



Key Tax and Regulatory aspects of AIF and FVCIs

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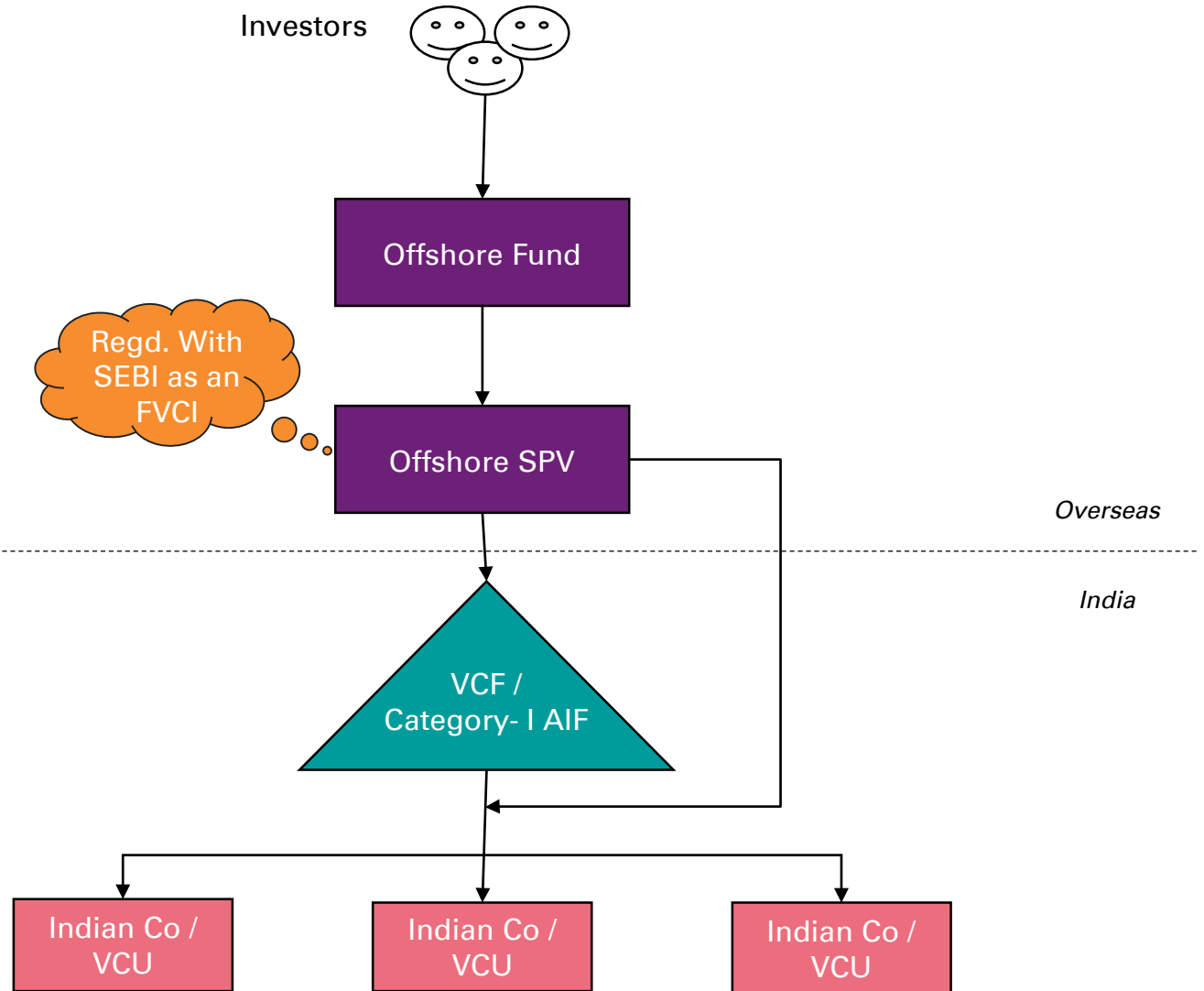
WIRC presentation

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A modern conference room with a large wooden table and black mesh chairs, surrounded by floor-to-ceiling windows overlooking a cityscape. The room is brightly lit by natural light from the windows, creating a warm and professional atmosphere. The text "FVCI - Key tax and regulatory aspects" is overlaid on the table in a white, sans-serif font.

