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Research

Sovereign Wealth Funds & Pension Funds: Investments into India

Regulatory, Legal and Tax Overview

May 2023

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We have always taken initiatives to provide updates and analysis on the latest legal developments. We believe in knowledge sharing and hence would appreciate any feedback or comment on this paper.

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Glossary of Terms

AIF	Alternative Investment Funds
AIF Regulations	Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012
AUM	Assets Under Management
CA, 2013	Companies Act, 2013
CBDT	Central Board of Direct Taxes
CCI	Competition Commission of India
Combination Regulations	Competition Commission of India (Procedure in regard to the Transaction of Business relating to Combinations) Regulations, 2011
Competition Act	Competition Act, 2002
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act, 1999
FPI	Foreign Portfolio Investor
FPI Regulations	SEBI (Foreign Portfolio Investors) Regulations, 2019
FVCI	Foreign Venture Capital Investor
FVCI Regulations	SEBI (Foreign Venture Capital Investors) Regulations, 2000
FY	Financial Year
GAPP	Generally Accepted Principles and Practices
GIC	Government of Singapore Investment Corporation's
IFSWF	International Forum of Sovereign Wealth Funds
IM	Investment Manager
INR	Indian Rupees
InvIT	Infrastructure Investment Trust
InvIT Regulations	SEBI (Infrastructure Investment Trusts) Regulations, 2014
IPO	Initial Public Offer
ITA	Income Tax Act, 1961
ITAT	Income Tax Appellate Tribunal
ITR	Income Tax Rules, 1962
LLP	Limited Liability Partnership

LLP, 2008	Limited Liability Partnership Act, 2008
LP	Limited Partners
NBFC	Non-Banking Financial Company
NCD	Non Convertible Debenture
NDI Rules	Foreign Exchange Management (Non-debt Instruments) Rules, 2019
OCD	Optionally Convertible Debenture
OCRPS	Optionally Convertible Redeemable Preference Shares
PF	Pension Fund
PM	Project Manager
QIB	Qualified Institutional Buyer
RBI	Reserve Bank of India
REIT	Real Estate Investment Trust
REIT Regulations	SEBI (Real Estate Investment Trusts) Regulations, 2014
SEBI	Securities and Exchange Board of India
SPV	Special Purpose Vehicle
SWF	Sovereign Wealth Fund
Takeover Code	SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 Takeover Code
USD	United States Dollar

Introduction

SWFs and PFs play a critical role in financing and enabling global development. SWFs refer to government owned investment vehicles that mostly invest abroad to meet some pre-determined macroeconomic objectives. PFs refer to funds set up by government or social security institutions with the objective of contributing to financing the relevant pay-as-you-go pension plans. Given the funding requirements for the Indian economy, it medium term growth prospects, its well established and transparent legal regime and the depth of its markets – SWFs, PFs and India are a match made in heaven! Naturally India has been emerging favorably for SWFs and PFs as compared to its Asian counterparts.

In 2022 alone SWFs have invested USD 6,712,000,000 (United States Dollar Six Billion Seven Hundred and Twelve Million) in India in 2022 as direct investment. This marks a significant increase from the USD 3,797,000,000 (United States Dollar Three Billion Seven Hundred and Ninety Seven Million) invested in India 2021 by SWFs.[1] While 2021 was plagued by Covid-19 pandemic, SWFs took several bets and became the fourth largest category of FPIs among 32 (Thirty Two) categories of FPIs investing in India.

The key evolution in the participation of SWFs and PFs that we are witnessing in India, is their transition from deploying money only as limited partners in private equity and public market funds managed by global GPs, to investing directly in enterprises of interest to such SWFs and PFs. The extent of interest and participation has grown rapidly and meaningfully enough for many of them to establish a physical presence in India and to base investment teams within the jurisdiction.

The major sectors that have received direct investments from SWFs include healthcare, entertainment, asset management, and renewables.[2] Notably, SWFs have also invested in new-age and emerging sectors such as space.

Notable deals undertaken in India by SWFs and PFs in 2022 and 2023 include:

a. GIC's investment into Asia Healthcare Holdings Pte. Ltd.[3] AHH's subsidiaries includes India's mother & childcare hospitals chain Motherhood Hospitals and leading fertility chain Nova IVF;

b. British Columbia Investment Management Corporation and Mubadala Investment Company's investment into Cube Highways Trust. Cube Highways Trust holds a portfolio of 18 (Eighteen) toll and annuity road assets spanning 1,423.60 kilometers across India;[4]

c. GIC's investment into Skyroot Aerospace Private Limited.[5] Skyroot Aerospace Private Limited was the first Indian private sector company to launch a rocket into space;[6]

d. GIC's investment into the electric vehicle startup Euler;[7]

1 Direct Investments: Sovereign Wealth Funds Double Down in India in 2022, Sovereign Wealth Fund Institute, https://www.swfinstitute.org/news/95321/direct-investments-sovereign-wealth-funds-double-down-in-india-in-2022.

2 Direct Investments: Sovereign Wealth Funds Double Down in India in 2022, Sovereign Wealth Fund Institute, https://www.swfinstitute.org/news/95321/direct-investments-sovereign-wealth-funds-double-down-in-india-in-2022.

3 TPG-Backed Asia Healthcare Holdings Raises $170 Million from Singapore's GIC, Press Release – TPG, https://press.tpg.com/news-releases/news-release-details/tpg-backed-asia-healthcare-holdings-raises-170-million.

4 Saurav Anand, Cube Highways InvIT raises $630 mn from Canada's BCI, Abu Dhabi's Mubadala, Mint, https://www.livemint.com/companies/news/cube-highways-invit-raises-630-mn-from-canada-s-bci-abu-dhabi-s-mubadala-11681891551791.html.

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6 Manish Pant, Skyroot Aerospace to launch India's first privately developed rocket into space next week, Business Today, https://www.business-today.in/technology/story/skyroot-aerospace-to-launch-indias-first-privately-developed-rocket-into-space-next-week-352189-2022-11-08.

7 Singh, GIC backs Indian EV startup Euler Motors in $60 million funding, Tech Crunch, https://techcrunch.com/2022/10/03/gic-backs-indian-ev-startup-euler-motors-in-60-million-funding.

e. Abu Dhabi Investment Authority's investment in Lenskart, an Indian eyewear retailer;[8]

f. Qatar Investment Authority's investment into the investment platform 'Bodhi Tree';[9]

g. Temasek's continuing investment into Manipal Health Enterprises Private Limited;[10]

h. GIC's investment in 3 (Three) subsidiaries of The Phoenix Mall[11];

i. Mubadala Investment Company's investment into Tata Power Company Ltd;[12]

j. GIC's investment in Hector Beverages, the maker of Paper Boat beverages and packaged foods;[13]

In addition to direct investments, SWFs also regularly allocated towards India through investment into India focused funds as LP(s). SWFs entrust the investment managers of such funds to utilize their monies in accordance with a defined investment strategy, which undergoes extensive diligence by such SWFs. Pursuant to such LP allocations, SWFs also get co-investment rights to make direct investments in certain opportunities. The table below depicts allocation of SWFs to alternate investments:

Asset	Allocation
Private Equity	7.5%
Real Estate	9.2%
Infrastructure	4.9%
Hedge / abolute return funds	3.1%
Commodities	1.3%

8 Pranav Dixit, Abu Dhabi Investment Authority invests $500 million in Lenskart, Business Todat, https://www.businesstoday.in/latest/corporate/story/abu-dhabi-investment-authority-invests-500-million-in-lenskart-373558-2023-03-16.

9 QIA gives financial backing to Bodhi Tree investment platform – A strategic partnership of Lupa Systems and Uday Shankar, QIA, https://www.qia.qa/en/Newsroom/Pages/QIA-GIVES-FINANCIAL-BACKING-TO-BODHI-TREE-INVESTMENT-PLATFORM---A-STRATEGIC-PARTNERSHIP-OF-LUPA-SYSTEMS-AND-UDAY-SHANKAR.aspx.

10 Reghu Balakrishnan, Temasek may pick 33% more in Manipal Health to become majority shareholder, Economic Times, https://economictimes.indiatimes.com/markets/stocks/news/temasek-may-pick-33-more-in-manipal-health-to-become-majority-shareholder/articleshow/97016440.cms.

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12 Tata Power to create India's most comprehensive renewable energy platform – raising US$ 525 million (₹ 4,000 crore) to fund growth of its renewable energy business, Mubadala, https://www.mubadala.com/en/news/tata-power-create-indias-most-comprehensive-renewable-energy-platform.

