

Alternative Investment Leaders Program



Cohort 2



Alternative Investment Funds in India – Background

What is Alternative Investment Fund?

AIF as per SEBI (Alternate Investment Funds) Regulations, 2012

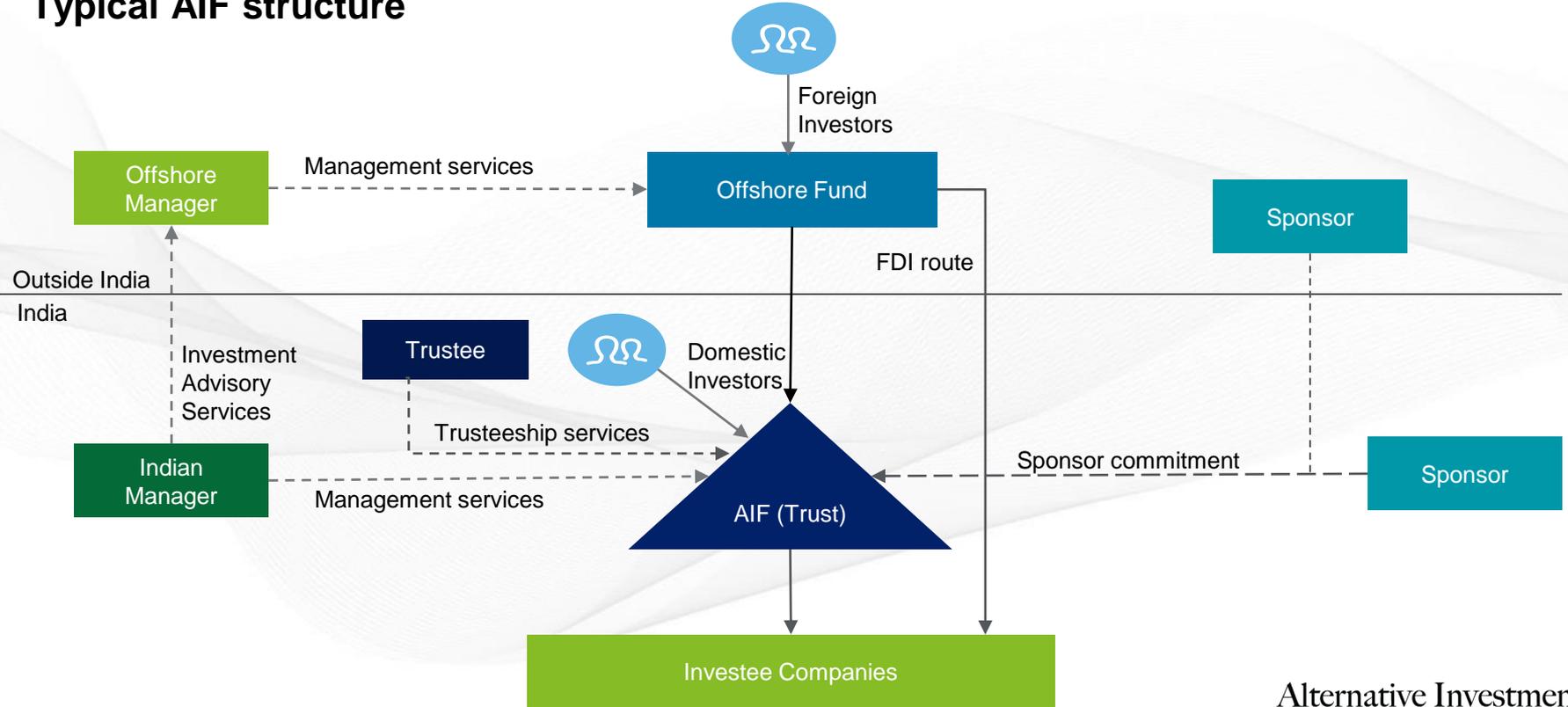
“AIF means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which:

- a. 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*
- b. 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.”*

Exemptions:

- Family trusts
- ESOP trusts
- Employee welfare trusts
- Holding companies
- Securitization trusts
- Funds managed by securitisation company or reconstruction company under SERFASI
- Any such pool of funds which is directly regulated by any other regulator in India.

Typical AIF structure



AIF v PMS (1/2)

Particulars	AIF	PMS
Regulatory framework	Comparatively liberal	Comparatively restrictive
Multiple strategies	Permissible. AIFs can invest in listed securities as well as make private investments in unlisted securities	PMS can invest only in listed securities (subject to exceptions)
Compliance for investors	Only disclosure of income required	Income to be considered in tax return and taxes to be paid
Regulatory registration for investors	No separate registration required for investors	Separate registration required for each investor
Investments	Investment made in the name of the AIF	Investment made in the name of the investors
SEBI-mandated minimum investment amount	INR 10 millions	INR 5 millions
POEM/ PE risk	Lower POEM/ PE risk for investors, as AIF is an entity resident in India	High POEM/ PE risk for investors under PMS structure
Benefit under tax treaties	May not be available for investors in Category III AIF	Available
Offsetting of losses at investor level	Not permissible for investors of Category III AIF	Permissible
Taxation	Taxation depends upon category of the AIF and characterisation of income in the hands of the AIF or its investors	Income taxable directly in the hands of the investors and accordingly, the tax is required to be paid directly by the investors

AIF v PMS (2/2)

Particulars	AIF	PMS
Pooling of funds	Pooling of funds is the essence of this investment model	Funds are not pooled, and investors have separate Demat accounts
Number of Investors	Maximum 1,000	No cap on the number of investors
Minimum corpus	Minimum corpus of INR 200 millions (INR 100 millions for Category-I angel funds)	No minimum corpus amount requirements
Types	Category I, II, and III, depending where Funds are invested	Discretionary and non-discretionary, based on the authority of the Fund Manager
Tenure	Tenure to be fixed and specified in the PPM of the AIF (except for open ended Funds)	No fixed tenure
Reporting to SEBI	Quarterly (monthly in case leverage is obtained)	Monthly

Categories of AIF

Category I AIF

- Invests in areas which are considered as **socially or economically desirable by the government/regulators**
- Do not undertake leverage other than to meet day to day operational requirements (subject to conditions) – leverage not permitted for investments
- Close ended funds
- Shall have a minimum tenure of 3 years (generally max tenure is of 10-12 years)
- Sub-categories - Venture Capital Funds, Small And Medium Enterprises Fund, Social Venture Funds, Infrastructure Funds, Special Situation Funds, Angel Funds

Category II AIF

- Funds that do not fall **under Category I and III AIFs** and for which no specific incentives or concessions are given by the government/ regulators
- Do not undertake leverage other than to meet day to day operational requirements (subject to conditions) - leverage not permitted for making investment
- Close ended funds
- Shall have a minimum tenure of 3 years (generally max tenure is of 10-12 years)

Category III AIF

- Funds that trade **with a view to make short term returns, employ diverse or complex trading strategies** and may employ leverage including through investment in listed or unlisted derivatives or complex or structured products
- Open ended or close ended funds
- No minimum tenure prescribed
- To include:
 - Hedge Funds
 - Funds which trade with a view to make short term returns

