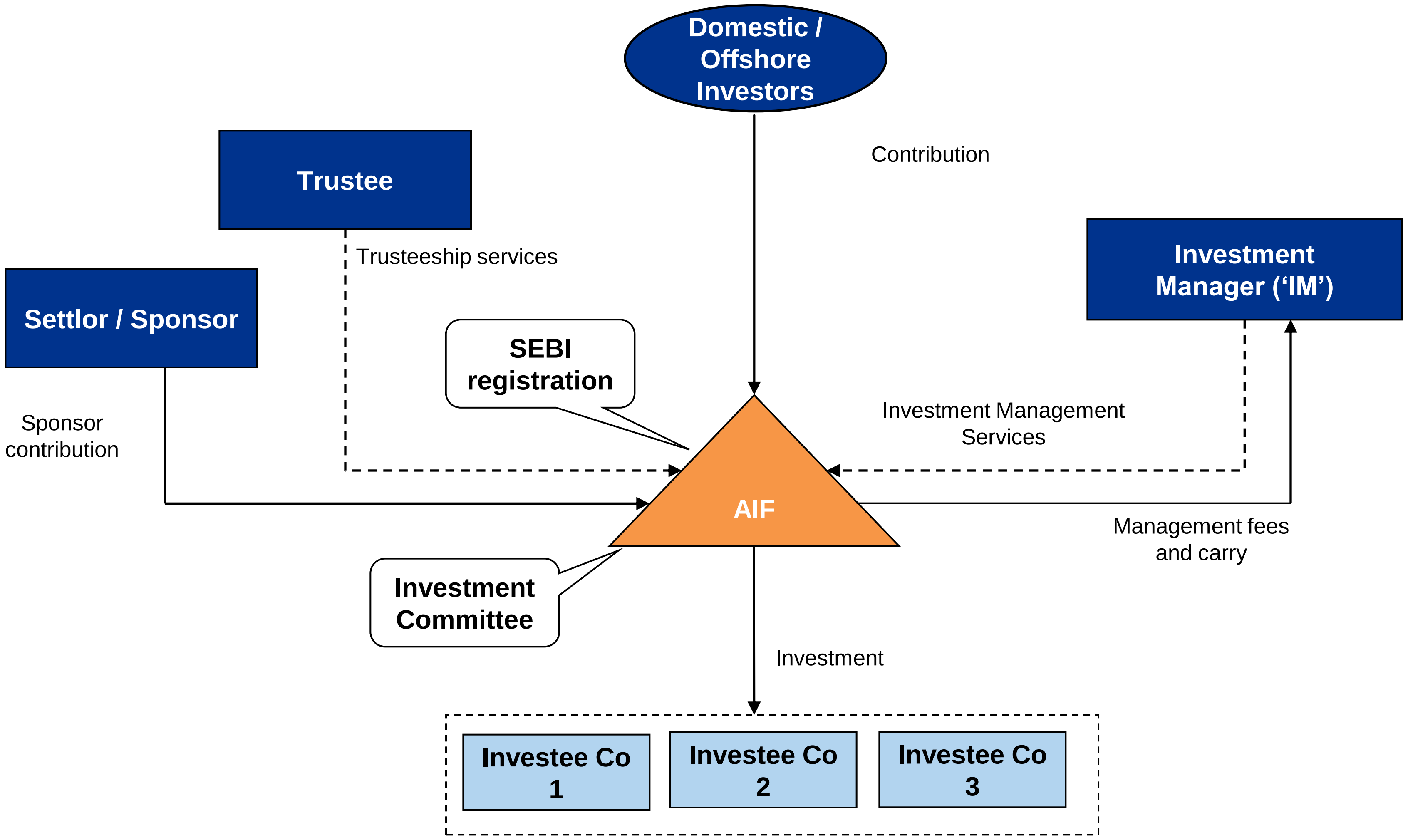
# Indian Association of Alternative Investment Funds (IAAIF)

