

# Bloomberg Tax

## Global Funds Still See Barriers in India Despite Tax Rules Fix

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- India amends safe harbor rules for offshore funds
- Funds avoid tax consequences if requirements are met

Global fund managers in India scored a win when the country relaxed its tax rules for those controlling offshore funds—but more changes may be needed to boost fund management in the country.

The Indian tax authority recently set minimum thresholds for how fund managers based in India are paid, removing the risk of potential disputes under earlier rules that required the payment to be comparable to what third-parties would pay.

The change will make it easier for global funds to meet requirements under “safe harbor” rules to ensure they don’t get hit with adverse tax consequences in India, practitioners said. But while the amendments are a step toward a business-friendly tax regime for offshore funds, meeting a host of other precise requirements to qualify for the special tax treatment will continue to be an obstacle.

“If the Government of India chose to relax those conditions, then we may see the increase in number of fund managers coming back to India,” said Ravi Sawana, a principal associate at Lakshmikumaran and Sridharan in Mumbai.

Such conditions include a requirement for investor broad-basing, which means a fund that’s established or incorporated outside of India must have at least 20 investors, and none of them can hold more than 49% of the shares. That’s difficult for certain funds to meet because of frequent changes to their beneficial ownership and lack of visibility to investors in omnibus accounts, Anis Chakravarty, a partner at Deloitte India in Mumbai, said in an email.

## Removing Risks

The 2015 Finance Act created the safe harbor provisions under Section 9A to encourage global fund managers to operate from India. Prime Minister Narendra Modi backed the provisions as part of his quest to transform the country into a financial hub, Pallav Narang, a partner at CNK RK & Co. in New Delhi, said..

The safe harbor rules remove the risk of creating a permanent establishment or triggering tax residency for the onshore management of offshore funds. A fund considered tax resident in India could face higher taxes on its investment income and also have its global income subject to tax in the country.

But the safe harbor rules weren't used often because of a laundry list of prerequisites, including that the fund manager be remunerated at an arm's length price by the fund, said Parul Jain, who co-heads the international tax practice at Nishith Desai Associates in New Delhi.

That requirement was a major concern for the fund management industry because calculating an arm's length payment was subjective and could lead to disagreements between the offshore fund and income tax authorities, practitioners said. "There was no certainty," Sawana said.

Multinationals value their transactions between their entities as if they were unrelated, a principle known as the arm's length standard under transfer pricing rules. To determine how unrelated parties would act, companies base those transactions on comparables, or real-world examples.

After facing industry pushback, India's Central Board of Direct Taxes removed the arm's length pricing requirement—minimizing the threat of a potential tax dispute—and [replaced](#) it with the minimum fees threshold. The amended rules became retroactively effective as of April 1, 2019.

## Changes Needed

But the change might have a limited impact on the Indian fund industry because of many other onerous safe harbor conditions, Hitesh D. Gajaria, a partner and head of tax at KPMG India, said in an email. Though certain categories, like Indian mutual funds and portfolio managers that provide advisory services to offshore funds, may now consider managing offshore funds from India, he said.

To qualify for the safe harbor, the eligible investment fund must meet 13 prescribed conditions and the eligible fund manager must meet four other conditions.

A commitment must be made to continuously meet the conditions during the fund's life cycle, said Sunil Gidwani, a partner at Nangia Andersen LLP in Mumbai. "Not everyone is happy to provide such assurances," he said in an email.

For instance, private equity funds are hindered by the condition that the fund can only invest a maximum 25% of an Indian company's capital, because these funds often invest more, Gidwani said, adding that the government should relax this rule.

Other cumbersome conditions include tracing the indirect Indian resident ownership in the fund, having a minimum number of persons in the fund, and ensuring that the fund and fund manager aren't "connected" persons, said Amit B. Jain, a global tax desk leader at EY in London, who focuses on Europe, Middle East, India, and Africa.

Funds usually prefer to control the manager and may not always have broad-based ownership, so the need for minimum members is challenging, he said.

India-based fund managers also struggle with a requirement that dictates the manager along with connected persons won't be entitled to more than 20% of the profits accruing or arising to the eligible investment fund, Chakravarty said.

This condition particularly impacts eligible investment fund groups that have offshoring operations in India as the remuneration to the offshoring outfit could also affect compliance, he said.

## Taking Advantage

Still, some funds sitting on the fence may be willing to apply for the safe harbor now that the possibility of a challenge on their arm's length pricing is removed, Gidwani said, adding that he will now advise clients to seriously consider availing themselves of the safe harbor if they want to manage funds from India.

Jain of Nishith Desai, agreed and said her firm will encourage clients meeting the other conditions to take advantage of the safe harbor benefits.

Funds and fund managers that meet all the prescribed conditions may want to apply to the CBDT for validation of their compliance, Chakravarty said. Those that don't meet the conditions are unlikely to opt for the regime until they have certainty that having the India-based fund manager won't result in adverse tax implications, he said.

Funds could either apply to the CBDT based on the facts of their case or lobby the Indian government for changes that they believe are required for the regime to be workable for them, Chakravarty said.

The CBDT didn't immediately respond to a request for comment.