AIF – Key Documents required

Particulars	Details
Trust deed/ LLP Agreement/ Memorandum and Articles of Association for the AIF	<ul style="list-style-type: none"> • Depending upon whether the AIF is set-up as a trust, company or LLP, the incorporation document of the AIF would be required • Similarly, investment manager would also need to be incorporated (unless the investment manager is an individual)
Private Placement Memorandum	<ul style="list-style-type: none"> • Private Placement Memorandum ('PPM') is the document provided to the prospective investors, detailing the information relating to investment objective of the AIF, principal terms relating to investing in AIFs, risk factors, legal, regulatory and tax considerations, disciplinary history of the investment manager and its associates, etc. • PPM helps the investor to make decision with respect to investing in the AIF
Contribution Agreement	<ul style="list-style-type: none"> • Contribution Agreement is an agreement signed between the AIF/ Investment Manager and the investors containing key clauses in relation to investment in the AIF
Investment Management Agreement	<ul style="list-style-type: none"> • Trustee delegates the investment management activities to the investment manager via the investment management agreement

Alternative Investment Funds in India – Key Regulatory Aspects

SEBI (AIF) Regulations, 2012 : Key conditions (1/2)

Parameters	Conditions
Category of investors	Any investors, resident or non-resident
Minimum Corpus	INR 20 crores
Minimum Investment by investors	<ul style="list-style-type: none"> • INR 1 crore • INR 25 lakhs (per employee / director of the fund or manager) • Accredited investors – No Minimum Investment amount
No of Investors	Maximum – 1000 investors
Schemes	Can launch schemes subject to filing of the PPM atleast 30 working days prior to launch
Co-investment by sponsor / manager	Permissible but not in terms more favorable than those offered to the Fund
Tenure	<ul style="list-style-type: none"> • Category I and II AIF to be close ended fund while Category III AIF may be open ended or close ended • Minimum tenure 3 years in case of Category I and II AIF • Extension of close ended fund permitted upto 2 years subject to approval of 2/3rds of unitholders by value

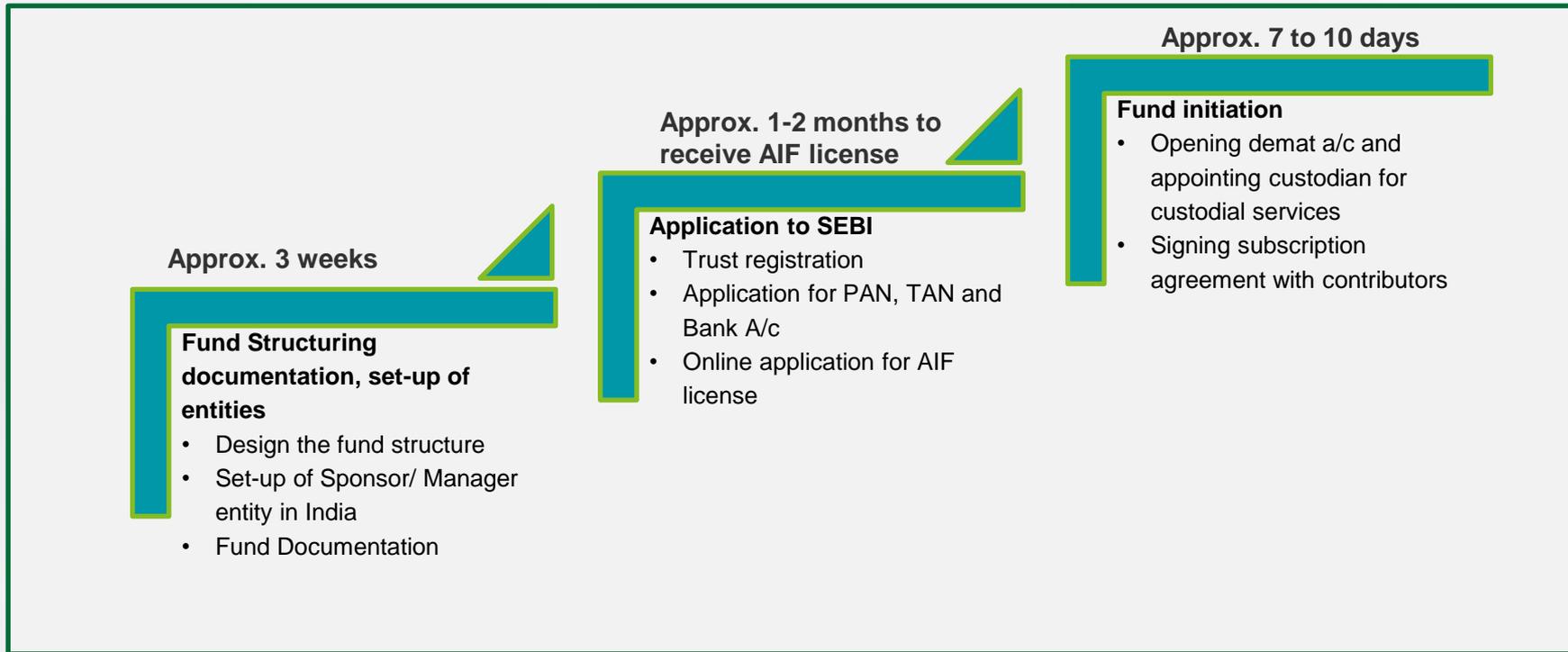
SEBI (AIF) Regulations, 2012 : Key conditions (2/2)

Parameters	Conditions
Sponsor Commitment	<ul style="list-style-type: none"> • Category I and II AIF - lower of continuing interest of 2.5% of the corpus or INR 50 million. • Category III AIF – lower of continuing interest of 5% of corpus or INR 100 million. • Investment through waiver of management fees prohibited
Investment per investee company	<ul style="list-style-type: none"> • Maximum 25% of the investible funds in one investee company by Category I and II AIFs • Maximum 10% of the investible funds or NAV in one investee company by Category III AIFs
Leverage / Hedging	<ul style="list-style-type: none"> • Category I and II AIF shall not borrow funds directly or indirectly or engage in leverage except for meeting temporary fund requirements • Category III AIF may engage in leverage or borrow subject to consent from the investors in the fund and subject to a maximum limit of 2 times the NAV of the fund.
Listing	Permissible for close ended AIFs
Valuation	<ul style="list-style-type: none"> • Category I and II AIF must undertake valuation of investments once every 6 months • Category III AIF must disclose such NAV to investors : quarterly for closed ended funds and monthly for open ended funds - NAV of the fund to be independent from fund management function
Custodian	<ul style="list-style-type: none"> • Category I and II AIF must appoint custodian if corpus is more than 500 crore rupees • Custodian is mandatory for all Category III AIF

