

# Impact Investing Simplified

A Guide to Making and Receiving  
Impact Investments in India

July 2019



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FOUNDATION





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**A Guide to Making and Receiving Impact Investments in India**

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July 2019



**Nishith Desai** Associates  
LEGAL AND TAX COUNSELING WORLDWIDE



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# Foreword

The Thomson Reuters Foundation has always championed the emerging inclusive economy. A key priority for TrustLaw, the Thomson Reuters Foundation's global pro bono service, is to support innovative organisations who are using market forces to address environmental, humanitarian and social problems across the globe.

In India there has been a rise in the number of social enterprises and there is a growing interest in impact investing, as social enterprises look to expand and seek alternate means of funds. Despite the growing interest, there is a knowledge gap among entrepreneurs and accelerators in understanding the legal landscape and managing negotiations in relation to impact investing in India.

In collaboration with Nishith Desai Associates and Aspen Network of Development Entrepreneurs (ANDE), TrustLaw's goal is to build capacity in this area by publishing this guide on "Impact Investing in India".

This guide aims to educate social enterprises, incubators, accelerators, capacity developers, and investors on impact investing. It includes relevant laws and potential structures to access impact investing funds and can be used as a resource when entering investment negotiations.

We are proud of this resource and hope the guide is a valuable tool to support impact investing in India. We also wish to acknowledge the outstanding effort and extensive resources that our partners provided in preparing this guide, including those who kindly agreed to be featured.

We hope that this guide will ultimately empower social enterprises to act with confidence and achieve the positive outcomes they seek.



**Nicholas Glicher**

*Chief Operating Officer*

*Thomson Reuters Foundation*

## Acknowledgements

The Thomson Reuters Foundation and the Aspen Network of Development Entrepreneurs (ANDE) are extremely grateful to the following authors of this Guide. This Guide would not have been possible without their expertise, time, and commitment.

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**Meyyappan Nagappan** - Leader, International Tax and Social Finance

**Rahul Rishi** - Leader, Social Sector Practice

**Anuja Maniar** - Associate, International tax

We would also like to thank the ANDE India Steering Committee and the ANDE SGB Finance Learning Lab for their insights and for leading the discussions that led to the production of this Guide. A final and special thanks to Tushar Thimmiah, while interning at Villgro, for drafting and sharing the template term sheet (Annexure I) as a part of this Guide.

## Disclaimer

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TrustLaw is the Thomson Reuters Foundation's global pro bono legal programme, connecting the best law firms and corporate legal teams around the world with high-impact NGOs and social enterprises working to create social and environmental change. We produce ground-breaking legal research and offer innovative training courses worldwide. Through TrustLaw, over 120,000 lawyers offer their time and knowledge to help organisations achieve their social mission for free. This means NGOs and social enterprises can focus on their impact instead of spending vital resources on legal support. TrustLaw's success is built on the generosity and commitment of the legal teams who volunteer their skills to support the NGOs and social enterprises at the frontlines of social change. By facilitating free legal assistance and fostering connections between the legal and development communities we have made a huge impact globally.

We have supported grassroots organisations to employ their first staff members, helped vulnerable women access loans to start their first businesses and brought renewable energy lighting to slums. Free legal assistance on these small projects has had a big impact on local communities working to overcome poverty and discrimination. At a global scale, we have supported legal reform activities to protect the rights of millions of domestic workers, changed legislation to support victims of violence, produced guides to protect people who experience street harassment, and crafted tools to support the prosecution of trafficking offenders.

Legal research reports and other TrustLaw publications are legal resources that take an in-depth look at a legal issue in a country or number of countries. This may be in the form of a comparative analysis of laws in different countries, or a legal landscape analysis. These resources aim to help TrustLaw members advocate for legal reform, inform policy activities or propose legal amendments.

Our resource library can be found on the TrustLaw homepage at [www.trust.org](http://www.trust.org).



## Aspen Network of Development Entrepreneurs

The Aspen Network of Development Entrepreneurs (ANDE) is a global network of organizations that propel entrepreneurship in emerging markets. ANDE members provide critical financial, educational, and business support services to small and growing businesses (SGBs) based on the conviction that SGBs will create jobs, stimulate long-term economic growth, and produce environmental and social benefits. Ultimately, we believe that SGBs can help lift countries out of poverty.

ANDE members share the view that targeted support for SGBs represents the most effective way to create the kinds of jobs that can lift families, and entire nations, out of poverty. ANDE members support “the missing middle”—the small and growing businesses that are engines of growth in emerging markets and have the potential to address critical social and environmental challenges. The ANDE team supports members globally and locally to build strong ecosystems for entrepreneurial growth. ANDE develops unique initiatives to address systemic challenges and seize opportunities that can only be approached through collective action.

Launched with 34 members in 2009, ANDE now comprises more than 280 members who collectively operate in more than 150 countries. Members of ANDE include both for and non-profit investment funds, capacity development providers, research and academic institutions, development finance institutions, foundations and corporations from around the world. ANDE is based in Washington, D.C. with regional chapters covering the ANDEAN countries, Brazil, East Africa, Central American and Mexico, East and Southeast Asia, India, South Africa, and West Africa.

To learn more, visit our website at [www.andeglobal.org](http://www.andeglobal.org).

## Nishith Desai Associates

At Nishith Desai Associates, we have earned the reputation of being Asia's most Innovative Law Firm – and the go-to specialists for companies around the world, looking to conduct businesses in India and for Indian companies considering business expansion abroad. In fact, we have conceptualized and created a state-of-the-art Blue Sky Thinking and Research Campus, Imaginarium Aligunjan, an international institution dedicated to designing a premeditated future with an embedded strategic foresight capability. We are a research and strategy driven international firm with offices in Mumbai, Palo Alto (Silicon Valley), Bangalore, Singapore, New Delhi, Munich, and New York. Our team comprises of specialists who provide strategic advice on legal, regulatory, and tax related matters in an integrated manner basis key insights carefully culled from the allied industries. As an active participant in shaping India's regulatory environment, we at NDA, have the expertise and more importantly – the VISION – to navigate its complexities. Our ongoing endeavors in conducting and facilitating original research in emerging areas of law has helped us develop unparalleled proficiency to anticipate legal obstacles, mitigate potential risks and identify new opportunities for our clients on a global scale. Simply put, for conglomerates looking to conduct business in the subcontinent, NDA takes the uncertainty out of new frontiers. As a firm of doyens, we pride ourselves in working with select clients within select verticals on complex matters. Our forte lies in providing innovative and strategic advice in futuristic areas of law such as those relating to Blockchain and virtual currencies, Internet of Things (IOT), Aviation, Artificial Intelligence, Privatization of Outer Space, Drones, Robotics, Virtual Reality, Ed-Tech, MedTech & Medical Devices and Nanotechnology with our key clientele comprising of marquee Fortune 500 corporations. NDA has been the proud recipient of the RSG-FT award for 2019, 2017, 2016, 2015, 2014 as the 'Most Innovative Indian Law Firm' and in 2016 we were awarded the 'Most Innovative Law Firm - Asia Pacific,' by Financial Times (London). We are a trust based, non-hierarchical, democratic organization that leverages research and knowledge to deliver extraordinary value to our clients. Datum, our unique employer proposition has been developed into a global case study, aptly titled 'Management by Trust in a Democratic Enterprise,' published by John Wiley & Sons, USA.

Globally, impact investment markets have been shown to thrive in jurisdictions where the Government is supportive. NDA has taken several steps over the past two decades for the creation of a favorable impact investment ecosystem including policy measures such as making representations on behalf of the Impact Investors Council to the CSR committee set up the Ministry of Corporate Affairs. We have also presented our book chapter on *"Enabling Impact Investment Ecosystem and Improving CSR Targeting"* at the invitation of the University of Lund at a conference for tax sustainability in Sweden which was attended by leading experts around the world.

However, while the current state of laws in India is less than desirable, we wish to share our excitement and the tremendous opportunities that exist even within the current system. Using our expertise, NDA has assisted several investors in setting up social impact funds, including social venture funds and category II Alternate Investment Funds for Social Alpha, Omnivore, and several impact funds for Lok Capital. NDA is also helping the Global Steering Group for Impact Investments in launching outcome based funds in India, namely the India Education Outcomes Fund (IEOF) which is a USD 1 billion fund aimed at improving the quality of K-12 education in government schools. We have also assisted Bridge International Academies, which is focused on low cost schooling, with their India entry and operations. We are also advising large US based Foundations on pioneering equity plays into the impact investment space in India.

On the philanthropic side, NDA has assisted Brookings Institution, Bill & Melinda Gates Foundation, David & Lucile Packard Foundation, Pisces Foundation, American India Foundation, Human Rights Watch, Jon Snow Inc., Amnesty International, The Global Steering Group for Impact Investment (GSG), Social Finance India (SFI), Impact Investors Council (IIC), Yunus Social Lab (YSB), The Global Education & Leadership Foundation (TGELF) and several industry bodies on impact investment.

## **NDA's achievements**

We also won the prestigious 'Innovation in the Rule of Law and Access to Justice' award together with Blueprint for Free Speech awarded by Financial Times (2019).

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# List of Abbreviations

Abbreviations	Meanings/Full forms
AIF	Alternate Investment Fund
AUM	Assets Under Management
BPT	Bombay Public Trust Act
CCD	Compulsorily Convertible Debentures
CCPS	Compulsorily Convertible Preference Shares
CSR	Corporate Social Responsibility
DDT	Dividend Distribution Tax
DFI	Development Finance Institutions
ECB	External Commercial Borrowing
ESG	Environmental, Social, and Governance
FATF	Financial Action Task Force
FCY	Foreign Currency
FCRA	Foreign Contribution (Regulation) Act
FDI	Foreign Direct Investments
FEMA	Foreign Exchange Management Act
FPI	Foreign portfolio investment
FVCI	Foreign Venture Capital Investor
GST	Goods & Services Tax
IEC	Import Export Code
IOSCO	International Organisation of Securities Commissions
IRC	Internal Revenue Code
ITA	Income Tax Act,
LLP	Limited Liability Partnership
MAMP	Minimum average maturity period
MAT	Minimum Alternate Tax
MHA	Ministry of Home Affairs
NCD	Non-Convertible Debentures
OECD	Organisation for Economic Co-operation and Development
OCD	Optionally Convertible Debentures
OCI	Overseas Citizen Of India
OCRPS	Optionally Convertible Redeemable Preference Shares
PAN	Permanent Account Number
PE	Private Equity
PIO	Person of Indian Origin
PLC	Private Limited Company
PRI	Program-related Investments
RBI	Reserve Bank of India
RDB	Rupee Denominated Bonds
SDG	Sustainable Development Goals
SEBI	Securities Exchange Board of India
SIB	Social Impact Bonds
SVF	Social Venture Funds
TAN	Tax Deduction Account Number
TDS	Tax Deduction at Source
TISPRO	Transfer or Issue of Security by a Person Resident Outside India

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UBS	Union Bank of Switzerland
USD	United States Dollar
VCF	Venture Capital Fund
WOS	Wholly-Owned Subsidiary

# 1. Introduction

Impact investors intentionally and explicitly seek the dual objective of producing both financial and social/ environmental returns. This is a significant move away from both traditional business (that only focuses on maximizing financial gains) and from traditional philanthropy (that involves grant making with no expectation of returns).

The rise of impact investing has been a timely response to several increasing uncertainties facing the world climate change, youth unemployment, poverty, steep economic inequality, lack of accessibility to water, basic education or healthcare, and the lack of absolute economic progress (that is leading to the rise of populism and the dismantling of institutions of liberal democracy), and the need for sustainable, impactful businesses are amongst several issues that require immediate and collaborative action.

The United Nations adopted the Sustainable Development Goals in 2015 calling for the partnership of governments, private sector, civil society, and citizens alike to end poverty and economic inequality as well as ensure environmental sustainability by 2030. While the governments of various countries are encouraged to integrate these missions in their development plans and policies, developing nations find it harder to implement them due to lack of funds, poor infrastructure, and resource constraints. They also find it difficult to efficiently use available funding in a highly targeted manner. This assumes further significance as sources of development finance dry up.

While impact investing is not a panacea for all the issues, it can make a significant difference by:

- Aligning interests of stakeholders in a manner that balances financial returns and environmental or social concerns;
- Adding to the available pool of capital to solve developmental issues;
- Having a positive influence on environmental and social issues;

- Improve targeting of spends and thereby ensure efficient use of available capital to maximize impact; and,
- Enabling people to attain a better economic status.

## Purpose of this Guide

Despite there being tremendous interest from impact investors, funders, and social enterprises, deal-making appears to be lower than expected.

The less than efficient functioning of the impact investment market is partly explained by:

- The differences between the social enterprises that are available to willingly invest in impact capital (considering their investment goals in terms of financial and social returns) and their liquidity requirements on the one hand, and the social enterprises actually available in the market that are ready to absorb impact capital on the other.
- An equally important reason cited by several stakeholders is complex legal, tax, and regulatory framework in this area. Further, in our experience, a limited understanding of the various laws that apply to this space also drives stakeholders to err on the side of abundant caution and therefore adopt an attitude of cautious enthusiasm.

With this in mind, we write this Guide with two goals. First, by setting out basic guidelines, we wish to help those already in the investing space and interested in getting involved in impact investing determine the right approach from the investors' and the social entrepreneurs' perspectives. Secondly, we wish to offer practical advice based on our experience, where we have witnessed critical impact investment discussions. In this paper, we will attempt to bridge the gap between theory and real-world implications, particularly in the Indian context.

In the following paper, we refer to several examples of Impact Investments in India, various sources of funding, impact investors, applicable laws, and discuss some innovative social finance models that NDA has developed. However, our intention while doing so is to be illustrative rather than comprehensive.

If you are a newcomer, you may have questions as to what is the best way to make or receive impact investments in India. How is it different from venture philanthropy or socially responsible investing? If you are a more seasoned stakeholder, you may be looking for more sophisticated financing models that allow you to scale and maximize impact or you may be wondering how impact investments can be tied legally to social and environmental objectives from a governance perspective.

In writing this Guide, we take another step forward in creating a world where making an impact investment into a social enterprise in India becomes as easy a choice as providing a grant or making a conventional investment from a legal perspective.

**Chapters 1 to 8** are intended for newcomers although some of the details in **Chapter 6** regarding the different entry routes into India might be of interest to seasoned impact investors. **Chapter 9** should be of interest to seasoned impact investors who are looking for new models for their future investments, and gives a high-level overview of what could be possible.

## 2. What is Impact Investing?



Traditionally, dominant economic theories of the firm and of management centred around the common belief that company's principal motivation is to generate profit for its shareholders. The formulation of these theories have been both resultant in and stemming from the fact that traditional forms of investment have been made for purely financial reasons. Some investors who made profits, would then simply set aside a portion of the profits for charity or philanthropy.

However, through the course of the 19<sup>th</sup> century, the influence of specific religious and social institutions gradually manifested in moral imperatives, it became a matter of ensuring that financial investment in "sin stocks" such as alcohol or tobacco should be avoided. This sort of approach, typified by some as 'Socially Responsible Investing' (SRI), has been more recently adopted by high net worth individuals who realized that their investment strategies needed to complement the goals that their own foundations were trying to achieve, otherwise, their disparate funds would be working at cross-purposes. The most recent evolution of this approach includes the adoption of Environmental, Social and Governance (ESG) standards by several funds or pooling vehicles used to gather investments and deployed for specific purposes or investments.

An evolution of traditional grant giving or charity began to become discernible, as 'venture philanthropy' emerged, representing a higher touch, higher engagement approach wherein non-financial assistance, mentorship and guidance vis-à-vis the achievement of operationally sustainable models were offered in addition to grant funding to help a new social enterprise become independent over time. While typically there are no (or very low) expected returns in this model, the risk of the social enterprise failing and the consequent risk of not recovering the grant was borne by the venture philanthropist.

Unlike with grants and venture philanthropy, impact investments bring with them an expectation of financial returns. Unlike with socially responsible investing, the long-term objective is to achieve more than just "do no harm" practices while making impact investments.

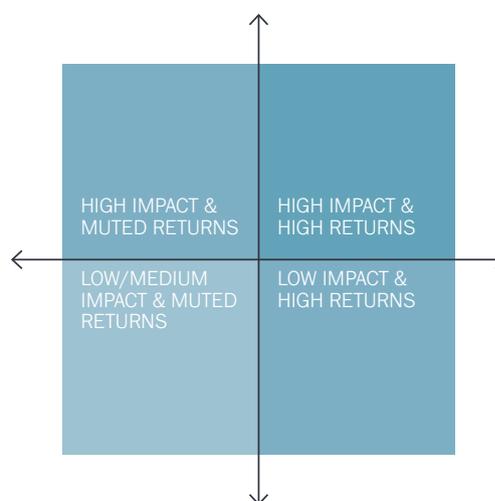
Impact investing therefore lies on a spectrum of investment philosophy upon which investors invest with the dual goals of both profit and impact.

### 3. Impact Investment Philosophies – Understanding The Investors

From the perspective of social enterprises, it is essential to understand investors’ goals before approaching them for funding or while negotiating an impact investment. The following parameters may be useful to consider:

- The **risk profile** that the investor may be willing to invest in – for instance a social start-up which could be perceived of as highly risky or in a successful start-up that is looking for finance to scale operations or in mature companies looking to expand into other geographies.
- The **scale of the intended investment** – some investors look for small to medium scale projects while other investors are interested in projects that have the scale to maximize impact and therefore worth their time and capital.
- The **time commitment or personal involvement of the investor** – some investors have the time, resource and expertise in the area where they wish to make a difference and hence be able to mentor or closely monitor the social enterprise by sitting on its board for instance. Some investors may have significant funds at their disposal but neither the time nor the experience in a particular sector to offer guidance and may therefore prefer to invest through intermediaries such as funds, or their own family offices run by professionals who are given a certain mandate.
- The **geography and sector** upon which the investor is focused – most investors are looking for opportunities either within a certain sector like agriculture or a certain geography such as India or South Asia or they may have a further specific goal in mind (i.e educating girls below the age of 12).
- **Liquidity requirements** of the investor – while social enterprises require patient capital and a willingness to defer return expectations beyond generally accepted horizons, investors also have to be cognizant of their yearly liquidity requirements for any annual disbursements of expenses.

- **Rate of financial and social returns on investment** – while some investors expect market or above market rate returns, many investors simply usually expect market rate or muted rates and concurrent returns of demonstrable social or environmental impact. This range of expectations also lies along a spectrum whereupon there could be different permutations as shown below:



Generally, high impact and high returns is the best possible outcome, although less frequent. Most deals are likely to fall either within the high impact and muted returns or low impact and high returns bucket.

While outcome-first projects where returns are likely to be tied to the achievement of outcomes should fall within the high impact and muted returns bucket in most cases, the socially responsible investing model may be more likely to result in low impact and high returns in most cases.

The summary by the OECD in its report is useful to see the risk, returns, and impact profile of different impact investors:

	Financial - only	Responsible	Sustainable	Impact		Impact - only	
	<b>Delivering competitive financial returns</b>						
	<b>Mitigating Environmental, Social and Governance risks</b>						
		<b>Pursuing Environmental, Social and Governance opportunities<sup>10</sup></b>					
			<b>Focusing on measurable high-impact solutions</b>				
			<b>Competitive financial returns</b>		<b>Below market financial returns</b>		
<b>Investment profile</b>	Limited or no regard for environmental, social or governance practices	Mitigate risky environmental, social or governance practices in order to protect value	Adopt progressive environmental, social or governance practices that may enhance value	Address societal challenges that generate competitive financial returns for investors	Address societal challenge(s) which may generate a below market financial return for investors	Address societal challenge(s) that require a below market financial return for investors	Address societal challenge(s) that cannot generate a financial return for investore

There are a diversity of goals reflected within the positioning of the key players on the impact investment landscape, and the starting point on any legal structuring exercise is to clearly understand what specific stakeholder parties want commercially.

Investors, new or sophisticated, too, should be relatively clear upon what their investment objectives are for each project since there is frequently no clear operational path forward, specifically for those enterprises engaged in the business of market-making and service to the last-mile. Navigating the relevant legal issues and identifying terms that meet the needs of both investors and entrepreneurs can be particularly challenging.

Once parties are clear on the parameters such as those mentioned above, as well as, on commercial objectives, it becomes easier to discern which instruments or approaches in deployment of funding may be most appropriate to the needs of a social venture. The specific instruments or methods of funding commonly used are addressed in the next chapter.

## 4. Who are The Impact Investors?

Impact Investors categories in India and abroad:

- High Net-worth Individuals and their family offices;
- Foundations and charities;
- Banks;
- Impact funds including pension funds, sovereign wealth, and social venture funds;
- CSR pooling vehicles;
- CSR funding by companies;
- Angel investors;
- Funding platforms or exchanges like the Impact Investment Exchange based out of Singapore.

It is important that social entrepreneurs understand the diversity of funding sources that they may potentially tap and the motivations behind the investments such investors make.

Apart from the social or commercial reasons, there could be instances where such investments are being made for legal reasons as well.

- For instance, CSR pooling vehicles are required under law to demonstrate that at least 80% of the funding they receive in a year is spent for

charitable purposes in the same year. Further, banks in India could be looking to comply with the Reserve Bank of India's regulations requiring them to set aside a portion of their loan portfolios for businesses in "high impact" sectors.

- Even social venture funds such as Social Alpha are required under law to invest at least 75% of their investible corpus into social ventures as defined under the SEBI regulations.
- Alternatively, some foreign banks, such as UBS could be responding to client interest instead of any tax or regulatory requirements.

