

## #2: REPRESENTATION TO SEBI ON SOCIAL VENTURE FUND GUIDELINES IN ALTERNATE FUND INVESTMENT REGULATIONS (AIF), 2012

A favorable policy environment for impact investors necessarily precludes clarity on the exact structure of the investment vehicles impact investors should adopt and the tax implications of the structure. While there are no direct regulations in place for impact investors in India, IIC looks to address ambiguities in two areas that are related to impact investing. These are:

1. Definitional Clarity of Social Venture Fund Guidelines
2. Tax implications for Social Venture Funds

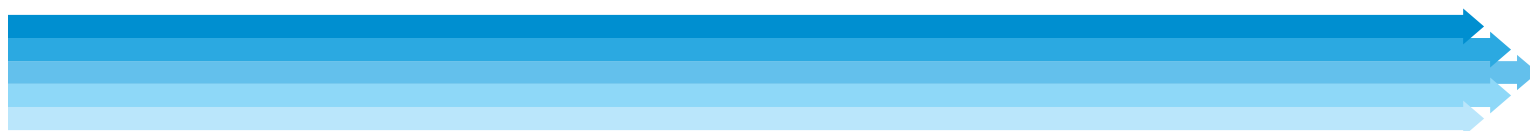
### 1. Definitional Clarity of Social Venture Fund Guidelines

Impact investors can currently adopt a Social Venture Fund (SVF) legal entity under Category I of SEBI's Alternate Investment Fund (AIF) Regulations. A *Social Venture Fund (SVF)* is an AIF that invests 75% or more of its corpus in unlisted securities or partnership interest of social ventures that satisfy social performance norms defined by the fund. The fund may accept from and give grants to social ventures and may accept restricted or muted returns.

- **Definition of Social Venture:** Currently a “social venture” is defined as a trust, society, company, venture capital undertaking or limited liability partnership formed with the purpose of promoting social welfare or solving social problems or providing social benefits and includes,- (i) public charitable trusts registered with Charity Commissioner; (ii) societies registered for charitable purposes or for promotion of science, literature, or fine arts; (iii) company registered under Section 25 of the Companies Act, 1956; (iv) micro finance institutions.

This definition of Social Venture is limiting as social ventures are commonly associated with not-for-profit entities. However, majority impact investments have been made in for-profit enterprises that address social problems. Suggested legal structure for Social Ventures currently are predominantly not-for-profit entities such as charitable trusts, societies, Section 25 companies etc. and a few for-profit structures such as venture capital undertakings. It is therefore important that the current scope of definition of the term ‘Social Venture’ be broadened. There is also a need to clearly delineate the specific enterprises that constitute those promoting social welfare or solving social problems or providing social benefits. Additionally, in order to ensure standardization it is important to define the social performance norms that these social ventures should satisfy

- **Social Performance Norms:** The SVF definition states that social ventures should satisfy performance norms defined by the fund. However, there are no guidelines on what these suggested norms could be. This is not surprising as world over, there has been no agreement yet on the most appropriate ways to measure “social impact”. However, it is important to clarify the expected performance norms else each individual fund can adopt norms to suit their own interests. This can also adversely impact the social ventures landscape with greater flow of capital towards ventures that confirm to the specific standards set by individual funds. As the nodal agency for impact investments, IIC would like to undertake an exercise to define national standards for social impact measurement and we have engaged with Prof. (Dr.) Abhijit Banerjee of MIT, a noted economist and famed



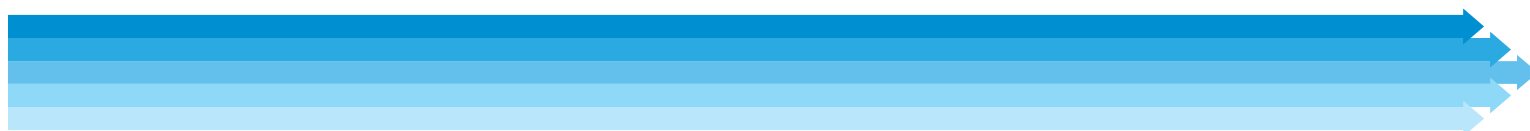
author of “Poor Economics” who is perhaps the pre-eminent authority on the subject. We are hoping to build standards, which are applicable across social enterprises, NGOs and non-profits, CSR programs as well as Government’s welfare programs (e.g., SSA or MNREGA). We very much hope Government can join in this initiative.

- **Muted/ Restricted Returns:** It is suggested that an SVF may accept restricted or muted returns, though SEBI does not provide a rationale as to why this should be the case or what the definition of muted returns itself is. Adopting a return-based definition is limiting and could deter mainstream capital from turning towards impact investing. Impact investors take on higher risk than mainstream investors due to the nature of the geographies and sectors that they operate in– they should be compensated for this risk by ability to accept similarly high returns. However, it is a well-known fact that many IIC members are as a policy, seeking impact first. Therefore, each individual SVF should be able to structure their own risk-return profile and thus, the muted returns constraint on SVFs should be revoked.

## 2. Tax Implications for Social Venture Funds

Social Venture Funds fall under Category I of the AIF Regulations. *Category I funds are those that invest in start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable. These are Alternative Investment Funds which are generally perceived to have positive spillover effects on economy and for which the Board or Government of India or other regulators in India might consider providing incentives or concessions.* The AIF guidelines further clarify that *such funds which are formed as trusts or companies shall be construed as a Venture Capital Company or a VCF as specified under sub-section (23FB) of Section 10 of the Act.*

- **Tax-pass through status:** Section 10 (23FB) of the Income Tax Act, 1961 affords a “tax pass through” to all Venture Capital Funds (VCF) registered under the erstwhile VCF Regulations. Post the change of regulations to the pass-through status should be applicable to Category I AIFs– VCFs are a subset of Category I AIFs. However, given the current wordings of the provisions, Category I AIFs that do not fall under the sub-category of VCFs and are not eligible for a tax pass through. The current restriction on the tax pass-through status does not incentivize investors registering as SVFs. We request you to revisit this since only a handful of funds have registered as SVFs to date.
- **Tax benefits:** The aim of the AIF guidelines is to support structures that create a positive spillover effect on the economy. The guidelines also state that the regulator may consider providing incentives or concessions to such funds that are able to generate these positive spillover effects. Social Venture Funds by virtue of investing in social ventures promote economic growth and job creation at the Bottom of the Pyramid. Thus in addition to clarifying the status on existing benefits such as tax-pass through there is a need to identify specific concessions for SVFs and the Limited Partners that support these SVF.



### **Recommended Amendments**

Based on the combination of factors discussed above, there is a need to address ambiguities in the SVF guidelines. Keeping this in view, IIC proposes the following amendments on the SVF guidelines in alternate fund investment regulations:

- *The muted returns constraint on SVFs should be revoked*
- *The minimum investment limit of INR 1 crore by an investor or limited partner (LP) should be reduced*
- *The fund minimum limit should be relaxed from INR 20 crore to INR 10 crore*
- *SVFs should be eligible for “tax pass through” under Category I AIF guidelines*
- *Grant investments to a fund should be tax exempted under Section 80G*
- *The Corporate Social Responsibility (CSR) guidelines should allow for financing to a Social Venture Fund*

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