

# TAX FLASH NEWS

13 August 2021

## **CBDT prescribes a methodology to compute income of specified funds covered under Section 10(4D) and Section 115AD of the Income-tax Act**

Section 10(4D) of the Income-tax Act, 1961 (the Act) provides tax exemption to any income accrued or arisen to, or received by a specified fund<sup>1</sup>:

- as a result of transfer of capital asset<sup>2</sup> on a recognised stock exchange located in any IFSC and where the consideration for such transaction is paid or payable in convertible foreign exchange or
- as a result of transfer of securities other than shares in a company resident in India or
- any income from securities issued by a non-resident [not being a Permanent Establishment (PE) of a non-resident in India] and where such income otherwise does not accrue or arise in India or
- any income from a securitisation trust which is chargeable under the head 'Profits and gains of business or profession',

to the extent such income accrued or arisen to, or is received, is attributable to units held by non-resident [not being the PE of a non-resident in India] or is attributable to the investment division of offshore banking unit, as the case may be, computed in the prescribed manner.

Further Section 115AD provides concessional rate of tax to the total income of a specified fund or Foreign Institutional Investor which includes income received in respect of specified securities or income by way of short-term or long-term capital gains arising from the transfer of such securities.

However, rules for determination of such income was not prescribed.

Recently, the Central Board of Direct Taxes (CBDT) has issued a Notification<sup>3</sup> prescribing new Rules 21AI and 21AJ. Rule 21AI provides for the methodology to compute exempt income of a specified fund for the purposes of Section 10(4D). Similarly, Rule 21AJ provides for the methodology to determine the income of a specified fund attributable to units held by non-residents under Section 115AD(1A).

<sup>1</sup> 'Specified fund' means:

- (i) a fund established or incorporated in India in the form of a trust or a company or a LLP or a body corporate,-
  - (I) which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the SEBI (Alternative Investment Fund) Regulations, 2012, made under the SEBI Act, 1992 (15 of 1992) or IFSC Authority Act, 2019 (50 of 2019);
  - (II) which is located in any IFSC; and
  - (III) of which all the units other than unit held by a sponsor or manager are held by non-residents; or
- (ii) investment division of an offshore banking unit, which has been—
  - (I) granted a certificate of registration as a Category-I foreign portfolio investor 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) and which has commenced its operations on or before the 31 March 2024; and
  - (II) fulfils such conditions including maintenance of separate accounts for its investment division, as may be prescribed.

<sup>2</sup> Referred to in clause (viiab) of Section 47 of the Act

<sup>3</sup> Notification No. 90/2021, dated 9 August 2021

## CBDT Notification

### Methodology to compute exempt income of a specified fund for the purposes of Section 10(4D)

For the purpose of exemption under Section 10(4D), the **income attributable to units held by non-resident (not being the PE of a non-resident in India) in a specified fund** shall be computed in accordance with the following formula:

<b>Exempt income under Section 10(4D) = A*C1 + B*C2 +D*FI+E*F2</b>			
<b>A*C1</b>	Any income accrued or arisen to, or received by a specified fund as a result of transfer of capital asset <sup>4</sup> , on a recognised stock exchange located in any IFSCs and where the consideration for such transaction is paid or payable in convertible foreign exchange	X	Ratio of the aggregate of daily 'assets under management' of the specified fund held by non-resident unit holders (not being the PE of a non-resident in India) <b>to</b> the aggregate of daily total 'assets under management' of the specified fund, from the date of acquisition of the capital asset <sup>5</sup> to the date of transfer of such capital asset.
<b>B*C2</b>	Any income accrued or arisen to, or received by a specified fund as a result of transfer of securities (other than shares in a company resident in India)	X	Ratio of the aggregate of daily 'assets under management' of the specified fund held by non-resident unit holders (not being the PE of a non-resident in India) <b>to</b> the aggregate of daily total 'assets under management' of the specified fund, from the date of acquisition of the security (other than shares in a company resident in India) to the date of transfer of such security.
<b>D*FI</b>	Any income accrued or arisen to, or received by a specified fund from securities issued by a non-resident (not being a permanent establishment of a non-resident in India) and where such income otherwise does not accrue or arise in India	X	Ratio of the 'assets under management' in the specified fund held by non-resident unit holders (not being the PE of a non-resident in India) <b>to</b> the total 'asset under management' of the specified fund, as on the date of receipt of such income from securities issued by a non-resident (not being a PE of a non-resident in India) and where such income otherwise does not accrue or arise in India.
<b>E*F2</b>	Any income accrued or arisen to, or received by a specified fund from a securitisation trust which is chargeable under the head 'profits and gains of business or profession'	X	Ratio of the 'assets under management' in the specified fund held by non-resident unit holders (not being the PE of a non-resident in India) <b>to</b> the total 'asset under management' of the specified fund, as on the date of receipt of such income from a securitisation trust which is chargeable under the head 'profits and gains of business or profession'.

The specified fund shall furnish an annual statement of exempt income in Form No. 10IG<sup>6</sup> electronically under digital signature on or before the due date.

<sup>4</sup> Referred to in clause (viiab) of Section 47

<sup>5</sup> Referred to in clause (viiab) of Section 47

<sup>6</sup> Form 10IG is notified for the statement of exempt income under Section 10(4D).

## **Methodology to determine the income of a specified fund attributable to units held by non-residents under Section 115AD(1A)**

For the purposes of Section 115AD(1A), the income of a specified fund by way of short-term or long-term capital gains<sup>7</sup>, attributable to the units held by non-resident (not being the PE of a non-resident in India) shall be calculated in accordance with the following formula:

<b>A = B*C</b>	
<b>A</b>	Income attributable to the units held by non-resident (not being the PE of a non-resident in India)
<b>B</b>	Income arising from transfer of the security
<b>C</b>	Ratio of the aggregate of daily 'assets under management' of the specified fund held by non-resident unit holders (not being the PE of a non-resident in India) to the aggregate of daily total 'assets under management' of the specified fund, from the date of acquisition of the security to the date of transfer of such security

For the purposes of Section 115AD(1A), the income of a specified fund by way of income received in respect of securities<sup>8</sup>, attributable to the units held by non-resident (not being the permanent establishment of a non-resident in India) shall be calculated in accordance with the following formula:

<b>X = Y*Z</b>	
<b>X</b>	Income attributable to the units held by non-resident (not being the PE of a non-resident in India)
<b>Y</b>	Income received in respect of securities
<b>Z</b>	Ratio of the 'assets under management' in the specified fund held by non-resident unit holders (not being the PE of a non-resident in India) to the total 'asset under management' of the specified fund, as on the date of receipt of such income.

The specified fund shall furnish an annual statement of income eligible for concessional taxation in Form No 10IH<sup>9</sup> electronically under digital signature on or before the due date.

The term 'assets under management' means the closing balance of the value of assets or investments of the specified fund as on a particular date.

### **Our comments**

The rules provide the computation mechanism for computing the income attributable to the units held by non-residents in a specified fund. The Rules essentially prescribe for computation of income eligible for exemption under section 10(4D) and eligible for taxation at the rates prescribed under section 115AD of the Act on a proportionate basis i.e. as ratio of assets under management held by non-resident unit holders (or rather represented by units issued to non-residents) to total assets under management. Application of the rules, in certain cases, may have an impact on the returns to the investors of the specified fund which would need careful examination depending upon the facts.

<sup>7</sup> Referred under Section 115AD(1)(b)

<sup>8</sup> Referred to in Section 115AD(1)(a)

<sup>9</sup> Form No. 10IH is notified for the statement of income of a specified fund eligible for concessional taxation under Section 115AD

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