In addition to the above, it may also be possible to raise low interest financing or market rate loans. Further, if the social enterprise is successful it may also be able to tap private equity and venture capital funding since many of them have an impact investment portfolio these days.

Apart from the sources of funding set out above, it is important to note that in our experience majority of the funding was received from offshore investors and foundations. Domestic funding was predominantly restricted to funding by charities in India and CSR pooling vehicles, with some banks offering innovative financing options.

## 5. What are the Key Impact Investment Instruments?

Impact investments may be deployed through a range of instruments and modalities the most popular of which are detailed in this chapter.

Instruments also depend on the kinds of recipient entities being considered and the corresponding regulatory or legal restrictions surrounding the same. For instance, if the social enterprise is set up as a charitable trust, then it would not be able to issue debt instruments such as a non-convertible debenture. Similarly, if the social enterprise is set up as an LLP, it may face difficulties in receiving grant money from foundations. Keeping this in mind, broadly the investments can be routed either through debt or equity instruments or quasi-debt/equity instruments as well depending on the circumstances and objective in mind.

Globally, it appears that the predominant instrument for funding in impact investing is private debt, accounting for 34% of impact investors' reported assets under management ("AUM"), followed by real assets (22%) and private equity (19%).<sup>1</sup>

In contrast to the global phenomenon, the impact-investing ecosystem in India continues to receive equity as the most dominant instrument, primarily due to historical restrictions in the regulatory environment related to the treatment of external capital, which paid very close attention to the specific areas where debt from outside India was not allowable. This has also been the case because of the desire to control early growth stage enterprises by investors, though it has been equally clear that many focused on impact have not sought majority/controlling stakes on the cap tables of their investees. Investors typically seek to be assured that their capital is being utilized in the most efficient manner and it is true that equity investment has allowed them to seek additional modalities of oversight, like seats on boards of directors and voting rights.

Recent studies indicate that impact equity accounted for almost one-fifth of overall equity transactions in India in 2014-15. Indeed, impact equity investments are expected to grow by 30% in coming years.<sup>2</sup> Survey results show that impact investment in India, going forward, will target livelihood, education, and health services.

There is a lack of debt funding for early and growth stage enterprises due naturally in part to insufficient collateral,<sup>3</sup> but also due to interest rates standards set by regulatory bodies that make taking such debt in vulnerable market-building models simply untenable. One will be hard pressed to grow base of pyramid models paying 20-25% interest on debt, and yet this is frequently what is on offer, if at all, to social entrepreneurs with risky business models. This trend seems to be changing now. Part of the reason for such change could be attributed to the launch of a billion-dollar India Impact Fund in October 2018. This fund aims to focus on providing debt capital to social enterprises in development sectors like finance, health, education and renewable energy. This kind of debt investment is introduced at a time when most of the US\$ 5.2 billion of impact investments made in India over the last six years have exclusively focused on equity.<sup>4</sup> The timing could not be better, as there is extensive anecdotal evidence from impact investor portfolios to support the point that working capital is a massive, if not the most challenging, operating constraint.

Although both foreign and domestic impact funds are active in India, a majority are based offshore due to more favourable tax regulations. Of the total of about 50 prominent impact investment funds active in India, the estimate is that approximately

1. Mudaliar et al, 2017 Annual Impact Investor Survey, 25. Available at [https://thegiin.org/assets/GIIN\\_AnnualImpactInvestorSurvey\\_2017\\_Web\\_Final.pdf](https://thegiin.org/assets/GIIN_AnnualImpactInvestorSurvey_2017_Web_Final.pdf), (last accessed on Jan. 22, 2019)

2. Asia Asset Management Journal, A Natural Destination, June 2014 Vol. 19 No.6

3. *Supra* note 13, at 3

4. Business Standard, *Social sectors poised to get private debt-capital boost*, available at [https://www.business-standard.com/article/news-ians/social-sectors-poised-to-get-private-debt-capital-boost-comment-118101900341\\_1.html](https://www.business-standard.com/article/news-ians/social-sectors-poised-to-get-private-debt-capital-boost-comment-118101900341_1.html) (last accessed on Jan, 22, 2019)

80% are based outside the country, to avoid issues related to taxation and repatriation.<sup>5</sup>

While a brief summary is provided below, more details are available at: [http://www.nishithdesai.com/fileadmin/user\\_upload/pdfs/Research%20Papers/Private\\_Equity\\_and\\_Private\\_Debt\\_Investments\\_in\\_India.pdf](http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Private_Equity_and_Private_Debt_Investments_in_India.pdf)

## I. Debt

Debt Investment in India can be made by way of various instruments, such as:

1. Non-Convertible Debentures (“NCDs”) are debt instruments which cannot be converted into equity shares of a company. Return on NCDs is by way of interest that is payable on them and upside on sale or extinguishment. They are regarded as corporate debt and will accordingly be subjected to the overall corporate debt auction limits of India. Investment in NCDs can be made under the FPI Route or by an FVCI. External capital to the country does not avail itself of this option.
2. Compulsorily Convertible Debentures (“CCDs”) are instruments which mandatorily convert into equity shares of the issuing company on the conditions decided mutually at the time of issuance of the instruments. CCDs generally have a lower rate of interest than NCDs. CCDs are considered as capital instruments and investment in CCDs may be made under the FDI route. Therefore, this is obviously an option that some outside the country have opted to trial.
3. Optionally Convertible Debentures (“OCDs”) are instruments that may be converted to equity shares of a company but such conversion is not mandatory. Investment in OCDs may be made under the FVCI route.
4. Rupee Denominated Bonds (“RDBs”) or Masala Bonds are newer bond instruments issued by corporates outside India but are denominated in Indian Rupees. These bonds are generally priced

at 450 basis points over the prevailing government security rate. These bonds are governed by the directions issued by Reserve Bank of India (“RBI”) from time to time.

5. External Commercial Borrowing (“ECB”) are loans from foreign parties that can be availed by eligible social enterprises subject to meeting certain conditions such as that the lender and the business of the social enterprise should also qualify under the regulations therein for this route to be viable.
6. Loans could also be availed of at market or preferred rates from banks against collateral or otherwise.

While debt is typically preferred since it does not dilute the stake of the founder in the social venture and is also seen as less risky from the investor’s perspective compared to equity investment, it does pose challenges at times. Should the social enterprise not do well, it gets further burdened with interest payment obligations which would not be the case if the investor invested through equity or shares of the company.

## II. Equity Instruments

1. Equity share: The most common type of equity instrument is an ordinary share in a company which broadly gives the right to vote, right to any dividends declared from the profits of the company and any residual profits left on the winding up of the company.
2. Preference shares: There are several other types of shares that are quasi-equity instruments such as preference shares which does not provide voting rights but assures payment of a certain dividend to the investor or redeemable preference shares where the same preference share is redeemable at the option of either the company or the shareholder.
3. Compulsorily Convertible Cumulative Preference Shares (CCCPs): share can be convertible into equity shares as per the terms of the instrument at pre-determined prices on the occurrence of an event such as the company meeting certain performance milestones for instance.. Shares

5. Supra note 12, at 3

may be optionally convertible, but for external investors the compulsorily convertible route is most commonly employed, and coupon rates (of up to 14%) associated with the preference shares provides some modicum of downside protection, though many investors will defer this or leave it at quasi 0%, allowing the investee the space and time to generate organic value.

Investments from abroad into social enterprises in India are subject to restrictions under foreign direct investment regulations which are elaborated in later chapters.

### III. Investment into LLPs

Investments into LLPs are investments into the partnership interest of the Limited Liability Partnership. Unlike companies, where usually the voting rights and the right to dividend or residual profits are tied to the number of shares owned by the investor, in an LLP there is considerable flexibility to determine voting rights or right to the partnership profits. Such items are commercially decided between parties and need not be proportional to the contribution to the capital or partnership interest of the LLP.

### IV. Grants to Section 8 Companies or Charities

While Section 8 companies, which can be set up for not for profit purposes only, can accept shareholder capital and issue shares in return, public charitable trusts that are set up as a trust are not companies and therefore cannot issue equity or debt instrument. Therefore, public charitable trusts usually accept money in the form of grants or donations to their corpus. Section 8 companies are similar to public charitable trusts in that sense as they obtain similar tax exemptions under the Income Tax Act, 1961 similar to public charitable trusts and therefore can accept grants without adverse tax consequences subject to adhering to certain conditions.

## V. Pay for success contracts / Social Impact Bonds

One of the most unique models of funding for social impact was developed over the last decade whereupon basically an impact investment is made through what is called a 'pay for success' contract. The outcome funder, or the party who is willing to pay contingently upon seeing a particular outcome such as increased school participation (i.e. above 80% in a particular district), would engage a social venture to provide the service with such outcomes as targets. When the outcome is achieved and then verified by an independent outcomes evaluator, the outcome funder pays the social venture the outcomes payments as a service fee. In its simple form, therefore, this is essentially a service contract.

What becomes far more interesting is when the dynamics of leverage are built into such arrangements, existing primarily for optimised cash flow in a social venture, ensuring that it may be managed with payments tied frequently to specific operational and financial milestones. Such mechanisms are also called development impact bonds, as capital is raised in the expectation of future cost savings; these thus often require underwriting by public bodies (who would otherwise bear the costs of the societal problem). Further, in several situations, for the purposes of supporting clear cash flow needs, risk investors or patient investors are willing to capitalize a specific intervention knowing well that there is a risk of outcomes not being achieved, and contingent payments not being released accordingly.. On the achievement of outcomes, these specific funders either pay the social enterprise which returns the funding and profits to the risk investors or the risk investors are paid directly by the outcome funders. The devil is in the details, and in determining who defines and ascertains what metrics correspond to the threshold of 'achievement' of an outcome, bearing in mind that outcomes in and of themselves are not time delimited phenomena. The specific instruments used apart from the pay for success contract depend on where involved parties are located, commercial considerations, and jurisdictional aspects as relevant.

## VI. High level summary of differences between Private Equity and Private Debt

Sl. No.	Particulars	Private debt	Private equity
1.	Assured returns	Investors are eligible for assured returns on their investment through interest and redemption premium, both of which can be legally assured.	Returns on PE investments cannot be assured.
2.	Capital repatriation	Capital can be fully repatriated.	Repatriation of capital limited to buy-back or reduction of capital in the case of companies and subject to meeting certain requirements under law.
3.	Tax benefits	Interest payments are a deductible expense of the borrower.	Dividend payment and buyback are taxed at the hands of the investee company at 15% or 20% respectively in addition to corporate tax of 30%.  Foreign tax credit against such tax paid in India may be available.
4.	Sources of payment	Interest may be paid out of any source of the borrower.	Dividends can be paid out of profits only. Reduction of capital may be done without profits, but is a court driven process and subject to lender approvals.
5.	Security	Debt may be secured by creation of security over the assets of the borrower.	No security creation is possible to secure the investment amount or returns thereon.
6.	Equity upside	Returns may be structured as interest or redemption premium and linked to cash flow, share price etc. Hence, achieving equity like structure with tax optimization.	Returns may be structured by way of dividends or capital reduction, both of which may be tax efficient structures.
7.	Governance Rights	Limited rights are provided usually. Voting rights could be agreed contractually in some cases.	Greater governance and voting rights. However, it depends upon the type of shares being held and the percentage of shareholding. Additional protections can be put in place such as: <ul style="list-style-type: none"> <li>■ covenants that the business is carried out in line with the Impact investor's mission or objectives;</li> <li>■ board presence through the right to appoint a nominee of the Impact Investor on the board of the social venture</li> <li>■ affirmative or veto rights on certain matters granted to the impact investor</li> <li>■ clawback or the right to have the promoter of the social venture buy out the impact investor in the event of any breach of covenants etc.</li> </ul>

## 6. What are the Impact Investment Vehicles and Entry Routes for Impact Investors?

As stated earlier, not all impact investors may have the time or expertise to personally monitor an impact investment. In such situations, such investors may opt for approaches that look more like socially responsible investing (SRI) models and invest in impact investment products that give them a financial stake while having only a broad say in the ultimate underlying investments. This is typical for impact investment funds or social venture funds (such as Category I or Category II SEBI regulated funds) that comply with environmental, social and governance criteria. Alternatively, several impact investors may prefer to have professionals or wealth managers who run their family office make suitable investments. In such cases, wealth managers or the family offices wear both the hats of a philanthropy and that of an impact investor depending on the way the investments or grants are made. For instance, while in providing grants there is no expectation of a return, up to 5% of foundations' capital under US law can be invested for returns under the Project Related Investment (PRI) scheme provided making a profit is not the main intention.

The other alternative for impact investors, who do not wish to be involved in the day to day operations of a social enterprise may also adopt the role of an outcome funder in a pay for success contract. Impact investors may also set up their own entities in India and route funding in various forms through such entities subject to applicable laws.

Below there is an illustrative cross-section of the multiple routes for foreign impact investors to invest into India, each with its own advantages and restrictions:

### I. Foreign Direct Investment Route

Under the Foreign Direct Investment (“FDI”) regime, investment can only be made into equity shares, fully and compulsorily convertible preference shares (“CCPS”) and fully and compulsorily convertible debentures (“CCDs”). Investment through subscription of equity shares, CCPS and CCDs subject to the restrictions applicable to FDI. Equity shares, CCPS and/or CCD can be issued or acquired by an investor under the FDI regime at a price equal to or more than the fair market value of such instrument. At the point of capitalization, minimum floor valuations are set and it is important to know that subsequent valuations must be undertaken by independent statutory third party auditors stipulated to utilize particular methodologies, with protections in place vis-à-vis external capital and its power to strip Indian companies (particularly SMEs) of their value. This means that the price/conversion formula of CCPS and CCD is required to be provided upfront at the time of issuance thereof.

Please see below a brief comparison for equity shares, CCPS and CCD under the FDI route:

Particulars	Equity Shares	CCPS	CCD
<b>Basis Character</b>	Participation in governance and risk based returns.	Fixed dividend – convertible into equity shares	Assured coupon – convertible into equity shares.
<b>Returns</b>	Dividend may be declared out of profits of the company.		Fixed or variable interest coupon - not dependent on profits.
<b>Limits to Payment</b>	No cap on dividend	There is no cap on dividend.	No legal restrictions have been imposed on interest on CCD. However, in practice we have seen that the interest is capped to 300 basis points over and above the prevailing State Bank of India's prime lending rate at the time

			of issuance of CCD. This is in line with the condition applicable earlier on CCPS.
<b>Tax Implication</b>	Dividend is payable from post-tax income and an additional dividend distribution tax of 15% is levied on the company making distributions.		Interest expense deductible. Withholding tax can be as high as 40% but it can be reduced to 7.5% if investment done from favourable jurisdiction.
<b>Statutory Liquidation Preference</b>	CCDs ranks higher than CCPS in terms of liquidation preference. Equity shares gets the last preference. However, liquidation preference may be fixed contractually		
<b>Others</b>	Buy-back or capital reduction permissible	CCPS and CCDs need to be converted to equity shares before they can be bought back or extinguished by the Indian company.	

## II. Foreign Portfolio Investment Route

Foreign Portfolio Investors (“FPIs”) are permitted to invest in, inter alia, listed (or to be listed) or unlisted non-convertible debentures (“NCDs”) issued by an Indian company. This requires obtaining a license from the Securities Exchange Board of India and is subject to applicable limits in force at the time.

## III. Foreign Venture Capital Investment Route

Unlike FDI regime where investors can only subscribe to equity / CCDs / CCPS, Foreign Venture Capital Investors (“FVCIs”) can also invest into optionally convertible redeemable preference shares (“OCRPS”), OCDs and even NCDs. Please note that a FVCI may only invest in debt of those companies in which it has already made an equity investment.

FVCIs are permitted to invest in (i) Indian companies engaged in any of the 10 (ten) sectors specified in this regard, including the infrastructure sector; (ii) start-ups irrespective of the sector in which the start-up is engaged; (iii) units of a VCF or of a Category I Alternate Investment Fund (Cat I AIF) or units of a scheme or a fund set up by a VCF or by a Cat I AIF. The entry and exit pricing applicable to FDI regime do not apply to FVCIs. Investments by FVCIs are also subject to certain restrictions prescribed by the Securities and Exchange Board of India (SEBI) such as the restriction on the percentage of investible funds which may be invested in debt.

## IV. External Commercial Borrowing

Funding Indian corporates through debt has traditionally been a preferred mode of funding due to inherent advantages such as security creation, minimum guaranteed returns and tax optimization for both the lender as well as the borrower. The modes for offshore debt funding have been limited to external commercial borrowings (“ECB”), non-convertible debentures (“NCD”), compulsorily convertible debentures and certain hybrid debt instruments. Each of these options have been subjected to regulatory restrictions in terms of eligible lenders, eligible borrowers, end-use restrictions, etc.

### A. Forms of ECB

- **Option 1:** Track I and Track II ECBs clubbed as ‘Foreign currency denominated ECB’ (“FCY ECB”)
- **Option 2:** Track III and Rupee denominated bonds clubbed as INR denominated ECB (“INR ECB”)

### B. Eligible borrowers

- **FCY ECB:** All entities eligible to receive foreign direct investment (“FDI”)
- **INR ECB:** Same as FCY ECB, i.e. all entities eligible to receive FDI and microfinance entities including registered not for profits, NGOs, Section 8 companies etc.

## C. Eligible Lenders

- FCY ECB and INR ECB:
- All residents of a FATF or IOSCO<sup>6</sup> compliant country.
- Individuals are eligible to be lenders under the ECB framework if they are foreign equity holders (i.e. hold 26% directly or 51% indirectly in the borrower).

## D. Minimum Maturity Period

- FCY ECB and INR ECB: MAMP of 3 years (irrespective of amount). However, for ECB raised from foreign equity holders for general corporate / working capital purposes, the MAMP is 5 years.

## E. End Use Restrictions

- FCY ECB and INR ECB: The end use restrictions in case of both FCY ECB and INR ECD are (a) real estate activities; (b) investment in capital market; (c) equity investments; (d) repayment of Rupee loans (except if from foreign equity holder); (e) working capital purposes and general corporate purposes (except if from foreign equity holder); and (f) on-lending for the above activities.

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6. The IOSCO (International Organisation of Securities Commissions) is an association of organisations that regulate the world's securities and futures markets. Members are typically primary securities and/or futures regulators in a national jurisdiction or the main financial regulator from each country.

## 7. How are Social Enterprises Set Up?

Under Indian laws, for availing tax benefits and exemptions, all charitable organizations must exist only as non-profits i.e. either as a trust or a *not-for-profit* company<sup>7</sup> (“**Company**”) or as a registered society (“**Society**”). The legal framework in India allow non-profits a choice to be registered either as a trust, a Society<sup>8</sup> or as a Section 8 Company.<sup>9</sup> The entity can be institutionalized and registered under any of the three statutes described herein-below:

- i. State-specific Public Trust Acts (“**Public Trust Acts**”) or under the Registration Act, 1908 if a state does not have local laws on public trusts;
- ii. Companies Act, 2013 (“**Companies Act**”); or
- iii. Societies Registration Act, 1860 (“**SRA**”).

### I. Types of non-profits in India

#### A. Public Charitable Trust

A trust means an express or constructive trust for either a public religious or charitable purpose or both. A trust is defined as “an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by him for the benefit of another”.<sup>10</sup> A trust is created by a deed of trust. It is the duty of the trustees to make an application for the registration of the public trust. A Settler is an individual or institution

who creates or settles the trust and entrusts the trust and the trust property to a trustee or trustees. Further, a settler can be a trustee if his / her name is added in the preamble as a trustee.

The Indian Trusts Act, 1882 (“**ITA, 1882**”) is applicable to private trusts. The principles of ITA are applied in States that do not have state-specific public trust legislations. For example, if a public trust is set up in the state of Maharashtra or Gujarat, it is set up and governed under the Bombay Public Trust Act, 1950 (“**BPT Act**”), albeit with certain variations in the provisions in the two States. Under BPT Act, office of the Charity Commissioner is the nodal agency for granting permission to set up a trust. It also oversees the affairs of such public trusts.

The management of a trust or, rather, who manages the trust (i.e., members of one particular family, etc.) does not determine the public nature of a trust. What is essential is whether the purpose of the trust and the application of its income and property are for the benefit of the public, not who controls it.

#### B. Section 8 Company

Likewise, charitable activities can also be carried out by forming a not-for-profit company in India. Incorporation of a not-for-profit company is governed by Section 8 of the Companies Act. Section 8 company can be set up if it proves that: (i) it is being set up for the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object; (ii) intends to apply its profits, if any, or any other income in promoting its objects; and (iii) intends to prohibit the payment of any dividend to its members. Additionally, such company shall also be able to enjoy all the privileges and be subject to all the obligations of limited companies. Setting up of a Section 8 Company is comparatively more complicated. It usually takes approximately four-five months for getting a conformation from the Registrar of Companies, indicating the successful setting up of the company.

7. In India, a not-for-profit company is established under Section 8 of the Companies Act. A Section 8 Company is established for promoting commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object, provided the profits, if any, or other income is applied for promoting only the objects of the company and no dividend is paid to its members.

A Section 8 Company is similar to a Trust or Society; except, section 8 Company is registered with the Central Government under the Ministry of Corporate Affairs. Trusts and Societies are registered under state government regulations.

8. The office of the registrar of societies or the sub-registrar, as the case may be, is the nodal office for registration of charitable societies in respective States in India.

9. The office of the Registrar of Companies (ROC) is the nodal office for the registration of Section 8 companies in India.

