

Alternative investment funds (AIFs)

- ❖ **Alternative Investment Fund** is a special investment category that differs from conventional investment instruments like stocks, debt securities etc.
- ❖ Alternative Investment Fund is a privately pooled investment vehicle that collects money from sophisticated private investors. Generally, Institutions, Ultra HNIs and HNIs invest in AIFs as substantial investments are required.
- ❖ AIFs include private equity, venture capital, hedge fund and angel fund etc.
- ❖ These investment vehicles adhere to the SEBI (Alternative Investment Funds) Regulations, 2012. AIFs can be formed as a company, Limited Liability Partnership (LLP), trust, etc.

WHY AIF?

The financial market in India is evolving at a rapid pace, as there is a rising trend of HNIs looking beyond traditional investment avenues like real estate, gold, fixed deposits as well as mutual funds. HNIs are increasingly seeking personalized solutions that can help diversify and grow their wealth at a much higher rate than commonly available investment options. This is where Alternative Investment Funds (AIF) and Portfolio Management Services (PMS) come in.

Features of AIF are as follows,

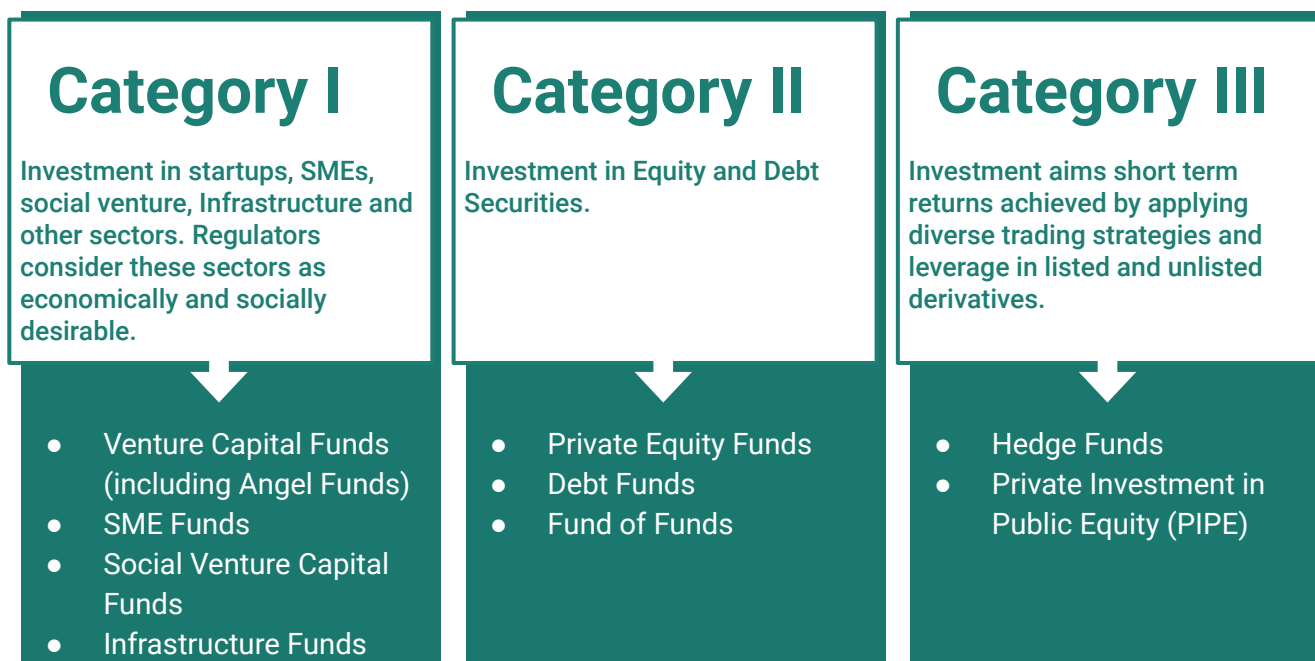
- ❖ Higher degree of flexibility in relation to traditional asset classes.
- ❖ Better returns with higher risk.
- ❖ Provides diversification as a result low correlation.
- ❖ Provides investment opportunities in unlisted companies and real estate projects.
- ❖ Provides structured products with capital protection along with appreciation.

History of AIF & Current Market Scenario

- ❖ In India, AIFs as a distinct asset class began only after SEBI passed its 2012 regulations.
- ❖ Edelweiss Alpha Fund was the country's first AIF, launched in June 2013, followed by DSP BlackRock Enhanced Equity Fund in May 2014.
- ❖ Indian AIF industry (alternative investment funds) is standing at Rs 8.33 lakh crore commitments raised as on 31st March 2023, an incredible 10 times growth in the past 6 years.
- ❖ According to SEBI, there are more than 1000 registered AIFs in India right now.
- ❖ The Union Cabinet too had approved the creation of an Alternative Investment Fund of Rs. 25,000 crores to revive affordable housing projects.

AUM across different asset class			
Indian AIF Industry	Rs. in Crores		Growth (in times)
	31-Mar-2017	31-Mar-2023	
Commitments Raised	84,304	833,774	9.89
Funds Raised	40,956	365,609	8.93
Investments Made	35,099	337,983	9.63
Other categories			
PMS (AUM)	1,042,097	2,773,822	2.66
Mutual Funds (AAUM)	1,830,546	4,051,147	2.21

Types of Alternative Investment Funds



Category I AIF and Category II AIF are close-ended funds with a minimum tenure of three years. However, Category III AIFs have an option to be open-ended in nature. Suppose a Category III AIF is an open-ended fund then in that case, an investor can subscribe to it anytime during the tenure of the fund

Who is Eligible to Invest in AIF?

