CASE STUDY 1

CA. M has a flourishing practice spanning in areas of auditing, taxation (both direct as well as indirect), consultancy (particularly in foreign exchange laws) in Chennai. His clients include many HNIs (High net worth individuals) apart from corporates and non-corporates.

One day, one of his HNI clients, Mr. P, called him to inquire about tweaking of certain rules pertaining to taxation on redemption of mutual fund investments. He had heard that redemption for certain types of mutual fund investments is now going to attract increased income tax payouts. He had also heard news of the same on BTBC news channel but was unable to comprehend it lucidly. There was no clarity to him whether changes have been made in income tax law or in rules framed by SEBI.

Rely Consultancy, an AMFI registered mutual fund distributor through which MF investments were made, was continuously forwarding messages received from AMFI (Association of Mutual Funds in India) to his mobile. The messages were, at the best, cryptic and required investors to be in touch with their Chartered Accountants/tax consultants.

Mr. P had an impressive investment portfolio of around ₹ 50 crores in various mutual funds and any changes in income tax payouts pertaining to it could affect his ROI adversely. Under stress, he sought for an immediate appointment with CA M. Armed with summary of investments made in mutual funds, he came to CA's office and sought his much-needed advice. The summary of mutual fund investments as on 31st March, 2023 looked as under: -

S.No.	Type of fund in which money invested	Date of Investment	Amount invested (in ₹ crores)
1	MTL Low Duration Fund	3/4/2020	10
2	Bon India Low Duration Fund	12/12/2020	15
3	ABD New Green Energy Fund	2/12/2022	15
4	SBA Life Arbitrage Fund	8/11/2021	10

Besides, he had also invested ₹ 5 lacs in a liquid fund. Since amount invested was small, he was not bothered about the same.

He also informed to CA M that funds stated at 1 and 2 are debt funds and funds stated at 3 and 4 are equity funds. He further informs that these debt funds have invested 30% of their proceeds in equity shares of domestic companies and equity funds have invested 70% of their proceeds in equity shares of domestic companies. The investment pattern of funds is going to remain unchanged in coming years too. He was planning to redeem his entire mutual fund investment portfolio in month of October 2023 tentatively depending upon suitable market conditions.

Their discussion also veered towards returns from debt funds. Debt funds invest predominantly in government and high-grade corporate bonds. Mr. P was of the view that interest rates in economy are likely to go up in few months' times keeping in view broad macroeconomic indicators.

The discussion stretched a bit and it came out that he plans to buy a villa in Goa. He is already 65 and wants to spend quality time in scenic beauty of Goa. In fact, it transpires that he is going to make an advance payment of ₹ 1.00 crore to owner of villa, Mr. Christopher, an Indian citizen who is non-resident. The non-resident owner of villa had acquired this ancestral property through registered will of his late father. The total consideration to be paid to Mr. Christopher amounts to ₹ 5 crores (including advance payment of ₹ 1 crores).

In fact, it is also one of the reasons for planned redemption of MF investments in current financial year. He enquires from CA M regarding any precautions to be taken/legal requirements to be complied with at the time of entering such transaction. Mr. P also discusses the matter with said Mr. Christopher over phone who happens to be in India at that time for a short visit. He, in turn, also enquires from CA M regarding investment avenues, if any available to non-residents like purchase of other house/investments in NHAI bonds, under taxation laws to save capital gains tax and other requirements pertaining to filing of income tax return. It also transpires that India does not have any DTAA with the country of which Mr. Christopher is a resident.

Mr. Christopher plans to repatriate proposed sale proceeds of villa to the country in which he is resident. He does not know about modalities of the same and inquires from CA M in this matter.

I. Multiple Choice Questions

1. Mr. P has invested ₹ 10 crores in SBA Life Arbitrage fund. Which of the following statements is most appropriate about arbitrage funds?

   (a) Such funds tend to provide better returns than equity. However, they have lower volatility in comparison to equity. Besides, they seek to capitalize on price differential between spot and futures market. Expense ratios in arbitrage funds are likely to be lower as compared to liquid funds.

   (b) Such funds tend to provide better returns than debt instruments. However, they have higher volatility in comparison to equity. Besides, they seek to capitalize on price differential between spot and futures market. Expense ratios in arbitrage funds are likely to be higher as compared to liquid funds.

(c) Such funds tend to provide better returns than debt instruments. However, they have lower volatility in comparison to equity. Besides, they seek to capitalize on price differential between spot and futures market. Expense ratios in arbitrage funds are likely to be higher as compared to liquid funds.

(d) Such funds tend to provide better returns than equity. Therefore, they have higher volatility in comparison to equity. Besides, they do not seek to capitalize on price differential between spot and futures market. Expense ratios in arbitrage funds are likely to be lower as compared to liquid funds.