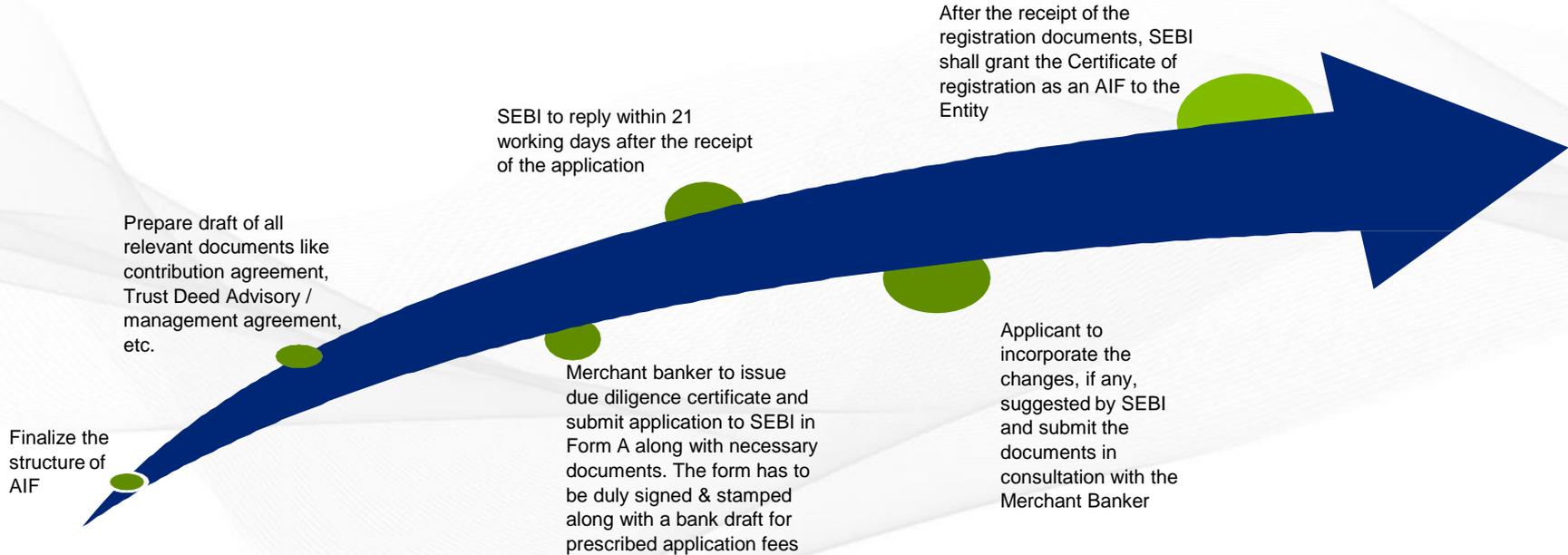
Category III AIF – open ended v close ended

Parameters	Open ended AIF	Close ended AIF
Nature of commitment from investors	Flexibility to commit funds and redeem anytime, subject to terms of the Fund	Restriction to commit funds only till the final closing and can redeem during the tenure of the Fund as per the terms of the Fund
Tenure	No fixed tenure	Fixed tenure (minimum 3 years, maximum tenure to be specified in the PPM)
Raising of capital commitment from the investors	Investment in terms of minimum contribution as per the AIF Regulations may be required upfront	<ul style="list-style-type: none"> • AIF may raise capital commitment upfront to the extent of minimum contribution as per the AIF Regulations • Drawdown can be made as per the drawdown schedule as mentioned in the PPM
Taxability	<ul style="list-style-type: none"> • Risk of being regarded as discretionary / indeterminate trust since the investors can enter and exit at any time • Risk of trust being regarded as a revocable trust owing to the redemption option • Possibility to structure the contributions as determinate 	<ul style="list-style-type: none"> • Risk of trust being regarded as a revocable trust owing to the redemption option • Possible to structure the fund as a determinate trust
Operational aspects	Comparatively more complex	Comparatively less complex

AIF set-up - Indicative timelines



AIF – Registration Process



Post Registration Regulatory Compliance:

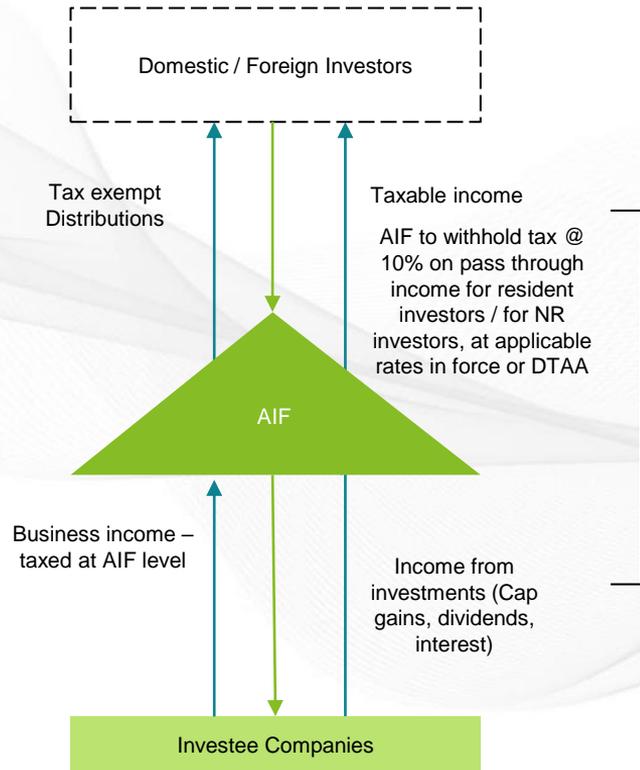
- An AIF needs to comply with the periodical reporting requirements specified by SEBI
- Any material change in the details of AIF should be intimated to SEBI

AIF – Set-up and ongoing cost

Particulars	Amount (in INR)
<u>Set-up Cost:</u>	
SEBI Registration Fees:	
<ul style="list-style-type: none"> • Application fees • Category I AIF (other than Angel Funds) • Category II AIF (other than Angel Funds) • Category III AIF (other than Angel Funds) • Fees for setting-up of a new scheme (other than Angel Funds) • Registration fee for Angel Funds 	<ul style="list-style-type: none"> • INR 0.1 millions • INR 0.5 millions • INR 1 million • INR 1.5 millions • INR 0.1 millions • INR 0.2 millions
Fees of tax consultants and other service providers (approx.), per Fund/ scheme	<ul style="list-style-type: none"> • Approx. INR 1 million to INR 1.5 millions
<u>Ongoing cost:</u>	
Fees of tax consultants and other service providers (approx.), per Fund/ scheme (excluding transaction charges such as brokerage, custody fees, etc.)	<ul style="list-style-type: none"> • Approx. INR 1.5 millions to INR 2 millions

Category I and II Alternative Investment Funds in India - Key Tax Aspects

Taxation of Category I and II AIF



Taxation Regime - Section 115UB read with section 10(23FBA) and section 10(23FBB) of the IT Act

- **One level of tax** – either income earned by AIF is taxed in the hands of AIF or its investors
- **Investment income such as capital gains, dividends and interest** - Pass-through available and hence taxed in the hands of investor and exempt at the AIF level [Section 10(23)FBA]
 - Income to be calculated at the AIF level
 - Such income will be allocated proportionately to each investor based on their respective share and taxable in the hands of each Investor, at applicable tax rate under the IT Act (subject to tax treaty relief, if any, available to the non-resident investor), as if the investor had directly made the underlying investments and the income had accrued directly to each investor
 - Characterization of income in the hands of investors same as that in the hands of AIF
 - **Effective April 1, 2019: loss** (other than business loss) shall be allowed to the investors, if such loss is in respect of a unit held by the investor for a period of at least 12 months
 - Any loss as on March 31, 2019, deemed as available for investor for the remaining periods
 - No deduction available for expenses incurred by the Fund such as management fees and admin expenses
- **Business income** - no pass through; such business income taxable at AIF level and correspondingly exempt in the hands of investors [Section 10(23FBB)]
- AIFs to withhold tax @ 10% on pass through income credited / distributed to investors (for non-residents, as per rates in force) [Section 194LBB]
- No withholding on payments to AIF for pass through income (CBDT Notification 51/2015 dated 24 June 2015)
- Reporting requirement – Form 64C (Statement of income distributed by an AIF to unitholders) to be provided to the Investors; Form 64D (Statement of income paid or credited by an AIF) to be filed with Income-tax Authority

Issue 1: Characterization of income



Traditional litigation issue – whether gains on exit of investments by AIF taxable as business income or capital gains;

Business income if AIF regarded as being engaged in the business of buying and selling securities; or

Capital Gains if AIF regarded as an Investor investing, rather than trading, in securities.

