Holding Entities HQD Singapore

Investors and high net-worth individual (HNIs) who have invested in private equity (PE) and venture capital (VC) funds are thinking of setting up holding entities headquartered in Singapore, following a recent ruling by a tax tribunal that indirect taxes may be applicable on carry fees.

Carry fee is essentially a share of profit or investment that fund managers tend to earn million in carry fees when they invest the money of PE or VC funds and they exit such investments.

The worry is that a goods and services tax (GST) rate of 18% could be levied on carry fees, experts said, and most funds are certain to pass on the GST levy to investors, impacting their returns.

A holding entity in Singapore, where the "Profits" are accumulated, could do away with not only the risk of a GST levy but also halve their direct tax outgo, the experts said.

Over the last two weeks, many PE funds have held "informal" interaction with their top investors about such an option. A tax tribunal had ruled recently that service tax-which was under the erstwhile tax regime but has since been subsumed under the GST-is applicable on cable on carry fees.

"The recent decision, while in the context of the erstwhile service tax regime, could open up several issues from a GST perspective as well, and these could have a significant bearing on various decisions to be taken by AIFs (alternative investment funds) and similar entities. There is a need to evaluate all tax issues emanating from the decision as the implications could be different for various entities," said MS Mani, partner, Deloitte India.

The tax department had argued that carry fee is nothing but a "variable pay" or variable performance fees and that indirect taxes should be levied on that.

This came after a tax tribunal held that indirect taxes are applicable on expenses incurred by VC, PE and mutual fund firms, even under a trust structure, ET reported previously.

This means expenses such as 'carry fees', legal fees and salaries incurred

Industry trackers said investors pay around 50% income tax in India on their returns from AIFs, PE or VC funds.

Against this, the tax outgo could drop to 20% if the holding entity is based outside the country or if the person receiving it is not an Indian citizen.

This also takes away the risk of 18% GST, tax experts said.

“Assuming that tomorrow Singapore also decides to slap GST on carry fees, which would be at 7%, so it would still make sense to move there,” said a tax expert in the know of developments.

In the last few years, many funds have created structures where they raise funds in India and provide returns to domestic investors.
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