

Helping BUSINESSES
Achieve Their Goals

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AIF - Tax, Structuring, & Regulatory overview

AIF Regulations – Key Aspects ...

Development of VC / PE

- AIF = Alternative Investment Fund i.e. VC / PE
- In India, earlier fund raising existed in its nascent stage from by PSU banks –by providing debt or
- Later, government started a development bank – like SIDBI / IDBI / ICICI – the volume
- Till 2000, only effective source of funding for companies requiring growth capital / expansion capital was public market – IPO

Why VC / PE funding is important

- To nurture entrepreneurship and related ecosystem in the country
- To stimulate the innovation
- Co's in Germany end up spending more than 5% of rev. on R & D

AIF Regulations – Key Aspects ...

VC Regs

- SEBI came out with VC Regulations, 1996 (effective from 4-Dec-1996)

By 2012

- VC Regs, MF Regs, CIS Regs, PMS Regs – thus, retail segment was well regulated
- What was not regulated was non-retail segment – For e.g. RE Funds
- VC Funds original aim of promoting early-stage companies
- Whereas PE growth / RE fund focus on larger companies / project – thus PE / RE funds were not regulated

AIF Regulations, 2012

- To develop long term cost effective & alternate source of funding or raising capital.
- To regulate such private pool of funding, SEBI came out with AIF Regulations, 2012 (effective from 21-May-2012)

Various Asset Classes in India

The asset allocation quilt

The table ranks 10 asset classes in order of their return performance—from the highest to lowest—for each calendar year in the 10-year period from 2010-2019. For example, gold gave a return of 24% in 2010, and large-caps came in second with 17.43% in the same year. The absence of any pattern in the returns of asset classes from one year to the next reinforces the importance of asset allocation to build a portfolio against trying to consistently predict the next winning asset class. A diversified portfolio of stocks, bonds and physical assets is key to steering through every market condition. Such a portfolio may not deliver the highest return in any given year but will perform competitively across market cycles

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Gold 24.00	Gold 29.00	Mid-cap 38.52	International 29.60	Small-cap 62.91	Credit risk 10.00	G-sec 15.00	Small-cap 59.64	Gold 8.00	International 27.31
Large-cap 17.43	Real estate 17.72	Small-cap 36.45	Large-cap 8.98	Mid-cap 54.69	Corporate bond 9.00	Corporate bond 12.00	Mid-cap 48.13	G-sec 8.00	Gold 18.00
Small-cap 16.69	Credit risk 8.00	Large-cap 25.70	Real estate 7.46	Large-cap 29.89	Mid-cap 7.43	Credit risk 12.00	Large-cap 27.91	Large-cap 5.91	Large-cap 12.65
Mid-cap 16.15	Corporate bond 8.00	Real estate 17.07	Credit risk 7.00	G-sec 17.00	G-sec 7.00	Gold 11.00	International 19.42	Corporate bond 5.00	G-sec 12.00
International 12.78	T-Bill 4.61	International 13.40	Corporate bond 6.00	Credit risk 14.00	Small-cap 6.10	Real estate 9.63	Credit risk 8.00	Credit risk 5.00	Corporate bond 10.00
Corporate bond 7.00	G-sec 4.00	G-sec 13.00	T-Bill bond 5.50	Corporate bond 13.00	T-Bill 5.38	International 9.54	Corporate bond 7.00	Real estate 4.83	Credit risk 8.00
Credit risk 6.00	International 0.00	Gold 12.00	G-sec 2.00	Real estate 11.91	Real estate 4.52	Mid-cap 7.97	Real estate 6.40	T-Bill 4.08	T-Bill 4.20
Real estate 5.50	Large-cap -24.64	Credit risk 11.00	Mid-cap -5.73	International 11.39	International -0.73	T-Bill 4.73	Gold 6.00	International -6.24	Real estate 2.60
G-sec 4.00	Mid-cap -34.19	Corporate bond 11.00	Small-cap -9.67	T-Bill 5.72	Large-cap -5.03	Large-cap 1.95	T-Bill 4.03	Mid-cap -13.38	Mid-cap -4.01
T-Bill 3.00	Small-cap -36.41	T-Bill 5.59	Gold -18.00	Gold 2.00	Gold -8.00	Small-cap 1.77	G-sec 2.00	Small-cap -23.53	Small-cap -8.98

Returns as of 20 December 2019; T-Bill: treasury bills; G-secs: government securities; For large-cap, we have used S&P BSE Sensex data; For mid-cap, S&P BSE Midcap data; For small-cap, S&P BSE Smallcap data; For T-Bills, CCIL Liquidity Weight data; For G-secs, CCIL All Sovereign Bond Index data; For corporate bonds, Crisil Corporate Bond Composite Index data; For credit risk, Crisil Composite Credit Risk data; For international, S&P 500 data; For gold, prices as per World Gold Council; For real estate, RBI House Price Index data
Source: Mint research

