

ALTERNATIVE INVESTMENTS: ANALYSING ITS PRACTICAL APPLICATION IN INDIA

- Ananya Shruti and Shashank Saurabh*

ABSTRACT

In 2012, the Securities Exchange Board of India (SEBI) introduced the concept of Alternate Investment Fund (AIF) in India with a view to make a major overhaul in the then SEBI (Venture Capital Funds) Regulations, 1996 and enact a law which would encompass all pooled structures that were not regulated by the earlier regime. In the last 7 years, we have witnessed a steep growth in the number of Registered AIFs depicting its popularity among the investors. In light of this, we attempt to analyse the expanding horizons of AIFs in India. Broadly, this article is divided into 4 parts: The first part outlines the meaning, scope, forms and advantages of an AIF. The second part, then, provides the existing legal framework within which AIF is governed. It lays down the key features of the 2012 Regulations, its co-existence with other laws such as Tax and FDI norms, and its pitfalls in the present scenario. In the third part, we assess the practical application of AIF with a specific case of Real Estate Sector in India. Here, we analyse the recent move of the government to revive the real estate industry by infusing Ten Thousand crores through Category II- AIF. Lastly, an attempt is made to re-define the role and functions of SEBI vis-à-vis AIFs. In connection to this, various reports by Alternative Investment Policy Advisory Committee have also been considered. Finally, it is concluded that in the imminent future, Indian economy will see an evolution in the investment sector in the form of a developing scope in AIF requiring the laws to expand accordingly.

* The authors are fourth-year students of B.A. LL.B. (Hons.) Five-Year Integrated Course at the National University of Study and Research in Law, Ranchi.

I. INTRODUCTION

The Securities and Exchange Board of India (SEBI) introduced the SEBI (Alternative Investment Funds) Regulations in 2012. Before the enactment of a special Regulation for AIF, the Investment Management Regulation was restricted to Collective Investment Scheme (CIS) Regulations, Regulation of Portfolio Managers, Mutual Fund Regulation and Venture Capital Fund (VCF) Regulation. SEBI came up with a regulation for AIF in 2012 after which the VCF Regulation was repealed and was subsumed in AIF.

The funds have to compulsorily get registered according to the AIF Regulations and follow the compliances prescribed by the Regulation. The scope of an AIF is wide enough as it includes both domestic and AIFs set up in International Financial Services Centres (IFSC) which are subjected to the SEBI (International Financial Services Centres) Guidelines, 2015.

In the last 7 years, we have witnessed a steep growth in the number of Registered AIFs depicting its popularity among the investors. In the imminent future, as per the growing number of registered AIFs in India¹ and increase in capital inflow through AIF², Indian economy will see an

¹ SEBI, *Registered Alternative Investment Funds*, GOVERNMENT OF INDIA (Dec. 6, 2019, 6:54 AM), <https://www.sebi.gov.in/sebiweb/other/OtherAction.do?doRecognisedFpi=yes&intmId=16>.

² SEBI, *Data relating to activities of Alternative Investment Funds (AIFs)*, GOVERNMENT OF INDIA (Dec. 4, 2019, 5:25 PM), <https://www.sebi.gov.in/statistics/1392982252002.html>.

evolution in the investment sector in the form of a developing scope in AIF requiring the laws to expand accordingly.

II. INVESTMENT STRUCTURE AND THE INDIAN ECONOMY

A. Major Investment Routes in India

Investment can either be made through financial assets – which can be further divided into market-linked products like stocks, bonds and mutual funds and fixed income products like Public Provident Fund, bank fixed deposit, non-financial assets – real estate, gold, etc.³

1. Domestic Investment Avenues in India

- a) **Direct Equity:** This involves investing in a company by purchasing its shares through the stock exchange market. In long term, these have been able to generate higher returns compared to other forms of asset.⁴
- b) **Public Provident Fund:** This is a comparatively safer investment as it is supported by a sovereign guarantee and has a long term of 15 years.

³ Sunil Dhawan, *Top 10 investment options*, THE ECONOMIC TIMES (Dec. 8, 2019, 3:46 PM), https://economictimes.indiatimes.com/articleshow/64066079.cms?from=mdr&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

⁴ *Id.*

- c) **Real Estate:** This is a highly illiquid asset and includes investment in residential property, retail and commercial projects. The location and proximity of the property to certain other properties determines the return.

Other forms of investment includes National Pension System, Bank fixed deposit, Bonds, Gold, etc.

2. *Major Foreign Investment Avenues in India:*

- a) **Foreign Direct Investment (FDI):** Investment can be made by non-residents into an Indian Company, Partnership Firm/Proprietary Concern, Trusts, Limited Liability Partnerships (LLPs), Investment Vehicle, Start-up Companies and other Resident Entities. In 2019, the Government allowed 100% FDI under automatic route in coal mining. Also, in Union Budget 2019-2020, the government came up with a recommendation to open FDI in media, insurance sector and aviation.⁵
- b) **Foreign Portfolio Investment (FPI):** FPI is an avenue through which foreign investors can invest in Indian listed equities and other securities.⁶ There are two categories of FPI.⁷ Category I includes

⁵ *About FDI in India*, IBEF (Dec. 8, 2019, 8:24 PM), <https://www.ibef.org/economy/foreign-direct-investment.aspx>.

⁶ Rajesh Gandhi & Karamjeet Singh, *Foreign portfolio investment in India*, DELOITTE (Dec. 8, 2019, 7:50 PM), <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/performance/performancemagazine/articles/lu-foreign-portfolio-investment-india.pdf>.

⁷ Regulation 5, Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, Gazette of India, pt. III sec. 4, (2019).

“government and government related investors such as central banks, sovereign wealth funds”; “pension funds and university funds”; “appropriately regulated entities such as insurance or reinsurance entities, banks”; “entities from the Financial Action Task Force member countries”; etc. Category II includes “all the investors not eligible under Category I foreign portfolio investors such as – appropriately regulated funds not eligible as Category I foreign portfolio investor; endowments and foundations; charitable organisations; corporate bodies”.⁸

- a. With the recent change brought by SEBI despite the route chosen, an investment will be considered an FPI if the foreign fund buys less than 10% stake in a company. Above 10%, the investment will be regarded as an FDI.⁹

- c) **External Commercial Borrowings (ECB):** ECB is a method through which Indian companies raise capital in foreign currency through suppliers’ credit, bank loans, securitized instruments and buyers’ credit. Through automatic route ECB can be raised up to USD 750 million.¹⁰ ECB is governed by the guidelines set by RBI.

⁸ *Id.*

⁹ Pavan Burugula, *New FPI/FDI classification by SEBI to hit many offshore funds*, ET MARKETS (Dec. 8, 2019, 5:04 PM), <https://economictimes.indiatimes.com/markets/stocks/news/new-fpi/fdi-classification-by-sebi-to-hit-many-offshore-funds/articleshow/71532706.cms?from=mdr>.