10. Section 3 of the Indian Trusts Act, 1882

Incorporating a Section 8 Company under the Companies Act require at least two (2) share-holders. The license to set up a Section 8 Company is subject to the following conditions: (i) the Company should be formed for the promotion of activities as listed under Section 8 of the Companies Act;<sup>11</sup> (ii) intends to apply its profits, if any, or other income in promoting its objects; and (iii) intends to prohibit the payment of any dividend to its share-holders.

### C. Charitable Society

Where seven (7) or more people come together to form a Society, the registration is done under the SRA. In Maharashtra and Gujarat State, all societies registered under SRA are also required to register as a trust under the BPT Act. Under SRA, a Society is granted registration subject to the following conditions: (i) the Society should have at least seven (7) members; and (ii) intends to carry out its activities for the promotion of literary, scientific and charitable activities.

With regard to simplicity and ease in registration procedures, trust offers the best choice. One needs just two trustees to start (societies require a minimum of seven), the paper work is less elaborate and in certain states where there are no Charity Commissioner; the trust deed can be easily registered with the sub-registrar's office.

Trusts also offer autonomy in management and administration. One may remain a trustee for life and new trustees may be selectively appointed over a period of time. In a Society or a Section 8 Company, there is need for a general body of members, periodic elections and annual general meetings. A Section 8 Company is generally more corporatized than a trust or a Society.

## II. Permissible activities for the proposed entity in India

Under Indian laws, the proposed entity can engage in charitable activities<sup>12</sup> and undertake activities in the nature of 'furthering trade, business or commerce'. However, the income earned from such activities should be ploughed back towards the objects of the entity. Further, non-profits are also allowed to receive foreign donations/grants per the rules and regulations prescribed under Foreign Contribution Regulation Act, 2010 ("FCRA").

## III. A brief overview of the legal position is summarized below

Basis	Public Charitable Trust	Section 8 Company	Charitable societies
Meaning	Private trusts are covered under the Indian Trusts Act, 1882. 'Charitable Trusts' under the Income Tax Act includes entities working towards the relief of poor, education, healthcare, environment protection, advancement of public utility etc.	Companies established for promoting commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object.	Societies registered under the Societies Registration Act 1860 consisting of at least 7 members intending to carry out its activities for the promotion of literary, scientific, charitable activities and other purposes elucidated under Section 20 of the Act.

11. *Supra* note 2

12. *Supra* note

<b>Governing Law</b>	<p>Primarily governed under the respective State laws and in the absence of these laws, they are governed under the Income Tax Act 1961. The religious and charitable trusts are governed under the Religious Endowments Act 1863, the Charitable Endowments Act 1890 and the Charitable and Religious Trusts Act, 1920.</p> <p>Other relevant statutes includes the Indian Trusts Act 1882, Indian Contract Act 1872, Companies Act 2013, Foreign Contribution Act 2010, The Registration Act 1908, Transfer of Property Act 1882 and several other state and union laws.</p>	<p>Prominently, Companies Act 2013 and The Companies (Incorporation) Rules, 2014 are applicable. If foreign donations are involved then the Foreign Contribution Act 2010 will be applicable for obtaining permission and registering for the same. Income Tax Act 1961 will also be applicable for availing tax benefits.</p>	<p>Societies Registration Act 1860 and Bye-Laws of the Societies are the prominent laws governing these societies. Several other State and Union Laws like Bombay Public Trust Act 1950, Income Tax Act 1961, Foreign Contribution Act 2010 and other Rules and Regulations will be applicable.</p>
<b>Constitution and liability of the entity</b>	<p>The trust shall be constituted wholly for lawful purposes mentioned under the Act else will be declared void.</p> <p>The competent trust author with the permission of a principal Civil Court of original jurisdiction, by or on behalf of a minor can create a trust. He / She must have an intention, a purpose, a beneficiary and a transferable property which shall be transferred to the trustee.</p> <p>Trusts are not separate legal entities under the Companies Act and hence, there are no statutory liabilities of the trust. The trustees and the beneficiaries have liabilities.</p>	<p>More than one person above the age of 18, existing company or association of persons can incorporate a Section 8 Company with at least 2 shareholders and 2 directors are required. One of the directors must be an Indian resident.</p> <p>It has to ensure that the profits earned are utilized in achieving its objectives and no dividend is paid to the members of the company. It is subject to all the obligations of limited companies.</p>	<p>It shall be constituted by at least 7 persons or group of associations when the members subscribe to the Memorandum of Association and register themselves with the Registrar of the Joint Stock Companies or as specified under the State Laws.</p> <p>The entity is responsible to acquire, hold and maintain the property. It can be sued and enforcement of judgments will be against the property of the society.</p>
<b>Permitted activities</b>	<p>All lawful activities aiming at fulfilling the objectives of the organization.</p>	<p>All lawful activities aiming at fulfilling the objectives of the organization and those permitted under the license.</p>	<p>All lawful activities aiming at fulfilling the objectives elucidated under the Societies Registration Act, its Bye Laws and Memorandum of Association.</p>
<b>Criteria for set-up</b>	<p>They shall be registered with the Charitable Commissioner with minimum three parties- Settlor, Trustee (minimum 2) and the beneficiaries. One of the beneficiaries can also take the role of a settlor and of a trustee in the presence of other beneficiaries.</p>	<p>Form INC-1 needs to be filed for verifying name availability. After this, Form RD-1 needs to be filed to obtain registration license from the Central Government. The company can then be incorporated by filing various other forms physically or electronically.</p>	<p>Memorandum of Association and a certified copy of Rules and Regulations needs to be filed along with a fee with the registrar for establishing a society.</p>
<b>Minimum capital to set up</b>	<p>No minimum capital requirement.</p>	<p>No minimum capital is required.</p>	<p>No minimum capital is required.</p>

<b>Documents Required</b>	<p>The following documents are required:</p> <ol style="list-style-type: none"> <li>Declaration of trust by the Settlor.</li> <li>Statement of objects elucidating the purpose and usage of the property.</li> <li>Trust deed elucidating the purpose, rights and obligations, management of trusts, procedure of appointment and removal of trustees, and beneficiaries, accounts and audits, dissolution etc.</li> </ol>	<p>The following documents are required:</p> <ol style="list-style-type: none"> <li>Memorandum of Association</li> <li>Articles of Association</li> <li>Estimated future income and expenditures for the next three years</li> <li>Rental agreement</li> <li>Declaration by all the members</li> </ol>	<p>The following documents are required:</p> <ol style="list-style-type: none"> <li>Letter requesting Registration signed by all the members</li> <li>Memorandum of Association</li> <li>Certified copy of Rules and Regulations</li> <li>Address Proof of registered location of society and No-Objection certificate from the Landlord</li> <li>Non-Judicial stamped affidavit by President or Secretary stating their relationship with the subscribers.</li> </ol>
<b>Approval of RBI in certain cases</b>	<p>Might be necessary in cases involving foreign donations, usage of grant etc.</p>	<p>In certain cases, at the time of submitting the declaration, RBI's approval is required for usage of grants, obtaining foreign donations etc.</p>	<p>Might be required in cases involving foreign donations, usage of grant etc.</p>
<b>Validity of the registration</b>	<p>Valid for a period of 5 years from its issuance date.</p>	<p>Can be revoked if in violation with the laws.</p>	<p>Indefinite period unless revoked by the respective authorities involved.</p>
<b>Time involved in set-up</b>	<p>Application for registration shall be made within 3 months from the establishment of the Trust.</p> <p>Notice for conducting a formal hearing with the parties is issued 10-15 days prior to the date of hearing.</p> <p>The registration is generally issued within 90 days of receiving the application.</p>	<p>Approximately, four-five months for getting a conformation from the Registrar of Companies.</p>	<p>Registration can be obtained within a month of filing the application.</p>
<b>Liabilities of authorized representatives / directors / partners</b>	<p>Mentioned in the Trust deed and under the respective Public Trust Acts enacted by the state governments. Additionally, the Indian Trusts Act can also be referred to,</p> <p>Unlimited liabilities of the authorized representative.</p>	<p>Limited liabilities of the members mentioned under the MOA, AOA, Declaration and relevant laws except in the case of personal liabilities, monetary gains, fraud etc.</p>	<p>Governing Body is responsible for managing the affairs, property, and governance of the society as per its Bye Laws. The governing body is liable to sue on behalf of the society.</p> <p>Limited liabilities of the members mentioned under the MOA, Bye laws and applicable laws except in the case of personal liabilities, monetary gains, fraud etc.</p>

<b>Basic registrations required post setting up of the entity</b>	May proceed for registering itself for claiming tax exemptions.	Director is required to file a declaration under Form No.INC.21 along with respective fee. The documents shall be verified by the Company Secretary or Chartered Accountant.	May proceed for registering itself for claiming tax exemptions.
<b>Ability to undertake income generating activities</b>	yes. Subject to conditions	yes. Subject to conditions	yes. Subject to conditions
<b>Indian Income Tax</b>	Can claim exemption subject to conditions.	Can claim exemption subject to conditions.	Can claim exemption subject to conditions.
<b>Management</b>	Trustees or the Board of trustees are responsible for managing the Trust. Their duties are elucidated in the Trust Deed/Indian Trusts Act/ State Public Trust Acts.	Directors will be responsible for managing the company	Governing Body is responsible for managing the affairs of the society as per its Bye Laws. Trustees are responsible to manage the property of the society. In their absence, the governing body is responsible for the same. Usually, they are elected from the General body.  General Body is responsible for ensuring compliance of the Memorandum of Association and proper governance of the functioning of the society.  These two need not be separate bodies.
<b>Statutory audit</b>	As per Schedule VIII and IX of the Income Tax Act 1961 if the annual income exceeds Rs. 15,000.  If the annual income is less than or equal to Rs. 15000, they are required to submit the documents within 3 months from the due date according to the Schedule IX-A and Schedule IX-B of the Income Tax Act 1961.	Copy of the financial statements shall be sent two weeks before the annual general meeting.	The Societies Registration Act 1860 is silent on this aspect but the State laws have inculcated additional provisions relating to accounting and auditing. The Income Tax Act 1961 also requires annual accounting and auditing.
<b>Internal audit</b>	Financial statements shall be submitted at the end of the accounting year unless otherwise directed by the Charity Commissioner.	If Section 138 of the Companies Act 2013 and Rule 13 of the Companies (Accounts) Rules 2014 is applicable then internal audit is required.	The Societies Registration Act 1860 is silent on this aspect but the State laws have inculcated additional provisions relating to accounting and auditing. The Income Tax Act 1961 also requires annual accounting and auditing

<b>Tax audit</b>	<p>The financial documents and internal audit report shall be submitted to the Charity Commissioner.</p> <p>They are also required to file annual returns before the due date.</p>	<p>Audit Committee shall be constituted with at least three directors who understand financial statements.</p> <p>Tax audit is mandatory and at the end of the financial year, these accounts and statements have to be submitted.</p>	<p>The Societies Registration Act 1860 is silent on this aspect but the State laws have inculcated additional provisions relating to accounting and auditing. The Income Tax Act 1961 also requires annual accounting and auditing</p>
<b>Compliances</b>	<p>Some of the compliances are as follows:</p> <ol style="list-style-type: none"> <li>Registration, Book keeping and regular submission of audit reports and financial statements.</li> <li>Providing regular information about the structural or managerial changes,</li> <li>Memoranda of immovable property to be sent within the specified time.</li> <li>If the gross annual income exceeds Rs 25,000, contribution has to be made to the Public Trust Administration Fund at 2% per annum.</li> </ol>	<p>Some of the compliances are as follows:</p> <ol style="list-style-type: none"> <li>Mandatory maintenance of financial statement and accounts at the end of the financial year.</li> <li>Filing for annual returns</li> <li>Filing of income tax returns with the Registrar of Companies.</li> <li>Mandatory annual auditing of accounts</li> <li>Conducting Annual General Meetings</li> <li>Maintenance of all the records, minutes of the meetings, notices etc.</li> </ol>	<p>Some of the compliances are as follows:</p> <ol style="list-style-type: none"> <li>Conducting Regular collective meetings</li> <li>Maintenance of all the records, minutes of the meetings, notices etc.</li> <li>Prior notice of the meeting and agenda shall be provided for the General meeting and for the governing body meeting.</li> <li>Establishing Quorum as per the bye-laws and conducting elections even with proxy votes as specified in the Bye Laws.</li> <li>Written Resolutions shall be passed by the members while taking a decision.</li> </ol>
<b>Meetings</b>	<p>The Trustees/Board of Trustees shall conduct the meetings for taking prominent decisions of the trusts.</p>	<p>Annual General Meeting shall be conducted twice a year after every 6 months.</p>	<p>Annual general meetings are mandatory.</p> <p>Special meetings may also be conducted for important decisions like amending or altering societal objectives along with a report sent at least 10 days prior to this meeting.</p> <p>Regular Governing body meeting shall also be conducted.</p>
<b>Overseas Direct Investments</b>	<p>Required to obtain prior permission from the Ministry of Home Affairs or obtain registration under Section 6(1) of Foreign Contribution Regulation Act 2010.</p>	<p>Required to obtain prior permission from the Ministry of Home Affairs or obtain registration under Section 6(1) of Foreign Contribution Regulation Act 2010.</p>	<p>Required to obtain prior permission from the Ministry of Home Affairs or obtain registration under Section 6(1) of Foreign Contribution Regulation Act 2010.</p>

<b>Closure</b>	<p>In the extinguishment of a Trust, assets are used for paying off the debts and the leftover amount is transferred to another Trust with similar objectives unless otherwise ordered by the court of law.</p>	<p>Voluntary closure, winding up of the company and conversion leads to its closure.</p>	<p>Consent of at least 3/5th of the members is required or by a court order. If the state government is involved in the functioning or funding of the society, then government's consent is required.</p>
	<p>The trustees, the beneficiaries and their related persons are prohibited from benefitting from these assets or income received after selling them.</p>	<p>The assets are used for paying off the debts and the leftover amount is transferred to another section 8 company with similar objectives unless otherwise ordered by NCLT.</p>	<p>Voluntary closure is another mode available under Section 248 of the Companies Act 2013.</p>
		<p>Conversion of the section 8 company into any other kind leads to the closure of the section 8 company.</p>	

**Setting up for-profit social enterprises by foreign non-profits in India:**

Several foreign non-profits explore the feasibility of setting up social enterprises in India to engage in social businesses. In order to achieve that, such foreign non-profits often consider setting up their subsidiaries in India through the FDI route.

Investments into India, including setting up a wholly owned subsidiary (“WOS”), are governed by Foreign Exchange Management Act, 1999 (“FEMA”) and the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (hereinafter called as “TISPRO Regulations”) issued thereunder. Further, Schedule I of the TISPRO Regulations deals with the foreign direct investment (FDI) into India.

Under Section 2(u) of FEMA, a ‘Person’ includes- (i) an individual, (ii) a Hindu undivided family, (iii) a company, (iv) a firm, (v) an association of persons or body of individuals whether incorporated or not, (vi) every artificial juridical person, not falling within any of the proceeding sub-clauses, and (vii) any agency, office or branch owned or controlled by such person.

Similarly, under Section 2(v) of FEMA, a ‘Person resident in India’ means- (i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include-

- a. A person who has gone out of India or who stays outside India, in either case- (a) for or on taking up employment outside India, or (b) for carrying on outside India a business or vocation outside India, or (c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;
- b. A person who has come to or stays in India, in either case, otherwise than- (a) for or on taking up employment in India; or (b) for carrying on in India a business or vocation in India, or (c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;
- (ii) any person or body corporate registered or incorporated in India,
- (iii) an office, branch or agency in India owned or controlled by a person resident outside India,
- (iv) an office, branch or agency outside India owned or controlled by a person resident in India.

Further, under Section 2(w) of FEMA, ‘Person resident outside India’ means a person who is not a Person resident in India. Per paragraph 1(1) of Schedule I of TISPRO Regulations, ‘a person resident outside India’ can purchase shares issued by an Indian company up to the extent and subject to the terms and conditions set out in Schedule I.

For the purposes of FEMA, a foreign non-profit would be considered as a body corporate registered outside India. Consequently, it should be permissible to set up as a WOS in India subject to the existing FDI Scheme, applicable laws/regulations, security and other conditionalities.

### **Viability and feasibility of setting up a non-profit entity in India by an off-shore foundation (non-profit), and exercising administrative and organizational oversight**

While it is possible to set up a not-for-profit entity in India. However, the viability of overseeing and providing directions to the proposed entity by foreign nationals and/or foreign non-profit would be subject to FCRA, FEMA provisions and state-specific charity laws, rules and regulations.

Exercising administrative oversight and providing directions to a non-profit entity can be achieved through the following:

- i. Appointing a foreign national as trustees on the board of the not-for-profit entity; or
- ii. Appointing key office-bearers of foreign foundations as trustees on the board of non-profit

## **A. Appointment of foreign nationals as office-bearer or trustees**

While there is no specific bar in law against a foreign national serving on the board of trustees of a public trust registered in India, there is certainly a high degree of sensitivity regarding the grant of approval for acceptance of foreign contributions under FCRA.

While FCRA is not a fiscal statute, this law is in place for the purposes of internal security, and is regulated by the Ministry of Home Affairs (“MHA”). The presence of a foreign trustee in a public trust may lead to greater scrutiny, leading to delays in the grant of FCRA approval, or even rejection of the application for registration.

In this context, please note that the annual report published by the MHA for the year 2004-05, one of the

common grounds for rejection of application is listed as: “If any of the office bearers/trustees, including the chief functionary, is a foreign national, other than those of Indian origin.”<sup>13</sup>

“Indian origin” is neither defined in the FCRA nor in the Citizenship Act, 1955. We have, therefore, relied on Section 2 (c) of the Foreign Exchange Management (Acquisition and Transfer of Immoveable Property in India) Regulations, 2000 (“FEMA Regulations re Immoveable Property”) for the definition of a person of Indian origin, which is as follows:

*“An individual (not being a citizen of Pakistan or Bangladesh or Sri Lanka or Afghanistan or China or Iran or Nepal or Bhutan) who*

- i. at any time held an Indian passport; or*
- ii. who or either of whose father or whose grandfather was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955.”*

Thus, if the office-bearers can satisfy the FCRA authorities that they, as trustees, are of Indian origin, their eligibility for trusteeship on that ground alone should not be an issue. However, it has been reported that as a matter of internal practice, the FCRA authorities are not very keen on granting registrations to organizations with foreigners on board. We are not aware whether the FCRA authorities, in practice, are distinguishing between foreign nationals of non-Indian origin and foreign nationals of Indian origin. Nonetheless, in certain cases we have seen FCRA authorities allowing PIO and OCI (overseas citizen of India) card holders to be appointed as trustees.

## **B. Jurisdiction of Indian courts**

A trust, unlike a Company or a Society, has no independent legal existence. In the event of any breach of trust, it is the trustees who are held jointly and severally (individually) liable, and not the trust as an entity. Please note that a public trust is always open to public scrutiny and subject to court enquiry and direction.

13. Please refer to Annexure-4 of the Annual Report. The same is available on [https://fcraonline.nic.in/home/PDF\\_Doc/annual/ar2004-05.pdf](https://fcraonline.nic.in/home/PDF_Doc/annual/ar2004-05.pdf). Website last accessed on March 22, 2017.

Under Section 92 of the Code of Civil Procedure, 1908, (“CPC” a central statute), any two or more interested persons or the Advocate General of the State where the public trust is registered may institute court proceedings for an enquiry into any alleged breach of trust, or where the direction of the court is deemed necessary for the administration of the trust, or to institute a suit for a court decree for specified purposes.

In addition, the Charitable and Religious Trusts Act, 1920, (“CRTA”, also a central statute), empowers any person having an interest to apply to the courts by petition to obtain the following: (i) directions to the trustees to furnish particulars about the trust, its objects and its management, both administrative and financial; (ii) directions that the accounts of the trust be examined and audited within a limited period of three years prior to the date of the petition.

Owing to these specific provisions of CPC and CRTA, a public trust is thus subject to public scrutiny and court enquiry and direction. In effect, all the trustees, including the foreign trustees, should be subject to such public scrutiny and the jurisdiction of Indian courts. While one trustee may be authorized by the other trustees to appear on their behalf for any court proceeding, any liability in respect of the trust (unless otherwise proved) will fall jointly and severally on all the trustees.

## C. Trust property

Under trust law, the legal ownership of trust property vests in the trustees. To determine who would be considered a proper trustee in this regard, (in the absence of any explanation in BPT Act from where we could draw a parallel), we referred to ITA, 1882, which deals with private trusts. The principles of the ITA, 1882 may be applied to public trusts in the absence of any corresponding provisions in public trust statutes. S. 60 of the ITA, 1882 provides that “the beneficiary has a right (subject to provisions of the instrument of trust) that the trust property shall be properly protected and held and administered by proper persons and by a proper number of such persons”. According to Explanation I to S. 60 of the ITA 1882, “a person domiciled abroad” is “not a proper person within the meaning of this term”. Further, while

FEMA is silent with regard to trusts or other not-for-profit entities (unless such entities set up a branch, a liaison office or a project office), we examined certain provisions in the FEMA Regulations re Immoveable Property with regard to a person of Indian origin resident outside India.

Clause 4 of the FEMA Regulations regarding Immoveable Property deals with the “Acquisition and Transfer of Property in India by a Person of Indian Origin” and provides that a person of Indian origin (as defined earlier), who is resident outside India, may acquire immovable property in India other than an agricultural property, plantation, or a farm house, provided that in case of acquisition of immovable property, the payment of purchase price, if any, shall be made out of:

- i. funds received in India through normal banking channels by way of inward remittance from any place outside India; or
- ii. funds held in any non-resident account maintained in accordance with the provisions of the Act and the regulations made by the Reserve Bank of India (“RBI”).