Various Asset Classes in the USA

Asset Classes Go In and Out of Favor

2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Compounded Return*	Risk**	
Real Estate 33.2%	Int'l Emerging 34.0%	Real Estate 36.0%	Int'l Emerging 39.4%	Fixed Income 5.2%	Int'l Emerging 78.5%	Real Estate 28.1%	Real Estate 9.4%	Int'l Emerging 18.2%	U.S. Small Cap 41.3%	Real Estate 32.0%	Real Estate 4.5%	U.S. Small Cap 26.6%	Int'l Emerging 37.3%	Cash Alt. 1.9%	U.S. Small Cap 9.2%	Real Estate 23.4%	HIGHEST
Int'l Emerging 25.6%	Commodities 21.4%	Int'l Emerging 32.1%	Commodities 16.2%	Cash Alt. 1.8%	U.S. Mid Cap 37.4%	U.S. Mid Cap 26.6%	Fixed Income 7.8%	U.S. Mid Cap 17.9%	U.S. Mid Cap 33.5%	U.S. Large Cap 13.7%	U.S. Large Cap 1.4%	U.S. Mid Cap 20.7%	Int'l Developed 25.0%	Fixed Income 0.01%	U.S. Mid Cap 8.9%	Int'l Emerging 21.4%	
U.S. Small Cap 22.6%	Real Estate 13.8%	Int'l Developed 26.3%	Int'l Developed 11.2%	Diversif'd Portfolio -21.8%	Int'l Developed 31.8%	U.S. Small Cap 26.3%	U.S. Large Cap 2.1%	Int'l Developed 17.3%	U.S. Large Cap 32.4%	U.S. Mid Cap 9.8%	Fixed Income 0.6%	U.S. Large Cap 12.0%	U.S. Large Cap 21.8%	Real Estate -4.2%	Real Estate 8.1%	U.S. Small Cap 17.8%	
Int'l Developed 20.3%	Int'l Developed 13.5%	U.S. Large Cap 15.8%	Diversif'd Portfolio 8.4%	U.S. Small Cap -31.1%	Real Estate 28.5%	Int'l Emerging 18.9%	U.S. Small Cap 1.0%	Real Estate 17.1%	Int'l Developed 22.8%	Fixed Income 6.0%	Cash Alt. 0.03%	Commodities 11.8%	U.S. Mid Cap 16.2%	U.S. Large Cap -4.4%	Int'l Emerging 7.9%	Commodities 16.3%	
U.S. Mid Cap 16.5%	U.S. Mid Cap 12.6%	U.S. Small Cap 15.1%	U.S. Mid Cap 8.0%	Commodities -35.7%	U.S. Large Cap 26.5%	Commodities 16.8%	Diversif'd Portfolio 0.4%	U.S. Small Cap 16.3%	Diversif'd Portfolio 12.3%	Diversif'd Portfolio 5.8%	Int'l Developed -0.8%	Int'l Emerging 11.2%	Diversif'd Portfolio 13.5%	Diversif'd Portfolio -5.0%	U.S. Large Cap 7.8%	Int'l Developed 16.3%	
Diversif'd Portfolio 11.8%	Diversif'd Portfolio 8.5%	Diversif'd Portfolio 13.3%	Fixed Income 7.0%	U.S. Mid Cap -36.2%	U.S. Small Cap 25.6%	U.S. Large Cap 15.1%	Cash Alt. 0.1%	U.S. Large Cap 16.0%	Real Estate 1.2%	U.S. Small Cap 5.8%	Diversif'd Portfolio -1.7%	Diversif'd Portfolio 7.5%	U.S. Small Cap 13.2%	U.S. Small Cap -8.5%	Diversif'd Portfolio 6.0%	U.S. Mid Cap 16.2%	
U.S. Large Cap 10.9%	U.S. Small Cap 7.7%	U.S. Mid Cap 10.3%	U.S. Large Cap 5.5%	U.S. Large Cap -37.0%	Diversif'd Portfolio 22.3%	Diversif'd Portfolio 12.4%	U.S. Mid Cap -1.7%	Diversif'd Portfolio 10.8%	Cash Alt. 0.1%	Cash Alt. 0.03%	U.S. Small Cap -2.0%	Real Estate 6.7%	Real Estate 3.8%	U.S. Mid Cap -11.1%	Int'l Developed 4.7%	U.S. Large Cap 13.5%	
Commodities 9.2%	U.S. Large Cap 4.9%	Cash Alt. 4.8%	Cash Alt. 4.7%	Real Estate -39.2%	Commodities 18.9%	Int'l Developed 7.8%	Int'l Developed -12.1%	Fixed Income 4.2%	Fixed Income -2.0%	Int'l Emerging -2.2%	U.S. Mid Cap -2.2%	Fixed Income 2.7%	Fixed Income 3.5%	Commodities -11.3%	Fixed Income 3.9%	Diversif'd Portfolio 8.8%	
Fixed Income 4.3%	Cash Alt. 3.0%	Fixed Income 4.3%	U.S. Small Cap -0.3%	Int'l Developed -43.4%	Fixed Income 5.9%	Fixed Income 6.5%	Commodities -13.3%	Cash Alt. 0.1%	Int'l Emerging -2.6%	Int'l Developed -4.9%	Int'l Emerging -14.9%	Int'l Developed 1.0%	Commodities 1.7%	Int'l Developed -13.8%	Cash Alt. 1.3%	Fixed Income 3.2%	
Cash Alt. 1.2%	Fixed Income 2.4%	Commodities 2.1%	Real Estate -17.6%	Int'l Emerging -53.3%	Cash Alt. 0.2%	Cash Alt. 0.1%	Int'l Emerging -18.4%	Commodities -1.1%	Commodities -9.5%	Commodities -17.0%	Commodities -24.7%	Cash Alt. 0.3%	Cash Alt. 0.8%	Int'l Emerging -14.6%	Commodities -2.5%	Cash Alt. 0.5%	LOWEST

