

FAQs



FAQs on Section 115TCA of the Income Tax Act, 1961

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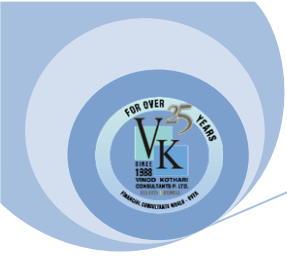
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The regulatory changes in the securitisation industry in the last few years have caused a see-saw swing in securitisation volumes. The revised guidelines on securitisation of standard assets issued in 2012 had brought back the PTCs regime only for it to fall out of favour with the introduction of distribution tax on securitisation trusts¹. Distribution tax was introduced with the intent to curb revenue leakage envisaged by the tax authorities in case of income received by mutual funds from investments in PTCs. The industry had made several representations to explain that world over, securitisation SPVs are pass-through in nature and that it would defeat the purpose of creating a conduit if tax was deducted at the time of distribution.

The Union Budget, 2016 has corrected this anomaly by replacing the distribution tax with tax deducted at source. ISF had played a lead role in explaining why distribution tax would have a negative impact on the industry. The change in the tax provisions were much awaited by the industry and hopefully will bring back the PTCs transactions allowing the markets to grow beyond direct assignments.

In this article we have attempted to address some of the questions that arise out of the proposed tax changes in the recent budget.

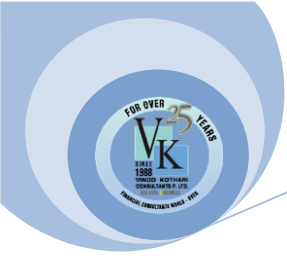
Overview of the provisions

1. What are the tax changes introduced in the budget pertaining to securitisation trusts? How do the provisions compare with the provisions of the existing law?

The Finance Bill, 2016 has proposed following amendments pertaining to securitisation trusts:

- a. **Distribution tax not applicable:** Sub-clause (5) of section 115TA is introduced to say that distribution tax as provided for in section 115TA shall not be applicable for income distributed by the trust to its investors on or after 1st June, 2016.
- b. **Section 115TCA introduced:** The section starts with a *non-obstante* clause, saying that any income accruing or arising to, or received by, a person, being an investor of a securitisation trust, out of investments made in the securitisation trust, shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person, had the investments by the securitisation trust been made directly by him.
- c. **Section 194LBC introduced:** Section 194LBC has been introduced whereby the income payable to a resident investor by a securitisation trust shall be subject to tax deduction at source at the rate of 25% for individual

¹ Finance Act, 2013 introduced Chapter XII EA in the Income Tax Act, 1961 pursuant to the provisions of which, the income distributed by the securitisation trusts would be subject to distribution tax at the rates specified in Section 115 TA of the Income Tax Act, 1961. Income received by the investors would be exempt from tax in the hands of the investors.



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or HUFs and at the rate of 30% for any other person. In case of a non-resident investor or a foreign company, the rates in force shall apply

- d. **Security receipts included as securities:** Security receipts² have been included in the definition of securities. Any investor who holds *securities*, issued by securitisation trusts shall be considered investor for the purpose of the chapter.
- e. **Securitisation trusts to include trusts set up by asset reconstruction companies:** The definition of securitisation trusts has been amended to include trusts set-up by a securitisation company or a reconstruction company formed, for the purposes of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

2. Do sections 115TA to 115TC become redundant with effect from the implementation date of sec. 115TCA?

No. the provisions will remain relevant for the purpose of definition of terms used in sec. 115TCA. Note that Explanation below sec. 115TC starts with the words “for the purposes of this Chapter”.

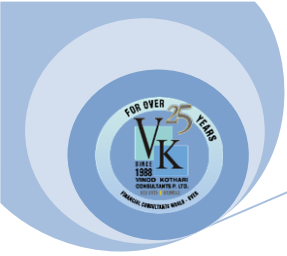
3. From when are the pass-through provisions applicable?

The exemption from distribution tax is applicable from 1st June, 2016. The proposed section for pass-through (section 115TCA) is applicable for income-year 2016-17. Also, Section 10 (35A) which was granting the tax exemption to distributed income has not been deleted. However, a proviso has been inserted to provide that nothing in the said section shall apply to distribution of income on or after 1st June, 2016. Therefore, for distributions made till 1st June 2016, there will be confusion as to whether sec 115TA applies, or sec 115TCA.

