5 points related to Conservative Hybrid Funds

What are Conservative Hybrid Funds (CHFs)

They are open ended hybrid mutual funds that predominantly invest in debt securities. According to SEBI their asset allocation should be:

Type of Instruments	Normal Allocation (% of Net Assets)
Debt securities (including securitised debt) & Money Market instruments	75 to 90
Equities & Equity related instruments	10 to 25

The Scheme invests 75-90% of its assets in government securities, treasury bills, bonds, debentures and other money market instruments. The rest is allocated to equities & equity related instruments.

It is 'conservative' in the sense that most of the corpus is invested in a mix of accrual and duration instruments without taking on excessive credit or interest rate risk.

It is 'hybrid' owing to the inclusion of Two asset classes within one Scheme.

How does a CHF help investors?

1. The debt allocation has the potential to provide investors with a regular income - in the form of rent or dividend.

2. The non-debt portion has the potential to grow in the Net Asset Value owing to changes in the market-price of the underlying assets over a period of time.

What are the costs inherent in a CHF

As per SEBI Regulations, there is no Entry Load however, there is a Total Expense Ratio and Stamp duty which is borne by the investor and Exit Load as applicable

Suitability

CHFs could be considered by those investors who are:

- Desiring diversified asset allocation within one scheme
- Preferring to outsource the task of managing the complexities involved in debt investing.
- Not attempting to try to profit from every movement in interest rates through active trading in debt securities.

How do CHFs differ from:

Aggressive Hybrid Funds (AHF) :
AHFs flip the asset allocation, investing 65-80% in equities and the remaining in debt. They are taxed like Equity Schemes.

Balanced Funds:
They invest 40 - 60% in equities and the balance in debt securities.

Dynamic Bond Fund:
Unlike a CHF they must invest across various 'durations'.

Multi-Asset Funds:
It should invest in a minimum of three asset classes (Say, Equities, Debt and Gold) with a minimum allocation of 10% in each asset class.

Taxation

For Resident and Non-Resident Investors

Dividend Taxation (in case of Income Distribution Cum Capital Withdrawal option)

Resident Individual/ HUF[$]	Domestic Company [@]	Non Resident Individuals[$/<]

Dividend

30%^ + Surcharge as applicable + 4% Cess	30% + Surcharge as applicable + 4% Cess 25%^^^ +Surcharge as applicable + 4% Cess 22%[&] + 10% Surcharge[&] + 4% Cess 15%[&] + 10% Surcharge[&] + 4% Cess	20% + Surcharge as applicable + 4% Cess
= 42.744% or 39% or 35.88% or 34.32%	= 34.944% or 33.384% = 29.120% or 27.820% = 25.17% = 17.16%	= 28.496% or 26% or 23.92% or 22.88%

Tax Deducted at Source!

10% (if dividend income exceeds INR 5,000 in a financial year)	10% (if dividend income exceeds INR 5,000 in a financial year)	=28.496% or 26% or 23.92% or 22.88%

Long Term Capital Gains##

Units held for more than 36 months		
20% with indexation + Surcharge as applicable + 4% Cess	20% with indexation + Surcharge as applicable + 4% Cess	10% without indexation and foreign currency fluctuation benefits + Surcharge as applicable + 4% Cess
= 28.496% or 26% or 23.92% or 22.88%	= 23.296% or 22.256%	= 14.248% or 13% or 11.96% or 11.44%

Short Term Capital Gains

Units held for 36 months or less		
30%^ + Surcharge as applicable + 4% Cess	30% + Surcharge as applicable + 4% Cess 25%^^^ +Surcharge as applicable + 4% Cess 22%[&] + 10% Surcharge[&] + 4% Cess 15%[&] + 10% Surcharge[&] + 4% Cess	30%^ + Surcharge as applicable + 4% Cess
= 42.744% or 39% or 35.88% or 34.32%	= 34.944% or 33.384% = 29.120% or 27.820% = 25.17% = 17.16%	= 42.744% or 39% or 35.88% or 34.32%

Tax Deducted at Source (Applicable only to NRI Investors) $ / # / <

Short term capital gains	Long term capital gains
42.744% or 39% or 35.88% or 34.32%^	14.248% or 13% or 11.96% or 11.44%

! Section 194K provides for withholding tax of 10% on any income (excluding the income in the nature of capital gains) exceeding INR 5,000 in aggregate for the financial year in respect of units of mutual fund in case of residents.