*Compounded returns are measured by the geometric mean of a given portfolio, which takes into account the sequence of returns over a given period of time and more accurately shows the portfolio's performance over that period of time, as compared to a simple average.

**Risk is represented by Standard Deviation, which is the measure of total volatility in a portfolio. It shows how widely a portfolio's returns have varied around the average over a period of time. Standard deviations on this chart were calculated using monthly returns.

Source: 2019 Morningstar

This chart is for illustrative purposes only and not indicative of any investment. The data assumes reinvestment of all income and does not account for taxes or transactions costs. This chart is based upon past index performance and is not indicative of future results. Indexes are unmanaged and cannot be invested in directly. Diversification does not guarantee a profit or protect against a loss. Note that the diversified portfolio's assets were rebalanced annually in order to maintain the designated allocations throughout the period.



History of VC and PE - internationally

International Overview

- The concept started post world war II
- To meet their livelihood, soldiers started some or the other business
- To fund the business started by the soldiers of WW II
- This concept was promoted by :
 - Georgis Doriot – Dean HBS and founder of INSEAD
 - Assisted by Ralph Flanders and Karl Compton (MIT President)
- Few leading global PE players:
 - Blackstone
 - Carlyle
 - KKR (Kohlberg, Kravis & Robert)
 - Warbug Pincus

 - ICICI Venture
 - True North
 - Keadara Capital
 - Aventus PE
 - Total around 721 AIF registered in India (as at 22-Jan-2021)

Broad Categories of VC / PE

**Broad
Categories
commercially
known**

**(not from
regulatory
perspective or
AIF Regulations
perspective)**

- Angel funding – INR 25 lakh to INR 1 Cr. (Indian Angel / Mumbai Angel)
- Seed funding – INR 1 Cr. To INR 3/4 Cr.
- VC – INR 5 Cr. Onwards
- PE (Growth Capital) – INR 25 Cr. Onwards
- Buy-out
- PIPE
- Real Estate Fund
- Mez Debt Fund
- Need for funding
 - Angel – incubation of idea
 - Seed funding – start up
 - VC – Idea based start up with bigger ticket size
 - PE – Growth / expansion / acquisition funding
 - PIPE – varied reasons
 - Mez – Predominantly debt with a potential range bound upside and limited downside...

