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## Legal Framework related to Alternative Investment Funds

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*The “SEBI (Alternative Investment Funds Regulations), 2012”<sup>1</sup> or the “AIF Regulations” permitted an Alternative Investment Fund (hereinafter “AIF”) in order to be incorporated as a trust, corporation, limited liability partnership (hereinafter “LLP”), or another form of legal entity or a corporate body. Before the reception of the “Finance Act, 2015”<sup>2</sup>, a wide range of AIFs had been not conceded tax passes in the form of rank merely on the basis of their position as SEBI registered AIFs, which was a significant step forward. AIFs were established as “determinate, private trusts” for a variety of reasons, including the ability to take advantage of tax go because of rank (that is the overall degree for tax collection from venture assets) under the guidelines of trust tax assessment. According to the Finance Act of 2015, a separate tax goes through for Category I as well as Category II AIFs was added into the Indian “Income Tax Act of 1961”<sup>3</sup>, independent of the lawful construction in which such AIFs were set up. This can't be in a way that may reduce the worth of a trust construction for AIFs in our country. This is since, “while companies and LLPs are subject to numerous governance and compliance requirements under the Companies Act, 2013 and the LLP Act, 2008, it provides the management team with the ability to incorporate bespoke terms of governance for an AIF that is set up as a trust, as may be agreed between the GP and the investors.” This article discusses the current Indian legal framework regarding AIFs.*

**Keywords:** *investment, funds, SEBI, AIF.*

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<sup>1</sup> Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012

<sup>2</sup> Finance Act, 2015

<sup>3</sup> Income Tax Act, 1961

## INTRODUCTION

It is controlled by the *Indian Trusts Act, 1882*,<sup>4</sup> which establishes the formation and administration of private trusts in our country, which are believed whose recipients are known as well as who are not individuals from the overall population or a class of individuals from the overall population at large (*hereinafter* "Trusts Act"). As a practical matter, however, the Trusts Act does not serve as a full guide to the activities of one private Indian trust. Subsequently, Indian courts might as well have utilized customary law standards of trust law to the extent that they are not clashing with the arrangements of the Trusts Act. There are several legal concerns to be taken into account when utilizing a trust for an AIF since it doesn't have a particular legitimate character, such as a corporation or a limited liability partnership (LLP) - that is, the trust does not have the authority to sue or be sued in its own right. It is represented by its trustee, who, as the lawful proprietor of the trust property, has the primary authority to sue or be sued on the trust's behalf. An irrevocably established, determinate trust has been determined to be the most suitable kind of trust for an AIF. This is because, "the determinacy of the trust is one of the conditions for the applicability of tax pass-through under trust taxation principles (in the unlikely event that the special tax pass through granted to Category I and Category II AIFs is revoked), and since 'irrevocability of settlement' ensures that the settlor of the AIF does not have the authority to revoke the trust and that the trust will continue until its purpose is served"<sup>5</sup>, this stems from traditional trust taxation principles.

When attempting to accomplish "determinacy", the AIF should make sure that its financial backers, as well as their helpful attentiveness, are capable of being determined or limited as compared to the conditions of the "trust deed" that establishes the AIF as a trust consistently over the course of the trust's existence. An optional trust, then again, gives the legal administrator the power to choose the helpful interest of the beneficiaries as well as the timing of distributions.

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<sup>4</sup> Indian Trusts Act, 1882

<sup>5</sup> L.C. Gupta, 'Challenges before Securities and Exchange Board of India' (*JSTOR*, 23 March 1996) <<https://www.jstor.org/stable/4403941>> accessed 10 November 2021

The following are the critical occasions in an AIF's life as a venture store, which is formed as a trust:

**Formation and Registration:** In contrast to a corporation or a limited liability partnership (both of which fall inside the ambit of the Ministry of Corporate Affairs), there is no free administrative substance that is answerable for the endorsement as well as guideline of trusts. The agreement of trust or trust deed, which is performed by the settlor as well as the legal administrator, is the only document that governs the establishment of a trust. The settlor (as the 'creator' of the trust) is expected to form trust with an underlying settlement total, which should be conveyed to the imminent legal administrator once the trust has been established and settled. The first settlement amount serves as the basis for calculating the 'remuneration sum' in order to establish the trust. "Whereas a trust may have its board of trustees, the trustee in the context of an AIF is often an independent institutional trustee, who agrees to offer trusteeship services to the AIF in exchange for a fee."<sup>6</sup>