CBDT circular dated February 29, 2016: Gains from sale of listed shares / securities held for more than 12 months would be treated as capital gains unless the taxpayer himself treats the same as stock in trade; irreversible option

CBDT has issued an instruction, dated May 2, 2016:

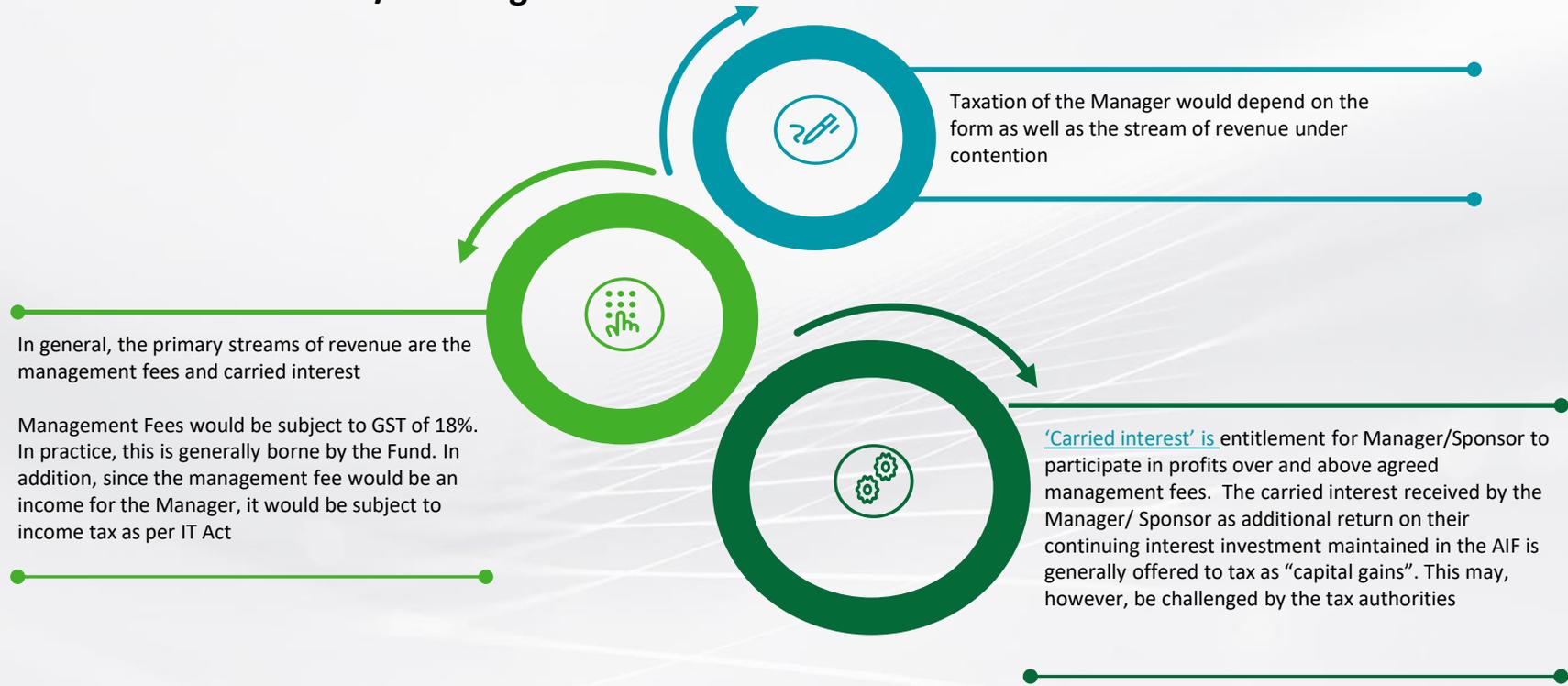
Gains arising from sale of unlisted shares are characterized as capital gains, irrespective of the period of holding of such unlisted shares, except:

- (i) where the genuineness of the transfer is questionable; or
- (ii) where the transaction involves the issue of lifting of corporate veil; or
- (iii) where the transfer is made along with control and management of the underlying business**

CBDT circular dated January 24, 2017: clarified that the third exception will not be applicable *inter-alia* in case of SEBI registered Cat-I & Cat-II AIFs.

This implies that gains made by Cat-I & Cat-II AIFs from their investments should be regarded as capital gains, provided genuineness is not challenged.

Issue 2: Carried Interest v/s Management Fees



In general, the primary streams of revenue are the management fees and carried interest

Management Fees would be subject to GST of 18%. In practice, this is generally borne by the Fund. In addition, since the management fee would be an income for the Manager, it would be subject to income tax as per IT Act

Taxation of the Manager would depend on the form as well as the stream of revenue under contention

‘Carried interest’ is entitlement for Manager/Sponsor to participate in profits over and above agreed management fees. The carried interest received by the Manager/ Sponsor as additional return on their continuing interest investment maintained in the AIF is generally offered to tax as “capital gains”. This may, however, be challenged by the tax authorities

Issue 3: Tax implications related to ‘units of AIFs’ and risk of deemed income - Investors in AIF

Whether units of AIF qualify as ‘security’ and taxability on transfer of units / receipt of units by investor?

- **Transfer of units of AIF by investor:**

- Mostly transfers are commercially restricted for Category I and II AIFs and allowed only in exceptional situations
- ‘Capital asset’ defined to mean ‘property’ of any kind
- Possible view that ‘units’ may be regarded as property and thus, trigger capital gains on transfer of such units by one investor to another investor
- No exemption available for units of AIFs

- **Redemption of Units**

- If units are redeemed consequent to underlying sale of investments by AIF – no additional tax implications should arise for investors on redemption of units

- **Receipt of units for consideration less than fair market value (FMV)**

- Section 56(2)(x) would trigger if units are received by investors in AIF for less than fair market value (as determined by merchant banker / accountant)

Issue 4: Deemed income – investments and exits by AIF

- Investment by AIF

- **Section 56(2)(viib) of IT Act**

- ❑ Any consideration received by investee company for issue of shares at premium - the amount exceeding fair market value of the shares, shall be charged to tax in the hands of investee companies
 - ❑ Blanket exemption available for investments by Category I AIF and Category II AIF

- **Section 56(2)(x) of IT Act**

- ❑ If any person receives or acquires shares and /or any securities of an Indian company from any person for a consideration which is less than the aggregate FMV of such shares / security by an amount exceeding INR 50,000, then the whole of aggregate FMV of such shares or security or aggregate FMV exceeding the consideration paid respectively, shall be chargeable to tax as ordinary income in the hands of such person - risk that issue of shares / securities for less than FMV could trigger tax in the hands of the receiver
 - ❑ Section 56(2)(x) may trigger where AIF invests in the portfolio company at a value which is less than the FMV

- Sale / Exit by AIF

- **Section 50CA of IT Act**

- ❑ At the time of sale / transfer of shares of unlisted portfolio companies, section 50CA provides for adoption of the value to be FMV [determined as per the Rules] as the value of consideration, where the actual consideration is lower than that (Deemed consideration). The difference shall be subjected to tax in the hands of the transferor

Issue 5: TCS / TDS impact on AIF



01

Tax Collected at Source (Section 206C(1H))

- The Finance Act, 2020, has inserted a sub-section (1H) in section 206C, mandating a seller to collect tax equal to 0.1 per cent of sale proceeds if the value of goods sold exceeds INR 5mn in a FY. The collection is to be made at the time of transaction.

