRECT TAX PROPOSALS</b> .....	<b>23</b>
1. GST Compliances on Securities Lending & Borrowing .....	24
2. Reversal of Input Credit under section 17(2) towards Capital Gain on MF Units .....	25
3. Sale of mutual fund units should not be regarded as Exempt service liable for reversal under Rule 42 of CGST Rules .....	26



# DIRECT TAX PROPOSALS



## 1. Request for Tax Concessions in Debt Mutual Funds

Background	Proposal	Justification
<p>The Finance Act, 2023 introduced a new section 50AA, which states that the gains on “Specified Mutual Fund” shall be deemed as short-term capital gains, irrespective of period of holding and the same will be taxable at the applicable rates.</p> <p>Specified Mutual Fund” has been defined as “Mutual fund by whatever name called where not more than 35% of its total proceeds is invested in the equity shares of domestic companies”. Consequently, a debt oriented mutual fund scheme which has debentures, SDL, and government securities as major portion of its portfolio holdings, shall be classified as Specified Mutual Fund.</p> <p>Before introduction of section 50AA , such mutual fund schemes enjoyed the twin benefit of indexation and lower long-term capital gains tax rate, if held for more than 3 years- However, post amendment in Finance Act, 2023, Debt mutual fund is considered as short-term capital asset irrespective of holding period and will be taxed at applicable rates, whereas if a debenture is held for more than 3 years (12 months in the case of listed debentures), then long-term capital gains of 10% without indexation is applicable.</p>	<p>It is requested that Capital gains on redemption of Units of Debt oriented mutual funds held for more than 3 years should be taxed at the rate of 10% without indexation, as applicable in respect of debentures.</p>	<p>India’s equity market is well developed, liquid and robust. The resilience of the Indian market during the tumultuous past three years has surprised many experts worldwide. The consistent mutual funds flows into the markets played vital role in the development and resilience of the equity market.</p> <p>While the debt market continues to be underdeveloped, India’s aspirations of becoming the third largest economy of the world by 2027 and a developed country by 2047 need to be backed by a liquid, deep and well-functioning debt market. Private sector investments cannot be leveraged without such a debt market.</p> <p>An active bond market could fulfil multiple purposes. Besides providing the borrowers with an alternative to bank credit, corporate bonds could lower the cost of long term finance. We need active participation by the retail investors in these markets which will not only help them in diversifying their investments but als help them in garnering inflation adjusted returns.</p> <p>It is against this backdrop, to encourage the retail investor participation in bond markets we request for an amendment to Finance Act, 2023 and consider the mutual fund units as “securities”, with long-term capital tax rate thereon should be according to / in line with the capital gains tax on bonds, debentures, SDL and G-secs etc.</p> <p>It is therefore logical and hence requested that capital gains on Units of Debt mutual funds held for more than 3 years should be taxed at the rate of 10% without indexation, as applicable in respect of LTCG from debentures.</p>



**2. Request to amend the definition of Equity Oriented Funds to include Fund of Funds investing in Equity Oriented Funds**

Background / Issue	Proposal	Justification
<p>(a) A Fund of Funds (FOF) scheme of a Mutual Fund scheme which invests in the units of other mutual fund schemes.</p> <p>Under current Income Tax regime, a FOF scheme is treated as an Equity Oriented Fund (EOF) only if (i) a minimum of 90% of the total proceeds of such fund is invested in the units of EOFs; and (ii) such EOFs also invest a minimum of <b>90%</b> of their total proceeds in the equity shares of domestic companies listed on a recognised stock exchange.</p> <p>While FOFs that invest predominantly in units of EOF meet the first criteria above, they may fall short on the second criteria as the underlying EOFs <u>by mandate have the flexibility to invest between 65% to 100%</u> in listed stocks of domestic companies. Thus, while technically EOFs do not need to invest a minimum of 90% of total proceeds in listed stocks, in practice, most of the EOFs do invest at least 90% in listed stocks.</p> <p>Consequently, despite FOFs investing in equity securities of domestic companies via EOFs, short term and <u>long-term gains from these funds get taxed as non-equity oriented mutual fund schemes.</u></p>	<p>a) It is requested that the definition of “Equity Oriented Funds” be revised to include investment in Fund of Funds schemes which invests a minimum of 90% of the corpus in units of Equity Oriented Mutual Fund Schemes, <b>which in turn invest minimum 65% in equity shares of domestic companies listed on a recognised stock exchange.</b></p> <p>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.</p>	<p>As emphasized in SEBI’s “Long Term Policy for Mutual Funds” published in 2014, similar instruments / financial products should get similar tax treatment.</p> <p>Hence, 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.</p> <p>Thus, there is a strong case for parity in taxation between investments in direct equity, Equity Oriented Funds, and Fund of Funds investing in Equity Oriented Mutual Fund Schemes.</p>
<p>(b) The Finance Act, 2023 introduced a new section 50AA, which states that the gains on “Specified Mutual Fund” shall be deemed as short-term capital gains, irrespective of period of holding and the same will be taxable at the applicable rates.</p> <p>While the above amendment was intended to remove tax arbitrage between Fixed Deposits and close-ended Debt Mutual Fund schemes (e.g., Fixed Maturity debt schemes ), it has resulted in investments in FOFs which invest more than 35% of their assets in domestic equities through other schemes including Exchange traded funds (ETFs), being taxed on capital gains earned as Short term capital gains under Section 50 AA, even though investments in these schemes would have been otherwise eligible for taxation as long term capital gains on a look-through basis.</p>	<p>b) It is also requested that CBDT may issue an appropriate notification, clarifying that where a mutual fund scheme (including Fund of Fund scheme) that invests more than 35% of the scheme’s AUM directly or indirectly (through investments in equity oriented/other mutual fund schemes (including ETFs)), in equity shares of domestic companies, such mutual fund schemes shall not be covered under section 50AA. In this regard, it is requested to amend the definition of Specified Mutual Fund in the Explanation (ii) of section 50AA of the Act as follows–</p>	<p>Since, the FoF schemes invests more than 35% of their total corpus directly or indirectly (through investments in equity oriented mutual fund schemes, including Equity ETFs), the proposed amendment will bring required parity in the taxation of the above schemes with that of a fund investing more than 35% of the total corpus in shares of domestic companies directly.</p>



This has adversely impacted the MF investors who invest in Equity Oriented ETFs through Equity FOF specifically created for those who do not have demat & trading account). This may discourage investors from investing in Equity Oriented FOFs.