¹⁰ *New External Commercial Borrowing (ECB) Framework*, AZB & PARTNERS (Dec. 8, 2019, 5:28 PM), <https://www.azbpartners.com/bank/new-ecb-framework/>.

B. Indian Economy – Contribution from Domestic and Foreign Avenues of Investment

Investment is an important source of capital flow in India and an essential part of India's GDP. A major source of growth, investment produces profit for several years by enhancing operational efficiency and promoting innovation.¹¹

Public and private sector have together contributed towards an increase in the domestic investment which has consequently led to growth of the Indian economy. While investments in Private Equity (investment is made primarily in equity or equity linked instruments or partnership interests of investee companies according to the stated objective of the fund) and Venture Capital (investment is primarily made in unlisted securities of start-ups, emerging or early-stage venture capital) escalated to US\$ 35.8 billion in 2018, in 2019 it further grew to US\$ 36.7 billion before September, 2019.¹²

According to Goldman Sachs India Securities, India acquired a capital of \$13 billion through investments in 2019 by the month of July.¹³ As per the data of RBI, capital inflow through FDI in 2019 by the

¹¹ Amit Kapoor, *The dynamics of India's growth slowdown*, THE ECONOMIC TIMES (Dec. 8, 2019, 5:54 PM), <https://economictimes.indiatimes.com/news/economy/indicators/the-dynamics-of-indias-growth-recession/articleshow/71020942.cms?from=mdr>.

¹² *Domestic Investment in India*, INDIAN BRAND EQUITY FOUNDATION (Dec. 6, 2019, 4:45 AM), <https://www.ibef.org/economy/domestic-investments>.

¹³ IANS, *India already received \$13 billion foreign capital inflows: Goldman Sachs*, THE ECONOMIC TIMES (Dec. 8, 2019, 5:17 PM), <https://cfo.economictimes.indiatimes.com/news/india-already-received-13-billion-foreign-capital-inflows-goldman-sachs/70659206>.

month of September was \$62 billion.¹⁴ Investment through FPI in India reached Rs 82,575 crore in 2019 by the month of October and was ranked the second highest among the emerging markets, following China.¹⁵

As of 30th June, 2019, Rs. 14,4479.629 crore fund was raised through Alternative Investment Fund in India¹⁶, thus clearly showing that AIF is a major avenue of investment in India in the current scenario.

III. UNDERSTANDING ALTERNATIVE INVESTMENT FUNDS (AIFS)

A. Meaning

AIF has been defined in Regulation 2 (b) of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012¹⁷ (the Regulation): “Alternative Investment Fund or AIF means any

¹⁴ Pavan Burugula, *New FPI/FDI classification by SEBI to hit many offshore funds*, ET MARKETS (Dec. 8, 2019, 5:04 PM), <https://economictimes.indiatimes.com/markets/stocks/news/new-fpi/fdi-classification-by-sebi-to-hit-many-offshore-funds/articleshow/71532706.cms?from=mdr>.

¹⁵ Rajesh Mascarenhas, *Rs 82,575 crore: FPI inflows in 2019 highest in Modi Era*, ET (MARKETS) (Dec. 8, 2019, 5:07 PM), <https://economictimes.indiatimes.com/markets/stocks/news/rs-82575-crore-fpi-inflows-in-2019-highest-in-modi-era/articleshow/72048314.cms>.

¹⁶ SEBI, *Data relating to activities of Alternative Investment Funds (AIFs)*, GOVERNMENT OF INDIA (Dec. 4, 2019, 5:25 PM), <https://www.sebi.gov.in/statistics/1392982252002.html>.

¹⁷ The Securities and Exchange Board of India (Alternative Investment Funds) Regulations, Regulation 2(b), Gazette of India, pt. III sec. 4, (2012): (b) “Alternative Investment Fund” means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which,-
(i) is a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors; and

fund established or incorporated in India which is a privately pooled investment vehicle which collects funds from sophisticated investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors”.¹⁸

The proviso to this regulation excludes family trusts (trusts set up for the benefit of ‘relatives’ as defined under Companies Act, 2013) ESOP (Employee Stock Option Plan) trusts, employee welfare trusts or gratuity trusts (trusts set up for the benefit of employees), ‘holding companies’ (defined under sub-section 46 of section 2 of Companies Act, 2013), other special purpose vehicles not established by fund managers, funds managed by securitisation company or reconstruction company and any such pool of funds which is directly regulated by any other regulator in India from the category of AIF.

B. Why AIF was introduced in India?

Before the enactment of a special Regulation for AIF, the Investment Management Regulation was restricted to CIS Regulations, Regulation of Portfolio Managers, Mutual Fund Regulation and Venture Capital Fund (VCF) Regulation. The reasons behind the introduction of AIF in India were:

(ii) is not covered under the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999 or any other regulations of the Board to regulate fund management activities.

¹⁸ SEBI, *Frequently Asked Questions (FAQs): SEBI (Alternative Investment Funds) Regulations 2012*, Gazette of India, pt. III sec. 4, GOVERNMENT OF INDIA (Dec. 6, 2019, 4:45 AM), https://www.sebi.gov.in/sebi_data/faqfiles/jan-2017/1485861425527.pdf.

1. Economic Issues and Conundrums

The VCFs are investments aimed at financing new ventures. The fund regulates the money of investors who desire to invest in start-ups and Small and Medium Enterprises that have strong growth potential, thus it is aimed at promoting companies at its nascent stage, were being used as a vehicle pool for other types of funds like real estate, private equity and PIPE (Private Investment in Public Equity), thus creating certain economic issues and conundrums discussed below:

- a) The use of VCF in other funds could lead to dereliction of new companies, thus, defeating the basic purpose of VCF.
- b) The concessions provided to the VCF by the Government could not be effectively targeted and utilized as the probability of them being used by established companies was very feasible.
- c) The restrictions imposed by the Government through the VCF Regulations aimed at start-up companies were not suited to other funds.
- d) Some concessions regarding investment sought by PE or PIPE funds were not pertinent for the VCF.
- e) AIF such as PE or VC are essential for the growth of corporate industry of a country as “they bring a lot of governance and good

quality money on the table of investee company.”¹⁹ Thus, SEBI considered the requirement of a special legal framework targeted towards AIF.

- f) AIF is susceptible to certain risks; to address these issues arising out of these funds a special legal framework was crucial according to SEBI.

2. *Global Influence*

The G-30 Report: The Report gave the following recommendation:

Managers of private pools of capital that employ substantial borrowed funds should be required to register with an appropriate national regulator (...). The regulator of such managers should have authority to require periodic regulatory reports and public disclosures of appropriate information regarding the size, investment style, borrowing, and performance of the funds under management.²⁰

- a) **Directive on Alternative Investment Fund Manager (AIFM) by the European Parliament and Council:** SEBI had referred to the directive on AIFM that addressed the requirement and duties of an authorizing and supervisory regime that would be legally binding on all AIFM governing AIF in the European Union.

