



July 2023

Introduction

This newsletter highlights the Private Equity (“PE”)/ Venture Capital (“VC”) investment trends and thriving sectors in India for the period January 2023 to June 2023. It broadly captures the regulatory developments in Alternative Investment Funds (“AIFs”), Real Estate Investment Funds (“REITs”), Infrastructure Investment Funds (“InvITs”), Venture Capital Funds (“VCFs”), Foreign Venture Capital Investors (“FVCIs”) and Foreign Portfolio Investors (“FPI”) space that shape the investment activities in India.

2023 Outlook

The trends show that PE/ VC funds are cautious of investing in India due to various factors, such as high valuation and implementation of ESG¹ parameters and corporate governance challenges with Indian corporates, especially start-ups including some of the unicorns. This declining trend is not limited to the Indian landscape, but also extends to other global economies. A fragile American banking system, unstable Europe and the geopolitical uncertainty with China and Russia are pushing global funds to be wary of major investments globally. The advent of 2023 registered a year-to-year decline in the value of PE/ VC investment deals. The decline majorly impacted Indian start-ups as they

¹ Environmental, Social, and Governance

continue to experience a 'funding winter' and recorded a 71% decline in investments in comparison with last year.

Sectors such as technology, e-commerce, education and media and entertainment that once dominated the investment space were not warmly received, whereas new sectors such as real estate and infrastructure are thriving due to the push given to them by the Government of India ("GoI"). In the Union Budget of 2023-24, the Finance Minister announced measures to improve infrastructure with emphasis on further development of sustainable cities to strengthen this sector's demand and supply side. To facilitate this, an "Urban Infrastructure Development Fund" is proposed to be set up to fund urban infrastructure in Tier 2 and Tier 3 cities.

Technology, IT/ ITES² and fintech start-ups are analyzing the impact of ChatGTP and other AI driven initiatives. These sectors are expected to witness consolidation as companies with high burn rates strive to raise funds and will look forward to sell/ merge with their well-funded peers for non-cash consideration, primarily through stock swap. As per the 2023 investment management outlook survey³, many active portfolio managers are leaning towards investing in AI, data analytics and data labelling. Such investments could help managers in alpha generation providing them with superior risk-adjusted returns to index investing.



Regulatory Developments

The regulatory bodies in India are periodically reviewing the regulatory framework, to boost investor confidence and bring transparency in the Indian investment and business environment. Some of the key regulatory developments for the period January 2023 to June 2023 are:

Tax incentives in the Union Budget 2023

1. Tax incentives are provided to foreign investment funds for relocating to International Financial Services Centre as an AIF. An example is the exemption on the capital gains arising from the transfer of shares/ units held by the shareholder/ unitholder of such foreign fund in consideration of shares/ units of the relocated AIF. The timeline to avail the benefit from such incentive is extended from March 31, 2023 to March 31, 2025.
2. A pass-through status is provided to InvITs and REITs ("**Business Trusts**") in respect of certain specified incomes such as interest, dividend and rental income (in case of REITs) received from special purpose vehicles (Indian companies in which a Trust holds the controlling interest or prescribed percentage). Any sum received by a unit holder (including on the redemption of units to the extent receipts exceed the cost of unit), will be taxed which is (a) not in the nature of exempted income in the hands of a Business Trust (i.e., interest, dividends and rental income), and (b) not chargeable to tax in the hands of a Business Trust.
3. At the time of distribution of income in the nature of interest and dividends to non-resident unit holders, Business Trusts are obligated to withhold income tax at 5%/ 10%, depending on the nature of income. Previously, a certificate allowing a lower tax rate, or no deduction of tax could not be obtained for such payments. However, it is now allowed the issuance of a certificate withholding a tax certificate that permits lower or no tax withholding on such payments.

Angel tax on non-resident investments

The Finance Act 2023 has expanded the scope of the angel tax provision to include the issuance of shares to non-residents from the financial year 2023-24. Previously, this tax was charged only on the issuance of

² Information Technology/ Information Technology Enable Sources

³ 2023 investment management outlook by Deloitte.

shares to persons resident in India. This is charged in the hands of the company (not being a 'company in which the public are substantially interested') receiving the consideration under the head of 'Income from Other Sources' on the amount of consideration received by it that is in excess of the 'fair market value' of the shares issued. This will have a significant impact on inbound investments in India. The GoI has also released the draft rules for valuation of shares for domestic and foreign investors. To read more, [click here](#)