Before the introduction of section 50AA, Capital gains on sale of Units of Equity Oriented Mutual Funds were governed by explanation to section 112A. Both section 112A and section 50AA of the Act cover capital gains arising from the transfer of units of Equity FOF. Further, both the sections are mutually exclusive and do not override each other.

As per section 112A (1) of the Income-tax Act, 1961, capital gains arising from transfer of long-term capital asset, being units of an equity-oriented fund, is taxable at the rate of 10% (exceeding ₹100,000), provided that STT is paid on transfer of such unit. Further, as per explanation to section 112A(1) of the Act, an equity oriented Fund is defined to mean “a fund set up under a scheme of a mutual fund specified under Section 10(23D) of the Act and —

(i) in the case where the fund invests in the units of *another fund* which is traded on a recognised stock exchange,

(A) a minimum of 90% of the total proceeds of such fund is invested in the units of such other fund; and

(B) such other fund also invests a minimum of 90% of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange”.

Section 50AA only mentions the “Equity Shares of Domestic Companies” and is silent on Equity FOF investing more than 90% in units of Equity Oriented Exchange Traded Funds (Equity ETF), which in turn invests more than 90% in Equity Shares of Domestic Companies. Due to this drafting omission, Equity Oriented FOF have remained outside the ambit of Section 112A, which does not seem to be the intent of the law. There is no such issue with taxation of Equity ETF investing more than 65% in Equity Shares of Domestic Companies as the same has been specifically excluded from the definition of “Specified Mutual Fund” given under section 50AA.

*"Specified Mutual Fund" means a Mutual Fund by whatever name called and having a specified maturity date, where not more than thirty-five (35) per cent of its total proceeds is invested directly or indirectly in the equity shares of domestic companies.*

*Provided that the percentage of equity shareholding held in respect of the Specified Mutual Fund shall be computed with reference to the annual average of the daily closing figures.*



<p>(c) The Finance Act, 2023 introduced a new section 50AA, which states that the gains on “Specified Mutual Fund” shall be deemed as short-term capital gains, irrespective of period of holding and the same will be taxable at the applicable rates.</p> <p>As per section 50AA, Specified Mutual Fund means <i>a Mutual Fund by whatever name called and having a specified maturity date, where not more than thirty-five (35) per cent of its total proceeds is invested directly in the equity shares of domestic companies.</i></p> <p><i>Provided that the percentage of equity shareholding held in respect of the Specified Mutual Fund shall be computed with reference to the annual average of the daily closing figures.</i></p> <p>However, in case of mutual fund scheme investing in overseas mutual fund / ETFs would be considered as Specified Mutual Fund for the purpose of section 50AA and the gains will be deemed considered as short-term capital gains.</p>	<p>c) A carve out should be provided under the definition of Specified Mutual Fund under section 50AA of the Act to exclude mutual fund schemes investing in overseas mutual fund / ETFs from its ambit.</p>	<p>Currently, gains from investing in overseas mutual funds or ETFs through equity Fund of Funds (FoF) are considered short-term capital gains, making these investments less attractive.</p> <p>However, since the investments by overseas equity oriented mutual fund / ETFs are primarily being made in the equity shares of a company, a clarification that such mutual fund schemes will not be considered as Specified Mutual Fund would bring much relief.</p> <p>This clarification would ensure parity, given that the mutual funds are investing more than 35% of their total proceeds in overseas mutual funds/ ETFs which, in turn, invest in equity shares.</p>
<p>(d) Regulation 2(ma) of SEBI (Mutual Funds) Regulations, 1996 defines “fund of fund scheme” as follows:</p> <p><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 multiple mutual fund schemes.</p> <p>However, the definition of equity-oriented fund in case of Fund of Fund scheme under Section 112A of the Income Tax Act refers to “<i>another fund</i>” instead of “<i>other funds</i>” and hence is not clear as to investments in multiple mutual fund schemes.</p>	<p>d) It is requested that the words “another fund” provided in the Explanation (a) to section 112A of the Income Tax Act should be replaced with the words “<b>other funds</b>” retrospectively, effective from the date of insertion of the Explanation.</p>	<p>It is expedient for CBDT to clarify that an equity oriented “Fund of Funds” may invest in more than one equity oriented fund schemes (rather than “another fund”) to avoid any ambiguity.</p>



### 3. 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> <ul 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> </ul> <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 <b>which have been specifically notified by</b> 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>	<ul 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> </ul>	<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> </ul>





<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>	<p>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.</p>	<ul style="list-style-type: none"><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>
---	--	--