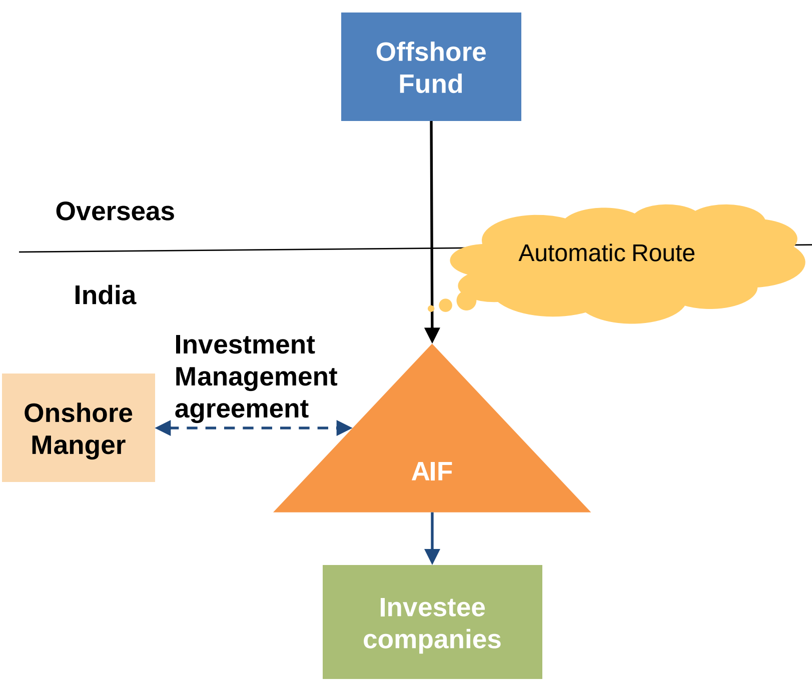
Structuring an AIF – Tax Efficiency

# Typical AIF Structure

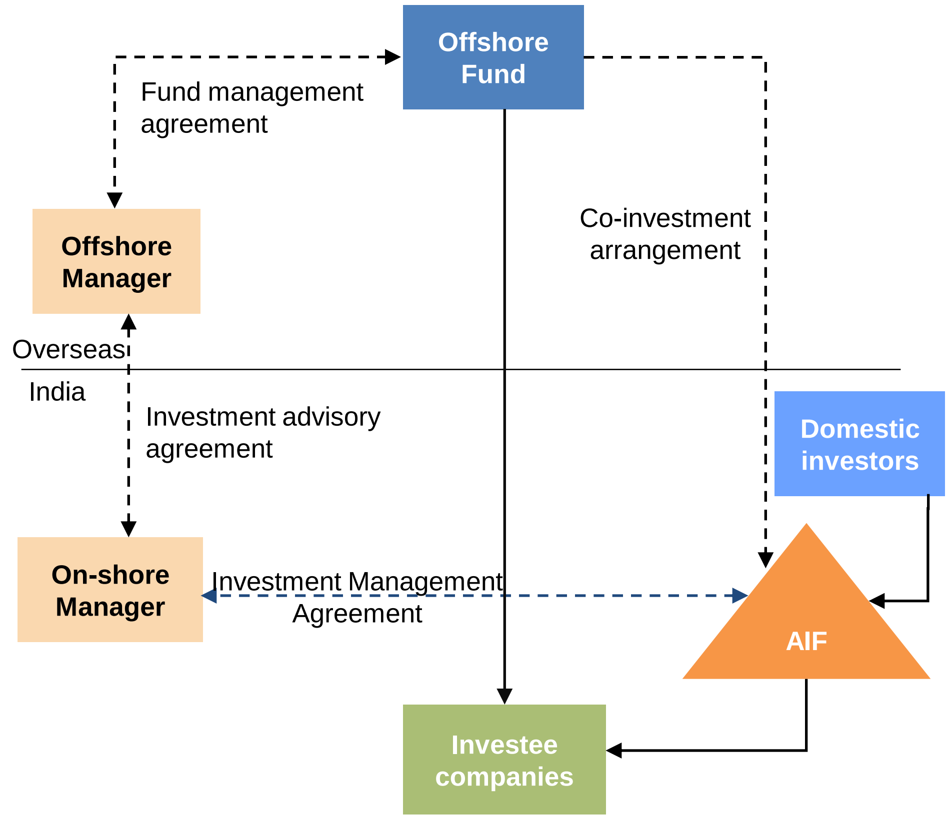


# Unified v/s. Co-investment - Investment structure

## Unified




## Co-investment




**Need to evaluate appropriate structure based on commercial objectives as well as tax and regulatory aspects**

# AIF – Indian Tax Implications

- Tax pass-through status for Category I and II AIFs on all income other than business income
  - Capital gains, dividend and interest income eligible for pass-through
  - AIF exempt, investors taxable
  - Income taxable in investors' hands, deemed to be of same nature and proportion as in AIF's hands
- Business income taxable at AIF level
  - Correspondingly such income exempt for investors
- Loss to be carried forward at AIF level for set off in future years
  - Losses not to be passed on to investors
- AIF to withhold tax on non-business income credited / paid at the following rates:
  - 10% for resident investors
  - Rates in force for non-resident investors
- Re-investments possible only on income post withholding tax
- Income received by the AIF to be exempt from deduction of tax at source by portfolio companies
- No distribution tax on income paid / distributed by AIFs
- Tax pass through status has not been accorded to Category III AIFs. Accordingly, the taxability of category III AIFs will be governed by the general principle of taxation (depending on the form in which category III AIF is set up i.e Trust or LLP or company)

# Alternative Instruments – Key Indian Tax Aspects

| Taxability in the hands of Investors of AIF | Equity Shares | Preference Shares (RPS / CCPS / OCPS) | Debenture (NCD / CCD / OCD) |
|---|---|---|---|
| **Dividend / Interest** | Issuer Co. required to pay DDT @ 20.36% (effective rate) | | |
| - Taxation in case of<br>○ Resident<br>○ Non-Resident | Dividend income > INR 10 lac taxable @10% for all resident except companies and specified trust/institution<br>Exempt | | 30%<br>40% or treaty rates, whichever is more beneficial to investor. |
| - Withholding tax by AIF<br>○ Resident<br>○ Non- Resident | 10%<br>Nil | | 10%<br>At the rates in force |