FVCI - Key tax and regulatory aspects

FVCI - Typical Structure



Definitions

Foreign Venture Capital Investors "FVCI"

FVCI is an investor incorporated outside India, registered under SEBI FVCI regulations, that proposes to make investments in Venture Capital Fund / Category I – AIF and Venture Capital Undertaking in accordance with SEBI FVCI Regulations

Venture Capital Undertaking "VCU"

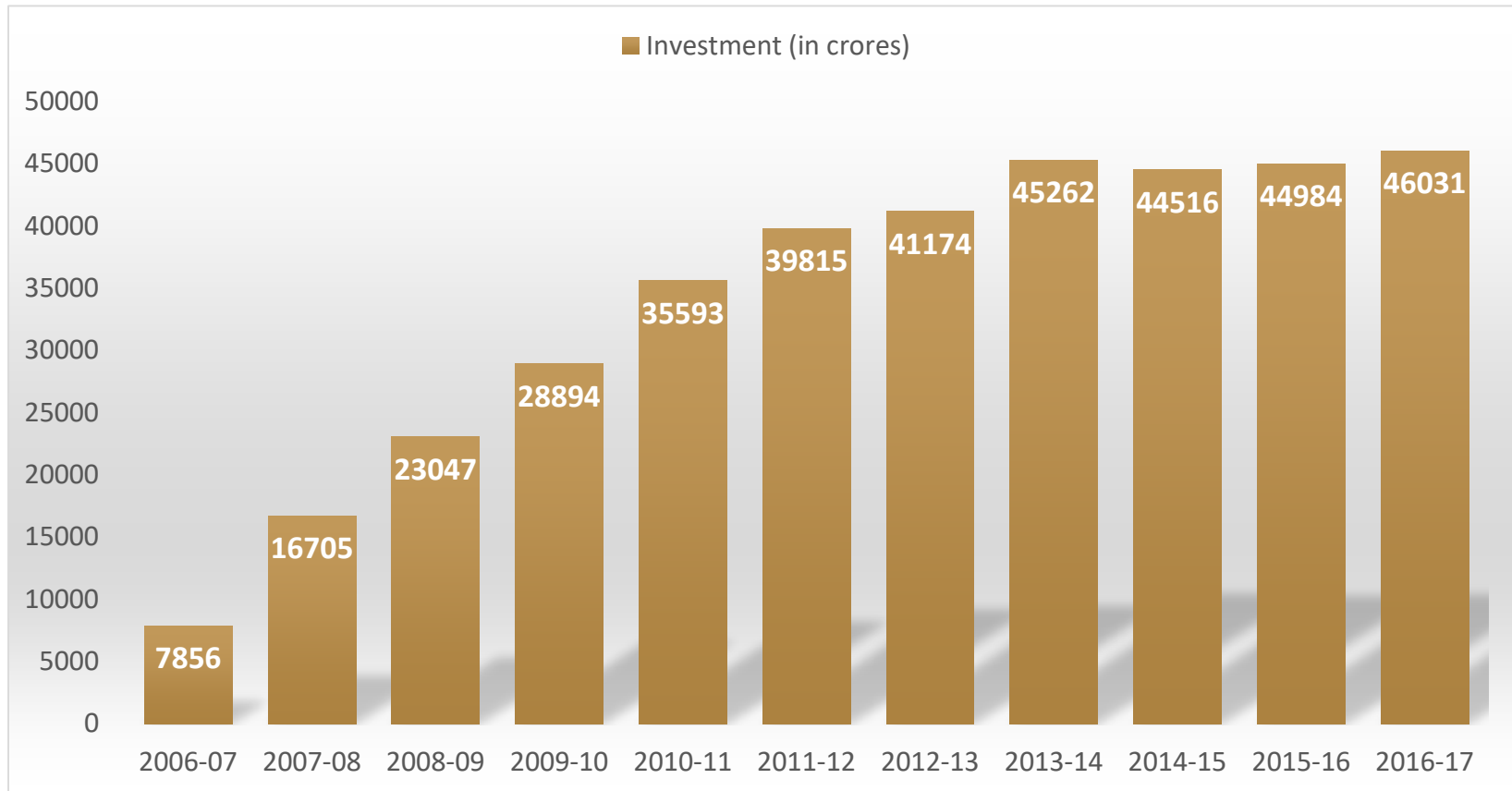
means a domestic company

- whose shares are not listed in a recognised stock exchange in India;
- which is engaged in the business of providing services, production or manufacture of articles or things, but does not include such activities or sectors which are specified in the negative list

