



Venture Capital at Crossroads

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Nishith Desai Associates is a multi-skilled law firm that specializes in Corporate & Securities laws, International Tax, Funds, ADRs, M&A, Information, Communication & Entertainment (ICE) laws, and Infrastructure & Project Finance. The firm has represented the underwriters for Infosys Technologies, Satyam Infoway, Rediff.com, Silverline Technologies and Wipro in their ADR listings. NDA was involved in the first cross-border stock swap merger out of India, that is, BFL's acquisition of Mphasis, and was also involved in Silverline's (NYSE listed company) acquisition of Seranova (NASDAQ). The firm also has a very strong Private Equity Practice, with significant experience both on the formation side and the investment side. The Private Equity Practice Group of Nishith Desai Associates has been involved in the setting up of the maximum number of venture capital & private equity funds investing in India. The firm has constantly been involved in policy reform initiatives and Mr. Nishith Desai has been on the Government committees for drafting regulations pertaining to venture capital funds and relating to employee stock options. The Private Equity Group has also been involved in large sized private equity investment deals in India.

The firm has received the 'Indian Law Firm of the Year 2000' and the 'Asian Law Firm of the Year 2001 (Pro Bono)' awards given by International Financial Law Review (IFLR), a Euromoney publication.

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I. INTRODUCTION

Venture capitalists are professional money managers who provide risk capital to businesses. Venture capitalists come in many forms and specialise in different ways, but all share the common trait of making investments at an early stage in privately held companies that have the potential to provide them a very high rate of return on their investment.

Private equity investments are essentially investments in relatively more matured companies at their expansion stage. Private equity firms focus on active investments and aim to acquire a large or controlling interest in companies with solid growth potential. As a result, private equity firms usually oversee, assist and, if necessary, redirect the company's activities or its management.

Given the skilled and cost competitive manpower, technology, research and enterprise with proper environment and policy support, Indian companies can achieve rapid economic growth in a sustainable manner, particularly in the knowledge-based sectors. A vibrant venture capital and private equity industry in India will fill the gap between the capital intensive, technology based enterprises and funding available from institutional lenders such as banks. The gap exists because companies in knowledge-based sectors are usually based on intangible assets such as human capital and technology which has not yet developed into a marketable commodity.

In line with the global trend, until early 2001, the focus of venture capital and private equity investors in India was in the information technology sector. However, with the technology sector slowdown following the dotcom bust, the venture capital and the private equity investors have diversified their interest into other high potential sectors such as pharmaceutical, biotech, media and entertainment and business process outsourcing (IT enabled services).

In 2002, during the period Jan-December, India attracted private equity investment of USD 980.18 million and fourth after in the Asia Pacific region only after South Korea, Japan and Australia (*Source: AVCJ Journal: December 2002*) whereas for the first half of 2003, India has already attracted private equity investment of USD 395.13 million and the activity has just about picked up in the second half which should see this figure go up substantially. The annual private equity disbursements in India have grown significantly over the past several years and as per the IVCA (Indian Venture Capital Association), the private equity investment is likely to touch USD 10 billion by 2007-08. A snapshot of the Indian private equity scenario is given below:

Year (Financial year)	Rupees (in millions)	US Dollars (in Millions)
1996-97	700	20
1997-98	3,200	80
1998-99	10,520	250
1999-2000	21,600	500
2000-01	54,700	1,200
2001-02	52,000	1,100
2002-03	-N.A.	1,050
2007-08 F	600,000	10,000

Source: Nasscom website

Total venture capital disbursements in India were to the tune of about \$1.1 billion in 2001 (as compared to \$1.3 billion in the previous year), according to the IVCA. Venture Capitalists feel that 2002 will see venture capital disbursements in the \$2 billion range, with India-centric capital to the tune of \$1 billion to be raised in 2002.

India, since the mid 60s, had a strong mutual fund sector that began in 1964 with the formation of the Unit Trust of India, an open-ended mutual fund, promoted by a group of public sector financial institutions, which eventually became the country's largest public equity owner and the largest mutual fund operating in Asia.

Thereafter, in November 1988, guidelines were issued by the (then) Controller of Capital Issues, which stipulated the framework for the establishment and operation of funds/companies that could avail of the fiscal benefits extended to them¹.

In 1988, Technical Development and Information Corporation of India (TDICI, now ICICI ventures) was set up, soon followed by Gujarat Venture Finance Limited. Both these organisations were promoted by financial institutions².

The formalisation of the Indian venture capital community began in 1993 with the formation of the Indian Venture Capital Association ("**IVCA**") headquartered in Bangalore. In 1996, the Securities and Exchange Board of India ("**SEBI**") introduced the SEBI (Venture Capital Funds) Regulations, 1996 ("**VCF Regulations**"), for regulating and promoting the activities of domestic venture capital funds. The move liberated the industry from a number of bureaucratic hassles and paved the path for the entry of a number of foreign funds into India. In 2000 the SEBI announced the SEBI (Foreign Venture Capital Investor) Regulations, 2000 ("**FVCI Regulations**") enabling foreign venture capital and private equity investors to register with it and avail of certain benefits provided there under.

This paper gives an overview of the current regulatory framework for the domestic and offshore private equity players. More importantly this paper also deals with the various issues being faced by venture capitalists and private equity players under the current regulatory framework which are creating an impediment to the smooth flow of venture capital and private equity funds into India. And lastly, an effort has been made to provide for a model set of regulations including necessary changes to the Income Tax Act.

1 *ibid.*

2 *ibid.*

II. CURRENT REGULATORY REGIME

Domestic and offshore VC funds investing in India are regulated by the SEBI. Until recently, SEBI only regulated the domestic VC funds *vide* the VCF Regulations. India did not have any mechanism to regulate or monitor foreign VC/private equity investors although regulations existed for domestic VC funds. While this put the domestic VC investors at a disadvantage especially after foreign investment in most sectors were through the automatic route, the Indian government felt the need to monitor (if not regulate) foreign investment in the VC sector. In order to address this, in September 2000, in addition to bringing in some major reforms to the existing VCF Regulations, which apply to VC funds based in India, the SEBI also introduced the SEBI (Foreign Venture Capital Investor) Regulations, 2000 ("**FVCI Regulations**") which would be applicable to offshore funds.

The legal framework within which VC funds operate are broadly covered within the ambit of the following regulations:

- SEBI (Foreign Venture Capital Investor) Regulations, 2000;
- SEBI (Venture Capital Funds) Regulations, 1996;
- SEBI (Disclosure & Investor Protection) Guidelines, 2000;
- Securities Contracts (Regulation) Act, 1956;
- Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000;
- SEBI (Substantial Acquisitions of Shares and Takeover) Regulations, 1997; and
- Indian Income Tax Act, 1961 ("**ITA**").

In this paper, we dealt with VCF Regulations, the FVCI Regulations and the provisions of ITA.

A. THE SEBI (VENTURE CAPITAL FUNDS) REGULATIONS, 1996

In December 1996, the SEBI notified the VCF Regulations. These regulations were further amended significantly on September 15, 2000 *vide* the SEBI (Venture Capital Funds (Amendment), Regulations, 2000. Indian Venture Capital Funds, whether existing or newly organized, who wish to avail of the tax benefits available to venture capital funds, must register with the SEBI and comply with the provisions of the VCF Regulations.

Under the VCF Regulations, a domestic venture capital fund can be organized either in the form of a trust or as a company. Though the guidelines do not appear to make registration with the SEBI mandatory, SEBI has made its intention clear to regulate all domestic VCFs.

Before discussing the provisions of the aforesaid regulations we have hereinbelow discussed a few of the important definitions:

It is important to note the definitions of certain terms like, Venture Capital Fund ("**VCF**"), Venture Capital Company ("**VCC**") and Venture Capital Undertaking ("**VCU**"), which are defined by the SEBI in the VCF Regulations.

1. VCF

"VCF³ means a Fund established in the form of a trust or a company including a body corporate and registered under SEBI VCF Regulations which-

- (i) has a dedicated pool of capital;*
- (ii) raised in the manner specified under the SEBI VCF Regulations; and*
- (iii) invests in venture capital undertaking in accordance with the SEBI VCF Regulations."*

The trust deed under which the trust is settled must be registered under the provisions of the Registration Act, 1908 (16 of 1908), VCFs may be set up either as trusts (funds) or as companies. In India, the governing law relating to trusts is the Indian Trusts Act, 1882. The VCF Regulations make it clear that a trust must be documented as well as registered.

2. VCC

The term VCC⁴ means a company incorporated under the Indian Companies Act, 1956 (1 of 1956).

3. VCU

"venture capital undertaking"⁵ means a domestic company:-

- (i) whose shares are not listed in a recognised stock exchange in India;*
- (ii) which is engaged in the business of providing services, production or manufacture of articles or things, but does not include such activities or sectors which are specified in the negative list by the Board, with approval of Central Government, by notification in the Official Gazette in this behalf."*

From the definition it is clear that VCU are only those domestic unlisted companies engaged in the business of providing services, production or manufacture of articles or things.

(a) Investment conditions and restrictions

In addition to the investment restrictions and conditions applicable to FVCIs, the following conditions would apply to a VCF:

- Minimum investment to be accepted from any investor should be Rs. 500,000 (approximately USD 11,500) except in the case of employees, principal officers or directors of the VCF, employees of the manager of the VCF where lower amounts may be accepted.
- Minimum capital commitments from its investors should be Rs. 50 million (approximately USD 10 million).

³ Section 2 (m) of the SEBI VCF Regulations.

⁴ Section 2 (c) of the SEBI VCF Regulations.

⁵ Section 2 (n) of the SEBI VCF Regulations.

- A VCF is not permitted to invest in associate companies. An “associate company” is defined to mean a company in which a director or trustee or sponsor or settlor of the VCF or the investment manager holds either individually or collectively, equity shares in excess of 15% of its paid-up equity share capital of VCU.⁶
- A VCF cannot invest more than 25% of its corpus in one VCU.
- An VCF can make investments in VCUs subject to the following restrictions:
 - (i) at least 75% of the investible funds has to be invested in unlisted equity shares or equity linked instruments.
 - (ii) not more than 25% of the investible funds can be invested by way of:
 - (a) subscription to the initial public offer of a VCU whose shares are proposed to be listed subject to a lock-in period of one year;
 - (b) debt or debt instrument of a VCU in which the VCF (defined later) has already made an investment by way of equity.
- The SEBI VCF Regulations restrict VCFs from listing their securities for a period of three years from the date of their issue.

Further, a VC fund registered under the VCF Regulations will be subject to investigation/inspection of its affairs by an officer appointed by SEBI and in certain circumstances the SEBI has the power to direct the VCF to divest the assets of the VCF, to stop launching of any new schemes, to restrain from disposing any assets of the VCF, to refund monies of investors to the VCF and also to stop operating in, assessing the, capital market for a specified period.

B. THE SEBI (FOREIGN VENTURE CAPITAL INVESTOR) REGULATIONS, 2000

As mentioned earlier the FVCI Regulations merely monitors and do not regulate foreign investment in the VC sector and do not make it mandatory for an offshore fund to register with the SEBI.

The term FVCI has been defined under the FVCI Regulations to mean:

“an investor incorporated or established outside India, which proposes to make investments in venture capital fund(s) or venture capital undertakings in India and is registered under the FVCI Regulations”.