13 Sneha Shah, Singapore GIC's big push to Paper Boat maker Hector, mint, https://www.livemint.com/companies/singapores-gic-set-to-invest-in-paper-boat-maker-hector-11660758011449.html.

Indian Interpretation of SWFs and PFs

While, corporate or securities laws in India have not defined the term SWF or PF, the 2020 CBDT Circular[14] and the ITA[15] lays down self-certification measures for SWFs applying for tax exemption which may be used as a yardstick on the Indian regulatory position as to the qualifying criteria for SWFs. Additionally, in relation to PFs, the self-certification measures for the purposes of availing exemption under Section 10(23FE) are mentioned in Rule 2DB of the ITR and the same may be interpreted as the qualifying criterial for PFs.

The qualifying criteria may be interpreted as an unofficial recognition of sovereign wealth enterprise ("**SWE**"). A SWE is a sovereign investment vehicle that is owned and controlled by a SWF.[16] SWEs are generally established for SWFs to have greater flexibility with respect to investments, for beneficial tax treatment, or to limit exposure by creation of an intermediate corporate entity. A SWE, generally being wholly owned and controlled by a SWF, tends to fulfill the abovementioned qualifiers and therefore, may seek recognition as an SWF for Indian tax purposes. For instance, the central government has recognized Qatar Holding LLC (wholly owned by the Qatar Investment Authority) as a SWF for the purposes of tax exemption under clause (23FE) of Section 10 of the ITA.

Needless to mention, not all SWFs are similar. The financial objective sought to be achieved by the fund plays a key role in determining the sub-category of SWF the fund falls under (although the law does not make such distinctions). Understanding the various sub-classes of SWFs is critical in understanding the asset allocation strategies of a particular fund. Broadly speaking the deployment strategies of SWFs are divided between fund of funds ("**FoF**") allocations and direct allocations. A FoF SWF invests into funds that are managed by third-party managers provided that these funds are in line with their investment policies. Whereas direct allocator SWF invests directly into portfolio companies with the aid of its in-house investment team.

The really interesting development that we are observing in India, is the growing share of the pie that direct allocations are garnering

Legal Form of SWFs and PFs

Typically, SWFs are established in one of the following three forms:[17]

a. SWFs are constituted by a pool of assets (arrangement) without a separate legal personality. The legal ownership of the pool of assets rests directly with the state/government or central bank and management of pool of assets is undertaken by a separate fund management entity owned by the government or an external asset manager. Examples include the Botswana Pula Fund and Norway's Government Pension Fund Global; or

b. SWFs are established under public law as legal identities distinct from the state/government or central bank, with full capacity to act. They are the legal owner of the investment assets and governed by a specific constitutive law. Examples include the Abu Dhabi Investment Authority, the Kuwait Investment Authority and the Qatar Investment Authority; or

14 Circular No. 15 of 2020, July 22, 2020, CBDT.

15 Section 10(23FE) (b), ITA.

16 Sovereign Wealth Enterprise, Sovereign Wealth Fund Institute, https://www.swfinstitute.org/research/sovereign-wealth-enterprise.

17 Snoeij, Richard. "Sovereign Immunity and Source State Taxation of Sovereign Wealth Funds: Is it Time to Re-Evaluate?." World tax journal.-Amsterdam 8.2 (2016): 225-242.

c. SWFs are established as state/government-owned corporations with a separate legal personality. They are the legal owner of the investment assets and typically governed by general company law, although specific laws can (also) apply. Examples include the China Investment Corporation and the Korea Investment Corporation

The different legal forms of SWFs have implications with respect to governance and taxation of SWFs.

PFs can be broadly categorized into two categories:

a. Social Security Reserve Funds are set up as part of the overall social security system, where the inflows are mainly surpluses of employee and/or employer contributions over current pay-outs. Among others, Denmark's Social Security Fund, Japan's Government Pension Fund and USA's Social Security Trust Fund fall within this category. Such funds may be managed by the social security institution itself or an independent, often, public sector fund management entity.

b. Sovereign Pension Reserve Funds refers to those funds which are established directly by the government and its financial inflows are mainly from direct fiscal transfers from the government. Unlike the first type of reserve fund, those within this category have been set up by governments to finance public pension expenditures at a specific future date. Some are not allowed to make any payouts for decades. Examples include the Australian Future Fund, the New Zealand Superannuation Fund, the Irish National Pension Reserve Fund and the Norwegian Government Pension Fund.[18]

The different legal forms of PFs have implications with respect to governance and taxation.

18 Adrian Blundell, Sovereign Wealth and Pension Fund Issues, Financial Market Trends, OECD 2008, https://www.oecd.org/pensions/private-pensions/40196131.pdf.

Tax Regime for SWFs and PFs in India

Tax Regime in India

Taxation of income in India is governed by the provisions of the ITA which contains separate rules for the taxation of residents and non-residents. Under Section 4 read with Section 5 of the ITA, non-residents are taxable only on their India-source income i.e., only and to the extent that such income accrues or arises or is deemed to accrue or arise in India or is received or deemed to be received in India.

Section 2(31) of the ITA defines 'person', the satisfaction of which is imperative for any entity to be taxed in India under Section 4 of the ITA. This definition does not include foreign state or a foreign state government within its ambit and as such a foreign state may not be covered within the scope of ITA. In relation to SWFs or PFs, the legal form of SWF or PF will determine as to whether it qualifies as a 'person' under the ITA or not.

Under Section 90(2) of the ITA, a taxpayer can choose to be taxed as per the provisions of a tax treaty entered into between India and the country of residence of the taxpayer or the ITA, whichever is more beneficial. Further, Section 90 of the ITA requires that a tax residency certificate ("**TRC**") be submitted as evidence of residential status of the taxpayer in order to be able to claim relief under the tax treaty.

Prior to 2020, ITA did not contain any specific provisions for taxation of SWFs or PFs. In absence of any specific exemption stemming from sovereign immunity, taxation of income earned by SWFs or PFs on from investments in India will be governed by provisions of relevant tax treaty.

Application of Tax Treaty to SWFs and PFs

Provisions of tax treaties are applicable to 'persons' who are 'residents' of a contracting state'. Several tax treaties include the State, its political sub-divisions and their local authorities in the definition of 'resident'. Whether an SWF or a PF qualifies as a resident for tax treaty purposes depends on the facts of each case. Specifically, in case where SWFs or PFs are established as subsidiaries of State or a political sub-division, whether it would qualify as a person or not will have to be determined on basis of language of the relevant tax treaty.

Exemption under Domestic Tax Law

In order to promote investment by SWFs and PFs, the Finance Act, 2020 exempted income of a specified person in the nature of dividend, interest or long-term capital gains arising from making specified investments (debt or equity) in India. The Finance Act, 2023 extended the applicability of Section 10(23FE) of the ITA to specified sum referred to in Section 56(2)(xii) of the ITA as well. Accordingly, any distributions received by SWFs / PFs in form of specified sum should be exempt from tax in their hands subject to fulfillment of conditions under Section 10(23FE) of the ITA.

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Specified Person

Specified persons[1] inter-alia includes the following:

a. SWFs which satisfies the following conditions:

   i. it is wholly owned and controlled, directly or indirectly, by the government of a foreign country;

   ii. it is set up and regulated under the law of such foreign country;

   iii. the earnings of the said fund are credited either to the account of the government of that foreign country. No portion of the fund's earnings should accrue to any private person except for payment(s) made to creditors or depositors for loan / borrowing (not taken for making investments into India);

   iv. the asset of the said fund vests in the Government of such foreign country upon dissolution except for payment(s) made to creditors or depositors for loan / borrowing (not taken for making investments into India);

   v. the fund should not participate in the day-to-day operations of its investee entities. It is clarified that monitoring mechanisms employed by the fund to protect its investment such as the appointment of director(s) shall not constitute a participation in the day to day operations of the investee entity

   vi. it is specified by the Central Government by notification in Official Gazette

b. Pension Fund that:

   i. is created or established under the law of a foreign country including the laws made by any of its political constituents being a province, State or a local body;

   ii. is not liable to tax in such foreign country or if liable to tax, exemption from taxation for all its income has been provided by such foreign country;

   iii. it does not participate in the day to day operations of investee but the monitoring mechanism to protect the investment with the investee including the right to appoint directors or executive director shall not be considered as participation in day to day operations of the investee; and

   iv. is specified by the central government, by notification in the official gazette.

c. A wholly owned subsidiary of Abu Dhabi Investment Authority which (i) is a resident of UAE and (ii) makes investment, directly or indirectly, out of the fund owned by the Government of the Abu Dhabi.

