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BUDGET BUZZ

THE 2024 UNION BUDGET – FROM AN AIF PRISM

Budget Proposal

The Union Budget 2024 has a number of proposals that would have an impact on the bottom lines of alternative investment funds (**AIF**).

- Angel tax has been abolished.
- Long term capital gains tax (**LTCG Tax**) has been increased from 10% to 12.5% on all financial and non-financial assets. Short term capital gains tax (**STCG Tax**) has been increased from 15% to 20%.
- Indexation benefits are no longer available for property sales. Henceforth individuals selling their real estate properties or securities will no longer be able to adjust their purchase price using inflation.
- Securities transaction tax (**STT**) on the sale of an option in securities has been increased from 0.0625% to 0.1% of the option premium. STT on the sale of futures in securities has been increased from 0.0125% to 0.02% of the price at which such futures are traded.
- Variable capital companies (**VCC**) will be permitted.

ELP's Insights

The Union Budget announced by the Finance Minister Ms. Nirmala Sitharaman has turned out to be a mixed bag for AIFs.

Angel tax was introduced in 2012 to combat money-laundering, but turned out to be nuisance for startups and AIFs investing in startups. The angel tax of 30% on investments received by any unlisted company, that exceeds its fair market value, resulted in many fights over valuations and fair value. In 2019, startups which met certain criteria were exempted from this angel tax, but many startups failed to qualify. AIFs which invest in startups will welcome its abolition.

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Category 1 and Category 2 AIFs that rely primarily on capital appreciation of their portfolio companies to provide returns to their investors will be negatively affected by the hike in LTCG Tax and STCG Tax.

Indexation, which adjusts the acquisition price of property on the basis of inflation, reduced the amount of capital gains and in some cases, even provided for a loss, if the cost of acquisition, when adjusted for inflation exceeded the sale price. Earlier, LTCG Tax on property was 10% after indexation. Henceforth, LTCG Tax shall be 12.5% without indexation. Category 2 real estate funds will be particularly affected by the removal of indexation benefits.

It has been claimed that the hike in STT on F&O is meant to discourage retail investors from participating in the F&O segment, which could lead to huge losses for such retail investors. However, many Category 3 AIFs invest extensively in derivatives and they will be adversely affected by this hike.

The VCC structure, which is prevalent in and has proved to be very popular in jurisdictions like Mauritius and Singapore, allows funds to have sub-pools within, that have different investment objectives, investors, and asset classes, though they are governed by the same board of directors and have the same fund manager, custodian, auditor etc. Though the VCC would be a company, many regulations applicable to companies would be disapplied, to give flexibility to the VCC. It remains to be seen how the government will operationalize the VCC structure, whether it will be done under the Companies Act, 2013 or under a different law.

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