

Why Has India's AIF Ecosystem Underpenetrated Relative to Its Economic Size? A Regulatory, Tax and Investor-Base Analysis

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Manuscript draft, 15 October 2026

(Main text: approximately 8,450 words (Sections 1 to 12, excluding tables, figures, references and appendices))

Abstract

Few economies are growing as quickly as India's, yet its Alternative Investment Fund (AIF) industry remains small when set against national output. We ask three questions here. How wide is the shortfall? Which regulatory and tax features discourage funds from forming onshore? And why do so few domestic institutions commit capital? Our approach is doctrinal and comparative, supported by descriptive benchmarks drawn from the United States, the UK and EU, Singapore, China and GIFT City. The shortfall exists, though its size shifts with the yardstick chosen. Commitments add up to roughly 4.9 per cent of GDP; drawn and invested capital is closer to 2 per cent; and private equity and venture capital put to work each year amounts to somewhere between 1 and 1.5 per cent of GDP. Three conclusions emerge. Rules have grown noticeably more supportive since 2024, but they are rewritten often and policed by several bodies at once, so outcomes are hard to foresee. Headline tax treatment of Category I and II vehicles is now close to neutral, which means uncertainty, together with the design of the Category III and offshore regimes, counts for more than the rates themselves. Finally, pension funds, insurers and similar long-horizon investors are let in only at modest, heavily qualified levels, so wealthy families and individuals dominate the investor pool. We conclude that the institutional investor base is the main bottleneck, with tax and regulatory uncertainty making it worse, and we set out a phased reform agenda.

Keywords: alternative investment funds, private capital, SEBI, emerging markets, fund regulation, institutional investors

JEL codes: G23, G24, G28, K22, O16

1. Introduction

India poses an odd problem for anyone interested in private markets. Official estimates (Ministry of Statistics and Programme Implementation [MoSPI], 2026, as reported by Outlook Business) put real growth for 2025–26 at 7.7 per cent and nominal output at around ₹346 lakh crore.¹ Its listed equity market is large and liquid. Entrepreneurial firms are numerous and are moving into the formal economy at speed. Its securities regulator, the Securities and Exchange Board of India (SEBI), built a purpose-made regime for pooled private vehicles as early as 2012.² Even so, the volume of institutional private capital channelled through that regime looks small for an economy of this size, whether one compares it with America, Britain or the more mature financial hubs of Asia.

None of this means the sector has stalled, and we are careful not to suggest otherwise. By June 2026, investors had pledged around ₹17.5 trillion to SEBI-registered AIFs, close to 25 per cent more than twelve months earlier (Business Standard, 2026a), and the count of registered funds is several times what it was five years ago. The interesting part is how the growth is distributed. Yearly PE-VC deployment has gone sideways since peaking in 2021³ (McKinsey & Company, 2026). Much of the pledged money has not yet been called. Home-grown general partners account for a far thinner slice of private equity activity than their counterparts in Korea or Japan. And most of the money appears to come from high-net-worth individuals (HNIs) and family offices, not from the pension and insurance pools that underpin

¹ One lakh is 100,000 and one crore is 10 million, so one lakh crore equals one trillion rupees; ₹346 lakh crore is therefore ₹346 trillion. Amounts in this paper follow the Indian convention of lakh and crore, with trillion used where the source itself uses it.

² SEBI (Alternative Investment Funds) Regulations, 2012, notified on 21 May 2012 (SEBI, 2012). Section 2.1 describes the framework.

³ PE-VC means private equity and venture capital taken together, as the trackers cited in Section 4.2 report them. Deployment is the amount invested in portfolio companies in a year, as distinct from the amount pledged to funds.

private markets in other countries.⁴ Our question, then, is why a sector that is big in rupee terms and expanding quickly still looks shallow compared with the economy around it.

Three research questions guide the analysis.

- **RQ1: By how much does India's AIF and private-capital pool fall short of comparable jurisdictions, and is that conclusion sensitive to the way size is measured?**
- **RQ2: What features of regulation and taxation discourage funds from forming and raising money onshore, and how do these compare with rival domiciles?**
- **RQ3: What keeps domestic institutions from investing in AIFs in meaningful amounts, and what would change that?**

The paper adds to existing work in three ways. Empirically, it compares the Indian industry with its peers on more than one yardstick and shows that conclusions about the gap hinge on whether one counts pledged, called or annually deployed capital, and on which data provider one relies. Doctrinally, it codes the statutes, regulations and circulars applying to AIFs in India alongside the equivalent rules in the US, the UK and EU, Singapore, China and the GIFT City International Financial Services Centre (IFSC), separating provisions that genuinely disadvantage onshore funds from doubt about how provisions will be enforced. On policy, it orders the barriers by importance, traces how they interact, and offers a phased programme that keeps quick administrative fixes apart from deeper structural change.

Put briefly, we argue that the shortage of domestic institutional limited partners (LPs)⁵ is what holds the market back, and that tax and regulation aggravate this shortage rather than create it. Since 2024 the rulebook has become considerably more accommodating, and

⁴ The investor mix is drawn from practitioner estimates, not from a SEBI release; see Section 8.1 and the limitations in Section 11. High-net-worth individual (HNI) is a market term; the AIF Regulations do not define it, and in practice it describes investors able to meet the ₹1 crore minimum.

⁵ Limited partners are the investors who commit capital to a fund without managing it; general partners (GPs) are the managers. The terms are used by convention here even though most Indian AIFs are trusts, where the corresponding roles are unit holders and the investment manager.

Category I and II funds now face headline tax treatment that is close to neutral. Investors are discouraged less by how heavy the burden is than by how hard it is to predict. Several regulators amend their rules frequently; there is a long record of disputes about whether fund income is capital gain or business profit; and pension funds, insurers and banks may commit only within narrow limits. Patient domestic savings therefore stay in listed markets, and footloose foreign money gravitates to offshore or IFSC vehicles.

The structure is as follows. We describe the institutional setting in Section 2 and review prior research, along with our four hypotheses, in Section 3. Section 4 covers data and method; Section 5 sizes the gap. Regulation, tax and the investor base are examined in Sections 6, 7 and 8. Section 9 brings the strands together and considers rival explanations, Section 10 sets out policy proposals, Section 11 discusses limitations and next steps for research, and Section 12 concludes.

2. Institutional background

2.1 Origin and architecture of the AIF framework

Before 2012, SEBI's only regime for private pools was the SEBI (Venture Capital Funds) Regulations, 1996, which dealt with venture capital alone. The SEBI (Alternative Investment Funds) Regulations, 2012 (the AIF Regulations) swept that away and created one regime for privately pooled vehicles not already caught by the rules on mutual funds, collective investment schemes or portfolio managers. Funds are sorted into three groups.⁶ Category I is for vehicles backing start-ups, early-stage businesses, SMEs, infrastructure and other areas that policymakers regard as socially or economically beneficial; venture capital, SME, social venture and infrastructure funds belong here, and so, after a 2025 change, do angel funds. Category II is a residual group. It takes in most private equity, private credit and

⁶ Regulation 3(4) of the AIF Regulations. The three categories are set out side by side in Table 1.

fund-of-funds vehicles, that is, anything outside Categories I and III that borrows only to meet routine operating needs. Category III houses hedge funds and listed-equity strategies, which may trade in complex ways and use leverage.

Some features have not changed since the regime began. Every fund needs a corpus of at least ₹20 crore. Each investor must put in no less than ₹1 crore, or ₹25 lakh in an angel fund. No scheme may have more than 1,000 investors. Sponsors or managers must retain an ongoing stake, and exposure to any one portfolio company is capped. Funds in Categories I and II have a fixed life and cannot be open-ended, whereas Category III funds may be. Table 1 brings these rules and the related tax treatment together. Because a number of these parameters were revised between 2024 and 2026, and the table reflects our reading of the consolidated text, readers should confirm each figure against the latest SEBI Master Circular before relying on or citing it.⁷

Table 1

The three SEBI AIF categories and 2025 overlays: features, who may invest and tax treatment

Category	Typical strategies	Key features	Investor eligibility	Headline tax treatment
Category I	Venture capital (including migrated VCFs), angel funds, SME, social venture and infrastructure funds	Closed-ended; invests in sectors with perceived economic or social benefit; concentration limits; no leverage beyond short-term operating needs	Minimum ₹1 crore (angel fund investors now accredited investors only); 1,000-investor cap per scheme	Statutory pass-through under s.115UB (now s.224, Income-tax Act, 2025) for non-business income; securities treated as capital assets from AY 2026–27
Category II	Private equity, private credit and debt funds, real estate funds, funds of funds	Closed-ended; no leverage beyond short-term operating needs; accounts for the largest share of commitments	Minimum ₹1 crore; 1,000-investor cap per scheme	As Category I; business income taxed at fund level

⁷ SEBI consolidates its operational circulars on AIFs in a Master Circular that is reissued from time to time. This draft relies on secondary summaries of the amendments (Section 4.5) and does not reproduce the Master Circular's text.