Specified Investments

Investment[2] by SWFs and PFs in following are eligible for exemption under Section 10(23FE) of the ITA:

a. Investments in InvITs or REITs;

b. Investment in company or enterprise engaged in business of (i) developing, or operating and maintaining, or developing, operating and maintaining any infrastructure facility or (ii) infrastructure sub-sectors mentioned in updated harmonised master list of infrastructure sub-sectors[3] ("Eligible Infrastructure Entity");

1 Clause (a) (b) and (c) to Explanation 1 of Section 10(23FE), ITA and Rule 2DB of the Income Tax Rules, 1962.

2 Section 10(23FE) (iii), ITA.

3 Notification S.O. 2227E, CBDT, July 6, 2020.

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c. Investment in Category I / II AIFs regulated under the SEBI (Alternative Investment Funds) Regulations, 2012 having not less than 50% (Fifty percentage) investment in Eligible Infrastructure Entity or Specified Company (defined below) or NBFC (defined below) or InvITs;

d. Investment in a domestic company set up after April 1, 2021 having minimum 75% (Seventy Five percentage) investment in Eligible Infrastructure Entity ("Specified Company");

e. Investment in a specified non-banking financial company ("NBFC") having minimum 90% (Ninety percentage) lending to Eligible Infrastructure Entity.

Detailed rules have been prescribed in relation to computation of income which will be considered to be exempt in hands of specified person.

Additional Conditions to be Fulfilled by SWFs/ PFs to Claim Exemption

Since the Finance Act 2020, 14 SWFs and 21 PFs have been notified under Section 10(23FE) indicating the enthusiastic participation of SWFs / PFs in the Indian investment ecosystem. The additional conditions required to be fulfilled by these SWFs / PFs in order to claim exemption under Section 10(23FE) of the ITA are as below:

a. Filing of income-tax returns: It has to file income tax returns, as per the provisions of the ITA, for all the years in which the investment(s) eligible for exemption under Section 10(23FE) of the ITA was held by it ("**Relevant Investment Period**");

b. Audit: It has to get books of account audited for the Relevant Investment Period by an accountant specified under Section 288 of the ITA. Further, such audit report has to be furnished in the specified format[4] at least one month in advance to the due date specified for furnishing tax returns under Section 139 of the ITA;

c. Quarterly statements: It has to electronically furnish a quarterly statement within one month from the end of each quarter in the specified format[5], in respect of each investment made by it during the said quarter;

d. Segmented accounts: It has to maintain a segmented account of income and expenditure in respect of all specified investments;

e. Ownership: It should continue to be owned and controlled, directly or indirectly, by its establishing government. Further, no other person should exercise control or have any ownership (directly or indirectly) in the SWF / PF at any point in time;

f. Applicable law: It should continue to be regulated under the law(s) of its establishing government.

In addition to above, PFs are also required to satisfy the below mentioned conditions:[6]

a. it is responsible for administering or investing the assets for meeting the statutory obligations and defined contributions of one or more funds or plans established for providing retirement, social security, employment, disability, death benefits or any similar compensation to the participants or beneficiaries of such funds or plans, as the case may be.

4 Annexed to the notification in the Official Gazette notifying an SWF as a specified person.

5 Form II, Circular No 15 of 2020, July 22, 2020, F. No. 370142/26/2020 – TPL, Ministry of Finance, Department of Revenue, Central Board of Direct Taxes.

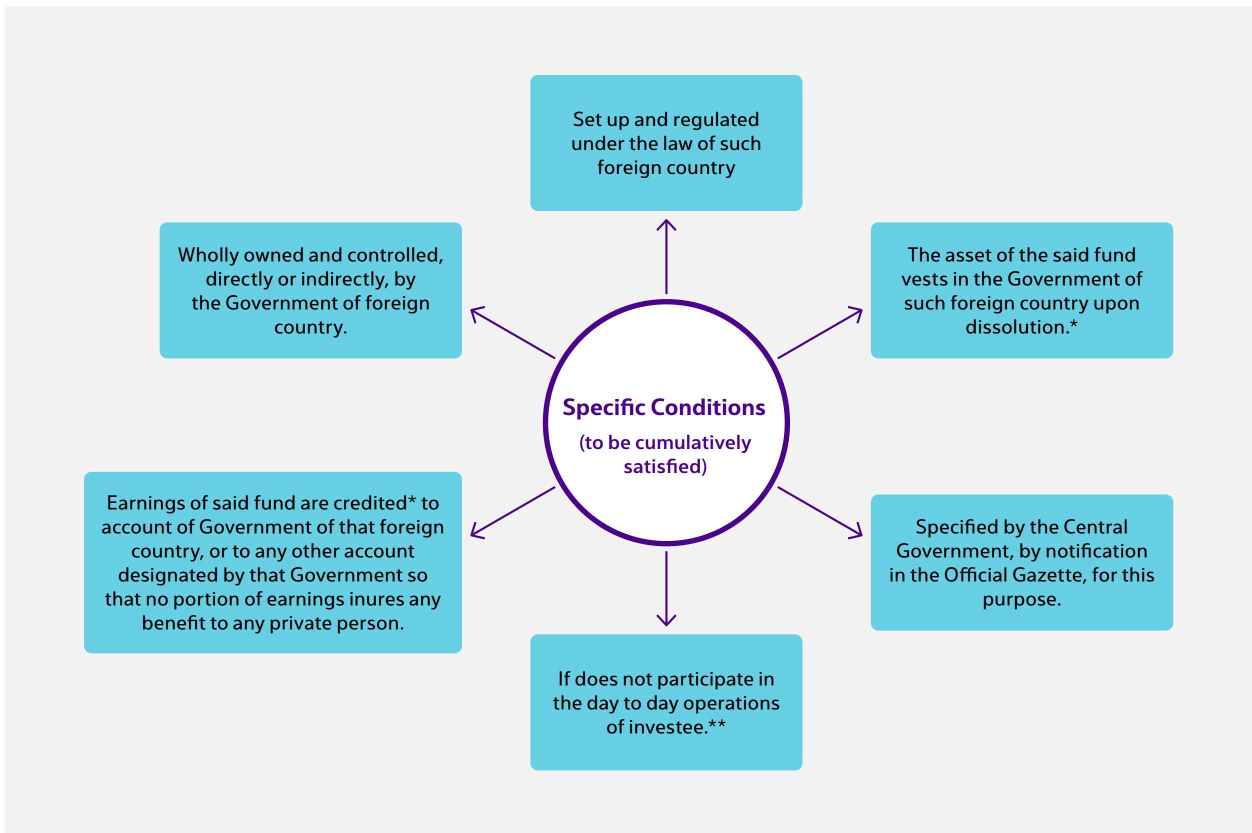
6 Rule 2DB of the ITR.

This condition is deemed to have been met if the value of such assets is not more than 10% (Ten Percentage) of the total value of the assets administered or invested by such fund, the ownership of such assets lie with the foreign government and the assets vest in the foreign government upon being dissolution of the fund;

b. the earnings and assets of the PF are used only for meeting statutory obligations and defined contributions for participants or beneficiaries of funds or plans and no portion of the earnings or assets of the pension fund inures any benefit to any other private person.

This condition, however, does not apply to (a) any payment made to creditors or depositors for loan taken or borrowing for reasons other than making an investment in India, and to (b) earnings from assets where the earnings are credited to the account of the government of the foreign country and do not inure any benefit to any private person