| **Taxability on conversion** | Not applicable. | Conversion of CCPS / OCPS into shares exempt from tax. w.e.f. 1 April 2017. (Finance Bill 2017) | Conversion of CCDs into shares exempt from tax. |
| **Taxation of Buyback / Capital Reduction** | Buy-back is subject to buyback distribution tax. (effective rate of 23.07%)<br>Capital reduction is subject to dividend tax implications to the extent of accumulated profits of the company (effective rate of 20.36%). Any payment over and above the said amount shall be subject to capital gains tax depending on the tenure for which the shares are held.<br>Buyback of Convertible Instruments – Possible post conversion into shares | | |

# Alternative Instruments – Key Indian Tax Aspects

IAAIF
INDIAN ASSOCIATION OF ALTERNATIVE INVESTMENT FUNDS

<table>
<tr><th>Taxability in the hands of Investors</th><th>Equity Shares</th><th>Preference Shares (RPS / CCPS / OCPS)</th><th>Debenture (NCD / CCD / OCD)</th></tr>
<tr><td>Availability of tax break (against taxable income, if any or carry forward of tax losses)</td><td colspan="2">Dividend is not allowable as deductible expense.</td><td>Interest should be allowed as a deductible expense subject to appropriate withholding of tax, transfer pricing. Thin capitalisation provisions proposed in Finance Bill 2017, whether applicable?</td></tr>
<tr><td>Taxability on transfer as per Indian domestic tax laws</td><td colspan="2">
<table>
<tr><th>Nature (Holding period)</th><th>Resident</th><th>Non-Resident</th></tr>
<tr><td colspan="3">Long term capital gain</td></tr>
<tr><td>Listed (> 1 year)</td><td colspan="2">Exempt (subject to STT paid on acquisition – Finance Bill 2017)</td></tr>
<tr><td>Unlisted (> 2 years)</td><td>20% (with Indexation)</td><td>10% (without forex conversion benefit)</td></tr>
<tr><td colspan="3">Short term capital gain</td></tr>
<tr><td>Listed (< = 1 year</td><td>15%</td><td>15%</td></tr>
<tr><td>Unlisted (< = 2 years)</td><td>30%</td><td>40%</td></tr>
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<tr><td colspan="3">Short term capital gain</td></tr>
<tr><td>Listed (< = 1 year Unlisted (< = 3 years)</td><td>30%</td><td>40%</td></tr>
</table>
</td></tr>
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Above tax rates are exclusive of surcharge & cess