"While it is not mandatory to register private trusts in general, the AIF Regulations require that the trust deed of the AIF be registered under the Indian Registration Act, 1908, in order for the AIF to be effective."<sup>7</sup> A previous appointment must be made alongside the sub-registrar of the important locale for the implementation of the trust deed to occur within the sight of the sub-recorder, two observers, and a stamp paper bearing the necessary stamp duty to be used in the execution (contingent upon the purview). The technique is clear and less tedious than submitting and getting an endorsement on the charter papers of the organization or limited liability partnership (LLP) alongside the registrar of companies or limited liability partnership (LLP), as appropriate.

**Appointment of the Manager:** It is recommended that the AIF trustee engages in a counterparty concurrence with the forthcoming director of the AIF, which would appear as an

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<sup>6</sup> Jitendra Soni and Kanad Bagchi, 'Crowdfunding in India: A Tale of Misplaced Regulations' (*JSTOR*, 29 November 2014) <<https://www.jstor.org/stable/24481069>> accessed 10 November 2021

<sup>7</sup> Kun Young Chang, 'The Effective Regulation of Transnational Securities Fraud in Global Markets' (*JSTOR*, December 2005) <<https://www.jstor.org/stable/43107122>> accessed 10 November 2021

'investment management agreement.'<sup>8</sup>Since the supervisor is just a counterparty specialist organization to the AIF, as opposed to being on the governing body of an AIF, which could be a corporation, or then again being an assigned accomplice of an LLP, a trust structure allows for the separation of the chief's responsibility (counting from a trustee and break of asset records viewpoint) from that of the AIF. Independently, from a taxation standpoint, the pay of the director as a specialist co-op is clearly distinguished from its support responsibility and benefit partaking in the AIF as a convey recipient, taking into account more inventive convey organizing options.<sup>9</sup>

**Contributions:** It is permissible for trusts to accept contributions from anyone other than the original settlor under the terms of the Trusts Act. In accordance with the contributory model of trusts, the financial backers in an AIF go into a legitimately official concurrence with the AIF's legal administrator (following up for the AIF's sake) and the AIF's supervisor, consenting to contribute a particular add up to the AIF as per the agreements laid out in the AIF's governing archives. This section will cover the contractual concerns and interactions that exist between the many agreements that are signed by the investor, trustee, and management of an AIF, among other things. In the case of a corporation, ideas such as share allocation, application money, and so on are regulated notions that must be adhered to in accordance with the Companies Act, 2013<sup>10</sup>.

**Issuance of Units:** For the units of an AIF, there is no legal need that a 'unit certificate' be generated or lodged with any government agency. The Trustee, via the Investment Manager, has the ability to give a statement of account to any LP who requests one.

**Investments:** Following the Trusts Act<sup>11</sup>, a trust's trustee is authorised to infuse the trust's assets in accordance with the stipulations of the deed of the trust. In the case of an AIF, the trustee might transfer significant sections of its range and responsibilities to the supervisor

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<sup>8</sup> Jayati Sarkar, 'Board Independence & Corporate Governance in India: Recent Trends & Challenges Ahead' (JSTOR, April 2009) <<https://www.jstor.org/stable/27768232>> accessed 10 November 2021

<sup>9</sup> *Ibid*

<sup>10</sup> Companies Act, 2013

<sup>11</sup> Trusts Act (n 4)

under the conditions of the investment management arrangement (except for those prohibited by relevant legislation). Therefore, the management is authorised to make all investment choices on the AIF's behalf, as well as for the benefit of the AIF.<sup>12</sup> The AIF's indenture, read in conjunction with the investment management agreement, governs the signing of papers with its investee firms. The manager must possess the necessary permission from the legal administrator to consent to venture arrangements for the benefit of the AIF since the legal administrator is the legitimate proprietor of the AIF's resources under the particulars of the AIF's operating agreement (counting any ventures).