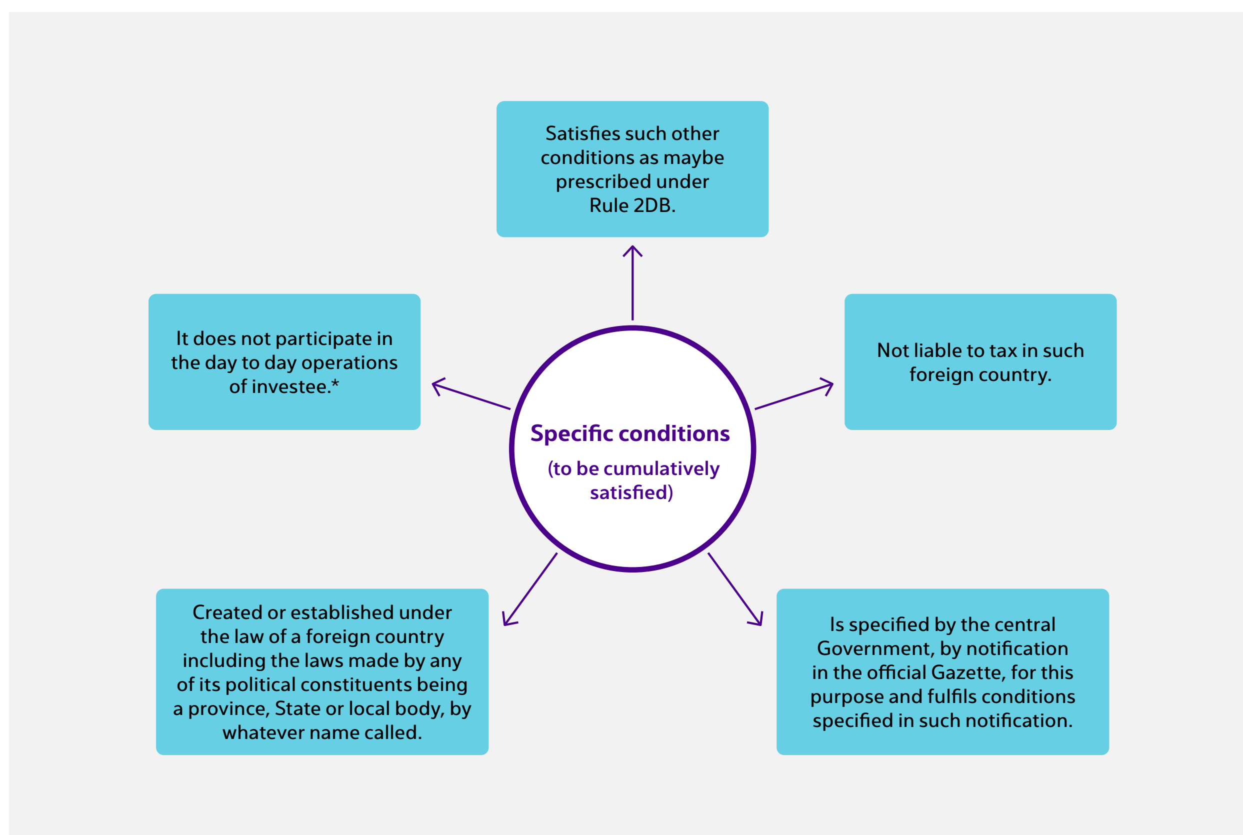
Specified Conditions: SWF



* *This condition shall not apply to any payment made to creators or depositors for loan taken or borrowing for purposes other than for making investment in India.*

** *The monitoring mechanism to protect the investment with the investee including the right to appoint directors or executive director shall not be considered as participation in the day to day operations of the investee.*

Specified Conditions: PF



* *The monitoring mechanism to protect the investment with the investee including the right to appoint director shall not be considered as participation in the day to day operations of the investee.*

Investment from Loan or Borrowing

Importantly, the exemption under Section 10(23FE) is not available to SWFs and PFs which have loans or borrowings, directly or indirectly, for the purposes of making the investment in India.[7] CBDT has clarified that if the loans and borrowings have been taken by the SWFs or any PFs or any of their group concerns, specifically for the purposes of making an investment by SWF or PF in India, such fund shall not be eligible for exemption. It has further been clarified that if the loans and borrowings have been taken by the SWF or PF or any of their respective group concern, not specifically for the purposes of making investment in India, it shall not be presumed that the investment in India has been made out of such loans and borrowings and such specified fund shall be eligible for exemption under Section 10(23FE) of the ITA, provided that the source of the investment in India is not from such loans and borrowings.[8]

7 Seventh proviso to Section 10(23FE) of ITA.

8 Circular No 19 of 2021 [F. NO. 370142/48/2021-TPL] October 26, 2021.

Secondary Investments

CBDT has clarified that certain secondary investment[9] by SWFs will be considered as 'investment' for purposes of Section 10(23FE) of the ITA, hence, eligible for exemption. The following transfers have been considered as investments:

a. Transfer of the shares or units of 'eligible infrastructure entity', or InvIT by any person to a SWF after the date of notification of such SWF under Section 10(23FE);

b. Transfer of the units of AIF or shares of domestic company or NBFC, which has invested in an Eligible Infrastructure Entity or InvIT, by any person to a SWF after the date of notification of such SWF under Section 10(23FE);

c. Transfer of the shares of domestic company or NBFC, which has invested in an Eligible Infrastructure Entity, by any person to an AIF where such investment by AIF is made out of the funds of the specified person after the date of notification of such SWF after the date of notification of such SWF under Section 10(23FE);

d. Transfer of the shares of an eligible infrastructure entity by a person to a domestic company where such domestic company has made investment out of the funds of the SWF after the date of notification of such SWF under Section 10(23FE).

Withdrawal of Exemption under Section 10(23FE)

As discussed above, exemption to SWFs and PFs under Section 10(23FE) of the ITA is provided subject to fulfillment of several conditions. In case any of those conditions violated in any previous year, exemption under Section 10(23FE) of the ITA will be withdrawn for all years in which exemption has been claimed and income will be taxable in the same previous year in which it is claimed to be exempt.[10] For example, if dividend income from specified income was claimed to be exempt by SWF in FY 21-22 and the SWF has violated any condition specified in Section 10(23FE) in FY 23-24, such dividend income will be taxable in FY 21-22 itself.

However, there are two exceptions to the aforesaid 'general rule':

a. **Lock-in period**

Exemption under Section 10(23FE) is available if the specified investments are held for a period of 3 (Three) years.[11] The non-adherence to the three-year rule may cause the fund's income to be chargeable to income tax, i.e. disqualified for exemption under Section 10(23FE).[12] In the event of such an inclusion to tax, the taxability of capital gains accruing on such investments (which did not adhere to the 3 (Three) year rule) is tabulated hereunder:

9 Para 4.6, circular no. 9 of 2022 [F. NO.370142/2/2022-TPL], May 9, 2022.

10 Para 4.4.2 of circular no. 9 of 2022 [F. NO.370142/2/2022-TPL], May 9, 2022.

11 Section 10(23FE) (ii), ITA.

12 Third Proviso Section 10(23FE), ITA.

Investments transferred before 3 years	Taxability	Reason
Investment(s) by the specified person in an Eligible Infrastructure Entity, InvIT, REIT, an AIF, a Specified Company, or an NBFC	In the hands of the specified person	Not be exempt from tax under Section 10(23FE) of the ITA
Investment(s) by such an AIF, out of the investment made by the specified person, in an eligible infrastructure entity, InvIT, REIT, an eligible domestic company, or an NBFC	Such capital gains will be taxable in the hands of the specified person	AIF is a pass-through entity and due to the income not being exempt from tax under Section 10(23FE) of the ITA
Investment(s) by such domestic company, out of the investment made by the specified person directly or through an AIF, in an eligible infrastructure entity	Income, attributable to such capital gains, shall be taxable in the hands of the specified person	Not be exempt from tax under Section 10(23FE) of the ITA
Lending by such NBFC(s), out of the investment made by the specified person either directly or through an AIF, to an eligible infrastructure entity	Income, attributable to such capital gain or other income of the NBFC, shall be taxable in the hands of the specified person	Not be exempt from tax under Section 10(23FE) of the ITA

Additionally, any interest or dividend on such investments (which is transferred in violation of the 3 (Three) years' rule) which was earlier exempt from taxation shall now be subject to tax in the hands of the specified person as the income of the relevant previous year in which the 3 (Three) year rule is violated.[13]

b. **Violation of investment thresholds by AIF / domestic company / NBFC**[14]

In case where the AIF / domestic company / NBFC fails to meet the threshold of minimum investment in an eligible infrastructure entity or InvIT, as the case may be, during any subsequent previous year, then income of specified person which has been exempted during any preceding previous year under the said clause (where minimum threshold was met during that previous year), shall remain to be exempted under the said clause and shall not be withdrawn solely because of the reason of minimum threshold not being met during the subsequent previous year. However, income of the specified person during the previous year of violation of minimum threshold and for all subsequent years, from such AIF/Company/NBFC shall not be exempted under the said clause. This is assuming that no other conditions specified in Section 10(23FE) or ITR have been violated.