Category	Typical strategies	Key features	Investor eligibility	Headline tax treatment
Category III	Hedge funds, long-short, PIPE and derivatives-oriented strategies	Open- or closed-ended; leverage permitted within limits; stricter concentration limits	Minimum ₹1 crore; 1,000-investor cap per scheme	No pass-through; taxed at fund level according to the fund's legal form (trust, company or LLP)
Overlays introduced 2025	Accredited Investor Only Funds (AIOFs), Large Value Funds (LVFs), co-investment schemes	AIOFs restricted to accredited investors; LVF minimum investment lowered from ₹70 crore to ₹25 crore; co-investment schemes single-asset and accredited-investor only	Accredited investors (plus sponsor and manager)	Follows the underlying category

Note. Based on the SEBI AIF Regulations 2012 as amended, together with Vinod Kothari Consultants (2025b), Angel One (2025), Taxguru (2025), Income Tax Department (2026) and Corporate Professionals (2026). Figures should be confirmed against the latest SEBI Master Circular.

2.2 Growth timeline and recent reforms

The legal and fiscal rules around AIFs have been built up piece by piece. A pass-through regime arrived with the Finance Act 2015⁸ and now sits in section 115UB of the Income-tax Act, 1961; for Category I and II funds, everything other than business income is taxed as though investors held the underlying assets themselves (Income Tax Department, 2026). Six years later, in 2021, the AIF Regulations introduced accredited investors, a class of sophisticated participant that most of the subsequent loosening has relied on.⁹

The pace of change picked up sharply after late 2023. Worried that lenders were using AIFs to roll over bad loans¹⁰, the Reserve Bank of India (RBI) issued circulars in December 2023 and March 2024 barring banks, non-bank finance companies and other regulated entities from AIFs holding downstream exposure to their own borrowers. Following consultation, those circulars gave way on 29 July 2025 to the RBI (Investment in AIF)

⁸ The pass-through regime for Category I and II AIFs was inserted in the Income-tax Act, 1961 as section 115UB, with the matching exemption in section 10(23FBA), by the Finance (No. 2) Act, 2014, and has applied from 1 April 2015 (assessment year 2016–17).

⁹ Accredited-investor status depends on income or net-worth criteria and must be certified by an accreditation agency recognised by SEBI. The precise thresholds differ by type of investor and have been revised, so they are not restated here.

¹⁰ Evergreening means giving a borrower fresh funding so that it can service or repay an existing, possibly stressed, loan and the loan avoids being classified as non-performing. The RBI's concern was that a lender could reach a stressed borrower indirectly by investing in an AIF that in turn invested in that borrower or its affiliates.

Directions, 2025). The outright ban is gone; in its place, one regulated entity may supply no more than 10 per cent of a scheme's corpus, and regulated entities taken together no more than 20 per cent (Vinod Kothari Consultants, 2025a; Chambers, 2025). On a separate track, SEBI changed its rules in July 2024 to let older venture capital funds migrate into a new Category I sub-class, and later moved the related winding-up deadline to 19 July 2026 (Nishith Desai Associates, 2024; YourStory, 2025).

Three further packages arrived over 2025 and 2026. First came the SEBI (AIF) (Second Amendment) Regulations, 2025, notified on 8 September 2025. They gave Category I and II funds a framework for co-investment and made angel funds their own Category I sub-class, restricted to accredited investors (Taxguru, 2025; Vinod Kothari Consultants, 2025b). Next, on 18 November 2025, the Third Amendment introduced the Accredited Investors Only Fund; a circular the following month brought the entry ticket for large value funds down to ₹25 crore from ₹70 crore (Angel One, 2025). Most recently, the Second Amendment Regulations, 2026 (notified 10 July 2026, effective 14 July 2026) removed the scheme fee for a fund's first scheme, gave SEBI ten working days rather than 30 days to receive scheme documents, spared accredited-investor-only funds from SEBI's comment process, and allowed angel funds to file their placement memoranda without going through that process (Sagus Legal, 2026). The common thread is lighter oversight where investors are sophisticated, a shift that moves India toward the American model of relying on exemptions.

Over the same years the sector has expanded fast. Press coverage of SEBI figures shows total commitments of ₹13.05 trillion in December 2024, ₹16.94 trillion by March 2026 and ₹17.53 trillion by June 2026; roughly three in every four rupees sit in Category II (Cafemutual, 2026a; Business Standard, 2026a). Practitioners count around 1,850 registered AIFs as of March 2026, compared with 732 five years before (Treelife, 2026a). We were unable to confirm this count from any primary SEBI publication.

2.3 Parallel and competing regimes

Investors who want exposure to Indian private assets have options besides AIFs, and the pull of those options is central to our story. Foreign Portfolio Investors (FPIs) hold listed securities through their own SEBI framework. Residents can use mutual funds or portfolio management services (PMS), which demand smaller minimums: ₹50 lakh for PMS, and ₹10 lakh for the Specialised Investment Fund, a mutual-fund-based product launched in 2025 (we have not verified either threshold). For fund domicile, though, the key alternative is GIFT City's IFSC, governed by the IFSCA (Fund Management) Regulations, 2022.¹¹ It comes with a separate set of rules and tax breaks: non-resident investors in Category III AIFs pay no tax on income attributable to them, management fees are outside goods and services tax¹², and IFSC units get a tax holiday (GIFT Gujarat, n.d.; Candour Legal, 2026). Estimates of its size vary. Practitioners cite 190 to 200 fund management entities and cumulative commitments anywhere from USD 12 billion to USD 26 billion, depending on source and date (Treelife, 2025; Candour Legal, 2026). That is modest beside the onshore market but rising, and the spread between estimates previews the data difficulties set out in Section 4.

3. Literature review and hypotheses

3.1 Private capital and economic growth

There are good reasons to care about the depth of private capital, chiefly its effect on innovation and new businesses. Looking across US industries, Kortum and Lerner (2000) found¹³ that a dollar of venture funding produced considerably more patents than a dollar of

¹¹ GIFT City (Gujarat International Finance Tec-City) is the site of India's International Financial Services Centre (IFSC). The sector regulator is the International Financial Services Centres Authority (IFSCA), established under the IFSCA Act, 2019.

¹² Goods and services tax (GST) is India's national indirect tax on supplies of goods and services. Fees that a manager charges an onshore AIF are generally within its scope, which is why Section 7.3 counts GST as a cost of onshore domicile.

¹³ Patent counts are an imperfect proxy for innovation, and the studies in this paragraph come mainly from the United States and Europe. How far their findings carry over to India is itself an open question.

corporate R&D. Samila and Sorenson (2011) traced venture finance to higher rates of firm creation, jobs and income in American regions. European data tell a similar story (Popov & Roosenboom, 2012). Lerner et al. (2011) reported that companies owned by private equity went on to file patents that were cited more often, and found no evidence that innovation fell away over time. All of this fits the broader research linking finance to growth (Levine, 2005; Rajan & Zingales, 1998). Reviews of the field (Da Rin et al., 2013; Kaplan & Strömberg, 2009) see private equity and venture capital as a significant, though imperfect, route for directing risk capital. For India, the implication is direct: if private capital is scarce relative to GDP, growth may suffer in manufacturing, deep technology and infrastructure, the very areas McKinsey & Company (2026) identifies as under-served by private markets.

3.2 Law, finance and the regulation of fund structures

A well-known line of work by La Porta et al. (1997, 1998) traced cross-country differences in financial development to how well the law protects investors and, behind that, to a country's legal tradition;¹⁴ the authors later revisited and refined the claim (La Porta et al., 2008). Scholars of private capital have taken this reasoning further. Using data from developing economies, Lerner and Schoar (2005) show that legal conditions shape both deal structures and investor returns in private equity. Cumming et al. (2006, 2010) connect the quality of legal systems with how venture investments are exited and governed. Armour and Cumming (2006) find that cross-national variation in venture fundraising and investment reflects legal, fiscal and regulatory factors such as insolvency rules and capital gains tax. Cumming and Johan (2013) pull this body of contracting evidence together. We draw two points from it. Written rules count, but enforcement and predictability count as well. And the

¹⁴ La Porta et al. separate common-law systems, which include England and its former colonies such as India, from the civil-law families, and report that common-law systems on average give outside investors stronger protection.

rules governing the fund itself, not only those governing portfolio companies, affect where funds are formed and how they are structured.