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

Background	Proposal	Justification
<ul style="list-style-type: none"> <li>In 1996, Govt. had introduced Sections 54 EA and 54 EB in the Income Tax Act, 1961 to channelise investment into priority sectors of the economy and to give impetus to the capital markets, by allowing capital gains tax exemption for investments in <u>specified assets, including mutual fund units</u>. In 2001, Sections 54EA &amp; 54EB were withdrawn and subsequently Section 54EC was introduced.</li> <li>Under Sec. 54EC, Long Term Capital Gains tax exemption is available only for investments in specified long-term assets, i.e., bonds issued by National Highway Authority of India and Rural Electrification Corporation that are redeemable after three years.</li> </ul>	<ul style="list-style-type: none"> <li>It is therefore proposed that mutual fund units, wherein the underlying investments are made in specified infrastructure sub-sector (as may be specified by the Government of India), be included in the list of the specified long-term assets qualifying for tax exemption on Long-Term Capital Gains under Sec. 54EC.</li> <li>The underlying investments of the mutual funds could be made into ‘infrastructure assets’ as defined by RBI, in line with ‘Master List of Infrastructure sub-sectors’ notified by the Government of India.</li> <li>The mutual fund units in the specified schemes can have a 3-year lock in period to be eligible for exemption under Sec. 54EC.</li> </ul>	<ul style="list-style-type: none"> <li>The Government’s plans to significantly increase investment in the infrastructure space will require massive funding. However, the bonds issued by REC or NHAI may be inadequate for this and/or may not be preferred by taxpayers as they provide low returns, and the banking sector may not be equipped to fund such mega infrastructure projects.</li> <li>Investment in specified mutual fund schemes with Sec. 54EC benefit can provide an alternative investment avenue in addition to existing options to the investors and also provide investors an option to earn market related returns. This could also help ease the burden cost of borrowing for infrastructure funding on the Government.</li> <li>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 increase investment in the infrastructure space supplementing the Government’s efforts in boosting the nation’s infrastructure.</li> </ul>

#### 5. Request for Parity in Taxation on gold and Gold ETF Mutual Funds

Background / Issue	Proposal	Justification
<p>Currently, Commodity ETFs &amp; Fund of Funds such as Gold/Silver ETFs and Gold Fund of Funds that invest 90% or more in units of Gold ETFs are currently are classified under non-equity instruments. Hence, they are automatically classified under / taxed as per Debt category. Consequently, the capital gains from Gold ETFs not being taxed in line with physical Gold, although the underlying investments of Gold ETFs is in physical gold.</p>	<p>It is proposed that Mutual Funds schemes and ETFs that have underlying investments in a commodity such as gold or silver, and Gold Fund of Funds that invests 90% or more in units of Gold ETFs should be taxed in accordance with capital gains taxation on the underlying commodity and not as debt / ‘non-equity’ instruments.</p>	<p>The current tax regime makes the ETFs/ mutual fund schemes that have underlying investments in a commodity such as gold and silver unattractive to investors.</p> <p>In fact, taxation for Commodity Funds / ETFs should be made more attractive to reduce dependence on imports of physical.</p>



**6. 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 for global / offshore funds. 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.</p> <p>However, some of the conditions were quite onerous in nature, 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 the safe harbour benefit.</p>	<p>Tax law should expressly provide that a fund manager in IFSC managing an offshore fund will not constitute a business connection of the offshore fund nor will the offshore fund be treated to be a tax resident of India on account of the fund manager being in IFSC.</p>	<p>The safe harbour provisions have several conditions that the offshore fund and the fund manager are required to satisfy. There are conditions on investment and investor diversification, condition that bars investment in associate entities as well as conditions that bars the fund from carrying out any other business in India. Ideally, such conditions should be, if required, imposed by the regulation rather than the tax law. Due to the onerous nature of the provisions, there have been only a handful of fund managers who have qualified for the exemption.</p> <p>Further, the objective of IFSC is to relocate offshore fund and/or their fund managers to IFSC. However, in the absence of a simple safe harbour regime, even willing fund managers may find it difficult to relocate to India. Tax laws in popular fund management jurisdictions like Singapore do not contain such onerous provisions.</p> <p>Thus, Fund managers managing an offshore fund from Singapore that invests into India are also not required to satisfy these conditions. However, if they choose to relocate the fund management to IFSC, they need to satisfy these conditions. To attract these fund managers, the tax law should treat them at par.</p>
<p><b>Alternatively, some of the conditions under section 9A can be relaxed / amended for offshore funds being managed by fund managers based out of IFSC.</b></p>		
<p><b>(a) Request for removing the sunset clause for exemption of certain condition to eligible fund managers– Sec. 9A(8A)</b></p>		
<p>In Finance Act, 2021, in order to encourage Fund management activities for Fund managers based out of IFSC and provide a “make in India” equivalent regime for the Asset Management industry, section 9A(8A) was introduced which granted powers to the Central Government to modify / rationalise the conditions laid down under the safe harbour provisions applicable to the eligible investment fund and its fund manager, where such fund manager is located in the IFSC and commences its operations on or before 31 March 2024.</p>	<p>It is recommended that the relaxation of certain specified conditions as per CBDT notification no 59/ 2022 dated 06 June 2022 read with section 9A(8A) is perpetually granted without any sunset clause.</p>	<p>To encourage fund management of offshore funds based in the IFSC, offering relaxations on some of the onerous conditions would attract many offshore funds and fund managers to relocate in IFSC and would assist in the growth of the asset management industry in IFSC.</p>



