

# Alternative Investment Funds: Taxation and regulatory services







## Introduction

An alternative investment fund (AIF) refers to any privately pooled investment fund (whether from Indian or foreign sources) in the form of a trust/company/body corporate/limited liability partnership (LLP). It collects the funds from the sophisticated investors, whether Indian or foreign, for investment in accordance with a demarcated investment policy for the benefit of the investors.

The Securities and Exchange Board of India (SEBI) regulates operations of AIFs in India and prescribes certain periodic compliances. Further, the Income-tax Act, 1961 (the Act), also provides for specified tax regime for Category I and II AIFs.

## Parties to AIF and their roles

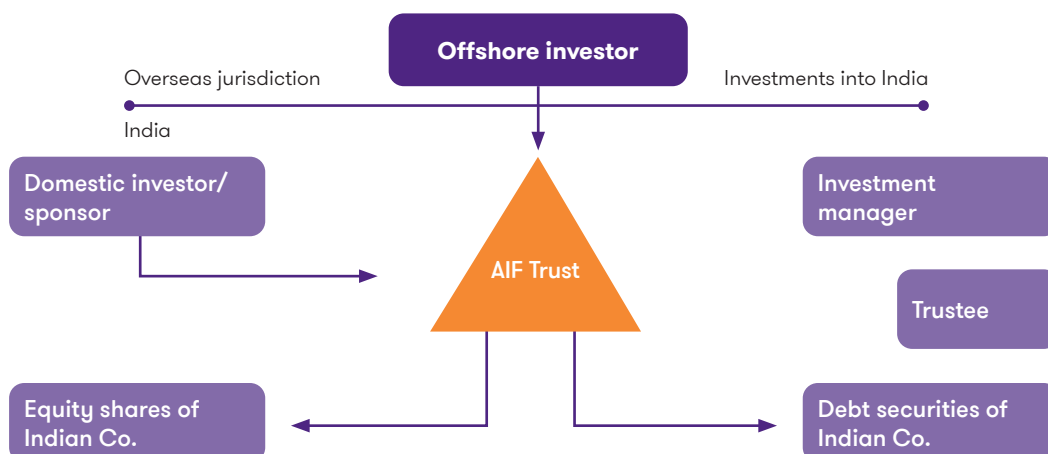
Typically, the parties involved in an AIF structure includes sponsor, trustee, manager and investors. The role of each party is as under:

- **Sponsor:** Plays a vital role by way of investing the initial corpus in an AIF and sets up the AIF
- **Trustee:** Responsible for overseeing the process, ensuring

compliance with extant regulatory framework (where the AIF is setup as Trust)

- **Manager:** Responsible for making investment decisions for funds pooled from investors
- **Investors:** Invests and holds beneficial interest in the AIF

## Typical structure of an AIF



## Categories of AIFs

Category	Description
Category I	<ul style="list-style-type: none"> <li>• Venture capital funds (including angel funds)</li> <li>• Small and medium enterprise funds</li> <li>• Social venture funds</li> <li>• Infrastructure funds</li> <li>• Others as may be specified <ul style="list-style-type: none"> <li>– Maximum 25% of investible funds can be invested in one investee company</li> </ul> </li> </ul>
Category II	<ul style="list-style-type: none"> <li>• Private equity funds</li> <li>• Debt funds <ul style="list-style-type: none"> <li>– Maximum 25% of investible funds can be invested in one investee company</li> </ul> </li> </ul>
Category III	<ul style="list-style-type: none"> <li>• Hedge funds</li> <li>• Funds that trade for making short term returns, deploys diverse/complex trading strategies <ul style="list-style-type: none"> <li>– Maximum 10% of investible funds can be invested in one investee company</li> <li>– They can invest in listed/unlisted companies, derivatives/complex/structured products</li> <li>– Leveraging is permitted either through investment in derivatives/borrowing, subject to prescribed conditions</li> <li>– FPIs can invest in Category III AIFs</li> <li>– Category III AIF can invest in commodity derivatives (maximum 10% of investable funds in one commodity)</li> </ul> </li> </ul>

## Tax regime of AIFs - Key aspects

### Category I and II AIFs

- Pass through status has been accorded; i.e. any income (other than business income) earned by the said AIF is taxable in the hands of the investors in the same manner as if the income were accruing or arising to or received by such person, had the investments made by AIF been made directly by him. Such income is exempt in the hands of the fund
- Business income is taxable at maximum marginal rate in the hands of AIF and is exempt in the hands of investors
- AIF to withhold tax on income (other than business income) paid/credited to resident investors at 10% and at rates in force for non-resident investors