**Compliance / Monitoring:** The Trustee is responsible for ensuring compliance with the AIF Regulations, for which it forces pertinent cutoff points under the Fund Documents (for instance, consistency with the need to provide an exit method to investors when there is a major change in the PPM).<sup>13</sup> The Investment Manager, on the other hand, is responsible for the Fund's commercial activities (such as withdrawals, distributions, notifications, and voting procedures), which are under his or her control.

**Liquidation:** Similarly, the trust's liquidation process is authorised to be guided solely by its trust deed, with only the bare minimum of legislative interference. At the point when an AIF is formed as a trust, the AIF Regulations should likewise be continued for the AIF to be wound up successfully. The AIF is obliged to be sold within one year of the termination of its term except if the financial backers in the AIF concur (the limit for such assent isn't specified in the AIF Regulations). From the point of view of good administration and consistency, the liquidation technique ought to be created and settled upon by all financial backers preceding the fund documents being sent to investors.

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<sup>12</sup> Vijay Sambamurthi, 'Recent Developments in Indian Law: Impavt on Private Equity Transactions' (*Manupatra*) <<http://docs.manupatra.in/newsline/articles/Upload/754A95A7-8144-48CE-903B-80C8F93287D1.pdf>> accessed 10 November 2021

<sup>13</sup> 'Capital Markets and Securities Laws' (*ICSI*, October 2017) <<https://www.icsi.edu/media/webmodules/publications/CapitalMarketandSecuritesLaw.pdf>> accessed 16 January 2022

## CURRENT LEGAL FRAMEWORK

- *Enforceability and Interplay of Fund Documents*

In most cases, reserves are set up in an authoritative document that permits the fundamental fund terms to be consolidated in the fund's contract papers, with just a few special conditions for select investors (that are not hurtful to different financial backers) being settled upon in isolated side letters. Such sanction arrangements are endorsed by the entirety of the fund's investors, as well as the fund and the management, and serve as legal documentation.<sup>14</sup> A good illustration of this construction is the restricted organization structure utilized in Delaware, where the restricted partnership agreement incorporates all of the important conditions about the fund. The aforementioned approach is followed worldwide for funds since all financial backers are expected to be qualified for equivalent admittance to legally binding remedies in the event of lawsuits against the fund originating from the fund's conditions, regardless of where they invest. There are just a few provisions agreed to in the side letter, all of which would need an individual case against the fund or the management and would not have an influence on the fund's activities in relation to other investors.<sup>15</sup>

The indenture of trust, which serves as the trust's charter instrument, may only be signed by the settlor and the trustee and is not performed by anyone else. Supporters of the funds don't have the authority to 'sign the trust deed. The agreement of trust, which serves as the AIF's charter instrument, is communicated with all of the fund's investors and is also disclosed with the Securities and Exchange Board of India (SEBI).<sup>16</sup> The Contribution Agreement for every Contributor is ordinarily not imparted to different Contributors since that incorporates portrayals and guarantees that are individual to each Contributor and so should not be shared with other Contributors as well. The Investment Management Agreement, as previously

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<sup>14</sup> Nagaraj Rayaprolu, 'Foreign Direct Investments in India in the 1990s: Trends and Issues' (*Research Gate*, January 2003) <[https://www.researchgate.net/publication/262123418\\_Foreign\\_Direct\\_Investment\\_in\\_India\\_in\\_the\\_1990s\\_Trends\\_and\\_Issues](https://www.researchgate.net/publication/262123418_Foreign_Direct_Investment_in_India_in_the_1990s_Trends_and_Issues)> accessed 10 November 2021

<sup>15</sup> *Ibid*

<sup>16</sup> Nandini Pathak and Richie Sancheti, 'Trusts as AIFs in India: Legal Considerations' (*Mondaq*, 01 May 2019) <<https://www.mondaq.com/india/trusts/802112/trusts-as-aifs-in-india-legal-considerations>> accessed 16 January 2022