(a) Eligibility criteria

In order to determine the eligibility of an applicant, SEBI would consider, *inter alia*, the applicant’s track record, professional competence, financial soundness, experience, whether the applicant is regulated by an appropriate foreign regulatory authority or is an income tax payer or submits a certificate from its banker of it’s or it’s promoter’s track record where the applicant is neither a regulated entity nor an income tax payer. The applicant can be a pension fund, mutual fund, investment trust, investment company, investment partnership, asset management company,

⁶ Regulation 2 (aa), SEBI VCF Regulations.

endowment fund, university fund, charitable institution or any other investment vehicle incorporated and established outside India.

(b) Investment Conditions and Restrictions

All investments to be made by an FVCI would be subject to the following conditions:-

- FVCIs are permitted to invest only in VCUs. A VCU has been defined to mean domestic companies which are not engaged in activities which have been classified under the negative list of the SEBI FVCI Regulations, which broadly includes undertakings engaged in real estate business, non-banking financial services, gold financing *etc.* and whose shares are not listed on a recognized stock exchange.
- While FVCIs are permitted to invest its entire corpus in a domestic SEBI VCF (defined later), it cannot invest more than 25% of the funds committed for investments in India in one VCU.
- An FVCI can make investments in VCUs subject to the following restrictions:
 - (i) at least 75% of the funds committed to India has to be invested in unlisted equity shares or equity linked instruments.
 - (ii) not more than 25% of the funds committed to India can be invested by way of:
 - a. subscription to the initial public offer of a VCU whose shares are proposed to be listed subject to a lock-in period of one year;
 - b. debt or debt instrument of a VCU in which the VCF (defined later) has already made an investment by way of equity.

An FVCI is required to appoint a domestic custodian and will have to enter into an arrangement with a designated bank for the purpose of opening a special non-resident Indian rupee or foreign currency account. SEBI acts as a nodal agency for all necessary approvals including the permission of the RBI for opening of the bank account. In addition to the above investment conditions and restrictions, there are certain reporting and disclosure requirements that need to be satisfied by a registered FVCI on a continuing basis.

(c) Benefits of Registration with the SEBI

Though it is not mandatory for an offshore fund to register with SEBI as a FVCI, the SEBI and the Reserve Bank of India (“**RBI**”) have extended certain benefits to funds registered under the FVCI Regulations making it beneficial to register. FVCIs registered with SEBI would be entitled to the following benefits:

- The FVCIs would be eligible to freely remit monies into India for making investments in a venture capital undertaking (“**VCU**”). Any fresh issue of shares by an Indian company in most sectors has been made automatic under the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (**FDI Regulations**). Therefore, any purchase of shares of an Indian company by a non-resident from a resident requires to be approved by the Foreign Investment Promotion Board (“**FIPB**”) and the RBI.

Such approval is granted on a case-by-case basis and generally takes approximately 4-8 weeks. However, as an FVCI, no prior approval of the FIPB or the RBI is needed for making investments into Indian VCUs.

- Generally, on the purchase of shares of an unlisted company by a non-resident, the minimum price to be paid would be linked to the net asset value of the shares. Similarly, for exits involving transfer from a non-resident to a resident, the exit price is capped at the price of the shares on the stock exchange (listed company) or to the net asset value (unlisted company). However, a special exemption has been carved out for FVCI's in as much that an FVCI may acquire or sell its Indian shares/ convertible debentures/units or any other investment at a price that is mutually acceptable to both the parties.⁷ Thus, there are no entry or exit pricing restrictions applicable to an FVCI.

This could be a very significant benefit for FVCI's, especially in the case of a strategic sale or buy-back arrangement with the promoters at the time of exit from unlisted companies.

- The transfer of shares from FVCIs to promoters is exempted from the public offer provisions under the SEBI (Substantial Acquisitions of Shares and Takeover) Regulations, 1997 ("**Takeover Code**"), if the portfolio company gets listed on a stock exchange post the investment. This ensures that if the promoters have to buy-back the shares from the FVCIs, they will not be burdened with the public offer requirement which would otherwise require an offer to the other shareholders of the company to buy upto 20% of the paid-up capital of the company.
- FVCIs registered with SEBI have been accorded the status of Qualified Institutional Buyer ("**QIB**") and are accordingly eligible to subscribe to the securities at the initial public offering of a VCU through the book-building route.
- Under the SEBI (Disclosure and Investor Protection) Guidelines, 2000 ("**SEBI DIP Guidelines**"), the pre-issue share capital of a company, which is in the process of an IPO, is locked-in for a period of one year from the date of allotment. However, an exemption has been granted to VC funds registered under the SEBI VCF Regulations and SEBI FVCI Regulations. This would facilitate the FVCI to exit from their investments post-listing. However, in the case of securities subscribed to in an initial public offering ("**IPO**"), there would be a lock-in of one year applicable to such investments.
- The term "promoter" and "promoter group" have been broadly defined under the SEBI DIP Guidelines to include any person who plays an instrumental role in the decisions of a company making a public offer. A private equity investor generally reserves certain veto rights in the company and in most cases is actively involved in the decisions of the Company. If the private equity investor is not registered as an FVCI, it could be treated as a part of the promoter group, thereby subjecting it to certain onerous requirements that are applicable to promoters. The SEBI has clarified that a SEBI registered venture capital fund or an FVCI, would generally not be treated as promoters for the purpose of the above guidelines.

⁷ Reserve Bank of India; Notification No. FEMA 32 /2000-RB dated December 26, 2000.

C. INDIAN INCOME TAX ACT, 1961

VCFs registered with SEBI are accorded a 'pass through' status for tax purposes. Section 10(23FB) of the ITA provides that any income of a VCF set up to raise funds for investments in VCU, will be tax exempt in India. Such exemption is available provided the VCF is registered with SEBI under the VCF Regulations and complies with the conditions laid down in the VCF Regulations. Such VC funds will be tax exempt in India in respect of any income arising out of investments made in unlisted Indian portfolio companies. Thus it can be seen that the income tax exemption is only available to domestic funds, which invest in unlisted Indian portfolio companies. Further, explanation 2 to section 10(23FB) of the ITA provides that the income of a VCF / VCU shall continue to be exempt if a company subsequent to the VC investment gets listed on a stock exchange.

Further, as per the provisions of section 115U of the ITA, the VCF / VCU will not be required to withhold any tax in India on the income distributed by it to the investors. As per the provisions of section 115U of the ITA, any income distributed by the VCF/ VCU will be chargeable to tax in the hands of the investors in the same manner as if it were the income of the investors, had they made such investments directly in the Indian portfolio companies.

III. ISSUES CURRENTLY FACED BY THE PRIVATE EQUITY PLAYERS

While the VCF and the FVCI Regulations were expected to significantly encourage formation of domestic VCFs and foreign private equity investors to register with SEBI, the number of such registrations with SEBI demonstrates that these regulations still fall short of the expectations of the players in this industry. While full credit should be given to the SEBI for formulating the guidelines which have helped in rationalizing the different set of conflicting guidelines that prevailed in the country and also given the industry a direction, it needs to be recognized that the VC industry is extremely dynamic and it would be important that the Regulations should either be flexible enough to accommodate foreseeable changes in the environment or would need to be reviewed from time to time.

Significant changes to the venture capital regulations were brought about in 2000 pursuant to the K B Chandrasekhar committee recommendations. While most changes recommended by the committee were accepted by SEBI in its SEBI (Venture Capital Funds) (Amendment) Regulations, 2000, and the newly promulgated FVCI Regulations, there were a few important ones which were left out which now seem even more critical. Furthermore, the overall changes in the dynamics of the industry and other related issues which are now coming to light with the above regulations being in force almost two years now, we believe it is perhaps the right time for SEBI and the Government to re-look at these guidelines and see if any corrective measures are required to set the VC industry rolling. Apart from regulatory changes, it will be extremely important for SEBI to build confidence amongst the players, both domestic as well as foreign, to give them the comfort in subjecting themselves to above regulations. In addition to changes in the above regulations, there are also some other legal and regulatory changes which are desired in order to further facilitate the growth of this industry the benefits of which the country will reap in terms of enhanced entrepreneurship and wealth creation.

Some of the critical issues, which are faced by the players in complying with the existing regulations and the statutes, have been highlighted in this section together with possible solutions

which can be explored by the regulators. The section has been divided to three sections viz. issues common to both FVCI and VCFs, specific VCF related issues and the FVCIs related issues.

A. ISSUES COMMON TO BOTH VCFS AND FVCIs

1. Investment in listed securities

The provision of the VCF Regulations and the FVCI Regulations which needs immediate attention is the restriction on investment in securities of a company whose shares are listed. VCFs and FVCIs are allowed to invest in VCU and the definition of VCU includes only those companies whose shares are unlisted. This condition again, can make registration with SEBI unattractive for most private equity funds as they typically prefer to keep the option open of investing in listed companies as well, if any attractive investment opportunity comes by.

In fact in the earlier guidelines, i.e. 1996 guidelines, VCFs were effectively allowed to invest upto 20% of their corpus in companies whose securities were listed. While making amendments in 2000, somehow this flexibility was taken away whereas there was a need to probably expand this limit. It would be unfair to say that companies whose shares are listed do not need private equity funding. On the contrary, listed companies may need more such private equity funding in order to build capacities and expansion, which would also result in shareholders wealth at large. Further, there are several under performing listed companies which could become a classic turn around cases if the right kind of funding and hand holding is given to them there by benefiting the shareholders and the country at large. Internationally, there are no such restrictions on investments by private equity players. This is getting more relevant in the context of the increased interest in PIPE deals. There is an immediate need to permit VCFs/FVCIs to invest up to a certain percentage of the corpus in listed securities. This limit could be anywhere between 30 to 50%.

2. Types of investment instruments:

The regulations allow flexibility to the VCFs/FVCIs to invest in equity or equity linked instruments as well as debt. While we do understand that the broad purpose of a venture capital would be to invest in risk capital and not in pure debt, it is also important to look at it from the investors perspective where they would want the flexibility to invest in instruments which give them flexibility to invest in some kind of hybrid instruments which are optionally convertible. Instruments like optionally convertible debentures or preference shares are one of the most preferred instruments. The definition of 'equity linked instrument' restricts the ability of the VCFs/FVCIs to invest in such optionally convertible instruments. Accordingly, the definition of 'equity linked instrument' should be broadened to provide for this flexibility. It should be left to the market forces to determine whether they would want debt investment from a VC player or from any other financial institution. This could mean in a larger context, the requirement of allowing only up to 25% of the capital in debt should be removed altogether.

3. *Investment in listed companies by way of preferential issue of shares*

The withdrawal of exemption to preferential issue of shares from public offer provisions could virtually kill the private equity investment in listed entities by substantially increasing the cost of acquisition. Further, it may be more important for the capital to be infused into the company as against buying out the existing shareholders as such capital can be effectively used to improve the shareholders wealth in the long run. While permitting the VCFs/FVCIs to invest in listed companies, it would be imperative to bring about a corresponding change in the SEBI Takeover Code to carve out exemptions for such preferential issue of shares to a SEBI registered VCFs/FVCIs. This would be an excellent incentive for the private equity players to register with SEBI.

4. *Investment in real estate and non-banking financial services company*

Under the current VCF Regulations and FVCI Regulations, VCFs/FVCIs are not allowed to invest in real estate and non-banking financial services. The restriction on non-banking services companies is creating problems where the investments are made through a separate holding company since there is no definition of non-banking financial services any where in the regulations. These are real operational difficulties faced by VCFs/FVCIs since at several instances the investments are required to be made in holding companies which may not be operational companies. SEBI needs to issue a clarification on this at the earliest. Further, non-banking financial services companies too need private equity and carry a similar risk profile as any other VCU. The investors in a VCF/FVCI are sophisticated investors and are fully expected to understand the risks associated with private equity/venture capital investments. Thus, imposing restrictions on investment by VCF/FVCI in the non-banking financial services sector will put this sector at a disadvantage as compared to other businesses and such restrictions should be done away with.