Short term/ long term capital gain tax will be deducted at the time of redemption of units in case of NRI investors only. However, as per section 196A of the Act withholding tax of 20% (plus applicable surcharge and cess) is applicable on any income in respect of units of mutual fund in case of non-residents. Hence, based on language provided in said section, it seems that apart from any income distributed to NRI, withholding tax at 20% (plus applicable surcharge and cess) may be applicable on capital gains notwithstanding that such capital gains are taxable at a rate lower than 20% (plus applicable surcharge and cess).

< As per the provisions of section 196A which is specifically applicable in case of non-resident unitholders, the withholding tax rate of 20% (plus applicable surcharge and cess) on any income in respect of units of a Mutual Fund credited / paid to non-resident unitholders shall apply, as section 196A does not make reference to “rates in force” but provide the withholding tax rate of 20% (plus applicable surcharge and cess). The non-resident unitholders may offer the income in respect of units of mutual fund to tax in their income-tax return at a lower tax rate by claiming the benefit under relevant tax treaty, if any, subject to eligibility and compliance with applicable conditions.

As per the provisions of section 196D of the Act which is specifically applicable in case of FPI/FII, the withholding tax rate of 20% (plus applicable surcharge and cess) on any income in respect of securities referred to in section 115AD(1)(a) credited / paid to FII shall apply. The Finance Act, 2021 inserted a proviso to section 196D(1) of the Act to grant relevant tax treaty benefits with effect from 1 April 2021 at the time of withholding tax on income with respect to securities of FPIs, subject to furnishing of tax residency certificate and such other documents as may be required. As per section 196D(2) of the Act, no TDS shall be made in respect of income by way of capital gain arising from the transfer of securities referred to in section 115AD of the Act.

@ Surcharge at the rate of 7% is levied for domestic corporate unit holders where the income exceeds Rs. 1 crore but less than Rs. 10 crores and at the rate of 12% where income exceeds Rs 10 crores.

$ Surcharge for the purpose of TDS and advance tax as per First Schedule Part II and III of the Finance Act, 2021 for Individual, HUF, AOP, BOI, AJP (other than FPIs):
i. Taxable income less than 50,00,000 – 0%
ii. Taxable income more than 50,00,000 upto 1,00,00,000 (including income by way of dividend+ or capital gains on securities covered u/s 111A and 112A) – 10%
iii. Taxable income more than 1,00,00,000 upto 2,00,00,000 (including income by way of dividend+ or capital gains on securities covered u/s 111A and 112A) – 15%
iv. Taxable income more than 2,00,00,000 upto 5,00,00,000 (excluding income by way of dividend+ or capital gains on securities covered u/s 111A and 112A) – 25%
v. Taxable income more than 5,00,00,000 (excluding income by way of dividend+ or capital gains on securities covered u/s 111A and 112A) – 37%
vi. Taxable income more than 2,00,00,000 (including income by way of dividend+ or capital gains on securities covered u/s 111A and 112A) but is not covered under iv and v above – 15%. Provided surcharge not to exceed

15% in case of income by way of dividend+ or capital gains on securities covered u/s 111A and 112A included in such total income

+Income distribution by mutual fund is technically not regarded as dividend

Surcharge for the purpose of TDS on income other than dividend+ and capital gains as per the Finance Act, 2021 in case of FPIs:

i. Taxable income less than 50,00,000 – 0%
ii. Taxable income more than 50,00,000 upto 1,00,00,000 – 10%
iii. Taxable income more than 1,00,00,000 upto 2,00,00,000 – 15%
iv. Taxable income more than 2,00,00,000 upto 5,00,00,000 – 25%
v. Taxable income more than 5,00,00,000 – 37%