Background & Regulatory Framework

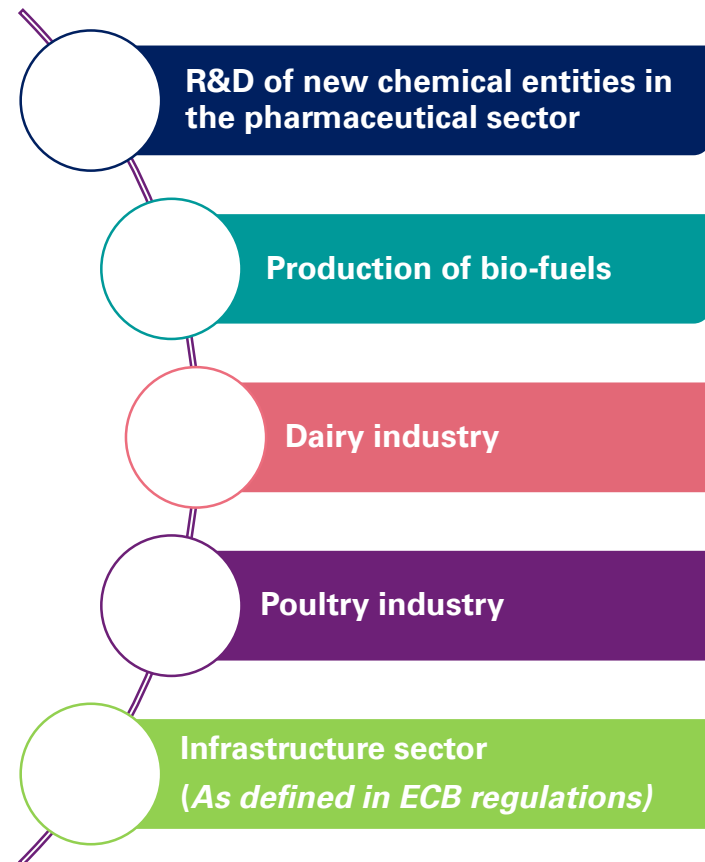
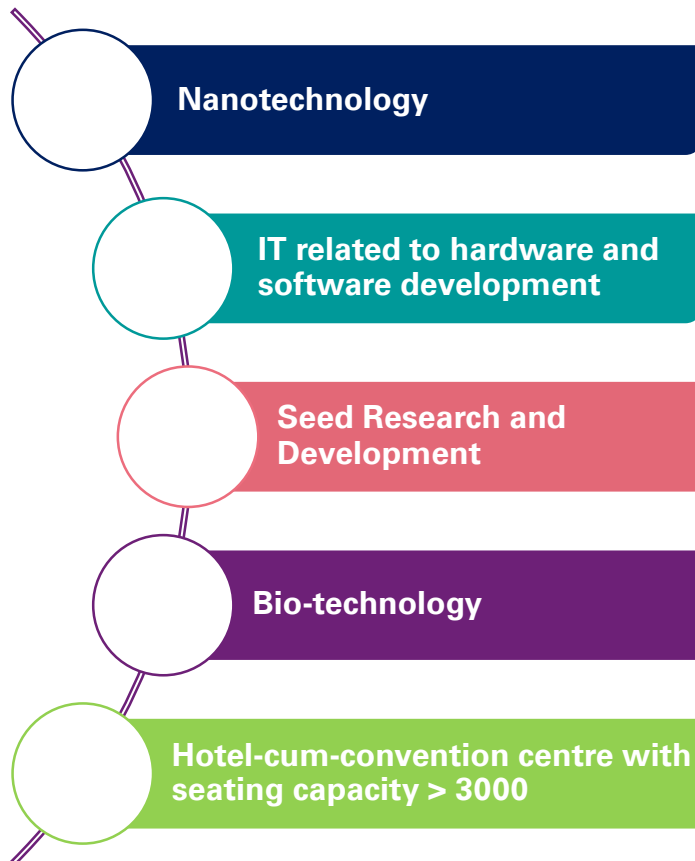
- Securities and Exchange Board of India ('SEBI') introduced the SEBI (Foreign Venture Capital Investors) Regulations, 2000 on September 15, 2000
- FVCI approvals are granted by SEBI after consultation with RBI
- Initially, approvals granted to FVCI were blanket approvals (i.e. without any sector specific restrictions)
- Subsequently, in 2007, RBI has started issuing its approval to FVCI for investment in only certain specified sectors – permitted sectors discussed in next slide
- As on 31 March 2017 FVCIs cumulative net investment is close to INR 46, 031 crores
- Following regulatory framework applicable to investments made by FVCI
 - SEBI (FVCI) Regulations, 2000
 - Schedule 7 to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000
 - Circulars issued by SEBI and RBI from time to time