There are also specific provisions with regard to the acquisition and transfer of immovable property in India by a person of Indian origin resident outside India in respect of gift, inheritance, etc.

It is not clear whether the presence of a foreign trustee will affect the acquisition by the trustees of any immovable property even if it falls in any of the three categories mentioned earlier (agricultural property, plantation, or a farm house), as immovable trust property is required to be registered in the name of the trust and not in the names of the individual trustees. Also, though the legal ownership of trust property is that of the trustees, such ownership is on behalf of the beneficiaries.

In this case, the beneficiaries would be Indian residents. Further, any transaction in this regard would involve trust funds, not the trustees’ individual financial resources. This concept has not been dealt with under the FEMA Regulations. Due to the lack of clarity on this issue, it is advisable to ascertain from the appropriate authorities whether

a foreign trustee is cause for any objection in this regard, a foreign trustee would, as mentioned, be considered one of the legal owners of trust property along with the other trustees and subject to any liabilities that may arise thereof.

TISPRO Regulations state that no person resident outside India is permitted to issue or transfer any security unless permitted by the RBI, subject to certain conditions, pursuant to an application made in this regard. While the investment of trust funds by a person resident outside India is not specifically covered by FEMA, we understand that approval of the RBI should still be required for such purposes if a foreign trustee is on the board.

## D. Governance Issues

From the point of view of best practices in governance, a trustee acts in a fiduciary capacity and has certain responsibilities and obligations regarding the operation of the trust. While facilities such as teleconferencing or video conferencing may be used optimally by a foreign trustee, including for attendance of board meetings, close monitoring of the trust operations will present some difficulty to a foreign trustee not resident in the country where the trust is registered. As mentioned, under the ITA, 1882, a person not resident in India is not considered a “proper person” to be entrusted with trust property.

Please note that under Section 47 of the BPT Act,<sup>14</sup> a trustee may be suspended, removed or discharged if

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14. Section 47. (1) any person interested in a public trust may apply to the Charity Commissioner for the appointment of a new trustee, where there is no trustee for such trust or the trust cannot be administered until the vacancy is filled, or for the suspension, removal or discharge of a trustee, when a trustee of such trust,—
- (a) disclaims or dies;
  - (b) is for a continuous period of six months absent from India without the leave of the Charity Commissioner or the Deputy or Assistant Charity Commissioner or the officer authorized by the State Government in this behalf;
  - (c) leaves India for the purpose of residing abroad;
  - (d) is declared an insolvent;
  - (e) desires to be discharged from the trust;
  - (f) refuses to act as a trustee;
  - (g) becomes in the opinion of the Charity Commissioner unfit or physically incapable to act in the trust or accepts a position which is inconsistent with his position as trustee;
  - (h) in any of the cases mentioned in Chapter III, is not available to administer the trust; or
  - (i) is convicted of an offence punishable under this Act or an offence involving moral turpitude.

she “leaves India for the purpose of residing abroad”,<sup>15</sup> or if she is “absent for a continuous period of six months without the leave of the Charity Commissioner”,<sup>16</sup>

While the BPT Act applies only to Maharashtra and Gujarat and is not enforceable against a trust registered elsewhere in India, (for example, Delhi, where registration of trust does not require an equivalent state-specific statute) the principles underlying its provisions may be relied upon or referred to for general guidelines on public trusts in India. An absentee trustee may trigger an enquiry by the authorities or by any interested member of the public, which could lead to a court enquiry into the governance and management of the trust.

While there is no specific law against the appointment of foreign trustees in a public trust, the BPT Act and the ITA, 1882 do specifically exclude a person residing abroad. While the provisions under FEMA regulations present a grey area, we have nevertheless referred to them by way of abundant caution as they concern a person of Indian origin and/or a person not resident in India.

(d) Setting up a Limited Liability Partnership vs. Private Limited Company

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- (2) The Charity Commissioner may, after hearing the parties and making such enquiry as he may deem fit, by order appoint any person as a trustee or may also remove or discharge any trustee for any of the reasons specified in sub-section (1).
  - (3) In appointing a trustee under sub-section (2), the Charity Commissioner shall have regard—
    - (a) to the wishes of the author of that trust;
    - (b) to the wishes of the persons, if any, empowered to appoint a new trustee;
    - (c) to the question whether the appointment will promote or impede the execution of the trust;
    - (d) to the interest of the public or the section of the public who have interest in the trust; and
    - (e) to the custom and usage of the trust.
  - (4) It shall be lawful for the Charity Commissioner upon making any order appointing a new trustee under sub-section (2) either by the same or by any subsequent order to direct that any property subject to the trust shall vest in the person so appointed and thereupon it shall so vest.
  - (5) The order of the Charity Commissioner under sub-section (2) shall be deemed to be the decree of the Court and an appeal shall lie therefrom to the High Court.]

15. Section 47(1)(c)

16. Section 47(1)(b)

<b>Basis</b>	<b>PLC</b>	<b>LLP</b>
<b>Meaning</b>	<p>An incorporated entity formed and registered under the provisions of Companies Act, 2013 ('<b>CA 2013</b>')</p> <p>It is a legal entity distinct from its shareholders.</p>	<p>LLP is a body corporate formed and incorporated under the provisions of LLP Act, 2008 ('<b>LLP Act</b>').</p> <p>It is a legal entity separate from that of its partners.</p>
<b>Governing Law</b>	<p>CA 2013 and the rules framed thereunder, Foreign Exchange Management Act, 1999 ('<b>FEMA</b>'), Foreign Exchange Management (Transfer or Issue of Security by Persons Resident Outside India), 2017 ('<b>TISPRO Regulations</b>') issued by the Reserve Bank of India ('<b>RBI</b>').</p>	<p>LLP Act and the rules framed thereunder, FEMA, TISPRO Regulations.</p> <p>FDI is permitted under automatic route in LLPs operating in sectors/activities where 100% FDI is allowed through automatic route and there are no FDI – linked performance conditions.</p>
<b>Constitution and liability of the entity</b>	<p>Any liability arising by virtue of the operations of a PLC are bound to be paid by PLC itself.</p> <p>The liability of the parent company is limited to the extent of its shareholding (unpaid) in PLC, unless the liability is associated with any wrongful act / omission of the parent company</p> <p>CA 2013 prescribes onerous liabilities on the directors and other officers of PLC for non-compliances.</p> <p>Directors' duties such as acting in good faith, not having conflicting interests, exercising diligence, etc., have been codified and any breach thereof is punishable.</p>	<p>Any liabilities arising by virtue of the operations of LLP are bound to be paid by LLP.</p> <p>The liability of each partner is limited to the extent of their capital commitments to LLP, unless the liability is associated with any wrongful act / omission of such partner.</p>
<b>Permitted activities</b>	<p>Lawful business activities.</p>	<p>Lawful business activities.</p>
<b>Criteria for set-up</b>	<p>PLC can be incorporated with minimum of 2 members (shareholders) and 2 directors.</p> <p>Members may be natural persons or body corporates, but the directors should be individuals. At least 1 of the directors should be a resident of India.</p>	<p>LLP can be incorporated with minimum 2 partners and 2 designated partners ('<b>DPs</b>').</p> <p>Partners may be the natural persons or body corporates but DPs should be individuals. At least 1 DP should be a resident of India.</p>
<b>Minimum capital to set up</b>	<p>There is no requirement of minimum capital to form a PLC. However, practical aspect of business and administrative costs should be considered by the entity to set the business running initially.</p>	<p>There is no requirement of minimum capital to form a LLP. However, practical aspect of business and administrative costs should be considered by the entity to set the business running initially.</p>

<p><b>Typical terms of approval</b></p>	<p>PLC has certain distinguishing characteristics in its articles of association such as -</p> <ul style="list-style-type: none"> <li>■ Restriction on right to transfer shares freely;</li> <li>■ The number of members in a PLC is minimum of 2) and a maximum of 200 members (excluding the present and past employees of the PLC);</li> <li>■ Prohibits any invitation to the public to subscribe to the securities of PLC.</li> </ul>	<p>LLP should operate well within the scope of LLP agreement which is subject to the applicable laws.</p>
<p><b>Approval of RBI in certain cases</b></p>	<p>Under the extant regulations, 100% Foreign Direct Investments ('<b>FDI</b>') is allowed under automatic route in all sectors except those where there is an express prohibition/ restriction.</p>	<p>Under the extant regulations, FDI is permitted under the automatic route in LLPs operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI linked performance conditions.</p>
<p><b>Validity of the registration</b></p>	<p>Until PLC decides to wind up its affairs or Registrar issues notices for striking off the name of the PLC.</p>	<p>Until LLP decides to wind up its affairs or Registrar issues notices for striking off the name of the PLC.</p>
<p><b>Time involved in set-up</b></p>	<p>Time involved in setting up of PLC is generally <b>8-10 weeks</b>. However, this timeline is completely subject to the approvals being received from the authorities and turnaround of the documentation involved.</p>	<p>Time involved in setting up of PLC is generally <b>10-12 weeks</b>. However, this timeline is completely subject to the approvals being received from the authorities and turnaround of the documentation involved.</p>
<p><b>Liabilities of authorized representatives / directors / partners</b></p>	<p>CA, 2013 contains several provisions, which make the directors liable for the contravention of any provisions. By virtue of holding fiduciary position in PLC, the directors are the first in line to be held liable for defaults.</p> <p>The liability of directors may also accrue under any other statutes.</p> <p>The directors are considered as agents of PLC. By virtue of legal relationship of principal and agency, the directors may also become vicariously liable for the acts of the PLC or other directors.</p> <p>The liability of the directors could arise in any one of the following ways:</p> <ol style="list-style-type: none"> <li>1. With fine only;</li> <li>2. With fine or imprisonment;</li> <li>3. With fine and imprisonment;</li> <li>4. With imprisonment only.</li> </ol> <p>Liability of shareholders is limited to the extent of amount due on the shares subscribed.</p>	<p>Partners are liable to the extent of their capital contributions to LLP and as per the terms mentioned in LLP agreement or in absence of such agreement, as per the provisions of 1<sup>st</sup> Schedule of the LLP Act.</p> <p>A partner should not be personally liable for the wrongful act or omission of any other partner of the LLP. However, in case of fraud, the liability of the partner indulged should be unlimited. The partner is an agent of the LLP and not of any other partner.</p> <p>The DP is responsible for doing all such acts, matters and things as are required to be done by the LLP in respect of compliance of the provisions of LLP Act including filing of any documents, returns, statement and the like report pursuant to the provisions of LLP Act and as may be specified in the LLP agreement. He/ She will be liable for any legal contravention and penalties imposed on the LLP.</p>

<p><b>Basic registrations required post setting up of the entity</b></p>	<p>PLC once setup, will require Registration under various laws and regulations such as:</p> <ul style="list-style-type: none"> <li>■ Professional Tax;</li> <li>■ Shops and Establishments Registrations;</li> <li>■ *Permanent Account Number ('PAN') / Tax Deduction Account Number ('TAN')</li> <li>■ Import Export Code ('IEC'); and</li> <li>■ *Goods and Service Tax</li> </ul> <p>*PAN, TAN and GST registrations are obtained at the time of incorporation.</p> <p><i>Kindly note above are the basic registrations. There shall be additional registrations needed based on the nature of the business of the Company.</i></p>	<p>LLP once set up, will require registration under various laws and regulations such as:</p> <ul style="list-style-type: none"> <li>■ Professional Tax;</li> <li>■ Shops and Establishments Registrations;</li> <li>■ PAN and TAN;</li> <li>■ IEC; and</li> <li>■ Goods and Service Tax.</li> </ul> <p><i>Kindly note above are the basic registrations. There shall be additional registrations needed based on the nature of the business of the Company.</i></p>
<p><b>Ability to undertake income generating activities</b></p>	<p>All income arising out of its business activities</p>	<p>All income arising out of its business activities.</p>
<p><b>Indian Income Tax</b></p>	<p>PLC are generally taxed on their world-wide income at the rate of approximately 25% (excluding surcharge and cess) for companies with a turnover less than INR 250 crores and at 30% (excluding surcharge and cess) subject to other conditions as specified under the Income Tax Act.</p> <p>PLC should not, by itself, construed to be a PE of the parent company and hence may not create tax exposure for the parent company.</p> <p>A PE may arise depending on the activities of the subsidiary PLC. Ex: if the premises of PLC are available at the disposal of the parent company, etc.</p> <p>On account of transfer pricing compliances, the PLC should be compensated on arm's length basis for any services rendered to the parent company and vice versa. They shall be subject to transfer pricing and file appropriate forms accordingly.</p>	<p>LLP should be taxed on world-wide profits at the rate of 30% (excluding surcharge and cess).</p> <p>LLP is not, by itself, construed to be a PE of the parent company and hence may not create tax exposure for the parent company.</p> <p>A PE may only arise depending on the activities of LLP. Ex: If it acts as an agent of the parent company, if the premises of LLP are available at the disposal of the parent company, etc.</p> <p>On account of transfer pricing compliances, the Indian subsidiary should be compensated on arm's length basis for any services rendered to the parent company and vice versa and should prepare transfer pricing study and file appropriate forms accordingly.</p>
<p><b>DDT</b></p>	<p>PLC is subjected to DDT when it pays dividend. Under the Income Tax Act, 1961, DDT is charged at the effective rate of 20.55%</p>	<p>DDT is not applicable on LLP. Once profit is declared and tax is paid by LLP, the profits so distributed is not subject to any further Indian taxes in the hands of the partners.</p>
<p><b>MAT</b></p>	<p>PLC should be required to pay MAT at the rate of 18.5% (excluding surcharge and cess) on its book profit if the income tax payable on the total income as calculated under the Income Tax Act, 1961 is less than the minimum.</p>	<p>MAT is not applicable on LLP. However, an AMT at the rate of 18.5% (excluding surcharge and cess) may be applicable.</p>
<p><b>Management</b></p>	<p>The board of directors will manage the day to day operations of the PLC.</p>	<p>LLP is managed by its partners.</p>

<b>Statutory audit</b>	Financial statements are subject to statutory audit by a chartered accountant or a chartered accountants firm.	Financial statements are subject to statutory audit by a chartered accountant or a chartered accountants firm.  <u>Exemption for statutory audit:</u> Any LLP, whose turnover does not exceed, in any financial year, INR 40 lacs, or whose contribution does not exceed INR 25 lacs, is not required to get its accounts audited.
<b>Internal audit</b>	Applicable, if any of the following criteria are met at any time during the preceding financial year: <ul style="list-style-type: none"> <li>■ Turnover of INR 200 crores or more; or</li> <li>■ Outstanding loans or borrowings from banks or public financial institutions exceeding INR 100 crores or more.</li> </ul>	Not applicable.
<b>Tax audit</b>	Applicable if the turnover exceeds INR 10,000,000  <b>Consequences of non-compliance:</b> Penalty @ 0.5 % of the total turnover or INR 150,000, whichever is less.	Applicable if turnover exceeds INR 10,000,000  <b>Consequences of non-compliance:</b> Penalty @ 0.5 % of the total turnover or INR 150,000, whichever is less.
<b>Applicability of transfer pricing</b>	Applicable vis-à-vis the parent entity and other affiliates.	Applicable vis-à-vis the parent entity and other affiliates.
<b>Compliances</b>	Following are few broad compliances of PLC in India: <ul style="list-style-type: none"> <li>■ Minimum 4 board meetings and 1 Annual General Meetings;</li> <li>■ Annual filings include the filing of financial statements and annual return of PLC with the RoC;</li> <li>■ Annual return with the income tax department;</li> <li>■ Filing of quarterly Tax Deduction at Sources ('TDS') returns;</li> <li>■ Filing of monthly goods and service tax returns; and</li> <li>■ Reporting of receipt of foreign direct investment and allotment of shares to the non-resident shareholders with the RBI in prescribed e-form FCGPR which is filed in Single Master Form within the prescribed timelines.</li> </ul> <p>The CA, 2013 prescribes onerous liabilities on directors and other officers for non-compliance with various routine compliances. Directors' duties such as acting in good faith, not having conflicting interests, exercising diligence, etc., have been codified and breach thereof has been made punishable.</p>	Following are few broad compliances for LLP's in India: <ul style="list-style-type: none"> <li>■ Yearly submission of statement of account &amp; solvency;</li> <li>■ Annual return with the RoC;</li> <li>■ Annual return with the income tax department;</li> <li>■ Filing of quarterly TDS returns;</li> <li>■ Filing of monthly Service Tax returns; and</li> <li>■ Reporting of receipt of foreign direct investment and the details of non-resident partners' contribution with RBI in prescribed eform FDI-LLP (I) within the prescribed timelines.</li> </ul>

<b>Meetings</b>	Requirement of convening the meetings of board and the members as per the provisions of CA 2013 and rules made thereunder.	Subject to the LLP agreement, no specific requirement of convening any meetings of partners.
<b>Overseas Direct Investments</b>	PLC can make investments and subscribe to the securities of foreign body corporates subject to the necessary compliances under the ODI regulations and the CA 2013.	LLP can also make investments and subscribe to the securities of foreign body corporates subject to the necessary compliances under the ODI regulations and the LLP Act.
<b>Closure</b>	PLC may be wound up under the Insolvency and Bankruptcy Code ('IBC'). As an alternative, where a PLC which has failed to commence its business within 1 year of its incorporation or commenced business but became defunct or inoperative for a period of 2 immediately preceding financial years or wherever the Registrar deems fit, the name of such PLC may be struck off from the register of companies maintained by the RoC by making necessary application as prescribed.	LLP can be wound up by complying with the procedures mentioned under the LLP Act.  The procedure for winding up of LLP is much simpler as compared to that of a PLC.
<b>Time involved in closure</b>	Approximately 2-3 years	Approximately 6-12 months

## 8. Tax And Regulatory Considerations

The impact investment sector involves both for profit and not-for-profit participants, and the following set out some of the key elements in addition to the considerations set out in the previous parts of this paper:

### I. Regulatory

- i. *Fundraising activities – It is a General Rule.*  
Charitable entities must raise fund legally and should not indulge in any lobbying activity in lieu of funds or grants promised. Lobbying in any form is not permitted under the Indian laws.
- ii. *Economic activities-* Should only engage in charitable activities and lawful economic, business, or commercial activities, provided that (i) the charitable entity is active solely and principally for the purpose of conducting appropriate non-profit-activities, and (ii) that no profits or are distributed as such to founders, members, officers, board members, or employees.
- iii. *FCRA approval-* The entity must ensure that prior permission or registration is granted by FCRA Wing, Ministry of Home Affairs, and Government of India before accepting any foreign contribution.
- iv. *Usage of foreign funds not unrestrictive-* The charitable entity should ensure that no part of the contribution is used for activities not permitted under the FCRA.
- v. *Citizenship-* It must be ensured that no foreign citizen or a Person of Indian Origin or an OCI (Overseas Citizen of India) card holder is either the trustee or governing council member. Such members may serve the entity in an ex-officio capacity.
- vi. *Directors-* In case of a section 8 company, at least one resident director must be appointed who has

stayed in India for a total period of 182 days in previous calendar year.<sup>17</sup>

- vii. *Annual Meetings -* Board meeting must be held at least once a quarter and minutes of the meeting must be maintained. The shareholders or members of the company must meet each year in the Annual General Meeting.

### II. Tax

#### A. Income Tax

Under Section 11 of the ITA, tax exemptions are allowed to charitable organizations which utilize their income wholly for charitable purposes.<sup>18</sup> While the definition of charitable purposes and the provisions of Section 11 of the ITA allow organizations to conduct commercial activities that are incidental to and in furtherance of charity,<sup>19</sup> in reality the tax department in India has in a lot of instances denied exemptions to organizations that simultaneously also carry out commercial activities. This has occurred despite a plethora of judicial pronouncements allowing charitable organizations to also engage in profitable activities and earn income, thereby creating an uncertainty whether tax exemption would as a principle, be

17. Section 149(3) of the Companies Act lays down certain criteria for appointment and qualification of directors. This clause is introduced to ensure that at least one director is resident in India in order to ensure regular functioning of the organization.

18. Section 11(1) of the ITA: Subject to the provisions of sections 60 to 63, the following income shall not be included in the total income of the previous year of the person in receipt of the income—

(a) income derived from property held under trust wholly for charitable or religious purposes, to the extent to which such income is applied to such purposes in India; and, where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of fifteen per cent of the income from such property;

19. Section 11(4A) of the ITA: Sub-section (1) or sub-section (2) or sub-section (3) or sub-section (3A) shall not apply in relation to any income of a trust or an institution, being profits and gains of business, unless the business is incidental to the attainment of the objectives of the trust or, as the case may be, institution, and separate books of account are maintained by such trust or institution in respect of such business.

allowed in such cases. Notably, the fear of denial of exemption has led to an increase in the cost of doing businesses for such social organizations.

Furthermore, Section 11(5) of the ITA allows for charitable institutions to accumulate and apply their income towards specified investments.<sup>20</sup> However,

20. Section 11(5) of the ITA: (5) The forms and modes of investing or depositing the money referred to in clause (b) of sub-section (2) shall be the following, namely:—
- (i) investment in savings certificates as defined in clause (c) of section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government;
  - (ii) deposit in any account with the Post Office Savings Bank;
  - (iii) deposit in any account with a scheduled bank or a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank).
- Explanation.—In this clause, “scheduled bank” means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);
- (iv) investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);
  - (v) investment in any security for money created and issued by the Central Government or a State Government;
  - (vi) investment in debentures issued by, or on behalf of, any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central Government or by a State Government;
  - (vii) investment or deposit in any public sector company: Provided that where an investment or deposit in any public sector company has been made and such public sector company ceases to be a public sector company,—
    - (A) such investment made in the shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public sector company ceases to be a public sector company;
    - (B) such other investment or deposit shall be deemed to be an investment or deposit made under this clause for the period up to the date on which such investment or deposit becomes repayable by such company;
  - (viii) deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and which is eligible for deduction under clause (viii) of sub-section (1) of section 36;
  - (ix) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes and which is eligible for deduction under clause (viii) of sub-section (1) of section 36;
  - (ixa) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.
- Explanation.—For the purposes of this clause,—
- (a) “long-term finance” means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years;
  - (b) “public company” shall have the meaning assigned to it in section 3 of the Companies Act, 1956 (1 of 1956);

these investments are very restrictive and are not in tandem with the changing dynamics of the social economy and do not envisage investments in social ventures as contemplated by SVFs. This in turn also dissuades non-profits from scaling up as it discourages innovative forms of investments that have the potential to yield higher social and financial returns.