4. Is there a total pass-through for securitisation trusts?

There is pass-through for securitisation trusts. However, any income credited to the investor by the securitisation trusts shall be subject to tax deduction at source under section 194LBC of IT Act. While the income is subject to tax deduction at source, the investor will be able to get full credit for tax paid. In case of tax exempt investors such as mutual funds, or other investors not likely to have as much tax liability, the

² “security receipt” shall have the same meaning as assigned to it in clause (zg) of sub-section (1) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. Briefly speaking, security receipts are used in acquisition of non-performing assets by asset reconstruction companies, which usually acquire them on the books of a trust, by issuing security receipts to the investors.



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investors may apply to the tax officer of relevant jurisdiction for certification at NIL rate of deduction of tax at source.

5. From when will section 115 TCA come into force?

The provisions of section 115TCA shall be applicable from 1st April, 2017. This implies that the provisions will be applicable for income year 2016-17.

Scope of applicability

6. What sort of securitisation trusts are the provisions of Chapter XII EA applicable to?

Chapter XII EA of IT Act includes the following types of securitisation trusts:

- a. Special Purpose Distinct Entity³ as defined under section 2 (1)(u) of Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008⁴;
- b. Special Purpose Vehicle⁵ as defined by the guidelines on securitisation of standard assets⁶;
- c. Special Purpose Vehicle which fulfils conditions as specified by RBI⁷;
- d. Trusts set up by securitisation company or a reconstruction company for the purposes of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

7. What sort of securities will the provision of Chapter XII EA applicable to?

The term “securities” now includes security receipts.

Securities mean debt securities issued by a Special Purpose Vehicle as referred to in the guidelines on securitisation of standard assets issued by the Reserve Bank of India.

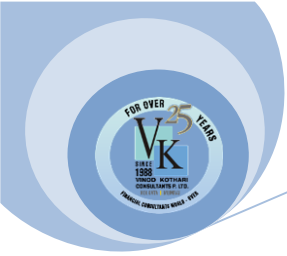
³ “special purpose distinct entity” means a trust which acquires debt or receivables out of funds mobilized by it by issuance of securitised debt instruments through one or more schemes, and includes any trust set up by the National Housing Bank under the National Housing Bank Act, 1987 (53 of 1987) or by the National Bank for Agriculture and Rural Development under the National Bank for Agriculture and Rural Development Act, 1981 (61 of 1981)

⁴ <http://www.sebi.gov.in/acts/sdireg.pdf>

⁵ 'SPV' means any company, trust, or other entity constituted or established for a specific purpose - (a) activities of which are limited to those for accomplishing the purpose of the company, trust or other entity as the case may be; and (b) which is structured in a manner intended to isolate the corporation, trust or entity as the case may be, from the credit risk of an originator to make it bankruptcy remote;

⁶ Guidelines on Securitisation of Standard Assets issued by RBI on 1st February, 2006, <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=2723&Mode=0>

⁷ Currently no conditions have been prescribed by RBI



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Security receipts⁸ shall have the same meaning as assigned to it in clause (zg) of sub-section (1) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

8. Will the provisions of Chapter XII EA be applicable to securitisation trusts outside the purview of Chapter XII EA?

The provisions of Chapter XII EA of IT Act are applicable to such securitisation trusts that are defined under the chapter (see responses to question 5 above). Any other securitisation trust outside the specified framework may not be eligible for the pass through structure. Since pass through is granted by specific provision of law, and is, by presumption, not applicable unless the trust is treated as a “special purpose vehicle” defined in sec 115TC, it will remain highly uncertain to expect a pass through treatment in case of any other securitisation trust. .

Manner of Taxation

9. What are the principles of tax proposed under Finance Bill 2016?

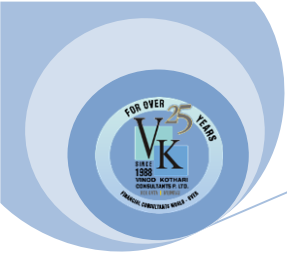
The principles of tax may be summed as follows:

- a) The nature of income, for example, business, profits or capital gains, in the hands of the investors will be the same as the nature of income in the hands of the SPV.
- b) The income is taxed, in the hands of the investor, at the time of distribution of the income, or, if the income is not distributed, that is, accumulated, then, at the time of crediting the income to the credit of the investor.
- c) Income remaining undistributed will be deemed credited to the investors in accordance with the respective investors’ entitlement. That is to say, there is no possibility of using the securitization SPV as a tax shelter.

10. How the securitisation trusts are going to be taxed after the insertion of Section 115 TCA?

The income distributed, or credited by the securitisation trusts shall be subject to tax deducted at source and not distribution tax. Note that there is a deemed credit, by virtue of sec. 115TCA (3) if the income is accumulated at the end of the financial year by the trust.

⁸ "security receipt" means a receipt or other security, issued by a securitisation company or reconstruction company to any qualified institutional buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitisation;



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11. How are the investors in securitisation transactions going to be taxed after the insertion of Section 115 TCA?