FVCI Investments in India



FVCI - Permitted Sectors

Current FVCI registration permits investments as an FVCI in the below sectors



FVCI - Negative list

FVCI investment currently prohibited in VCU engaged in the business of following activities or sectors (negative list):



Non-banking financial companies, other than Core Investment Companies (CICs) in the infrastructure sector, Asset Finance Companies (AFCs), and Infrastructure Finance Companies (IFCs) registered with RBI

Gold financing

Activities not permitted under industrial policy of Government of India

Any other activity which may be specified by the SEBI in consultation with Government of India from time to time

FVCI - Key advantages

Benefits of FVCI over FDI

Exchange control pricing norms not applicable to subscription, purchase and sale of securities from / to residents

- Companies Act pricing guidelines on subscription will apply

Sale of listed shares to promoters exempt from open offer requirements

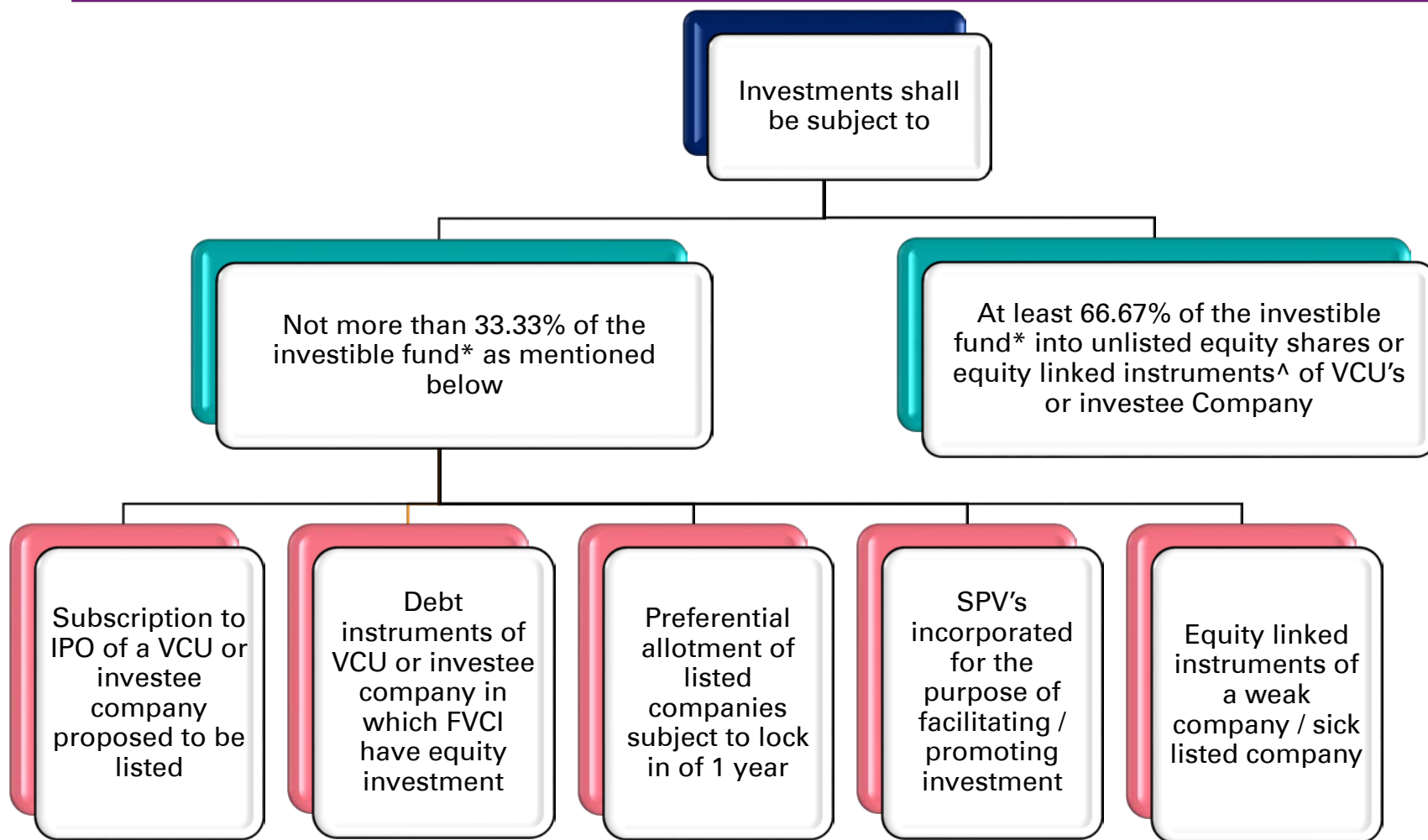
Can invest in optionally convertible instruments and debt securities without triggering ECB norms