For profit entities should pay taxes at applicable rates on their net profits. Further, they may be able to carry forward losses and set it off against profits in the future.

## B. GST

Goods and Services Tax (“GST”) is broadly chargeable on all taxable “supplies” of goods or services or both supplied by a “taxable person”. Thus, GST would only be chargeable on a provision of services if:

- a. the provision of services amounts to a “supply” for the purposes of GST; and
- b. the services are supplied by a “taxable person”.

Further, per Section 7(1)(a) of the Central Goods and Services Tax, 2017 (“CGST Act”) “supply” includes all forms of supply of goods or services or both made or agreed to be made for a consideration in the course or furtherance of a business. Section 2(17) of the CGST Act defines the term “business” to include among others “admission, for a consideration, of persons to any premises”. Section 2(107) of the CGST Act defines “taxable person” to mean a person who is registered, or who is liable to be registered under sections 22 or 24 of the CGST Act. The term “person” is defined under section 2(84) of the CGST Act to include all natural and juristic persons, including trusts.

Sections 22 and 24 of the CGST Act specify the entities that are required to be registered for GST. The

- 
- (c) “urban infrastructure” means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyovers or urban transport;
  - (x) investment in immovable property.
- Explanation.—“Immovable property” does not include any machinery or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;
- (xi) deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (18 of 1964);
  - (xii) any other form or mode of investment or deposit as may be prescribed

general rule for registration is laid down in Section 22, which requires every supplier to be registered in the State or Union Territory from where he makes a taxable supply of goods or services both, if his aggregate turnover in a financial year exceeds INR 20,00,000 (approx. USD 31,000).

Section 24 requires specific categories of suppliers to compulsorily register for GST, irrespective of whether they cross the threshold under Section 22. Per section 24(v), all “non-resident taxable persons making taxable supply” are required to compulsorily register for GST, irrespective of whether the aggregate turnover threshold is exceeded. In this regard, section 2(77) of the CGST Act defines “non-resident taxable person” as follows:

*(77) “non-resident taxable person” means any person who occasionally undertakes transactions involving supply of goods or services or both, whether as principal or agent or in any other capacity, but who has no fixed place of business or residence in India*

For specific activities carried out by not for profits that are exempt from GST, please refer to Annexure III which is the Government circular issued in relation to the same. Other services provided by for profit entities should usually be subject to tax at applicable GST rates unless specifically exempted.

### III. Alternate Investment Fund Regulations

An alternative investment fund (“AIF”) is a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors. Social venture funds (“SVFs”) are privately pooled investment vehicles set up for the purpose of promoting social welfare or solving social problems or providing social benefits.<sup>21</sup>

21. Regulation 2(v) of SEBI (AIF) Regulations [social venture fund means an Alternative Investment Fund which invests primarily in securities or units of social ventures and which satisfies social performance norms laid down by the fund and whose investors may agree to receive restricted or muted returns; Regulation 2(u) [social venture means a trust, society or company or venture capital undertaking or limited liability partnership formed with the purpose of promoting social welfare or solving

AIFs, including SVFs, are regulated by Security Exchange Board of India (SEBI) under the SEBI (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”). Being private investment vehicles set up for a social cause, the AIF Regulations allow SVFs to provide muted or nil returns to investors, and also permit them to receive and deploy grants for downstream investments in social ventures.<sup>22</sup>

AIFs have mobilized large amounts of money for investment into India. Category II AIFs have raised commitments to the tune of INR 1.3 lakh crore as of June 30, 2018. Category I AIFs have raised commitments of INR 28,717 crore as of the same date, with SVFs raising INR 1,133 crore of such total. Various AIFs, including non-SVFs, are engaged in promoting social welfare projects in India. While the investment program of AIFs is the prerogative of the investment manager, in practice, it is often seen that such program is heavily influenced by contributors through the agreements entered into with respect to contribution to the AIF.

AIFs therefore, could therefore present a suitable avenue for companies undertaking CSR activities to channel investments into socially beneficial projects and ensure compliance through arrangements which are ultimately under the purview of a statutory regulator i.e. SEBI. Therefore, the existing CSR framework should be amended to allow CSR funding to AIFs primarily investing in social ventures (as understood under the AIF Regulations). In this respect, it would be preferable

social problems or providing social benefits and includes,-  
(i) public charitable trusts registered with Charity Commissioner;  
(ii) societies registered for charitable purposes or for promotion of science, literature, or fine arts;  
(iii) company registered under Section 25 of the Companies Act, 1956;  
(iv) micro finance institutions

22. Regulation 16 of the SEBI (AIF) Regulations:

(4) The following conditions shall apply to social venture funds in addition to the conditions laid down in sub-regulation (1):-  
(a) at least seventy five percent of the 15 [investable funds] shall be invested in unlisted securities or partnership interest of social ventures.  
(b) such funds may accept grants, provided that such utilization of such grants shall be restricted to clause (a)16[.]  
17[Provided that the amount of grant that may be accepted by the fund from any person shall not be less than twenty-five lakh rupees: Provided further that no profits or gains shall accrue to the provider of such grants.]  
(c) such funds may give grants to social ventures, provided that appropriate disclosure is made in the placement memorandum.  
(d) such funds may accept muted returns for their investors i.e. they may accept returns on their investments which may be lower than prevailing returns for similar investments

to provide such allowance in respect of all Category I and II AIFs with an investment programme primarily focused on social ventures, This can ensure a greater flow of funding to social welfare projects since, as discussed above, Category I AIFs other than SVFs and Category II AIFs have historically (and as may be expected going forward too) raised much greater commitments than SVFs.

For all such AIFs, the Fund and the investment managers may be bound, through appropriate fund documents, to adhere to the relevant policy if they accept funding from companies from their CSR budgets. A parallel is seen in the insurance industry, wherein the Insurance Regulatory and Development Authority of India (“IRDA”) has stipulated that Category II AIFs which accept investments from insurers (regulated by the IRDA) should invest a minimum of 51% of their funds in infrastructure entities, small and medium enterprises, venture capital undertakings or social venture entities.<sup>23</sup> Typically, this requirement is incorporated in fund documentation by insurers while entering contribution agreements or related fund documents, thereby binding the investment manager and the AIF.

However, specifically with respect to receipt of grants by SVFs, greater regulatory clarity would be welcome on few salient aspects (discussed here). While permission in this regard has been granted, the regulations are not very clear on the interplay between a grant and an investment with a muted return and what each should constitute. Further, there is a legislative blind-spot between the AIF Regulations, the Foreign Contribution Regulation Act, 2010 (FCRA) and the Income Tax Act, 1961 (“ITA”). While the AIF Regulations allow SVFs to receive grants, both from domestic as well as foreign sources, the provisions of the FCRA clearly state that no foreign contributions can be received by any organization in India without taking specific approval from the Ministry of Home Affairs (“MHA”).<sup>24</sup> Thus, despite SVFs being purely regulated under the AIF Regulations for the purposes

of receiving grants and making investments using such grants, the provisions of FCRA only envisage non-profit entities to receive foreign grants. Even under the provisions of ITA, typically only non-profit entities are considered as compatible vehicles to receive grants, while AIFs typically are for-profit Special Purpose Vehicle (SPVs). Thus, there are certain non-convergences between the provisions of the AIF Regulations, the ITA and the FCRA in respect of receipt of foreign and/or domestic grants, and its application thereof.

## IV. CSR laws

As a brief background, most developed jurisdictions have a well-established Corporate Social Responsibility (“CSR”) policy. In 2001, the EU defined CSR as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis”. The social responsibility of businesses therefore encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time. In 2014, India became the first country in the world to make CSR contributions mandatory, through Section 135 and Schedule VII of the Companies Act, 2013 as well as the CSR Rules, 2014. Schedule VII lays down the activities towards which CSR funding may be used:

- i. *eradicating extreme hunger and poverty;*
- ii. *promotion of education;*
- iii. *promoting gender equality and empowering women;*
- iv. *reducing child mortality and improving maternal health;*
- v. *combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;*
- vi. *ensuring environmental sustainability;*
- vii. *employment enhancing vocational skills;*
- viii. *social business projects;*

23. Paragraph 1.5 (Investment in Alternative Investment Fund), Investments – Master Circular, IRDAI (Investment) Regulations, 2016.

24. Section 11 of the FCRA

- ix. *contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and*
- x. *such other matters as may be prescribed.*

The CSR provision is applicable to companies with an annual turnover of INR 10 billion or more, or a net worth of INR 5 billion or more, or a net profit of INR 0.05 billion or more during any financial year. Companies that trigger any of the aforesaid conditions must spend at least two per cent (2%) of their average net profits made during the three immediately preceding financial years on CSR activities and/or report the reason for spending or non-expenditure. In terms of scale, companies engaging in CSR spend approximately INR 12,000 crores, as compared to the government's annual expenditure of more than INR 3,00,000 crore on the social sector.

Under the provisions of Section 135, CSR Rules, 2014 ("CSR Rules") and Schedule VII ("Schedule VII") of the Companies Act, 2013 ("Companies Act"),<sup>25</sup> the Board of Directors ("**Board**") of a company may decide to undertake its CSR activities approved by the CSR committee, through a registered trust or a registered society or a company established by the company or its holding or subsidiary or associate company under section 8 of the Companies Act or otherwise, provided that:

- if such trust, society or company is not established by the company or its holding or subsidiary or associate company, it shall have an established

25. Activities which may be included by companies in their Corporate Social Responsibility Policies

Activities relating to:—

- (i) eradicating extreme hunger and poverty;
- (ii) promotion of education;
- (iii) promoting gender equality and empowering women;
- (iv) reducing child mortality and improving maternal health;
- (v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;
- (vi) ensuring environmental sustainability;
- (vii) employment enhancing vocational skills;
- (viii) social business projects;
- (ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and
- (x) such other matters as may be prescribed.

track record of three years in undertaking similar programs or projects.

- the company has specified the project or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.

Further, a company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR committees of respective companies are in a position to report separately on such projects or programs in accordance with the CSR Rules.

For-profit organizations can be engaged to carry out certain parts of the CSR programs. However, such spending should be restricted to 5% of the total allocable CSR funds towards capacity building, training, project management etc. for the employees who undertake CSR projects on behalf of the company.

Every qualifying company will be required to constitute a CSR Committee ("**Committee**") consisting of three or more directors.<sup>26</sup> The Committee shall formulate and recommend to the Board, a CSR policy which shall indicate the activities to be undertaken; recommend the amount of expenditure to be incurred on the activities referred and monitor the CSR policy of the company.<sup>27</sup> The Board shall take into account the recommendations made by the CSR Committee and approve the CSR policy of the company.<sup>28</sup>

26. *ibid*,

27. Section 135 (3) The Corporate Social Responsibility Committee shall,—

- (a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
- (b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
- (c) monitor the Corporate Social Responsibility Policy of the company from time to time

28. Section 135(4) The Board of every company referred to in sub-section (1) shall,—

- (a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
- (b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

## V. US laws – Programme Related Investments

In the United States, many foundations make investments through Program-related Investments (“PRIs”) in the form of loan, equity investment, or guaranty, in pursuit of their charitable mission, rather than to generate income. The recipient can be a non-profit organization or a for-profit business enterprise.<sup>29</sup> The United States Internal Revenue Code (“IRC”) under “exceptions for Program-Related Investment provides that, *“investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes.”*<sup>30</sup> Thus, PRIs are those in which, the primary purpose is to accomplish one or more of the foundation’s exempt purposes; production of income

or appreciation of property is not a significant purpose; and influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose.<sup>31</sup> In determining whether a significant purpose of an investment is the production of income or the appreciation of property, it is relevant whether investors who engage in investments only for profit would be likely to make the investment on the same terms as the private foundation. If an investment incidentally produces significant income or capital appreciation, this is not, in the absence of other factors, conclusive evidence that a significant purpose is the production of income or the appreciation of property.<sup>32</sup>

Thus, PRIs are necessarily made by foundations to support charitable activities and may be in various forms, whether loan, guarantee or equity. It is also not important that PRIs produce market-rate returns. A financial return is by necessity hard wired into an impact investment which is not the case in PRIs.

29. Paul Brest, *Investing for Impact with Program-Related Investments*, available at, [https://ssir.org/articles/entry/investing\\_for\\_impact\\_with\\_program\\_related\\_investments#](https://ssir.org/articles/entry/investing_for_impact_with_program_related_investments#) (last accessed on Jan. 22, 2019)

30. IRC 4944(c)

31. 26 CFR (Code of Federal Regulations) 53.4944-3

32. Internal Revenue Service, *Program-related Investments*, available at <https://www.irs.gov/charities-non-profits/private-foundations/program-related-investments> (last accessed on Jan. 22, 2019)

## 9. Illustrations of Innovative Social Finance

### Pay for Success/SIB/DIB



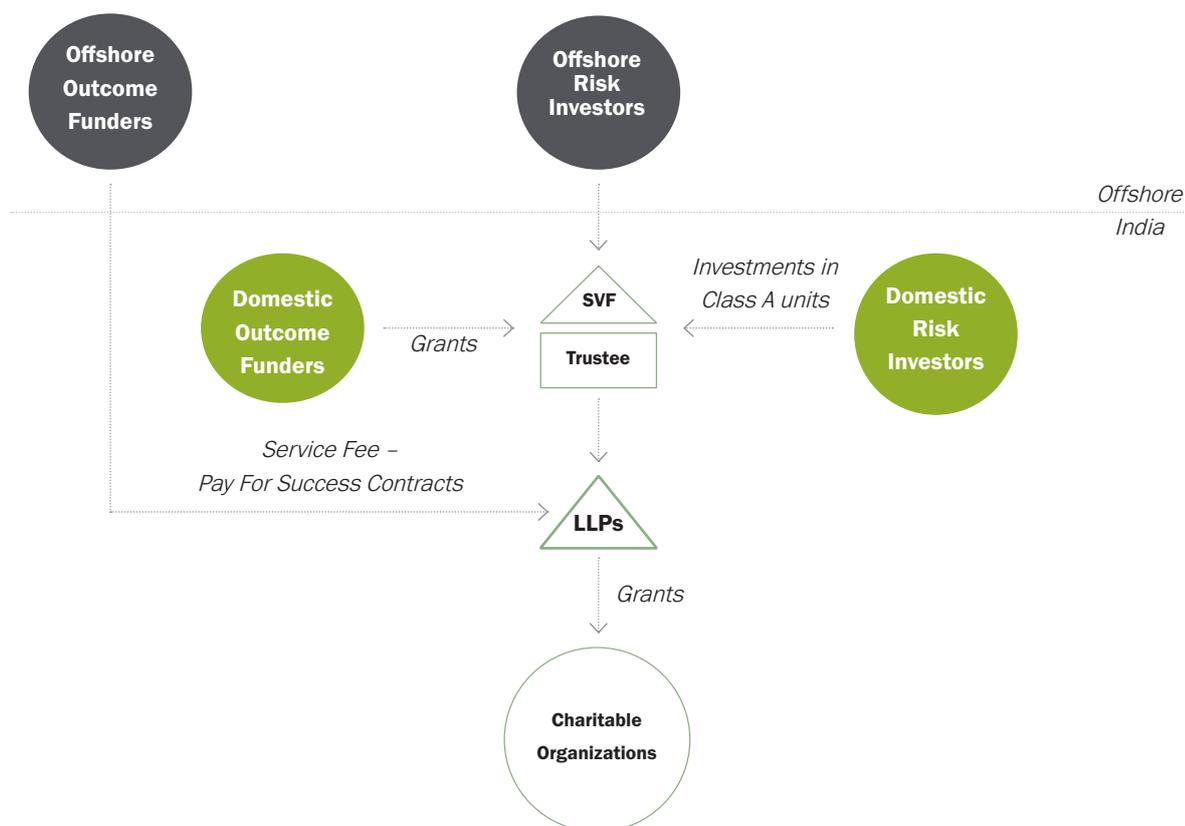
**Description:** In this simple SIB model, the social venture or enterprise is structured as either a for-profit entity or a not-for-profit such as a LLP or a Sec. 8 company respectively. In the present example while the outcome funder is offshore, the same contract could be entered into with a local outcome funder as well. On the achievement of outcomes, the outcome funder should pay the social enterprise the agreed cost and profit for that project.

**Advantages:** The main advantages of this model are that the payment is tied to outcomes and also out of the ambit of FCRA since it is not a grant. It does not trigger any other regulatory restrictions that might be applicable in the case of debt or equity instruments. It is simple from a documentation perspective as well and offers flexibility to document the commercial intention of the parties.

**Disadvantages:** The main challenges in this model are that many of the social enterprises are likely to be cash strapped and may not be willing to risk the entire service on the result of the outcome. Hence to solve the cash flow and the capital risk issue, risk funding from more risk or returns oriented investors may be required.

Other factors to bear in mind are that from a tax perspective for instance, if the outcome funders are based offshore any GST leakage could be optimized by qualifying the service as an export of service. If on the other hand, the outcome funder is onshore then GST is likely to be applicable. Deal specific items or considerations would also have to be optimized for increasing returns and protecting against risks.

## Social Venture Fund-I (Outcome Funding Model)

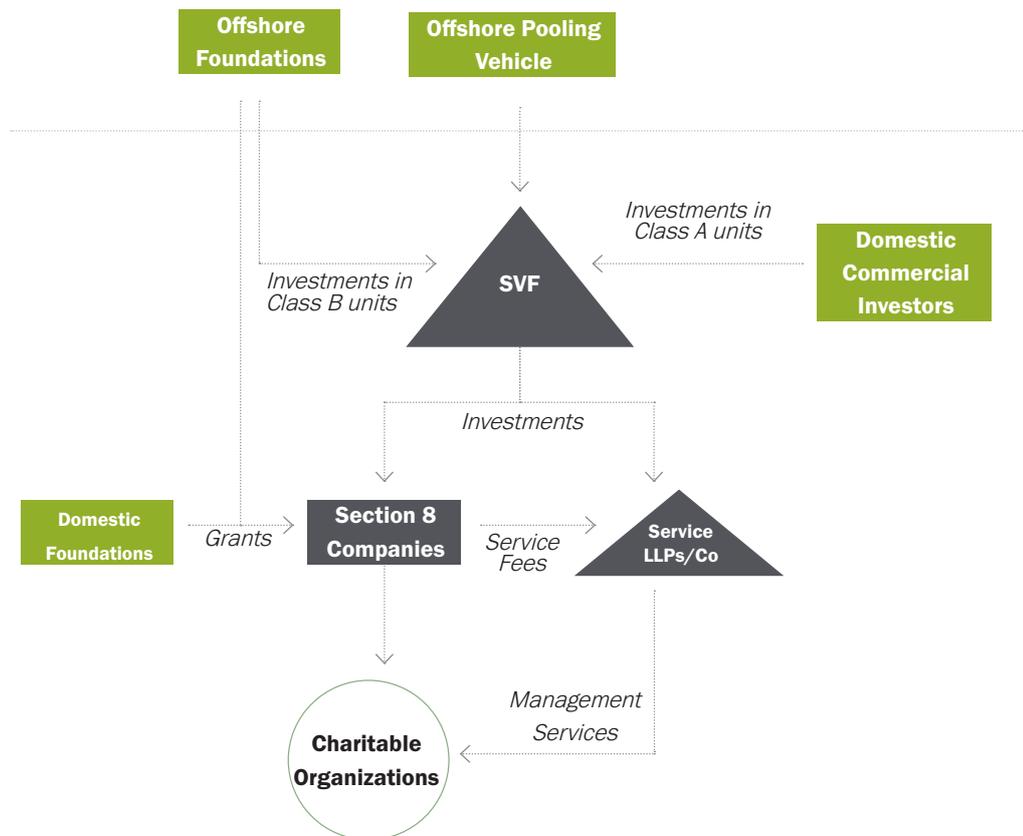


**Description:** In this model, a Social Venture Fund is set up and managed by a fund manager. Risk investors in India and abroad invest in units of the SVF. The SVF uses this capital to invest in social enterprises or through captive investments provides funding to service providers (in consultation with risk investors) who will help achieve the outcome with respect to specific projects. Once outcome is verified the outcome funders in India can make the outcome funding to the SVF and the outcome funding by offshore funders can be received by the captive entities which will upstream the returns to investors.

**Advantages:** The main advantages are that this structure enables pooling in of funding from several sources of both risk and outcome funding capital. As a consequence, the scale of impact that can be achieved through such a platform increases significantly when compared with a simple SIB model which is more suited to a project specific arrangement between limited parties.

**Disadvantages:** The main disadvantage is that the capital involved should be of a significant size to justify the costs of setting up this structure. Secondly, there are several novel elements in this innovative financing structure, which commercially speaking, impact investors or the social enterprises may need comfort that it will not be challenged by any of the tax or regulatory authorities. Since it is the first of its kind structure, no precedents exist to confirm that such a model has been shown to successfully work.

