
EXPENSES INCURRED FOR THE MANAGEMENT OF A VCF FUND ESTABLISHED AS A TRUST, TAXABLE: CENTRAL EXCISE AND SERVICE TAX APPELLATE TRIBUNAL, BANGALORE

The Bangalore Central Excise and Service Tax Appellate Tribunal (“CESTAT”) in the case of *ICICI Econet and Internet Technology Fund vs. Commissioner of Central Tax, Bangalore*, has ruled for the Venture Capital Funds (“VCF”) which are set-up as trusts that these trusts act as a service provider, thereby suggesting that arrangement between the contributor and the trust is that of a receiver and supplier of services and hence the consideration provided in lieu of the management of these trusts is levi-able to service tax.

Brief Facts:

- ICICI Econet (“Appellant”) is a VCF established as a trust with an Indenture of Trust or Trust deed. The VCF had an Investment Manager or an Asset Management Company (“AMC”) to whom management fees was being paid. Further, the AMC was also a contributor to the VCF and was paid a carried interest or commonly termed as a carry.
- To ensure that the contributors receive relevant professional and experienced advice, the Trustees appointed an Asset Manager. In addition, various other service providers like custodian, brokers, etc were appointed.
- The trust debited the charges pertaining to the other service providers as expenses incurred in relation to management of the Fund and the value of the investments of the contributors would accordingly be determined net of such debits.
- All these transactions were as per the original agreement drawn up at the time of receiving the contributions. The revenue has alleged that the expenses so reduced and the carry paid to the AMC are for the services rendered by the VCF to their investors and should be offered to service tax.
- The VCF had during the period expensed out the entire CENVAT credit received by it in view of the position taken to not discharge service tax on the output side, which was contested by the Revenue.

Observations of the court

- Appellant is a person registered as per section 2(m) of the VCF regulations under the SEBI Act, 1992. Furthermore, these trusts are treated as juridical persons for the purposes of SEBI Regulations, they should also be treated so for the purpose of taxation. Furthermore, Taxation Law being a specific legislation just as the SEBI Act, 1992 should prevail over the general Trust Act and the definition given thereof. The trust is established with pecuniary interest and the objective is to earn profits. Therefore, the Services rendered by the VCF established as trust to its contributors get squarely covered under the banking and other financial services category. Therefore, the expenses which are retained from the profits of investors would qualify as a consideration against such services and would be liable to service tax.
- Reliance was placed on the decision of the Hon’ble Supreme Court in **Bangalore Club Vs. CIT & Ors.** reported in **2013-5-SCC-509**, wherein the following three conditions have been laid down:
 - There must be a complete identity between the contributors and participators;
 - The actions of the participators and contributors must be in furtherance of the mandate of the association, and;
 - There must be no scope of profiteering by the contributors from a fund made by them which could only be expended or returned to themselves.
- Clubs are mostly for leisure and other social activities, and the trust in the present case is established with the intent to pursue a commercial activity. Furthermore, the VCF distributes unequal profits to its investors as per its own discretion. Also, the trust received contributions from its contributors, but, unlike clubs, it invested money in asset classes outside rather than spend the money directly for the

benefit of the contributors Hence, the principle of mutuality does not apply to the trust in the present case.

- The carry paid to the AMC is actually an additional performance fees which should form a part of the taxable income of the trust.
- Therefore, the case was remanded back to the adjudicating authority for the purpose of re-computing the tax amount after considering eligible input tax credits, provisions for losses and cum-tax benefits.

VA Comments:-

- This judgment has a huge negative implication upon the banking and finance sector. Therefore, the grounds considered by the CESTAT Bangalore in passing this judgment may be appealed before the High Court.

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