Applicability of Angel Tax

The Finance Act, 2023 extended the applicability of the infamous 'angel tax' to non-residents. Angel tax provisions consider the difference between (i) the consideration received by an investee company by way of issuance of shares and (ii) the FMV of such shares, as income from other sources in the hands of such company. The CBDT has proposed to exclude the applicability of angel tax provisions to government and government related investors such as central banks, SWFs, international or multilateral organizations or agencies including entities controlled by the government or where direct or indirect ownership of the government is 75% (Seventy Five percentage) or more.[15]

13 Para 4.1.4, circular no. 9 of 2022 [F. NO.370142/2/2022-TPL], May 9, 2022.

14 Para 4.3.2, circular no. 9 of 2022 [F. NO.370142/2/2022-TPL], May 9, 2022.

15 CBDT Press Release dated May 19, 2023.

Modes of Investment-Regulatory Framework

While a separate category or regulatory framework has not been created under Indian laws to cater particularly to investments by an SWF or PF, such investments can be made through any of the existing routes of investment as mentioned below:

a. Foreign Direct Investment;

b. Foreign Portfolio Investment;

c. Foreign Venture Capital Investment.

Foreign Direct Investment

FDI in India is governed by FEMA read with the NDI Rules, the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019, together with the consolidated FDI Policy by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India. Under Schedule V of the NDI Rules, long term investors such as SWFs and PFs can invest into Indian securities subject to compliance with terms and conditions of investment promulgated by the RBI and the SEBI.

Permitted Sectors

Under the FDI route, foreign investments can be made into "permitted sectors" that include, inter alia, infrastructure, manufacture, civil aviation sector, satellite establishment and operation, e-commerce, pharmaceuticals, insurance, etc. Such investment will be subject to sectoral caps and can be made either through the automatic route (i.e., not subject to approval of central government) or the approval route (i.e., subject to approval of the central government), depending upon the sector in which foreign investment is sought to be made.

Press Note 3 Approvals

In accordance with Press Note 3 (2020 Series) issued by the Department for Promotion of Industry and Internal Trade on April 17, 2020 and Rule 6(a) of the NDI Rules, acquisition of any ownership interest in an Indian entity by any non-resident investor requires approval of the central government if the non-resident investor belongs to, or, any beneficial owner(s) of the non-resident investor belong to countries that share land borders with India. This is not usually an issue for most SWFs and PFs on account of the source of their funds, and can actually be a competitive advantage.

Instruments for Investment

FDI is permitted to be made in "equity instruments" issued by any Indian company, which include equity shares, fully and compulsorily convertible preference shares, fully and compulsorily convertible debentures, convertible notes, partly paid shares and warrants. Equity instruments through which investment is made are permitted to have optionality clause, however, the equity instrument will be subject to a lock-in period

of 1 (One) year (or higher, if prescribed for the specific sector), and will not have the right to exit at an assured price.[1]

FDI is also permitted through swap of shares, subject to the condition that valuation of the shares is made by a merchant banker registered with SEBI or an investment banker outside India registered with the appropriate regulatory authority in the host country.[2]

Downstream Investment

Indirect FDI or downstream investment can be made by an Indian company, which is owned or controlled by non-residents, into another Indian company. As per the FDI Policy such downstream investment is required to comply with the same norms as applicable to direct FDI in respect of relevant sectoral conditions and caps with regard to the sectors in which the downstream entity is operating. Such downstream investments is considered to be indirect FDI in an Indian entity if they have been made in the following manner: (a) another Indian entity which has received foreign investment and (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India ("**Non-Indian Entity**"); or (b) an investment vehicle whose sponsor or manager or investment manager (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India.[3] Downstream investment into Indian entities require that funds for investments to be brought from abroad or arranged through internal accruals (i.e., profits transferred to reserve account after payment of taxes).

Pricing Guidelines

Under the NDI Rules, in case of unlisted companies, the price at which a non-resident investor subscribes to primary equity instruments issued by an Indian company, or, purchases secondary equity instruments from a person resident in India cannot be lower than the price computed by any internationally accepted pricing methodology as calculated by a chartered accountant or a merchant banker registered with the SEBI.[4]

In case of listed companies, the pricing guidelines prescribed by FEMA do not apply. Fair value of instruments of a listed company are to be valued in accordance with the SEBI (Issue of Capital and Disclosure Requirements) Regulation, 2018.

Deferred Consideration

The NDI Rules permits the transfer of shares between a resident buyer and a non-resident seller or vice versa on a deferred consideration basis, subject to the following conditions:

a. the deferred consideration should not exceed 25% (Twenty Five percentage) of the amount;

b. the deferred consideration should be paid within a period of 18 (Eighteen) months from the date of the agreement for transfer of shares;

c. the deferred consideration maybe paid under an escrow arrangement, whose term shall not exceed 18 (Eighteen) months; and

d. if the total consideration is paid, the seller may furnish an indemnity valid for a period of 18 (Eighteen) months, for deferred portion of the condition.

1 Explanation to Rule 2(k), FEMA (Non-Debt Instruments) Rules, 2019.

2 Rule 21, FEMA (Non-Debt Instruments) Rules, 2019.

3 Private Equity and Private Debt Investments in India, Nishith Desai Associates (2022). https://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research_Papers/Private_Equity_and_Private_Debt_Investments_in_India.pdf.

4 Rule 21, FEMA (Non-Debt Instruments) Rules, 2019.

Foreign Portfolio Investment

An FPI refers to a person that is registered as such under the FPI Regulations. FPIs in India are regulated through the FPI Regulations, the NDI Rules (Schedule II) and Master Circular for FPI issued by SEBI.

Regulation 5(a)(i) and (ii) of the FPI Regulations identify SWFs and PFs respectively as "Category I FPI". As such, an SWF, once registered as an FPI, can purchase or sell equity instruments of an Indian company listed or to be listed on a recognised stock exchange subject to compliance with, inter alia, the below conditions:

Investment Limits

With respect to the investment under the FPI route, the total holding of an FPI or an investor group, should be (a) less than (i) 10% (Ten percentage) of the total paid-up equity capital on a fully diluted basis or (ii) 10% (Ten percentage) of the paid-up value of each series of debentures or preference shares or share warrants issued by an Indian company, and (b) the total holdings of all FPIs put together, including any other direct and indirect foreign investments in the Indian entity should not exceed the FDI sectoral caps applicable to the Indian company. If, however, the Indian entity is engaged in a sector where FDI is not permitted, the threshold of aggregate holding will be 24% (Twenty Four percentage). A breach of these requirements will result in the investment being categorized as FDI instead of investment by FPI.

Clubbing of Investment Limits

Where 2 (Two) or more FPIs including foreign Governments / their related entities have common ownership, directly or indirectly, of more than 50% (Fifty percentage), or, common control,[5] all such FPIs are considered to form part of an investor group.

Further, investments by foreign Government agencies are clubbed with the investment by the foreign Government or its related entities for the purpose of calculation of 10% (Ten percentage) limit for FPI investments in a single company, if they form part of an investor group. However, clubbing is not applicable where, *inter alia*:[6]

a. FPIs are appropriately regulated public retail funds; or

b. FPIs are public retail funds and investment managers of such FPIs are appropriately regulated.

Public retail fund includes, *inter alia*, pension funds, and therefore, pension funds regulated under the laws of the jurisdiction where it was constituted need not comply with the provisions pertaining clubbing of investment limits.

5 "Control includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of shareholding or management rights or shareholders agreements or voting agreements or in any other manner." Para 2.1.8, Consolidated FDI Policy.

6 Regulation 22(4), SEBI FPI Regulations.

Consideration

FPIs can purchase instruments of an Indian company through public offer or private placement, subject to the individual/ aggregate limits, and the following conditions:

a. In case of subscription by way of public offer, the price of the shares issued to FPIs should not be less than the price at which shares are issued to resident investors.

b. In case of subscription by way of private placement, the price should not be less than: (i) the price arrived at in terms of the pricing guidelines issued by SEBI; or (ii) the fair price worked out as per any internationally accepted pricing methodology for valuation of shares, on an arm's length basis. Such fair price arrived at should be certified by a SEBI registered merchant banker or chartered accountant or a practicing cost accountant.

Instruments

FPIs are permitted to make investments by way of, *inter alia*:

a. dated Government securities / treasury bills;

b. non-convertible debentures / bonds issued by an Indian company;

c. commercial papers issued by an Indian company;

d. security receipts issued by asset reconstruction companies;

e. Listed non-convertible / redeemable preference shares or debentures issued in terms of Regulation 6 of Foreign Exchange Management (Debt Instruments) Regulations, 2019;

f. Securitised debt instruments, including (i) any certificate or instrument issued by an SPV set up for securitisation of asset(s) with banks, Financial Institutions or NBFCs as originators;

g. Units of REIT, InvITs and unit of Category III AIFs;

h. Debt securities issued by REITs / InvITs

As seen from the category of instruments available under this route, investments in debt can also be made by an FPI. Therefore, this route is suitable for yield focussed instruments and other debt and hybrid investments.