3.3 Institutional investors and alternative asset allocation

Private markets are shaped by the kind of investor that supplies the money and by the incentives that investor faces. A classic example comes from Gompers and Lerner (1998). In 1979 the US authorities clarified the prudent-man standard under the Employee Retirement Income Security Act so that pension plans could back venture funds,¹⁵ and venture commitments jumped as a result; few regulatory changes have released institutional money so visibly. LPs also differ in how well they invest. Lerner et al. (2007) found endowments earning more from private equity than banks, insurance companies or advisers, while Sensoy et al. (2014) showed this edge over public pension plans fading as the asset class grew up. Andonov et al. (2018) linked board composition and political representation at public pension funds to how much they put into local private equity. The lesson from this research is that LP rules, governance and expertise are core determinants of market depth, not just context.

3.4 Tax neutrality and fund domiciliation

Most funds are structured so that tax falls on investors rather than on the vehicle itself. Applying that idea to private equity partnerships has generated an extensive debate about carried interest (Fleischer, 2008).¹⁶ Poterba (1989) and Gompers and Lerner (1998) both see capital gains tax as one influence on how much venture capital is supplied. Da Rin et al. (2006) conclude that public policy, taxation and state funding schemes among them, affects whether venture markets develop. Gilson (2003) warns that policymakers hoping to copy the American venture model must address organisational form, institutional investors and exit

¹⁵ The change was a 1979 clarification by the US Department of Labor of the “prudent man” standard in the Employee Retirement Income Security Act of 1974 (ERISA), under which the prudence of an investment is judged in the context of the whole portfolio and not in isolation.

¹⁶ Carried interest is the share of a fund's profits, customarily 20 per cent above a hurdle, that goes to the managers. Whether it should be taxed as capital gain or as ordinary income is the question Fleischer examines; the US rule is noted in Table 3.

routes, because subsidies alone will not do the job. Why managers choose Singapore, Mauritius, the Cayman Islands or Luxembourg as a home for their funds is a question discussed mainly by practitioners and policy analysts, not academics. We could find no rigorous peer-reviewed study of how treaty-based structures operate for funds investing in India¹⁷, and this strikes us as an open gap.

3.5 Emerging-market private capital and India-specific studies

Work on emerging economies usually highlights fragile institutions and an active state. Bruton and Ahlstrom (2003) apply institutional theory to venture capital in China. Dossani and Kenney (2002) describe India's attempt in the 1990s to build a venture ecosystem and identify three obstacles: restrictive regulation, unfavourable tax treatment and scarce exits. Groh et al. (2010) build attractiveness indices from tax, investor protection, skills and exit conditions, though their focus is European. For India today, most of the evidence is grey literature. It includes surveys by Bain & Company and IVCA (2026a, 2026b), the LP survey run by McKinsey and IVCA (McKinsey & Company, 2026), and committee reports such as that of SEBI's Alternative Investment Policy Advisory Committee (2016).

3.6 Gap statement and hypotheses

In short, prior work shows that regulation, taxation, institutional investors and exit markets all bear on how deep private capital becomes. What is missing is an integrated look at India since the reforms of 2024–2026; studies of India tend either to describe the market or to examine a single obstacle in isolation. We offer a joint qualitative assessment of regulatory, tax and investor-base constraints as they stand today. Given our doctrinal and

¹⁷ That is, structures that route investment through a jurisdiction such as Mauritius or Singapore to claim treaty relief. Section 7.3 explains why that relief has narrowed.

comparative design, the four hypotheses below are framed qualitatively and weighed against the documentary record rather than tested statistically.

- **H1 (Regulatory): Heavy compliance and unpredictable rule-making hold back the creation of AIFs and the raising of domestic capital.**
- **H2 (Tax): Uncertain, complex taxation of funds and their investors, coupled with offshore structures chosen for tax reasons, steers money away from onshore AIFs.**
- **H3 (Investor base): Tight limits, legal or practical, on how much long-horizon domestic institutions can commit, combined with large minimum tickets, keep the LP pool narrow.**
- **H4 (Competition): Funds and investor money migrate from domestic AIFs to offshore vehicles and to GIFT City.**

4. Data and methodology

4.1 Research design

The research combines legal analysis of a doctrinal and comparative kind with simple quantitative benchmarks. We chose not to interview practitioners. Public documents on this subject are plentiful, from regulations, circulars and consultation papers to tax statutes and investor surveys, while securing a representative group of institutional interviewees would have been very difficult. As Section 11 acknowledges, the cost of this choice is that practitioner views reach us second-hand, chiefly through McKinsey and IVCA's survey of over 50 global LPs (McKinsey & Company, 2026). Because no human participants took part, ethics approval was not required.

4.2 Benchmark metrics and data sources

Seven indicators are used. The first three express cumulative AIF figures relative to GDP: commitments (M1), capital actually called, which SEBI labels funds raised (M2)¹⁸, and investments made (M3). Each takes the March 2026 SEBI quarterly figure, as published in the press, and divides it by provisional 2025–26 nominal GDP of ₹346.36 lakh crore;¹⁹ SEBI states that funds raised and investments made are reported net (SEBI, 2026). M4 relates yearly PE-VC investment to GDP. Three Indian estimates feed into it (Bain & Company and IVCA, 2026a; McKinsey & Company, 2026; EY-IVCA as reported by Entrepreneur India, 2026), set against India's 2025 nominal GDP of USD 4.13 trillion from the IMF (2025) World Economic Outlook.²⁰ M5, the drawdown ratio, divides funds raised by commitments. M6 measures how much of the money raised by Category I and II AIFs comes from domestic investors, and M7, taken from McKinsey & Company (2026), measures how much PE deployment is led by Indian general partners.

Comparator figures come from three sources: PitchBook's 2025 US private equity deal value of \$1.2 trillion, the PitchBook-NVCA 2025 US venture deal value of \$339.4 billion (PitchBook, 2026; Fortune, 2026), and KPMG's 2025 UK private equity deal value of \$204.6 billion (KPMG, 2026). These are scaled by the IMF's October 2025 GDP estimates, USD 30.6 trillion for America and USD 3.96 trillion for Britain.²¹ We should be upfront about the weaknesses here, which Section 11 revisits. Buyout deal value is normally recorded

¹⁸ “Funds raised” in SEBI's tables means capital actually drawn down from investors. It should not be confused with commitments, which are the sums investors have pledged.

¹⁹ That is ₹346.36 trillion. The ratios are $M1 = 16.94 \div 346.36 = 4.89$ per cent; $M2 = 7.03 \div 346.36 = 2.03$ per cent; and $M3 = 6.76 \div 346.36 = 1.95$ per cent, with all numerators in ₹ trillion (Section 5).

²⁰ On GDP of USD 4,130 billion, the three estimates give $USD\ 36\ billion \div 4,130 = 0.87$ per cent (Bain and IVCA), $USD\ 44\ billion \div 4,130 = 1.07$ per cent (McKinsey) and $USD\ 60.7\ billion \div 4,130 = 1.47$ per cent (EY-IVCA), which the text rounds to roughly 0.9, 1.1 and 1.5 per cent.

²¹ United States: $(USD\ 1,200\ billion\ PE + USD\ 339.4\ billion\ VC) \div USD\ 30,600\ billion = 5.03$ per cent. United Kingdom: $USD\ 204.6\ billion \div USD\ 3,960\ billion = 5.17$ per cent.

at enterprise value and therefore includes borrowed money²², while Indian PE-VC activity consists largely of minority growth stakes, so the comparison exaggerates the gap in equity. Even inside India the trackers diverge widely. For 2025, Bain and IVCA count USD 36 billion of PE-VC investment, McKinsey counts USD 44 billion of private-capital deployment, and EY-IVCA counts USD 60.7 billion. Matching capital figures for China, Singapore and the IFSC sit behind paid databases such as Preqin and PitchBook, to which we had no access. For those three jurisdictions we therefore compare regulation and tax (Sections 6 and 7) rather than capital volumes.

4.3 Comparator selection

Five comparators were chosen against criteria settled before any coding took place. America has the most developed private-capital market and is where the limited-partnership fund originated. Britain, whose common-law tradition India inherited, and the European Union share a common framework for alternative funds under the Alternative Investment Fund Managers Directive.²³ Singapore competes most directly with India for regional fund domicile and management, offering the variable capital company as a dedicated corporate fund vehicle along with tax incentives for funds. China, the region's other giant economy, is a useful contrast because the state steers so much of its private capital. Finally, GIFT City's IFSC is India's own response to offshore domicile and so competes head-on with onshore AIFs. To guard against cherry-picking, the set includes both stronger and weaker comparators, and we note where India performs well; its share of Asia–Pacific PE-VC deployment, for instance, grew from roughly 12 per cent over 2015–19 to roughly 21 per cent over 2020–24 (McKinsey & Company, 2026).

²² Enterprise value is equity value plus net debt. A buyout recorded at USD 100 million of enterprise value that was funded half by debt involved only about USD 50 million of equity, which is why the US and UK ratios overstate the equity gap.