- ❖ Resident Indian individuals, Non-Resident Indians (NRIs) and foreign nationals can invest in alternative investment funds.
- ❖ Also, there is a cap on investment by each investor. The minimum investment permitted is **₹1 crore**. For angel investors, the minimum investment is **₹25 lakhs**.
- ❖ There is no minimum or maximum prescribed limit for investment by an **accredited investor**. It will usually depend on the limits and caps set by each investment vehicle.
- ❖ For directors, employees and fund managers of the AIF, the minimum amount is ₹25 lakhs.
- ❖ AIFs come with a minimum lock-in period of three years except Category III.
- ❖ The number of investors in every scheme is restricted to 1000, except angel funds, where the number of investors go up to 49.
- ❖ To invest in an AIF you must provide proof of income, PAN card and ID proof.

Taxation of Alternative Investment Funds

Taxation for Category I & II		
Nature of income earned by the fund	Taxability	Tax Rate
Other than business income including Capital Gains	Pass through - AIF does not pay tax. Investor pays tax.	Tax Rates applicable as per Investor's tax slab
Business income	Taxed at AIF, such income is not taxable to unit holder.	AIF formed as company or LLP, Taxed at the rates applicable to company or LLP. AIF formed as Trust, Taxed at Maximum Marginal Rate of 39%

Taxation for Category III			
Nature of income earned by the fund	Basic Tax	Surcharge & Edu. Cess	Tax Rate
Long Term Capital Gain - Equity	10%	15% + 4%	11.96%
Short Term Capital Gain - Equity	15%	15% + 4%	17.94%
Business/Dividend / Interest/ Debt Income	30%	25% + 4%	39%

Benefits of Alternative Investment Funds

PROS	CONS
Flexibility offered is higher than MFs as allowed to invest in unlisted shares and use shorting and leverage	High Investment Amount , out of reach of small investors
Low volatility as funds not put in investment options that trade frequently hence not related to broader market fluctuations	Tax Disadvantage as no tax concessions
AIFs allocate their funds to wide array of assets significantly higher than other investment vehicles which leads to excellent portfolio diversification and safeguards your investments in time of market volatility	Funds are complex in nature , hence due diligence required before deciding fund
High return potential as they offer numerous investment options, better source of passive income compared to conventional investment instruments, less prone to fluctuations as schemes not linked to stock market	Distribution in India remains expensive and complicated despite tremendous growth

At the end, if Investors are looking for a more professionally managed portfolio that can help them diversify and grow their existing wealth at a higher rate by taking a higher risk, then Investors should consider investment in AIF.

Sources:- SEBI, Economic Times & other public news articles

SEBI Regulation for AIFs

Over the years, the Securities and Exchange Board of India (SEBI) has implemented some AIF investment restrictions that individuals must know before investing in these schemes. Some of them are:

- ❖ An AIF can launch schemes subject to the filing of the placement memorandum with SEBI. Furthermore, prior to the launch of the scheme, an AIF has to pay ₹1 lakh as scheme fees to SEBI while filing the placement memorandum. Such a fee has to be paid at least 30 days prior to the launch of the AIF scheme. However, payment of scheme fees does not apply if it is the launch of the first scheme by the Alternate Investment Fund (other than angel fund) and to angel funds.
- ❖ An AIF cannot launch a scheme or fund of any size. Each scheme of the Alternative Investment Fund (other than angel fund) should have a corpus of **at least ₹20 crore**. In the case of an angel fund, it should have a corpus of at least **₹10 crore**.
- ❖ Angel funds raise funds by issuing units to angel investors. Also, angel funds accept investments not less than ₹25 lakhs from an angel investor for a maximum period of three years.
- ❖ Sponsor(s) is a person(s) who has established the AIF. In the case of a company, a promoter is the sponsor. In case of a Limited Liability Partnership, a designated partner is the sponsor.

Category I	Category II	Category III
The sponsor/manager will contribute an amount not less than 2.5% of the corpus or ₹5 Cr, whichever is lesser. Also, for angel investors, this amount will be not less than 2.5% of the corpus or ₹50 lakhs, whichever is lesser.	The sponsor/manager will contribute an amount not less than 2.5% of the corpus or ₹5 Cr, whichever is lesser.	The sponsor/manager will contribute an amount not less than 5% of the corpus or ₹10 Cr, whichever is lesser.
Not permitted to invest more than 25% of its investible funds in a single investee company directly or through investments in units of other AIFS	Not permitted to invest more than 25% of its investible funds in a single investee company directly or through investments in units of other AIFS	Not permitted to invest more than 10% of its investible funds in a single investee company directly or through investments in units of other AIFS
May invest in investee companies or venture capital undertaking or in special purpose vehicles or in limited liability partnerships or in units of other AIFs as specified in the regulations	Shall invest primarily in unlisted investee companies directly or through investment in units of other AIFs	May invest in securities of unlisted or unlisted investee companies
May not borrow funds directly or indirectly	May not borrow funds directly or indirectly	Can borrow to invest and can currently borrow up to 200% of the fund size.
Shall not engage in leverage except for meeting temporary funding requirement for not more than 30 days not more than 4 times in a year and not more than 10% of the investible funds	Shall not engage in leverage except for meeting temporary funding requirement for not more than 30 days not more than 4 times in a year and not more than 10% of the investible funds	The leverage shall not exceed 2 times of the NAV of the fund.