



Tax alert: HC allows exemption to VCF sans separate SEBI registration for each scheme

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The Bombay High Court (HC) has allowed exemption under section 10(23FB) of the Income-tax Act, 1961 (ITA) to a registered Venture Capital Fund even if no separate registration was obtained for each scheme. Further, the holding of shares by trustee in its fiduciary capacity, on behalf of the Fund, cannot be considered for determining whether Venture Capital Undertaking is an associated company or not.

In a nutshell



As per the VCF regulations, only the Trust is required to be registered as a VCF and separate registration is not required for each scheme operated by the Fund. With reference to each scheme, the only requirement is that the Trust or the Fund must submit a copy of the private placement memorandum for each scheme before SEBI.

From the VCF Regulations, it was clear that registration is granted to the Trust and not for an individual scheme operated by the Trust.



The VCF Regulations prohibit investments in an 'associate company' by a VCF. Associate company is defined in the relevant VCF Regulations, *inter alia*, to mean a company in which the trustee holds, either individually or collectively, equity shares in excess of 15% of the paid-up equity share capital of a VCU. Therefore, the holding of the trustees is to be seen in their individual capacity and not by virtue of the Fund making an investment in the VCU which investment (shares) must be held by the trustee in that capacity.

Background:

- The taxpayer¹ is a Trust created under the Indian Trust Act, 1882 and is a Venture Capital Fund (VCF) registered with the Securities Exchange Board of India (SEBI) under the SEBI (Venture Capital Funds) Regulations, 1996 (VCF Regulations). The primary activity of the taxpayer is to float various schemes with a focus to invest primarily in entities engaged in the real estate sector dealing with immovable property of any kind and any rights and interests therein.
- During the Financial Year 2013-14, corresponding to Assessment Year (AY) 2014-15, the taxpayer claimed exemption under section 10(23FB) of the Income-tax Act, 1961 (ITA) being income earned by it from investment in Venture Capital Undertakings (VCUs).

The taxpayer had floated separate schemes and under each scheme, separate units were issued to unit holders of each scheme and the unit holders in each scheme had rights to the profits earned from the investments made in their scheme. The taxpayer maintained separate accounts for each scheme and investments from the funds contributed to each scheme were also separately recorded.

Income from each scheme was also separately determined. The details of the claim for exemption under Section 10(23FB) of the Act is also determined scheme-wise. As all separate schemes were floated by the taxpayer fund, the income-tax return was filed by the taxpayer in a consolidated manner, considering all the separate schemes which comprised the taxpayer fund.

- During the course of assessment proceedings, the Assessing Officer (AO) denied the exemption under section 10(23FB) of the ITA [Schedule V of the Income-tax Act 2025], *inter-alia*, on following reasons:
 - Every scheme floated by the taxpayer had a separate identity. The contributors of the respective schemes were different and did not have any claim on the result of the other scheme. Separate books of accounts were maintained for each of the separate schemes. Investments made by each scheme were different and did not have any relationship with one another.
 - Therefore, it was as if, there were separate funds being operated by the taxpayer. There was nothing to show that SEBI had accepted or granted recognition / registration to each of the separate funds floated by the taxpayer. Each such fund was required to be separately registered with SEBI for claiming exemption under section 10(23FB) of the ITA.
 - The trustees held shares in excess of 15% of the equity share capital of various VCUs, and therefore, such investments were in contravention of the ITA and the scheme.
- Aggrieved, the taxpayer filed an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)]. The CIT(A) allowed the taxpayer's appeal and allowed the exemption under section 10(23FB) and held as below:
 - The schemes launched by a VCF were not separate and distinct from the Fund itself. VCF Regulations permit a VCF to launch various schemes so that each such scheme may have a distinct objective, a separate bank account, separate set of investors and underlying investment of each such scheme. Each such scheme did not require separate registration.

Once the Trust is registered with SEBI as a VCF, such registration is valid for all schemes launched by the said VCF.

For exemption under section 10(23FB) of the ITA, the AO only needs to enquire whether the taxpayer held a valid certificate of registration. If the Trust is registered with SEBI as per the relevant VCF Regulations, then it should be accepted that such certificate is granted after ensuring that the conditions laid down before granting such certificate are fulfilled.

¹ PCIT v Mile stone real estate fund [ITA No. 1209 of 2022] (Bombay HC)

- To determine whether a VCU was an associated company or not, one had to see the shareholding of the trustees in their personal capacity in such undertaking and not the shareholding which the trustees are holding for and on behalf of the taxpayer.

There is no restriction on the percentage of holding by the VCF in the VCU and a VCF can hold up to 100% shares of a VCU. Therefore, the finding of the AO that to see as to whether the VCU was an associated company, the shares held by the trustee for and on behalf of the Fund was also required to be considered, was clearly unsustainable and bad in law.