Pre-IPO shares NOT subject to 1 year post IPO lock-in, if shares held by FVCI for at least 1 year before IPO

- In case of CCPS / CCDs, pre-conversion period included

Holds QIB status (akin to FPI)

FVCI - Investment Conditions & Restrictions



* Investible fund - Fund committed for investments in India net of expenditure for administration and management of the fund

^ Equity linked instruments include: CCDs, OCDs, CCPS, OCPS, share warrants etc.

Eligibility criteria seen by SEBI

- Whether applicant is an investment company/ trust,/ partnership, pension fund, mutual fund, endowment fund, university fund, charitable institution or Investment manager, Asset/ Investment management company, any other Investment vehicle outside India
- Whether applicant regulated in foreign home country/ income-tax payer (if not, can submit banker's certificate of self/ promoter)
- Applicant's track record, professional competence, Financial soundness, Experience, General reputation & integrity
- Whether applicant is fit and proper and Applicant has not been rejected by SEBI in past

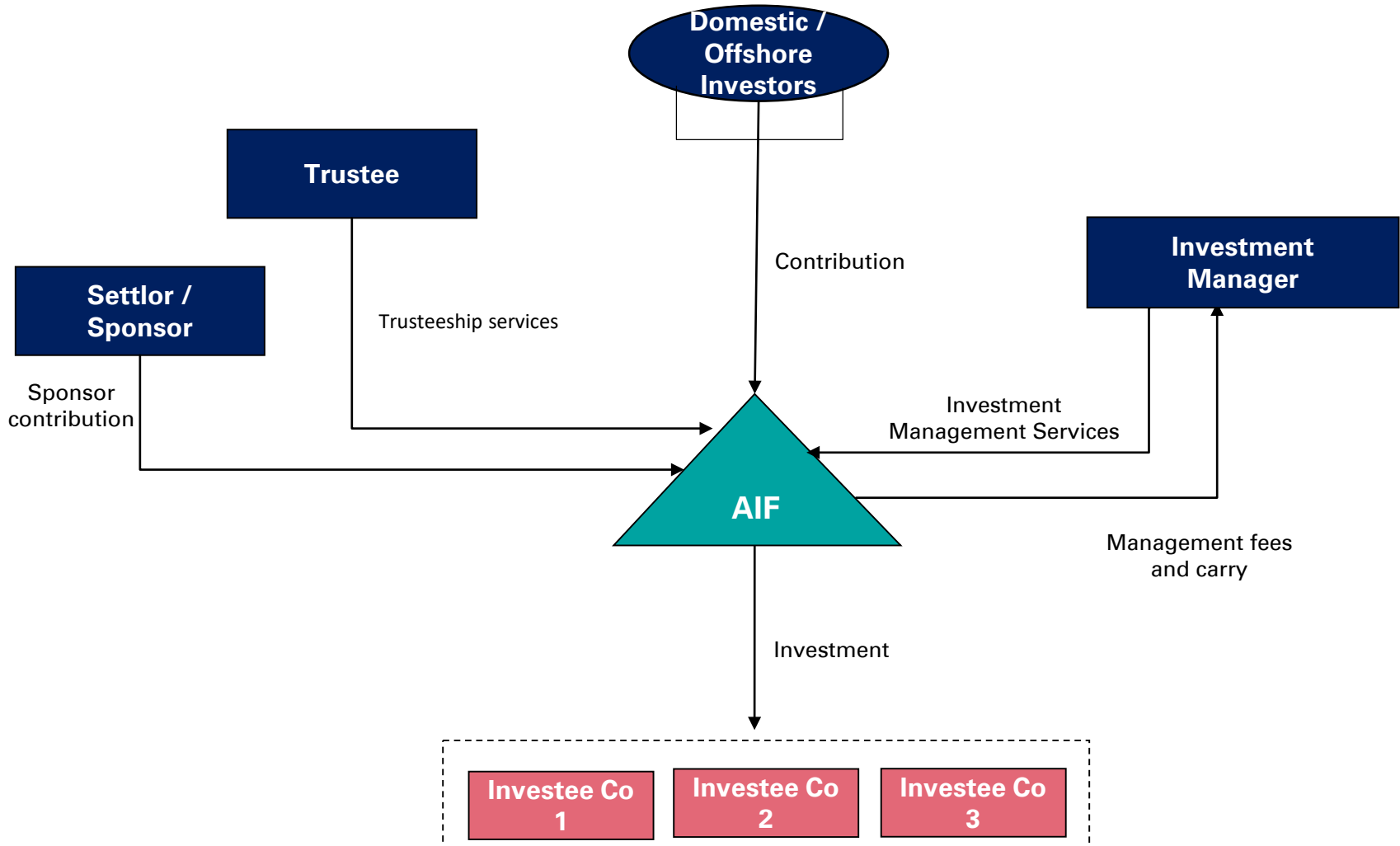
Key requirements to be furnished to SEBI at the time of making FVCI application :