AIFs

1. **Transaction in corporate bonds through request for quote ("RFQ") platform-** AIFs must undertake at least 10% of their total secondary market trades in corporate bonds by value in a month by placing/ seeking quotes on the RFQ platform. All transactions in corporate bonds wherein AIF(s) is on both sides of the trade will be executed via the RFQ platform in 'one-to-one' mode. However, any transaction entered by an AIF in corporate bonds in 'one-to-many' mode which gets executed with another AIF, will be counted in 'one-to-many' mode and not in 'one-to-one' mode.
2. **Direct Plan for schemes and trail model for distribution commission-** It is specified that for investors who have on-boarded AIFs/ schemes of AIFs from May 1, 2023:
 - a) schemes of AIFs will have an option of 'Direct Plan' for investors, which will not entail any distribution fee/ placement fee;
 - b) AIFs must disclose any distribution fee/ placement fee, to the investors of the AIF/ scheme of the AIF at the time of on-boarding;
 - c) Category I AIFs and Category II AIFs may pay upto one-third of the total distribution fee/ placement fee to the distributors on upfront basis, and the remaining fee must be paid on an equal trail basis over the tenure of the fund; and
 - d) Category III AIFs must charge any distribution fee/ placement fee to investors only on an equal trail basis over the tenure of the fund and no upfront distribution fee/ placement fee can be charged, directly or indirectly. Any distribution fee/ placement fee paid will be only from the management fee received by the managers of such Category III AIFs.
3. **Guidelines for excluding an investor from an investment of AIFs-** An AIF may excuse its investor from participating in a particular investment in the following circumstances:
 - a) if the investor, based on the opinion of a legal professional/ legal advisor, confirms that its participation in the investment opportunity would be in violation of an applicable law or regulation;
 - b) if the investor, as part of the contribution agreement or any other agreement signed with the AIF, had disclosed to the manager that, the investor's participation in such investment opportunity would be in contravention to the investor's internal policy;
 - c) if the manager of the AIF is satisfied that the participation of such investor in the investment opportunity would lead to the scheme of the AIF being in violation of applicable law or regulation or would result in material adverse effect on the scheme of the AIF; and
 - d) if the investor of an AIF is also an AIF or any other investment vehicle, such investor may be partially excused or excluded from participation in an investment opportunity, to the extent of the contribution of the said fund/ investment vehicle's underlying investors who are to be excused or excluded from such investment opportunity.
4. **Credit Default Swaps ("CDS")-** The key conditions applicable to AIFs for dealing in CDS are as follows:
 - a) Category I AIFs and Category II AIFs may buy CDS on underlying investment in debt securities only for the purpose of hedging;
 - b) Category III AIFs may buy CDS for the purpose of hedging or otherwise within permissible leverage as specified in the Securities and Exchange Board of India ("SEBI") circular dated July 29, 2013;
 - c) Category III AIFs may sell CDS subject to the condition that effective leverage undertaken is within the permissible limits as specified in SEBI circular dated July 29, 2013; and
 - d) Category II AIFs and Category III AIFs may sell CDS by earmarking unencumbered Government bonds/ Treasury bills equal to the amount of the said CDS exposure.

5. **Introduction of the Corporate Debt Market Development Fund-** A new category of AIF called Corporate Debt Market Development Fund (“**CDMDF**”) is introduced. The CDMDF will act as a backstop facility for purchase of investment grade corporate debt securities to instill confidence amongst the participants in the corporate bond market during times of stress and to generally enhance secondary market liquidity.
6. **Issue of units in dematerialized form-** It is now mandatory for AIFs to issue units in dematerialized form subject to the conditions specified by SEBI.
7. **Approval of investors for buying or selling investments-** The amendment has introduced additional conditions which will need to be complied with by AIFs while buying or selling investments.
 - a) AIFs will require the approval of 75% of the investors by value of their investment in the AIF, to invest in:
 - a) associates; or
 - b) units of AIFs managed or sponsored by its manager, sponsor, or associates of its manager or sponsor.
 - b) The approval of 75% of the investors by value of their investment in the scheme of the AIF is required to buy or sell investments, from or to:
 - a) associates; or
 - b) schemes of AIFs managed or sponsored by its manager, sponsor or associates of its manager or sponsor; or
 - c) an investor who has committed to invest at least 50% of the corpus of the scheme of the AIF.

However, the investor specified under para (c) above who has committed to investing at least 50% of the corpus of the scheme of the AIF and is buying or selling the investment, from or to, the AIF, will be excluded from the voting process.
8. **Valuation of investment-** AIF’s will have to carry out valuation of their investments in accordance with the manner specified by SEBI from time to time. The manager of the AIF must ensure that the AIF appoints an independent valuer who satisfies the criteria specified by SEBI from time to time. The manager and the key management personnel of the

manager must ensure that the independent valuer computes and carries out valuation of the investments of the scheme of the AIF in the manner specified by SEBI.

