Govt may tap MFs for divestment

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The proposals in the Union Budget hint that the government will use the mutual fund (MF) route more aggressively to meet this year's ₹1-trillion-plus disinvestment target.

It has proposed tax exemptions to exchange traded funds (ETFs) that have central public sector enterprises (CPSEs) as the underlying. These ETFs will get the status of equity-linked savings schemes (ELSS). Additionally, the Budget has proposed extending the concessional tax rate of short-term capital gains to equity-oriented fund of funds (FoF) that are set up for disinvestments in state-owned companies or CPSEs.

"Equity-oriented FoF attract short-term capital gains tax of 30 per cent. The Budget has proposed reducing it to 15 per cent for FoF used for disinvestment," said Bhavin Shah, partner and leader (financial service tax), PwC India.

FoF are subject to higher short-term capital gains tax, given these are not treated as equity-oriented schemes for taxation purpose. As a result, the 30 per cent tax rate applicable for debt funds is levied on these too. The proposal aims to incentivise even those investors who wish to place short-term bets. Experts say this will make participation in new and follow-on fund offerings attractive to traders scouting for arbitrage gains.

"The FoF structure could give the government an on-tap option. This will help the government react dynamically to market sentiment, and help increase retail participation in capital markets via CPSE ETFs," said Sundeep Sikka, CEO of Reliance Nippon Life AMC.

An FoF structure will also allow investors without demat accounts to participate in CPSE ETFs, said a senior executive of another fund house. The current framework requires an individual or entity to have a demat account to participate in an ETF. However, it is not required in the case of FoF.

According to industry sources, the government has been looking at other MF products, following the success of ETFs in its disinvestment drive.

Experts say ELSS can bring in long-term retail money into such ETFs, as it comes with a three-year lock-in period. "The ELSS incentive will give retail investors a reason to consider CPSE ETFs," said Radhika Gupta, CEO of Edelweiss MF.

In FY19, the government mopped up ₹45,079 crore — above half the total money it raised — by selling stakes in CPSEs through ETFs.

For FY20, the government has pegged its disinvestment target at ₹1.03 trillion —28 per cent higher than last year.

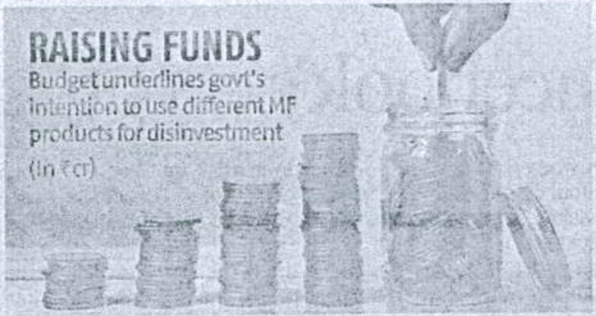
The government has so far used two ETFs — CPSE ETF and Bharat 22 ETF — to divest its stakes. In the last fiscal, two separate tranches of the Bharat 22 ETF and one tranche of the CPSE ETF were launched.

All three follow-on offerings were oversubscribed. However, CPSE ETFs tend to attract institutional investors and high net-worth investors, who typically come in to take advantage of the discounts offered.

RAISING FUNDS

Budget underlines govt's intention to use different MF products for disinvestment

(in ₹cr)



Mode of disinvestment	FY18	FY19	Chg (%)
IPO	24,040	1,914	-92
ETF*	14,500	45,079	211
OFS	13,711	5,236	-62
Strategic disinvestment	42,468	15,913	-63
Buyback	5,337	10,670	100
Other disinvestment	NA	6,157	NA
Total	1,00,056	84,969	

*exchange-traded fund, Source: Dipam

CPSE ETF's new tranche likely next week

The Centre may launch another tranche of the CPSE ETF next week to raise a minimum of ₹8,000 crore, said people in the know. The follow-on fund offer (FFO) could open for subscription on July 18. The people said the FFO will have a green-shoe option, which allows the Centre to retain oversubscription. The previous tranche, in March 2019, was oversubscribed over three times, helping the Centre raise ₹10,000 crore. So far, the Centre has mobilised ₹38,500 crore by launching five tranches of the CPSE ETF.

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