- Firm commitment letter from investor for contributing at least USD 1 million
- Furnishing copies of financial statements of the applicant and investors
- Copy of certificate of registration with home regulator; or Copy of income tax return filed in the home country; or Copy of bankers certificate showing fair track record of the applicant



Alternative Investment Fund
- Key tax and regulatory aspects

Typical Domestic Fund Structure - AIF



Alternative Investment Funds Regulations

SEBI released AIF Regulations on May 21, 2012 to regulate all funds established in India raising funds from Indian or foreign investors

Category I

- AIFs with positive spillover effects on the economy
- Incentives given by SEBI, GOI
- Close ended funds – minimum tenure of 3 years
- Not to invest more than 25% of corpus in an investee co.
- No leverage permitted
- Manager or Sponsor shall have a continuing interest of not less than 2.5% of corpus or Rs. 5 Crore, whichever is less

VCF (including Angel Funds),
SME Funds,
Social Venture funds,
Infrastructure funds

Category II

- No incentives given by SEBI, GOI, or other regulators in India
- Close ended funds – minimum tenure of 3 years
- Not to invest more than 25% of corpus in an investee co.
- No leverage permitted, Hedging permitted
- Manager or Sponsor shall have a continuing interest of not less than 2.5% of corpus or Rs. 5 Crore, whichever is less

Private equity funds,
Debt funds,
Other funds not classified under
Category I or III

Category III

- AIFs which trade for making short term returns
- Employs diverse or complex trading strategies
- No incentives given by SEBI, GOI, or other regulators in India
- Open ended / close ended
- Not to invest more than 10% of corpus in one investee co.
- Leverage permitted
- Sponsor contribution – 5% or 10 crore, whichever is less

Hedge funds

AIF - Statistics

Data as on March 31, 2018, Source – SEBI website

Category of AIF	Fund raised (INR in crore)	%
Category I	10,794	12.66%
Category II	50,451	59.16%
Category III	24,031	28.18%
Total	85,276	

More than 50% of the overall AIFs is Cat – II AIF

Key Aspects

- Constitution of AIF – Trust versus LLP ?
- Minimum contribution per investor – INR 1 crore
- Minimum fund size – INR 20 cr
- Sponsor contribution – required on an ongoing basis; pro-rata can be withdrawn – SREI ruling?
- Sponsor contribution calculated on investible funds; green shoe option to be considered
- Whether pooling compulsory ? AIF with one investor ?
- Term of AIF to be specified upfront; 1+1 extension permitted
- Pure loan permitted ?
- Investment by Cat I and II – ‘primarily’ in unlisted
- Investment in Associates require 75% investors approval

Foreign investment in AIFs – Regulatory Aspects

- Non-residents including FPIs and NRIs permitted to invest in units of Cat I and Cat II AIFs under the Automatic Route
 - Earlier, FDI in AIF was subject to FIPB approval
- In Cat III, only FPI allowed to invest upto 25% stake
- Downstream investment by AIF to be regarded as foreign investment if neither Sponsor nor Investment Manager of the said AIF is Indian “owned and controlled” as defined under the FEMA Inbound Regulations
 - Amount of foreign investment in corpus of AIF not relevant for determining whether downstream investment by AIF is foreign investment

Foreign investment in AIFs – Regulatory Aspects

- In case IM / Sponsors do not qualify as IOC, investment by AIF considered as foreign investment; FDI conditions related to sectoral caps to apply
 - Restrictions extended to instruments, pricing as well ?
- Investors of AIF are all domestic; however Manager / Sponsor is foreign owned – Investments by AIF still considered foreign?
- Cat III AIF having Foreign investor – can it invest in unlisted share ?
 - Can invest in securities or instruments allowed to be invested by FPIs

