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CBDT prescribes minimum remuneration for fund managers

The CBDT has issued Notification dated 27 May 2020 prescribing minimum remuneration payable by qualifying offshore funds to their India-based fund managers

Background:

- Section 9A of the Indian Income-tax Act, 1961 (ITA) provides that offshore funds carrying out fund management activity through an India-based fund manager (IM) would:
 - neither be considered to be resident of India;
 - nor be regarded as having a business connection (similar to permanent establishment) in India.The above is subject to satisfaction of certain conditions.
- One of the conditions (effective 1 April 2019) relates to payment of prescribed minimum remuneration payable by offshore funds to their IM. The Central Board of Direct Taxes (CBDT) in November 2019 released draft rules prescribing three different minimum fee rates, depending on the type of fund and the remuneration arrangement.
- The CBDT has now finalised and prescribed the minimum remuneration payable by an offshore fund to their Indian IM, vide notification dated 27 May 2020 (Notification). The same has been introduced as an amendment to the existing Rule 10V of the Income-tax Rules, 1962 (Rules) relating to guidelines for application of Section 9A of the ITA.

Highlights of the Notification:

- The prescribed minimum remuneration to the Indian IMs are as follows: (Sub-rule 12 to Rule 10V of the Rules)

Sr.no.	Type of offshore fund	Minimum remuneration to the Indian IM
1	Category-I foreign portfolio investor being: <ul style="list-style-type: none">a. Government and government related investors such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled or at least 75% directly or indirectly owned by such Government and Government related investor(s);b. Pension funds and university funds;c. Appropriately regulated entities such as insurance or reinsurance	0.10% of the assets under management. The term "assets under management" means the annual average of the monthly average of the opening and closing balances of the value of such part of the fund, which is managed by the fund manager

Sr.no.	Type of offshore fund	Minimum remuneration to the Indian IM
	entities, banks, asset management companies, investment manager, investment advisors, portfolio managers, broker dealers and swap dealers; d. Entities from the Financial Action Task Force member countries which are university related endowments of such universities that have been in existence for more than five years.	
2	All other offshore funds	a. 0.30% of the asset under management; or b. 10% of profits derived by the fund in excess of the specified hurdle rate ¹ where the remuneration to the IM is only profit / income linked; or c. 50% of the management fee ² (attributable to management activity undertaken by the fund manager) as reduced by the amount incurred towards operational expenses including distribution expenses, if any. This is applicable only in cases where the offshore fund is making payment to another fund manager.

- The offshore fund could pay lower amount of remuneration to the Indian IM by obtaining prior approval from the CBDT.
- Sub-rules 5 to 10 to Rule 10V of the Rules which include deeming the offshore fund manager and the Indian IM as associated enterprises / related parties and thus, subject to Indian transfer pricing regulations, have been deleted with effect from 1 April 2019.
 - The offshore fund and the Indian IM will now not be deemed to be associated enterprises for the purpose of arriving at arm's length price and will not be required to carry out the transfer pricing compliances (unless they qualify as associated enterprises / related parties under the Indian transfer pricing regulations).
- The Indian IM would be required to obtain a report from an accountant in Form 3CEJA (provided in the Notification) certifying that the management fee received is in accordance with the prescribed methodology under these rules. The same will be in addition to any transfer pricing report required to be furnished (Sub rule 13 to Rule 10V of the Rules).

¹ "Specified hurdle rate" means a pre-defined threshold beyond which the fund agrees to pay a share of the profits earned by the fund from the fund management activity undertaken by the IM.

² "Management fee" means the amount mentioned in the certificate obtained from an accountant, as defined in clause (i) of Explanation to Rule 11UB of the Rules.

- The annual statement of activities required to be furnished by an eligible offshore fund to the tax authorities in Form 3CEK, has been amended.

Comments:

- The rules are relevant for offshore funds which undertake fund management activities from India and not in other cases.
- The notification will help offshore funds identify the minimum remuneration required to be paid to their IM from an income-tax perspective.
- The notification will reduce transfer pricing compliances required to be carried out by offshore funds and the Indian IM, which otherwise do not qualify as associated enterprises / related parties under the Indian transfer pricing regulations.



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