2. Mr. P is of the view that interest rates in economy are likely to rise. What likely impact it would have on NAV of debt fund? (Ignore other factors like duration of bonds etc.)

(a) It is likely to lead to fall in NAV of debt fund.

(b) It is likely to lead to rise in NAV of debt fund.

(c) NAV of debt fund is likely to remain at past level.

(d) NAV of debt fund is not affected by movement in interest rate.

3. As regards proposed purchase of villa in Goa from Mr. Christopher is concerned, which of the following statements is likely to be correct as regards deduction of tax at source (TDS) is concerned? Assume he does not have any other taxable income in India except capital gain from proposed sale of villa. Ignore surcharge and cess.

(a) Mr. P is required to obtain TAN. TDS is required to be deducted @ 1% of ₹ 5 crores. Entire TDS can be deducted at time of/before registration of title deed.

(b) It is not mandatory for Mr. P to obtain TAN. TDS is mandatorily required to be deducted @ 20% on ₹ 5 crores. However, TDS would be deducted at time of making advance payment as well as at time of making balance payment.

(c) It is not mandatory for Mr. P to obtain TAN. An application can be made to Assessing Officer for determining capital gains on which tax is to be deducted. In that case, TDS would be deducted at lower rate after determination of capital gains by AO in the international wing. If lower deduction certificate is not available, TDS would be deducted at maximum marginal rate of 30% on ₹ 5 crores. However, TDS would be deducted at the time of making advance payment as well as at time of making balance payment.

(d) Mr. P is required to obtain TAN. An application can be made to Assessing Officer for determining capital gains on which tax is to be deducted. In that case, TDS would be deducted at lower rate after determination of capital gains by AO in the international wing. If lower deduction certificate is not available, TDS would be deducted at 20% on ₹ 5 crores. However, TDS would be deducted at the time of making advance payment as well as at time of making balance payment.

4. As regards Mr. Christopher's enquiry regarding purchase of another residential property In India and investment in bonds of NHAI (National Highways Authority of India) and filing of income tax return, which of following statements is most appropriate? (Ignore issue of refund arising on account of TDS deduction for return filing.)

(a) Non-residents can make above said investments to save capital gains tax. However, after making investments, if he has no taxable income, there is no legal obligation to file income tax return.

(b) Non-residents can make above said investments to save capital gains tax. However, if his total income before giving effect to deduction against such investments exceeds basic exemption limit, there is legal obligation to file income tax return.

(c) Non-residents cannot make above investments to save capital gains tax. Such investments can be made by residents only to save capital gains tax. Therefore, question of obligation of filing of return would become superfluous as he would be compulsorily required to file income tax return showing taxable income from sale of villa.

(d) Non-residents can make investments by purchase of another residential property in India but cannot make investments in bonds of NHAI which can be subscribed by residents only. Therefore, filing of return would depend upon whether he has taxable income left after investing in residential house property.

5. Mr. Christopher plans to repatriate from India sale proceeds of villa. Which of the following statements is most appropriate in this regard?

(a) Proceeds up to USD 250000 can be repatriated in a financial year by using Liberalised Remittance Scheme (LRS) as it is a capital account transaction falling under the scheme.

(b) Proceeds up to USD 250000 can be repatriated in a calendar year by using Liberalised Remittance Scheme (LRS) as it is a capital account transaction falling under the scheme.

(c) Proceeds can be repatriated using NRO account subject to certain restrictions in a financial year.

(d) Proceeds up to USD 200000 can be repatriated in a financial year by using Liberalised Remittance Scheme (LRS) as it is a capital account transaction falling under the scheme.

II. Descriptive Questions

6. Since Mr. P wants to redeem his entire portfolio in month of October 2023, what should be the advice of CA. M to him regarding income tax implications of such redemption? (Do not calculate income tax liability in each case. Just describe manner of taxation and rates. Ignore surcharge and cess). What further advice he should offer regarding news heard on TV/messages received on mobile?

7. Mr. P has also plan to invest further amount of ₹10 crores in MTL Low Duration Fund and Bon India Low Duration Fund taken together in FY 2023-24. What are tax implications on redemption of above investment after holding it for more than 3 years down the line? (Assume that tax law as applicable in FY 2023-24 remains unchanged at time of redemption).

8. Mr. Christopher, a non-resident, is planning to sell his villa in Goa. Examine validity of transaction w.r.t FEMA, 1999.

ANSWERS TO THE CASE STUDY 1

I. Answers to the Multiple Choice Questions

1. **(c)** Arbitrage funds provide better returns than debt instruments as they work on the principle of capitalizing price differential between spot and futures market. Equities are riskiest and obviously have high rate of returns. However, arbitrage funds have lower volatility as compared to equity.

Typically, expense ratios in arbitrage funds are likely to be higher as compared to liquid funds. Since arbitrage funds would carry large number of trades to capitalize price differential between different markets, expense ratios tend to be higher as compared to liquid funds. Liquid funds invest in highly liquid money market instruments and debt securities of short tenure which are normally held till maturity resulting in lower expenses.