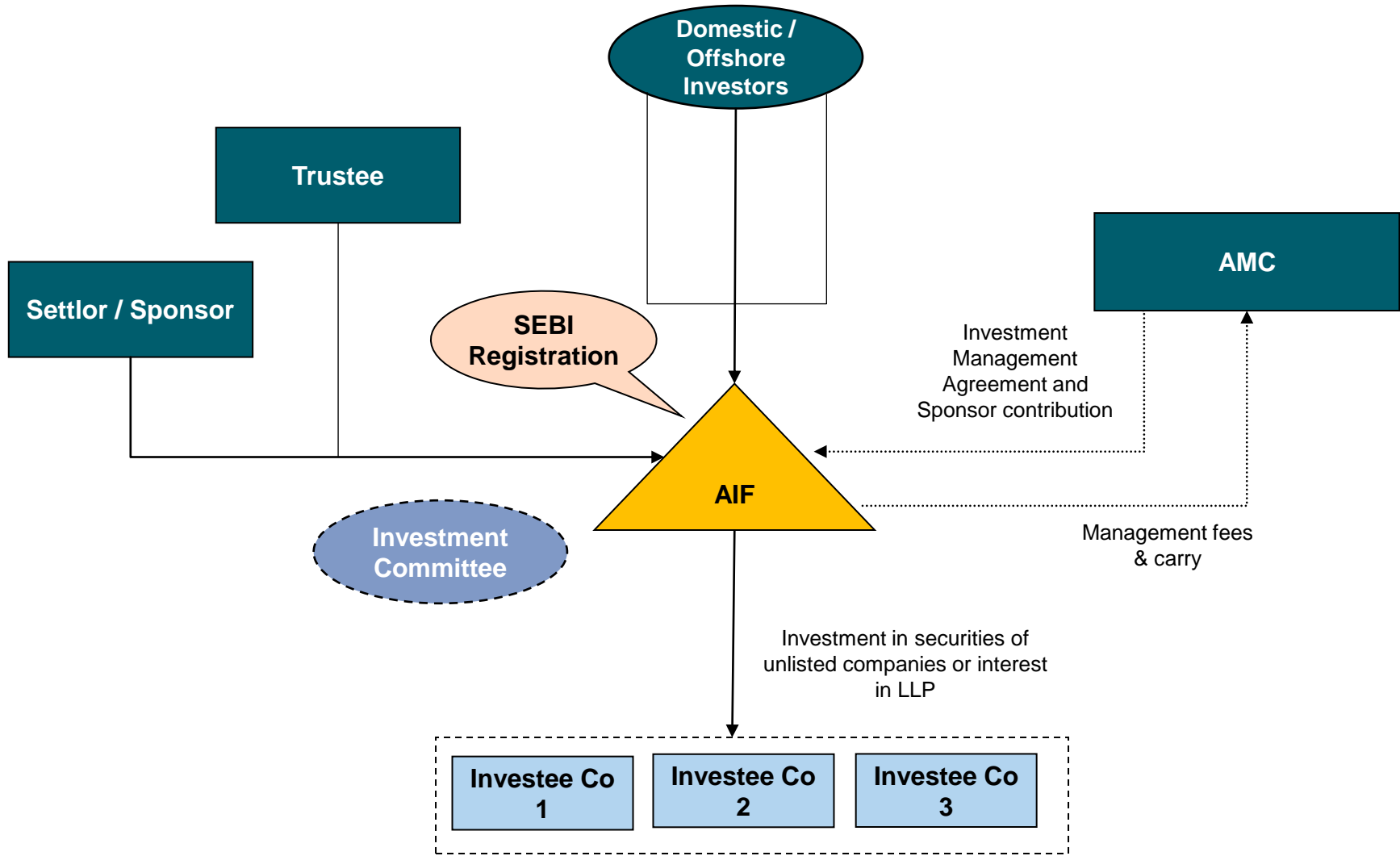
Which is, arguably, the first known venture capital investment in the world...

Can you Identify the person ?



- **Queen Isabella funded the expedition of Christopher Columbus**
- **Columbus wanted to find Asia to obtain the Asian spices.**
- **Found the USA in 1492**

Typical Domestic Fund Structure



AIF Regulations – Background

Notified by SEBI on 21 May 2012

SEBI (Venture Capital Funds) Regulations, 1996 (VCF Regulations) repealed

Existing VCFs grandfathered

All un-registered Funds required to register going forward

Endeavour to extend the perimeter of regulation to unregulated funds and realignment of regulations to international standards

AIF Regulations – Key Aspects ...

Registration

- Any fund established or incorporated in India (excludes offshore funds)

Form of AIF

- Trust or a Company or a LLP or a body corporate

Exclusions from AIF Regulations

- MF / CIS
- Family trusts
- ESOP trusts,
- Employee welfare trusts,
- Gratuity trusts,
- Holding companies,
- Regulated SPVs not managed by fund managers,
- Securitization / reconstruction companies registered with RBI,
- Funds regulated by SEBI /any other regulator in India

Minimum corpus

- INR 20 crores

Maximum investors

- 1000 investors (no minimum no of investors specified)

SEBI ICDR

- All AIFs shall have QIB status under SEBI ICDR

... AIF Regulations – Key Aspects

Minimum contribution per investor

- INR 1 crore from investor (INR 25 lakhs from employees or directors of AIF)

Listing

- Possible for closed ended AIFs with minimum tradable lot of INR 1 crore, however funds are not to be raised through the stock exchange mechanism

Foreign Investments

- May invest in securities of companies incorporated outside India (subject to conditions of RBI / SEBI)

Investment in associates

- Not permitted, except with the approval of 75% of the investors by value of their investment in AIF

Un-invested portion of the corpus

Can be invested in liquid mutual funds, bank deposits, other liquid assets such as T-bills, commercial papers, etc. till deployment of funds.

AIF Regulations – Categories of AIF

CATEGORY I

- AIFs with positive spillover effects on economy
- Incentives given by SEBI, GOI, or other regulators in India
- Includes -
 - VCF / Angel Fund (Annex)
 - SME Funds (Annex)
 - Social Venture funds
 - Infrastructure funds
 - Others – as may be specified.