<p>Central Board of Direct Taxes (CBDT) vide notification no 59/2022 dated 06 June 2022 provided certain relaxations to Fund Managers based out of IFSC as per the powers conferred by Section 9A(8A) of the Act.</p>		
<p><b>(b) Participation of eligible fund managers in the Fund – Sec. 9A(3)(c)</b></p>		
<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.</p> <p>Further, the proviso to the section states that aggregate participation or investment by the eligible Fund manager in the Fund during the first three years of operation, not exceeding twenty-five crores’ rupees, shall not be taken into account.</p>	<p>We recommend amending the proviso of section 9A(3)(c) to allow aggregate participation or investment by the eligible Fund manager in the Fund to up to one hundred crore rupees.</p>	<p>The seed capital is one of the important sources of finance for the Fund in the early stages of the Fund. Further, allowing higher amount of exemption for seed capital eases the fund to smoothly meet setup cost and operational expenses. Also, a high seed capital instils confidence in the prospective investors for making investments in the Fund.</p>
<p><b>(c) Ultimate beneficiary confirmation – Section 9A(3)(c) read with Rule 10V</b></p>		
<p>As per section 9A(3)(c), the aggregate participation or investments in the Fund, directly or indirectly, by a person resident in India does not exceed five percent.</p> <p>While the Fund is able to validate the participation of direct investors (being natural persons in the Fund), in the context of the global fund industry, a significant set of investors in such Funds includes institutional investors or reputed discretionary wealth managers who allocate a portion of the wealth managed by them on behalf of their clients to specified asset managers. In such cases, the eligible investment managers have no access to the investors in those funds or the clients of the wealth managers.</p> <p>In order to alleviate the above challenge, Rule 10(V)(2) of the Rules was introduced which states that where the direct investor is the Government or the Central bank or a sovereign fund or a multilateral agency or appropriately regulated investor in the form of pension fund or University fund or a bank or collective investment vehicles such as mutual funds, the fund shall obtain a</p>	<p>We recommend amending the first proviso to the section 9(A)(3) of the Act as below:</p> <p>“....</p> <p><i>(c) the aggregate participation or investment in the fund, directly or indirectly, by persons resident in India does not exceed five per cent of the corpus of the fund.</i></p> <p><i>(m) ...</i></p> <p><i>Provided that the conditions specified in clauses (c), (e), (f) and (g) shall not apply in case of an investment fund set up by the Government or the Central Bank of a foreign State or a sovereign fund, or such other fund as the</i></p>	<p>There are Practical challenges for retail funds to monitor indirect participation of persons resident in India, especially on a continuous basis.</p> <p>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.</p> <p>We also wish to mention that section 9A is not an incentive regime, it just confers a protection to offshore funds from adverse Indian tax related consequences. Further, the Fund still needs to pay taxes on their incomes earned from Indian capital markets.</p> <p>Only the presence of clause (c) in the section 9A does not prevent the participation of resident investors in the FPI. It is currently preventing the Indian portfolio managers to manage the offshore funds as the offshore funds can continue to invest in India by locating the manager outside India.</p>



<p>declaration in writing from the direct investor regarding the participation, if any, of a person resident in India and the indirect participation in the fund of any person resident in India may be determined by the fund on the basis of such declaration.</p> <p>Additionally, where the investor is an unregulated fund, the Fund is required to undertake ‘appropriate due diligence’ to ascertain the indirect Indian participation and the extent thereof.</p> <p>However, obtaining declarations from the funds to verify participation by Indian investors is practically not possible as the funds can be open ended, broad based or can be listed on stock exchanges. Thus, to monitor Indian participation becomes extremely challenging.</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><i>Central Government may subject to conditions, if any, by notification* in the Official Gazette, specify in this behalf.”</i></p> <p>*CBDT is requested to issue a notification (similar to Notification no. 41/ 2020) as under:</p> <p><b>In exercise of the powers conferred by the proviso to sub-section (3) of section 9A of the Income-tax Act, 1961(43 of 1961), the Central Government hereby notifies that the conditions specified in clause (c) of the said sub-section shall not apply in case of an investment fund set up by a Category-I foreign portfolio investor registered under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992)</b></p>	<p>By the proposed changes, it will allow the Indian portfolio managers to manage the offshore funds and will create an ecosystem for fund management, employment, talent, investment flows and nurturing of global best practices in the market. It would also help create employment opportunities in the fund management industry and encourage talent to remain in the country and contribute to the economic growth.</p>
<p><b>(d) Clarification on person acting on its behalf whose activities constitutes business connection in India – Section 9A(3)(1)</b></p>		
<p>For an offshore Fund to carry out its investment activities in India, the Fund is required to obtain services of various third-party service providers.</p> <p>As per SEBI regulations, the offshore fund is required to appoint a custodian or a broker to make portfolio investments in India.</p> <p>Further, the Fund may require to outsource a part of its back office / support functions of the fund managers (such as fund administration, fund accounting, etc) to an outsourcing entity in India (which is a group entity of the Fund manager).</p>	<p>We recommend providing a clarification that the outsourcing of back office / support activities or appointment of custodian or broker would not constitute business connection by a person acting on behalf of the Fund as per section 9A(3)(1).</p>	<p>Back office and support services, such as fund administration and fund accounting, along with the appointment of a broker or custodian for portfolio investments in India, are crucial for conducting investment activities in India. Clarifying that these services do not constitute a business connection would provide a much relief to the offshore funds with fund managers based in India availing the benefits of safe harbour provisions as per section 9A of the Act.</p>



## 7. Request for extending the exemption provided for mutual funds under section 10(23D) to CDMDF

Background / Issue	Proposal	Justification
<ul style="list-style-type: none"> <li>In the Union Budget 2021 – 22, post considering the challenges faced by some debt MFs and their investors, the Honorable Finance Minister Smt. Nirmala Sitharaman proposed to establish a credit backstop facility for MFs to help address ‘dislocation’ periods in the corporate bond market. This would lead to the larger development of the corporate bond market.</li> <li>This backstop facility has been set-up in the form of a Fund with MFs and Asset Management Companies (AMCs) as its investors. This Fund, albeit, has been set-up as an AIF registered under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (AIF Regulations).</li> <li>The Corporate Debt Market Development Fund (CDMDF) is a special purpose Alternative Investment Fund (AIFs) that has been set-up pursuant to a larger initiative of the Government of India and the Securities and Exchange Board of India (SEBI) for the benefit of the mutual fund (MFs) industry and its investors. CDMDF seeks to provide liquidity to the corporate bond market during periods of ‘dislocation’.</li> <li>Unlike other AIFs which raise funds from investors to earn or maximise returns, the main objective of CDMDF is to provide liquidity to the corporate bond market, which would benefit the MF industry and its investors at large. CDMDF does not have any commercial objective such as maximizing returns, targeted returns, hurdle, performance fees etc. as well. Investors in CDMDF are expected to be AMCs of MFs in India, and their open-ended debt oriented mutual fund schemes. CDMDF is a collaborative initiative lead by the Honorable Government of India and the SEBI along with the MF industry for betterment of the bond market and the MF industry.</li> </ul>	<p>In case of Mutual Funds (MFs), the income of the MFs is taxable in the hands of its investors.</p> <p>Considering the role which CDMDF is proposed to play in the Indian debt markets, it would be vital to introduce a similar tax regime to a MF for CDMDF whereby income of CDMDF should be exempt and distributions be taxed in the hands of its investors. .</p> <p>In order to provide for a ‘unit level taxation ’ to CDMDF, section 10(23D) of the Act should be amended to the extent that the exemption provided for mutual funds is extended to CDMDF by deeming it as a MF for limited purposes of the Act.</p>	<ul style="list-style-type: none"> <li>CDMDF is included as a separate Chapter i.e. Chapter III-C AIF under the AIF Regulations.</li> <li>From an income-tax perspective, as per the provisions of section 115UB of the Act, a tax pass through status has been accorded only to Category I and Category II AIFs under the AIF Regulations. In the absence of specific tax regime for CDMDF, normal trust taxation principles could apply to CDMDF.</li> <li>As per the trust taxation principles, in case the income of a trust is characterised as business income, then whole of such income is subject to tax at Maximum Marginal Rate (MMR) i.e. 42.744%<sup>1</sup>. In such a case, distributions should not be taxable in the hands of the investors of CDMDF.</li> <li><u>Characterisation of income:</u> A determination of whether the securities are held as capital assets or as stock-in-trade is a mixed question of law and would depend on the facts and circumstances of each particular case, and upon whether the activities of CDMDF could be regarded as amounting to the carrying on of a business or profession.  Some of the following principles have been laid down by various judicial precedents for characterisation of income from sale of securities as “business income” or “capital gains”. These may be used as broad guidelines for determining the character of income.  Any single factor in isolation cannot be conclusive in determining the exact nature of the transaction of investment in securities. All factors and principles need to be construed harmoniously. The following key guidelines characterise the income from sale of securities as business income or capital gains:</li> </ul>