Secondly, the real estate market is extremely vibrant in the current economy. If real estate sectors as any other sector need private equity funding why should it not be made available. In fact, now even foreign investors have been allowed to invest in specific sectors such as integrated townships or SEZs. Thus restriction on investment in real estate needs to be re-looked.

5. *Special Voting Rights*

The Companies Act provides that Indian companies can have differential voting rights, subject to compliance with certain detailed (and confusing) rules issued by the Department of Company Affairs (which falls within the Ministry of Finance) in this regard. Since typically private equity investors seek special veto rights and since they are typically not interested in wresting control of the Indian companies, the DCA could announce special provisions for VCFs/FVCIs that gives them a veto on certain specified matters. This issue is currently being addressed contractually through Shareholders' Agreements and can sometimes result in needless litigation to enforce these rights.

B. ISSUES SPECIFIC TO VCFs:

1. *Registration:*

There seems to be confusion as to whether it is mandatory for the domestic VCFs to register with SEBI. The current VCF Regulations state that any venture capital fund or a company wishing to raise monies and invest in accordance with the VCF Regulations shall be required to register with SEBI under the VCF Regulations. This can be interpreted to mean if a venture capital fund, which does not wish to raise monies or invest in accordance with these regulations, is not required to register with SEBI. If the interpretation of the regulator is the same as this then there should be enough clarity on this front. While internationally in most countries, it is not mandatory to register a fund as a VCF unless certain incentives are desired to be enjoyed by the applicant. It should be left to the player to decide whether it wishes to avail of such benefits such as tax pass through, QIB status, exemption from public offer provisions, etc. in which case he would be required to register with SEBI under the VCF Regulations. If the above benefits are not desired, there should be no mandatory requirement to register. With a view to facilitate and encourage registrations, SEBI should focus more on incentivising players to register with them. Further, corresponding clarification would also be required that such unregistered trusts would not fall within the mutual fund ambit as that would defeat the purpose of giving the players that flexibility.

2. *Direct participation in projects*

Also in respect of several funds with specific objectives, the requirement of investing only in VCUs would make it imperative that such investments will have to be in companies and not directly into the projects. For funds such as project development funds or for that matter media or film funds, the preference would be to participate directly in the projects. The above requirement takes away the flexibility for such funds. This could lead to an additional layer of tax at the VCU level and more importantly will not allow the VCC or VCF to set-off profits of one project against losses of other projects. This also adds to the risk of non-repatriability of income from the SPVs formed for specific projects in the event of a loss. For e.g. if a project specific SPV makes a loss on a project, it will not be able to repatriate the capital back to the VCC or VCF as the current corporate laws impose restrictions on redemptions of shares both in terms of the proceeds that can be used for such redemption as well as amount of such redemption. Hence the definition of VCU needs to be broadened to allow direct participation in projects.

3. *Investment in offshore VCUs*

The SEBI registered VCFs should be given a flexibility to invest upto a certain percentage of their corpus in overseas companies, say 20%. This will allow Indian VCFs to participate in global structures of VCUs as against restricting them to participation in domestic VCUs. This could also address the issue of situations where at the time of exit from a domestic VCU, shares in overseas companies are offered to the VCFs as a result of a share swap. While this would also require corresponding change in the exchange control regulations, from a macro perspective it could potentially result in higher inflow of foreign exchange as it will offer better opportunities for the Indian VCFs to exit in the international market through strategic sale.

4. *Flexibility to distribute in specie*

The VCF Regulations state that upon winding up of a scheme, the assets of the scheme shall be liquidated and the proceeds be distributed amongst the investors. It will be important to provide flexibility in the VCF Regulations to permit in-specie distribution of assets, as it may be difficult to liquidate all the assets.

5. *Taxation*

There also needs to be rationalization of the provisions of the ITA in order to reduce confusion and bring about more clarity. For example, the income of the VCFs have been exempted from tax under section 10(23FB) of the ITA however a corresponding change in the provisions related to withholding of tax while making payment to a VCF need to be brought about in section 196 of the ITA so that any VCU making payment to a VCF is not required to withhold tax thereby bringing VCFs at par with mutual funds. Further, 10(23FB) should be simplified on lines with 10(23D) and all definitions of a VCF or a VCC or a VCU should have a reference to the VCF Regulations. This would greatly simplify the need for corresponding changes to the ITA whenever there is a change under VCF Regulations. Several of these desired amendments to the ITA have been laid out in **Annexure 3** of this paper.

C. ISSUES SPECIFIC TO FVCIs

1. *Investment Limits*

The FVCI Regulations require that a registered FVCI cannot invest more than 25% of its "investible funds" in a single VCU. "Investible funds" has been defined to mean the funds allocated for investments into India, net of operating expenses. This condition could be a big problem for large funds that operate on a global basis, as these funds typically do not have any country-specific allocation of investments. Therefore, large global funds are virtually incapable of complying with this condition. The Regulations do not specify a timeframe within which the funds have to be invested, but such a condition is causing a lot of uneasiness amongst most of the large private equity players, who are therefore, wary of registering with the SEBI. This is probably one reason why only about 8 funds have registered with the SEBI as FVCIs.

2. *Minimum Capitalisation Norms*

The Indian foreign investment policy and exchange control laws require that any foreign investment in a company which is carrying out non-fund based non-banking financial services activity requires the Indian company to be capitalised at least to the extent of USD 500,000. Most private equity funds prefer to have a wholly-owned subsidiary in India to act as an advisor and for carrying out several on-the-ground information gathering activities on behalf of the fund. These companies typically have a very low requirement of cash as they do not typically have very significant expenses. However, because of the minimum capitalisation norms, private equity funds are being forced to lock in cash into their Indian advisory companies, which they do not have a very good use for. This can put off many funds from focusing seriously on investing in India. Therefore, wholly-owned Indian subsidiaries of FVCIs registered with SEBI can be exempted from these requirements.

IV. CONCLUSION

As it can be seen that there are several issues in respect of VC players that needs immediate attention in order to foster growth of the VC industry in India and to encourage foreign private equity players to invest in India. We need to understand that India is one amongst several destinations that is vying for the huge private equity pool available globally. If the Indian regulations do not smoothen the inflow of this global private equity capital, it will by pass the shores of India leaving Indian entrepreneurs and companies thirsty of capital. In the current market where raising monies from public has become difficult proposition, Indian companies are left with no choice but to dip into this private equity pool and any roadblock in doing so will virtually ring the death bell for these companies.

Since the SEBI has now been made a nodal agency to regulate and facilitate the growth of VC industry, it would be imperative that the initiative be taken up by the SEBI and equally important by the associations like the CII and the Indian Venture Capital Association (“**IVCA**”) to take up the issues with the respective authorities and ensure that these critical roadblocks are smoothened to foster growth of this industry.

ANNEXURE I

Model SEBI (Venture Capital Funds) Regulations, 1996

THE GAZETTE OF INDIA
EXTRAORDINARY
PART II - SECTION 3 - SUB-SECTION (ii)
PUBLISHED BY AUTHORITY
NOTIFICATION
MUMBAI

THE 4TH DAY OF DECEMBER, 1996
SECURITIES AND EXCHANGE BOARD OF INDIA
(VENTURE CAPITAL FUNDS) REGULATIONS, 1996

S.O. 850(E) In exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) the Securities and Exchange Board of India hereby, makes the following regulations with the objective of facilitating and promoting venture capital investments in Indian Companies by venture capital funds.

CHAPTER I PRELIMINARY

Short title and commencement

- (1) These regulations may be called the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996.
- (2) They shall come into force on the date of their publication in the Official Gazette.

Definitions

- In these regulations, unless the context otherwise requires, -

(a) "Act" means the Securities and Exchange Board of India Act, 1992 (15 of 1992);

¹[(aa) "associate company" means a company in which a director or trustee or sponsor or settlor of the venture capital fund or a partner of a partnership or asset management company holds either individually or collectively, equity shares in excess of 15% of its paid-up equity share capital of venture capital undertaking".]

(b) "certificate" means a certificate of registration granted by the Board under regulation 7;

(c) "company" means a company incorporated under the Companies Act, 1956 (1 of 1956);

(d) "economic offence" means an offence to which the Economic Offences (Limitation of Prosecutions) Act, 1974 (12 of 1974) applies for the time being;

(e) "enquiry officer" means an enquiry officer appointed by the Board, under regulation 33;

²[(ee) 'equity linked instruments' includes instruments convertible into equity shares or share warrants, preference shares, debentures ~~compulsorily convertible into equity.~~]

(f) "Form" means any of the forms set out in the First Schedule;

³[(g) ***]

⁴[(h) 'inspecting or investigating officer' means an inspecting or investigation officer appointed by the Board under regulation 25.]

^{5*}[(hh) 'investible funds' means corpus of the fund net of expenditure for administration and management of the fund.]

[(hhh)] 'partnership' means a partnership organized under the Limited Partnership Act •

(i) "Schedule" means a schedule annexed to these regulations;

^{6*}[(j) 'negative list' means a list of items specified in Third Schedule.]

(k) "trust" means a trust established under the Indian Trusts Act, 1882 (2 of 1882) ^{7*}[or under an Act of Parliament or State Legislation];

^{8*}[(l) 'unit' means beneficial interest of the investors in the scheme or fund floated by trust or ^{9*}[shares] issued by a company including a body corporate or interest in a partnership.]

^{10*}[(m) 'venture capital fund' means a fund established in the form of a trust or a company including a body corporate or a partnership and registered under these regulations which-

- (i) has a dedicated pool of capital,
- (ii) raised in a manner specified in the regulations, and
- (iii) invests in venture capital undertaking in accordance with the regulations.]

^{11*}[(n) 'venture capital undertaking' means a ~~domestic~~ company or an enterprise or an undertaking –

~~(i) whose shares are not listed on a recognised stock exchange in India;~~

~~(ii) which is engaged in the business for providing services, production or manufacture of article or things or does not include such activities or sectors which are specified in the negative list by the Board with the approval of the Central Government by notification in the Official Gazette in this behalf.]~~

CHAPTER II REGISTRATION OF VENTURE CAPITAL FUNDS

Application for grant of certificate

3. (1) Any company or trust ^{12*}[or a body corporate] or a partnership to carry on any activity as a venture capital fund on or after the commencement of these regulations shall make an application to the Board for grant of a certificate.

(2) Any company or trust ^{13*}[or a body corporate] or a partnership, who on the date of commencement of these regulations is carrying any activity as a venture capital fund without a certificate shall make an application to the Board for grant of a certificate within a period of three months from the date of such commencement:

Provided that the Board, in special cases, may extend the said period upto a maximum of six months from the date of such commencement.

(3) An application for grant of certificate under sub-regulation (1) or sub-regulation (2) shall be made to the Board in Form A and shall be accompanied by a non-refundable application fee as specified in Part A of the Second Schedule to be paid in the manner specified in Part B thereof.

(4) Any company or trust ^{14*}[or a body corporate] or a partnership referred to in sub-regulation (2) who fails to make an application for grant of a certificate within the period specified therein shall cease to carry on any activity as a venture capital fund.

(5) The Board may in the interest of the investors issue directions with regard to the transfer of records, documents or securities or disposal of investments relating to its activities as a venture capital fund.

(6) The Board may in order to protect the interests of investors appoint any person to take charge of records, documents, securities and for this purpose also determine the terms and conditions of such an appointment.