CATEGORY II

- No incentives given by SEBI, GOI, or other regulators in India
- Includes -
 - Private Equity funds
 - Debt funds
 - Other funds (not falling under Category I or III) which does not undertake leverage

CATEGORY III

- AIFs which trade for making short term returns, includes hedge funds / PIPE funds, etc.
- Employs diverse or complex trading strategies

AIF – Comparison

Particulars	Category I	Category II	Category III
Close Ended/ Open Ended	Close Ended only	Close Ended only	Open or Close Ended
Minimum Tenure	3 years	3 years	No Restriction
Maximum Tenure	As per fund docs		
Extension up to 2 years for Close ended funds only	Allowed only for closed ended fund - if approved by min 75% investors (by value)		
Investment in other AIFs	Can invest in units of Category I AIF of same sub-category	Can invest in units of Category I and II AIF	Can invest in units of Category I and II AIF
Investment in one investee company	Max 25% of Corpus*	Max 25% of Corpus*	Max 10% of Corpus*
SEBI Registration Fees	INR 500,000	INR 1,000,000	INR 1,500,000

* **Corpus** = Fund committed by investors (vide Q10 of FAQ released by SEBI)

AIF – Comparison

Particulars	Category I	Category II	Category III
Listing	May be listed subject to minimum tradable lot of Rs. 1 Crore	May be listed subject to minimum tradable lot of Rs. 1 Crore	Close ended schemes can be listed subject to minimum tradable lot of Rs. 1 Crore
Buy-back of Units	Not allowed	Not allowed	Allowed for Open ended funds
Borrowing/ Hedging	<ul style="list-style-type: none"> - Generally not allowed - Only for temporary funding requirements not more than 30 days - Only up to 4 occasions in a year - not more than 10% of the corpus 	Same as Category I However, it may engage in hedging subject to guidelines specified by SEBI.	Can borrow or take leverage subject to <ul style="list-style-type: none"> - consent from the investors and maximum limit 200% of NAV - Separate leverage norms issued by SEBI to be complied with
Appointment of Custodian	Only if corpus is more than INR 500 Crores	Only if corpus is more than INR 500 Crores	Mandatory- Irrespective of corpus size

Sponsor / Manager

- ❑ **Sponsor-** Any person(s) who sets up the AIF & includes:
 - promoter in case of company
 - designated partner in case of LLP
- ❑ **Manager-** Any person appointed by AIF to manage its investments
- ❑ Sponsor/Manager shall have a certain **continuing interest** in the AIF
- ❑ Shall not be through the waiver of management fees
- ❑ Sponsor/Manager's minimum contribution shall be Continuing interest of not less than:

Category I and II AIFs	Category III AIFs	Angel Funds
2.5% of the corpus or INR 5 crores, whichever is lower	5% of the corpus or INR 10 crores, whichever is lower	2.5% of the corpus or INR 50 lakhs, whichever is lower

Sponsor / Manager- Obligations under AIF

General obligations / responsibilities :

- Fulfil 'Fit and Proper persons' criteria of SEBI regulations
- Have necessary infrastructure/ manpower in place
- Personal representation by Sponsor/ Manager (at the time of AIF Application) to appear before SEBI
- Co-investment not on more favourable terms as offered to AIF
- Responsible for maintaining transparency as per AIF regulations
- Prior Approval of SEBI on change in control of AIF/ Sponsor/ Manager
- Intimation to SEBI on any material change in Sponsor/ Manager
- Frame dispute resolution
- Annual reports to investors and audit
- Provide information to SEBI, if called for & also assist SEBI during inspection

Sponsor / Manager- Obligations under AIF

- Disclose investments in AIF - disciplinary history, conflicts of interest, fees ascribed, any fees charged to investee company by an associate
- Sponsor to act in a fiduciary capacity towards its investors
- Maintenance of following records for 5 years after winding up of Fund:
 - Assets under the scheme/fund
 - Valuation policies and practices
 - Investment Strategies
 - Particulars of Investors and their contribution
 - Rationale for investments made
- Manager shall prepare a **Compliance Test Report (CTR)** on compliance & to be submitted within 30 days from the end of FY. Sponsor shall intimate his observations/comments to the manager
- Intimation to SEBI in case of any violation of AIF Regulations/ Circulars

Sponsor / Manager- Mitigating Factors

- ❑ The Indian Trusts Act levy obligations on the trustee of AIF.
- ❑ Also, the **key Fund Documents** like the **IMA** (between Trustee & Investment Manager), **Contribution Agreement** (between Trustee, Investment Manager & Contributor) do not have Sponsor as the party.
- ❑ Hence the Sponsor, not being a party to the Fund documents may **escape the contractual liability**, otherwise typically applicable on the Investment Manager and the Trustee.
- ❑ Thus, it can be seen that the SEBI AIF Regulations specify certain obligations to be fulfilled by the entity/individual named as Sponsor but there are certain factors which mitigate individual Sponsor's liability/risks under Law and Fund Documents.