²³ Directive 2011/61/EU (AIFMD). The two regimes have diverged since the UK left the EU: the UK kept the Directive as domestic law, supervised by the Financial Conduct Authority, and is not bound by AIFMD II. The paper nonetheless treats the UK and EU as a single comparator, as Table 2 does, which is a simplification.

4.4 Doctrinal method and coding framework

For the legal analysis we relied first on primary materials, namely statutes, regulations, notifications and circulars, and turned to credible legal commentary only where a primary text was unavailable. Every jurisdiction is scored against eight headings. Four concern regulation: how funds are authorised, how managers are authorised, who may invest, and what limits apply to leverage and investments. Two concern conduct: reporting and disclosure, and the duties placed on managers. The final two concern tax, for the fund and for its investors. Using the rules in Appendix C, we mark each entry as favourable, neutral or restrictive compared with the median across the six jurisdictions. Appendix A reports the full grid, and Tables 2 and 3 condense it. One researcher carried out the scoring; before submission an independent second coder should repeat it.

4.5 Validity and reliability

We cross-check findings across several kinds of material: publications by regulators, legislation, data from industry bodies, consulting reports and legal commentary. Appendix B lists every source with the definition applied and when it was accessed; all online material was accessed on 7 October 2026. A clear shortcoming is our reliance on newspaper coverage of SEBI releases for much of the AIF data, in place of SEBI's own statistics page. Some practitioner figures, among them the number of IFSC funds and the breakdown of AIF investors, could not be traced to any primary source. These are flagged where they appear and need checking before publication. Since the rules change so often, all legal statements describe the position on 7 October 2026.

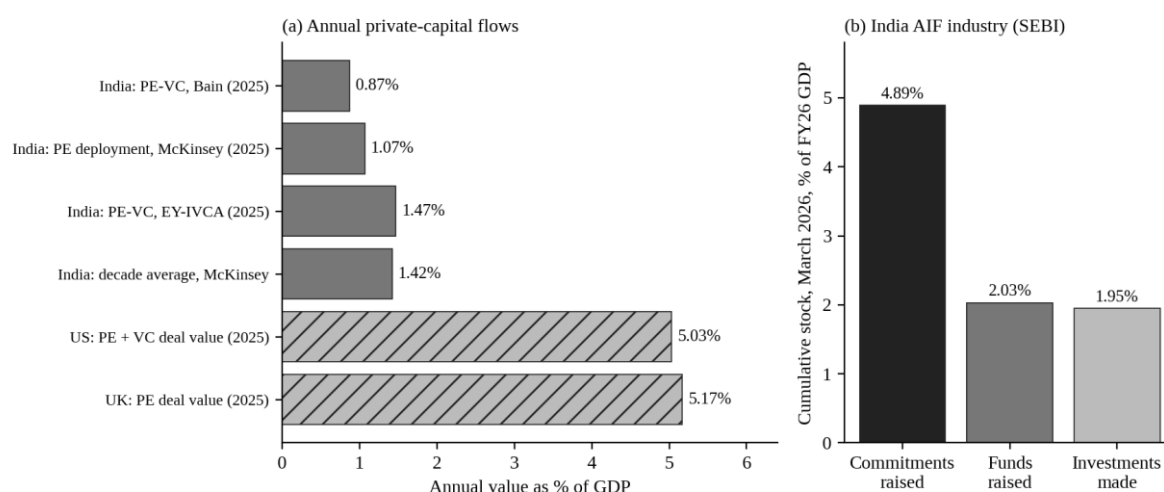
5. Measuring the gap: benchmarking

Turning to RQ1, Figure 1 presents the core measures. Its left panel, (a), compares annual private-capital flows with GDP. For India the ratio varies by source: roughly 0.9 per cent on Bain and IVCA numbers, 1.1 per cent on McKinsey's 2025 deployment figure, and

1.5 per cent on EY-IVCA's estimate. Over the last ten years McKinsey puts the average at 1.42 per cent, which is over twice the 2006–2015 average of 0.68 per cent (McKinsey & Company, 2026). Headline equivalents for America and Britain are near 5.0 and 5.2 per cent. Those figures, however, rest on deal value (see Section 4) and do not compare cleanly with India's, so they mark the outer limit of the gap; the hatched bars signal this. Panel (b) gives India's cumulative AIF position at March 2026. Commitments stood at 4.9 per cent of FY26 GDP, capital called at 2.0 per cent, and investments at 1.95 per cent.

Figure 1

Private capital as a share of GDP



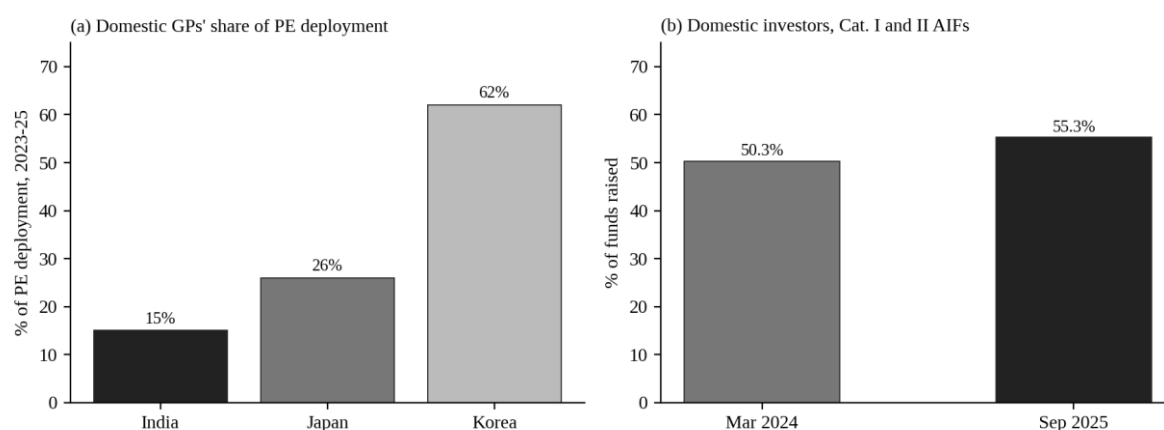
Note. In panel (a), Indian ratios divide the estimates of Bain & Company and IVCA (2026a), McKinsey & Company (2026) and EY-IVCA (reported in Entrepreneur India, 2026) by IMF 2025 nominal GDP. Hatched US and UK bars show PE deal value, with venture deal value added for the US, from PitchBook (2026), Fortune (2026) and KPMG (2026), also divided by IMF 2025 GDP; because they rest on enterprise value they are not directly comparable. Panel (b) divides SEBI figures, as published by Business Standard (2026a) and Cafemutual (2026a), by provisional FY26 nominal GDP (MoSPI, 2026).

RQ1 also has a domestic dimension, shown in Figure 2. The ideal measure would be the proportion of LP money supplied by Indian institutions, but none of the sources available to us reports this for AIFs. We use two stand-ins instead. In panel (a), Indian general partners led about 15 per cent of the country's PE deployment in 2023–25. Japan's figure is roughly 26 per cent and Korea's roughly 62 per cent. India has improved from 10 per cent in 2020–22 (McKinsey & Company, 2026). In panel (b), practitioner reports put the domestic share of

money raised by Category I and II AIFs at 55.3 per cent in September 2025, compared with 50.3 per cent in March 2024 (Treelife, 2026a; MNCL, 2026). The upward trend is welcome. As Section 8 shows, though, it reflects wealthy households and family offices rather than institutions.

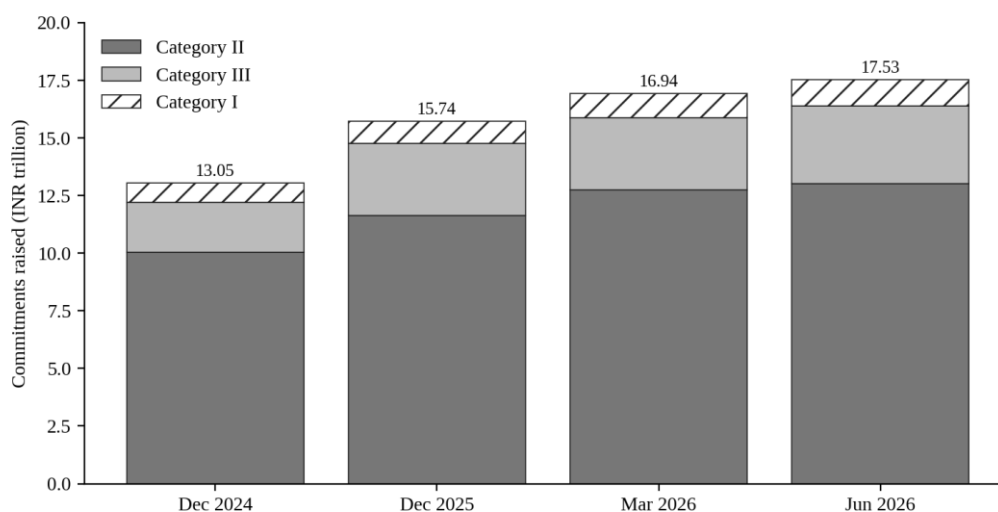
Figure 2

Domestic participation proxies



Note. Panel (a) is from McKinsey & Company (2026), drawing on Preqin, PitchBook, S&P Capital IQ and Venture Intelligence. Panel (b) uses practitioner summaries of SEBI data (MNCL, 2026; Treelife, 2026a), which we have not checked against a primary SEBI release.