02

Tax Deducted at Source (Section 194Q)

- Effective July 1, 2021, 'Buyer' of goods liable to TDS at time of credit to account of or payment to (whichever is earlier) resident seller at the rate of 0.1 percent on transaction value exceeding INR 5mn during the FY.
- If other TDS / TCS provisions apply, then TDS provisions under section 194Q shall not apply except in case of TCS under section 206C(1H). In case of conflict between TDS provisions under section 194Q and TCS provisions under section 206C(1H), TDS provisions to apply.

03

Ambiguity for AIFs

- In September 2020, the CBDT issued a circular to clarify the applicability of section 206C (1H). It said the section won't apply to transactions of securities and commodities traded through recognized stock exchanges. This seems to suggest that TCS provisions could otherwise extend to the sale of shares and securities
- As per sale of Goods Act, 1930 "goods" includes stock and shares whereas the Central Goods and Services Tax Act, 2017 (CGST Act) excludes money and securities from "goods"
- Ambiguity whether shares and securities, including units of AIF, could be regarded as 'goods', and whether AIFs / investors could be regarded as sellers / buyers for the purpose of above provisions

Issue 6: Withholding under section 194LBB

*“Where **any income**, other than that proportion of income which is of the same nature as income referred to in clause (23FBB) of section 10, is payable to a unit holder in respect of units of an investment fund specified in clause (a) of the Explanation 1 to section 115UB, the person responsible for making the payment shall, **at the time of credit of such income to the account of payee or at the time of payment thereof** in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon”*

Food for thought!

- Whether TDS u/s 194LBB is to be deducted on exempt income?
- Whether TDS u/s 194LBB is to be deducted in case of Capital Loss?

Relief from indirect-transfer provisions



CBDT Circular No 28, 2017

- The Indirect Transfer Provisions as per Explanation 5 of section 9 of the IT Act could impact the redemption and / or the transfer of the interest by the underlying investors in the Fund.
- Following representations from stakeholders in this regards, the CBDT issued a Circular clarifying that the **Indirect transfer provisions will not apply to income accruing or arising to a non-resident on account of redemption or buyback of share / interest held indirectly in specified funds in India (being a VCF or a Category I or II AIF), if such income accrues or arises from or in consequence of transfer of shares or securities held in India by the specified funds, and such income is chargeable to tax in India.**



CBDT Circular No 4, 2015

- The CBDT, had also issued a circular dated March 26, 2015, clarified that the indirect tax provisions are not applicable to dividends declared by a foreign company outside India that does not have the effect of transferring any underlying assets located in India.
- In light of the Circular, dividend income received by the underlying investors from offshore Fund shall not fall within the ambit of provisions relating to taxation of indirect transfers

Category III Alternative Investment Funds in India - Key Tax Aspects

Taxation of Category III AIF

- No separate code for taxation of Category III AIFs.

Factors influencing taxation of category III AIF

Form of entity

- Tax rate would differ based on whether fund is a- Trust or company or LLP

Pass through status

- No Pass-through status available like Category I/ II AIFs, except in case of determinate/ revocable trust

Nature of income

- Tax rates would differ based on whether categorized income is dividends, interest, capital gains, or business income

Nature of fund

- Based on whether the fund is open ended or close ended, the taxability would differ



In case of open-ended category III AIF

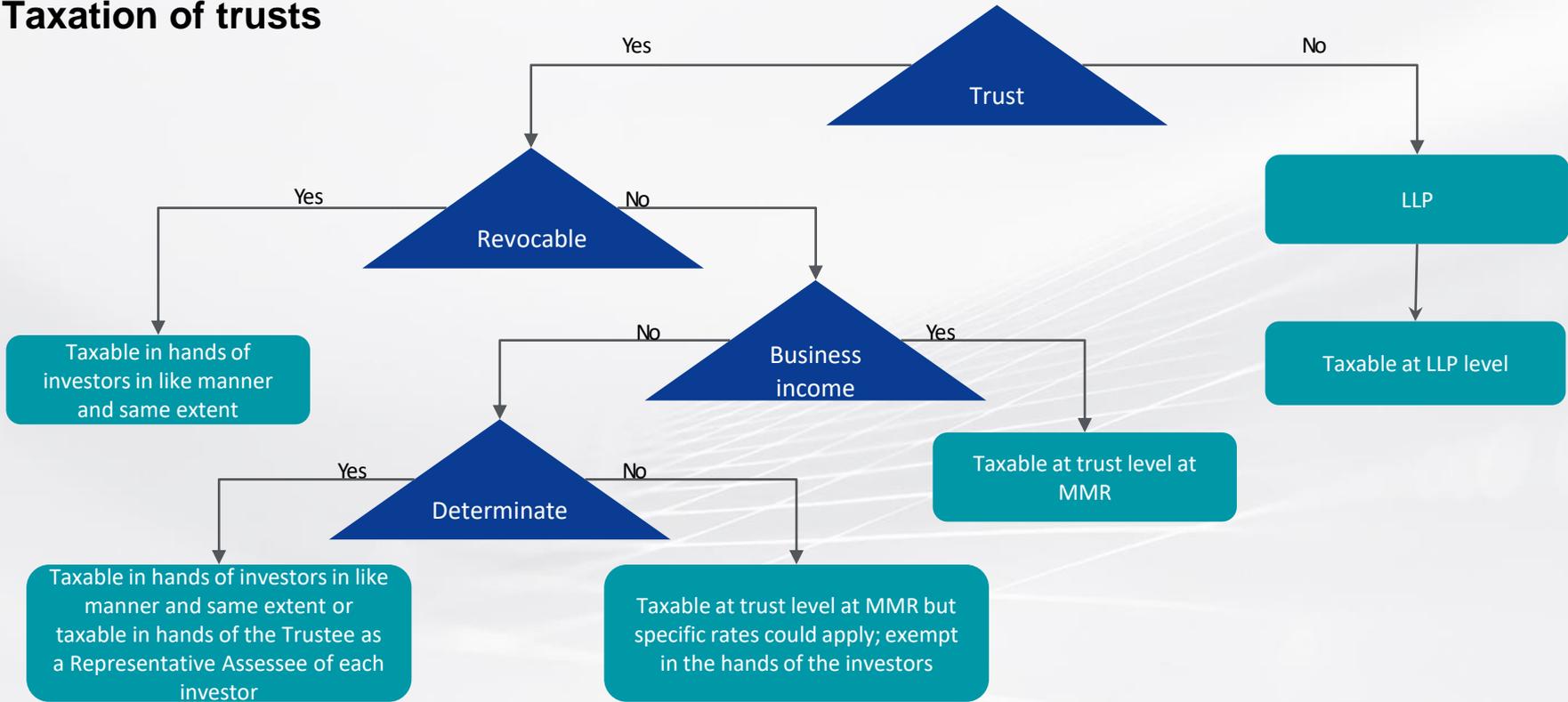
Risk of being regarded as **discretionary trust** since investors can enter and exit at any time. The trust could be regarded as a revocable trust owing to the redemption option after a fixed period



In case of close-ended category III AIF

Possible to structure the fund as a **determinate trust**. The trust could be regarded as a revocable trust owing to the redemption option after a fixed period