Manager to AIF – Key Requirements/ Obligations

- Key investment team to have at least 1 key personnel with 5 years or more relevant experience
- Manager to disclose its affiliation with other intermediaries in PPM
- Manager to frame written policies and procedures to identify/ mitigate 'Conflicts of interest'
- **Other general obligations:**
 - Address all investor complaints
 - Provide to SEBI any information sought by it
 - Maintain all records as may be specified by SEBI
 - Take all steps to address conflict of interest
 - Ensure transparency and disclosure
 - Provide assistance/ information/ documents/ records to SEBI on inspection
 - Provide description of valuation procedure and methodology for valuing assets to investors

Most requirements on manager – sponsors also made responsible in certain circumstances

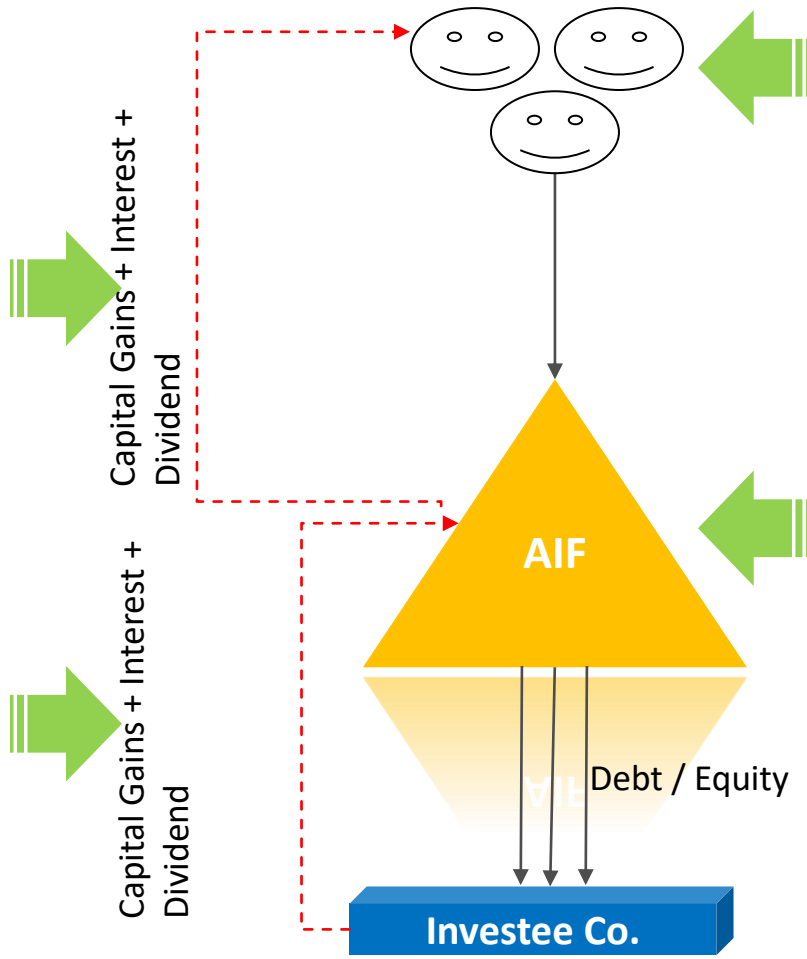
AIF – Key Regulatory and Other Considerations

- **AIF – Trust v. LLP**
- **Clarity on the meaning of the term “continuing interest”**
 - **Sponsor commitment can be drawn down pro rata with other investments**
- **Cat II AIF cannot give pure loans, they can invest in debt securities**
- **Outbound Investment by AIF is subject to certain conditions and prior SEBI approval**
- **Asset manager to be LLP vs. Company**
- **Necessity for sponsor to be a person / persons who has set up the AIF:**
 - **Could it be a person other than the person / persons who have set up the AIF (e.g. a holding company of the manager, employees of the manager)?**
- **Carried interest for sponsor / other employees – Direct v Employee Trust**
 - **Limit of INR 25 lakhs v. INR 1 crore**
 - **Employee Trust – whether AIF?**
- **To have independent trustee vs. in house trustee?**

Tax implications on AIF (Cat I & II)

• All income pass through - taxable in Investors hands (except business income)

• No TDS to be deducted by investee company on interest income paid to AIF (CBDT circular no. 51/2015)



• Business Income Exempt in the hands of investors

• Business income taxable @ MMR
 • TDS @ 10% to be deducted u/s. 194LBB by AIF on all income paid or credited to resident investors and @ rates in force in case of non-resident investor

CHARACTERISATION OF INCOME- CRITICAL PARAMETER

Tax implications on AIF (Cat I & II)

Section of the Act	Gist of the Section
AIF	
10(23FBA)	Exemption for income of Category I and II AIFs (other than business income)
10(23FBB)	Exemption for business income in the hands of unit holders
115UB	Pass-through taxation for unit holders of Category I and II AIFs, reporting requirements
139(4F)	Return of income by Category I and II AIFs
194LBB	TDS by Category I and II AIFs on payment of income to unit holders
VCF	
10(23FB)	Exemption to VCF in respect of income from investments in Venture Capital Undertakings (VCU)
115U	Pass-through taxation for unit holders of VCFs for certain income, reporting requirements
139(4C) (ec)	Return of income by VCF

