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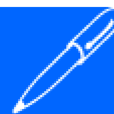

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Venturing out is going to get tough

Tax Proposal To Make VC Funds Unattractive For Corporate Investors

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WITH the FM pulling local VC funds into the tax net, one may well see many of them de-registering with Sebi. "While the tax raised from this move will be negligible, it will be a bad signal to investors and a loss of face for us. We have raised 10-year funds with investments in specific sectors planned, it will become difficult for us to explain the sudden changes to the investors," said Rahul Shah, managing partner, IL&FS Venture Fund.

A senior manager in another domestic venture fund said: "The situation is difficult. This will kill the domestic venture funds." All the domestic funds, be it IL&FS, ICICI Venture and IDFC, already have foreign sponsored funds, where only foreign investors such as Calpers invest. The Indian funds have registered these entities in Mauritius, largely for tax efficiency purposes.

But they are also registered in India. Why? There are three reasons. The most important was to give Indian corporates and financial institutions a taste of the venture capital asset class. The second was to be able to invest in and exit from, without being double checked by RBI, into unlisted companies. The third reason was that, once registered, venture funds were able to exit companies immediately when they go public (provided they had invested a year before the company filed for IPO); unregistered funds can't sell till a year after the IPO.

The unkindest cut is that today a mutual fund is more tax efficient for an investor compared to a venture fund. "VCFs across the world have a pass through status. In India MFs are exempt and foreign funds are exempt and we don't understand why a move which will hurt the domestic guys has been taken," says Mr Shah of IL&FS Venture Fund.

The impact of the new tax proposal will be to make venture fund an unattractive proposition for corporate investors like M&M, Reliance and banks like ICICI, UTI Bank and Bank of Baroda along with insurance companies like LIC who have invested in VCFs. Now these entities pay long-term or short-term capital gains tax once they receive the proceeds from a sale of investment done by a VC fund. Since most venture funds are registered as trusts and since a trust and its investors are considered as one and the same for taxation purposes, presumably there might not be any impact. But there is one grey area. "If a trust is shown as conducting a business activity, it could be subjected to tax at the rate of maximum marginal rate, that is 30% plus surcharge," says Siddharth Shah, head, funds practice, Nishith Desai Associates.

While the FM in selecting his 'Chosen Seven' may have wanted to check investments in sectors like real estate, he has ignored a sector desperately seeking funds — infrastructure.

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