Taxation of trusts

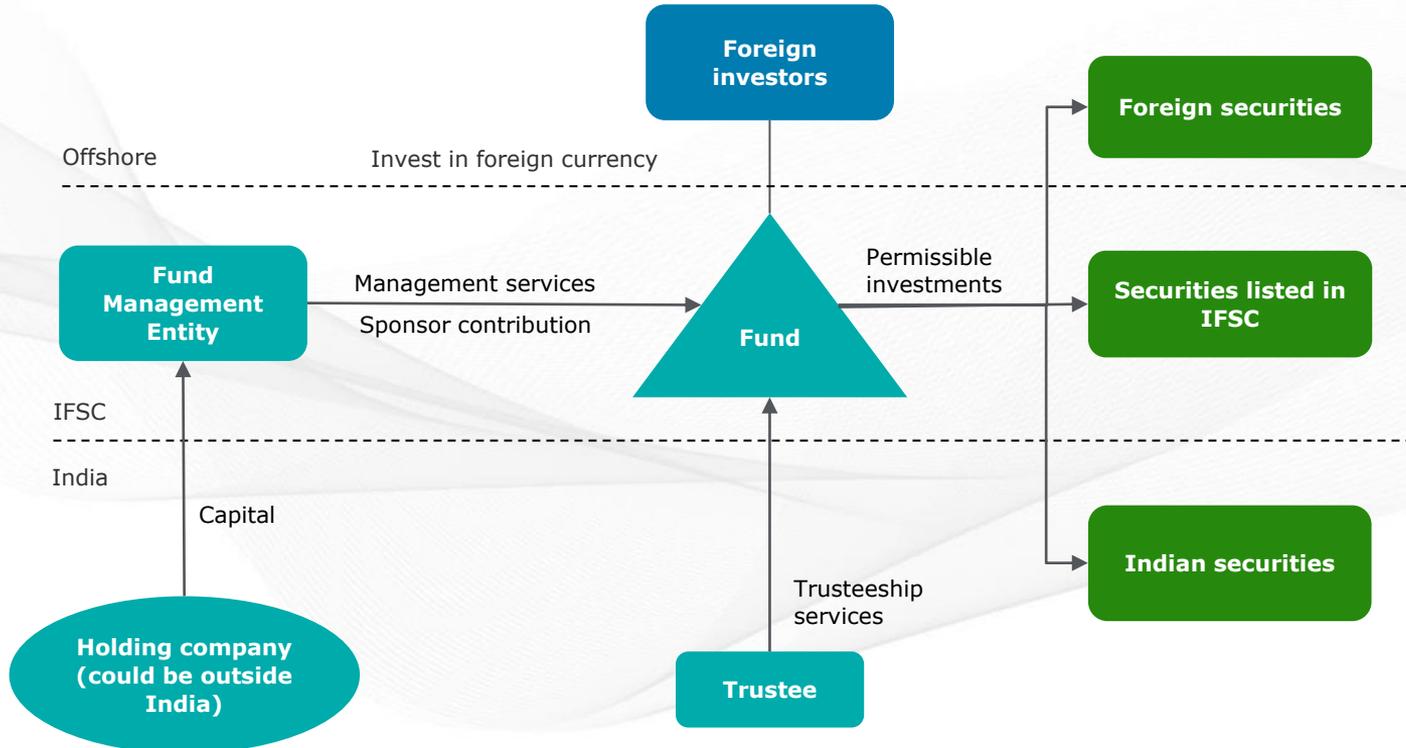


Key income-tax challenges faced by Category III AIFs

- Complex trust taxation provisions apply
 - If discretionary trust - entire income of AIF could be taxed at MMR
 - No clarity on effective MMR - general rate (30 percent) v. specific tax rates (long term capital gains or short-term capital gains, etc)?
 - No clarity on whether credit for taxes paid by the Trust in Indian would be available to investor in home country
- Characterization of Income
 - No certainty on characterization, unlike FPIs who have a similar regulatory framework
 - CBDT circulars do not apply to short term capital gains
- Allowance of management fees and expenses incurred by AIF against income earned?
- Exemption from indirect transfer provisions not granted
- Determinate Trust: Issues related to 'tax withholding' by portfolio companies on dividend and interest income and passing of tax credit to investors?
Whether investor eligible to claim tax treaty benefits which are subject to investment thresholds?

Funds and Fund Management Entity in IFSC – Key Regulatory Aspects

Typical structure | Fund Management Entity and Fund in the IFSC



Constituents

- **Fund**: can be set up as a trust or partnership or company
- **Trustee (in case AIF is a trust)**: Settlor shall appoint Trustee for AIF who would, in fiduciary capacity, hold title over the trust property and will be responsible for compliances of AIF
- **Fund Management Entity**: Responsible for managing the investment and divestment decisions on a sole, exclusive and discretionary basis

Resident Individual investors are also allowed to invest in the AIF set-up in IFSC under the liberalized remittance scheme upto US\$ 250,000 per individual. However, in such cases the AIF should not invest in local Indian securities

IFSCA (Fund Management) Regulations, 2022 - Background

- International Financial Services Centres Authority (IFSCA) is endeavoring to develop a comprehensive regulatory framework for Investment Funds based on global best practices, with a special focus on ease of doing business
- IFSCA notified the Final IFSCA (Fund Management) Regulations, 2022 (“FM Regulations”), to be effective from 19 May 2022

Regulating Fund Manager instead of Fund

- In line with global practices, IFSCA intends to regulate the Fund Managers as against exercising regulatory oversight over the Funds

Single registration for multiple activities

- A Fund Manager can undertake host of activities related to fund management viz. manage retail schemes, non-retail schemes, undertake portfolio management services or operate as a manager to various investment trusts by seeking a single unified registration from IFSCA

Risk Based approach based on activity to be undertaken

- Fund Management Entity (“FME”) can be registered under three categories, depending upon the activity proposed to be undertaken
 - Authorised FME
 - Registered FME (Non-Retail) – also permitted to do Portfolio Management
 - Registered FME (Retail) – also permitted to do Portfolio Management
- Higher regulatory oversight for Fund Management Entity managing Retail Funds as compared to Fund Management Entity managing non-retail Funds or Venture Capital Funds

Regulatory Framework | Fund Management Entity in IFSC

Authorised FME

- Permitted to manage schemes investing in start-ups or early-stage ventures through Venture Capital Scheme
- Green channel available for launch of new Schemes
- Can be set-up as Company, LLP or Branch
- Permissible investors - accredited investors and investors investing atleast USD 250,000 (USD 60,000 for employees/ directors/ designated partners of FME)
- Minimum net worth required of USD 75,000
- Independent directors not required
- Minimum 1 Key Managerial Personnel (“KMP”) with requisite qualification and experience required
- Leverage permissible, subject to consent of 2/3rd investors by value
- Co-investment structure permissible, subject to conditions

Registered FME (for Non-retail Funds)

- Permitted to Manage Venture Capital and Restricted Schemes investing in securities, financial products and other permitted asset classes. Also allowed to undertake Portfolio Management activities
- PPM to be filed with IFSCA 21 working days prior to launch of the scheme
- Can be set-up as Company, LLP or Branch
- Permissible investors – accredited investors and investors investing atleast USD 150,000 (USD 40,000 for employees/ directors/ designated partners of FME)
- Minimum net worth required of USD 500,000
- Independent directors not required
- Minimum 2 KMPs with requisite qualification and experience required
- Leverage permissible, subject to consent of 2/3rd investors by value
- Co-investment structure permissible, subject to conditions

Registered FME (for Retail Funds)

- Permitted to manage Retail Schemes as well as Non-retail Schemes investing in securities, financial products and such other permitted asset classes. Also allowed to undertake Portfolio Management activities
- Prior approval of IFSCA required for launching of new schemes
- Can be set-up as Company or Branch
- Retail as well as non-retail investors permitted to invest
- Minimum net worth required of USD 1,000,000
- Minimum 4 directors (50% to be independent)
- Minimum 2 KMPs with requisite qualification and experience required
- Not permissible except to meet temporary liquidity needs for specified purpose
- Co-investment structure not permissible