As per the provisions of section 115TCA, any income accruing or arising to, or received by, a person, being an investor of a securitisation trust, out of investments made in the securitisation trust, shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person, had the investments by the securitisation trust been made directly by him.

The income of the investors shall be subject to tax deduction at source at the time of distribution. Such income will be taxable in the hands of the investors. The investors will get full credit for the tax deducted at source.

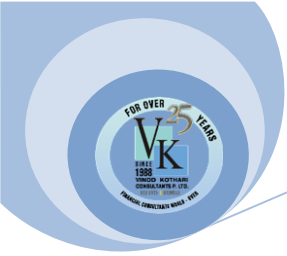
12. While pass-through provisions are applicable from 1st June, 2016, the taxation on investors shall be applicable from 1st April, 2017, what is the implication of the same? Is there a timing mismatch?

The provisions of distribution tax are exempt from 1st June, 2016. The provisions of pass-through are applicable from 1st April, 2016. For income distributed in April and May, 2016, distribution tax will be applicable as the exemption is from 1st June, 2016 and the income shall also be taxable in the hands of the investors as the pass-through is granted since 1st April, 2016.

Therefore, there seems to be a confusion on how the income accruing/ credited/ arising in April and May 2016 shall be subject to tax. While the provisions of section 115TCA starts with a non-obstante clause, it may be argued that a later provision overrides an earlier provision, and therefore, there will be no distribution tax for the 1st April 2016. At the same time, the provision for deduction of tax at source in sec. 194LBC applies from 1st June 2016. To avoid confusion, trusts may take steps to defer distribution by till 1st June 2016.

13. Section 10(35A) provided for an exemption in the hands of the investors with respect to the income received from securitisation trusts as per Section 115TA, what will be the status of this exemption after 1st June, 2016?

Section 115TCA has an overriding impact. Further a proviso has been inserted to provide that nothing in the said section shall apply to distribution of income on or after 1st June, 2016. Thus, on account of the above proposed amendment, exemption under section 10(35A) will be not be available from 1st June 2016.



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14. Section 115TCA is applicable on “income distributed” or on any income accrued to the investors?

The provisions of section 115TCA is applicable on any income accruing, arising or received. Whether distributed/ credited or not if the income has accrued, it shall be deemed to have been credited on the last day of the previous year.

15. What happens to the income distributed by securitisation trusts under the existing transactions, between 1st April, 2016 and 1st June, 2016?

As discussed in question 11 above, there is no clarity on the income distributed by securitisation trusts between 1st April, 2016 and 1st June, 2016.

16. Under section 115 TCA (4) the securitisation trusts are required to furnish a statement giving details of income distributed or credited during the previous year. Will the format of statement under section 115 TA (3) be used for statement required under section 115 TCA (4)?

There is a provision for prescription of a format prescribed under section 115TCA (4).

17. What are the provisions of section 194LBC pertaining to income distributed by securitisation trusts?

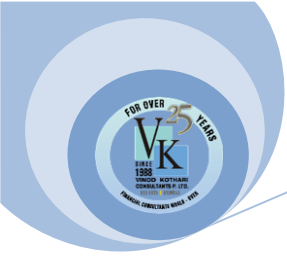
Section 194LBC, applicable from 1st June 2016, states that the income payable to:

- a. Resident investor by a securitisation trust shall be subject to tax deduction at source at the rate of
 - i. 25% for individual or HUFs and
 - ii. 30% for any other person.
- b. In case of a non-resident investor or a foreign company, the rates in force shall apply.

18. Will TDS provisions be levied on income distributed/ credited to mutual funds as well?

Section 197⁹ of the IT Act, requires the assessee to apply to the assessing officer to get a certificate for lower rate of TDS being applicable to the assessee. The AO

⁹ 197. 99(1) Subject to rules made under sub-section (2A), where, in the case of any income of any person or sum payable to any person, income-tax is required to be deducted at the time of credit or, as the case may be, at the time of payment at the rates in force under the provisions of sections 192, 193, 194, 194A, 194C, 194D, 194G, 194H, 194-I, 194J, 194K, 194LA, 194LBB, 194LBC (Inserted from 1st June, 2016) and 195, the Assessing Officer is satisfied that the total income of the recipient



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having satisfied may allow TDS to be deducted at the rate specified in the certificate. As far as the trust is concerned, the trust will have to deduct tax at source unless it receives a NIL or lower deduction certificate from the investor.