<sup>1</sup> Effective 1 April 2023, the rates provided under sub-section (1A) of section 115BAC of the Act shall be applicable unless an option is exercised under the sub-section (6) of section 115BAC to opt out of the regime. Under this new regime introduced in the Finance Act, 2023, the rate of surcharge shall be capped at 25% (instead of 37%) resulting in effective rate of 39% (i.e., 30% plus a surcharge at the rate of 25% and health and education cess at the rate of 4%) instead of 42.744%.



### **Key features of CDMDF**

- CDMDF is a closed-ended Fund similar to a Category-I AIF.
- Each AMC must make a mandatory one-time capital commitment of 2 bps of the AUM of its specified debt-oriented MF schemes or any such percentage as may be prescribed by SEBI.
- Each specified debt-oriented MF scheme must make a mandatory capital commitment of 25 bps of its AUM or any such percentage, as maybe prescribed by SEBI.
- In times of market dislocation, CDMDF may leverage by way of borrowing not exceeding 10 times its corpus from banks, bond market or repo market, subject to maximum of INR 30,000 crore. Such borrowing shall be guaranteed up to maximum of INR 30,000 crores.
- The term of CDMDF is 15 years from the date of initial closing.
- In normal times, CDMDF shall deal only in liquid and low risk debt instruments, using only its corpus from contributions and surpluses.
- CDMDF would purchase investment grade listed debt securities at times of market dislocation with a view to stabilize the markets. These securities are the ones where during market dislocation the MF schemes may experience liquidity stress and therefore find it difficult to sell in the open market. During such times, these MF schemes also usually ace redemption pressure from their investors and accordingly, CDMDF may be able to ease such pressure by providing liquidity to such MF schemes. It is important to note that CDMDF can buy securities during the market dislocation only from the specified schemes that have invested in CDMDF.
- During market dislocation, corpus of CDMDF and debt so managed by CDMDF shall be utilised to purchase, from the participating investors, eligible investment grade listed debt securities which have residual maturity not exceeding 5 years. The securities so purchased should be sold within 3 months as market recovers.

- Motive for the purchase of securities as perceived at the time of sale;
- The frequency of transactions and the period of holding of the securities;
- Treatment of the securities and profit or loss on their sale in the accounts of the assessee;
- The source of funds out of which the securities were acquired, borrowed or owned;
- The existence of an object clause permitting trading in securities;
- Acquisition of the securities – from primary market or secondary market; and
- The infrastructure employed for share transactions.

In the lights of the above, to arrive at the exact nature of the transaction, all the factors and principles as stated above need to be considered in totality.

To summarise, the income earned by CDMDF is likely to be characterised as business income, amongst other, on account of following factors:

- CDMDF shall buy and hold low-risk liquid/debt securities which could be immediately liquidated in future;
- Most of the investments would be of short-term duration resulting in higher frequency of transactions;
- During ‘market dislocation’ periods, CDMDF is expected to take leverage up to 10 times from banks up to INR 30,000 crores which shall be guaranteed by the Honorable Government of India. Thus, in times of ‘market dislocation’, the source of funds would largely be through borrowed funds;
- Acquisition of low-risk liquid/ debt securities would largely be through secondary market operations; etc.