Funds launched under these regulations will be deemed to be respective AIF category for tax purposes

Regulatory Framework | Funds in IFSC

Venture Capital Schemes

- Permitted to invest in listed, to be listed as well as unlisted securities
- Atleast 80 percent of the AUM required to be invested in in investee companies incorporated for less than 10 years or other venture capital schemes
- Minimum corpus required : USD 5 million; Maximum corpus: USD 200 million
- Maximum 50 investors per Scheme
- Skin in the game contribution required by FME:
 - Targeted corpus < USD 30 mn: Minimum 2.5% but not exceeding 10%
 - Targeted corpus > USD 30 mn: Minimum USD 750,000 but not exceeding 10%

Restricted Schemes (schemes for Non-retail)

- Permitted to invest in listed, to be listed as well as unlisted securities, derivatives (including commodity derivatives). Close ended scheme may also invest upto 20% of corpus in physical assets such as real estate, bullion, art or any other specified asset
- No investment restriction conditions applicable
- Minimum corpus required : USD 5 million; Maximum corpus: NA
- Maximum 1,000 investors per Scheme
- Skin in the game contribution required by FME (for open ended scheme):
 - Targeted corpus < USD 30 mn: Minimum 5% but not exceeding 10%
 - Targeted corpus > USD 30 mn: Minimum USD 1,500,000 but not exceeding 10%

Retail Schemes

- Permitted to invest in listed, to be listed as well as unlisted securities, derivatives (including commodity derivatives) and other securities
- Maximum investment in a single investee company: 10% of AUM (15% with prior approval of fiduciaries), no restriction for Index schemes
- Maximum investment in a sector: 25% of AUM (50% in case of FS sector), no restriction for sectoral, thematic or Index Scheme
- Minimum corpus required : USD 5 million; Maximum corpus: NA
- Minimum 20 investors required, with no single investor investing more than 25%
- No restriction on the maximum number of investors per scheme
- Skin in the game contribution required by FME: Lower of 1% of the corpus or USD 200,000 (for both open and close ended scheme)

FME and Fund – Fees to be paid to IFSCA

Particulars	Amount (in INR)
<u>Application and registration fees</u>	
Application fees	• USD 2,500
Registration fees for FME	
• Authorised FME (except Family Investment Fund)	• USD 5,000
• Registered FME (Non -retail)	• USD 7,500
• Registered FME (Retail)	• USD 10,000
• Family Investment Fund	• USD 15,000
<u>Registration Fee for various activities to be undertaken by FME</u>	
• Venture Capital Scheme	• USD 7,500
• Restricted Scheme (Category I AIF)	• USD 7,500
• Restricted Scheme (Category II AIF)	• USD 15,000
• Restricted Scheme (Category III AIF)	• USD 22,500
• Retail Scheme	• USD 22,500
• ETF	• USD 22,500
• Investment Trusts	• 0.05% of the issue size
• Portfolio Management activities	• USD 5,000
Annual Fees to be paid by the Fund Management Entity	• USD 2,000 per year
Applications for Regulatory / Innovation Sand box, Fund lab, etc.	• USD 5,000

Funds and Fund Management Entity in IFSC - Key Tax Aspects

Tax exemptions and reliefs – Funds in IFSC

Particulars	Key considerations
Inbound Funds (akin to Category I & II AIFs)	<ul style="list-style-type: none"> • Pass through available for all incomes except business income. Investors are taxed on income arising from investments made by the AIF as if the investments were made directly by them (similar to domestic tax regime) • Income taxable directly in the hands of the investors • Foreign investors eligible to claim benefits under the tax treaty • Foreign investors exempt from obtaining PAN and filing Tax return in India, subject to suitable TDS and other conditions
Inbound Funds akin to Category III AIFs (where all investors are non-residents)	<ul style="list-style-type: none"> • Funds in IFSC (which are <i>akin</i> to Category III AIFs) are taxable at the fund level, i.e., Fund would be regarded as the taxpayer under the Indian tax law • No tax on gains arising from transfer of derivatives, bonds, RETIs / INVITs and any security other than shares of Indian companies • Gains from shares of Indian companies are taxable at domestic Indian tax rates (10%/15%/30%) • No tax on income from foreign securities • No capital gains tax on transfer of specified securities traded on the IFSC stock exchanges • Concessional tax rate : (a) 10% for dividend and other income from Indian securities; (b) 4% for interest on specified bonds listed on the IFSC stock exchange • Income exempt in the hands of the foreign investors • No capital gains tax on transfer of units of the Fund • Foreign investors exempt from obtaining PAN and filing Tax return in India, subject to conditions • Interest income on Long term and rupee denominated bonds listed in IFSC exchanges taxable at lower rate of 4%
Outbound Funds	<ul style="list-style-type: none"> • No specific tax exemptions, Normal tax regime applicable
Other aspects	<ul style="list-style-type: none"> • Exemption from STT / CTT / stamp duty in respect of transactions carried out on the IFSC exchanges

▄ Tax exemptions and reliefs – Fund Management Entity in IFSC

Particulars	Key considerations
Income tax	<ul style="list-style-type: none"> • 100% tax exemption on business income for 10 consecutive years out of 15 years, at the option of the company • Concessional rate of MAT of 9 percent (plus applicable surcharge and cess) • MAT not applicable if the Company in IFSC opts for the concessional tax regime provided under section 115BAA i.e., opts for the tax rate of 22% (plus applicable surcharge and cess), subject to conditions. • Once the concessional tax regime under section 115BAA is opted, it shall apply to all subsequent assessment years • Amount of dividend distributed by a IFSC company to its holding company may be taxable in the hands of the holding company • Benefits can be claimed under section 80M by a domestic holding company and benefits of DTAA can be claimed by foreign investors • Interest income earned by non-residents on lending monies to IFSC units not taxable
Indirect taxes	<ul style="list-style-type: none"> • No GST rate on procurement of goods and services from within India • Custom duty exemption on import of goods from outside India • GST exemption on procurement of services from outside India, for authorized operations • Supply of services to foreign customers without payment of GST
Others	<ul style="list-style-type: none"> • Exemption from Securities Transaction Tax ('STT') / Commodities Transaction Tax ('CTT') / Stamp Duty in respect of transactions carried out on the IFSC exchanges • Other operational benefits

IFSC FME – Implications for Company v. LLP v. Branch

Particulars	Company	LLP	Branch
Profits earned by the IFSC Manager entity	100% tax deductible for 10 out of 15 years	100% tax deductible for 10 out of 15 years	100% tax deductible for 10 out of 15 years
Tax on distribution	Dividend distributed taxable in the hands of the shareholders at applicable rates	Exempt	No tax on distribution by branch to head office
Applicability of MAT/ AMT	MAT applicable @ 9%. However, applicability of MAT can be mitigated for companies opting special tax regime under section 115BBA	AMT applicable @ 9%	MAT/ AMT applicability can be mitigated if non-IFSC profits are sufficiently high
Compliance burden	High	Medium	Low
Time required for set-up	Comparatively high	Comparatively low	Low
NOC from SEBI	Required, except in certain specified situations	Required, except in certain specified situations	Not required
Approval from RBI	May not be required, subject to conditions	May not be required, subject to conditions	Not required

Note: The above tax rates will be increased by applicable surcharge and cess, where tax is payable at the rate as provided under the Income-tax laws

Implications on relocation of offshore funds to IFSC

Original Fund or its wholly owned SPV



- A fund established/incorporated/ registered outside India, which collects funds from its members for investing it for their benefit and:
 - is a non-resident;
 - is a resident of a country or a specified territory with which India has signed a tax treaty or a specified association
 - its activities are subject to investor protection regulations in its home country