Eligibility Criteria

4. For the purpose of the grant of a certificate by the Board the applicant shall have to fulfil in particular the following conditions, namely:-

(a) if the application is made by a company, -

(i) memorandum of association has as its main objective, the carrying on of the activity of a venture capital fund;

(ii) it is prohibited by its memorandum and articles of association from making an invitation to the public to subscribe to its securities;

(iii) its director or principal officer or employee is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;

(iv) its director, principal officer or employee has not at any time been convicted of any offence involving moral turpitude or any economic offence.

^{15*}[(v) it is a fit and proper person].

(b) if the application is made by a trust, -

(i) the instrument of trust is in the form of a deed and has been duly registered under the provisions of the Indian Registration Act, 1908 (16 of 1908);

(ii) the main object of the trust is to carry on the activity of a venture capital fund;

(iii) the directors of its trustee company, if any, or any trustee is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;

(iv) the directors of its trustee company, if any, or a trustee has not at any time, been convicted of any offence involving moral turpitude or of any economic offence;

^{16*}[(v) the applicant is a fit and proper person.]

^{17*}[(c) if the application is made by a body corporate

(i) it is set up or established under the laws of the Central or State Legislature.

(ii) the applicant is permitted to carry on the activities of a venture capital fund.

(iii) the applicant is a fit and proper person.

(iv) the directors or the trustees, as the case may be, of such body corporate have not been convicted of any offence involving moral turpitude or of any economic offence.

(v) the directors or the trustees, as the case may be, of such body corporate, if any, is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant.]

(cc) if the application is made by a Partnership:

i) the instrument of partnership is in the form of a deed and has been duly registered under the provisions of the Limited Partnership Act;

(ii) the main object of the partnership is to carry on the activity of a venture capital fund;

(iii) the partners are not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;

(iv) the partners have not at any time, been convicted of any offence involving moral turpitude or of any economic offence;

(v) the applicant is a fit and proper person.

^{18*}[(d)^{19*}[the applicant] has not been refused a certificate by the Board or its certificate has ^{20*}[not] been suspended under regulation 30 or cancelled under regulation 31.]

Furnishing of information, clarification

5. The Board may require the applicant to furnish such further information as it may consider necessary.

Consideration of application

6. An application which is not complete in all respects shall be rejected by the Board: Provided that, before rejecting any such application, the applicant shall be given an opportunity to remove, within thirty days of the date of receipt of communication, the objections indicated by the Board.

Provided further that the Board may, on being satisfied that it is necessary to extend the period specified in the first proviso, extend such period by such further time not exceeding ninety days.

Procedure for grant of certificate

7. (1) If the Board is satisfied that the applicant is eligible for the grant of certificate, it shall send an intimation to the applicant.

(2) On receipt of intimation, the applicant shall pay to the Board, the registration fee specified in Part A of the Second Schedule in the manner specified in Part B thereof.

(3) The Board shall on receipt of the registration fee grant a certificate of registration in Form B.

Conditions of certificate

8. The certificate granted under regulation 7 shall be inter-alia, subject to the following conditions, namely:-

(a) the venture capital fund shall abide by the provisions of the Act, ^{21*}[***] and these regulations;

(b) the venture capital fund shall not carry on any other activity other than that of a venture capital fund;

(c) the venture capital fund shall forthwith inform the Board in writing if any information or particulars previously submitted to the Board are found to be false or misleading in any material particular or if there is any change in the information already submitted.

Procedure where certificate is not granted

9. (1) After considering an application made under regulation 3, if the Board is of the opinion that a certificate should not be granted, it may reject the application after giving the applicant a reasonable opportunity of being heard.

(2) The decision of the Board to reject the application shall be communicated to the applicant within thirty days.

Effect of refusal to grant certificate

10. (1) Any applicant whose application has been rejected under regulation 9 shall not carry on any activity as a venture capital fund.

(2) Any company or trust ^{22*}[or a body corporate] referred to in sub-regulation (2) of regulation 3, whose application for grant of certificate has been rejected under regulation 9 by the Board shall, on and from the date of the receipt of the communication under sub-regulation (2) of regulation 9, cease to carry on any activity as a venture capital fund.

(3) The Board may in the interest of the investors issue directions with regard to the transfer of records, documents or securities or disposal of investments relating to its activities as a venture capital fund.

(4) The Board may in order to protect the interests of the investors appoint any person to take charge of records, documents, securities and for this purpose also determine the terms and conditions of such an appointment.

CHAPTER III INVESTMENT CONDITIONS AND RESTRICTIONS

Minimum investment in a venture capital fund

11. (1) A venture capital fund may raise monies from any investor whether Indian, foreign or non-resident Indians ^{23*}[by way of issue of units]

(2) No venture capital fund set up as a company or any scheme of a venture capital fund set up as a trust or as a partnership shall accept any investment from any investor which is less than five lakh rupees:

Provided that nothing contained in sub-regulation (2) shall apply to investors who are,-

(a) employees or the principal officer or directors of the venture capital fund, or directors of the trustee company or trustees where the venture capital fund has been established as a trust; or

^{24*}[(b) the employees of the fund manager or asset management company.]

^{25*}[***]

^{26*}[(3) Each scheme launched or fund set up by a venture capital fund shall have firm commitment from the investors for contribution of an amount of atleast Rupees five crores before the start of operations by the venture capital fund.]

^{27*}[Investment conditions and restrictions]

12. All investment made or to be made by a venture capital fund shall be subject to the following conditions, namely:-

(a) venture capital fund shall disclose the investment strategy at the time of application for registration;

(b) venture capital fund shall not invest more than 25% corpus of the fund in one venture capital undertaking;

(c) shall not invest in the associated companies; and

(d) venture capital fund shall make investment in the venture capital undertaking as enumerated below:

(i) atleast ~~75~~50% of the investible funds shall be invested in unlisted equity shares or equity linked instruments.

^{28*}[***]

(ii) Not more than 25% of the investible funds may be invested by way of

(a) subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed subject to lock-in period of one year;

(b) debt or debt instrument of a venture capital undertaking in which the venture capital fund has already made an investment by way of equity.]

(iii) Not more than 30% of the investible funds can be invested in venture capital undertaking whose shares are listed on a recognized stock exchange in India.

(iv) Not more than 20% of their investible funds can be invested in the equity shares or equity linked instruments of a venture capital undertaking incorporated or operating outside of India.

^{29*}[**Prohibition on listing**

13. No venture capital fund shall be entitled to get its units listed on any recognised stock exchange till the expiry of three years from the date of the issuance of units by the venture capital fund.]

CHAPTER IV GENERAL OBLIGATIONS AND RESPONSIBILITIES

Prohibition on inviting subscription from the public

14. No venture capital fund shall issue any document or advertisement inviting offers from the public for the subscription or purchase of any of its ^{30*}[***]units.

[Private placement

15. A venture capital fund may receive monies for investment in the venture capital fund ^{31*}[only] through private placement of its ^{32*}[***]units.

^{33*}[**Placement memorandum or subscription agreement**

16. (1) The venture capital fund shall –

(a) issue a placement memorandum which shall contain details of the terms and conditions subject to which monies are proposed to be raised from investors; or

(b) enter into contribution or subscription agreement with the investors which shall specify the terms and conditions subject to which monies are proposed to be raised.

(2) The Venture Capital Fund shall file with the Board for information, the copy of the placement memorandum or the copy of the contribution or subscription agreement entered with the investors along with a report of money actually collected from the investor.]

Contents of placement memorandum

17. (1) The placement memorandum ^{34*}[or the subscription agreement with investors] referred to in sub-regulation (1) of regulation 16 shall contain the following, namely:-

(a) details of the trustees or trustee company ^{35*}[and the directors or chief executives] of the venture capital fund;

^{36*}[(b) (i) the proposed corpus of the fund and the minimum amount to be raised for the fund to be operational.

(ii) the minimum amount to be raised for each scheme and the provision for refund of monies to investor in the event of non receipt of minimum amount].

^{37*}[(c) details of entitlements on the ^{38*}[***] units of venture capital fund for which subscription is being sought.]

(d) tax implications that are likely to apply to investors;

(e) manner of subscription to the units ^{39*}^{40*}[***] of the venture capital fund];

(f) the period of maturity, if any, of the ^{41*}[fund];

(g) the manner, if any, in which the ^{42*}[fund shall] be wound up;

(h) manner in which the benefits accruing to investors in the units of the trust are to be distributed;

^{43*}[(i) details of the fund manager or asset management company if any, and the fees to be paid to such manager.]

^{44*}[(j) The details about performance of the fund, if any, managed by the Fund Manager

(k) investment strategy of the fund.

(l) any other information specified by the Board.]

^{45*}[***]
^{46*}[***]
^{47*}[***]

Maintenance of books and records

20. (1) Every venture capital fund shall maintain for a period of ^{48*}[eight] years books of accounts, records and documents which shall give a true and fair picture of the state of affairs of the venture capital fund.

(2) Every venture capital fund shall intimate the Board, in writing, the place where the books, records and documents referred to in sub-regulation (1) are being maintained.

Power to call for information

21. (1) The Board may at any time call for any information from a venture capital fund with respect to any matter relating to its activity as a venture capital fund.

(2) Where any information is called for under sub-regulation (1) it shall be furnished ^{49*}[within the time specified by the Board].

Submissions of reports to the Board

22. The Board may at any time call upon the venture capital fund to file such reports as the Board may desire with regard to the activities carried on by the venture capital fund.

Winding up

23. (1) A scheme of a venture capital fund set up as a trust shall be wound up,

(a) when the period of the scheme, if any, mentioned in the placement memorandum is over;

(b) if it is the opinion of the trustees or the trustee company, as the case may be, that the scheme shall be wound up in the interests of investors in the units;

(c) if seventy five percent of the investors in the scheme pass a resolution at a meeting of unit holders that the scheme be wound up; or

(d) if the Board so directs in the interests of investors.

(2) A venture capital fund set up as a company shall be wound up in accordance with the provisions of the Companies Act, 1956 (1 of 1956).

^{50*}[(2A) A venture capital fund set up as a body corporate shall be wound up in accordance with the provisions of the statute under which it is constituted.]

[(2B) A venture capital fund set up as a partnership shall be wound up in accordance with the provisions of the Limited Partnership Act]

^{51*}[(3) The trustees or trustee company of the venture capital fund set up as a trust or the Board of Directors in the case of the venture capital fund is set up as a company (including body corporate) shall intimate the Board and investors of the circumstances leading to the winding up of the Fund or Scheme under sub-regulation (1).]

Effect of winding up

24. (1) On and from the date of intimation under sub-regulation (3) of regulation 23, no further investments shall be made on behalf of the scheme so wound up.

(2) Within three months from the date of intimation under sub-regulation (3) of regulation 23, the assets of the scheme shall be liquidated, and the proceeds accruing to investors in the scheme distributed to them after satisfying all liabilities.

(3) Notwithstanding anything contained in sub regulations (2) above, subject to the provisions of their respective constituent documents and the approval of seventy five percent of the investors in the scheme, the venture capital fund may also distribute its assets amongst the investors.

CHAPTER V INSPECTION AND INVESTIGATION

Board's right to inspect or investigate

25. (1) The Board may ^{52*}[suo moto or upon receipt of information or complaint] appoint one or more persons as inspecting or investigating officer to undertake inspection or investigation of the books of accounts, records and documents relating to a venture capital fund for any of the following reasons, namely:-

(a) to ensure that the books of account, records and documents are being maintained by the venture capital fund in the manner specified in these regulations;

(b) to inspect or investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the venture capital fund;

(c) to ascertain whether the provisions of the Act and these regulations are being complied with by the venture capital fund; and

(d) to inspect or investigate suo moto into the affairs of a venture capital fund, in the interest of the securities market or in the interest of investors.