How commitments have grown in each category is shown in Figure 3. The total moved up from ₹13.05 trillion (December 2024) to ₹17.53 trillion (June 2026). Category II holds about three-quarters of the money. Category III, however, is expanding fastest. At ₹3.1 trillion in March 2026, its commitments were up some 37 per cent year on year, well ahead of the 25.6 per cent recorded across all categories (Business Standard, 2026b). Category I, calculated here as the remainder, is only around 6 per cent of commitments, even though this is the home of the early-stage and infrastructure funds that policy most wants to encourage.

Figure 3*India AIF commitments raised by category*

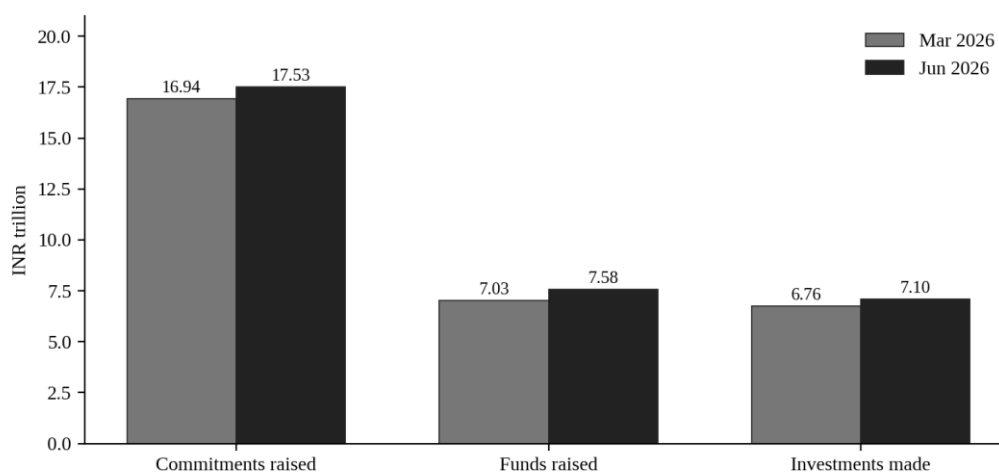
Note. Total, Category II and Category III figures for December 2024, December 2025, March 2026 and June 2026 come from SEBI data published by Cafemutual (2026a, 2026b, 2026c) and Business Standard (2026a). Category I for March and June 2026 is an approximate residual.

Figure 4 splits the headline number into its parts, and this is where the data begin to explain the gap rather than just describe it. Any single commitments figure mixes up four separate things: what investors have promised, what managers have called, what has actually been invested, and how many different managers are doing the investing. As of March 2026, the funds had called ₹7.03 trillion out of ₹16.94 trillion promised.²⁴ That is a drawdown ratio of 41.5 per cent. Of the ₹7.03 trillion called, ₹6.76 trillion, or 96 per cent, had been invested. Called money, in other words, is almost fully at work; it is the uncalled portion that is large, at around three-fifths of commitments. Closed-ended funds still inside their investment period are expected to have uncalled capital, and when commitments grow fast the ratio falls mechanically, so this is not evidence of failure. What it does show is that the capital genuinely deployed is about 2 per cent of GDP, well below the 4.9 per cent headline.

²⁴ Drawdown ratio: $7.03 \div 16.94 = 41.5$ per cent. Share of called capital invested: $6.76 \div 7.03 = 96.2$ per cent. Uncalled commitments: $16.94 - 7.03 = ₹9.91$ trillion, or 58.5 per cent of commitments, the “around three-fifths” in the text.

Figure 4

Breaking down the AIF figures: pledged, called and invested capital



Note. SEBI data as reported by Business Standard (2026a) and Cafemutual (2026a). INR trillion. Funds raised and investments made are on a net basis.

Taken together, the breakdown shows the gap widening as one moves from fundraising, through yearly deployment, to the depth of domestic LPs and managers. Fundraising is strong and rising. Yearly deployment, on the other hand, is small next to GDP and has not grown since 2021. McKinsey & Company (2026) records a 2021 peak of \$74 billion against \$44 billion in 2025, and Bain & Company and IVCA (2026a) record a 17 per cent drop in 2025 PE-VC investment, to \$36 billion, as big buyouts slowed. Manager concentration is high as well. Between 2022 and 2024 Indian private equity firms raised \$13.68 billion, and the top six GPs captured 64 per cent of it, compared with 59 per cent in 2016–2018 (McKinsey & Company, 2026). So our answer to RQ1 is that the gap is genuine but sensitive to the yardstick. On commitments it is small to moderate. On yearly deployment it is large, though deal-value comparisons overstate it. On domestic institutional participation it is structural. Because these indicators largely reflect the same underlying frictions, the following sections examine regulation, tax and the investor base in turn.

6. Regulatory analysis

6.1 Registration, eligibility and investment conditions

On paper the AIF regime is proportionate. Each fund registers with SEBI under the relevant category, and who may invest depends on sophistication, tested through the ₹1 crore minimum and, increasingly, through accredited-investor status. Funds that take money only from accredited investors now face much less red tape. The 2026 amendment removes them from SEBI's comment process, waives the fee on a first scheme, and shortens filing from 30 days to ten working days (Sagus Legal, 2026). The lower ₹25 crore threshold for LVFs (Angel One, 2025) and the new co-investment route (Taxguru, 2025) respond directly to industry demand for customised vehicles. Registering a fund and designing a product is far less onerous than it was before 2024.

Rules on what funds may invest in remain tighter than American practice. Category I and II vehicles are limited in how much they may place in one company and in how much they may borrow, and Category I venture funds must invest most of their corpus in venture capital undertakings. Sponsors or managers have to keep a stake in the fund. Since 2025, angel funds may invest only directly, may not run schemes, and may back only start-ups that are not part of large business groups (AIF Services, 2025). There are sound investor-protection reasons for these limits, and the EU's AIFMD contains many similar ones. Even so, they leave managers less room to manoeuvre and make structuring more expensive than in the United States, where private funds operate through statutory exclusions and commercially negotiated terms.

6.2 Layering of regulators and compliance burden

India's regime is unusual mainly because so many regulators are involved. SEBI oversees the fund itself; the RBI oversees banks and non-bank lenders that might invest; IRDAI is responsible for insurers and PFRDA for pension funds; and the Central Board of

Direct Taxes decides tax treatment.²⁵ A manager hoping to raise money from more than one type of LP must satisfy all of them. Compliance adds further layers. Funds report to SEBI every quarter, must meet valuation and benchmarking standards, and since 2024 must carry out extra checks designed to prevent loan evergreening via AIFs, a topic on which a SEBI circular of October 2024 built on the RBI's measures (Chambers, 2025). Each obligation can be justified in isolation. Added up, however, they raise the fixed cost of managing a fund, and first-time and mid-sized managers bear the heaviest share.

6.3 Regulatory process: frequency of change, consultation and clarity

It is the process of regulation, more than its content, that gives most cause for concern. The RBI's handling of lender investment in AIFs illustrates the point. December 2023 brought a blanket restriction; March 2024, a clarification; May 2025, a draft proposing an overall cap of 15 per cent; and July 2025, final directions setting the cap at 20 per cent with softer provisioning (Vinod Kothari Consultants, 2025a; ELP Law, 2025). For about a year and a half, an important group of domestic institutional investors was either barred or unsure of its position. SEBI has also been busy, issuing at least four sets of amending regulations between July 2024 and July 2026, plus numerous circulars. Consultation did take place, notably on co-investment (Acuity Law, 2025), but practice has sometimes trailed the law: observers noted that co-investment schemes, though defined in the regulations, could not be launched until operating details were finalised (AIF Services, 2025). For managers planning fundraises that take years, a regime moving in a liberal direction but changing constantly rewards those who wait and penalises those who go first.

²⁵ IRDAI is the Insurance Regulatory and Development Authority of India; PFRDA is the Pension Fund Regulatory and Development Authority; the Central Board of Direct Taxes (CBDT) administers the direct-tax laws within the Ministry of Finance.