¹⁹ SEBI, *Concept Paper on Proposed Alternative Investment Funds Regulation for Public Comments*, SECURITIES AND EXCHANGE BOARD OF INDIA (Dec. 5, 2019, 6:42 PM), https://www.sebi.gov.in/sebi_data/commndocs/alternativeinvestment_p.pdf.

²⁰ *Id.*

- b) **Private Fund Investment Advisers Registration Act, 2010 of USA:**
The Act mandated the registration of all Investment Advisors to private funds with the Securities and Exchange Commission (SEC) which would subject them to anti-fraud rules, record-keeping and reporting obligations.
- c) **The IOSCO Consultation Report on Hedge Funds Oversight (2009):** Regulatory hedge fund oversight must be risk-based that concentrates on hedge funds that are susceptible to more risk and are all together important.
- d) **The IOSCO Report on Private Equity Conflicts of Interests (2010):** The report specified the principles to be addressed while assessing the quality of mitigation of conflicts of interests by private equity firms.
- e) **The Institutional Limited Partners Association (ILPA) Principles:**
These principles aim at enhancing the PE sector by governance, alignment of interest and transparency practices.

C. Types of AIFs in India

According to Regulation 3 of the Regulation, AIF in India can be registered under three categories:

- a) **Category I:** This category includes infrastructure funds, Small and Medium Enterprise Funds (SME), venture capital funds, social venture funds, and such other AIFs that the Government may cite.

These funds have “positive spill over effect”²¹ on the economy thus Government provides concessions and incentives for the same.

- b) **Category II:** This category includes AIFs such as private equity funds or debt funds that engage in borrowing to meet the everyday practical functions. Government does not provide incentives and concessions for this category funds.²²
- c) **Category III:** This category includes hedge funds, funds that trade to gain short term returns or open ended funds. These involve complex and diverse trading approach. Government does not provide incentives and concessions for this category funds.²³

D. Domestic and Foreign Investment in AIF

While domestic AIF is regulated by SEBI with help of the Regulation of 2012 that enumerates all the categories of AIF and holds certain guidelines for these funds to function in India, in 2016-17 Budget, the Government of India authorized the Foreign Investment in AIF.²⁴ This was implemented by the amendment brought to the Securities and Exchange Board of India (International Financial Services Centres)

²¹ Regulation 3(4) (a), Securities and Exchange Board of India (Alternative Investment Funds) Regulations, Gazette of India, pt. III sec. 4, (2012).

²² Regulation 3(4) (b), Securities and Exchange Board of India (Alternative Investment Funds) Regulations, Gazette of India, pt. III sec. 4, (2012).

²³ Regulation 3(4)(c), The Securities and Exchange Board of India (Alternative Investment Funds) Regulations, Gazette of India, pt. III sec. 4, (2012).

²⁴ Samrat Sengupta, *The Viewpoint: Alternative Investment Fund - Regulations and Perspectives*, BAR & BENCH (Dec. 6, 2019, 8:11 PM), <https://barandbench.com/alternative-investment-fund-regulations-perspectives/>.

Guidelines, 2015 that provided for operation of AIF in IFSC.²⁵ Further, in 2019 vide a circular SEBI eased the norms of investment for the AIF operating in IFSC.²⁶ Therefore, the provisions applicable to domestic AIFs regarding investment stands the same for ones operating in IFSC. In 2015, Gujarat International Finance Tec-City (GIFT City) was introduced which helped the development of financial services within the territories of India that were otherwise being carried out offshore by the foreign subsidiaries or branches of Indian financial institutions.²⁷

E. Foreign Investments by AIFs

AIFs can invest in the securities of companies incorporated outside India depending on the RBI and SEBI guidelines.²⁸

²⁵ SEBI, *Securities and Exchange Board of India (International Financial Services Centres) Guidelines, 2015 - Permissible investments by Portfolio Managers, Alternate Investment Funds and Mutual Funds operating in IFSC*, SECURITIES AND EXCHANGE BOARD OF INDIA (Dec. 7, 2019, 11:29 AM), https://www.sebi.gov.in/legal/circulars/may-2017/securities-and-exchange-board-of-india-international-financial-services-centres-guidelines-2015-permissible-investments-by-portfolio-managers-alternate-investment-funds-and-mutual-funds-operatin-_34951.html.

²⁶ SEBI, *Securities and Exchange Board of India (International Financial Services Centres) Guidelines, 2015-Permissible investments by Alternative Investment Funds operating in IFSC*, SECURITIES AND EXCHANGE BOARD OF INDIA (Dec. 7, 2019, 5:13 AM), https://www.sebi.gov.in/legal/circulars/aug-2019/securities-and-exchange-board-of-india-international-financial-services-centres-guidelines-2015-permissible-investments-by-alternate-investment-funds-operating-in-ifsc_43867.html.

²⁷ Sharda Balaji & Avaneesh Satyang, *India: Opportunities and Challenges for AIFs in India's First IFSC, GIFT City, Gujarat*, MONDAQ (Dec. 8, 2019, 11:06 AM), <http://www.mondaq.com/india/x/824084/Fund+Management+REITs/Opportunities+And+Challenges+For+AIFs+In+Indias+First+IFSC+GIFT+City+Gujarat>.

²⁸ Subramaniam Krishnan & Mamta Shroff, *Alternative Investment Funds and Venture Capital Funds – An Overview*, 10 THE CHAMBER'S JOURNAL 9, 15 (2018).

- a) Investment by an AIF in Venture Capital Undertakings (VCUs), a domestic company with shares that are not listed on a stock exchange, can be made subject to the overall ceiling of USD 750 million.
- b) For investing in an offshore VCU a prior approval of SEBI is required.
- c) Only up to 25% of the investible funds of a scheme of the AIF can be invested in foreign investments.

F. Advantages of AIFs

AIF are non-traditional forms of investments that have certain advantages listed below:

- a) They offer diversification as the investors are allowed access to assets that are not just associated to the stock market.
- b) The returns are likely to be higher than the ones from bonds, mutual funds and stocks.
- c) If a resident Indian citizen is in control of the sponsor and manager of AIF, the capital incoming from AIF is not subjected to restrictions by the FDI norms like sectoral caps, limited choice of instruments etc.²⁹

²⁹ Swaraj S. Dhanjal, *Investors committed ₹1.17 trillion in alternative investment funds in FY19*, LIVEMINT (Dec. 6, 2019, 7:03 PM), <https://www.livemint.com/market/stock-market-news/investors-committed-1-17-trillion-in-alternative-investment-funds-in-fy19-1557937382176.html>.

- d) Certain treaty benefits are provided to the foreign investors while tax benefits in the form of ‘tax pass through’ are available to the category I and II AIFs.
- e) Since AIF have nominal association with stocks and bonds, they are not very affected by struggling markets and are likely to perform their best at these times.
- f) They can grow long-term returns as part of a balanced investment portfolio, particularly in times of financial unpredictability.
- g) As AIFs are rarely assigned or handed over, they lead to lower transaction costs than standard ones.³⁰

G. The New Mode of Investment and Its Growing Impact- Statistics

1. Registered AIFs in India and Increase in the Number

Currently, 628 AIFs are registered with SEBI³¹; some of them are ‘021 Capital Trust’, ‘2Point2 Capital Trust’, ‘3F Ventures’, ‘A91 Partners Trust’, etc. In 2016 the number of registered AIFs was 235³². This shows the upward moving trend of AIF.