+Income distribution by mutual fund is technically not regarded as dividend

Surcharge for the purpose of advance tax under section 2(9) of the Finance Act, 2021 in case of Individual, AOP, BOI or AJP FPIs

i. Taxable income less than 50,00,000 – 0%
ii. Taxable income more than 50,00,000 upto 1,00,00,000 (including capital gains on all securities) – 10%
iii. Taxable income more than 1,00,00,000 upto 2,00,00,000 (including capital gains on all securities) – 15%
iv. Taxable income more than 2,00,00,000 upto 5,00,00,000 (excluding capital gains on all securities) – 25%
v. Taxable income more than 5,00,00,000 (excluding capital gains on all securities) – 37%
vi. Taxable income more than 2,00,00,000 (including capital gains on all securities) but is not covered under iv and v above – 15%. Provided surcharge not to exceed 15% in case of capital gains on all securities included in such total income

^ Assuming the investor falls into highest tax bracket.

^^^ The Finance Act, 2021 provide that in case of domestic company, the rate of income-tax shall be 25% if its total turnover or gross receipts in the financial year 2019-20 does not exceed Rs. 400 crores.

& The corporate tax rates for domestic companies (not claiming specified incentives and deductions) at the rate of 22% under section 115BAA and domestic manufacturing companies (not claiming specified incentives and deductions) set-up and registered on or after 1 October 2019 at the rate of 15% under section 115BAB. The tax computed in case of domestic companies whose income is chargeable to tax under section 115BAA or section 115BAB shall be increased by a surcharge at the rate of 10%.

The base year for indexation purpose has been shifted from 1981 to 2001 to calculate the cost of acquisition or to take fair market value of the asset as on that date. Further, it provides that cost of acquisition of an asset acquired before 1 April 2001 shall be allowed to be taken as fair market value as on 1 April 2001.

Health and Education Cess shall be applicable at 4% on aggregate of base tax and surcharge.

Domestic companies may be subject to minimum alternate tax which is not specified in above tax rates.

Transfer of units upon consolidation of mutual fund schemes of two or more schemes of equity-oriented fund or two or more schemes of a fund other than equity-oriented fund in accordance with SEBI (Mutual Funds) Regulations, 1996 is exempt from capital gains.

Transfer of units upon consolidation of plans within mutual fund schemes in accordance with SEBI (Mutual Funds) Regulations, 1996 is exempt from capital gains.

The cost of acquisition of the units in the consolidated plan / scheme shall be the cost of units in consolidating plan / scheme of mutual fund and period of holding of the units of consolidated plan / scheme shall include the period of holding for which the units in consolidating plan / scheme of mutual fund were held.

In case of mutual fund portfolio segregation, the period of holding of segregated units shall be counted from date of holding of original units and the cost of acquisition of segregated units shall be apportioned between original units and segregated units based on net asset value prevailing immediately before segregation.

In relation to payments in the nature of interest, royalty, fees for technical services and payments on transfer of any capital assets, relaxation has been provided to non-residents from deduction of tax at higher rate of 20% in the absence of PAN subject to them providing specified information and documents (like Tax Residency Certificate (TRC), Tax Identification Number, etc.)

The Finance Act, 2021 inserted a new section 206AB w.e.f. 1 July 2021 which would apply on any sum or income or amount paid, or payable or credited, by a person (herein referred to as deductee) to a specified person, as defined. This section shall not apply where the tax is required to be deducted under sections 192, 192A, 194B, 194BB, 194LBC or 194N of the Act. The TDS rate in this section is higher of the followings rates:
• twice the rate specified in the relevant provision of the Act; or
• twice the rate or rates in force; or
• the rate of five per cent.

It is also provided that if the provision of section 206AA of the Act is applicable to a specified person, in addition to the provision of this section, the tax shall be deducted at higher of the two rates provided in this section and in section 206AA of the Act. 'Specified person' means a person (excluding non-residents who do not have a permanent establishment in India) who has not filed income-tax returns for the two preceding years and aggregate of TDS and TCS in his case is INR 50,000 or more in each year.

Mutual Fund investments are subject to market risks,
read all scheme related documents carefully.