6.4 Comparison with other jurisdictions

Table 2 sets India beside its peers across six regulatory headings. Several things are apparent. With the 2026 amendments in place, India's registration requirements are roughly on a par with those of the EU and Singapore. America places the fewest demands on the fund vehicle but compensates with extensive securities legislation, active enforcement and frequent litigation.²⁶ Obligations in the EU have grown obligations through AIFMD II (Directive (EU) 2024/927), which member states were due to transpose by April 2026.²⁷ Singapore combines a light fund regime with substance conditions attached to its tax incentives. China requires registration and filing, sets qualified-investor thresholds, and gives state-guided capital a large role. In GIFT City, a single regulator, IFSCA, handles authorisation through one window. A dagger (†) marks entries based on the author's general knowledge of a regime rather than a source collected for this study; these should be checked.

Table 2

Regulatory dimensions: India and comparator jurisdictions

Dimension	India (onshore AIF)	United States†	UK / EU†	Singapore	GIFT City (IFSC)
Fund authorisation	SEBI registration by category; scheme filing (10 working days from July 2026); AIOFs exempt from SEBI comments	Private funds generally unregistered; rely on exclusions and Regulation D offerings	AIFMD authorisation or registration of the manager; marketing passport in EU	Private funds largely not authorised; VCC registered with ACRA	Registration with IFSCA; Category I to III structure
Manager authorisation	Manager and sponsor requirements within AIF Regulations	Registered adviser, or exempt reporting adviser under venture and private fund exemptions	AIFM authorisation; sub-threshold registration	MAS licence or registration of the fund manager required for a VCC	Fund Management Entity authorised by IFSCA; substance requirements

²⁶ The SEC's 2023 rules for private fund advisers were vacated by the Fifth Circuit in *National Association of Private Fund Managers v. SEC* (June 2024), which is why Table 2 records them as vacated.

²⁷ Directive (EU) 2024/927 amends the AIFMD and the UCITS Directive. Among other things it introduces harmonised rules for funds that originate loans and requires additional liquidity-management tools. The transposition deadline was 16 April 2026.

Dimension	India (onshore AIF)	United States†	UK / EU†	Singapore	GIFT City (IFSC)
Investor eligibility	₹1 crore minimum; accredited investors for AIOFs, LVFs, angel funds and co-investment	Accredited investors and qualified purchasers	Professional investors; limited retail access	Accredited and institutional investors	Accredited and other eligible investors; USD 5 million minimum corpus (Cat. III)
Leverage and investment restrictions	Concentration limits; no leverage for Cat. I and II beyond operational needs	Few statutory limits; market-set terms	Leverage disclosure and caps; loan-origination rules in AIFMD II	Few limits for private funds	Category-specific, broadly modelled on SEBI
Reporting	Quarterly reporting to SEBI; benchmarking and valuation	Form ADV and Form PF for registered advisers	Annex IV reporting; depositary oversight	Periodic regulatory returns to MAS	Periodic reporting to IFSCA
Manager obligations	Continuing interest; due diligence; evergreening checks	Fiduciary duty under Advisers Act; SEC private fund adviser rules vacated in 2024	Remuneration, depositary and risk-management rules	Fit-and-proper, AML/CFT and substance requirements	Key personnel and decision-making within IFSC

Note. Entries for India and GIFT City draw on Sagus Legal (2026), Angel One (2025), Taxguru (2025) and Candour Legal (2026); Singapore entries draw on VCC Singapore (2026). A dagger (†) marks entries resting on the author's general knowledge, which should be checked before citation.

6.5 Assessment against H1 and H4

We find partial support for H1. By international standards, running a registered AIF does not involve an exceptional compliance load, and recent reforms have lightened it further, above all for funds limited to accredited investors. The evidence does support a narrower claim: unpredictable rule-making, together with several regulators whose requirements overlap, makes it costlier and riskier to launch an onshore fund and to attract domestic institutional money. LPs themselves say as much, calling for clearer rules and quicker approvals (McKinsey & Company, 2026). On H4, the IFSC appears to offer managers an easier route for raising non-resident money, yet it remains small and its substance rules create practical friction (Candour Legal, 2026). Since the IFSC's main advantage lies in tax, we pick up H4 again in Section 7.

7. Tax analysis

7.1 The pass-through framework and fund-level treatment

For Category I and II AIFs, tax law looks through the fund to its investors. Section 115UB of the Income-tax Act, 1961 treated a unit holder's fund income as if the holder had owned the underlying investments directly, and preserved the nature of that income when it reached the investor (Income Tax Department, 2026). Any business income, by contrast, is taxed in the fund's hands. The 1961 Act was replaced on 1 April 2026 by the Income-tax Act, 2025; pass-through now appears in section 224 of the new law, and withholding, formerly in section 194LBB, is governed by the section 393 framework (AltPort Funds, 2026). We follow the literature in citing the 1961 section numbers, so anyone referring to current law should convert them to their 2025 equivalents.

Section 115UB specifically excludes Category III funds. They are taxed in their own right under the ordinary rules for their legal form. A trust falls under the representative-assessee provisions; a company is taxed like any other company; an LLP is treated as a firm (Corporate Professionals, 2026). Investors generally escape a second charge when the fund distributes, but the fund level determines how income is classified, what rate applies and how losses are handled. The point is significant because Category III is growing faster than any other category, meaning that more and more of the industry's money is held under a regime without statutory look-through.

7.2 Characterisation of income and capital gains rates

The longest-running tax problem has been classification. Should a fund's profits on securities be treated as capital gains or as business income? For Category I and II funds the answer matters a great deal, because business income cannot pass through under section 115UB and is taxed inside the fund. The Finance Act 2025 settled the matter by amending section 2(14) of the 1961 Act: from assessment year 2026–27, securities held by a section

115UB investment fund are capital assets²⁸ (Lakshmikumaran & Sridharan, 2025; Bharat Tax, 2026). Category III funds were not included (Treelife, 2026b). According to commentators, the Finance Act 2026 did not alter section 115UB (Bharat Tax, 2026).

Investor rates became simpler with the Finance Act 2024. Gains on listed shares held for the long term now attract 12.5 per cent once they exceed ₹1.25 lakh, while short-term gains are taxed at 20 per cent (Steptrade Capital, 2025).²⁹ Tax is withheld on pass-through income under section 194LBB, now part of the section 393 framework. The upshot is that a resident who invests through a Category II fund pays about the same headline tax as one who invests directly, which is precisely the aim of look-through treatment.

7.3 Treaty, indirect-tax and structural issues

Some aspects of the wider tax system discourage onshore funds even when fund-level rules are neutral. Goods and services tax is charged on management fees, a cost IFSC fund managers avoid (Candour Legal, 2026), and issuing or transferring units attracts stamp duty (Chambers, 2025). Investors who once relied on treaties with Mauritius and Singapore lost much of that protection when the 2016 protocols³⁰ made capital gains arising from 2017 onward taxable in India, and the general anti-avoidance rule became effective the same year. The memory of retrospective tax on indirect transfers, though repealed in 2021, still shapes how foreign LPs assess Indian tax risk.³¹ We rely on general knowledge for these points and flag them for checking. In the McKinsey–IVCA survey, both heavy and moderate allocators

²⁸ Assessment year 2026–27 is the year in which income earned in financial year 2025–26 (1 April 2025 to 31 March 2026) is assessed.

²⁹ These rates apply to listed equity shares on which securities transaction tax has been paid, with “long-term” meaning a holding of more than twelve months. They took effect on 23 July 2024 under the Finance (No. 2) Act, 2024.

³⁰ The India–Mauritius protocol (10 May 2016) and the India–Singapore protocol (30 December 2016) moved to source-based taxation of capital gains on shares acquired on or after 1 April 2017. Earlier investments were grandfathered, and gains during a transition period to 31 March 2019 were taxed at half the domestic rate, subject to limitation-of-benefits conditions.

³¹ The retrospective amendment of 2012, which reversed *Vodafone International Holdings BV v Union of India* (Supreme Court, 20 January 2012) on the taxation of indirect transfers of Indian assets, was repealed by the Taxation Laws (Amendment) Act, 2021.

list tax complexity among their main concerns, and LPs ask for clearer rules on carried interest and pass-through status (McKinsey & Company, 2026).

7.4 Offshore and IFSC advantages

GIFT City's offer is pitched squarely against Singapore and Mauritius. Consider a Category III AIF located in the IFSC. Income from specified transactions that is attributable to its non-resident investors is tax-free. Those investors can, subject to conditions, skip obtaining a PAN and filing Indian returns.³² The manager's fees bear no GST, the surcharge on some gains is capped, and the IFSC unit itself pays no income tax for any ten years out of its first fifteen (GIFT Gujarat, n.d.; Corpzo, n.d.; Beacon Filing, 2026). Singapore, for its part, levies no capital gains tax, grants fund income exemptions under sections 13O, 13U and 13D³³ if funds meet thresholds for assets, local spending and staff, and has many tax treaties (VCC Singapore, 2026). The regimes are compared in Table 3. A Category III fund based onshore and investing in India gets none of this: it pays tax itself, enjoys no treaty cover, and cannot offer foreign LPs an exemption.