## Social Venture Funds – II (Socially Responsible Investing)

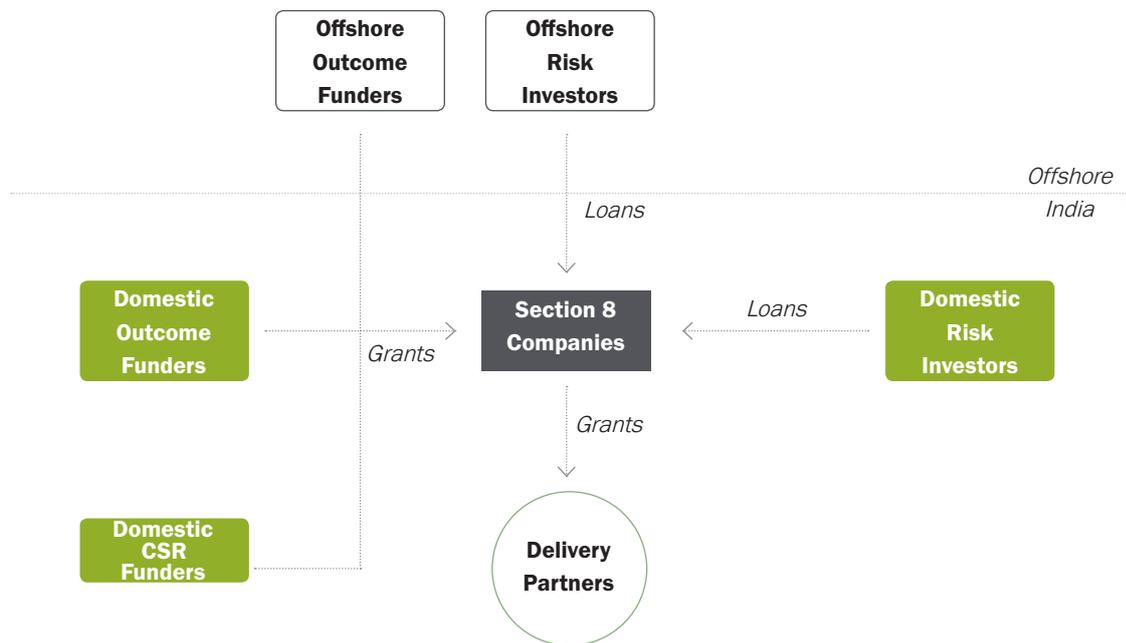


**Description:** In this model, a Social Venture Fund is set up and managed by a fund manager. Risk investors in India and abroad invest in units of the SVF. The SVF uses this capital to invest into a section 8 company which will run a hospital or an education institution. The SVF would also have a captive service LLP which would provide management services to the Section 8 company. Typically, this is the model currently in the market, without the SVF.

**Advantages:** The primary advantage of this model, compared with the current structure in the market, is that while primarily the investors would be paid returns from the profits made from the operations of the Section 8 company and the Service LLP together, subject to payment of applicable taxes, they also have access to additional outcome funding provided they are able to meet such outcome funding targets. This is likely to significantly improve returns and outcomes for the stakeholders involved.

**Disadvantages:** The main disadvantage is that the capital involved should be of a significant size to justify the costs of setting up this structure. Secondly, there are several novel elements in this innovative financing structure, which commercially speaking, impact investors or the social enterprises may need comfort that it will not be challenged by any of the tax or regulatory authorities. Since it is the first of its kind structure, no precedents exist to confirm that such a model has been shown to successfully work. Further, while it might be easier to set this up from scratch, moving existing structures into this model might prove a challenge.

## Recoverable grant structure

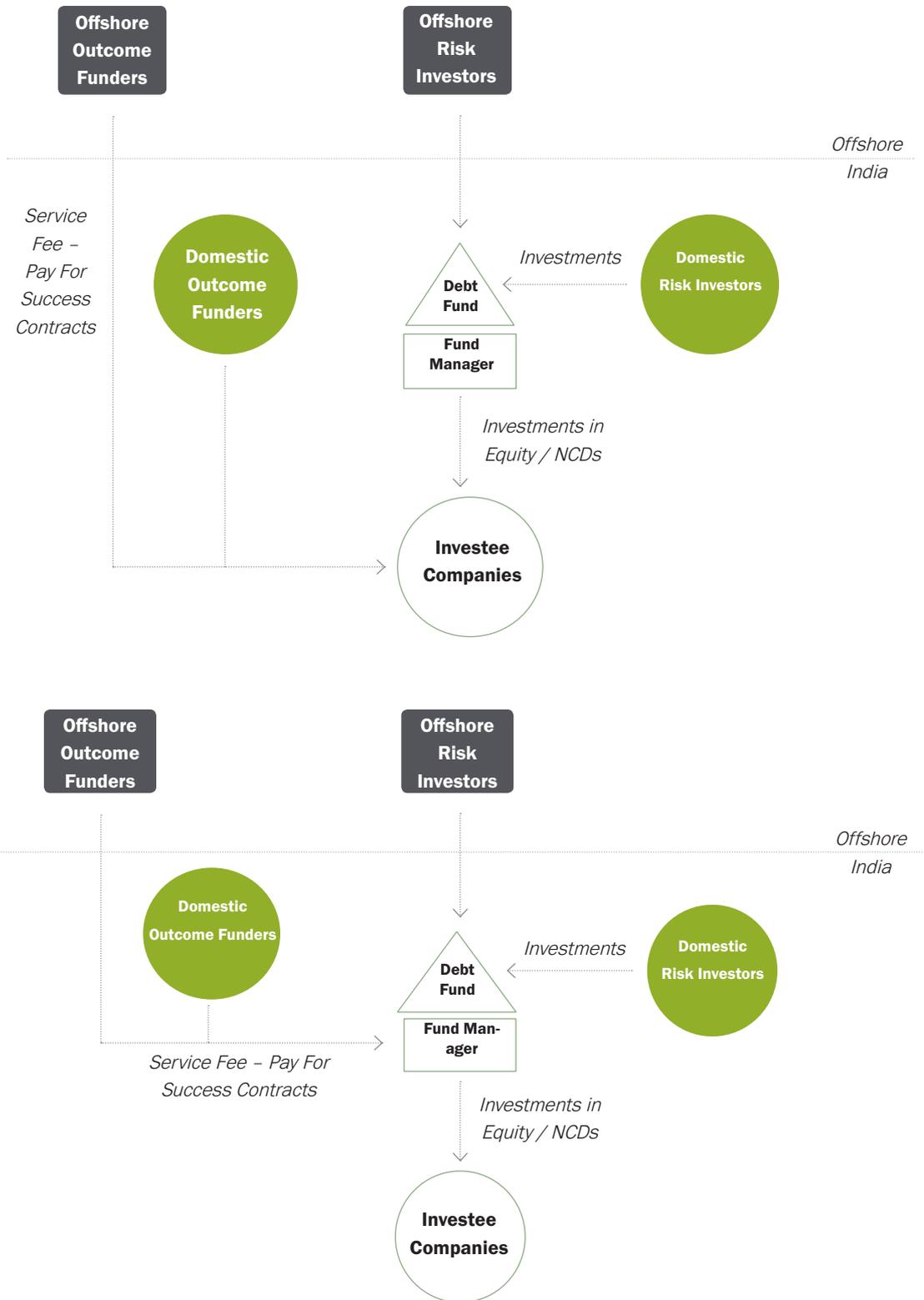


**Description:** In this model, we have tried to emulate the recoverable grant structure that appears to be popular in the US. Here a section 8 company would act as the intermediary. It would take a loan from either domestic or offshore risk investors and use the funding to fund delivery partners who will work towards achieving the pre-agreed outcome. On achievement of outcome, the outcome funders being domestic charities or CSR pooling vehicles or offshore outcome funders may pay the section 8 company. The section 8 company shall then pay back the loan and interest amount.

**Advantages:** The main advantages of this model are that it enables risk investors to participate in a model where they could get the principal amount and interest back. Further, it also unlocks CSR funding and offshore funding as potential outcome funding capital. It also de-risks the operations of the section 8 as it will not be bearing the risk of non-achievement of outcomes in this case.

**Disadvantages:** The main disadvantages are that certain legs of this structure require compliance with External Commercial Borrowing regulations issued by the RBI and FCRA for it to reach its full potential. Further, to prevent any adverse consequences on the non-achievement of outcome the contracts would have to be carefully drafted and write off of loans or interest payments should also be managed properly.

# Category II Debt Fund



Description: In this model, instead of a social venture fund which can accept grants from charities, a Category II Debt Fund is instead used as the pooling vehicle. Risk investors subscribe to units of the Debt Fund. The Debt Fund in turn can invest into any security of company including debt and equity instrument. The returns from achieving any outcome can be either directly paid to the fund manager or the investee company which will upstream profits to the debt fund or repay the principal amount and interest. These will be paid as returns to the investors.

Advantages: In some ways, a Category II debt fund offers more flexibility and investors who wish a lower risk and lower returns profile may find this a more

appealing option. The other advantage is that it allows for scaling up of impact by improving the ability to pool capital from multiple sources although not so much as in the SVF structures. Better suited for a socially responsible investing model than an outcome funding model although it is possible.

Disadvantages: The Investee companies should be eligible to issue debt securities which involves having a net worth of INR 4 crores, which could significantly reduce the investee pool. Further, debt funds cannot provide simple loans under the current regulations. Further, debt funds cannot directly pool capital from charities or foundations.

## 10. Conclusion

Traditionally profit-making and philanthropy were strictly separate, and the laws do not permit intermixing of capital that is set aside for philanthropy with return seeking investments. An overriding concern is naturally that philanthropy capital should not be used for the purpose of subsidizing the financial return of others, particularly when that capital deployment in itself has triggered fiscal benefit to donor entities. The purism of this distinction has resulted in several issues: shareholders today primarily seek financial returns and a common misconception is that adding any other parameter to company operations, particularly when driven by any other kind of capital, may result in muted returns and a 'contaminated' model. This cosmetic divide in law also constrains charities who spend a significant amount of time fund raising, translating therefore to an impairment from investing precious resource into their growing social ventures and eventually recouping their capital through other means.

As aforementioned, impact investments on the other hand are investments intended to create positive social and environmental impact in society while also clearly generating some level of financial return. The days of debate regarding the 'trade-off' between social impact and financial return are well behind us, and it is in effect the Indian case *writ large* that has contributed to this assertion; doing well by doing good does work, now that we have a market where the minimum thresholds of capital concentration have long since been achieved, and a semblance of capital liquidity prevails. An impact investment should be able to maximize both financial returns and social/environmental impact than an investor who pursues a profit maximizing investment strategy or a philanthropy that donates a certain portion of the financial returns to achieve social or environmental goals. Thus, loosening regulatory and tax laws to allow for such inter-mixing should encourage impact investments not only into social ventures but is likely to also allow for greater participation of investors with non-financial incentives in the activities of other companies and influence matters towards increased sustainability.

The market for impact investment in India is vast. India is the largest and most active impact investment market in Asia, benefitting from a broad range of investor and entrepreneur experience with impact investing. To date approximately USD 5 billion has been deployed by development finance institutions ("DFIs"), while USD 437 million has come from other impact investors. This definition is wide and does encompass a full range of ESG and other types of trading utilizing social parameters of one or another kind.

India, between 2010 and 2016, attracted over 50 active impact investors, who, along with mainstream investors, poured more than US \$5.2 billion into social ventures. About US \$1.1 billion was invested in 2016 alone. Despite the active impact investors, there is still huge unutilized potential to achieve impact. As impact investing in India has grown to a billion-dollar-a-year industry, investments have been supported by different types of investors, with high expectations of impact, varied expectations of risk and return, and vastly different strategies and portfolio approaches. All of this said, the typical social entrepreneur in India working at the early stages of growth will typically still face liquidity constraints, and it is important that we encourage a mindful approach that encourages patience and an appropriate risk appetite; the greatest impact is where capital is clearly additional. Crowding in on the high ticket more mature/scaling end of the capital spectrum is simply not going to be as impactful as joining the precious few who are taking risk and testing patience with equity approach or with pioneering debt extension via dedicated non-banking financial companies (NBFCs).

In India, 60% of all impact investments have been made in just 15 impact enterprises. The most popular sectors that have emerged are energy, education, healthcare, and livelihood and nearly 85% of the investments have been made in these sectors alone. There are continuous new opportunities in each of these sectors and they investable and can be built to scale with the right support.

In India, impact enterprises are today present across the country and are operating across regions, with strong representation in Southern India. Maharashtra is the leading state with 35% of all impact enterprises in the country having a presence there.

The huge millennial population, growing middle class, and unmet social requirements are catalysts for investing in social and environment projects, bearing

strong potential for significant turnover and profit. The growth of the impact investment market is substantially dependent upon the investment made in investable impact enterprises, which are ready to absorb capital and provide meaningful outcomes. Exciting opportunities await those who wish to engage in this space.

## Annexure - I

## De-mystifying Term Sheets

What it says	What it means	Entrepreneur-friendly terms	Investor-friendly terms	Comments, suggestions, mitigation strategies
<b>Investors</b> Investor No. 1: [ ] shares ([ ]%), ₹[ ] Investor No. 2: [ ] shares ([ ]%), ₹[ ] [as well other investors mutually agreed upon by Investors and the Company]	Name of the investor who are putting in money in this round. Could also allow for an additional amount from investors that are yet to be identified.			
<b>Issuer</b> [ ]	Legal name of the enterprise			
<b>Promoters and Existing Shareholders:</b> [ ]	Names of the founders / promoters			
<b>Valuation</b> The Original Purchase Price is based upon a fully-diluted pre-money valuation of ₹[ ] and a fully diluted post-money valuation of ₹[ ] (including an employee pool representing [ ]% of the fully diluted post-money capitalization).	This is the valuation of the enterprise before and after the financing.			
<b>Amount of the offering</b> ₹[ ]	The total amount of money being raised in this round of financing. May include an amount reserved for the yet-to-be-identified investors mentioned above.			Modify this provision to account for staged investments or investments dependent on the achievement of milestones by the Company.
<b>Number of shares, price per share</b> ₹[ ] per share (based on the capitalization of the Company set forth below) (the “ <b>Original Purchase Price</b> ”).	Mathematically derived from the amount of financing and % of post-money valuation to be held by Investors.			
<b>% of the company</b> [ ] on fully-diluted basis post-financing	Mathematically derived from the amount of financing and post-money valuation.			

<p><b>Securities</b> Investors will subscribe to compulsorily convertible cumulative preference shares (“Preference Shares”) and equity shares (“<b>Common Stock</b>”) (collectively the Preference Shares and Common Stock subscribed to by Investors shall be referred to as “<b>Investor Shares</b>”) as per the Valuation laid out below.</p>	<p>What is the type of instrument investors will get. Could be Compulsorily Convertible Debenture (CCD), Preference Shares, or Common Stock equity shares.</p>			
<p><b>Use of proceeds:</b> To fund the business of the Company, including sales and marketing expansion (including staff), client operations, management expenses and salaries.</p>	<p>How you can use the money.</p>	<p>Broader is better.</p>	<p>Narrower is better.</p>	
<p><b>Dividends:</b> Preference Shares will pay a dividend of [ ]% per year. After preferential dividends have been paid to the holders of the Preference Shares, the Preference Shares will participate pro rata in any other dividends or distributions payable to holders of Equity Shares.</p>	<p>Whether the investors will earn a dividend or not and if so, what the rate of dividend is. Also specifies if the dividend only accrues (is not to be paid out) or needs to be paid.</p>	<p>No dividend ideal, and accrued, not paid</p>	<p>A high rate of dividend which delivers target rate of return and is paid out regularly.</p>	<p>Equity investors will enjoy the upside that comes from creating a valuable enterprise. To also get an annual assured dividend is unfair and excessive.</p>
<p><b>Conversion price and terms</b> The Conversion price for the Investors would be equal to the purchase price. Accordingly, the Investors shall be entitled to convert each preference share into one equity share.  The conversion price would be suitably adjusted for proportionate anti-dilution protection for issue of new shares by the Company at a price below the Acquisition Price, rights issue, stock splits, stock dividends etc.</p>	<p>Convertible Preference Shares can be converted into Common Stock. This clause specifies the ratio at which the conversion takes place.</p>	<p>Not more than 1:1</p>	<p>&gt; 1:1</p>	<p>Make sure you have modeled the effect of conversion terms in various future scenarios of exits.</p>
<p><b>Compulsory conversion trigger(s)</b> Each preference share will automatically and mandatorily convert into equity share at the then applicable conversion rate upon the earlier occurrence of: a. Upon the closing of a firmly underwritten public offering with minimum proceeds to the Company of ₹[ ] (a “<b>Qualified IPO</b>”); or b. Upon the expiry of [ ] ([ ]) years from the date of issuance.</p>	<p>Preference shares are mandatorily converted when you have an IPO, or after a period of time.</p>	<p>Smaller size of Qualified IPO and shorter timeframes are better.</p>	<p>Larger size and longer timeframes better.</p>	

<p><b>Liquidation preference</b></p> <p>In the event of any liquidation, dissolution or winding up of the Company, the proceeds shall be paid as follows:</p> <p>[ ]</p>	<p>How the proceeds will be distributed to various shareholders in the event of a liquidation. Preference Shares have a “preference” in that they get distributions first – and common stock gets distributions after that (if there’s anything left).</p>	<p>[Alternative 1 (non-participating Preferred Stock): First pay [one] times the Original Purchase Price [plus accrued dividends] [plus declared and unpaid dividends] on each share of Series A Preferred (or, if greater, the amount that the Series A Preferred would receive on an as-converted basis). The balance of any proceeds shall be distributed pro rata to holders of Common Stock.]</p>	<p>[Alternative 2 (full participating Preferred Stock): First pay [one] times the Original Purchase Price [plus accrued dividends] [plus declared and unpaid dividends] on each share of Series A Preferred. Thereafter, the Series A Preferred participates with the Common Stock pro rata on an as-converted basis.]</p>	<p>[Alternative 3 (cap on Preferred Stock participation rights): First pay [one] times the Original Purchase Price [plus accrued dividends] [plus declared and unpaid dividends] on each share of Series A Preferred. Thereafter, Series A Preferred participates with Common Stock pro rata on an as-converted basis until the holders of Series A Preferred receive an aggregate of [_____] times the Original Purchase Price (including the amount paid pursuant to the preceding sentence).]</p>
<p><b>Liquidation event(s)</b></p> <p>A merger or consolidation (other than one in which stockholders of the Company own a majority by voting power of the outstanding shares of the surviving or acquiring corporation) and a sale, lease, transfer, exclusive license or other disposition of all or substantially all of the assets of the Company will be treated as a liquidation event (a “Deemed Liquidation Event”), thereby triggering payment of the liquidation preferences described above.</p>	<p>This clause defines what a liquidation event is for purposes of invoking the liquidation preference mentioned above.</p>			
<p><b>Anti-dilution protection:</b></p> <p>In the event that the Company issues additional securities at a purchase price less than the current Series A Preferred conversion price, such conversion price shall be adjusted in accordance with the following formula: [ ]</p>	<p>This clause is to protect investors in case the value of a company declines after they’ve invested in it.</p>	<p>[Alternative 3: No price-based anti-dilution protection.]</p>	<p>[Alternative 2: Full-ratchet – the conversion price will be reduced to the price at which the new shares are issued.]</p>	<p>Weighted average anti-dilution protection – broad-based or narrow-based, are also often used. Conceding on this clause can be used to mitigate Investor concerns in a situation of a very rich valuation.</p>

<p>The following issuances shall not trigger anti-dilution adjustment:</p> <ul style="list-style-type: none"> <li>(i) securities issuable upon conversion of any of the Series A Preferred, or as a dividend or distribution on the Series A Preferred;</li> <li>(ii) securities issued upon the conversion of any debenture, warrant, option, or other convertible security;</li> <li>(iii) Common Stock issuable upon a stock split, stock dividend, or any subdivision of shares of Common Stock; and (iv) shares of Common Stock (or options to purchase such shares of Common Stock) issued or issuable to employees or directors of, or consultants to, the Company pursuant to any plan approved by the Company's Board of Directors.</li> </ul>				
<p><b>Board of directors</b> At the initial Closing, the Board shall consist of [ ] members comprised of (i) [name] as [the representative designated by [], as the lead Investor, (ii) [name] as the representative designated by the remaining Investors, (iii) [name] as the representative designated by the Founders, (iv) the person then serving as the Chief Executive Officer of the Company, and (v) [ ] person(s) who are not employed by the Company and who are mutually acceptable [to the Founders and Investors][to the other directors].</p>	<p>This clause specifies how the board of the company will be reconstituted after the investment. Investors exercise effective control over the affairs of the company through membership of the board of directors.</p>	<p>Try to get the Investors to specify who will be their representative on the board because at the early stages, you're looking for mentoring from the assigned board member and have to make sure you can work with him/her.</p>		<p>An odd number of board members is desirable.</p>
<p><b>Director indemnification:</b> The Investor Directors will be entitled to customary indemnification from the Company pursuant to the charter documents and definitive agreements. The Company will also obtain D&amp;O insurance reasonably satisfactory to the Investor.</p>	<p>The company pays to buy insurance against the directors getting sued.</p>			<p>The cost of D&amp;O insurance depends on the nature of your business. For startups, the premium can be as low as ₹30,000 p.a.</p>
<p><b>Vesting of founders' shares</b> All Founders to own stock outright subject to Company right to buyback at cost. Buyback right for [ ]% for first [12 months] after Closing; thereafter, right lapses in equal [monthly] increments over following [ ] months.</p>	<p>Investors want founders to stick around and grow the company and make it valuable. This clause is how they ensure that.</p>	<p>No vesting, or a very short vesting period. Credit for prior work done by specifying a vesting start date that is the in the past.</p>	<p>A long vesting period, that is back-loaded (higher percentages in the later stages of vesting).</p>	