³⁰ Jamie McGeachie, *Alternative investing: Is it right for you?*, SWITZERDAILY (Dec. 6, 2019, 8:51 PM), <https://switzer.com.au/the-experts/jamie-mcgeachie/alternative-investing-is-it-right-for-you/>.

³¹ SEBI, *Registered Alternative Investment Funds*, SECURITIES AND EXCHANGE BOARD OF INDIA (Dec. 6, 2019, 6:54 AM), <https://www.sebi.gov.in/sebiweb/other/OtherAction.do?doRecognisedFpi=yes&intmId=16>.

³² PTI, *Sebi registered Alternative Investment Funds count touches 235*, ET (MARKETS) (Dec. 6, 2019, 7:00 AM),

2. Year-Wise Growth in the Data relating to Activities of AIFs

It is clear from the tables provided below that the AIF industry in India is rapidly growing after the enactment of the Regulations for AIFs by SEBI:

Category	As on 31 st December, 2012			As on 30 th June, 2019		
	Commitments Raised	Funds Raised	Investment Made	Commitments Raised	Funds Raised	Investment Made
Category I:						
Infrastructure Fund	301	0	0	12441.72	6428.7	5520.94
Social Venture Fund	0	0	0	1338.12	967.77	874.37
Venture Capital Fund	36	6.65	0.2	21078.495	7143.442	5296.75
SME Fund	0	0	0	119.68	95.98	40.94
Category I Total	337	6.65	0.2	34978.0	14635.89	11733
Category II	0	0	0	208306.486	89998.06	74816.695
Category III	22.5	0	0	47055.429	39845.677	33208.433
Grand Total	359.5	6.65	0.2	290339.93	144479.629	119758.128

- Comparative Table showing amount of funds raised through AIF in 2012 and 2019³³
- (All figures in Rs. Crores)

[//economictimes.indiatimes.com/articleshow/53430941.cms?from=mdr&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst](http://economictimes.indiatimes.com/articleshow/53430941.cms?from=mdr&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst).

³³SEBI, *Data relating to activities of Alternative Investment Funds (AIFs)*, SECURITIES AND EXCHANGE BOARD OF INDIA (Dec. 4, 2019, 5:25 PM), <https://www.sebi.gov.in/statistics/1392982252002.html>.

IV. LEGAL FRAMEWORK GOVERNING AIFS

A. Definitions

1. Updated definitions through Amendments are:

- a) “Custodian”³⁴ has been defined as a person who has registered himself as thus under the Securities and Exchange Board of India (Custodian) Regulations, 1996.
- b) “Goods”³⁵ have been defined to include the ones notified by the Central Government under Section 2 (bc) of the Securities Contracts (Regulation) Act, 1956.
- c) The definition of “investee company”³⁶ was expanded to include real estate investment trust or infrastructure investment trust by the SEBI (Real Estate Investment Trusts) Regulations, 2014.
- d) Angel fund was included in the definition of “venture capital fund” by the SEBI (Alternative Investment Funds) (Amendment) Regulations, 2013.

2. Certain lacunae in the definitions provided

³⁴ Regulation 2 (ha), SEBI (Alternative Investment Funds) (Amendment) Regulations, Gazette of India, pt. III sec. 4, (2019).

³⁵ Regulation 2 (ka), SEBI (Alternative Investment Funds) (Amendment) Regulations, Gazette of India, pt. III sec. 4, (2019).

³⁶ Regulation 2 (o), SEBI (Alternative Investment Funds) (Amendment) Regulations, Gazette of India, pt. III sec. 4, (2019).

a) *Sponsor*: “Sponsor” is defined as any person who sets up the AIF.³⁷ In case AIF is a trust, approval of Foreign Investment Promotion Board would be required if SEBI considers the sponsor to be the ‘settlor’ of AIF. This would lead to an added burden of setting up of trust on the sponsor who was introduced to provide reassurance to the investors regarding the credibility of the fund.

Recommendation: SEBI can separate the functions of the sponsor and the ‘settlor’ so that the administrative functions like setting up of the Trust does not fall under the functions of the sponsor.

b) *Corpus*: The manager or the sponsor of the Fund is required to hold a minimum amount of interest in the corpus as provided in Regulation 10 (d).³⁸ The bare reading of this provision leads to the understanding that such interest will have to be maintained until the entire capital of the fund is paid back to the investors. Such ambiguity is adverse to the interest of the sponsor who is solely appointed to reassure the investors.³⁹

Recommendation: It can be clarified that the manager or the sponsor who is required to hold interest in the AIF to maintain his ‘skin in the game’ for the comfort of the investors shall only be required to do so

³⁷ Regulation 2 (w), SEBI (Alternative Investment Funds) Regulations, Gazette of India, pt. III sec. 4, (2012).

³⁸ Regulation 10 (d), SEBI (Alternative Investment Funds) Regulations, Gazette of India, pt. III sec. 4, (2012).

³⁹ Mukul Aggarwal et al., *Alternative Investment Funds: SEBI scores half century on debut*, NISHITH DESAI ASSOCIATES (Dec. 7, 2019, 3:17 PM), http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/alternative-investment-funds-sebi-scores-half-century-on-debut-1.html?no_cache=1&cHash=32e398826c44412ecdf4a3fd9f41edf0.

pro rata to the outstanding capital of the investors and not till the entire fund capital is paid back to the investors.

c) *Regulation 10(d) – Sponsor affiliation*: The Regulations do not mandate the sponsor to be affiliated to the investment manager. In this case the manager does not have a significant personal stake in the fund.

Recommendation: The Regulation must thus be amended to ensure that if the sponsor is the fulfilling the condition under 10(d), he must be required to be either be an affiliate of the investment manager or part of his corporate group so that investor's confidence in the fund is maintained.

B. Compliances Required According to the AIF Regulation

1. Registration of AIFs

- a) AIF must attain a certificate of registration from SEBI by applying in Form 'A' OF THE First Schedule of the AIF Regulations.⁴⁰
- b) Unless the AIF is granted registration it cannot accept money from investors, however, commitments from investors may be accepted.⁴¹

2. Conditions put on AIFs

- a) AIF can raise fund by issuance of units to Indian, foreign or non-resident Indians.⁴²

⁴⁰ *Supra* note 38, Reg. 3 (5).

⁴¹ *Supra* note 38, Reg. 6 (5).

⁴² *Supra* note 38, Reg. 10 (a).

