Managing off-shore funds

Why in news?

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Central Board of Direct Taxes (CBDT) has recently notified the revised rules for a safe harbour regime.

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What is the background?

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- The government and CBDT have taken steps in the past for making India a tax-certain jurisdiction and creating a positive business climate.
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- 'Safe harbour' regime is one such area of the direct tax laws that is concerned with management of offshore funds.
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- Safe harbour provisions were introduced under the Income-tax Act, 1961 by the Finance Act, 2015.
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What are the drawbacks?

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- Too many **eligibility conditions** relating to annual reporting requirements, investor diversification and tax residence are cumbersome to adhere to.
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- Another key reason for the local management of off shore funds not happening is the **Indian tax regime**.
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- There are **investment diversification conditions** like not allowing more than 26 per cent stake in underlying entities, etc.
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- The private equity industry is thus largely not expected to benefit from provisions of the safe harbour rules.

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- Given huge FPIs in Indian capital markets with some registered with SEBI, a need arises for managing these from within India than from abroad.
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What are the recent changes?

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- To further simplify the safe harbour regime, certain relaxations are now introduced.
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- Application of certain **investor diversification** rules are relaxed for certain categories of Foreign Portfolio Investors (FPI)(Category I & II).
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- There was a requirement for funds wanting to avail safe harbour to qualify as a **tax resident** of overseas jurisdictions.
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- This condition proved to be a hurdle for funds in certain countries given the local taxation regimes.
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- To address this, the residency criteria for investors has been relaxed by notifying 121 countries/specified territories.
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- Now, an offshore fund can invest from these countries without it qualifying as a tax resident of that overseas country/specified territory.
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- It has introduced mechanism to seek **pre-approval** for setting up fund management activities in India.
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- Also, the earlier condition on relationship that the fund and the fund manager should not be "**connected persons**" is done away with.
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What are the potential benefits?

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- Local management of off-shore funds can lead to more participants, increased volumes, employment opportunities and buoyancy in tax revenues.
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- It could make a positive impact on **India's forex position.**

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- Also, FP Investor being regarded as a tax resident of India can further lead to global income of the FPI being potentially **taxable** in India.
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- It will benefit fund managers in India who can now approach Category-I and Category-II FPIs for management of their India assets.
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- This include the domestic mutual fund houses, portfolio management service (PMS) and alternative investment fund (AIF) asset managers.
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- The provisions are said to be the Make- in-India equivalent for the fund management industry.
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Source: Business Standard

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