

Indian VCs may get pass-through tax sops in Budget

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The government is considering a proposal to extend the benefit of tax pass-through to domestic venture capital (VC) funds on investments across all sectors in the coming Budget. At present, this benefit is restricted to investments in only nine sectors — biotechnology, nanotechnology, IT hardware and software, R&D for new chemical entities, seed research, dairy, poultry, bio-fuels and large hotel-cum-convention centres.

Sources said that VCs had been urging the government to do away with this anomaly for quite some time now. They have also received positive feelers this time, the sources added.

A pass-through in taxation means that the business entity itself need not pay taxes. Instead, all taxable income is passed through to its owners or members. According to the provisions of the Income Tax Act, VC funds that invest in nine sectors do not pay any tax on the gains realised on such investments. But the investors, or limited partners (LPs), in these funds pay the tax.

For funds that invest in sectors other than the prescribed ones need to pay tax at the time of exit. Industry players said that the tax treatment often discouraged a lot of domestic private equity (PE) funds to invest in other sectors even if the underlying opportunity was good.

“It has discouraged funds from registering in India. It is a bit too late to allow the exemption now as the damage has already been done. A couple of funds that were earlier planning to register in India had to change their plans after the 2007 Budget,” said Arun Natarajan, managing director, Venture Intelligence, a firm that tracks PE players and VC funds.

Interestingly, foreign VC funds registered with the Securities and Exchange Board of India (Sebi) are exempted from paying any tax in India as most of them are also registered in Mauritius.

“An extension of the same benefit to Indian VC funds will restore parity with foreign funds that do not have to pay any tax,” said Rajesh Singhal, managing partner, Religare Milestone Private Equity.

At present, there are 132 Sebi-registered domestic VC funds and 129 foreign venture funds.

“A clarity on the taxation regime will act as a morale booster for the PE industry. It will be conducive for domestic VC funds that have been waiting to get the benefit extended to all sectors,” said Shefali Goradia, partner, BMR Advisors.