Table 3

Tax treatment compared: onshore India, GIFT City, Singapore and others

Dimension	India onshore Cat. I / II	India onshore Cat. III	GIFT City Cat. III (non-resident LPs)	Singapore (13O / 13U)	US, UK / EU, China†
Fund-level tax	Pass-through for non-business income; business income taxed at fund	Taxed at fund level by legal form; no pass-through	Taxed at fund level, with exemption for income attributable to non-resident investors	Qualifying income from designated investments exempt	Generally tax-transparent partnership or look-through treatment (verify for China)
Characterisation of income	Securities treated as capital assets from AY 2026–27	Not covered by capital-asset clarification	Exempt for non-residents	No capital gains tax in Singapore	US: carried interest long-term gain if held over three years (§1061); others vary

³² PAN is the Permanent Account Number issued by the Income Tax Department, which an investor ordinarily needs in order to file a return in India.

³³ Sections of the Singapore Income Tax Act 1947: section 13O is the onshore fund scheme, 13U the enhanced-tier fund scheme and 13D the offshore fund scheme. The conditions attached to each should be taken from the current statute and Monetary Authority of Singapore guidance.

Dimension	India onshore Cat. I / II	India onshore Cat. III	GIFT City Cat. III (non-resident LPs)	Singapore (13O / 13U)	US, UK / EU, China†
Investor-level tax	Taxed on pass-through income at own rates; LTCG 12.5% / STCG 20% on equity	Distributions generally not taxed again	Exempt on income from fund and transfer of units, subject to conditions	Depends on investor jurisdiction	Investor taxed in own jurisdiction
Indirect tax	GST on management fees; stamp duty on units	As Cat. I and II	No GST on management fees	GST applies to certain services; concessions available	VAT / sales tax varies
Compliance for foreign LPs	PAN and return filing; withholding	PAN and return filing	PAN and return-filing exemption subject to conditions	No Singapore filing for non-resident investors	Withholding and treaty forms
Conditions / substance	None specific beyond category rules	None	FME, key personnel and decisions in IFSC	Minimum assets, local spend and professionals	Not applicable

Note. Entries for India and GIFT City draw on Income Tax Department (2026), Lakshmikumaran & Sridharan (2025), Corporate Professionals (2026), GIFT Gujarat (n.d.) and Candour Legal (2026); Singapore draws on VCC Singapore (2026). † The final column relies on the author's general knowledge, is provided only to round out the comparison, and should be verified rather than treated as a sourced finding.

7.5 Assessment against H2 and H4: rules versus uncertainty

Two different problems need to be kept apart, since they require different remedies: rules that genuinely disadvantage onshore funds, and uncertainty about how rules will apply. The first kind exists but is narrow. It comprises tax at fund level for Category III, GST and stamp duty on the vehicle, and the lack of any exemption for foreign LPs, something the IFSC does offer. Category I and II funds now face broadly neutral headline rules. Uncertainty seems the larger obstacle. Classification of fund gains was resolved only in 2025, and only for some funds, leaving managers and investors exposed to tax risk for ten years. Retrospective laws, anti-avoidance provisions and indirect-transfer rules make further surprises seem plausible, and LPs in the McKinsey survey mention complexity along with unclear treatment of carry and pass-through (McKinsey & Company, 2026). We therefore regard H2 as partly supported, since complexity and uncertainty matter more than headline rates. H4 is partly supported on tax grounds, because non-resident LPs fare better under the IFSC package, but the scale data argue for caution. Reported IFSC commitments of USD 12–

26 billion compare with onshore commitments near ₹17.5 trillion, about USD 190 billion at today's exchange rate,³⁴ although the two series are not strictly comparable.

8. Investor-base analysis

8.1 Who may invest, and who does

In principle, any investor able to put up ₹1 crore may invest in an AIF, within the category rules, and institutions may do so to the extent their own supervisors allow. In practice, money comes overwhelmingly from HNIs, family offices and companies. Practitioners estimate that family offices and HNIs provide 80–90 per cent of funds raised (AssetPlus, 2025), although no published SEBI breakdown confirms this. The pool of accredited investors has reportedly more than tripled, reaching 2,773 by March 2026 (Treelife, 2026a). Foreign LPs still account for a meaningful portion of commitments. If domestic investors supplied around 55 per cent of Category I and II money in September 2025, foreign investors made up a sizeable minority.

8.2 Pension funds, insurers and banks

Nothing about India's LP base stands out more than the narrow room given to long-horizon domestic institutions. PFRDA does allow the National Pension System (NPS)³⁵ to buy into SEBI-registered Category I and II AIFs, but within cautious limits. NPS schemes for government employees may hold up to 1 per cent of assets in AIFs. Schemes for the private sector have a 5 per cent allowance shared across a basket of infrastructure investment trusts, debt AIFs and certain bonds. No pension fund may own over 10 per cent of a given AIF, and that AIF must have a minimum corpus (Business Today, 2026; NPS Trust, n.d.; PFRDA, 2025a, 2025b). These rules date only from the master circulars of December 2025. Measured

³⁴ ₹17.5 trillion ÷ USD 190 billion implies an exchange rate of about ₹92 per US dollar. The rate is approximate, and the comparison is indicative only.

³⁵ The National Pension System is the contributory pension scheme regulated by PFRDA. Separate master circulars govern investment under the government-sector and non-government-sector schemes (PFRDA, 2025a, 2025b).

against a pension pool of around ₹45 lakh crore (Business Today, 2026), the limits are tiny; measured against yearly AIF commitments, they could matter a lot if pension funds used them in full.

IRDAI has allowed insurance companies into Category I and II AIFs for several years, though only on terms. A Category II fund qualifies only if at least 51 per cent of its portfolio is in infrastructure, SMEs, venture capital or social ventures. Funds of funds and leveraged funds do not qualify at all, and limits apply both per fund and in total (IRDAI, n.d.). Banks and NBFCs operate under the RBI's July 2025 Directions. One lender may hold at most 10 per cent of a scheme, all lenders together at most 20 per cent, and investments are subject to an evergreening test and to provisioning (ELP Law, 2025). Reports from 2020 suggested the Employees' Provident Fund Organisation might be allowed³⁶ to invest in infrastructure via AIFs (Business Standard, 2020), but we could not establish whether such permission now exists. The overall picture is consistent: institutions are permitted to invest in theory, yet ceilings and eligibility tests restrict them in practice, and for banks the regulator's caution about evergreening adds a further brake.

8.3 Binding constraints

We identify four binding constraints. The first is regulatory: investment rules restrict both how much institutions may allocate and which funds are eligible, as set out above. The second is the size of the entry ticket. At ₹1 crore, most individuals who are not HNIs or accredited investors are shut out. The third is capability. Public institutions need expertise in valuation, risk management and manager selection, and building it takes time; the NPS Bharat Fund of Fund partly fills this need (NPS Trust, n.d.). The fourth is appetite for risk, which illiquidity and exit history both affect. According to the McKinsey–IVCA survey,

³⁶ The Employees' Provident Fund Organisation (EPFO) is the statutory body that manages the Employees' Provident Fund. Its investment pattern is set by the Central Government, so it sits outside the PFRDA and IRDAI frameworks described above.

pension funds invested in India hold just 14 per cent of their Indian alternatives exposure in private markets, whereas funds of funds hold 82 per cent; moderate allocators, meanwhile, focus on fees, returns after adjusting for risk, governance and transparency, and past exits (McKinsey & Company, 2026). The evidence on exits is mixed. Total exit value grew by about 3 per cent in 2025 to some \$34 billion, public markets supplied roughly 40 per cent of that value, and venture investors realised close to \$2 billion through IPOs (Bain & Company and IVCA, 2026a; Entrepreneur India, 2026).

8.4 Contrast with comparator LP bases

American endowments and public pension plans have served as anchor LPs at least since ERISA was clarified in 1979 (Gompers & Lerner, 1998). Research documents their importance as well as the wide spread in their results (Lerner et al., 2007; Sensoy et al., 2014). European pension funds and insurers invest under prudential rules that may either help or hinder allocation to private assets; this observation draws on general knowledge rather than detailed sources. Across Asia, sovereign and state-linked investors are leading LPs, and China's guidance funds direct public money into private vehicles. What distinguishes all these markets from India is that patient domestic institutions form a large and steady part of the LP base. In India they are only beginning to enter, and on a small scale. McKinsey & Company (2026) expects the pension regulator's recent steps to diversify the domestic LP base away from dependence on foreign investors.