### Category III AIFs

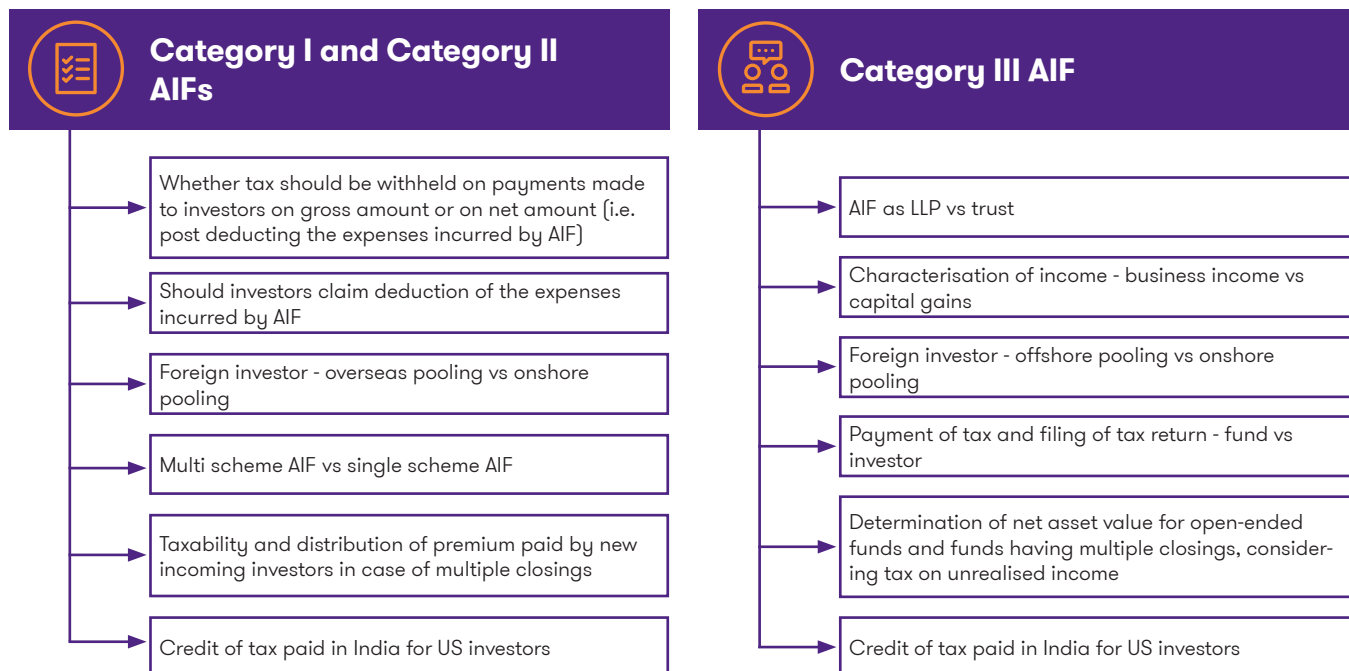
Unlike Category I and Category II, there is no specific tax regime for Category III AIFs. Therefore, the income earned by these AIFs is taxable depending upon the legal structure of the fund (i.e. trust, LLP or company)

## Why AIFs?

- Investing in capital markets through Category III AIF basis the experience and expertise of the professional fund managers
- Investors can seek an exposure in complex or illiquid assets, such as unlisted securities, securities of start-ups, complex structured products, government securities, corporate bonds across sectors in a systematic manner, through Category I and Category II AIFs
- Investing in AIF provides investors the flexibility in terms of structure, sector, instruments, etc. that is otherwise not available under the traditional MFs



## Common issues faced by AIFs



## Our service offerings



### Advisory services

- Conceptualisation of fund structure
- Advise on tax issues relating to the AIFs
- Evaluation of alternate jurisdictions considering investor's preference, costs, taxation, regulatory and other aspects
- Advice on taxation of income earned by the AIF in the hands of the AIF and investors
- Advise on regulatory matters relating to AIFs in terms of SEBI AIF regulations, FDI regulations, FEM (non-debt) rules, FATCA regulations, RBI guidelines, etc.



### Implementation services

- Review of various documents such as trust deed, private placement memorandum, investment management agreement, contribution agreement, and other document(s) from Indian income tax and regulatory perspective
- Liaise with the lawyers and fund managers to set up the fund
- Provide tax chapter of the private placement memorandum to the fund from an Indian income tax perspective
- Assist in preparing and filing SEBI application and following up with SEBI for processing the application

- Assist in responding to queries raised by SEBI with respect to the application
- Assist in obtaining PAN for the fund
- Assist in registering the fund with SEBI under SCORES and with FIU-IND



### Compliance services

- Assistance with attestation services evaluating compliance of the AIF with the clauses mentioned in PPM
- Annual tax compliances services, such as filling of income tax return, TDS return, Form 64C, Form 64D, advance tax, etc.
- Provide regulatory compliances services, such as FLA return, Form InVi, Form DI, compliance test return, monthly filings, quarterly filings and event-based filings with SEBI
- Review distribution working and income distribution letters to be issued to investors
- Conduct income tax and regulatory due diligences of investee companies
- Draft internal policies, such as valuation policy, risk management policy, investment policy, KYC/AML policy
- Representation before income tax authorities, SEBI authorities, RBI authorities, association of AIFs (if any), etc.



## Why Grant Thornton Bharat ?

Dedicated tax team, led by partner/director, with vast and varied experience in providing focused services to the financial services sector

New ideation and updation upon change in law and regulations by way of emails, webinars, alerts, flash news, etc.

Partner-led pro-active, pragmatic and solution-oriented approach

Experience in providing end-to-end solutions to AIFs



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