9. **Appointment of compliance officer-** As per the amendments, the manager of each AIF is required to appoint a compliance officer for the AIF. The compliance officer is responsible for monitoring compliance of the AIF with the provisions of the SEBI Act, 1992, rules, regulations, notifications, circulars, guidelines, instructions or any other directives issued by SEBI. The compliance officer is required to immediately and independently report any non-compliance observed by him to SEBI, as soon as possible but no later than 7 (seven) working days from the date of observing such non-compliance.

FPIs

1. **Streamlined boarding process of FPIs-** Designated Depository Participants (“**DDPs**”) may grant FPI registration to the applicant on the basis of scanned copies of the executed Common Application Form (“**CAF**”) and the certified supporting documents and payment of the applicable fees. They are required to update the CAF module as per the standard process for issuance of Permanent Account Number (“**PAN**”) card. Post PAN allotment, the scanned copies of the applicant’s certified Know Your Client (“**KYC**”) documents must be uploaded on the KYC Registration Agencies by the DDP/ custodian. Only upon receipt and verification of the physical documents by the DDP/ custodian, the custodian will make an application to the clearing corporation for the allotment of a custodial participant code to the FPI and carry out necessary steps for enabling the FPI to transact in the Indian securities markets. FPIs may use digital signatures for the purpose of execution of CAF and other registration related documents, in accordance with the provisions of the Information Technology Act, 2000.
2. **Disclosure of information to SEBI-** FPIs are required to inform SEBI and DDPs, within 7 (seven) working days, if there is:
 - a) information or particulars previously submitted to SEBI or DDP found to be false or misleading, in any material respect;
 - b) material change in the information including any direct or indirect change in its structure or

ownership or control or investor group previously furnished by him to SEBI or DDP; and

- c) penalty, pending litigation or proceedings, findings of inspections or investigations for which action may have been taken or is in the process of being taken by an overseas regulator against it.

REITs and InvITs

- Dematerialized form of securities-** InvITs/ REITs are required to hold the securities of holding companies and special purpose vehicles only in dematerialized form. In case the existing securities holdings are in physical form, the managers of the InvITs/ REITs are directed to dematerialize the same on or before June 30, 2023. This move aims to facilitate transparency and doing business.
- Appointment of auditors and woman director-** The investment manager/ manager of the InvIT/ REIT must appoint a woman independent director on the board of the investment manager/ manager, establish a vigil mechanism, submit the compliance reports and appoint an individual or a firm as the auditor. The investment manager/ manager cannot appoint or re-appoint an auditor (a) in the case of an individual, for more than 1 (one) term of 5 (five) consecutive years; and (b) in the case of an audit firm, for more than 2 (two) terms of 5 (five) consecutive years. The auditors must undertake a limited review of the audit of all the entities or companies whose accounts are to be consolidated with the accounts of the InvIT/ REIT.
- Applicability of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”)-** Certain provisions of the LODR Regulations, such as constituting an audit committee, nomination and remuneration committee, risk management committee and stakeholders relationship committee, employees obligations including senior management and obligations in respect of independent directors, are made applicable to InvITs and REITs.
- Leverage calculation-** It has been clarified that overnight mutual funds, characterized by investments in overnight securities and with maturity of 1 (one) day, will be considered cash and cash equivalents; and the amount of cash and cash equivalent will be excluded from the value of the REIT/ InvIT assets.

- Definition of “change in control”-** The definition of ‘change in control’ is amended to include the right to appoint a majority of the directors or control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly. This may be through the authority shareholding or management rights or shareholders agreements or voting agreement.



Road Ahead

From January 2023, SEBI is engaged in consultation with the various stakeholders to improve the governance, operation, and registration provisions for REITs, InvITs, AIFs, FVCIs, and VCFs. Some of the anticipated amendments are listed below:

AIFs

- To address the concerns of the priority distribution model (“PDA”) in the AIF schemes, SEBI is considering introducing *prorata* and *paripassu* rights of the investors. It is proposed that:
 - while making investment, the rights of each investor may be required to be maintained prorata to their commitment to the scheme;
 - while distributing the proceeds of the investment, the rights of each investor may be maintained on pro rate to the investment made in the investee company;
 - the ongoing PDA-based scheme may continue without new commitments and investments; and
 - differential rights, other than the hurdle rate of return, performance linked fee/ additional return and management fees, which can affect the rights of other investors cannot be granted and all investors will be required to be treated equally in AIFs.
- To ensure that AIFs do not hold their certificate of registration indefinitely, without any intention of carrying out the activity of an AIF, it is proposed that

the AIF may pay a renewal fee equal to 50% of its applicable registration fee for the subsequent block of 5 (five) years from the date of grant of their registration, within 3 (three) months of expiry. Existing AIFs who have completed 5 (five) years from the date of grant of certificate of registration are required to pay renewal fee equal to 50% of its applicable registration fee.