- Aggrieved, the Revenue filed an appeal before the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT), which was dismissed and ITAT confirmed the CIT(A)'s order.
- Aggrieved the Revenue filed an appeal before the Bombay High Court (HC).

Relevant provisions of the ITA

Section 10

“In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included—

....

(23FB) any income of a venture capital company or venture capital fund [from investment] in a venture capital undertaking...

...Explanation- for the purposes of this clause-

...(b) “venture capital fund” means a fund —...

...(A) operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908), which—

(I) has been granted a certificate of registration, before the 21st day of May, 2012, as a Venture Capital Fund and is regulated under the Venture Capital Funds Regulations...”

Decision of the HC:

The HC acknowledged that the issue for consideration was whether (i) the taxpayer was eligible for claiming exemption under 10(23FB) of the ITA even though no separate recognition / registration was obtained from SEBI for every contributory scheme and (ii) the taxpayer made investments in associated concerns in which trustees held shares (by virtue of being trustees of the taxpayer) exceeding 15% of the paid-up equity share capital either individually or collectively and therefore not eligible for exemption under section 10(23FB) of the ITA.

In this regard, the HC held as follows:

- As per the VCF regulations, only the Trust is required to be registered as a VCF and separate registration is not required for each scheme operated by the Fund. With reference to each scheme, the only requirement is that the Trust or the Fund must submit a copy of the private placement memorandum for each scheme before SEBI.

From the VCF Regulations, it was clear that registration is granted to the Trust and not for an individual scheme operated by the Trust.

Therefore, the CIT(A)'s order was to be upheld that what was contemplated under the VCF Regulations is the registration of the Trust, which was then entitled to operate separate schemes. The said finding was also confirmed by the ITAT. Considering the concurrent findings by the appellate authorities, the question did not give rise to any substantial question of law and the same was not to be entertained.

- For a VCU to be considered as an associated company, the trustees or the settlor should hold more than 15% of the shares of the VCU, individually or collectively, in their personal capacity and not with respect to

the shares held by the trustee on behalf of the Fund.

The VCF Regulations prohibit investments in an 'associate company' by a VCF. Associate company is defined in the relevant VCF Regulations, *inter alia*, to mean a company in which the trustee holds, either individually or collectively, equity shares in excess of 15% of the paid-up equity share capital of a VCU. Therefore, the holding of the trustees is to be seen in their individual capacity and not by virtue of the Fund making an investment in the VCU which investment (shares) must be held by the trustee in that capacity. The CIT(A) rightly held that the holding of the shares by the trustee in its fiduciary capacity, on behalf of the Fund, could not be considered for determining whether the VCU is an associated company or not.

- Once the taxpayer operates under a trust deed registered under the provisions of the Registration Act, 1908 and has a registration from SEBI as a VCF [granted before 21st May 2012], which has not been cancelled or withdrawn, the conditions in the definition are satisfied.

Nothing was brought on record by the Revenue that SEBI, which is the appropriate regulatory authority, had alleged or taken any action against the taxpayer for any violation of the Venture Capital Regulations even though quarterly reports are filed by the taxpayer before SEBI. In the absence of such allegation or violation, it was not open to the Income-tax Department to make such an allegation and deny exemption under section 10(23FB) of the ITA.

Comments:

A venture capital fund is a pooled investment vehicle that collects capital from investors such as high-net-worth individuals, institutional investors etc., to invest in potential high-growth companies in exchange for units in such Fund. The Fund may float various schemes which may be subscribed by different subscribers.

The Fund may be eligible for exemption under section 10(23FB) of the ITA, subject to satisfaction of conditions. The HC in this ruling while holding that the taxpayer Fund was eligible for claiming exemption under 10(23FB) of the ITA, has laid the following principles:

- As per the VCF regulations, only the Trust is required to be registered as a VCF and separate registration is not required for each scheme operated by the Fund. With reference to each scheme, the only requirement is that the Trust or the Fund must submit a copy of the private placement memorandum for each scheme before SEBI.

From the VCF Regulations, it was clear that registration is granted to the Trust and not for an individual scheme operated by the Trust.

- The VCF Regulations prohibit investments in an 'associate company' by a VCF. An associate company is defined in the relevant VCF Regulations, *inter alia*, to mean a company in which the trustee holds, either individually or collectively, equity shares in excess of 15% of the paid-up equity share capital of a VCU. Therefore, the holding of the trustees is to be seen in their individual capacity and not by virtue of the Fund making an investment in the VCU which investment (shares) must be held by the trustee in that capacity.

It is pertinent to note that this ruling relates to the erstwhile VCF regime and eligibility for exemption under section 10(23FB). Post-May 2012, registration of VCFs are generally governed under Category I Alternate Investment Funds (AIFs) under the AIF Regulations or the relevant IFSC² regulations.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.

² International Financial Services Centre



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