<ul style="list-style-type: none"><li>• CDMDF shall also be liable for all its operating expenses, including payment of guarantee fees or reimburse such guaranteed fees to Member Lending Institutions etc.</li></ul> <p><b><u>Issues:</u></b></p> <ul style="list-style-type: none"><li>• While CDMDF has been launched as an AIF, there are no express provisions in the Act with respect to taxation of CDMDF and its investors.</li><li>• Under the current framework for taxation of investment funds, the Act largely provides for single incidence of taxation. It could be in the form of “unit based” taxation as adopted for SEBI registered MFs (where the income of the MFs is exempt from tax and the investors are liable to taxation at the time of distribution of income or redemption of units) or “pass through” taxation as provided for SEBI registered Category I/II AIFs (where the investors in an AIF are liable to pay tax on the income earned by the AIF with no taxation in the hands of the AIF except for AIFs earning business income).</li><li>• Unlike MFs and Category I/II AIFs for whom specific tax regimes with one level of tax incidence (in the hands of investors) have been codified in the Income-tax Act, 1961 (Act), there is currently no express regime in the tax law with respect to taxation of CDMDF. In the absence of specific tax provisions, there could be ambiguities in taxation of CDMDF/its investors.</li><li>• In the absence of express provisions for taxation of CDMDF and its investors in the Act, there could be significant potential taxation challenges/ambiguities for CDMDF and its investors.</li></ul>		<ul style="list-style-type: none"><li>• Considering the nature of activities proposed to be undertaken by CDMDF, it could be regarded as carrying on a business thereby resulting in taxing of its income at MMR of 42.74%.</li></ul> <p>If the income earned by CDMDF is regarded as business income, then such income will first be taxed in its own hands, on net income basis, at MMR i.e. 42.74%. Such income shall be exempt in the hands of CDMDF’s investors i.e. the MFs. However, taxes will have to be discharged by investors of the MFs at the time of subsequent distribution/ redemption of MF units thereby resulting in double taxation of same income.</p> <ul style="list-style-type: none"><li>• Further, even the losses, if any, incurred by CDMDF will not pass through to the investors. Thus, if the tax regime akin to MFs is not applicable to CDMDF, then it would result in substantial loss of income in the hands of retail investors of MFs on account of double taxation.</li><li>• Given the above, it may be appropriate to consider extending the MF type “unit taxation” approach to CDMDF and its investors. Accordingly, similar to MFs, single level of incidence of taxation could be considered for CDMDF such that income of CDMDF is exempted from tax (like MFs) and any distribution/redemptions, taxable in the hands of its investors.</li><li>• The recommendation with respect to extending the mutual fund-type taxation regime to CDMDF may require appropriate amendments to the Income Tax Act. This will ensure that investors in MFs investing in CDMDF do not suffer unintended or additional taxation.</li></ul>
--	--	--





## 8. Request 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. 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 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</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>



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.



**9. Increase in threshold limit of withholding tax (TDS) on Income distribution by Mutual Fund scheme**

Background / Issue	Proposal	Justification
<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.</p> <p>This has been causing hardship to retail investors especially for individuals in lower income bracket.</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 especially for individuals in lower income bracket.</p> <p>Increasing the threshold limit to ₹50,000 would mitigate the hardship faced retail investors, who will have to claim the refund of TDS in the next AY.</p>

**10. Taxability of long-term capital gains under section 112A of the Act**

Background/Issue	Proposal	Justification
<p>As per the current provisions of section 112A of the Act, 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).</p> <p>The income tax is applicable/payable on LTCG exceeding ₹1 lakh in a financial year.</p>	<p>It is requested that the LTCG on listed equity shares or units of equity-oriented fund schemes –</p> <ul style="list-style-type: none"> <li>(i) held for more than one year and upto three years be subjected to LTCG tax @ 10% (plus applicable surcharge and cess) on the capital gains exceeding ₹2 lakh in a financial year.</li> <li>(ii) held more than three years be exempted from Capital Gains tax years by suitable amendments to section 112A.</li> </ul>	<p>The existing threshold limit of ₹1,00,000 in a financial year is very low.</p> <p>Exemption from capital tax after 3 years holding period will encourage long-term investments in equities and will help channelize more household savings in to the equity markets, thus helping the Indian economy.</p>



### 11. 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
<p>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.</p> <p>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.</p> <p>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.</p>	<p>It is requested 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.</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 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.</p> <p>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.</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 by the introduction of the proposed amendment.</p>



## 12. 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 markets in Asia. However, the Indian corporate bond market has remained comparatively small and shallow, and there is over-dependence on the 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.</li> <li>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>The heavy demands on bank funds by large companies, in effect, crowds-out smaller enterprises from getting 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 the 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>



### 13. Request for relaxation to the mutual funds in case of deduction of TDS for inoperative PAN cases

Background	Proposal	Justification
<p>In the context of a mutual fund, it is mandatory to deduct TDS while paying –</p> <ul style="list-style-type: none"><li>(i) Income distribution dividend in respect of all category of unitholders and</li><li>(ii) redemption proceeds in case of Non-Resident unitholders.</li></ul> <p>Additionally, if the PAN of the investor is inactive/ inoperative, then TDS must be deducted at a higher rate in accordance with section 206AA of the Act.</p>	<p>It is requested that CBDT should clarify that mutual funds are not required to deduct TDS at higher rates in case PAN becomes inoperative <u>if the PAN was valid when the investor was onboarded by the mutual fund AMCs.</u></p>	<p>There are instances in case of resident investors that at the time of onboarding the investor, the PAN is operative, however later it becomes inoperative, then the mutual fund is compelled to withhold additional tax at the time of payment of income distribution.</p> <p>Similarly, in case the residential status of the investor is “non-resident” at the time of onboarding and PAN is operative, however if later the status of such investor changes to “resident” and PAN becomes inoperative, then again mutual fund is compelled to withhold additional tax at the time of payment of income distribution / redemption or income/.</p> <p>Hence, clarification in this regard from CBDT will mitigate the hardship for individual investors and also reduce compliance burden for mutual fund AMCs.</p>