- b) The lower limit for the corpus should be Rs. 20 crore.⁴³
- c) The minimum amount an AIF can accept from an investor is Rs. 1 crore.⁴⁴
- d) The manager or the sponsor of the Fund is required to invest 2.5% of the fund's corpus or Rs. 5,00,00,000, whichever is lower.⁴⁵
- e) The amount of investment made by the manager or the sponsor must be disclosed to the investors.⁴⁶
- f) A particular scheme of AIF cannot have more than one thousand investors.⁴⁷
- g) The AIF can only accept or solicit fund by way of private placement.⁴⁸

3. Tenure

- a) The tenure for Category I and Category II AIF, that are close ended, is to be decided at the time of making application⁴⁹ and the minimum tenure is 3 years.⁵⁰
- b) Category III AIF can be open as well as close ended.⁵¹

⁴³ *Supra* note 38, Reg. 10 (b).

⁴⁴ *Supra* note 38, Reg. 10 (c).

⁴⁵ *Supra* note 38, Reg. 10 (d).

⁴⁶ *Supra* note 38, Reg. 10 (e).

⁴⁷ *Supra* note 38, Reg. 10 (f).

⁴⁸ *Supra* note 38, Reg. 10 (g).

⁴⁹ *Supra* note 38, Reg. 13 (1).

⁵⁰ *Supra* note 38, Reg. 13 (2).

- c) The tenure for close ended AIF may be increased by 2 years by following the procedure prescribed in the Regulation⁵², in absence of which the fund will be wound up within 1 year of the expiration of the tenure.⁵³

4. Listing

- a) Close ended AIF's units can be listed on the stock exchange market with minimum tradable lot being of Rs 1 crore.⁵⁴
- b) After the fund/scheme closes only then can its units be listed.⁵⁵

5. General Investment Conditions

- a) Following the conditions put by RBI or the Board, AIF can invest in companies incorporated outside India.⁵⁶
- b) The terms of co-investment in an Investee company by the Manager or the Sponsor cannot be more favourable than the terms offered to AIFs.⁵⁷
- c) AIFs can only invest in associates if it receives an approval from 75% of investors according to the amount they have invested in AIF.⁵⁸

⁵¹ *Supra* note 38, Reg. 13 (3).

⁵² *Supra* note 38, Reg. 13 (4).

⁵³ *Supra* note 38, Reg. 13 (5).

⁵⁴ *Supra* note 38, Reg. 14 (1).

⁵⁵ *Supra* note 38, Reg. 14 (2).

⁵⁶ *Supra* note 38, Reg. 15 (1) (a).

⁵⁷ *Supra* note 38, Reg. 15 (1) (b).

⁵⁸ *Supra* note 38, Reg. 15 (1) (e).

- d) Category I and Category II AIF can only invest up to 25% of its investable funds in each Investee Company.⁵⁹
- e) Category III AIF can only invest up to 25% of its investable funds in each Investee Company.⁶⁰

6. *Winding up*

The fund is wound up according to the method prescribed in Regulation 29 and Regulation 26(2) requires the records to be maintained up to 5 years of winding up of the fund.

7. *Legal structure for an AIF*

The table on the next page depicts the structure of an AIF as required by the AIF Regulations.⁶¹

⁵⁹ *Supra* note 38, Reg. 15 (1) (c).

⁶⁰ *Supra* note 38, Reg. 15 (1) (d). Sameer Mittal, *Alternative Investment Funds: An Insight*, OUTLOOK MONEY (Dec. 7, 2019, 3:17 PM), <https://www.outlookindia.com/outlookmoney/investment/alternative-investment-funds-an-insight-3405>.

⁶¹ Suneet Barve, *Alternative Investment Funds (AIF) – Legal aspects*, ASSOCIATION OF INTERNATIONAL WEALTH MANAGEMENT OF INDIA (Dec. 7, 2019, 7:39 PM), <https://www.aiwmindia.com/wp-content/uploads/2018/09/ICUL-Presentation-Sep-18-2018.pdf>.

Criteria	Trust	Company	LLP
Compliance	Low	High	Moderate
Client Confidentiality	High	Moderate	Low
Market Practice	More than 97% of the AIFs are set up as Trusts	Minimal	Less than 3% AIFs are set up as LLP
Acceptability with Investors and Distributors	High	Low	Moderate
Ease of Operations	High	Low	Moderate
Mitigation of GST on Management Fee	Debatable	No	Yes

8. For operation of AIF in IFSC following are required:

- a) AIF must attain a certificate of registration in conformance with the provisions of Chapter II of AIF Regulations along with payment of the non-refundable application fee.⁶²
- b) The lower limit for the corpus should be USD 3 million.⁶³
- c) The minimum amount an AIF can accept from an investor is USD 150,000.⁶⁴
- d) The manager or the sponsor of the Fund is required to invest 2.5% of the fund's corpus or USD 750,000, whichever is lower.⁶⁵

⁶² SEBI, Operating Guidelines for Alternative Investment Funds in International Financial Services Centres, Guideline 2 (2015).

⁶³ *Id.* Guideline 6.

⁶⁴ *Id.* Guideline 7.

⁶⁵ *Id.* Guideline 8.

- e) Investment by an AIF in IFSC can be made in units of other AIFs in IFSC and India subject to the provisions of AIF Regulations.⁶⁶
- f) Category I and II AIF should have a custodian registered with the Board appointed if the corpus of the AIF is more than USD 70 million.⁶⁷

C. Co-existence with Other Laws and Regulations

1. Tax Laws

Below are the various principles of taxation vis-à-vis AIFs:

- a) *Pass-through' status to AIFs and taxation of unit holders:* According to the provision of Section 115UB (1) of the Income Tax, the AIFs have been granted a pass through status which essentially means that the tax is chargeable at the hands of the unit holders treating it as an income of the unit holders supposing the investment was directly made by them. However, business income is treated differently and is taxed at the AIF level. In India, the pass through status is accorded to only Category I and Category II AIFs.⁶⁸
- b) *Characterization of income:* Section 115UB (3) of the Act stipulates that wherein any income is paid or credited by the AIF to the unit holders, it shall have the same nature and in same proportion as that of the AIF.

⁶⁶ *Id.* Guideline 9.

⁶⁷ *Id.* Guideline 11.

⁶⁸ Anish Thacker & Partha Tambday, *Alternative Investment Funds and Venture Capital Funds Direct Tax – Key Provisions*, 10 THE CHAMBER'S JOURNAL, 28, 30 (2018).

- c) *Losses to be passed on to unit holders:* Earlier, according to the Section 115UB (2) of the Act, where the net result of the assessment was a loss, it could not be set-off against any other head of income and hence such a loss did not pass to the unit holders, rather got carried forward and set-off by the AIF in accordance with the provisions of the Act. However, the Finance Bill, 2019 brought amendment to this provision and now the loss (not being in the nature of business losses) are subjected to passed on to the unit holders.⁶⁹
- d) *Tax rates applicable to AIFs:* In terms of Section 115UB (4), the income of the AIF is supposed to be charged in accordance with rates specified by Finance Act of the relevant year (in case AIF is set-up as a company or LLP) and in case where AIF is set up as a trust, then the applicable rate is 30% as Maximum Marginal Rate.
- e) *Taxability of undistributed income on accrual basis:* The provision of Section 115UB (6) of the Act clearly states that when, in any financial year, the income of an AIF is remains unpaid or credited to the unit holders, then such undistributed income shall have the effect to be credited to the unit holders on the last day of the relevant year.

