



# TAX FLASH NEWS

## Foreign investment allowed in AIFs, REITs and InvITs under automatic route

### Background

In line with what the Finance Minister had indicated in his Union Budget speech in February 2015, the Cabinet issued a Press Release dated 6 May 2015<sup>1</sup> wherein an approval was accorded to Real Estate Investment Trusts (REITs) as eligible financial instruments/structures under the Foreign Exchange Management Act, 1999 (FEMA).

The Reserve Bank of India (RBI) vide its notification dated 16 November 2015<sup>2</sup> (the Notification) has allowed foreign investment to be carried out in investment vehicles registered and regulated under the respective regulations framed by the Securities and Exchange Board of India (SEBI) or any other relevant regulating authority, and also includes Alternative Investment Funds (AIFs), REITs and Infrastructure Investment Funds (InvITs) by persons resident outside India, including Registered Foreign Portfolio Investors (RFPIs) and Non-Resident Indians (NRIs).

### Key amendments

Vide the notification, the RBI has amended certain provisions of the Foreign Exchange Management (Transfer or Issue of Securities by Persons Resident in Outside India) Regulations, 2000 (the Regulations). Schedule 11 has now been inserted in the Regulations. The key amendments in this regard are as follows:

- Foreign investors (including RFPIs and NRIs) are allowed to invest in units of investment vehicles such as AIFs, REITs and InvITs under the automatic route. However, citizens of or entities incorporated in Pakistan or Bangladesh are not permitted to make investments under this route.

<sup>1</sup> <http://pib.nic.in/newsite/PrintRelease.aspx?relid=121308>

<sup>2</sup> Notification No. FEMA. 355/2015-RB

- Units acquired under Schedule 11 can be sold, transferred or redeemed as per the regulations framed by SEBI or directions issued by the RBI.
- If neither the sponsor nor the manager/investment manager is Indian owned and controlled, then downstream investments by such an investment vehicle shall be regarded as a foreign investment.
- Ownership and control of such an investment vehicle would be determined *qua* the sponsor and the manager/investment manager i.e. the extent of foreign investment in the corpus of the investment vehicle shall not be relevant to determine whether a downstream investment by the investment vehicle is a foreign investment or not.
- In case the sponsor and the manager/investment manager are individuals, the downstream investment by such an investment vehicle would be treated as domestic investments if both of them are resident Indian citizens.
- Limited Liability Partnerships (LLPs) have been excluded from acting as a sponsor or manager/investment manager of an investment vehicle.
- A downstream investment by a foreign owned and controlled investment vehicle would need to be compliant with the sectoral caps and conditions as laid down in the FDI policy.
- A downstream investment in an LLP by a foreign owned and controlled investment vehicle would need to be compliant with the relevant FEMA regulations and FDI policy.
- Portfolio investments by foreign owned and controlled Category III AIFs can be made in only those securities or instruments that are permitted for RFPIs.

- An investment vehicle receiving the foreign investment shall submit reports to the RBI/ SEBI as may be prescribed from time to time.

## Our comments

The above highlighted liberalisation measures are expected to benefit the private equity/venture capital industry in India and help foreign investors to invest directly in Indian pooling instruments rather than routing their investments through foreign pooling vehicles.

As per the Notification, LLPs cannot act as a sponsor or manager/investment manager of an investment vehicle, since the ownership and control of an LLP cannot be determined under the extant FDI Policy. However, subsequent to the release of the Notification, the Department of Industrial Policy and Promotion (DIPP) has, *vide* Press Note 12 dated 24 November 2015, defined Indian ownership and control in case of LLPs. The RBI might take this recent amendment into account and consider allowing LLPs to act as a sponsor or manager/investment manager of an investment vehicle.



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