Transfer of assets on or before 31 March 2023

Relocation

Consideration in the form of shares or units or interest in the resultant fund

Resultant Fund



- Fund established / incorporated in India in the form of a trust or a company or a limited liability partnership
- Fund Manager to obtain registration. Fund to be set-up as Venture Capital Scheme, Restricted Scheme or Retail Scheme
- located in IFSC

Exemption from mandatory Sponsor/Manager commitment

-Exemption does not apply to new funds set-up in IFSC



Exemption from capital gains on transfer of capital assets



Period of holding of securities of the original fund to continue



Cost of acquisition of securities to remain unchanged



Continuation of grandfathering benefits under the treaties

SEBI has permitted off-market free of cost transfer of securities

No requirement to obtain PAN for non-resident investor investing in a fund having only non-resident investors

Key steps - Relocation of offshore funds to IFSC

- 1 Identification of office space in GIFT City for AIF, Manager and obtaining NOC from GIFT SEZ
- 2 Application to SEZ authorities (Development Commissioner, Kandla SEZ) for Fund, Fund Manager and obtain letter of approval
- 3 Setting-up Fund entity (Trust, Partnership, Company), Investment Manager entity
- 4A Application to IFSCA to obtain registration for the Fund Manager,
- 4B Finalization of Fund documents such as Private Placement Memorandum (capturing commercials of offshore fund) and other relevant documents i.e. Investment Management Agreement, Contribution Agreement (incorporating relocation details)
- 5 Filing PPM and other documents with IFSCA
- 6 Application for FPI license for the Fund
- 7 In case of relocation, existing FPI to approach local custodian for one-time 'off-market' transfer of its securities to the resultant Fund
- 8 In case of relocation, once the securities are transferred from offshore fund to IFSC fund, surrender of FPI license, winding up of the fund in offshore jurisdiction and intimation of winding up to Indian tax authorities

Key implications - IFSC v Offshore Jurisdictions

1

Restricted Scheme (*akin* Category III AIF) set up in IFSC exempt from capital gains tax on non-equity securities (similar to Mauritius, Singapore, Ireland), foreign securities and securities listed on IFSC exchanges

2

Concessional tax rate of 10% on dividend and other income from securities. Tax rate of 4% interest on bonds listed on the IFSC exchanges

3

GAAR provisions - Substance would be blessed by IFSC Authority. LOB and MLI PPT clauses under tax treaties not relevant

Foreign investors not required to obtain PAN/ file tax return

4

Moderate to significant cost saving in operating a fund in IFSC as compared to foreign jurisdictions

No STT/ CTT/ stamp duty on transactions in IFSC exchanges

5

Tax holiday for 10 years out of 15 years, concessional MAT rates of 9% (plus surcharge and cess). No GST on services provided by Manager, leading to significant direct tax and GST savings

6

No direct / indirect tax exposure on carry accruing to Investment Manager or Sponsor in IFSC

How can we help?

Assisting in setting-up of AIF

Discussion on Fund Structure:

- Understanding the business objectives, nature of investments, etc.
- Discussion on key aspects of the structure, like management fees, carried interest, etc.
- Providing advice on the constitution, ownership/ management structure of the AIF related entities
- Advising on tax impact on varied streams of income earned by the Fund
- Advising on tax implications in the hands of investors

Assistance in setting-up of entities:

- Assist in preparation/ review of trust deed/ LLP agreement/ Memorandum and Articles of Association or any other document in relation to the set-up of Fund/ Fund Manager
- Assistance in filing entity set up documents with the respective regulator;
- Follow up with the regulator to understand the status of the applications filed and provide clarifications from time to time.

Services from a tax and regulatory perspective

Assistance in the following Fund documents:

- Trust Deed
- Private Placement Memorandum
- Investment Management Agreement
- Contribution Agreement
- Carry document, if any

Assistance to obtain AIF license from SEBI:

- Prepare the draft application with information and details for registration of AIF with the SEBI
- Finalizing the AIF application and assist in submitting the same to the SEBI through Merchant Banker
- Following up with the SEBI authorities with respect to the status of the application
- Assist in responding to queries raised by the SEBI on the application filed
- Review the registration certificate received from SEBI

Ongoing advisory and compliance services

Advance Tax

Assistance in preparation of advance tax computation on a quarterly basis and advise on the quarterly advance tax liability

Withholding tax

Advising on withholding tax liability on a monthly basis
Assist in preparation and filing of the quarterly withholding tax returns

Income Tax Return

Reviewing the financial statements and Assistance in preparation of the income-tax computation, related annexures, return of income and its filing with the Indian tax authorities

Computation of taxes for NAV

Assistance in computation of taxes (including provisions) arising on capital gains and other income to arrive at the NAV based on monthly basis

Computation of taxes on redemption

Assistance in computation of taxes allocable to investors at the time of redemption

FATCA/CRS

Preparation and filing of annual FATCA/CRS returns with the Indian tax authorities

Review of reporting prescribed by SEBI, RBI

Assisting in review and filing of quarterly report before SEBI
Reviewing the annual compliance test report
Assisting in Single Master Form reporting, Annual Foreign liabilities and assets reporting before RBI

Statement of Income and tax for distribution to investors

Assistance in preparation of Statement of allocation of Income and taxes for distribution to the investors
Tax communications to be sent by Manager to investors

Contact us



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Rajesh is a senior partner in the tax and regulatory practice of Deloitte India. He is part of the financial services group and specializes in fund structuring (both local and overseas), advisory and compliance services. He has over 25 years of experience of advising clients in domestic and international tax matters, exchange control norms and capital market regulations. He leads the Deloitte India asset management tax practice as well as the US-India corridor for our tax practice.

He has been a core member of a high-powered working group (H R Khan Committee) constituted by Indian capital market regulator to simplify and rationalize the Indian Foreign Portfolio Investor regulations. He is regularly quoted in the India's leading financial newspapers for his views on tax and regulatory developments in the Investment Management Industry.

In the year 2019, he represented Deloitte India in a committee set up by the Department of Economic Affairs, Ministry of Finance, Government of India to review the tax issues faced by FPIs and other institutional investors and provide recommendations.

In addition to the clients in the financial services sector, he has served clients across diversified sectors such as consumer business, manufacturing and technology. He has led the India desk in the International Core of Excellence program for Deloitte Tax LLP, New York from 2009 to 2012.

He has been an associate member of the Institute of Chartered Accountants of India since 1997. He also has the distinction of being accorded 41st place all over India at the final examination of the Institute of Chartered Accountants of India

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Vijay is based out of our Mumbai office and has over 10 years of experience in corporate and international tax.

Vijay specializes in advising clients in the financial services sector, with primary focus on the asset management industry.. He has experience of advising foreign portfolio investors, private equity clients, alternative investment funds in evaluating market entry options, setting-up, domestic and international tax matters, exchange control norms, capital market regulations, etc.

Vijay has been an associate of Institute of Chartered Accountants of India since 2012 and is also completed Bachelors in Commerce.



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Hardik is based out of our Mumbai office and has over 9 years of experience in corporate and international tax.

Hardik specializes in advising clients in the financial services space from tax and regulatory perspective. His experience encompasses advising clients on setting-up funds, cross-border taxation, international expat taxation, ongoing tax and regulatory advisory services etc.

Hardik has been an associate of Institute of Chartered Accountants of India since 2012 and is also a qualified LLB. from the Government Law College, Mumbai.



THANK YOU