Notice before inspection or investigation

26. (1) Before ordering an inspection or investigation under regulation 25, the Board shall give not less than ten days notice to the venture capital fund.

(2) Notwithstanding anything contained in sub-regulation (1), where the Board is satisfied that in the interest of the investors no such notice should be given, it may by an order in writing direct that the inspection or investigation of the affairs of the venture capital fund be taken up without such notice.

(3) During the course of an inspection or investigation, the venture capital fund against whom the inspection or investigation is being carried out shall be bound to discharge its obligations as provided in regulation 27.

^{53*}[Obligation of venture capital fund on inspection or investigation]

27. (1) It shall be the duty of every officer of the Venture Capital Fund in respect of whom an inspection or investigation has been ordered under the regulation 25 and any other associate person who is in possession of relevant information pertaining to conduct and affairs of such Venture Capital Fund including fund manager or asset management company, if any, to produce to the Investigating or Inspecting Officer such books, accounts and other documents in his custody or control and furnish him with such statements and information as the said Officer may require for the purposes of the investigation or inspection.

(2) It shall be the duty of every officer of the Venture Capital Fund and any other associate person who is in possession of relevant information pertaining to conduct and affairs of the Venture

Capital Fund to give to the Inspecting or Investigating Officer all such assistance and shall extend all such co-operation as may be required in connection with the inspection or investigations and shall furnish such information sought by the inspecting or investigating officer in connection with the inspection or investigation.

(3) The Investigating or Inspecting Officer shall, for the purposes of inspection or investigation, have power to examine on oath and record the statement of any employees, directors or person responsible for or connected with the activities of venture capital fund or any other associate person having relevant information pertaining to such Venture Capital Fund.

(4) The Inspecting or Investigating Officer shall, for the purposes of inspection or investigation, have power to obtain authenticated copies of documents, books, accounts of Venture Capital Fund, from any person having control or custody of such documents, books or accounts.]

Submission of Report to the Board

28. The inspecting or investigating officer shall, as soon as possible, on completion of the inspection or investigation submit an inspection or investigation report to the Board: Provided that if directed to do so by the Board, he may submit an interim report.

Communication of findings etc. to the venture capital fund

29. The Board shall, after consideration of the inspection or investigation report or the interim report referred to in regulation 28, communicate the findings of the inspection officer to the venture capital fund and give him an opportunity of being heard.

(2) On receipt of the reply if any, from the venture capital fund, the Board may call upon the venture capital fund to take such measures as the Board may deem fit in the interest of the securities market and for due compliance with the provisions of the Act and these regulations.

^{54*}[(3) The Board may after consideration of the investigation or inspection report and after giving reasonable opportunity of hearing to the venture capital fund or its trustees, directors issue such direction as it deems fit in the interest of securities market or the investors including directors in the nature of:-

(a) requiring a venture capital fund not to launch new schemes or raise money from investors for a particular period;

(b) prohibiting the person concerned from disposing of any of the properties of the fund or scheme acquired in violation of these regulations;

(c) requiring the person concerned to dispose of the assets of the fund or scheme in a manner as may be specified in the directions;

(d) requiring the person concerned to refund any money or the assets to the concerned investors along with the requisite interest or otherwise, collected under the scheme;

(e) prohibiting the person concerned from operating in the capital market or from accessing the capital market for a specified period.]

CHAPTER VI PROCEDURE FOR ACTION IN CASE OF DEFAULT

Suspension of certificate

30. ^{55*}[Without prejudice to issue of directions or measure under regulation 29,] the Board may suspend the certificate granted to a venture capital fund where the venture capital fund:

(a) contravenes any of the provisions of the Act or these regulations;

(b) fails to furnish any information relating to its activity as a venture capital fund as required by the Board;

(c) furnishes to the Board information which is false or misleading in any material particular;

- (d) does not submit periodic returns or reports as required by the Board;
- (e) does not co-operate in any enquiry, inspection or investigation conducted by the Board;
- (f) fails to resolve the complaints of investors or fails to give a satisfactory reply to the Board in this behalf.

Cancellation of certificate

31. The Board may cancel the certificate granted to a venture capital fund:-

- (a) when the venture capital fund is guilty of fraud or has been convicted of an offence involving moral turpitude;
- (b) the venture capital fund has been guilty of repeated defaults of the nature specified in regulation 30; or

Explanation : In this regulation, "fraud" has the same meaning as is assigned to it in section 17 of the Indian Contract Act, 1872. (9 of 1872)

- (c) contravenes any of the provisions of the Act or these regulations.

Manner of making order of cancellation or suspension

32. No order of suspension or cancellation of certificate shall be made by the Board, except after holding an enquiry in accordance with the procedure specified in regulation 33.

Manner of holding enquiry before suspension or cancellation

33. (1) For the purpose of holding an enquiry under regulation 32, the Board may appoint one or more enquiry officers.

(2) The enquiry officer shall issue to the venture capital fund, at its registered office or its principal place of business, a notice setting out the grounds on which action is proposed to be taken against it and calling upon it to show cause against such action within a period of fourteen days from the date of receipt of the notice.

(3) The venture capital fund may, within fourteen days from the date of receipt of such notice, furnish to the enquiry officer a written reply, together with copies of documentary or other evidence relied on by it or sought by the Board from the venture capital fund.

(4) The enquiry officer shall give a reasonable opportunity of hearing to the venture capital fund to enable him to make submissions in support of its reply made under sub-regulation (3).

(5) Before the enquiry officer, the venture capital fund may appear through any person duly authorised by the venture capital fund:

Provided that no lawyer or advocate shall be permitted to represent the venture capital fund at the enquiry:

Provided further that where a lawyer or an advocate has been appointed by the Board as a presenting officer under sub-regulation (6), it shall be lawful for the venture capital fund to present its case through a lawyer or advocate.

(6) The enquiry officer may, if he considers it necessary, ask the Board to appoint a presenting officer to present its case.

(7) The enquiry officer shall, after taking into account all relevant facts and submissions made by the venture capital fund, submit a report to the Board and recommend the penal action, if any, to be taken against the venture capital fund as also the grounds on which the proposed action is justified.

Show-cause notice and order

34. (1) On receipt of the report from the enquiry officer, the Board shall consider the same and may issue to the venture capital fund a show-cause notice as to why the penal action as proposed by the enquiry officer ⁵⁶[or such appropriate action] should not be taken against it.

(2) The venture capital fund shall, within fourteen days of the date of the receipt of the show-cause notice, send a reply to the Board.

(3) The Board, after considering the reply, if any, of the venture capital fund, shall, as soon as possible pass such order as it deems fit.

Effect of suspension and cancellation of certificate

35. (1) On and from the date of the suspension of the certificate, the venture capital fund shall cease to carry on any activity as a venture capital fund during the period of suspension, and shall be subject to such directions of the Board with regard to any records, documents or securities that may be in its custody or control, relating to its activities as venture capital fund, as the Board may specify.

(2) On and from the date of cancellation of the certificate, the venture capital fund shall, with immediate effect, cease to carry on any activity as a venture capital fund, and shall be subject to such directions of the Board with regard to the transfer of records, documents or securities that may be in its custody or control, relating to its activities as venture capital fund, as the Board may specify.

Publication of order of suspension or cancellation

36. The order of suspension or cancellation of certificate passed under regulation 35 may be published by the Board in two newspapers.

^{57*}Action against intermediaries

37. The Board may initiate action for suspension or cancellation of registration of an intermediary holding a certificate of registration under section 12 of the Act who fails to exercise due diligence in the performance of its functions or fails to comply with its obligations under these regulations. Provided that no such certificate of registration shall be suspended or cancelled unless the procedure specified in the regulations applicable to such intermediary is complied with.

Appeal to the Central Government

38. Any person aggrieved by an order of the Board under these regulations may prefer an appeal to the Securities Appellate Tribunal in accordance with section 15T of the Act.]

**FIRST SCHEDULE – FORMS
FORM A**

**SECURITIES AND EXCHANGE BOARD OF INDIA
(VENTURE CAPITAL FUNDS) REGULATIONS, 1996
(SEE REGULATION 3)**

**APPLICATION FOR GRANT OF CERTIFICATE OF REGISTRATION
AS VENTURE CAPITAL FUND
SECURITIES AND EXCHANGE BOARD OF INDIA
MITTAL COURT, 'B' WING, 1st FLOOR
NARIMAN POINT, MUMBAI 400 021
INDIA**

INSTRUCTIONS:

- i. This form is meant for use by the company or trust or partnership (hereinafter referred to as the applicant) for application for grant of certificate of registration as venture capital fund.
 - ii. The applicant should complete this form, and submit it, along with all supporting documents to the Board at its head office at Mumbai.
 - iii. This application form should be filled in accordance with these regulations.
 - iv. The application shall be considered by the Board provided it is complete in all respects.
 - v. All answers must be legible.
 - vi. Information which needs to be supplied in more detail may be given on separate sheets which should be attached to the application form.
 - vii. The application must be signed and all signatures must be original.
 - viii. The application must be accompanied by an application fee as specified the Second Schedule to these regulations.
1. Name, address of the registered office, address for correspondence, telephone number(s), fax number(s), telex number(s) of the applicant and the name of the contact person.
 2. Please indicate to which of the following categories the applicant belongs.
 - (i) a company established under the Companies Act, 1956 (1 of 1956)
 - (ii) a trust set up under the Indian Trusts Act, 1882 (2 of 1882)
 - (iii) a limited partnership set up under the Limited Partnership Act.

3. Date and place of incorporation or establishment and date of commencement of business (enclose certificate of incorporation, memorandum and articles of association or trust deed or partnership deed in terms of which incorporated or established).
4. (a) Details of members of the Board of Trustees or directors of the trustee company, as the case may be, in case the applicant has been set up as a trust.
(b) Details of members of the Board of Directors of the venture capital fund in case the applicant has been set up as a company.
(c) Details of the general partners of the venture capital fund in case the applicant has been organized as a limited partnership.
5. Please state whether the applicant, his partner, director or principal officer is involved in any litigation connected with the securities market which has an adverse bearing on the business of the applicant; or has at any time been convicted for any moral turpitude or at any time has been found guilty of any economic offence. In case the applicant is a trust, the above information should be provided for the members of the Board of Trustees or of the above mentioned persons connected with the Trustee Company.
If yes, the details thereof.
6. Please also state whether there has been any instance of violation or non-adherence to the securities laws, code of ethics/conduct, code of business rules, for which the applicant, or its parent or holding company or affiliate may have been subject to economic, or criminal, liability, or suspended from carrying out its operations, or the registration revoked temporarily.
7. Details of asset management company, if any. (enclose copy of agreement with the asset management company).
8. Declaration statement (to be given as below).

We hereby agree and declare that the information supplied in the application, including the attachment sheets, is complete and true.

AND we further agree that, we shall notify the Securities and Exchange Board of India immediately any change in the information provided in the application.

We further agree that we shall comply with, and be bound by the Securities and Exchange Board of India Act, 1992, and the Securities and Exchange Board of India (Venture Capital Fund) Regulations, 1996, and Government of India guidelines / instructions as may be announced by the Securities and Exchange Board of India from time to time.

We further agree that as a condition of registration, we shall abide by such operational instructions/directives as may be issued by the Securities and Exchange Board of India from time to time.

For and on behalf of.....