<p>[In the event of a merger, consolidation, sale of assets, or Change of Control of the Company [and/or] should a Promoter be terminated without cause, such person shall be entitled to accelerated vesting of any outstanding Common Stock held by Promoters.]</p>		<p>Full acceleration in the event of termination or change of control.</p>	<p>Start date is when the financing is closed. No or very little acceleration for termination and that too only after change of control.</p>	
<p><b>Stock options</b> The Company will create an ESOP pool of [ ]% on fully diluted basis before investment.</p>	<p>Investors want to make sure that a good pool is set up to attract the talent the company will need before their money comes in, so that they don't have to dilute to create stock options.</p>			
<p><b>[Lock-in of founders' shares]</b> The Founder shareholders cannot in any way sell / transfer their respective shareholdings before the end of [ ] years from the date of Investments by Investors, in whatever form, without providing the Right of First Refusal to Investors, or without the Investors exercising their Tag Along Rights (as provided for below). Any exception to this will require written consent from Investors]</p>	<p>This clause is to prevent Founders from bailing out of the enterprise without approval of the Investors.</p>			
<p><b>Tag-along / take-me-along rights</b> Subject to the lock-in provisions herein contained and to the extent the rights of first refusal are not exercised, in the event a Promoter proposes to transfer any Common Stock, the Investors would have a right to sell its shares on the same terms to the same party. The Tag Along Right shall be a pro-rata right so long as the total number of shares transferred by the Founders is less than [ ]% of their shareholding in the company (on a fully diluted basis). If any shares in addition to the above are proposed to be transferred, the Investors shall have the first option to sell their shares to the proposed purchaser.</p>	<p>This clause allows Investors can force the Founders to "taken them along" when selling their shares. You can't sell without also giving an opportunity for Investors to participate.</p>			

<p><b>Right of First Refusal:</b> Investors will have the right of first refusal, subject to customary exceptions, with respect to any shares of capital stock of the Company proposed to be transferred by Promoters and future employees holding greater than 1% of the Company stock. Rights to purchase any unsubscribed shares will be reallocated among the participating purchasers pro rata to their participation amounts.</p>	<p>In case you find a buyer for your shares, Investors want the right to buy them instead, increasing their shareholding and preventing anyone else from acquiring them.</p>			
<p><b>Drag-along rights</b> Holders of Preferred Stock and the Founders [and all future holders of greater than [1]% of Common Stock (assuming conversion of Preferred Stock and whether then held or subject to the exercise of options)] shall be required to enter into an agreement with the Investors that provides that such stockholders will vote their shares in favor of a Deemed Liquidation Event or transaction in which 50% or more of the voting power of the Company is transferred and which is approved by [the Board of Directors] [and the holders of ____% of the outstanding shares of Preferred Stock, on an as-converted basis (the “Electing Holders”)], so long as the liability of each stockholder in such transaction is several (and not joint) and does not exceed the stockholder’s pro rata portion of any claim and the consideration to be paid to the stockholders in such transaction will be allocated as if the consideration were the proceeds to be distributed to the Company’s stockholders in a liquidation under the Company’s then-current Certificate of Incorporation.]</p>	<p>This clause is used in cases where the investors find a buyer, but the buyer wants to acquire the whole company or else is not interested. By “dragging along” other investors, the selling investors can make sure that a minority investor cannot block the deal.</p>			
<p><b>Sale Rights:</b> Upon written notice to the Company from the Electing Holders, the Company shall initiate a process intended to result in a sale of the Company.</p>				

<p><b>Protective provisions</b> [So long as [insert fixed number, or %, or “any”] shares of Series A Preferred are outstanding,] in addition to any other vote or approval required under the Company’s Charter or Bylaws, the Company will not, without the written consent of the holders of at least [__]% of the Company’s Series A Preferred, either directly or by amendment, merger, consolidation, or otherwise:</p> <ul style="list-style-type: none"> <li>i. liquidate, dissolve or wind up the affairs of the Company, or effect any merger or consolidation or any other Deemed Liquidation Event;</li> <li>ii. amend, alter, or repeal any provision of the Certificate of Incorporation or Bylaws [in a manner adverse to the Series A Preferred];</li> <li>iii. create or authorize the creation of or issue any other security convertible into or exercisable for any equity security, having rights, preferences or privileges senior to or on parity with the Series A Preferred, or increase the authorized number of shares of Series A Preferred;</li> <li>iv. purchase or redeem or pay any dividend on any capital stock prior to the Series A Preferred, [other than stock repurchased from former employees or consultants in connection with the cessation of their employment/services, at the lower of fair market value or cost;] [other than as approved by the Board, including the approval of [_____] Series A Director(s)]; or</li> <li>v. create or authorize the creation of any debt security [if the Company’s aggregate indebtedness would exceed \$[_____] [other than equipment leases or bank lines of credit] [unless such debt security has received the prior approval of the Board of Directors, including the approval of [_____] Series A Director(s)];</li> </ul>	<p>Investors are investing in a specific entity, with a specific business idea / plan / promise. The last thing they want is a situation where after their investment, the company changes direction, founders issue themselves fresh shares, sell the company or its assets, etc. This clause prevents that from happening.</p>			<p>Read each sub-clause carefully and make sure you are comfortable with it.</p>
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<p>vi. create or hold capital stock in any subsidiary that is not a wholly-owned subsidiary or dispose of any subsidiary stock or all or substantially all of any subsidiary assets;</p> <p>vii. materially change the business of the Company or its subsidiaries</p> <p>viii. Approve an annual operating plan and budget [or</p> <p>ix. increase or decrease the size of the Board of Directors.]</p>				
<p><b>[Pay to play]</b> [Unless the holders of [__]% of the Series A elect otherwise,] on any subsequent [down] round all [Major] Investors are required to purchase their pro rata share of the securities set aside by the Board for purchase by the [Major] Investors. All shares of Series A Preferred of any [Major] Investor failing to do so will automatically [lose anti-dilution rights] [lose right to participate in future rounds] [convert to Common Stock and lose the right to a Board seat if applicable].]</p>	<p>This clause means that holders of preferred stock lose some or all of their rights if they don't participate in future funding rounds. It is helpful in ensuring that you have investors who are in it for the long-term and will support you through your journey.</p>			
<p><b>Information rights</b> The Preference Shares will have customary information and inspection rights including the receipt of (i) audited annual financial statements; (ii) unaudited quarterly financial statements; (iii) annual operating plans; and (iv) monthly management reports to Investor in a form to be agreed by the parties, including dashboards of key performance indicators.</p>	<p>This clause ensures that Investors get all the information they need to monitor their investment.</p>			
<p><b>Right to Participate Pro Rata in Future Rounds:</b> All [Major] Investors shall have a pro rata right, based on their percentage equity ownership in the Company (assuming the conversion of all outstanding Preferred Stock into Common Stock and the exercise of all options outstanding under the Company's stock plans), to participate in subsequent issuances of equity securities of the Company (excluding those issuances listed at the end of the "Anti-dilution Provisions" section of this Term Sheet.</p>	<p>This is the converse of the "Pay to Play" round. It gives the Investors a right (but not an obligation) to participate in all future rounds in the proportion required to maintain their shareholding.</p>	<p>Define Major investors with a high enough shareholding threshold so that not all shareholders get this right.</p>	<p>All Investors have this right.</p>	

<p>In addition, should any [Major] Investor choose not to purchase its full pro rata share, the remaining [Major] Investors shall have the right to purchase the remaining pro rata shares.</p>				
<p><b>Redemption Rights:</b> Unless prohibited by governing law, the Series A Preferred shall be redeemable at the option of holders of at least [__]% of the Series A Preferred commencing any time after [_____] at a price equal to the Original Purchase Price [plus all accrued but unpaid dividends] [plus an amount that provides holders an annual rate of return of [ ]%]. Upon a redemption request from the holders of the required percentage of the Series A Preferred, all Series A Preferred shares shall be redeemed [(except for any Series A holders who affirmatively opt-out)].</p>	<p>Redemption rights allow Investors to force the Company to redeem their shares at cost (and sometimes investors may also request a small guaranteed rate of return, in the form of a dividend).</p>			<p>In practice, redemption rights are not often used; however, they do provide a form of exit and some possible leverage over the Company.</p>
<p><b>Counsel and Expenses</b> [Investor/Company] counsel to draft Closing documents. Company to pay all legal and administrative costs of the financing [at Closing], including reasonable fees (not to exceed \$[____]) and expenses of Investor counsel[, unless the transaction is not completed because the Investors withdraw their commitment without cause]. Company Counsel: [ ] Investor Counsel: [ ]</p>	<p>You are going to pay for your legal counsel as well as your investors'</p>	<p>Cap the amount payable to Investor counsel.</p>	<p>No cap on amount payable.</p>	<p>While this might sound patently unfair, it is unfortunately the norm around the world (partly because of the way in which funds are permitted to incur expenses by their investors). Just grin and bear it.</p>
<p><b>Conditions precedent</b> Standard conditions to Closing, which shall include, among other things, satisfactory completion of financial and legal due diligence, qualification of the shares under applicable laws, the filing of a Certificate of Incorporation establishing the rights and preferences of the Series A Preferred, and an opinion of counsel to the Company. [May include other specific conditions.]</p>	<p>These are the things that need to be done before the financing can happen.</p>	<p>Keep the list as small and doable as possible.</p>		
<p><b>Non-compete</b> Each Founder and key employee will enter into a [one] year non-competition and non-solicitation agreement in a form reasonably acceptable to the Investors.</p>	<p>Investors don't want the Founders to leave and create a competing enterprise, or poach employees.</p>	<p>Keep the period as low as possible, and define "competition" and "solicitation" narrowly.</p>	<p>Lengthy and open-ended non-competition / non-solicitation agreements.</p>	<p>Non-competes and non-solicitation agreements may not be enforceable in many jurisdictions.</p>

<p><b>Proprietary information agreement:</b> The Company will have all employees and consultants enter into a proprietary information and invention agreement reasonably acceptable to the Investors.</p>	<p>Investors want to make sure that all IP and secrets of the enterprise (key value creators) are adequately protected.</p>	<p>This is beneficial to all. Make sure you exclude any prior Intellectual Property you created prior to the venture.</p>		
<p><b>No-shop / Exclusivity / Confidentiality</b> The Company agrees to work in good faith expeditiously towards a closing. The Company and the Founders agree that they will not, for a period of [_____] weeks from the date these terms are accepted, take any action to solicit, initiate, encourage or assist the submission of any proposal, negotiation or offer from any person or entity other than the Investors relating to the sale or issuance, of any of the capital stock of the Company [or the acquisition, sale, lease, license or other disposition of the Company or any material part of the stock or assets of the Company] and shall notify the Investors promptly of any inquiries by any third parties in regards to the foregoing. [In the event that the Company breaches this no-shop obligation and, prior to [_____] , closes any of the above-referenced transactions [without providing the Investors the opportunity to invest on the same terms as the other parties to such transaction], then the Company shall pay to the Investors \$[_____] upon the closing of any such transaction as liquidated damages.] The Company will not disclose the terms of this Term Sheet to any person other than officers, members of the Board of Directors and the Company's accountants and attorneys and other potential Investors acceptable to [_____] , as lead Investor, without the written consent of the Investors.</p>	<p>This means that once you've signed this term sheet, you cannot tell anyone about it, or the terms in it. You cannot have any further discussions with any other investors (even if you've already started the discussions). This is a binding clause.</p>	<p>Keep the period as short as possible (maybe 4 weeks).</p>	<p>Lengthy and watertight clause.</p>	<p>This clause is only applicable once you've received a signed term-sheet and counter-signed it and returned it. Many investors will send you an email of a draft term sheet and tell you that you can't share it with anyone. This is not true.</p>
<p><b>Validity</b> This Term Sheet expires on [_____] , 20__] if not accepted by the Company by that date.</p>	<p>Once an investor gives you a signed term-sheet, they want you to sign it as soon as possible so that the no-shop clause becomes valid.</p>	<p>Longer validity time period so that any Investors you've been speaking to also have a chance to put a term sheet down.</p>	<p>Shorter validity period (48 hours!)</p>	

<p><b>Governing law</b> This Term Sheet shall be governed by and construed in accordance with the laws of India. Any dispute arising out of or relating to this Term Sheet shall be subject to the jurisdiction of courts in [ ].</p>	<p>This tells you that if things become nasty, which laws will be used to interpret any dispute, and where you'll have to file lawsuit.</p>	<p>Jurisdictions where you're familiar with the laws and where costs are low.</p>	<p>Jurisdiction of Investor.</p>	<p>Foreign investors may often specify their country jurisdiction. This means you'll have to get lawyers in those markets and travel there for arbitration / court hearings.</p>
<p><b>Closing</b> Closing shall take place within 90 days of execution of the definitive agreements or on satisfaction of the Conditions Precedent, whichever is later or as mutually agreed between the parties hereto.</p>	<p>This specifies when the deal "closes" - i.e., the money is transferred.</p>	<p>Shorter time frame following the execution of definitive agreements.</p>	<p>Longer time-frame.</p>	
<p><b>Termination</b> This Term Sheet will terminate upon completion of the activities contemplated herein and the execution of the definitive agreements to the satisfaction of the Investors.</p>	<p>Specifies when the term sheet ceases to be valid.</p>			
<p>Representations and Warranties: Standard representations and warranties by the Company. [Representations and warranties by Founders regarding technology ownership, etc.].</p>	<p>Investors have decided to invest in the company on the basis of certain assumptions (you haven't committed fraud, your books are clean, you haven't stolen IP, you have disclosed all material information, etc.). This clause protects them if any of those things are untrue.</p>	<p>A more narrow and specific set of representations and warranties are better and less open to interpretation later.</p>		<p>Founders' representations are controversial and may elicit significant resistance as they are found in a minority of venture deals. They are more likely to appear if Founders are receiving liquidity from the transaction, or if there is heightened concern over intellectual property (e.g., the Company is a spin-out from an academic institution or the Founder was formerly with another company whose business could be deemed competitive with the Company), or in international deals.</p>

				Founders' representations are even less common in subsequent rounds, where risk is viewed as significantly diminished and fairly shared by the investors, rather than being disproportionately borne by the Founders.
<p><b>Definitive agreements:</b> The investment will be made pursuant to a stock purchase agreement which will contain, among other things, appropriate representations and warranties of the Company and the Investors and customary closing conditions. The Company and the Investors will also enter into other customary agreements such as a shareholders agreement.</p>	<p>The Term Sheet is only a documentation of a general agreement. Very little in it is binding. This clause states that the closing and funding will only happen after the definitive agreements (which are binding) are negotiated and signed.</p>			<p>A narrow window in which they should be signed puts pressure on all parties to get things done quickly.</p>
<p><b>Non-binding</b> The intent of this Term Sheet is to describe, for negotiation purposes only, some of the key terms of the proposed financing. Except for the provisions entitled "No-shop / Exclusivity / Confidentiality", "Validity", "Termination", "Closing", "Counsel and Expenses" and "Governing law" this Term Sheet is not intended to be a binding agreement between any party.</p>				

# Annexure - II

## Term Sheet

1.0	TRANSACTION DESCRIPTION		POINTS TO BE CONSIDERED
1.1	Company	[●] (hereinafter referred to as the “Company”)	-
1.2	Promoters	[●] (“Promoter”)	-
1.3	Investor	[●] (“Investor”)	-
1.4	Current Capital Structure	<p>The current paid up and issued share capital of the Company comprises of [●] equity shares with a face value of Rs. [●] per share;</p> <p>The Promoters [along with [●] and [●]] currently hold [100%] of the current paid-up and issued share capital of the Company.</p> <p>The shareholding pattern of the Company as on the date of this Term Sheet is set forth in Exhibit I hereunder.</p>	
1.5	Transaction	<p>i. The Investor shall make an investment of Rs./USD [●] (the “Investment Amount”) into the Company by way of subscription to [●] [Compulsorily Convertible Preference Shares (“CCPS”) / [Equity Shares] with a face value of Rs. [●] per share at a price of [●] per share (the “Subscription Shares”).</p> <p>ii. The shareholding pattern of the Company, immediately upon Closing shall be as set forth in Exhibit II hereunder.</p>	<p>Nature of the instrument which shall be subscribed by the investor to be specified.</p> <p>Nature of such instrument to be decided based on the commercials that are agreed between the investor and the company such as whether investor will have any preferential return, anti-dilution protection, fixed return in the form of dividend etc.</p>
1.6	Use of Proceeds	The Company shall utilize the Investment Amount towards [●]	Use of proceeds to be mentioned based on the commercials agreed between the company and investor for example setting up of a project, capital expenditure, expansion etc.
1.7	Statutory Approvals	The parties understand and agree that the Company and the Promoters shall be responsible for obtaining the statutory approvals required for completion of the Transaction.	<p>Generally the approvals that have to be obtained for the purposes of a transaction are limited to approvals from various government authorities with whom the Company is registered.</p> <p>Also, sometimes approval also has to be obtained by the Purchaser. To that extent, language may have to be modified.</p>
1.8	Definitive Documentation; Expected Date for Signing & Closing	The parties shall enter into a share subscription agreement (“SSA”) for the furtherance of the said Transaction within [60] days from the date of signing of this Term Sheet, which date may be mutually extended by the parties.	SSA sets out (a) the actions that have to be undertaken by the Company prior to the issuance of the shares; (b) representation and warranties in relation to the business.

		<p>The parties agree that the Company, Promoters and the Investor shall enter into one common Shareholders Agreement (“SHA”) that shall inter alia incorporate the rights of the Investor and the rights and obligations of the shareholders of the Company.</p> <p>Thereafter, the closing of the Transaction (“Closing”) shall take place within the time frame to be specified in the SSA, subject to completion of all the conditions precedent.</p>	<p>SHA sets out the inter-se rights and obligations of the Company, the Promoter, the Investor (and other shareholders, if applicable).</p>
<b>2.0</b>	<b>SSA AND SHA</b>		
<b>2.1</b>	<p>Conditions Precedent for subscription to the Subscription Shares:</p>	<ul style="list-style-type: none"> <li>i. A complete legal and financial due diligence of the Company to be completed to the satisfaction of the Investor.</li> <li>ii. Obtaining of all regulatory permissions, approvals or consents required in relation to the Investor’s acquisition of the subscription Shares.</li> <li>iii. Execution of the SSA and SHA in form and substance in accordance with the agreed terms as enshrined in this Term Sheet, together with any other agreements and documents that may be deemed necessary by the parties.</li> <li>iv. Amendment of the Company’s Articles of Association and any existing shareholders agreement to permit the issuance of the Subscription Shares and all associated rights of this Transaction and as provided for in the SSA and SHA.</li> <li>v. No material adverse change shall have occurred in the business, financial condition, results of operations, or prospects of the Company and its subsidiaries.</li> <li>vi. The parties shall have successfully fulfilled or waived the other conditions precedent as may be set out in the SSA.</li> <li>vii. Any other conditions precedent that may be deemed necessary by the Investor pursuant to the due diligence conducted on the Company or otherwise.</li> </ul>	<p>This is a standard list and will have to be customized particularly based on diligence findings.</p>
<b>2.2</b>	<p>Board of Directors</p>	<p>The Board of Directors of the Company (the “<b>Board</b>”) immediately upon Closing shall comprise of [●] directors, of which Promoter shall appoint [●] Directors and the Investor shall appoint [●] Directors.</p>	