# INDIRECT TAX PROPOSALS



## 1. GST Compliances on Securities Lending & Borrowing

Background / Issue	Proposal	Justification
<p>SEBI has prescribed the Securities Lending Scheme, 1997 for the purpose of facilitating lending and borrowing of securities. Under the Scheme, lender of securities lends to a borrower through an approved intermediary to a borrower under an agreement for a specified period with the condition that the borrower will return equivalent securities of the same type or class at the end of the specified period along with the corporate benefits accruing on the securities borrowed. The transaction takes place through an electronic screen-based order matching mechanism provided by the recognised stock exchange in India. There is anonymity between the lender and borrower since there is no direct agreement between them. The lenders earn lending fee for lending their securities to the borrowers.</p> <p>The lender temporarily lends the securities to a borrower and charges lending fee for the same from the borrower. The borrower of securities can further sell or buy these securities and is required to return the lent securities after stipulated period of time. The lending fee charged from the borrowers of securities has the character of consideration and this activity is taxable in GST since 01.07.2017 under forward charge mechanism (i.e., the lender has to pay the GST).</p> <p>With effect from 1st October, 2019, the borrower of securities shall be liable to discharge GST as per Sl. No 16 of Notification No. 22/2019-Central Tax (Rate) dated 30.09.2019 under reverse charge mechanism (RCM). The nature of GST to be paid shall be IGST under RCM.</p> <p><b>GST Compliances</b></p> <ol style="list-style-type: none"> <li>Services of securities lending are taxable supplies under GST. Thus, the Fund, being a registered person is required raise tax invoices in view of Rule 46 of the Central Goods and Services Tax Rules, 2017 ('CGST Rules'), in respect of lending fees charged to the borrower and indicate on the face of the invoice that service is taxable under RCM.</li> <li>Such supplies provided by the Fund will have to be reported in the monthly GSTR 1 as B2B supplies with an indication that the same are inter-state supplies taxable under reverse charge mechanism.</li> <li>In addition to the above, at the time of filing GSTR 9 for the Fund, details of supplies with respect to lending of securities will have to be reported in the annual return, along with details of other supplies in the relevant tables.</li> <li>Further, the turnover of such supplies shall be included in computing the amount of turnover of two crore rupees for determining the applicability of audit and reconciliation in Form GSTR 9C under Section 35(5) of the CGST Act, read with Rule 80(3) of the CGST Rules. Where the amount of turnover crosses rupees two crore, details of such supplies, along with other supplies, shall be reported by the Fund in Form GSTR 9C in the relevant tables.</li> </ol>	<p>Request for relaxation to Mutual Funds for complying with various GST compliance on securities lending related transactions.</p>	<p>It is recommended that the lender should be exempted from complying with the issue of invoice as per Rule 46 of CGST rules, reporting of such supplies in GSTR 1 and Annual Return in GSTR 9 as the lender do not have borrowers information from the registered intermediary.</p> <p>The transaction takes place through an approved intermediary, there is anonymity between the lender and the borrower under the scheme and there is no direct arrangement. Hence, the borrower cannot be identified and accordingly an invoice cannot be raised in the name of the borrower by the Fund.</p> <p>There are other compliance requirements as well in terms of reporting and returns which will not yield any additional information to the Department.</p> <p>Further, there is no revenue loss to the Government as the GST is paid under reverse charge mechanism and all transactions are done through the registered intermediary</p>





## 2. Reversal of Input Credit under section 17(2) towards Capital Gain on MF Units

Background / Issue	Proposal	Justification
<p>As per Section 17(2), where input goods or services are used for both taxable supplies and for exempt supplies, amount of ITC shall be restricted to so much of input tax as is attributable to the said taxable supplies. Therefore, Input Tax Credit (ITC) with respect to exempt supplies will have to be reversed as per Rule 42 and Rule 43 of CGST Rules.</p> <p>Common ITC attributable towards taxable and exempt supplies to be calculated basis the turnover of exempt supplies for each tax period as follows:</p> <p>E / F * C where, E = Exempt supplies during the period F = Total turnover during the period C = Common ITC attributable</p> <p>As per explanation 2(b) to Chapter V of CGST Rules, value of security shall be taken as one percent, of the sale value of such security.</p> <p>As per notification 03/2018 issued on 23 January 2018, interest on deposits, loans or advances is not to be considered as exempt income for the purpose of ITC reversal. However, the MF Units are not provided with this exemption for ITC reversal.</p> <p>Therefore, if an entity earns capital gain on mutual fund units, it has to do the reversal of input tax credit as per the above predefined formula under GST regulations.</p>	<p>Mutual Fund units should also be exempted like Fixed Deposits to avoid reversal of Input Tax Credit as per the predefined formula under GST regulations.</p>	<p>This Input Tax Credit reversal leads to unnecessary and avoidable deterrence for Mutual Fund investments.</p>



**3. Sale of mutual fund units should not be regarded as Exempt service liable for reversal under Rule 42 of CGST Rules**

Background / Issue	Proposal	Justification
<p>Section 17(3) of the CGST Act requires transactions in securities to be treated as exempt supplies requires reversal of input tax credit as per provision of Rule 42 of CGST Rules. This discourages the investors from investing in mutual funds.</p> <p>GST is applicable on supply of goods or services. Both ‘goods’ and ‘services’ are defined to specifically exclude ‘securities’ under GST law. The definitions are reproduced below for ready reference:</p> <p>Goods - means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply.</p> <p>Services - means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination to another form, currency or denomination for which a separate consideration is charged.</p> <p>Given the above, it is clear that securities are neither ‘goods’ nor ‘services’.</p>	<p>An explanation was added to Rule 43 of the Central Goods and Services Tax Rules, 2017 vide notification 3/2018 – Central Tax dated 23 January 2018, to exclude interest on fixed deposits from the valuation of exempt service for the purpose of input tax credit reversal.</p> <p>We submit that fixed deposits and mutual funds are alternative investment options available to investors.</p> <p>It is recommended that a similar benefit of non-reversal of input tax credit available for interest on fixed deposits should be granted to the income earned from sale of mutual fund units. This will allow mutual fund industry to have a level playing field with other investment alternatives.</p>	<p>1) The benefit of non-reversal of input tax credit available for interest on fixed deposits should be granted to the gains from investment in mutual funds.</p> <p>2) Purpose of reversal of input tax credit is to disallow credit attributable to an output, which is not liable to tax.</p> <p>3) Because the money in mutual funds is professionally managed by expert fund managers after extensive market research for the benefit of investors, the investors have no role to play in determining the value of investments. Investors do not incur any expense in managing the mutual fund. In fact, the fund managers are responsible for studying and channelising the funds in most profitable manner.</p> <p>Given the above, it can be said that the investors do not avail any services with respect to investment in mutual fund units other than the charges charged by the mutual fund. Since no substantial services are availed by the investors in relation to investment in mutual fund units, reversal of credit should not be warranted.</p> <p>4) Further, on expenses incurred by mutual fund, which are charged to the schemes, input tax credit is not availed by the mutual fund or by the investors and therefore there’s no loss to the revenue if the benefit of non-reversal of input tax credit is extended to gains from investment in mutual fund.</p>