# Jurisdiction Analysis

| Income Streams | Mauritius | Singapore | Cyprus |
|---|---|---|---|
| **Taxability of various income streams in India after considering benefits under the Treaty** | | | |
| Interest Income (subject to beneficial ownership test) | 7.5% on gross basis (with effect from 1 April 2017) / 5% (on NCDs, subject to conditions in Co-investment) | 15% on gross basis / 5% (on NCDs, subject to conditions in Co-investment) | 10% on gross basis / 5% (on NCDs, subject to conditions in Co-investment) |
| Capital Gains on transfer of shares | Taxable (refer next slide) | Taxable (refer next slide) | Taxable (refer next slide) |
| Capital gains on transfer of debt instruments | Not taxable | Not taxable | Not taxable |
| LOB clause in treaty | Exists (applicable only till March 2019) | Exists | Does not exist |

Above tax rates are exclusive of surcharge & cess

# Jurisdiction Analysis

| | Particulars | India-Mauritius Treaty & India-Singapore Treaty | India-Cyprus Treaty |
|---|---|---|---|
| 1 | Investment in shares made prior to April 1, 2017 – whether eligible for grandfathering under Tax treaty | • Yes | • Yes |
| 2 | Investment in shares made post April 1, 2017 and sold prior to March 31, 2019 | • Benefit of 50% reduction in applicable tax rate available subject to LOB clause | • Taxable in India per domestic tax rates |
| 3 | Investment in shares made post April 1, 2017 and sold on or post April 1, 2019 | • Taxable in India per domestic tax rates | • Taxable in India per domestic tax rates |

| | |
|---|---|
| **India-Mauritius Treaty – LOB Clause** | Mauritius resident will not be deemed to be shell / conduit company if-<br>- it is listed on recognized stock exchange of Mauritius; or<br>- its expenditure on operations in Mauritius is equal to or more than Mauritian Rupees 1.5 mn (approx. USD 40k) in preceding12 months from date the gains arise |
| **India-Singapore Treaty – LOB Clause** | • Singapore resident will not be entitled to the treaty benefits if its affairs were arranged with the primary purpose to take advantage of the treaty benefits<br>• A shell / conduit company shall not be entitled to the treaty benefits<br>• Singapore resident will not be deemed to be a shell/conduit company if—<br>- it is listed on a recognised stock exchange of Singapore; or<br>- its total annual expenditure on operations in Singapore is equal to or more than S$200,000 in the immediately preceding period of 24 months (12 months for the period April 1, 2017 to March 31, 2019) from the date the gains arise |

# Unfinished Agenda – Open Tax Issues

- The Exemption from Section 56(2)(viib) to AIF (VCF sub category) should be extended to all Category I and Category II AIF
- Tax pass-through status for category III AIF
- Tax pass--through for losses of AIF to the investors
- Relief to AIFs from withholding tax obligation on distribution of exempt income to resident investors
- Withholding tax on Gross vs. Net Basis
- Thin capitalisation (Co. Investment Vs. Unified Investment) and related GAAR issues
- Taxability of dividends at AIF level (especially Category III AIF)
- Withholding of tax in case of income received prior to Final Closing

# Thank you

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