Foreign Venture Capital Investment

The FVCI Regulations were promulgated to incentivise and stimulate foreign investment into venture capital undertakings in India. The FVCI Regulations make it mandatory for offshore funds to register themselves with SEBI in order to avail the benefits of the FVCI Regulations.

Some of the benefits extended by SEBI and RBI to FVCI(s) in comparison to investment through FDI route include:

a. **Free pricing**: Registered FVCIs are not restricted by the pricing guidelines applicable to investments through FDI and are provided the advantage of free pricing both at the time of entry as well as exit of their investments. A sale or transfer of securities or instruments can be made by at a price that is mutually agreed between buyers and sellers.[7]

b. **Instruments**: An FVCI can invest in equity instruments, equity-linked instruments (instruments optionally or mandatorily convertible into equity share) or debt instruments, which include OCRPS, OCDs and NCDs.

c. **Lock-in**:[8] Under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, the entire pre-issue share capital (other than for promoters, where lock in is for a longer period of 18 (Eighteen) months) of a company conducting an IPO is locked-in for a period of 6 (Six) months from the date of allotment in the public issue. However, an exemption from this requirement has been granted to registered FVCIs, provided, the shares have been held by them for a minimum period of 6 (Six) months from the date of purchase by the FVCI. This exemption enables the FVCI to exit from its investments, post-listing.

d. **Exemption under the Takeover Code**: SEBI has also exempted promoters of a listed company from the public offer provisions in connection with any transfer of shares of a listed company, from FVCIs to the promoters, under the Takeover Code.

e. **QIB Status**: FVCIs registered with SEBI have been accorded QIB status and are eligible to subscribe to securities at an IPO through the book building route.[9]

Sectors

FVCIs can invest only in the following sectors:

a. Biotechnology;

b. IT related to hardware and software development;

c. Nanotechnology;

d. Seed research and development;

e. Research and development of new chemical entities in pharmaceutical sector.

f. Dairy industry;

g. Poultry industry;

h. Production of bio-fuels;

i. Hotel-cum-convention centres with seating capacity of more than three thousand;

j. Infrastructure sector.[10]

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7 Schedule VII, FEMA (Non-Debt Instruments) Rules, 2019.

8 Regulation 17, SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018.

9 Definition of "Qualified Institutional Buyer", SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

10 Schedule VII, FEMA (Non-Debt Instruments) Rules, 2019.

Investment Thresholds

The FVCI Regulations specify that:

at least 66.67% (Sixty Six point Six Seven percentage) of the investible funds of a FVCI shall be invested in unlisted equity shares or equity-linked instruments of venture capital undertaking;

up to 33.33% (Thirty Three point Three Three percentage) of the investible funds of a FVCI may be invested by way of: (i) subscription to an initial public offer of a venture capital undertaking or investee company whose shares are proposed to be listed; (ii) debt or debt instrument of a venture capital undertaking or investee company in which the FVCI entity has already invested by way of equity; (iii) preferential allotment of equity shares of a listed company, subject to a lock-in period of 1 (One) year.

Investment Vehicles

Infrastructure and real estate are two of the most significant pillars of an economy, and India is no exception to the same. The development of a country is often perceived through developments in the infrastructure and real estate sector of the country. Infrastructure and real estate sectors have the capabilities to propel the economy on their own and prepare a groundwork not only for growth of its citizens but to attract further investments from across the globe.

The government has acknowledged the need to boost the infrastructure and real estate sectors as only upon the development of these sectors, other sectors will grow.[1] The Indian government has gone on record with a target of USD 5 Trillion GDP by the year 2025. For this, India needs to spend about USD 1.4 trillion over these years on infrastructure alone.[2]

Enormous financial resources are required for development of the infrastructure and real estate sectors which cannot be met without the involvement of external partners such as SWFs and PFs. While SWFs and PFs are entitled to invest in India in general, and these sectors in particular, through any of the ordinary routes, we have been observing a pronounced preference for REITs and InvITs. REITs and InvITs serve as ideal vehicles for such pools of funds as they combine the following key characteristics:

a. Listed, liquid and regulated securities;

b. Yield products; and

c. Quasi sovereign credit in most cases.

REITs and InvITs bear conceptual similarities to mutual funds in their broad operations and management structures. REITs and InvITs, like mutual funds, pool in money from investors and issue units to the investor and the pooled money is invested further.

InvITs are regulated by InvIT Regulations and are vehicles that utilize the money invested by the investors for further investment into the infrastructure sector and hold income-generating assets, for instance, roads, highways, power, gas pipelines, energy projects, etc. Similarly, REITs are vehicles that are regulated by the REIT Regulations and the money invested by the investors are utilized for further investment into income or revenue generating real estate projects like hotels, hospitals and convention centers, composite real estate projects, etc.

InvITs and REITs, though in nascent stages in India, have already started playing key roles in development of the projects by achieving capital infusion through private players and recycling of funds.

Owing to the promising sectoral growth, less volatility and good returns on investment, InvIT and REITs have been gaining traction and attracting a lot of investments. Approximately, a sum of USD 2.56 Billion was raised by InvITs in the year 2021-22 alone by way of initial offers, preferential issue, rights issue, etc.[3]

1 Report of the Task Force Department of Economic Affairs Ministry of Finance Government of India, Volume I, https://dea.gov.in/sites/default/files/Report%20of%20the%20Task%20Force%20National%20Infrastructure%20Pipeline%20%28NIP%29%20-%20volume-i_1.pdf.

2 Ministry of Finance, Govt. of India, Press Release dated January 31, 2022 https://pib.gov.in/PressReleasePage.aspx?PRID=1793805.

3 K.R.Srivats, All you need to know about InvITs and infrastructure funding, The Hindu Business Line, May 11, 2022, available at, https://www.thehindubusinessline.com/blexplainer/all-you-need-to-know-about-invits-and-infrastructure-funding/article65403672.ece.

However, as enormous public money is involved and invested in InvITs and REITs, the SEBI regulations provide for a well-regulated structure and laws to be followed including the provisions on mechanism of investment, rights and obligations of parties, mandatory distribution of profits, etc., which the paper will discuss in details throughout the following chapters.

Infrastructure Investment Trusts

Infrastructure sector, being capital intensive and with projects having long gestation periods, InvITs are ideal investment avenues for long term investors such as SWFs and PFs. Recognising the potential for investment under this sector, the Government of India, through SEBI promulgated the InvIT Regulations.

Structure and Parties: An InvIT is a trust registered with SEBI in accordance with the InvIT Regulations. It raises funds by issuing units to its investors and invests those funds in assets in infrastructure sector. As on May 10, 2023, there are 20 (Twenty) registered InvITs in India.[4]

Parties: The important parties for an InvIT include:

a. Trustee[5] – A person that holds the assets of the InvIT in trust for benefit of unit holders or investors;

b. Sponsor[6] – A company or an LLP or any other body corporate that sets up the InvIT. A sponsor should hold at least 15% (Fifteen percentage) units of an InvIT after initial offer of units on a post-issue basis for a period not less than three years from date of listing of units;

c. IM[7] – A company or an LLP designated as such and is primarily responsible for investment decisions with respect to the underlying assets or projects of the InvIT including any further investment or divestment of the assets. An IM also oversees the activities of a Project Manager.

d. PM[8] – A company or an LLP which is designated as such by the InvIT and is responsible for execution or management of an infrastructure project and for achievement of all milestones pertaining the same;

e. Holding Company[9] – A company or an LLP in which the InvIT holds or proposes to hold not less than 51% (Fifty One percentage) of the equity share capital or interest and which in turn has made investments in other SPV(s) which hold the infrastructure assets. A holding company cannot engage in any other activity other than holding the underlying SPV or holding infrastructure projects and activities incidental to such holdings;

f. SPV[10] – A company or LLP that is directly responsible for the infrastructure project. An InvIT or a holding company must hold at least 51% (Fifty One percentage) of the equity share capital or interest of an SPV (except in case of public-private partnership projects, where such holding is disallowed by the government or under a concession agreement). At least 90% (Ninety percentage) of assets of an SPV should be directly held in infrastructure projects. It cannot invest in other SPVs or engage in activities other than those pertaining to its underlying infrastructure project.

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4 Registered InvITs, SEBI (as on May 10, 2023), available at https://www.sebi.gov.in/sebiweb/other/OtherAction.do?doRecognisedFpi=yes&intmId=20.