described, is a counterparty agreement between two parties. As previously explained, in order to accomplish worldwide principles on reserve documentation, the arrangement of trust is much of the time viewed as an AIF's likeness a restricted partnership agreement, with all conditions of the fund that are expected to be restricting being joined into the agreement of trust itself. Anyway, from a contract legal viewpoint, the design of an 'all encompassing' indenture of trust necessitates specific concerns, that should be considered as well as communicated to all applicable parties previous to the initiation of fund paperwork. Due to the fact that Contributors are not considered as parties to the agreement of trust, there is much speculation as to whether or not the Contributors will be able to uphold the arrangement of trust. The law of privity of agreements (as it is regularly deciphered in precedent-based law countries) gives that an individual who isn't involved with an agreement isn't permitted to bring a case for infringement of that agreement against the other party. Beneficiaries of a trust, however, are authorised to bring a claim for breach of trust under the law of privity of contracts because of an exemption from the law of contract. This idea has been affirmed by Indian courts on several occasions. Because of this, the Contributors (despite the fact that they are not signatories to the understanding of trust) are on the whole similarly qualified to state a case under the details of the trust deed.<sup>17</sup>

If you want to guarantee that your trust papers are easy to enforce, make sure that the interaction between the arrangement of trust, investment executives' understanding, commitment understanding, and PPM is determined in each of them. For example, "the investment manager is not a party to the indenture of trust, and most investors would prefer that all commercials be incorporated in a document that is signed by the investment manager (as the majority of claims are likely to be raised against the investment manager) – in order to ensure that all documents co-exist in harmony". The Contribution Agreement must contain the necessary provisions to ensure that all documents co-exist in harmony with one another. In India, unlike in a number of other countries, the PPM of an AIF is considered legally binding. "AIF Regulations state that (i) SEBI reviews the PPM before considering an application for registration of a proposed AIF; (ii) all investors are expected to have read, understood, and

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<sup>17</sup> Capital Markets and Securities Laws (n 13)

agreed to the terms of the PPM before investing in the AIF; and (iii) any changes to the PPM must be approved by a majority vote of the AIF investors.”<sup>18</sup>

The PPM is often cited as an example of a document that ought not to be remembered for the meaning of “Fund Papers” as controlling records of the AIF since it is an “unsigned marketing document.” Nonetheless, regardless of whether the PPM is excluded from the meaning of Fund Documents for an AIF, it is required (by the righteousness of the AIF Regulations) that every financial backer in the AIF recognizes that the person in question has perused, comprehended, and agreed to invest according to the terms and conditions pre-decided in the PPM before investing. A correctly designed PPM for AIFs has a more noteworthy legitimate importance than in most different nations (i.e., from the viewpoint of raising support, yet in addition according to the point of view of proceeding with reserve tasks), and the risk of “misselling” might be kept away from by utilizing an appropriately planned PPM for AIFs.

- *Arbitrability of trust disputes*

“Vimal Shah & Ors. vs Jayesh Shah & Ors.<sup>19</sup>: The Supreme Court of India has held that disputes arising between beneficiaries or trustees of a trust cannot be referred to arbitration because an arbitration clause contained in a Trust Deed is not an arbitration agreement between the trustees inter se, between the beneficiaries inter se, or between the trustees and the beneficiaries for the purposes of the Arbitration & Conciliation Act, 1996. According to the AIF Regulations, the method for dispute resolution for an AIF, whether by arbitration or any other mechanism, shall be jointly negotiated and agreed upon by the investors and the AIF before it is implemented.”<sup>20</sup> The debate resolution system in the trust plan and the Contribution Agreement are both expected to guarantee that the asset administrative work for

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<sup>18</sup> Srishti Chhabra and Nandini Pathak, ‘The Changing Contours of AIF Regime in India: Third Amendment Regulations, 2021 and Proposals’ (*The National Law Review*, 9 September 2021) <<https://www.natlawreview.com/article/changing-contours-aif-regime-india-third-amendment-regulations-2021-and-proposals>> accessed 16 January 2022

<sup>19</sup> *Vimal Shah & Ors. v Jayesh Shah & Ors* [2016]

<sup>20</sup> Arbitration & Conciliation Act, 1996

an AIF (which is formed as a trust) meets the business demands of the AIF while also taking into consideration the aforementioned legal reality.

## CONCLUSION

It is critical to realize that each fund needs customised fund paperwork based on factors such as the targeted asset class, the kind of financial backers, the locale of fuse, as well as the jurisdiction of ventures. In this aspect, market practice is similarly in a state of flux.