Taxation of Cat I and Cat II AIF

Finance Act, 2015 introduced a special tax regime for Cat I and Cat II AIF



- Investor in an AIF shall be chargeable to income-tax in the same manner as if it were the income (other than business income) accruing or arising to, or received by, such person had the investments, made by AIF, been made directly by him
- Such income (other than business income) shall be taxable in the hands of the investor directly and the AIF shall be exempt from tax. Business income shall be taxable @ MMR in hands of AIF and shall be exempt in hands of investors - INCOME CHARACTERISATION A CRITICAL PARAMETER
- The income paid or credited by AIF shall be deemed to be of same nature and proportion in hands of the Investor as if it had been received by, or had accrued or arisen to AIF
- AIF to withhold tax @ 10% on income (other than business income) paid or credited to resident investors and @ rates in force in case of non-resident investor. Income accrued, arisen or received by AIF shall be deemed to be credited to investors account in proportion to their share at year end where not distributed by AIF
- Losses now (from AY 2020-21) allowed be passed on to investors for set off
- Income received by AIF would be exempt from TDS requirement. No distribution tax on payments made by AIF.
- AIF to provide to revenue and investors, details of various components of income paid or credited to investors

Issues



- **Fund to withhold tax at 10 per cent on income credited/paid to resident investors**
 - **Is WHT applicable on exempt income?**
- **Re-investments possible only on income post WHT**
- **Taxability of Carried Interest - capital gains v other income**

Taxation Issues in Cat III AIF



- Unlike Cat I & II, no tax pass through status accorded to the Cat III funds
- Thus, to get the benefit of ‘pass through’ - the taxation for Cat III funds to be governed by complex trust taxation provisions – that were introduced for private and family trust
- Significant complexities due to following Cat III fund features:
 - a) It may have two sets of portfolio – Trading (short term) & Investment (long-term)
 - b) Cat III fund may be Open Ended or Close Ended
 - c) Cat III are generally set-up as trust due to operational complications
 - d) Long-short Cat III funds may invest in derivatives
- The trust taxation aspects:
 - a) Taxation depends whether the trust is a determinate trust or indeterminate trust
 - b) Determinate Trust – Income may get taxed only at one level i.e. either at Fund level or in the hands of investors. However, if the trust has business income then whole of the income becomes taxable at highest tax rate - MMR (~ 35.535 %)
 - c) Indeterminate Trust – the entire income is taxable at highest tax rate - MMR (~ 35.535 %)

Step Chart for setting up of AIF with approximate timelines...

Sr No.	Steps	Approximate number of weeks to complete							
		1 to 2		3 to 4		5 to 6		7 to 14	
	<u>Setting up of manager entity</u>								
1	Finalization of AMC structure								
2	Set up of AMC structure								
	<u>Setting up of Trust</u>								
1	Determine the Settlor of the Trust								
2	Determine the Sponsor of the Trust								
3	Appointment of Trustee								
4	Review and finalisation of Trust Deed								
5	Review and finalisation of Investment Management Agreement								

...Step Chart for setting up of AIF with approximate timelines.

Sr No.	Steps	Approximate number of weeks to complete							
		1 to 2		3 to 4		5 to 6		7 to 14	
6	Registration of the Trust								
7	Obtaining Permanent Account Number for the Trust								
8	Opening a Bank Account of the Trust in India								
	<u>Obtaining AIF Registration from SEBI (post registration of Trust)</u>								
9	Compiling the requisite information / documents for preparing the AIF Application								
10	Preparing and finalizing the AIF Application								
11	Filing of AIF Application with SEBI								
12	Responding to queries raised (if any) by SEBI								

...Step Chart for setting up of AIF with approximate timelines

Sr No.	Steps	Approximate number of weeks to complete							
		1 to 2		3 to 4		5 to 6		7 to 14	
13	Having meetings and discussions, if required, with SEBI in connection with the AIF Application								
14	Obtaining the AIF Registration								
	<u>Investor Documentation</u>								
15	Drafting of Private Placement Memorandum ('PPM')								
16	Review of PPM from a tax and legal perspective and finalizing the same								
17	Drafting and Review of Contribution Agreement								
18	Obtaining Firm Commitment Letter from the Investors								

Annexure – Cat I - SME Fund

❑ **Cat I – Investment in:**

- Investee Company
- VCU
- SPV
- LLP
- Units of other Cat I AIF

❑ No borrowing of funds allowed by Cat I AIF

❑ Cat I - SME Funds

• **75% of the corpus in :**

- i. Unlisted VCUs
- ii. SMEs or SMEs proposed to be listed on SME Exchange (lock-in for one year from the date of investments)

- May subscribe to unsubscribed portion of the issue in the process of market making under SEBI – ICDR

❑ The aforesaid % of investment to be achieved at the end of the fund investment life cycle