3. AIFs, other than those having 50% or more contribution from a single investor or investors belonging to the same group, may be entitled to avail benefits designated for qualified institutional buyers (“QIBs”).

FPIs

SEBI is contemplating additional disclosures for FPIs to safeguard the minimum public shareholding requirement and compliance with the provisions of Press Note 3 of 2020, which prescribed that an entity of a country that shares land border with India, or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the Government approval route.

REITs/InvITs

Affirming that a strong and independent board of directors of the manager/ investment manager of a REIT/ InvIT is important, SEBI proposes:

1. a unitholder holding a minimum of 10% of units, will be entitled to nomination rights, i.e., for every 10% held, the unitholder will be entitled to nominate one director on the board of the manager/ investment manager of the REIT/ InvIT;
2. formation of the unitholders council with members nominated by the unitholders holding minimum 10% of units, with the aim of making it mandatory for the manager/ investment manager of the REIT/ InvIT to constitute such a Unitholders Council;
3. making the stewardship code, which is currently applicable to mutual funds and all categories of AIFs, applicable to the entities having representation on the board of directors of the manager/ investment manager of the REIT/ InvIT and/ or the Unitholders Council;

4. having at least one “sponsor” (sponsor is defined as a person who sets up the REIT/ InvIT and is designated as such at the time of application for registration) throughout the life of the REIT/ InvIT ensuring that the said sponsor holds a certain percentage of units in the REITs/ InvITs on a perpetual basis.

FVCIs

1. While filing the registration application, FVCIs may be permitted to avail the services of DDPs for obtaining a certificate of registration. The requirement of PAN and demat account can be pre-requisites for the purpose of registration of FVCIs. Form A can be aligned with the common application form used for FPIs.
2. It is proposed to align the eligibility criteria of FVCIs with FPIs.
3. FVCIs may soon be required to hold the instruments/ securities of their investments only in dematerialized form.
4. To ensure that FVCIs do not hold their certificate of registration indefinitely, without any intention to carry out the activity of an FVCI, it is proposed that an FVCI may pay a renewal fee of USD 2500 (US Dollars two thousand five hundred) if it wishes to continue with its registration for the subsequent block of 5 (five) years.
5. FVCIs, who are other than corporate bodies and family offices, may be designated as QIBs.

VCFs

VCFs, other than those having 50% or more contribution from a single investor or investors belonging to the same group, may be entitled to avail benefits designated for QIBs.

Conclusion

While the regulatory landscape in India continues to evolve promoting the ease of doing business, the microeconomic factors and global trends have been uncertain, thereby impacting investments in India. With the decline in funding due to the ‘funding winter’, the valuation of start-ups has corrected and led to market consolidation by acquiring start-ups with high capital burn out.

JSA Private Equity Practice

We provide legal services to PE funds across the full range of their operations and activities, besides International and Domestic entities. The PE practice represents both investors and investee entities in diverse sectors. We are actively involved in legal and governmental issues affecting the Private Equity and Venture Capital industry on a national level, including legislative and regulatory matters, and provide ongoing support, advice and views to the various committees of SEBI. The PE practice complements and works closely with our Investment Funds practice to provide legal advice on several aspects such as:

- Onshore and Offshore structuring and formation of funds in India and overseas and enabling tax efficient modes of investing in India;
- Investment structures to ensure compliance with Takeover Regulations, Insider Trading Regulations;
- Representation of funds, either alone or as lead members of a syndicate;
- Drafting applications for regulatory approvals and liaising with regulatory authorities, including SEBI/ Reserve Bank of India (RBI) registrations and compliance;
- Drafting offer documents for the raising of funds;
- Due Diligence of prospective investee companies and targets;
- Negotiation assistance from term sheet stage till closing;
- Assisting in downstream investments;
- Advising on ongoing activities of portfolio companies;
- Assistance with exit strategies and implementation thereof;
- Advising investee companies on issues relating to receiving venture capital and PE investment;
- Negotiations and drafting of transaction documents including investor agreements, share subscription/purchase agreements, joint venture agreements and shareholder agreements;
- Documentation and overall transactional support, including working closely with regulators like RBI, Foreign Investment Facilitation Portal (FIFP) and SEBI; and
- Structuring incentives and sharing of the 'carry' for fund managers and research analysts.

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17 Practices and
24 Ranked Lawyers



16 Practices and
11 Ranked Lawyers



7 Practices and
2 Ranked Lawyers



11 Practices and
39 Ranked Partners
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11 winning Deals in
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10 A List Lawyers in
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