(Name of the applicant)

Authorised signatory

(Name)

(Signature)

Date:

Place:

FORM B
[SEE REGULATION 7(3)]
SECURITIES AND EXCHANGE BOARD OF INDIA
(VENTURE CAPITAL FUNDS) REGULATIONS, 1996
CERTIFICATE OF REGISTRATION AS VENTURE CAPITAL FUND

I. In exercise of the powers conferred by sub-section (1) of section 12 of the Securities and Exchange Board of India Act, 1992, (15 of 1992) read with the regulations made thereunder, the Board hereby grants a certificate of registration to _____ as a venture capital fund subject to the conditions specified in the Act and in the regulations made thereunder.

II. The Registration Number of the venture capital fund is IN/VC/ /

Date:

Place: MUMBAI

By order

Sd/-

For and on behalf of

SECURITIES AND EXCHANGE BOARD OF INDIA

SECOND SCHEDULE
[SEE REGULATIONS 3(3) AND 7]

**SECURITIES AND EXCHANGE BOARD OF INDIA
(VENTURE CAPITAL FUNDS) REGULATIONS, 1996.**

FEEs

PART A

Amount to be paid as fees

Application fee (Rs) 25, 000
Registration fee for grant of certificate (Rs) 5, 00, 000

PART B

I. The fees specified above shall be payable by bank draft in favour of "The Securities and Exchange Board of India" at _____

^{58*}**[THIRD SCHEDULE**

**SECURITIES AND EXCHANGE BOARD OF INDIA (VENTURE CAPITAL FUNDS)
REGULATIONS, 1996**

[SEE REGULATION 2(3)]

Negative List

~~1. Real Estate~~

~~21. Non-banking financial services~~

~~23. Gold Financing~~

~~34. Activities not permitted under industrial policy of Government of India.~~

~~45. Any other activity which may be specified by the Board in consultation with Government of India from time to time].~~

ANNEXURE II

Model SEBI (Foreign Venture Capital Investors) Regulations, 2000

THE GAZETTE OF INDIA
EXTRA ORDINARY
PART II SECTION 3 SUB-SECTION (ii)
PUBLISHED BY AUTHORITY
MUMBAI
THE 15TH DAY OF SEPTEMBER, 2000
NOTIFICATION
SECURITIES AND EXCHANGE BOARD OF INDIA
(FOREIGN VENTURE CAPITAL INVESTORS) REGULATIONS, 2000

S.O. 832 (E) In exercise of the powers conferred by sub-section (1) of Section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Securities and Exchange Board of India hereby makes the following regulations with the objective of facilitating and promoting investments in Indian Companies by offshore private equity and venture capital funds namely

CHAPTER I PRELIMINARY

Short title and commencement

1. (1) These regulations may be called the Securities and Exchange Board of India (Foreign Venture Capital Investors) Regulations, 2000.

(2) They shall come into force on the date of their publication in the Official Gazette.

Definitions

2 (1) In these regulations, unless the context otherwise requires, -

(a) "Act" means the Securities and Exchange Board of India Act, (15 of 1992);

(b) "certificate" means a certificate of registration granted by the Board under regulation 7.

(c) "designated bank" means any bank in India which has been permitted by the Reserve Bank of India to act as banker to the Foreign Venture Capital Investor.

(d) "domestic custodian" means a person registered under the Securities and Exchange Board of India (Custodian of Securities) Regulations, 1996.

(e) "enquiry officer" means an enquiry officer appointed by the Board, under regulation 24.

(ee) "Inspection or Investigation Officer" means an officer appointed by the Board, under regulation 16.

(f) "equity linked instruments" includes equity shares, share warrants, American Depository Receipts/Global Depository Receipts, Foreign Currency Convertible Bonds, preference shares, debt instruments that are either optionally or compulsorily convertible instruments and all other forms of instruments that are convertible into equity shares.
~~into equity share or share warrants, preference shares, debentures~~

~~compulsorily convertible into equity.~~

(g) "Eligible Investor" means an entity incorporated and established outside India, which has as its main objects, the activity of making investments in portfolio companies, which has a broad-based shareholding or ownership, and the investment activities of which are managed by professionals with a good track record in investment or fund management.

(g) "~~F~~Foreign ~~v~~Venture ~~e~~Capital ~~i~~Investor" means an Eligible iInvestor ~~incorporated and established outside India,~~ which proposes to make investment in ~~v~~Venture ~~e~~Capital ~~f~~Fund(s) or ~~v~~Venture ~~e~~Capital ~~u~~Undertakings in India and is registered with the Board under these Regulations.

(h) "form" means any of the forms set out in the First Schedule.

~~(i) "investible funds" means the funds committed for investments in India, net of expenditure for administration and management of the fund.~~

(j) "negative list" means a list of items as specified in Third Schedule.

(k) "Schedule" means a schedule annexed to these regulations;

(l) "Venture Capital Fund" means a Fund established in the form of a Trust, a company including a body corporate or a partnership and registered under Securities and Exchange Board of India (Venture Capital Fund) Regulations, 1996, which :

- (i) has a dedicated pool of capital;
- (ii) raised in the manner specified under the Regulations; and
- (iii) invests in venture capital undertaking in accordance with the Regulations.

(m) "~~v~~Venture ~~e~~Capital ~~u~~Undertaking" means a domestic company:-

~~(i) whose shares are not listed in a recognised stock exchange in India;~~

~~(ii) which is engaged in the business of providing services, production or manufacture of articles or things, but does not include such activities or sectors which are specified in the negative list by the Board, with approval of Central Government, by notification in the Official Gazette in this behalf."~~

(2) Words and expressions used and not defined in these regulations but defined in the Act or Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 shall have the same meaning as are respectively assigned to them in the Act or the said regulations.

CHAPTER II REGISTRATION OF FOREIGN VENTURE CAPITAL INVESTORS

Application for grant of certificate

3. An Eligible Investor ~~For the purposes of~~ seeking registration under these regulations, ~~the applicant~~ shall make an application to the Board in Form A along with the application fee as specified in Part A of the Second Schedule to be paid in the manner specified in Part B thereof.

Eligibility Criteria

4. (1) For the purpose of the grant of a certificate to an applicant as a Foreign Venture Capital Investor, the Board shall consider the following ~~factors conditions for to determine the applicant's~~ eligibility, namely: -

(a) the ~~applicant's~~ track record, professional competence, soundness, experience, general reputation of fairness and integrity ~~of the sponsors or investment managers of the applicant~~

(b) Whether the applicant has been granted necessary approval by the Reserve Bank of India for making investments in India; ~~3**]~~

(c) whether the applicant is an investment company, investment trust, investment partnership, pension fund, mutual fund, endowment fund, university fund, charitable institution or any other ~~similar~~ entity ~~with similar main objects~~, incorporated outside India; or

(d) whether the applicant is an asset management company, investment manager or investment management company or any other investment vehicle incorporated outside India; ~~4**]~~

(e) whether the applicant is authorised to invest in ~~v~~Venture ~~e~~Capital ~~f~~Funds or carry on ~~the activities as of~~ a ~~5**]~~ Foreign ~~v~~Venture ~~e~~Capital ~~i~~Investors; ~~6**]~~

(f) whether the applicant is regulated by an appropriate foreign regulatory authority or is an income tax payer; or submits a ~~certificate from its banker of its or its promoter~~ track record where the applicant is neither a regulated entity nor an income tax payer.

(g) ~~that~~ the applicant has not ~~earlier~~ been refused a certificate by the Board.

(h) whether the applicant is a fit and proper person.

Furnishing of information, clarification

5. The Board may require the applicant to furnish such further information as it may consider necessary.

Consideration of application

6. An application which is not complete in all respects shall be liable to be rejected by the Board:

Provided that, before rejecting any such application, the applicant shall be given an opportunity to remove, within thirty days of the date of receipt of communication, the objections indicated by the Board.

Provided further that the Board may, on being satisfied that it is necessary to extend the period specified above may extend such period not beyond ninety days.

Procedure for grant of certificate

7. (1) If the Board is satisfied that the applicant is eligible for the grant of certificate, it shall send an intimation to the applicant.

(2) On receipt of intimation, the applicant shall pay to the Board, registration fee specified in Part A of the Second Schedule in the manner specified in Part B thereof.

(3) The Board shall on receipt of the registration fee grant a certificate of registration in Form B.

Conditions of certificate

8. The certificate granted to the ~~fForeign vVenture eCapital 7*fiInvestor~~ under regulation 7 shall be inter-alia, subject to the compliance by the Foreign Venture Capital Investor of the following conditions, namely:-

- (a) it shall abide by the provisions of the Act, and these regulations;
- (b) it shall appoint a domestic custodian for purpose of custody of securities;
- (c) it shall enter into arrangement with a designated bank for the purpose of operating a special non-resident rupee or foreign currency account.
- (d) it shall forthwith inform the Board in writing if any information or particulars previously submitted to the Board are found to be false or misleading in any material particular or if there is any change in the information already submitted.

Procedure where certificate is not granted

9. (1) On considering an application made under regulation 3, if the Board is of the opinion that a certificate should not be granted, it may reject the application after giving the applicant a reasonable opportunity of being heard.

(2) The decision of the Board to reject the application shall be communicated to the applicant.

Effect of refusal to grant certificate

10. Any applicant whose application has been rejected under regulation 9 shall not be eligible for any benefits or exemptions granted to Foreign Venture Capital Investors under any law, statute, rule, or regulation passed by Parliament or issued by any Governmental Authority ~~carry on any activity as a Foreign Venture Capital Investor.~~

CHAPTER III INVESTMENT CONDITIONS AND RESTRICTIONS

Investment Criteria for a Foreign Venture Capital Investor

11. All investments to be made by a ~~fForeign vVenture eCapital iInvestors~~ shall be subject to the following conditions: -

(a) it shall disclose to the Board its investment strategy.

~~(b) while it can invest its total funds committed in one venture capital fund it shall however not invest more than 25% of the funds committed for investments to India in one Venture Capital Undertaking.~~

(~~e~~b) it shall make investments in the Venture Capital Undertaking as enumerated below:

(i) it shall invest only in equity or equity-linked instruments; provided however, that a Foreign Venture Capital Investor may invest in debt securities that are not convertible into equity shares of Venture Capital Undertakings in which it has already made an equity investment; provided further, that at any given point in time, the total investment by a Foreign Venture Capital Investor in debt securities that are not convertible to equity shares- shall not exceed 25% of the aggregate of .:

- the total investment made by the Foreign Venture Capital Investor till that date in equity or equity-linked instruments, and
- the total investments made by the Foreign Venture Capital Investor in debt instruments that are not convertible into equity shares.;

(ii) A Foreign Venture Capital Investor may invest in equity or equity-linked instruments and subject to (i) above, in debt instruments, of listed as well as unlisted Venture Capital Undertakings; provided however, that at any given point of time, the total investment by a Foreign Venture Capital Investor in listed or to-be-listed securities shall not exceed 30% of the aggregate of :

- the total investment made by the Foreign Venture Capital Investor till that date in unlisted Venture Capital Undertakings, and
- the total investment made by the Foreign Venture Capital Investor till that date in listed Venture Capital Undertakings.

- ~~(i) atleast 75% of the investible funds shall be invested in unlisted equity shares or equity linked instruments.~~
- ~~(ii) not more than 25% of the investible funds may be invested by way of:~~
- ~~(a) subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed subject to lock in period of one year;~~
- ~~(b) debt or debt instrument of a venture capital undertaking in which the 8*[foreign venture capital investor] has already made an investment by way of equity.~~

CHAPTER IV GENERAL OBLIGATIONS AND RESPONSIBILITIES

Maintenance of books and records

12. (1) Every Foreign Venture Capital Investor shall maintain for a period of eight years, books of accounts, and documents which shall give a true and fair picture of the state of affairs of the Foreign Venture Capital Investor.

