Budget 2013: Angel investors, private equity and venture capital funds seek liberal tax regime

The risk capital industry, which comprises angel investors, private equity and venture capital funds, has sought incentives in the Budget, including higher flow of domestic capital through a liberal tax regime.

The sector, which is battling a drop in new deal flows and disenchantment amongst global investors, has also asked for a uniform tax structure for all funds and greater clarity on the controversial tax avoidance rules.

"The government must mandate insurance companies, the Employee Provident Fund and public sector enterprises to set aside 1%-2 % of their corpus for investment in private equity and venture capital funds," said Mahendra Swarup, president of Indian Venture Capital Association.

The industry feels that uncertainty on policy issues—only partially mitigated by the deferment of the General Anti-Avoidance Rule (GAAR)—has had a hand in depressing sentiment in last year's investments. Data shows that total investments in 2012 dropped to $7.5 billion (Rs 40,387 crore), shrinking about 16 % from the $9.6 billion invested a year earlier. At the same time, fund managers have struggled to raise fresh capital.

"India is no longer one of the top three destinations for risk capital globally," said Mayank Rastogi, a partner at the private equity practice for Ernst & Young, a consulting firm.

In 2012, the industry saw an inflow of $3.8 billion for new funds, less than half of the targeted amount of $9.8 billion. According to IVCA's Swarup, the decade-old domestic industry should cut its dependence on foreign capital. "In China, RMB (yuan) denominated funds are larger than dollar funds," he said.

The industry's wish list also includes clearer guidelines on long-term capital gains for risk capital investors and changes to de-listing norms. "If a private equity fund can buy out minority shareholders at an agreed price rather than a price discovered during an open offer, it will facilitate more buyouts," said JM Trivedi, partner and head of South Asia at private equity fund Actis. Experts agree that a uniform tax structure will benefit the industry.

In the last Budget, a tax benefit had been extended to all investments made by venture capital funds registered with the market regulator, Sebi. However, in September, Sebi announced the Alternative Investment Fund Regulations, which allows tax benefit to only a certain category of funds, including social venture and infrastructure funds. Experts say the government should the government should address this incongruity, as a single structure of taxation for all funds is critical to promote private equity and venture capital investments in the country.

"The classic private equity fund set up under the AIF regulations does not qualify for an automatic tax pass through," said Subramaniam Krishnan, a partner in the financial services practice at Ernst & Young.

It is such regulatory flip-flops in the past year that have become a cause for worry for risk capital funds. This includes uncertainty over whether the recommendations of the recently convened Parthasarathi Shome Committee will be adopted. This includes the deferment by three years for implementation of GAAR and the parameters where it can be applied. "It will be comforting if the government adopts them soon. It will provide a fillip to PE investing by allaying uncertainty around exits," Trivedi said.

Seeking consistency in the regulatory framework, Swarup said, "This industry invests for the long term with a 7-10 year horizon, and a consistent policy framework is required to build an investment thesis."

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