⁶⁹ *Finance bill, 2019: Key highlights for taxation of Alternative Investment Funds and IFSC units (June-July 2019 edition, Part II)*, NISHITH DESAI ASSOCIATES (Dec. 3, 2019, 8:40 AM), http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/finance-bill-2019-key-highlights-for-taxation-of-alternative-investment-funds-and-ifsc-units-jun.html?no_cache=1&cHash=d7b4d0313bb44395b5c7dd45cf63c663.

2. *FDI and FEMA Norms*

- a) In all Categories of AIFs a 100% FDI is allowed under Automatic route.⁷⁰
- b) According to FEMA Regulations, an AIF is not subject to the FDI downstream norms if its Sponsor and Manager are “owned and controlled” by Indian resident citizens.⁷¹
- c) To determine whether downstream investment by AIF is a foreign investment, the extent of foreign investment in the corpus will not be factored.
- d) A foreign downstream investment by an AIF has to adhere to the sectoral caps and conditions/restrictions that are applicable to the company in which the downstream investment is made.
- e) According to FEMA Regulations, portfolio investment can be made by a Category III AIF with any foreign investment in only those securities or instruments in which a FPI is allowed to invest.⁷²

⁷⁰ Suneet Barve, *Alternative Investment Funds (AIF) – Legal aspects*, ASSOCIATION OF INTERNATIONAL WEALTH MANAGEMENT OF INDIA (Dec. 7, 2019, 7:39 PM), <https://www.aiwmindia.com/wp-content/uploads/2018/09/ICUL-Presentation-Sep-18-2018.pdf>.

⁷¹ Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, Regulation 14, Gazette of India, pt. III sec. 4, (2017).

⁷² Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, Schedule 8 Regulation 1 (5), Gazette of India, pt. III sec. 4 (2017).

D. AIF as an Alternative to other Routes of Foreign Investment in India

1. AIF Regime alternative to FDI regime

AIF allows foreign investors to invest in India via the automatic route and there is no requirement to adhere to the FDI norms if the fund has an Indian in control and ownership of the management and the sponsor. Therefore, for investments that may have otherwise not been permissible or practicable under FDI route the investors are opting for AIF.⁷³

2. AIF Regime alternative to External Commercial Borrowings (ECB)

ECB is a way through which Indian citizens can borrow capital from foreign investors in the form of finance lease, bank loans, foreign currency convertible bonds of investment etc. The ECB Regulations put too many limits on investors including the pay-out limit on coupons, restrictions on the end use and class of lenders, etc., thus, AIF is also becoming an alternative to ECB.

3. AIF Regime alternative to FPI regime in listed securities and debt investments

AIF route can be opted for investment in listed securities and IPOs if due to some reason the FPI registration is not granted. Also, since

⁷³ *Supra* note 70.

corporate debt is insufficient to meet the FPI limits, AIF can be used to route such money to the Indian economy.

E. Ambiguities in the Legal Framework of AIF in India

1. Loans by an AIF

While SEBI has clarified in its FAQs that AIF being a privately pooled vehicle cannot provide loans⁷⁴, however, in its order in the matter of *SREI Multiple Asset Investment Trust*,⁷⁵ SEBI held that “‘financing’ is included in the Defined Investment Policy (DIP) of the fund, the AIF can use the amount contributed by the investors for the purpose of giving loans,”⁷⁶ thus contradicting itself.

2. Category III AIF

The Regulation is not clear about the exit/redemption option available to the investors in a close ended fund and the restrictions and right connected to the same. Also, the Regulation does not go in detail about the rights, compliances and other provisions in case the AIF manager/sponsor is under foreign ownership or control.

⁷⁴ SEBI, *Frequently Asked Questions (FAQs)*, SECURITIES AND EXCHANGE BOARD OF INDIA (Dec. 4, 2019, 5:25 PM), https://www.sebi.gov.in/sebi_data/faqfiles/jan-2017/1485861425527.pdf.

⁷⁵ 2017 SCC OnLine SEBI 136: [ADJUDICATION ORDER NO. RA/JP/235 -236/2017]

⁷⁶ Vallari Dubey, *Can AIFs grant loan?*, VINOD KOTHARI CONSULTANTS (Dec. 4, 2019, 6:06 AM), <http://vinodkothari.com/2018/03/can-aif-grant-loans/>.

3. Category II AIF

Since SEBI requires the fund's portfolio to be more in unlisted companies it must come up with a strategy to make sure that the AIFs are complying with this requirement and maintaining the expected ratio.

V. UNDERSTANDING THE PRACTICAL WORKING OF AIFS VIS-À-VIS REAL ESTATE SECTOR

A. Dismal Picture of the Real-Estate Sector

Real-estate projects totalling to 5.76 lakh units in the top seven cities in the country, which were either started in 2013 or before are supposed to be struck in various stages of non-completion.⁷⁷ According to statistics supplied by ANAROCK, a real estate services company in India, real estate projects worth ₹1.77 Lakh crore are pending in the top 7 cities in India.⁷⁸

Presently, with approximately 4,00,000 units, the Mumbai Metropolitan Region (MMR) and National Capital Region (NCR) [2,10,000 and 2,00,000 respectively] tops the list of stalled projects. These

⁷⁷ Virendra Joshi et al., *Addressing Challenges & Progressing Ahead in REAL ESTATE*, ANAROCK (Jan. 13, 2019, 10:15 PM), <https://api.anarock.com/uploads/research/Addressing%20Challenges%20&%20Progressing%20Ahead%20in%20Real%20Estate.pdf>.

⁷⁸ Kailash Babar, *Total 5.6 lakh housing units delayed across India's top 7 cities: Report*, THE ECONOMIC TIMES (Dec. 3, 2019, 8:05 AM), <https://economictimes.indiatimes.com/industry/services/property/-/construction/total-5-6-lakh-housing-units-delayed-across-indias-top-7-cities-report/articleshow/68784014.cms?from=mdr>.

projects in the MMR and NCR regions are valued at Rs. 3,60,000 crore (Approx.).⁷⁹

Notably, the NBFCs act as a prominent source of funding for the realty projects in India. Henceforth, as a result of collapse of IL&FS, the real-estate sector is struggling to find capital to meet its requirements to complete its stalled projects.