(2) Every Foreign Venture Capital Investor shall intimate to the Board, in writing, the place where the books, records and documents referred to in sub-regulation (1) are being maintained.

Power to call for information

13. (1) The Board may at any time call for any information from a Foreign Venture Capital Investor with respect to any matter relating to its activity as a Foreign Venture Capital Investor.

(2) Where any information is called for under sub-regulation (1) it shall be furnished within the time specified by the Board.

General Obligations and Responsibilities

14 (1) Every Foreign Venture Capital Investor or a global custodian acting on behalf of the foreign venture capital investor shall enter into an agreement with the domestic custodian to act as a custodian of securities for the Foreign Venture Capital Investor.

(2) Every Foreign Venture Capital Investor shall ensure that domestic custodian takes steps for,-

(a) ~~maintaining records of monitoring of the investments made by~~ ef of the Foreign Venture Capital Investors ~~————~~ in India

(b) furnishing of periodic reports once every 6 months to the Board regarding the details of investments made by the Foreign Venture Capital Investor

(c) furnishing such information as may be called for by the Board.

Appointment of designated bank

15. Foreign Venture Capital Investor shall appoint a branch of a bank approved by Reserve Bank of India as designated bank for opening of foreign currency denominated accounts or special non-resident rupee account.

CHAPTER V INSPECTION AND INVESTIGATIONS

Board's right to inspect or investigate

16. The Board may, suo-moto or upon receipt of information or complaint, cause an inspection or investigation to be made in respect of conduct and affairs of any ~~f~~Foreign ~~v~~Venture ~~e~~Capital ~~i~~Investor by an Officer whom the Board considers fit for any of the following reasons namely: -

(a) to ensure that the books of account, records and documents are being maintained by the ~~f~~Foreign ~~v~~Venture ~~e~~Capital ~~i~~Investor in the manner specified in these regulations.

(b) to inspect or investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the foreign venture capital investor;

(c) to ascertain whether the provisions of the Act and these regulations are being complied with by the ~~f~~Foreign ~~v~~Venture ~~e~~Capital ~~i~~Investor; and

(d) to inspect or investigate suo-moto into the affairs of a ~~f~~Foreign ~~v~~Venture ~~e~~Capital ~~i~~Investor in the interest of the securities market or in the interest of investors.

Obligation of Foreign Venture Capital Investor on investigation or inspection by Board

17. (1) It shall be the duty of every Foreign Venture Capital Investor in respect of whom an inspection or investigation has been ordered under regulation 16 and any other person associated who is in possession of relevant information pertaining to conduct and affairs of such Foreign Venture Capital Investor, including the asset management company or fund manager, to produce to the Inspecting or Investigating Officer such books, accounts and other documents in his custody or control and furnish him with such statements and information as the said Officer may require for the purposes of the inspection or investigation.

(2) It shall be the duty of Foreign Venture Capital Investor and any other person associated who is in possession of relevant information pertaining to conduct and affairs of the Foreign Venture Capital Investor to give to the Inspecting or Investigating Officer all such assistance and ~~shall to~~ extend all such co-operation as may be required in connection with the

inspections or investigations and ~~shall to~~ furnish such information sought by the Inspecting or Investigating Officer in connection with the inspections or investigations.

(3) The Inspecting or Investigating Officer shall, for the purposes of inspection or investigation, have power to examine on oath and record the statement of any person responsible for or connected with activities of Foreign Venture Capital Investor or any other person associated having relevant information pertaining to such Foreign Venture Capital Investor.

(4) The Inspecting or Investigating Officer shall, for the purposes of inspection or investigation, have power to get authenticated copies of documents, books, accounts of Foreign Venture Capital Investor, from any person having control or custody of such documents, books or accounts.

Submission of the Report

18. The Inspecting or Investigating Officer shall on completion of inspection or investigations, submit a report to the Board.

Board's right to issue any direction to Foreign Venture Capital Investor

19. The Board may after consideration of the inspection or investigation report and after giving a reasonable opportunity of hearing to the Foreign Venture Capital Investor, require it to take such measure or issue such directions as it deems fit in the interest of capital market and investors, including directions in the nature of: -

(a) requiring the person concerned to dispose of the securities or disinvest in a manner as may be specified in the directions;

(b) requiring the person concerned not to further invest for a particular period;

(c) prohibiting the person concerned from operating in the capital market in India for a specified period.

CHAPTER VI PROCEDURE FOR ACTION IN CASE OF DEFAULT

Board's right to suspend or cancel certificate of registration

20. Without prejudice to the appropriate directions or measures under regulation 19, it may after consideration of the investigation report, initiate action for suspension or cancellation of the registration of such Foreign Venture Capital Investor;

Provided that no such certificate of registration shall be suspended or cancelled unless the procedure specified in regulation 23 is complied with.

Suspension of certificate

21. The Board may suspend the certificate where the Foreign Venture Capital Investor:

(a) contravenes any of the provisions of the Act or these regulations;

(b) fails to furnish any information relating to its activity as a Foreign Venture Capital Investor as required by the Board;

(c) furnishes to the Board information which is false or misleading in any material particular;

(d) does not submit periodic returns or reports as required in Regulation 14(2) ~~by the Board;~~

(e) does not co-operate in any enquiry or inspection conducted by the Board;

Cancellation of certificate

22. The Board may cancel the certificate granted to a Foreign Venture Capital Investor: -

(a) when the Foreign Venture Capital Investor has been found ~~is~~ guilty of fraud or has been convicted of an offence involving moral turpitude;

Explanation: The expression "fraud" has the same meaning as is assigned to it in section 17 of the Indian Contract Act, 1872. (9 of 1872)

(b) the Foreign Venture Capital Investor has been guilty of repeated defaults of the nature mentioned in the ~~+~~Regulation 21; ~~or~~

(c) the Foreign Venture Capital Investor does not continue to meet the eligibility criteria laid down in these ~~+~~Regulations; or

(d) contravenes any of the provisions of the Act or these regulations.

Manner of making order of cancellation or suspension

23. No order of penalty or cancellation or suspension of certificate shall be imposed on the Foreign Venture Capital Investor except after holding an enquiry in accordance with the procedure specified in ~~the +~~Regulation 24.

Manner of holding enquiry before suspension or cancellation

24. (1) For the purpose of holding an enquiry under ~~+~~Regulation 23, Board may appoint one or more enquiry officers.

(2) The enquiry officer shall issue to the Foreign Venture Capital Investors, at its registered office or its principal place of business or its agent or representative in India, a notice setting out the grounds on which action is proposed to be taken against it and calling upon it to show cause against such action within a period of fourteen days from the date of receipt of the notice.

(3) The Foreign Venture Capital Investor may, within fourteen days from the date of receipt of such notice, to the enquiry officer a written reply, together with copies of documentary or other evidence relied on by it or sought by the Board from the Foreign Venture Capital Investor.

(4) The enquiry officer shall give a reasonable opportunity of being heard ~~hearing~~ to the Foreign Venture Capital Investor to enable it ~~him~~ to make submissions in support of its reply made under sub-~~+~~Regulation (3).

(5) Before the enquiry officer, the Foreign Venture Capital Investor may appear through any person duly authorised by the Foreign Venture Capital Investor:

~~Provided that no lawyer or advocate shall be permitted to represent the Foreign Venture Capital Investors at the enquiry:~~

~~Provided further that where a lawyer or an advocate has been appointed by the Board as a presenting officer under sub-regulation (6), it shall be lawful for the Foreign Venture Capital Investor to present its case through a lawyer or advocate.~~

(6) The enquiry officer may, if he considers it necessary, ask the Board to appoint a presenting officer to present its case.

(7) The enquiry officer shall, after taking into account all relevant facts and submissions made by the Foreign Venture Capital Investor, submit a report to the Board and recommend the penal action, if any, to be taken against the Foreign Venture Capital Investor as also the grounds on which the proposed action is justified.

Show-cause notice and order

25. (1) On receipt of the report from the enquiry officer, the Board shall consider the same and may issue to the Venture Capital Investor a show-cause notice as to why the penal action as proposed by the enquiry officer or such appropriate action should not be taken against it.

(2) The Foreign Venture Capital Investor shall, within fourteen days of the date of the receipt of the show-cause notice, send a reply to the Board.

(3) The Board, after considering the reply, if any, of the Foreign Venture Capital Investor, shall, as soon as possible pass such order as it deems fit.

Effect of suspension and cancellation of certificate

26. (1) On and from the date of the suspension of the certificate, Foreign Venture Capital Investor shall cease to carry on any activity as a Foreign Venture Capital Investor during the period of suspension, and shall be subject to such directions of the Board with regard to any records, documents or securities that may be in its custody or control, relating to its activities as Foreign Venture Capital Investor, as the Board may specify.

(2) On and from the date of cancellation of the certificate, the Foreign Venture Capital Investor shall, with immediate effect, cease to carry on any activity as a Foreign Venture Capital Investor, and shall be subject to such directions of the Board with regard to the transfer of records, documents or securities that may be in its custody or control, relating to its activities as Foreign Venture Capital Investor, as the Board may specify.

Publication of order of suspension or cancellation

27. The order of suspension or cancellation of certificate passed under Regulation 25 shall ~~may~~ be published by the Board in two English language newspapers.

Action against intermediary

28. The Board may initiate action for suspension or cancellation of registration of an intermediary holding a certificate of registration under section 12 of the Act who fails to exercise due diligence in the performance of its functions or fails to comply with its obligations under these Regulations.

Provided that no such certificate of registration shall be suspended or cancelled unless the procedure specified in the Regulations applicable to such intermediary is complied with.

9* Appeal to Securities Appellate Tribunal

29. Any person aggrieved by an order of the Board under these regulations may prefer an appeal to the Securities Appellate Tribunal in accordance with section 15T of the Act.

CHAIRMAN
SECURITIES AND EXCHANGE BOARD OF INDIA

**FIRST SCHEDULE
FORM A
SECURITIES AND EXCHANGE BOARD OF INDIA
(FOREIGN VENTURE CAPITAL INVESTORS) REGULATIONS, 2000
(REGULATION 3)**

**APPLICATION FORM FOR GRANT OF CERTIFICATE OF
REGISTRATION AS FOREIGN VENTURE CAPITAL INVESTOR
WITH THE SECURITIES AND EXCHANGE BOARD OF INDIA**

**SECURITIES AND EXCHANGE BOARD OF INDIA
Mittal Court `B' Wing, 1st Floor
Nariman Point, Bombay - 400 021, INDIA**

1. Name, address, telephone no., telex no. and fax no. of the applicant. In case the applicant has a representative office in India, the particulars may also be given for that office.

2. Please indicate whether the applicant belongs to any one or more of the following categories:

Pension Fund, Mutual Fund, Investment Trust, Investment company, trust, Investment partnership, Asset Management Company, Investment manager, Investment Management Company, Endowment fund, University fund, Charitable institutions or any other investment vehicle incorporated and established outside India.

3. a) The date and place of incorporation of the applicant. (Details of statute under which incorporated).

b) Brief description of the principal activities of the applicant and the year of commencement of such activities.

c) Brief description of the group, if any, to which the applicant belongs.

4. Whether any of the following documents are submitted?
i. Copy of certificate of registration with home regulator; or
ii. Copy of income tax return filed in the home country; or
iii. Copy of bankers certificate fair track record of the applicant

5. Please also state whether there has been any instance of violation or non-adherence to the securities laws, code of ethics/conduct, code of business rules, for which the applicant, or its parent/ holding company or affiliate may have been subjected to economic, or criminal liability or suspended from carrying out its operations, or the registration has been revoked, temporarily or permanently. If no, submit an undertaking.