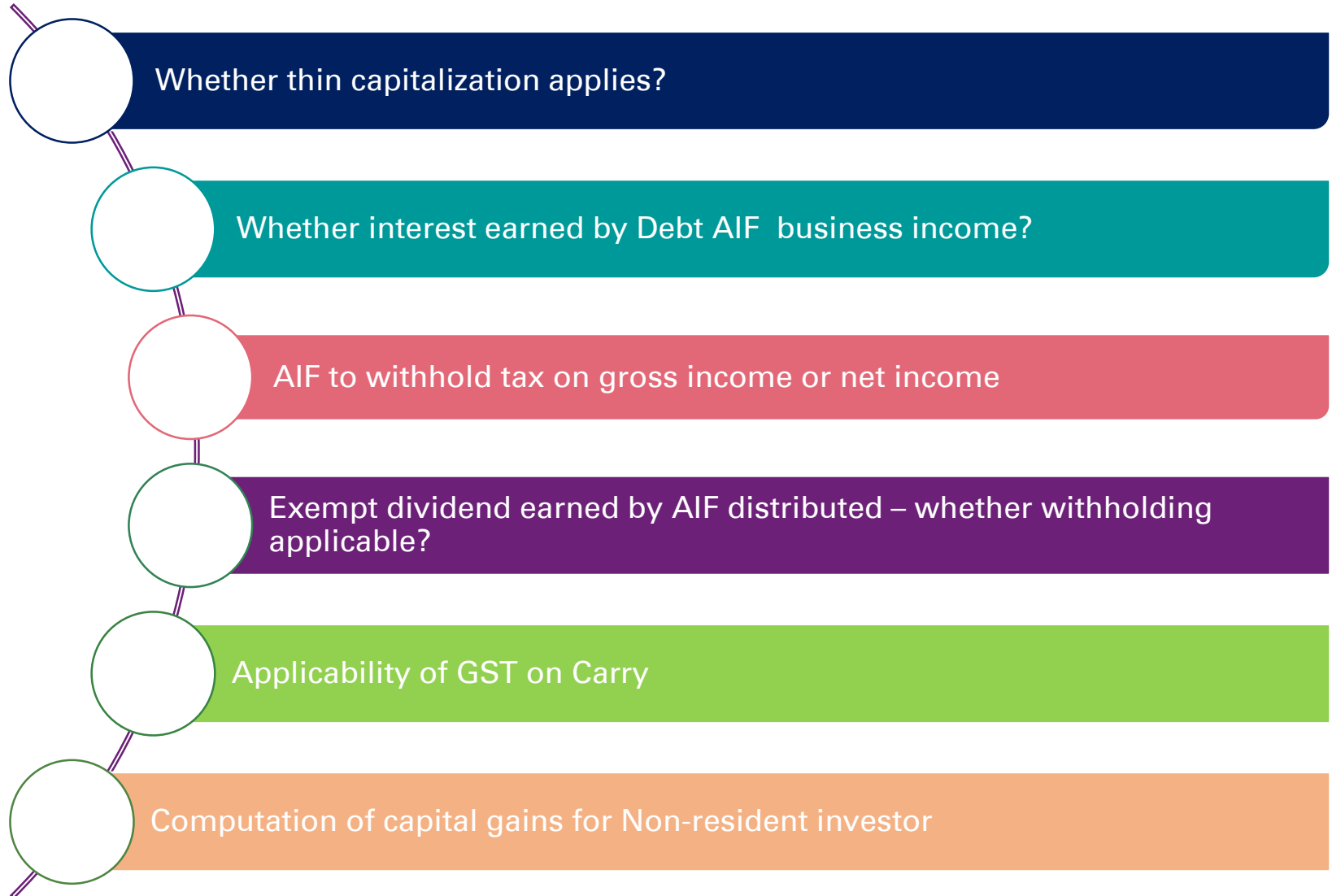
AIF - Sponsor/ Manager

- Key investment team to have at least 1 key personnel with atleast 5 years relevant experience
 - experience in advising or managing pools of capital or in fund or asset or wealth or portfolio management or in the business of buying, selling and dealing of securities or other financial assets and has relevant professional qualification
- Have necessary infrastructure/ manpower in place to discharge activities
- Co-investment not on more favourable terms as offered to AIF
- Prior Approval of SEBI on change in control of AIF/ Sponsor/ Manager
 - Intimation to SEBI on any material change in Sponsor/ Manager
- Manager and Sponsor can be the same entity
- Constitution of Manager entity – LLP versus company
- FDI in Manager entity – to comply with minimum capitalisation norms
- FDI in LLP (acting as Manager to AIF) – not permitted; NRI permitted since investment by NRI under Schedule 4 regarded as domestic investment