1. Possible reasons for its deplorable condition are:⁸⁰

- a) *Almost Negative Rate of Investment:* There has been a significant drop in the rate of investment in the residential real-estate sector, from two to three digit value to a low single-digit with a negative return in certain places in the last decade.
- b) *Slowdown in the Economy:* This has to necessarily deal with employment generation and job security in the country. In such times, cash-conservation becomes a crucial aspect in a country wherein its people are uncertain with their jobs or securing new jobs.
- c) *Uncertainty in Under-construction Properties:* The principle of cause and effect has a direct relation when it comes to low homebuyer sentiment which is leading to the heavy backlog of delayed and half-

⁷⁹ Koustav Das, *Explained: Will govt's Rs 25,000 crore boost help revive ailing real estate sector?*, INDIA TODAY (Dec. 3, 2019, 8:02 AM), <https://www.indiatoday.in/business/story/real-estate-sector-stress-fund-rs-25000-crore-will-it-be-enough-to-revive-ailing-sector-1616512-2019-11-07>.

⁸⁰ Larissa Fernand, *10 Reasons why Real Estate Sector is in a Slump*, MORNING STAR (Dec. 3, 2019, 8:05 AM), <https://www.morningstar.in/posts/54373/whats-causing-slow-real-estate.aspx>.

constructed projects in the market. Notably, these under-construction homes were once the first choice of the Indian homebuyers' owing to its competitive prices.

- d) *The evil named 'demonetization' eliminated the Cash Component:* For the past many years, real estate has been one of the most preferred areas for parking unaccounted money, that is, black money. Cash component was indeed a significant factor which drove this market, which ultimately got struck by the infamous move of demonetization by the Government.

B. The Recent Move of the Government to Infuse Fund via AIF

The Finance Minister on November 7, 2019 announced that the Government will pump-in Rs 10,000 crore into an Alternative Investment Fund (AIF) with a further contribution of Rs 15,000 crore by the LIC and SBI.⁸¹ This fund is established to focus on the revival of real-estate sector. Experts consider this emergency fund "critically important" in the light of the fact that it will serve the twin of purpose, of the developer in completing the project and of the homebuyers awaiting the handover of their completed houses.⁸² The key features of this fund are presented below:

⁸¹ Madhurima Nandy, *FAQs on government's special fund for real estate sector*, LIVEMINT (Dec. 3, 2019, 8:05 AM), <https://www.livemint.com/news/india/faqs-on-government-s-special-fund-for-real-estate-sector-11573129003057.html>.

⁸² Das, *supra* note 79.

1. Structure

The fund is set-up under the Category- II AIF debt fund registered with SEBI. The role of ‘sponsor’ is to be carried by the Government and it shall invest Rs 10,000 crore into the fund. In view that this is the first AIF under the ‘special window’, the responsibility of ‘investment manager’ has been granted to SBICAP Ventures Limited. The investments in this fund are primarily intended to be structured in the form of non-convertible debentures taking into consideration the legal and regulatory aspects. The returns are supposed to be fixed by the investment manager subject to the risk profile and specifications of each project.

2. Size

With a commitment by the Government to infuse Rs 10,000 crore in the fund for the affordable and middle-income group housing sector via a ‘special window’, the fund expects matching contributions from the LIC and banks such as SBI amounting to Rs 15,000 crore which in the end would sum up to a total of Rs 25,000 crore.

3. Criteria

For the purpose of funding, certain criteria are laid down below:

- Where the project is stalled on account of lack of required funds
- The projects must be in the affordable and middle-income category

- Projects with net worth positive (including projects covered under NCLT proceedings and NPAs)
- Registration under RERA, 2016
- Projects which are 70% close to completion.

4. Monitoring

The stalled projects are expected to get fuel (capital) through the mechanism of this ‘special window’. For ensuring that the funds are being utilized only for the purpose of completing the projects, its responsibility is cast upon the investment manager and the developer or the appointed project manager. Stipulations laid down by RERA vis-à-vis standard financial controls will be adopted.

5. Funding Process

After receiving the inputs from external due diligence bodies, the investment manager shall prepare an exhaustive investment review. The contractual arrangement with the developers would include the monitoring mechanism for funding and approval of investment therein. Only after the completion of documentation, the disbursement is to start.

6. Projects which are pending and are before the NCLT

In order to select projects for funding, the government has broadened its scope by also including NPAs and projects under the NCLT proceedings. However, these projects must be at a stage where the

resolution plan has neither been accepted nor rejected by the Committee of Creditors. Notably, the projects pending before the High Court and Supreme Court excluded from the purview of this fund.

C. Analysis: Overall Benefit of the Real Estate Sector

In the words of an Industry expert, the fund size is insufficient to tackle the mammoth problem of stalled projects but will indeed serve as a “lubricant to ignite the vehicle that had been jammed.”

The fund is only a fraction of total worth of the unfinished realty projects in the country’s top seven cities and according to estimates it will cover 6% of the total stalled projects, but taking into consideration the move by the Government, other sovereign and pension funds have consented to pull the real estate sector out of crisis. Even if the estimated number of projects is revived, the circulation of money will start which will ultimately benefit all the developers in the market.⁸³

Therefore, although the special window is created for the purpose of reviving affordable and mid-income category but minimizing the stress of developers in this category will indeed have an indirect collateral benefit to the entire sector including the luxury segment.

⁸³Abhijit Chowdhury et al., *Govt's Rs 25,000 crore realty fund can only help 6% of stalled constructions*, THE ECONOMIC TIMES (Dec. 3, 2019, 8:20 AM), <https://economictimes.indiatimes.com/industry/indl-goods/svs/construction/govts-rs-25000-crore-realty-fund-can-only-help-6-of-stalled-constructions/articleshow/71953143.cms?from=mdr>.

VI. REDEFINING THE ROLE OF SEBI VIS-À-VIS ALTERNATE INVESTMENT FUND

A. Risks Attached to AIFs

AIFs differ from traditional investments like stocks, bonds as they have higher fees and are comparatively more volatile. They have very high minimum ticket sizes and the tax efficiency is really low. Also, since they provide an opportunity of higher return, the scope of risk increases. Additionally, AIF generally invest in illiquid assets thus making exit difficult. AIF's do not generally declare portfolios therefore they are less transparent.⁸⁴

Since AIFs invest in varied directions, it provides wider opportunities but also exposes the investors to the decisions of the fund management team which might be wrong and bring loss to them. Without a healthy “stop-loss strategies or hedging strategies”⁸⁵, the difference between gross returns and net returns in an AIF could be as high as 40% to 50%.

B. Steps to Be Taken By SEBI/ Role of SEBI

SEBI is gradually becoming more professional and proactive in dealing with AIFs and foreign investment into India. A number of meetings have been conducted by SEBI with the venture capital industry

⁸⁴ Aniruddha Bose, *The Pros And Cons Of Cat 3 AIF's*, BUSINESS WORLD (Dec. 9, 2019, 10:42 AM), <http://www.businessworld.in/article/The-Pros-And-Cons-Of-Cat-3-AIF-s/17-08-2018-158047/>

⁸⁵ *Id.*

body, advisors, and a leading credit rating agency to decide upon the ways to increase transparency in AIFs.