Annexure – Cat I – SME Fund

❑ Definition of Micro, Small & Medium Enterprises

Enterprise	<u>Existing</u>		<u>Proposed</u>
	Manufacturing Sector (Investment in Plant & Machinery)	Service Sector (Investment in Equipments)	Based on Turnover (No Distinction in Manufacturing & Service Sector)
Micro	Less than Rs 25 Lakhs	Less than Rs 10 Lakhs	Less than Rs 5 Crores
Small	More than Rs 25 Lakhs but less than Rs 5 Crores	More than Rs 10 Lakhs but less than Rs 2 Crores	More than Rs 5 Crores but less than Rs 75 Crores
Medium	More than Rs 5 Crores but less than Rs 10 Crores	More than Rs 2 Crores but less than Rs 5 Crores	More than Rs 75 Crores but less than Rs 250 Crores

Annexure – Cat I – Venture Capital Fund

- ❑ **Cat I – Investment in:**
 - Investee Company
 - VCU / SPV / LLP
 - Units of other Cat I AIF

- ❑ **No borrowing of funds allowed by Cat I AIF**

- ❑ **Cat I - Venture Capital Funds**
 - **66.67 % of the corpus in :**
 - i. Unlisted VCUs
 - ii. Companies proposed to be listed on SME Exchange (lock-in for one year from the date of investments)

 - **Maximum 33.33% of the corpus to be invested in :**
 - i. IPO of VCUs
 - ii. Debt / Debt instruments of VCUs, where fund has already invested in Eq.
 - iii. Preferential allotment or QIB quota of a listed company – (lock-in for one year from investments)
 - iv. Equity shares of a listed financially weak company or a listed sick industrial company.

 - May subscribe to unsubscribed portion of the issue in the process of market making under SEBI – ICDR

- ❑ **The aforesaid % of investment to be achieved at the end of the fund investment life cycle**

Annexure – Cat I – Venture Capital Undertaking

❑ **Venture Capital Undertaking**- means a domestic company:

(i) which is not listed on a recognised stock exchange in India at the time of making investment; and

(ii) which is engaged in the business for providing services, production or manufacture of article or things and does not include following activities or sectors:

- non-banking financial companies;
- gold financing;
- activities not permitted under industrial policy of Government of India;
- any other activity which may be specified by the Board in consultation with Government of India from time to time;

PMS v AIF

Key features	PMS	AIF
Pooling	Manager obliged to segregate securities - not permitted	Portfolio assets held by fund vehicle - pooling investments of investors feasible
Networth for Manager	INR 5 crore	Not prescribed
Non-resident investors	FDI restrictions are applicable non-resident may lead to POEM / PE concerns	Foreign investment permitted under the automatic route
Investor lock-in	Client can terminate the agreement - no lock-in. Exit load may be levied	Close ended Category I and II AIFs locked in for minimum 3 years
Sponsor participation	No skin in the game required for portfolio manager	Minimum sponsorship requirement
Investor taxation	Income taxable in the hands of investors	Category I and II AIFs: tax pass through (except unabsorbed losses of the fund)
Investment corpus for investor	INR 50 lakhs	INR 1 crore (exceptions for manager employees/directors)
Leverage	PMS not permitted to engage in leverage activities	No restrictions on AIFs to engage in leverage activities
Derivatives	Permitted for hedging purposes	No restrictions on use of derivations subject to leverage cap

Where practicing CA can assist

The engagement propose to include followings :

1. Conceptualization of fund structure which shall inter alia include the following:

- Assist in conceptualisation of the fund structure from Investment as well as fund raising perspective
- Advising on funding structure i.e. separate unit class/ shares (issued to various classes of investors)
- Advising on the pros and cons of the various options from a tax and regulatory perspective
- Assist in conceptualisation of structure of Carried Interest (Distribution Water Fall)
- Drafting tax section in the PPM
- Legal review and drafting of the agreement as well as employment contract

2. Implementation of the AIF structure

- Assistance in compiling the information and enclosures required to be submitted along with the SEBI the application
- Assistance in preparing the draft application to be made to SEBI for obtaining approval.
- Assistance in filing the application with SEBI & responding to queries, if any, raised by SEBI

3. Advise on establishment & composition of Investment Committee, Advisory Board, etc.

4. Liaising with Lawyers as well as the Trustees for various tax and regulatory matters

Where practicing CA can assist

Other On-going tax or regulatory compliances *

- Compliances with SEBI AIF Regulations
- Filing annual tax returns / Quarterly advance tax calculations & withholding tax (TDS)
- Annual issuance of Form 64C to investors
- Compliances with the Trustee
- FATCA & CRS Compliances
- RBI compliances
- SEBI SCORE Registration
- Application to CERSAI for CKYC registration
- AML compliances and appointment of Compliance Officer

** Note: The fees for aforesaid on-going compliances to be agreed upon separately after the fund commences its operations.*



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