Background / Issue	Proposal	Justification
<p><b>(1) Lack of sufficient time for filing the various monthly compliances for large turnover entities as compared to entities with less turnover.</b></p>	<p>For large entities having a turnover of INR 10 crore or more, the payment of taxes should be allowed on a monthly basis while the return filing should be made quarterly.</p>	<p>In the current situation, large tax paying units are required to pay and file their returns on monthly basis which increases the compliance burden significantly. As opposed to this, small taxpayers file their returns on a quarterly basis and are also not required to file their Annual returns. This is in direct contrast to the filing provisions in Income tax, wherein large entities are given more time to complete their audits and file their returns as compared to individuals and small entities. The same logic should be applied to Indirect tax as well to avoid the errors in filing for large tax paying units.</p>
<p><b>(2) Redundancy of filing of Annual Return i.e. GSTR 9 and 9C as there is no CA certification required on same and there is mandatory matching of ITC with monthly/quarterly returns and 2A.</b></p>	<p>There filing of Annual Returns. should be discontinued. Instead, annual 3B filing should be introduced in its place where the reconciliation could be provided between financials, ITC and monthly/quarterly returns filed.</p>	<p>The main purpose of filing Annual Returns is to provide the reconciliation of the turnover with the returns filed throughout the year. This is a separate exercise which is undertaken in addition to the filing of the regular returns. Since the annual returns are no longer required to be audited and certified by a chartered accountant, it defeats the purpose of an external accuracy check on the returns filed. Also, which the amendments in the GST law, ITC to be availed is to be mandatorily matched invoice wise with the department generated report of 2A which reduces the scope of error and mismatches.</p>
<p><b>(3) Grant of refund of GST paid on Capital Goods</b> Section 54 of Central Goods and Services Tax Act, 2017 ('CGST Act') read with Rule 89 of Central Goods and Services Rules, 2017 ('CGST Rules')</p>	<p>It is recommended that refund of GST paid on capital goods should be allowed to companies which are exporting their services without payment of GST on such export of services.</p>	<p>1) Exporters who are exporting their services from India are not eligible to claim the refund of GST paid on capital goods used for providing export service. 2) The existing restriction is against the principle of indirect taxes wherein set-off of taxes paid for input services or capital goods is allowed while paying taxes on output services. 3) Non-grant of refund of GST paid on capital goods to such companies hampers the working capital of such companies.</p>
<p><b>(4) Procedural requirements in granting GST refunds to export entities</b> Practical difficulties to be resolved in obtaining GST refund claim by exporters.</p>	<p>1) There should be clear guidance to the taxpayer and field officers for documents/ details required for processing GST refund claims in order to promote ease of doing business.</p>	<p>While processing the GST refund claim, various procedural difficulties are faced by the taxpayer: 1) Submission of physical documents like input invoices on which GST input tax credit has been claimed although already matched with GSTR-2A/ GSTR-2B 2) Calling for justification of nexus of input services with output services provided by the taxpayer, although there are no such requirements under section 16 of CGST Act 3) Calling for data/ details which are available on GST portal like Electronic credit and cash ledger</p>



Background / Issue	Proposal	Justification
<p><b>(5) Notices for amendment in GST registration</b></p> <p>a) Providing facility to amend certain common fields like name of the company, directors, authorized signatory, bank account at one level i.e., Permanent Account Number (PAN)</p> <p>b) Providing field in GST registration amendments tab to upload requisite supporting documents.</p>	<p>At the time of making amendment, facility should be given to update/ amend the common fields once at Permanent Account Number (PAN) level for all registrations so that such amendments can be carried out once for all GST registrations.</p> <p>At the time of making amendment application itself an option for uploading supporting documents for any change in GST registration should be given, in order to provide ease of doing business.</p>	<p>1) In case taxpayer has multiple GST registrations, repetitive exercise needs to be carried out multiple times to amend the certain common fields by login into each GST registration. It is inefficient and error-prone to repeat the same activity for each GST registration.</p> <p>2) While taxpayers amend GST registration certificate for addition/deletion of director and additional place of business etc. there is no option of uploading any supporting documents at the time of making application for amendment. After submitting the application for amendment, GST authorities issue online notices to submit proof of addition/deletion of director or deed for additional place of business etc.</p>
<p><b>(6) Notice issued in Form DRC-01C</b></p> <p>Issue of notice under Form DRC-01C in respect of difference in input tax credit available in Form GSTR 2B and input tax credit claimed in the GSTR 3B return of that month.</p>	<p>1) Notice under Form DRC-01C should not be issued on the basis of difference of input tax credit available in Form GSTR 2B and input tax credit claimed in the GSTR 3B return of that month.</p>	<p>1) As per section 16(4) of CGST Act, taxpayer can claim input tax credit in respect of any invoice or debit note for supply of goods or services or both till 30th November following the end of financial year or furnishing of the relevant annual return, whichever is earlier. Therefore GSTR 2B of a particular month should not be considered for the purpose of matching of credit availed in GSTR 3B. Frequent notices in Form DRC-01 are being issued for matching the input tax credit availed in GSTR 3B of a particular month with the input tax credit appearing in GSTR 2B of that month.</p> <p>2) Taxpayer need to file the reply of Form DRC-01C - Part B within 7 days. In case no response is filed by the taxpayer he will not be able to file their subsequent period Form GSTR-1 which will result into fine to the taxpayer.</p> <p>3) In case taxpayer has multiple GST registrations, such exercise needs to be carried out for multiple registrations and these result into undue hardship to the taxpayer.</p> <p>4) Law allows input tax credit of earlier months to be taken in future months and availing input tax credit is linked to a financial year and not to a particular month. Hence, issuance of notices checking credit of a month without taking cognizance of cumulative un-availed credit of that financial year is adding difficulties to businesses.</p>