5 Regulation 2(1)(zzb), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

6 Regulation 2(1)(zz), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

7 Regulation 2(1)(zf), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

8 Regulation 2(1)(zp), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

9 Regulation 2(1)(sa), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

10 Regulation 2(1)(zy), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

Investment Conditions and Distributions by InvIT

An InvIT is a growth vehicle and the unitholders invest in such entities in expectation of profits and return of their investment. As the InvIT is a specialized vehicle formed with the intent to invest into infrastructure projects, SEBI provides certain conditions and restrictions pertaining to investments by InvITs to ensure that the object of the InvIT Regulations is not defeated.

a. **Investment Conditions:** An InvIT is permitted to invest only in a holding company, SPV or infrastructure projects or securities in India in accordance with the investment strategy as detailed in the offer document or placement memorandum.[11] If the InvIT has to invest in an infrastructure public private partnership project, then the same has to be routed through the holding company or the SPV.[12]

   In circumstances where the InvIT invests in any infrastructure projects through SPVs, (a) a shareholders'/ partnership agreement has to be entered into between the InvIT and the shareholders/partners of the SPV, wherein such agreement shall specify that the shareholder or partner of the SPV shall not exercise any rights to prevent the InvIT from complying with the InvIT Regulations,[13] (b) the IM shall ensure that in every meeting of the SPV, the voting of the InvIT is exercised.

   In circumstances where the InvIT invests in any infrastructure projects through the Holding company, apart from complying with the aforementioned conditions, the ultimate holding interest of the InvIT in the underlying SPV(s) shall not be less than 26% (Twenty Six percentage).[14]

   Lastly, the InvITs shall: (a) not invest in units of other InvITs;[15] (b) undertake lending to any person other than the holding company or the SPV(s), provided however, investment in debt securities is permitted;[16] and (c) hold an infrastructure asset for a period of not less than 3 (Three) years from the date of purchase of such asset by the InvIT, directly or through holding company and/or SPV.[17]

b. **Distributions by InvIT:**

   i. The manner and quantum of distributions in an InvIT is one of its most remarkable features which attracts many potential investors. The following conditions are placed on the InvIT, the Holding company and SPV regarding distribution of the net distributable cash flows:[18]

      1) not less than 90% (Ninety Percentage) of net distributable cash flows of the SPV shall be distributed to the InvIT /Holding company in proportion of its holding in the SPV, subject to applicable provisions under the CA, 2013 or LLP, 2008;

      2) not less than 90% (Ninety Percentage) of net distributable cash flows of the InvIT shall be distributed to the unit holders;

      3) not less than 90% (ninety percent) of net distributable cash flows generated by the Holding company on its own, shall be distributed by the Holding company to the InvIT. Provided however, the entire cash flows received by Holding company from underlying SPVs shall be distributed to the InvIT;

11 Regulation 18(1), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

12 Regulation 18(2), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

13 Regulation 18(3)(a), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

14 Regulation 18(3A)(a), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

15 Regulation 18(9), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

16 Regulation 18(10), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

17 Regulation 18(11), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

18 Regulation 18(6), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

Further, if any infrastructure asset is sold by the InvIT or Holding company or SPV or if the equity shares or interest in holding company/SPV are sold by the InvIT, then the cash flows generated through such sale shall be distributed as per the above mechanism. Provided however, if the InvIT proposes to reinvest the sale proceeds in other infrastructure projects within a period of the 1 (one) year, then such sale proceeds shall not be distributed.

The distributions from the net distributable cash flows (as mentioned above) shall be declared and made not less than once every 6 (Six) months in every financial year in case of a publicly offered InvITs and not less than once every year in case of a privately placed InvITs.[19] Any amount remaining unclaimed or unpaid out of the distributions shall be transferred to the 'Investor Protection and Education Fund' constituted by the board of the IM.[20]

Real Estate Investment Trust

A REIT is essentially a pool of real estate assets that is structured similarly to a mutual fund and has the potential to provide consistent income. REITs invests its funds in holding and developing real estate properties. As on May 10, 2023, there are a total of 5 (Five) registered REITs in India. The REIT Regulations cover the registration process, the eligibility criteria for all the parties to a REIT and other requirements related to units of a REIT.

Parties

The important parties for a REIT include

a. Trustee – A person that holds REIT's assets in trust for benefit of unit holders;[21]

b. Sponsor – Any person that sets up the REITs and is designated as a sponsor at the time of application made to the Board.[22] A sponsor should hold at least 15% (Fifteen percentage) units of an REIT after initial offer of units on a post-issue basis for a period not less than three years from date of listing of units;[23]

c. Manager – A company or an LLP or body corporate incorporated in India which manages assets and investments of a REIT and undertakes its operational activities.[24]

d. Holding Company – A company or an LLP in which the REIT holds or proposes to hold not less than 50% (Fifty percentage) of the equity share capital or interest. A holding company will in turn make investment in other special purpose vehicles, which ultimately hold the real estate properties. A holding company cannot engage in any activity other than holding the underlying SPV or holding real estate/ properties and activities incidental to such holdings;[25]

e. SPV – A company or LLP that directly holds the real estate / properties. A REIT or a holding company must hold at least 50% (Fifty percentage) of the equity share capital or interest of an SPV (except in case of public-private partnership projects, where such holding is disallowed by the Government or under a concession agreement). Additionally, at least 80% (Eighty percentage) of assets of an SPV should

19 Regulation 18(6)(c), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

20 Regulation 18(6)(e), SEBI (Infrastructure Investment Trusts) Regulations, 2014.

21 Regulation 2(1)(zv), SEBI (Real Estate Investment Trusts) Regulations, 2014.

22 Regulation 2(1)(zt), SEBI (Real Estate Investment Trusts) Regulations, 2014.

23 Regulation 11(3), SEBI (Real Estate Investment Trusts) Regulations, 2014.

24 Regulation 2(1)(w), SEBI (Real Estate Investment Trusts) Regulations, 2014.

25 Regulation 2(1)(qa), SEBI (Real Estate Investment Trusts) Regulations, 2014.

be directly held in properties. Lastly, it cannot invest in other SPVs or engage in activities other than holding and developing property and activities incidental to the same.

Distribution of Monies

The following is a summary of the distribution policy that is outlined in regulation 18(16) of the REIT Regulations. This policy applies to distributions made by the REIT, its holding company, or special purpose vehicles.

a. The REIT or its holding company must receive at least 90% (Ninety percentage) of the net distributable cash flow generated by special purpose vehicles, in proportion to the REIT's or holding company's ownership stake in the special purpose vehicles (subject to applicable provisions of the CA, 2013 and the LLP Act).

b. The following is the minimum amount of net distributable cash flow that a holding company is required to transfer to a real estate investment trust (subject to the rules of the Companies Act of 2013 or the Limited Liability Partnership Act of 2008, as applicable):

   i. A total of 100% (One Hundred percentage) of the cash flow that was received by the holding company from the SPV; and

   ii. With respect to the cash flows generated by the holding company on its own, a total of 90% (Ninety percentage) of such net distributable cash flows.

c. A REIT is required to distribute to its unitholders at least 90% (Ninety percentage) of the net distributable cash flow that it generates each year.

d. A REIT is required to distribute at least 90% (Ninety percentage) of the proceeds arising from the sale of property, equity shares, or an interest in a holding company or a special purpose vehicle, unless the REIT intends to reinvest the proceeds within 1 (One) year.

e. Distributions are required to be made at least once every 6 (Six) months.