AIF – Tax aspects

- Tax pass-through status for all Category II AIFs on all income other than business income
 - AIF exempt, investors taxable at rates applicable to them
 - Income taxable in investors' hands, deemed to be of same nature and proportion as in AIF's hands
- Income received by the AIF to be exempt from deduction of tax at source by portfolio companies
- AIF to withhold tax on non-business income credited / paid at the following rates:
 - 10% for resident investors
 - Rates in force for non-resident investors and no withholding on exempt income
- Business income taxable at AIF level
 - Correspondingly such income exempt for investors
- Reporting requirements for providing income details to investors and tax authorities prescribed
- Loss to be carried forward at AIF level for set off in future years
 - Losses not to be passed on to investors
- No exemption for Category II AIFs from applicability of Section 56(2)(x), Section 56(2)(viib) and Section 50CA of the Act

The Ambiguity



Annexures

Annexure 1 - Definition of Infrastructure

Category	Infrastructure Sub-sector
Transport	Roads and bridges; ports (capital dredging); shipyards ("Shipyard" is defined as a floating or land-based facility with the essential features of waterfront, turning basin, berthing and docking facility, slipways and/or ship lifts, and which is self sufficient for carrying on shipbuilding/ repair/breaking activities); inland waterways; airport; railway track, tunnels, viaducts, bridges (including support terminal); urban public transport (except rolling stock in case of urban road transport)
Energy	Electricity generation, transmission and distribution; oil pipelines; oil/gas/liquefied natural gas (LNG) storage facility (including strategic storage of crude oil); gas pipelines (including city gas distribution network)
Water Sanitation	Solid waste management; water supply pipelines; water treatment plants; sewage collection, treatment and disposal system; irrigation (dams, channels, embankments, etc.); storm water drainage system; slurry pipelines
Communication	Telecommunication (fixed network) (including optic fibres / cable networks which provide broadband / internet); telecommunication towers; Telecommunication & Telecom Services
Social and Commercial Infrastructure	Education institutions (capital stock); hospitals (capital stock) (including medical colleges, para medical training institutes and diagnostics centres); three-star or higher category classified hotels located outside cities with population of more than one million; Common infrastructure for industrial parks, SEZ, tourism facilities and agriculture markets; post harvest storage infrastructure for agriculture and horticultural produce including cold storage; terminal markets; soil-testing laboratories; cold chain (including cold room facility for farm level pre-cooling, for preservation or storage of agriculture and allied produce, marine products and meat); Hotels with project cost of more than Rs.200 crores each in any place in India and of any star rating*; Convention Centres with project cost of more than Rs.300 crores each* *(Available for eligible projects for a period of three years; eligible costs exclude cost of land and lease charges but include interest during construction)

Annexure 2 – Definition of CIC & IFC

CIC

NBFC carrying on business of acquisition of shares/securities & fulfills following conditions

- holding $\geq 90\%$ of net assets in Group Cos (equity shares, preference shares or debt)
- holding $\geq 60\%$ of net assets in equity investment in Group Cos (including compulsorily convertible instruments within 10 years from the date of issue)
- No trading in investments except through block sale for dilution / divestment
- Does not undertaking any other financial services activity

IFC

Non-deposit taking NBFC that fulfills the following:

- a minimum of 75% of its total assets deployed in “infrastructure loans
- Net owned funds of Rs. 300 crore or above
- minimum credit rating 'A' or equivalent of CRISIL, FITCH, CARE, ICRA, Brickwork or equivalent rating by any other credit rating agency accredited by RBI
- CRAR of 15% (with a minimum Tier I capital of 10%)

Annexure 3 -Definition of AFC and Sick Company

AFC

NBFC:

- >60% of its total assets and total income is from carrying on business of financing of physical assets supporting productive/economic activity,
- such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines.

Sick
Company

Financial weak Company:

- has accumulated losses at the end of the previous financial year
- Networth at the beginning of the previous financial year has been eroded >50% but <100%

THANK YOU

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