2. (a) Debt funds invest in government bonds/securities, high grade corporate bonds etc. There is inverse relationship between market value of bond and interest rates. As interest rate goes up, market value of bond falls and vice-versa. In economic conditions of rising interest rates, people would be unwilling to buy bonds carrying lower interest rates issued previously. Therefore, price of bond falls exhorting people to buy such bonds which were issued at a lower coupon rate. It, in turn, leads to fall in NAV.

3. (d) Tax on purchase of immovable property from non-resident owner is deducted u/s 195 of Income Tax Act, 1961 where the deductor is required to obtain TAN. There is no DTAA agreement with overseas country in which Mr. Christopher is residing. TDS would be deducted @ 20% on ₹ 5 crores. However, application can be made to AO u/s 195(2) or 197 for determination of capital gains on which tax is to be deducted. In that case, tax would be deducted at lower rate. Tax is deducted u/s 195 at the time of credit of such income to the account of payee or at the time of payment, whichever is earlier. Therefore, TDS deduction is required at time of paying advance as well as at the time of making balance payment.

4. (b) Non-residents can make investments by purchasing another residential property u/s 54 and/or by purchasing bonds of NHAI in accordance with provisions of section 54EC. There is no bar in these sections for investments to be made by Non-residents.

Under Section 139 of Income Tax Act, every person, if his total income without giving effect to the provisions of section 54 or section 54B or section 54D or section 54EC or section 54F or section 54G or section 54GA or Chapter VI-A exceeded the maximum amount which is not chargeable to income-tax, shall, on or before the due date, furnish a return of his income. Therefore, there is a legal obligation to file the return when total income before giving effect to deduction u/s 54 & 54EC exceeds basic exemption limit.

5. (c) Liberalised Remittance Scheme is available for resident individuals only. Sale proceeds of villa would be repatriated by non-resident Mr. Christopher using NRO account subject to certain restrictions in accordance with relevant regulations/circulars i.e. USD 1 million per financial year.

II. Answers to the Descriptive Questions

6. MTL Low Duration Fund and Bon India Low Duration Fund are debt funds. However, in case of MTL Low Duration Fund, holding period would likely to be more than 36 months. It would qualify as a long- term capital asset by virtue of provisions of 2(29AA) and 2(42A) of Income tax act. Therefore, long term capital gain would arise on redemption of units of this fund. Indexation benefit would be available and long- term capital gain would be taxable @ 20% u/s 112 of Income-tax Act, 1961.

In case of Bon India Low Duration Fund (another debt fund), holding period would likely to be less than 36 months. Therefore, short term capital gains would arise on redemption of units of this fund. Short-term capital gain would arise on redemption of these units taxable at normal rates of tax applicable to Mr. P. There is no special rate for short term capital gain on debt funds.

ADB New Energy Green Fund is an equity- oriented fund as it has invested more than 65% of its proceeds in equity shares of domestic companies. Short-term capital gains would arise due to redemption of units of this Fund in month of October 2023 as holding period would be less than 12 months in accordance with provisions of section 2(42A) of Income-tax Act. Such short-term capital gains of equity-oriented funds would be taxable @15% u/s 111A of Income-tax Act, 1961.

SBA Life Arbitrage Fund is also an equity-oriented fund just like ADB New Energy Green Fund. However, long term capital gains would arise on redemption of units of this fund as holding period would be more than 12 months. Such long- term capital gains would be taxable @10% u/s 112 A of Income-tax Act, 1961 exceeding ₹ 1 lakh.

CA M should inform Mr. P that there is no change in taxation pertaining to redemption of his investment portfolio as it stood on 31st March, 2023 and these would continue to be taxed as discussed above. The news/messages received by him are applicable to investments made on or after 1st April, 2023.

7. Both MTL Low Duration Fund and Bon India Low Duration Fund have invested 30% of their proceeds in equity shares of domestic companies. Finance Act, 2023 has introduced ***new section 50AA*** which states that capital gains arising on redemption of units of a Specified Mutual Fund which has been acquired on or after 1st April, 2023 shall deemed to be arising from transfer of a short-term capital asset. Specified Mutual Fund is a mutual fund which invests not more than 35% of its total proceeds in the equity shares of domestic companies.

Therefore, if Mr. P redeems his proposed investment even holding it for a period of more than 3 years down the line, indexation benefit would not be available to Mr. P and such income would be deemed as short-term capital gains and it would be taxable in accordance with slab rates applicable to him.

8. As per section 6(5) of the FEMA, 1999, a person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

   In the given case, villa at Goa was an ancestral property and was obtained through registered will of his father, who was an Indian resident. Sale of villa by a non-resident owner, is a valid transaction.