2.3	Other Conditions in the SSA and SHA	<ol style="list-style-type: none"> <li>1. Conversion Ratio: The initial conversion ratio of the CCPS shall be 1:1</li> <li>2. The Investor shall have customary shareholder rights in the Company, exercisable at the Investor's sole discretion, as maybe enumerated in the Definitive Documentation, including but not limited to the following. <ol style="list-style-type: none"> <li>a. Pre-emptive rights with respect to any fresh issue of shares by the Company: The Investor shall have a pro rata right to participate in any future issue of shares by the Company, on the same terms and conditions (including price) as offered to the other shareholders/party(s).</li> <li>b. Rights of First Refusal: In the event that the Promoters of the Company intend to sell their shareholding in the Company or a portion of it to a third party, then such selling shareholder shall first offer its shares or a portion of it as the case maybe to the Investor at the same price as it had offered to the third party. The Investor, at its sole discretion shall decide whether to exercise its right of first refusal and whether to exercise its right over all the shares offered for sale by the selling shareholder or a portion of it.</li> <li>c. Anti-dilution rights: If at any time after Closing, the Company issues to any Person (other than pursuant to the ESOP or bonus issue) any equity shares, convertible preference shares or other instruments that are convertible into equity shares or which confer a right to subscribe to equity shares at a later date, at a price per share that is lower than the price per share paid by the Investor (as computed at the time of subscription to the Subscription Shares by the Investor), then the Investor shall be entitled to anti-dilution protection on a [broad based weighted average basis]. In such an event, the Company shall be bound to, and the Promoter shall be bound to cooperate with the Investor and the</li> </ol> </li> </ol>	<p>The conversion ratio will be applicable if the Investor is subscribing to convertible preference shares.</p> <ol style="list-style-type: none"> <li>a. Pre-emptive right enables the investor to maintain its shareholding in the company in future in the Company wishes to issue shares.</li> <li>b. Right of First Refusal is a transfer restriction that is applicable vis-à-vis the promoter of the company i.e. in the event the promoter wishes to transfer its shares, it shall first notify the Investor and along with the price at which such shares shall be transferred. Thereafter the Investor shall have right (but an obligation) at the prescribed price, only if the investor does not but the shares at prescribed price, the Promoter shall have a right to offer shares to a third party.</li> <li>c. Anti-dilution right is a valuation preservation right wherein in the event the Company issues new shares at a valuation, which is lower than the valuation at which shares were issued to the Investor, the Investor is compensated for the loss of value.</li> <li>d. Affirmative vote rights are set of veto matters which restricts the Company from taking certain actions either at Board level or shareholder level of otherwise without seeking prior approval of the Investor.</li> <li>e. In case of CCPS, a fixed rate of dividend can be prescribed.</li> <li>f. Liquidation preference means the preference given to any shareholder vis-à-vis other shareholders to receive the consideration in the event the company is being sold or assets of the company are being sold.</li> </ol>
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	<p>Company such that, the Company forthwith takes all necessary steps to either adjust the conversion ratio or issue additional equity shares to the Investor.</p> <p>d. Affirmative vote rights: The Company shall not be permitted to pass any resolution or take any decisions on certain reserved matters at both the Board and Shareholder levels, unless the Investor has accorded its consent to such reserved matter. An indicative list of such reserved matters is provided in the Exhibit III hereunder.</p> <p>e. Dividend: [On the CCPS, the Investor shall be entitled to a receive dividend at a rate of [●] % per annum.]</p> <p>f. Liquidation preference: At a liquidation event (as will be defined in the SHA) the Investor will be entitled to receive, in preference to the holders of equity shares (and after conversion, in preference to the remaining shareholders), an amount equal to 100% of the Investment Amount plus any accrued and unpaid dividends (including accruing dividends).</p> <p>g. Information Rights: The Investor shall receive from the Company (i) summarized un-audited monthly financial statements within [15] calendar days of the close of the preceding calendar month, (ii) quarterly (un-audited) financial statements within [30] calendar days from the end of the preceding quarter, (iii) annual (audited) financial statements within [60] calendar days following the closure of the preceding Financial Year and (iv) operating / business plan within [30] calendar days from the end of the preceding Financial Year.</p> <p>h. Tag-Along Right: In the event the Promoter, at any point of time decide to sell their shareholding in the Company or a portion of it to a third party, then the Investor shall have the right (but not the obligation) to require the Promoter to ensure that such third party shall purchase the shares held by the Investor in the Company at the relevant time.</p>	<p>g. Information rights means the right of the Investor to get certain information with respect to the company and its operations such as financials of the company, monthly performance of the company, any notices received by the company from a government authority etc.</p> <p>h. Tag along right is a transfer restriction wherein in the event any shareholder transfer its shares to a third party, such shareholder shall also have to ensure that other shareholders also have a right to transfer their shares to a third party at the same price at which the first shareholder has transferred the shares.</p> <p>i. Drag along right is a transfer restriction wherein the investor has a right to force the promoter to transfer their part/full stake in the company based on the investor's discretion.</p> <p>j. SHA should also specify the shares held by the Investor in the Company should not be subject to any transfer restriction.</p> <p>k. Exit options generally specify the manner/options using which an exit shall be provided to the Investor such as company undertaking an IPO, buy back of investor's shares, promoter acquiring investor's stake, strategic sale of the company etc.</p> <p>l. Inspection right means that the investor has a right to inspect the premises of the company and/or its books of account at its discretion.</p>
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- i. Drag-Along Right: In the event the exit is not provided to the Investor by [●], the Investor shall have right to drag the part and/or entire shareholding of the Promoter to a third party to whom the Investor is transferring its shares.
- j. The shares held by the Investor in the Company shall be freely transferable at any point of time.
- k. Exit options: The Company and the Promoter shall undertake to provide exit to the Investor by way of:
  - i. Initial Public Offering: The Investor shall have the right to require the Company to make an Initial Public Offering before [Insert Date] (“Drop Dead Date”).
  - ii. In the event, the Company is unable to provide the Investor with a successful exit under (i) above by the Drop Dead Date, then, the Investor shall have the following exit rights, exercisable at the Investor’s option:
    - Buy Back Option: Subject to applicable laws, the Investor shall have the right to require the Company to buy back the shares held by the Investor at a price per share determined so as to provide the Investor with the entire Investment Amount or the fair market value determined in the manner to be specified in the SHA.
    - Sale to Third Party: In the event the Investor is unable to successfully exit by exercising the Buy Back Option mentioned above by [Insert Date], then the Investor shall have the right to sell its shareholding in the Company to any third party without any restriction.
    - If the above options do not materialize, the Promoters will endeavour in assisting the Investor in finding a suitable buyer of the Investor’s shareholding.
- l. Inspection Rights: The Investor shall be authorized at all times during normal business hours, subject to reasonable notice being given, to visit the offices of the Company and to inspect its material contracts and financials.

		<p>3. Within 60 (sixty) calendar days of the Closing, the Company shall procure a suitable Directors and Officers liability insurance cover for all the members of the Board of the Company and the Company shall procure a suitable Key Man Insurance cover for all key personnel of the Company as identified by the Investor.</p>	
<b>2.4</b>	Representations and Warranties:	<p>The Company and the Promoter shall provide representations and warranties in the SSA, to the Investor with respect to the Company, its operations and the Subscription Shares.</p>	<p>The scope of representations and warranties depends on the level of compliances of the company and diligence findings.</p> <p>Further, it also depends on the commercials agreed between the company and investor.</p>
<b>2.5</b>	Indemnity	<p>The Company and the Promoter shall indemnify the Investor against any loss, liability, damage that may be incurred by the Investor in connection with the Subscription Shares or in case of any breach of the representations and warranties of the Company and Promoter as may be included in the SSA.</p>	<p>Terms of indemnity depend on the commercials agreed between the company and investor.</p>
<b>2.5</b>	Termination of SSA and SHA	<p>The SHA shall terminate upon divestment of equity by the Investor.</p>	
<b>3.0 GENERAL</b>			
<b>3.1</b>	Expenses	<p>1. All expenses in connection with the issue of the Subscription Shares, including but not limited to stamp duty on the Subscription Shares shall be borne by the Company.</p> <p>2. Transaction expenses, including but not limited to expenses incurred by the Investor towards diligence exercise on the Company shall be reimbursed by the Company up to a maximum of Rs. [●].</p>	
<b>3.2</b>	Confidentiality	<p>All parties hereto shall keep all negotiations confidential and maintain the contents of this Term Sheet in strictest confidence and shall make no announcement or disclosure without the prior written approval of the other party save in respect of disclosures or announcements which may be required by any law or regulation, and any disclosures to each party's consultants, advisors, employees/directors (or by the Investors to its Affiliates or their employees/ directors/ advisors/ consultants) on a need-to-know basis or those of its Affiliates.</p>	
<b>3.3</b>	Exclusivity	<p>The Company and the Promoter agree that following [90] days from the execution of this Term Sheet, they shall not solicit, discuss and/ or encourage subscription to the Subscription Shares by any other person in any manner and will not provide any information relating to the Company to any other potential investor.</p>	

3.4	Termination	This Term Sheet shall terminate [90] days from its execution. It shall automatically stand terminated upon replacement by the SSA and the SHA.	
3.5	Amendment	The parties may amend the terms of this Term Sheet by mutual consent in writing.	
3.6	Governing Law and Arbitration	<p>i. <u>Governing Law:</u> Any disputes arising out of or in connection with the validity, interpretation or implementation of this Term Sheet, the SSA and / or the SHA shall be governed by the laws of India.</p> <p>ii. <u>Arbitration:</u></p> <p>a. In the event of there being any dispute or difference between the parties hereto as to any clause or provision of this Term Sheet or as to the interpretation thereof or as to any account or valuation or as to the rights, liabilities, acts, omissions of any party hereto arising under or by virtue of these presents or otherwise in any way relating to this Term Sheet, such dispute will be referred to Arbitration by three arbitrators, one to be appointed by each party and the arbitrators so appointed will appoint the third arbitrator.</p> <p>b. The seat of Arbitration shall be at [●].</p> <p>c. The Arbitration proceedings shall be held in accordance with [Indian law.]</p> <p>d. The Award given by the arbitrator shall be final and binding on the parties hereto.</p>	
3.7	Legally Binding Understanding	It is hereby expressly agreed between the parties that the terms and conditions set forth in this Term Sheet are not legally binding on the parties, save and except to the extent specifically stated herein. Notwithstanding anything contained herein, the clauses pertaining to confidentiality, exclusivity, governing law and arbitration set out in this Term Sheet, shall be legally binding on the parties.	

<Signature Page Follows>

For [■] Signature:  Name: Date: Place:	For [■] Signature:  Name: Date: Place:
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## Exhibit I

### Summary of Shareholding pattern of the Company on the date of execution of this Term Sheet

[Details to be filled in by parties]

## Exhibit II

### Summary of post-money shareholding pattern of the Company on a fully diluted basis

[Details to be filled in by parties]

## Exhibit III

### Indicative list of reserved matters with respect to Investor's affirmative vote rights

- *[any alteration of the rights of Investor Shares;*
- *any change in the capitalization table in **Exhibit II**, except for secondary sales by the Promoters, such that the secondary sale does not result in a Change in Control;*
- *any transaction involving the acquisition of substantially all the assets, shares, voting power or Controlling interest in any other company, business, partnership firm, or body corporate by the Company;*
- *any transaction involving the acquisition of substantially all the Shares of the Company by a person who is not a party to this Term Sheet, SSA and / or SHA;*
- *any transaction involving the sale of substantially all the assets of the Company;*
- *any transaction involving the merger of the Company with another company;*
- *any amendment, modification, or waiver of any provisions of the Articles or Memorandum of the Company;*
- *the creation of any subsidiary, whether by formation, acquisition or otherwise;*
- *any change in the scope of business entry into any new business, suspension or cessation of business or transfer of all or a material portion of business, in each case, by the Company;*
- *the acquisition or disposal of assets, real or personal, tangible or intangible (including but not limited to the Company's Intellectual Property), for an amount in excess of US\$ / Rs. [•] individually or US\$ / Rs. [•] in the aggregate, in any financial year;*
- *the appointment or dismissal of any officers or members of the Key Management Team;*
- *the appointment of the Auditors of the Company, the replacement of such Auditor;*
- *any change in the size or composition of the Board or any committee of the Board other than in the manner as set out in SSA and / or SHA;*
- *any binding agreement to take any of the foregoing actions;*
- *any cancellation and/or reduction of the Shares of the Company;*
- *any commencement of a voluntary winding up by the Company;*
- *any transaction with its Affiliates or its subsidiary or with any of the Promoters or any of their Affiliates, other than those mentioned in the SHA and / or SSA;*
- *any declaration of dividend;*
- *the commencement of any litigation by the Company involving an amount in excess of US\$ / Rs. [•]. Provided however no such consent shall be required in the event the litigation has been commenced (i) in the ordinary course of business; or (ii) against any customer, vendor, employees or competitors of the Company; or (iii) in relation to matters in which either of the Investors may be interested; or (iv) in connection with an investment or (v) as a result of any compelling events or circumstances (including matters involving any criminal charge or prosecution), where prompt notice is given to each Investor immediately thereafter);*
- *any IPO or public sale of Shares; or*
- *any change to the Terms of Reference of the compensation committee.]*

## Annexure - III

### Government Notification with respect to GST exemptions for charitable entities

The provisions relating to taxation of activities of charitable institutions and religious trusts have been borrowed and carried over from the erstwhile service tax provisions. All services provided by such entities are not exempt. In fact, there are many services that are provided by such entities which would be within the ambit of GST.

Notification No.12/2017-Central Tax (Rate) dated 28th June 2017 exempts services provided by entity registered under Section 12AA of the Income-tax Act, 1961 by way of charitable activities from whole of GST vide entry No. 1 of the notification, which specifies that “services by an entity **registered under Section 12AA** of Income-tax Act, 1961 by way of **charitable activities**” are exempt from whole of the GST. Thus as per this notification, exemption is given to the charitable trusts, only if the following conditions are satisfied.

- a. Entities must be registered under Section 12AA of the Incometax Act, and
- b. Such services or activities by the entity are by way of charitable activities.

Thus, it is essential that the activities must conform to the term “charitable activities’ which has been defined in the notification as under “charitable activities” means activities relating to:

- i. public health by way of:
  - a. care or counseling of
    - i. terminally ill persons or persons with severe physical or mental disability;
    - ii. persons afflicted with HIV or AIDS;
    - iii. persons addicted to a dependence-forming substance such as narcotics drugs or alcohol; or

- b. public awareness of preventive health, family planning or prevention of HIV infection;
2. advancement of religion, spirituality or yoga;
3. advancement of educational programmes or skill development relating to:
  - a. abandoned, orphaned or homeless children;
  - b. physically or mentally abused and traumatized persons;
  - c. prisoners; or
  - d. persons over the age of 65 years residing in a rural area;
4. preservation of environment including watershed, forests and wildlife.

This notification makes the exemption to charitable trusts available for charitable activities more specific. While the income from only those activities listed above is exempt from GST, income from the activities other than those mentioned above is taxable. Thus, there could be many services provided by charitable and religious trust which are not considered as charitable activities and hence, such services come under the GST net. The indicative list of such services could be renting of premises by such entities, grant of sponsorship and advertising rights during conduct of events/functions etc.

This is also borne out from the fact that in so far as renting out of religious precincts is concerned, there is a limited exemption available to such entities. Activities not covered by the specific exemption would be taxable. Entry No.13 of notification no.12/2017 - Central Tax (Rate) dated 28th June, 2017, provides the following exemption to entities registered under Section 12AA of the Income Tax Act:

Services by a person by way of:

- a. conduct of any religious ceremony;
- b. renting of precincts of a religious place meant for general public, owned or managed by an entity registered as a charitable or religious trust under section 12AA of the Income-tax Act, 1961 (hereinafter referred to as the Income-tax Act) or a trust or an institution registered under sub clause (v) of clause (23C) of section 10 of the Income-tax Act or a body or an authority covered under clause (23BBA) of section 10 of the said Incometax Act:

Provided that nothing contained in entry (b) of this exemption shall apply to:

- i. renting of rooms where charges are one thousand rupees or more per day;
- ii. renting of premises, community halls, kalyanmandapam or open area, and the like where charges are ten thousand rupees or more per day;
- iii. renting of shops or other spaces for business or commerce where charges are ten thousand rupees or more per month.

Thus, the law gives a limited exemption to renting of only religious precincts or a religious place meant for general public by the entity registered under Section 12AA of the Income Tax Act. As per clause (zc) of the said notification, the term “general public” means “the body of people at large sufficiently defined by some common quality of public or impersonal nature”.

The term “religious place” as per the clause (zy) of the said notification means “a place which is primarily meant for conduct of prayers or worship pertaining to a religion, meditation, or spirituality”. Dictionary meaning of “precincts” is an area within the walls or perceived boundaries of a particular building or place, an enclosed or clearly defined area of ground around a cathedral, church, temple, college, etc.

This implies that if immovable properties owned by charitable trusts like marriage hall, convention hall, rest house for pilgrims, shops situated within the

premises of a religious place are rented out, income from letting out of such property is wholly exempt from GST. But if such properties are not situated in the precincts of a religious place meaning thereby not within walls or boundary walls of the religious place, income from such letting out will lose this exemption and income from it will be liable to GST.

Income from a religious ceremony organised by a charitable trust is exempt as per the above notification. So the income from Navratri functions, other religious functions, and religious poojas conducted on special occasions like religious festivals by persons so authorised for this purpose by the charitable or religious trust are exempt from GST.

But a careful perusal of this exemption shows that all income from such a religious ceremony is not exempt (services other than by way of conduct of religious ceremony are not exempt). Therefore, the nature of income is an essential factor for ascertaining whether it will be taxable or exempt. If income loses its religious nature, it is definitely chargeable to GST. For example, if with regard to Ganeshutsav or other religious functions, charitable trusts rent out their space to agencies for advertisement hoardings, income from such advertisement is chargeable to GST, as this will be considered as income from the advertisement services. Further, if donation for religious ceremony is received with specific instructions to advertise the name of a donor, such donation income will be subject to GST. But if donation for religious ceremony is received without such instructions, it may not be subject to GST.

Similarly, entry No.80 of notification no.12/2017-Central Tax (Rate), provides the following exemption to an entity registered under Section 12AA.

Services by way of training or coaching in recreational activities relating to:

- a. arts or culture, or
- b. sports by charitable entities registered under section 12AA of the Income-tax Act.

Thus, services provided by way of training or coaching in recreational activities relating to arts or culture or sports by a charitable entity will be exempt from GST.

### **GST on management of educational institutions by charitable trusts**

If trusts are running schools, colleges or any other educational institutions specifically for abandoned, orphans, homeless children, physically or mentally abused persons, prisoners or persons over age of 65 years or above residing in a rural area, such activities will be considered as charitable activities and income from such supplies will be wholly exempt from GST.

Meaning of the word rural area defined in said notification is rural area means the area comprised in a village as defined in land revenue records excluding the area under any municipal committee, municipal corporation, town area committee, cantonment board or notified area committee or any area that may be notified as an urban area by the Central Government or a State Government.

#### **Import of Services**

Also as per the entry no. 10 of Notification no.9/2017-Integrated Tax (Rate) dated 28.06.2017, if charitable trusts registered under Section 12AA of Income-tax Act receives any services from provider of services located in non-taxable territory, for charitable purposes, such services received are not chargeable to GST under the reverse charge mechanism.

#### **Services by and to Education Institutions (including institutions run by Charitable trusts)**

If the trust is running school for the purpose which is not covered above (i.e. not coming within the scope of charitable activities as defined in the notification), income from such activity will not be exempt under notification no. 9/2017-Integrated Tax (Rate) or 12/2017-Central Tax (Rate), but will be exempt under entry 66 of notification no.12/2017-Central Tax (Rate). Entry 66 provides for exemption w.r.t supply by and to educational institutions and only the following services received by eligible educational institution are exempt:

1. Transportation of students, faculty and staff of the eligible educational institution.
2. Catering service including any mid-day meals scheme sponsored by the Government.

3. Security or cleaning or house-keeping services in such educational institution.
4. Services relating to admission to such institution or conduct of examination.

If such school or other educational institution gives property owned by such institution on rent to others, no exemption will be available for such services. Therefore, all services received by educational institutions managed by charitable trusts (for other than charitable activities, as defined) except those services mentioned above are taxable.

#### **GST on arranging yoga and meditation camp by charitable trusts**

Charitable trusts organise yoga camps or other fitness camps and they generally are not free for participants, as trusts charge some amount from the participants in the name of accommodation or participation. If trusts are arranging residential or non-residential yoga camps by receiving donation or other charges from the participants, these will not be considered charitable activities (as it is different from advancement of religion, spirituality or yoga). Since donation is received for participation, it will be considered commercial activity and it will definitely be covered under the GST. Similarly, if charitable trusts organise fitness camps in reiki, aerobics, etc., and receive donation from participants, such income that comes under health and fitness services and will also be taxable.

#### **GST on running of public libraries by charitable trusts**

No GST will be applicable if charitable trusts are running public libraries and lend books, other publications or knowledgeenhancing content/material from their libraries. This activity is specifically excluded by way of entry No. 50 of Notification No. 12/2017- Central Tax Rate (and is applicable for everyone, including charitable trusts); which means services by private libraries are not exempt. Thus, if donors of public library remain open to all and if it caters to educational, informational and recreational needs of its users and finance for such libraries can be provided from donation, subscription, from special fund created for this purpose or from

combination of all such sources, it will be called public library and no GST will be applicable on such services.

### **GST on hospital managed by charitable trusts**

Entry no. 74 of Notification No. 12/2017-Central Tax Rate (applicable to all persons including charitable trusts) exempts healthcare services at clinical establishment, an authorised medical professional or paramedics. As per clause (zg), health care services means any service by way of diagnosis or treatment or care for illness, injury, deformity, abnormality or pregnancy in any recognised system of medicines in India and includes services by way of transportation of the patient to and from a clinical establishment, but does not include hair transplant or cosmetic or plastic surgery, except when undertaken to restore or to reconstruct anatomy or functions of body affected due to congenital defects, developmental abnormalities, injury or trauma. Therefore, all treatment or diagnosis or care for illness, injury, deformity, abnormality or pregnancy by a clinical establishment is covered. Such services provided by doctors and paramedics either provided as an employee (clinical establishment) or in their individual capacity is exempt. Transportation of patients to and from a clinical establishment is also exempt. The clinical establishment, as per clause (s), means a hospital, nursing home, clinic, sanatorium or any other institution by, whatever name called, that offers services or facilities

requiring diagnosis or treatment or care for illness, injury, deformity, abnormality or pregnancy in any recognised system of medicines in India, or a place established as an independent entity or a part of an establishment to carry out diagnostic or investigative services of diseases.

So, if charitable trusts run a hospital and appoint specialist doctors, nurses and provide medical services to patients at a concessional rate, such services are not liable to GST. If hospitals hire visiting doctors/ specialists and these deduct some money from consultation/visit fees payable to doctors and the agreement between hospital and consultant doctors is such that some money is charged for providing services to doctors, there may be GST on such amount deducted from fees paid to doctors.

### **GST on services provided to charitable trusts**

Services provided to charitable trusts are not out of ambit of GST. All services other than those specifically exempted provided to charitable trusts will be subject to GST.

### **GST on supply of goods by Charitable Trusts**

There is no exemption for supply of goods by charitable trusts. Thus any goods supplied by such charitable trusts for consideration shall be liable to GST. For instance, sale of goods shall be chargeable to GST.





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