19. Will the TDS provisions be applicable on Excess Interest Spread as well?

The basis of taxability under sec. 115 TCA is either of these: (a) distribution or crediting of income; or (b) if income is not distributed or credited, then, the entitlement to such income as at the end of the income year. As regards excess spread, usually, transactions may provide for a pass-through of the excess spread, or its trapping and pooling to create or replenish a cash reserve, to serve as a liquidity or credit support. In any event, if it is clear that the excess spread is available for the credit of the originator, then the excess spread will be deemed to be the income of the originator. However, if the excess spread has been retained by way of credit enhancement, such that there is no clarity as to who is “entitled” to such income, then the accumulated income is not liable to be taxed as the income of the originator, as there is no entitlement in such case.

20. Will over collateralisation be subject to tax deduction at source?

Over collateralisation is merely creating a security. Therefore receivable forming part of the seller’s interest shall not be subject to tax deduction at source.

21. Have the TDS provisions nullified the removal of distribution tax?

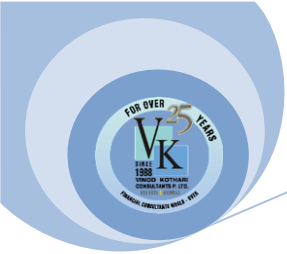
Deduction of tax at source is not as bad as suffering distribution tax, for several reasons:

- a. The investor gets full credit for tax paid.
- b. The investor may seek a certificate for deduction of tax at lower rate. If the investor is tax exempt, say, in case of a mutual fund, the investor may apply for certification at NIL rate of deduction of tax at source.

justifies the deduction of income-tax at any lower rates or no deduction of income-tax, as the case may be, the Assessing Officer shall, on an application made by the assessee in this behalf, give to him such certificate as may be appropriate.

(2) Where any such certificate is given, the person responsible for paying the income shall, until such certificate is cancelled by the Assessing Officer, deduct income-tax at the rates specified in such certificate or deduct no tax, as the case may be.

(2A) The Board may, having regard to the convenience of assesseees and the interests of revenue, by notification in the Official Gazette, make rules specifying the cases in which, and the circumstances under which, an application may be made for the grant of a certificate under sub-section (1) and the conditions subject to which such certificate may be granted and providing for all other matters connected therewith.



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22. Can FPIs now invest in PTCs?

As an annexure to the budgetary speech, the Finance Minister seems to have permitted foreign portfolio investors (FPIs) to invest in securitization vehicles. So far, FPIs were permitted to invest in security receipts issued by ARCs, but not in securitization transactions. However appropriate provisions have to be inserted in the FPI regulations for the proposed amendment to take effect.

23. The tax u/s 115TCA is applicable to “income” of the securitisation trust. Is it correct to say that income of the trust will have to be computed applying the usual principles of computation of income under the income tax Act?

Yes, the understanding is correct. Sec. 115TCA exposes to tax income of the securitisation trust in the hands of the investors. In that sense, it is a vicarious tax that the investors pay on the income determined in the hands of the trust. The income will first have to be determined after allowing all such deductions as are claimable in the hands of the trust. Once the income is determined, it becomes taxable in the hands of the investors.

24. What is the point of time when the income becomes taxable?

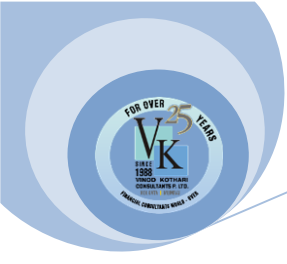
In view of a combined reading of sec 115TCA (2) and (3), the manner, the point of taxability is earliest of:

- a. Distribution
- b. Giving of credit to investors
- c. at the close of the financial year

25. Several securitisation transactions require an income to be retained – say, in a cash reserve account. Is this income to be credited to investors, or will this income also be liable to be taxed in the hands of the investors?

The credit enhancement structures in several transactions require pooling of income, trapping of income or redirection of income. These incomes are retained, pooled or redirected to be used as credit support. For example, if the transaction requires a cash reserves to be maintained in the transaction, whether the reserve will be used for paying off senior investors in time to come or it will be used to go back to the originator is not known at the time of trapping.

The question of a tax on investors arises only where the investors are determinate. If an income is accumulated or retained, but there are no determinate investors, there is no question of tax on the investors.



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26. Is it correct to say that the basis of taxation of income earned by the trust in the hands of investors is the entitlement to income by the investors?

Sec 115TCA (3) gives an impression that the entitlement to income is the basis in case of income which is neither distributed, nor credited to the account of the investors. That is, in case of accumulation with no corresponding clear entitlement, there is no question of tax in the hands of investors.

27. Is it possible to contend that a securitisation trust pooling income, without any clear identifiable investor, may be taken as a representative assessee, liable to tax at MMR?

Sec 115TCA starts with a non obstante provision. Therefore, there is no question of tax applying rep tax principles.

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