1. Increasing Transparency

- a) As in the current reporting system the AIFs divulge very less information, to increase transparency SEBI can take steps that may require the AIFs to disclose information regarding net asset value, performance numbers and fees and historical data in order to increase awareness among the investors.
- b) A classified private document (private placement memorandum) can be made available to the investors to inform them about some essential details.⁸⁶

2. Creating provisions for special rights in some cases

- a) There can be provisions for presenting certain discretionary terms to some sophisticated external investors who are provided with some special rights.
- b) There can also be a provision to allow large institutional investors with more information regarding the fund than individual investors.

⁸⁶ Sugata Ghosh, *Sebi nudges AIFs to make more disclosures for better transparency*, ET MARKETS (Dec. 9, 2019, 10:42 AM), [//economictimes.indiatimes.com/articleshow/69884129.cms?from=mdr&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst](https://economictimes.indiatimes.com/articleshow/69884129.cms?from=mdr&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst).

3. Ensuring that the fund is credible and trustworthy

- a) SEBI can take steps for developing a benchmark that can evaluate the performance of AIFs and rate them accordingly.
- b) It can also take measures to oversee the source of funding of an AIF so that the investor's money is not misused.⁸⁷

4. Creating platforms for registration of complains against false tips

- a) For cases where investors lose money on receiving tips through email or SMS, a particular number or email can be created where the complains regarding these tips can be registered to SEBI.
- b) Also, ids can be created on social media platforms where such tips can be forwarded and SEBI can act on such complains without waiting for a formal complaint.⁸⁸

⁸⁷ Ashley Coutinho, *SEBI may tighten AIF regulations to better monitor the source of funding*, BUSINESS STANDARD (Dec. 9, 2019, 10:42 AM), https://www.business-standard.com/article/economy-policy/sebi-may-tighten-aif-regulations-to-better-monitor-the-source-of-funding-118022200265_1.html.

⁸⁸ Narendra Nathan, *How Sebi can control 'tips' on social media*, ET MARKET (Dec. 9, 2019, 10:42 AM), [//economictimes.indiatimes.com/articleshow/57178093.cms?from=mdr&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst](http://economictimes.indiatimes.com/articleshow/57178093.cms?from=mdr&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst).

C. Changes in Regulations

1. Recommendations by the Alternative Investment Policy Advisory Committee in its 3rd Report are:

a) For the promotion of IFSCs with regard to AIFs:

- i. Subject to sufficient safe guards like additional reporting requirements and private placement of fund unit only with credited investor, the Report recommended providing relief in the form of lowering the maximum leverage for IFSC-domiciled AIFs.
- ii. Issuance of a circular with respect to the circular issued by SEBI on 1st October, 2015 to clarify that the AIFs in IFSC do not require the authorization of SEBI or RBI to invest outside India.

b) Regarding Income Tax Act, 1961

- i. The income of a foreign investor earned by investing outside India through an IFS fund should be exempted from payment of tax.
- ii. Foreign investors in an AIF in IFSC should be exempted from acquiring PAN number and filing return of income except when they earn any other income from India.

c) GST-Related Recommendations

- i. Management and other services should be exempted from paying GST.

- ii. The liability of paying GST on directors contingent upon default made by a private company should not be advanced to the nominee/non-executive directors, particularly when they are appointed by AIFs.

d) Suggested New Tax Code for Listed AIFs

- i. While interest for the domestic investors are taxed at their respective tax rates, the foreign investors should be taxed at 5%
- ii. Tax on dividend should be exempted in the hands of the investor.

Few others recommendations were provided in the Alternative Investment Policy Advisory Committee (AIPAC) 3rd report along with some Important Pending Recommendations from Previous AIPAC Reports.⁸⁹

2. Other probable amendments

- a) *Investors' consent*: The Regulation requires 75% of the investors assent for any change to be implemented in the fund, however, it very often happens that a change is rejected because all the investors are not available to vote even if the ones voting are all in favour of the change, hence, the Regulation could be amended to allow changes if 75% of the members present and voting agree to the change.

⁸⁹ AIPAC, *3rd Report submitted by Alternative Investment Policy Advisory Committee*, SECURITIES AND EXCHANGE BOARD OF INDIA (Dec. 4, 2019, 5:25 PM), https://www.sebi.gov.in/reports/reports/jan-2018/3rd-report-submitted-by-alternative-investment-policy-advisory-committee-_37460.html.

- b) *Investors' consent for the change of manager*: SEBI requires 75% of the investors assent for changing the manager. Thus, the Regulation must clarify that unless the manager makes any contract that specifically asks for the approval of each investor for such removal or the private placement memorandum states so, the change shall be implemented.
- c) *Tax liability at the time of winding up*: The regulation must clarify that at the end of the tenure of the fund, the company, LLP or the trust will not be considered wound up unless all its tax liabilities are fulfilled or the limitation period is over. The fund will only cease its operation after the completion of such tenure.
- d) *A permanent capital vehicle (PCV)*: A comparatively new concept, PCV can allow the availability of capital over an unlimited period. This would remove the liability of liquidating the fund's portfolio at the end of its tenure.⁹⁰

VII. SUGGESTIONS AND RECOMMENDATIONS

Few suggestions that the Government could work on to improve and increase the scope of AIF in India are:

- a) Syncing its policies regarding AIF involving foreign investors with the economically developed countries to attract more investments;

⁹⁰ Vinod Joseph & Deeya Ray, *India: SEBI's AIF Regulations 2012 - A Few Tweaks Required*, MONDAQ (Dec. 9, 2019, 10:42 AM), <http://www.mondaq.com/india/x/859964/Securities/SEBIs+AIF+Regulations+2012+A+Few+Tweaks+Required>.

- b) Adopting certain rules and norms regarding AIF from other countries with high rate of investment through AIF;
- c) Forming strict laws to curb the scope of fraud or negligence that may lead to loss to the investors, thus, increasing the confidence and trust of both foreign and domestic investors;
- d) Forming simple and attractive tax regime for foreign investors, widening the scope of AIFs in India.
- e) To increase the confidence in investors, the AIFs could be made to reveal not only their financial details but also their process of decision making and other details like process of entry and exit of investors, the records of previous returns.
- f) Disclosure of objectives of the fund can also increase the ease of investment.

VIII. CONCLUSION

India is a developing country with a Government that is laboriously concentrating on making India a hub of international business by gradually increasing the convenience of transacting with the country. To achieve this goal the policies need to be abreast with the global infrastructure and a rich economy is needed for the same. Investment is an important source of capital flow in India and an essential part of India's GDP. A major source of growth, investment produces profit for several years by enhancing operational efficiency and promoting innovation.

Presently, with many amendments and clarifications the regulatory framework for AIFs has developed a regime that has strengthened the scope of AIF in India. However, few ambiguities and lacunae need to be addressed to provide a more flexible structure for this avenue of investment to grow. The current data as discussed in the paper shows that the AIF sector, both domestic and foreign, will only grow in the future and the Government must make India ready to make maximum gains from the same.