

**REGULATORY ISSUES IN VENTURE CAPITAL/PRIVATE EQUITY  
FINANCING OF INDIAN TECHNOLOGY COMPANIES**

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**The Securities and Exchange Board of India (Venture Capital Funds)  
Regulations, 1996 and the Securities and Exchange Board of India (Foreign  
Venture Capital Investors) Regulations, 2000 (“SEBI FVCI Regulations”)  
(cumulatively, the “SEBI Regulations”)**

The SEBI Regulations, among others, specify the investment criteria for venture capital and private equity investors seeking to invest in Indian companies. A foreign venture capital investor proposing to carry on venture capital activity in India may register with the Securities and Exchange Board of India (“SEBI”), subject to fulfilling the eligibility criteria and other requirements contained in the SEBI FVCI Regulations. The SEBI FVCI Regulations prescribe the following investment guidelines, which can impact overall financing plans of foreign venture capital funds.

- a) The foreign venture capital investor must disclose its investment strategy and life cycle to SEBI, and it must achieve the investment conditions by the end of its life cycle.
- b) At least 66.67% of the investible funds must be invested in unlisted equity shares or equity linked instruments.
- c) Not more than 33.33% of the investible funds may be invested by way of:
  - (i) subscription to initial public offer of a venture capital undertaking, whose shares are proposed to be listed.
  - (ii) debt or debt instrument of a venture capital undertaking in which the foreign venture capital investor has already made an investment, by way of equity.
  - (iii) preferential allotment of equity shares of a listed company, subject to a lock-in period of one year.

- (iv) the equity shares or equity linked instruments of a financially weak or a sick industrial company (as explained in the SEBI FVCI Regulations) whose shares are listed.

A foreign venture capital investor may invest its total corpus into one venture capital fund.

Other than the tax benefits listed below, one key advantage of registering under the SEBI FVCI Regulations is that at the time of an IPO of the investee company, a SEBI-registered foreign venture capital investor will not be subject to the one year lock-in period in respect of pre-issue share capital held by it.

### **Foreign Exchange Management (Transfer of Issue of Security by a Person Resident Outside India) Regulations, 2000 (the “FEMA Regulations”)**

The FEMA Regulations prescribe the manner in which a foreign venture capital investor can make investments. A foreign venture capital investor, can through SEBI, apply to the Reserve Bank of India (“RBI”) for permission to invest in an Indian venture capital undertaking, a venture capital fund or in a scheme floated by a venture capital fund. The consideration amount for investment can be paid out of inward remittances from abroad through normal banking channels. Subject to RBI approval, a foreign venture capital investor can maintain a foreign currency or rupee account with an authorized Indian bank. The funds held in such accounts can be used for investment purposes.

The FEMA Regulations prescribe the sectoral limits on foreign investments into India. A company, which is *inter alia* engaged in the print media sector, atomic energy and related projects, broadcasting, postal services, defence and agricultural activities, must obtain the approval of the Foreign Investment Promotion Board or Secretariat of Industrial Assistance, depending on the quantum of investment, before issuing shares to a foreign venture capital investor situated abroad.

### **Income-Tax Act, 1961 (the “IT Act”)**

The income of venture capital companies or funds set up to raise funds for investment in venture capital undertakings is tax exempt, if they are registered with SEBI and in compliance with Indian government and SEBI Regulations. The income of such companies and/or funds will continue to be exempt, if the undertaking in which its funds are invested, subsequent to the investment, gets

listed on a stock exchange. However, tax will be payable by the shareholders of or withdrawers from the company or fund.

Venture capital companies or funds are exempt from withholding tax in respect of income distributed to their investors. The provisions of the IT Act regarding taxation on distributed profits (dividend), distributed income and deduction of tax at source do not apply to venture capital companies or funds.