If a distribution is not made within 15 (Fifteen) days of a declaration, then the manager shall be liable to pay interest to the unitholders at the rate of 15% (Fifteen percentage) per annum until the said distribution is made. However, such interest shall not be recovered in the form of fees or any other form that is payable to the manager by the REIT.[26]

Alternative Investment Funds

We have also seen SWFs allocating towards AIFs in India. Under the AIF Regulations, SWFs have been have been deemed as an Accredited Investor (**"AI"**) and need not obtain a certificate of accreditation to reap the benefits of an AI status.[27] By virtue of its status as an AI, SWFs are eligible for the following exemptions:

a. Not subject to the minimum investment requirement of INR 10,000,000 (Indian Rupees Ten Million);[28] and

b. Not subject to the minimum grant amount for social impact funds.[29]

26 Regulation 18, SEBI (Real Estate Investment Trusts) Regulations, 2014.

27 Regulation 2 (ab), AIF Regulations.

28 Regulation 10 (c), AIF Regulations.

29 Regulation 16 (4) (a), AIF Regulation.

Likewise, as AIs, SWFs will now be eligible to invest into large value fund for accredited investors ("**AI Fund(s)**") which are AIFs (or schemes therein) where each investor (other than the investment manager, sponsor, employees or directors of the AIF or employees or directors of the investment manager) is an AI and invests not less than INR 70,000,000 (Indian Rupees Seventy Million). Additional exemptions made available for AI Funds are as follows:

a. **Timelines for certain regulatory filings relaxed for AI Funds Filings**

   Unlike conventional AIFs which have to submit their private placement memorandums ("**PPMs**") thirty days in advance to SEBI (via a merchant banker) and incorporate the comments therein to launch scheme, an AI Fund may submit its PPMs at any time to time and isn't required to incorporate SEBI's comments in the concerned PPM.[30]

b. **Extension of tenure beyond two years**

   Subject to the terms of the fund documents that govern the AI Fund, it is permitted to extend its term beyond two years unlike a conventional AIF which has to liquidate (or carry forward) its portfolio after it has exhausted the extension period of two years.[31] The flexibility of extensions protects AI Funds from the risk of having a poor vintage year.

c. **Relaxation of diversification norms**

   As opposed to conventional AIFs which may only invest 25% (category I and category II AIFs)[32] or 10% (category III AIFs)[33] of the investible funds in the a portfolio investment, an AI Fund is permitted to invest up to invest 50% (category I and category II AIFs) or 20% (category III AIFs) of the investible funds, as the case may be, in a single portfolio investment. This flexibility enables SWFs to bet big on its winners.[34]

Additionally, SWFs status as an AI exempts it from the minimum investment threshold of INR fifty lakh while opting for portfolio management services.[35]

30 Regulation 12, AIF Regulations.

31 Regulation 13 (5), AIF Regulation.

32 Regulation 15(1) (c), AIF Regulation.

33 Regulation 15(1) (d), AIF Regulation.

34 The changing contours of AIF regime in India: third amendment regulations, 2021 and proposals, Nishith Desai Associates, http://nishithdesai.com/SectionCategory/33/Funds-Hotline/12/40/FundsHotline/4795/1.html.

35 Regulation 23, SEBI (Portfolio Managers) Regulations, 2020.

Compliances under Competition Law

The Competition Act was promulgated in the year 2002 for the purpose of regulating (i) anti-competitive agreements, (ii) abuse of dominant position and (iii) combinations that are likely to have adverse impact on competition in India.

As the regime on anti-competitive agreements and abuse of dominant positions don't usually come into play in investment transactions, we will be limiting this chapter to a discussion on regulation of combinations. The Combination Regulations set out the manner in which the CCI regulates combinations in India.

Combination

In terms of Section 5 of the Competition Act, a 'combination' involves:

a. acquisition of control, shares, voting rights or assets of an enterprise by a person;

b. acquisition of control of an enterprise where the acquirer already has direct or indirect control of another enterprise engaged in identical business; or

c. merger or amalgamation between or amongst enterprises, that cross the financial thresholds set out in Section 5.

The above provisions are also applicable to the acquisition of units of a REIT or an InvIT.

The financial thresholds for a combination are determined with reference to (i) the combined asset value and the turnover of the acquirer and the target in the event of an acquisition, and the combined asset value and the turnover of the combined resultant company, in the event of an amalgamation or merger, and (ii) the combined asset value and the turnover of the "group" to which the target/resultant company will belong pursuant to the proposed acquisition/merger.

The financial thresholds pertaining to assets and turnover in India, or in India and outside India, for the purposes of determining whether a transaction qualifies as a "combination" are:

a. the acquirer and the enterprise that is acquired, jointly have either (i) in India, (A) assets of value higher than INR 10,000,000,000 (Indian Rupees Ten Billion), or, (B) turnover more than INR 30,000,000,000 (Indian Rupees Thirty Billion); or (ii) in India or outside India, (A) assets of value more than USD 500,000,000 (United States Dollar Five Hundred Million) in aggregate, with at least assets of INR 5,000,000,000 (Indian Rupees Five Billion) in India, or, (B) turnover of more than USD 1,500,000,000 (United States Dollar One Thousand and Five Hundred Million), with at least INR 15,000,000,000 (Indian Rupees Fifteen Billion) in India ; or

b. the group to which the target entity will belong post acquisition, jointly have or would jointly have, either (i) in India (A) assets of the value of more than INR 40,000,000,000 (Indian Rupees Forty Billion) or (B) turnover more than INR 120,000,000,000 (Indian Rupees One Hundred and Twenty Billion), or (ii) in India or outside India, in aggregate, (A) assets of value of more than USD 2,000,000,000 (United States Dollar Two Billion), with at least INR 5,000,000,000 (Indian Rupees Five Billion) in India, or, (B) turnover more than USD 6,000,000,000 (United States Dollar Six Billion), with at least at least INR 15,000,000,000 (Indian Rupees Fifteen Billion) in India.

In addition to the above, any transaction in connection with acquisition of any control, shares, voting rights or assets of an enterprise, merger or amalgamation, the value of which exceeds INR 20,000,000,000

(Indian Rupees Twenty Billion) and where the enterprise being acquired / merged / amalgamated has "substantial business operations in India", will require an approval from the CCI.[1]

For determination of existence of combination, as mentioned above, a "group" of enterprises includes an enterprise that directly or indirectly,

a. have 26% (Twenty Six percentage) or more of the voting rights in the other enterprise; or

b. can appoint more than 50% (Fifty percentage) of board members other enterprise: or

c. control the management or affairs of the other enterprise.

Further, "control" refers to material influence over management, affairs or strategic commercial decisions[2] by:

a. one or more enterprises, jointly or singly, over another enterprise or group;

b. one or more groups, jointly or singly, over another group or enterprise.

De-minimis Exemptions to Combination[3]

Enterprises that are party to any form of combination as described above, but, where the value of assets of the acquired/to be acquired entity or the merged entity is not more than INR 3,500,000,000 (Indian Rupees Three Billion Five Hundred Million) in India or turnover is not more than INR 10,000,000,000 (Indian Rupees Ten Billion) in India, are exempted from provisions of Section 5 of the Competition Act.

Green Channel

The CCI had initially, through insertion of Regulation 5A to the Combination Regulations in the year 2019, introduced an automated approval system for certain transactions that do not have or are at risk of having appreciable adverse effect on competition in India. This Green channel route, which was brought into effect on August 15, 2019, was introduced in furtherance of ease of doing business initiatives of the Government of India, with the aim to provide a faster review and disposal of combination transaction.

To avail of the benefit of the green channel route, the qualifying criteria is that the parties to the combination, their group entities and each of their, direct or indirect investee entities (even an investment of a single share in a company shall make such company an investee entity) should: (i) not produce/provide similar or identical or substitutable product or service or; (ii) not engage in any activity relating to production, supply, distribution, storage, sale and service or trade in product or service which are at different stage or level of production chain or; (iii) not engage in any activity relating to production, supply distribution, storage, sale and service or trade in product or service which are complementary to each other.[4]

Once the form filed under the system is acknowledged, the combination transaction is deemed approved and can be completed immediately.

1 As included through the Competition (Amendment) Act, 2023, which will be brought into effect on such date as may be notified by the Central Government in the Official Gazette of India.

2 Earlier defined in terms of "controlling affairs or management", which has been revised through the Competition (Amendment) Act, 2023, and will be brought into effect on such date as may be notified by the Central Government in the Official Gazette of India.

3 Notification No. S.O. 998(E) dated March 27, 2017.

4 Schedule III, Competition Commission of India (Procedure in regard to the transactions of business relating to combinations) Regulations, 2011.

Conclusion: The Way Forward

In conclusion, SWFs and PFs are important vehicles of international funding in the modern globalized economy. The long-term investment horizons and the healthy risk appetite by SWFs ensure that they are not fair-weather friends – cementing their status as reliable pools of foreign capital. This further underlines the importance of SWFs for a developing capital-hungry economy like India.

Further, India is also an attractive investment destination for SWFs due to its independent judicial system, political stability, and demographic constitution in addition to the attractive returns that it provides investors. Thus, in order to achieve the USD 5 Trillion GDP by the year 2025, active participation of SWFs and PFs in India is essential in the coming years, and we expect the Indian regulatory regime to continue to roll out the red carpet for SWFs and PFs.

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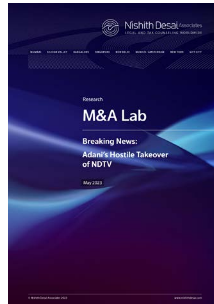

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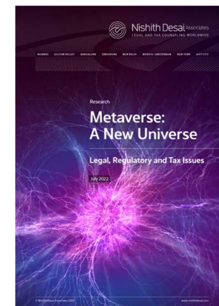

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