~~6. Please indicate the names of the clients on whose behalf you propose to invest in India.~~

6.7. Please indicate the manner in which you propose to conduct your investments in India i.e. whether through an establishment in India or through any other office outside India. Please give details, and also the name of the contact person/compliance officer.

8. Name and address of the designated bank branch in India through whom investment is proposed to be made.

9. a) Name, address, telephone no., telex no., and fax no. of the domestic custodian. Please also present the background information on the custodian, including volume of business handled, infrastructure and the number of investment companies for which the domestic custodian is acting, or has acted, as custodian.

b) Particulars of the agreement entered into with the domestic custodian.

We hereby agree and declare that the information supplied in the application, including the attachment sheets, is and true.

AND we further agree that we will immediately notify the Securities and Exchange Board of India of any change in the information provided in the application.

We further agree that we shall comply with the provisions of the Act, and Regulations issued thereunder and all other relevant laws. We further agree that as a condition of grant of certificate of registration, we shall abide by such instructions/ directives as may be issued by Securities and Exchange Board of India under the provisions of the Act from time to time.

For and on behalf of _____
(Name of the applicant)

Authorised Signatory _____
(Name)
(Signature)

Date:

Place:

Note:

1. Securities and Exchange Board of India (SEBI) reserves the right to call for any further information from the applicant regarding his application.

2. Applications, superscribed "Application for Registration of Foreign Venture Capital Investors", should be in duplicate, in sealed envelopes, at Securities and Exchange Board of India's office.

Documents to be enclosed with the application:

- a. Documents to support registration or regulation by a Securities Commission and / or Self Regulatory Organisation, or any other appropriate regulatory/registering authority; or
- b. Copy of income tax return filed in the home country; or
- c. Copy of bankers certificate for fair track record of the applicant

FORM B
SECURITIES AND EXCHANGE BOARD OF INDIA
(FOREIGN VENTURE CAPITAL INVESTORS) REGULATIONS, 2000
[SEE REGULATION 7(3)]
CERTIFICATE OF REGISTRATION AS FOREIGN VENTURE
CAPITAL INVESTOR

I. In exercise of the powers conferred by sub-section (1) of section 12 of the Securities and Exchange Board of India Act, 1992, 15 of 1992) read with the regulations made thereunder the Board hereby grants a certificate of registration to -----
----- as a Foreign Venture Capital Investor subject to the conditions specified in the Act and in the regulations made thereunder.

II. The Registration Number of the foreign venture capital investor is IN/FVCI/ /

Date:

Place: MUMBAI

By order

Sd/-

For and on behalf of

SECURITIES AND EXCHANGE BOARD OF INDIA

SECOND SCHEDULE
SECURITIES AND EXCHANGE BOARD OF INDIA
(FOREIGN VENTURE CAPITAL INVESTOR) REGULATIONS, 2000
[SEE REGULATIONS 3 AND 7(2)]
FEES
PART A

Amount to be paid as fees

Application fee (US\$)

1, 000

Registration fee shall be payable at the time of registration for grant of certificate US \$ 10, 000

PART B

I. The fees specified above shall be payable by bank draft in favour of "The Securities and Exchange Board of India" payable at Mumbai.

THIRD SCHEDULE
[SEE REGULATION 2 (j)]
SECURITIES AND EXCHANGE BOARD OF INDIA
(FOREIGN VENTURE CAPITAL INVESTOR) REGULATIONS, 2000
NEGATIVE LIST

1. Real estate

2. Non-banking financial services

3. Gold financing

4. Activities not permitted under the Industrial Policy of Government of India

5. Any other activity which may be specified by the Board in consultation with the Government of India from time to time.

ANNEXURE III

AMENDMENTS TO THE PROVISIONS OF THE INCOME TAX ACT, 1961

Section 2 (42A): ["short-term capital asset" means a capital asset held by an assessee for not more than [thirty-six] months immediately preceding the date of its transfer:]

[Provided that in the case of a share held in a company [or any other security listed in a recognised stock exchange in India or a unit of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963) or a unit of a Mutual Fund specified under clause (23D) of section 10] or a unit of a Venture Capital Fund specified under clause (23FB) of section 10 or a share of a Venture Capital Company specified under clause (23FB) of section 10, the provisions of this clause shall have effect as if for the words "thirty-six months", the words "twelve months" had been substituted.]

[Explanation 1].—(i) In determining the period for which any capital asset is held by the assessee—

(a) in the case of a share held in a company in liquidation, there shall be excluded the period subsequent to the date on which the company goes into liquidation ;

(b) in the case of a capital asset which becomes the property of the assessee in the circumstances mentioned in [sub-section (1)] of section 49, there shall be included the period for which the asset was held by the previous owner referred to in the said section ;

[(c) in the case of a capital asset being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a transfer referred to in clause (vii) of section 47, there shall be included the period for which the share or shares in the amalgamating company were held by the assessee ;]

[(d) in the case of a capital asset, being a share or any other security (hereafter in this clause referred to as the financial asset) subscribed to by the assessee on the basis of his right to subscribe to such financial asset or subscribed to by the person in whose favour the assessee has renounced his right to subscribe to such financial asset, the period shall be reckoned from the date of allotment of such financial asset ;

(e) in the case of a capital asset, being the right to subscribe to any financial asset, which is renounced in favour of any other person, the period shall be reckoned from the date of the offer of such right by the company or institution, as the case may be, making such offer ;]

[(f) in the case of a capital asset, being a financial asset, allotted without any payment and on the basis of holding of any other financial asset, the period shall be reckoned from the date of the allotment of such financial asset ;]

[(g) in the case of a capital asset, being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, there shall be included the period for which the share or shares held in the demerged company were held by the assessee;]

[(h) in the case of a capital asset, being a unit or units of a Venture Capital Fund, which becomes the property of the assessee in consideration of a reorganisation, there shall be included the period for which the a unit or units of held in the Venture Capital Fund were held by the assessee;

(ii) In respect of capital assets other than those mentioned in clause (i), the period for which any capital asset is held by the assessee shall be determined subject to any rules which the Board may make in this behalf ;]

[Explanation 2.—For the purposes of this clause, the expression "security" shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) ;]

Existing:

Section 10 (23FB): ~~any income of a venture capital company or venture capital fund which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and regulations made thereunder set up to raise funds for investment in a venture capital undertaking.~~

~~Explanation[1] For the purposes of this clause,—~~

~~(a) "venture capital company" means such company—~~

~~(i) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and regulations made thereunder;~~

~~(ii) which fulfils the conditions as may be specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification in the Official Gazette, in this behalf;~~

~~(b) "venture capital fund" means such fund—~~

~~(i) operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908) or operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);]~~

~~(ii) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and regulations made thereunder;~~

~~(iii) which fulfils the conditions as may be specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification in the Official Gazette, in this behalf; and~~

~~(c) "venture capital undertaking" means a domestic company—~~

~~(i) whose shares are not listed in a recognised stock exchange in _____ India;~~

~~(ii) which is engaged in the business for providing services, production or manufacture of an article or thing but does not include such activities or sectors which are specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification^{18c} in the Official Gazette, in this behalf.]~~

~~[Explanation 2.— For the removal of doubts, it is hereby declared that the income of a venture capital company or venture capital fund shall continue to be exempt if the shares of the venture capital undertaking, in which the venture capital company or venture capital fund has made the initial investment, are subsequently listed in a recognised stock exchange in India;]~~

Section 47 – new sub-section to be inserted

(vie) _____ any transfer, in a scheme of reorganisation, of a capital asset being a unit or units held in a venture capital fund, by such venture capital fund to the resulting venture capital fund, if –

(a) _____ the unitholders holding not less than three-fourths in value of the units of such venture capital fund continue to remain unitholders of the resulting venture capital fund, and

(b) _____ the resulting venture capital fund has been or will be granted a certificate of registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and regulations made thereunder;

(vif) any transfer by a unitholder, in a scheme of reorganisation, of a capital asset being a unit or units held by him in a venture capital fund, if—
(a) the transfer is made in consideration of the issue to him of any unit or units held in a venture capital fund, and
(b) the resulting venture capital fund has been or will be granted a certificate of registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and regulations made thereunder;

Section 49. Cost with reference to certain modes of acquisition.

(1) Where the capital asset became the property of the assessee—

(i) on any distribution of assets on the total or partial partition of a Hindu undivided family;

(ii) under a gift or will;

(iii) (a) by succession, inheritance or devolution, or

[(b) on any distribution of assets on the dissolution of a firm, body of individuals, or other association of persons, where such dissolution had taken place at any time before the 1st day of April, 1987, or]

(c) on any distribution of assets on the liquidation of a company, or

(d) under a transfer to a revocable or an irrevocable trust, or

(e) under any such transfer as is referred to in clause (iv) [or clause (v)] [or clause (vi)] [or clause (via)] or clause (vie) or clause (vif) of section 47;

Section 115 U:

(1) Notwithstanding anything contained in any other provisions of this Act, any income received by a person out of investments made in a venture capital company or venture capital fund shall be chargeable to income-tax in the same manner as if it were the income received by such person had he made investments directly in the venture capital undertaking.

(1a) Notwithstanding anything contained in any other provisions of this Act, any tax deducted at source on payments made to a venture capital company or a venture capital fund on shall be available as a tax credit to the person receiving such income from a venture capital company or a venture capital fund in the same manner as if it was the tax deducted at source on income received by such person had he made investments directly in the venture capital undertaking.

(2) The person responsible for making payment of the income on behalf of a venture capital company or a venture capital fund and the venture capital company or venture capital fund shall furnish, within such time as may be prescribed, to the person receiving such income and to the prescribed income-tax authority, a statement in the prescribed form and verified in the prescribed manner, giving details of the nature of the income paid during the previous year and such other relevant details as may be prescribed.

(3) The income paid by the venture capital company and the venture capital fund shall be deemed to be of the same nature and in the same proportion in the hands of the person receiving such income as it had been received by, or had accrued to, the venture capital company or the venture capital fund, as the case may be, during the previous year.

(3a) If any tax has been deducted at source when payments are made to a venture capital company or a venture capital fund a corresponding tax credit for such taxes paid shall be available to the shall be shall be deemed to be of the same nature and in the same proportion in the hands of the person receiving such income as it had been received by, or had accrued to, the venture capital company or the venture capital fund, as the case may be, during the previous year.

(4) The provisions of Chapter XII-D or Chapter XII-E or Chapter XVII-B shall not apply to the income paid by a venture capital company or venture capital fund under this Chapter.

Explanation.—For the purposes of this Chapter, “venture capital company”, “venture capital fund” and “venture capital undertaking” shall have the meanings respectively assigned to them ~~in~~ under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and regulations made thereunder clause (23FB) of section 10.]

Section 196:

Notwithstanding anything contained in the foregoing provisions of this Chapter, no deduction of tax shall be made by any person from any sums payable to—

- (i) the Government, or
- (ii) the Reserve Bank of India, or
- (iii) a corporation established by or under a Central Act which is, under any law for the time being in force, exempt from income-tax on its income, or
- (iv) a Mutual Fund specified under clause (23D) of section 10, or
- (v) a Venture Capital Fund or a Venture Capital Company specified under clause (23FB) of section 10.

where such sum is payable to it by way of interest or dividend in respect of any securities or shares owned by it or in which it has full beneficial interest, or any other income accruing or arising to it.]