8.5 Assessment against H3

Of the four hypotheses, H3 receives the strongest support. Document after document shows long-horizon domestic institutions operating under ceilings that are low, new or hedged with conditions. The investor base is accordingly dominated by rich individuals and family offices, whose capital can move quickly and whose total allocation is bounded by how concentrated wealth is. The same weakness explains why Indian GPs play such a small part.

Lacking institutional anchors, local managers find large funds hard to raise, and the market leans ever more on a few big GPs and on overseas LPs. PFRDA's late-2025 change signals that regulators understand the problem, although its impact will show only once pension money is actually committed.

9. Discussion and synthesis

9.1 Ranking the barriers and their interaction

Weighing the evidence, we order the barriers as follows. First, and most important, is the domestic institutional LP base, which is small and has only just been opened up (H3). This barrier underlies the shallow domestic manager pool, the dependence on wealthy individuals and foreign money, and the scarcity of long-dated anchor commitments; removing it would have the greatest effect. Second is uncertainty over tax (H2). It shapes where foreign LPs domicile and which structures domestic managers adopt, and its cost comes mostly from unpredictability rather than rates. Third is the instability of regulation and the overlap between regulators (H1), which adds cost and risk to launching funds and securing institutional money. Fourth is competition from offshore centres and the IFSC (H4). It matters for where funds are based, but it is more a symptom of the first three barriers than a cause in its own right.

The barriers are difficult to tackle because each amplifies the others. Uncertain tax treatment and tight institutional limits jointly favour offshore domicile. A foreign LP unsure how India will tax it will lean toward an IFSC or Singapore vehicle, while a domestic institution confined to onshore AIFs and small ceilings cannot provide the anchor money that would make an onshore fund competitive. Making it cheaper to set up a fund, as the 2026 amendment does, will not by itself raise commitments while the likely investors remain constrained. Raising institutional ceilings without settling tax questions could, conversely, increase demand for funds that still lack the classification certainty institutions need. Reform

therefore has to be ordered carefully and coordinated among regulators instead of being attempted piecemeal.

9.2 Alternative explanations

Some explanations lie outside regulation, tax and the LP base altogether, and they should be considered seriously. One is the state of exit markets. Funds realise returns through listings and trade sales, and LPs, especially moderate allocators, put exit record and distributions relative to paid-in capital near the top of their selection criteria while scoring Indian GPs as only average on these (McKinsey & Company, 2026). Exits have been steady rather than abundant; if they are the binding constraint, regulatory change will achieve little. A second is the youth of the domestic fund-management industry. Indian GPs handle a small share of deployment, and limited track records cap the fund sizes LPs will support. A third is valuation pressure linked to deployment clustering in a few sectors, a point McKinsey makes. A fourth is the macro backdrop, such as tighter liquidity worldwide and exposure to the rupee, which Bain and IVCA blame for the 2025 slowdown. Our doctrinal approach cannot separate these factors from the barriers we analyse, and we acknowledge this as a limitation. Several of them, however, depend on the institutional base too. More domestic institutional LPs would also finance bigger local managers and longer-lived funds, which in turn would strengthen track records and widen exit routes.

Table 4 summarises how each hypothesis fares against the evidence.

Table 4

Hypotheses versus findings

Hypothesis	Assessment	Principal evidence	Confidence
H1 Regulatory burden and unpredictability reduce AIF formation and domestic fundraising	Partly supported	Burden eased by 2024–26 reforms; frequent amendment, multi-regulator layering and an 18-month RBI cycle create unpredictability; LPs ask for regulatory clarity	Moderate: relies on documents, not on direct measurement

Hypothesis	Assessment	Principal evidence	Confidence
H2 Tax complexity, uncertainty and structuring divert capital offshore	Partly supported	Headline rules for Cat. I and II broadly neutral after Finance Act 2025; Cat. III fund-level tax; characterisation risk and retrospective-legislation history deter LPs	Moderate: uncertainty is hard to observe directly
H3 Limited domestic institutional allocation and high tickets narrow the LP pool	Supported	NPS 1% and 5% ceilings, 10% single-fund cap; insurer conditions; RBI 10% / 20% caps; HNI and family-office dominance; pensions hold 14% of India exposure in private markets	Moderate to high
H4 Offshore and GIFT City structures divert domicile and capital	Partly supported / inconclusive	IFSC package favours non-resident LPs; IFSC scale small relative to onshore pool; data inconsistent across sources	Low to moderate: scale data unreliable

Note. Assessments are qualitative judgements on documentary evidence, not statistical tests.

10. Policy recommendations

What follows are the author's own proposals. Each one rests on a particular finding and is addressed to a named body. We divide them into quick fixes, achievable within twelve months under existing powers, and structural reforms, which call for legislation, joint action by regulators or a transition lasting several years.

10.1 Quick fixes

- **SEBI: predictable rule changes (H1). Set out an annual timetable for amending the AIF Regulations. Publish consultation papers early, accompany each change with an impact assessment and a defined transition period, and allow managers and LPs to plan fundraising around changes they can see coming. Release any implementing circulars together with the regulation they support.**
- **SEBI: better data (RQ1). Report each quarter how AIF commitments and capital raised break down by investor type, distinguishing resident from foreign investors and HNIs and family offices from institutions, so that policymakers can see who is really investing.**
- **CBDT and the Ministry of Finance: tax certainty (H2). Resolve the classification questions still outstanding, including those affecting Category III and assets**

other than securities, and make advance rulings available for fund structures.

State publicly that changes to fund taxation will never apply retrospectively.

10.2 Structural reforms

- **IRDAI, PFRDA and EPFO: limits that rise with readiness (H3).** Move from fixed caps to tiered ones that increase as an institution demonstrates sound governance and investment capability. Channel early allocations through fund-of-funds vehicles such as the NPS Bharat Fund of Fund to manage risk, and publish a multi-year path so that managers can anticipate how institutional demand will grow.
- **CBDT and the Ministry of Finance: even-handed treatment of strategies (H2, H4).** Explore letting long-term, unleveraged Category III funds opt into pass-through, so that neutrality depends on what a fund does rather than the category it carries. Also examine whether resident investors deserve a counterpart to the IFSC package.
- **RBI and SEBI: sharper anti-evergreening tools (H1, H3).** Swap blanket caps for look-through tests that catch the real abuse, namely loans recycled through AIFs to distressed borrowers, so that sound institutional investment is not swept up with it.
- **IFSCA and SEBI: joint action against arbitrage (H4).** Apply a rule that the same activity receives the same minimum investor protection wherever it takes place. Consider allowing Indian managers to operate onshore and IFSC funds in parallel under shared substance requirements, so the choice of domicile reflects the target investors rather than regulatory gaps.
- **SEBI and industry: liquidity and new vehicles.** Encourage a secondary market in AIF units, along with longer-life or evergreen funds offering periodic exit

windows; the LP survey points to such features as a way to accommodate long-horizon institutional money (McKinsey & Company, 2026).

11. Limitations and future research

Several caveats apply. Above all, the data are hard to compare. Estimates of Indian PE-VC activity differ by up to twofold between trackers; comparator figures measure enterprise value, not equity invested; and we lacked matching capital data for China, Singapore and the IFSC. Much of the AIF data reached us through newspaper reports of SEBI releases rather than from SEBI directly, and certain practitioner numbers, such as the investor mix of AIF commitments and the count of IFSC funds, could not be matched to primary sources. Methodologically, the study is doctrinal and qualitative, so our hypotheses are judged on documentary weight, not statistical tests, and a single person did the coding. With no interviews, our picture of perceived regulatory and tax risk rests on a secondary survey of largely global LPs; the views of Indian institutions, most relevant to H3, are missing. Lastly, the rules are in flux, and reforms from 2025–2026 such as the PFRDA permissions and the RBI Directions are too recent for their effects to be visible.

Future studies could close these gaps in several ways. Panel analysis of manager- or fund-level data could trace how commitments react when institutions gain new permissions. Event studies built around specific reforms (the RBI's December 2023 circular and its July 2025 relaxation, the 2025 Finance Act's classification fix, and PFRDA's December 2025 master circulars) would give causal evidence about which barriers truly bind. Surveys of Indian LPs, insurers, pension funds and banks in particular, would supply the first-hand evidence this paper lacks. With licensed data, comparative studies could also put Singapore, China and the IFSC on the same footing as India when measuring how much private capital each economy uses.

12. Conclusion

India's AIF sector is sizeable and expanding rapidly, yet it remains shallow relative to the economy and to the world's leading private markets. On RQ1, the gap is genuine, but how big it looks depends on the measure. Commitments near 4.9 per cent of GDP exaggerate the money at work, since only about 2 per cent has been called and invested. Yearly deployment, between roughly 1 and 1.5 per cent of GDP, trails US and UK deal values by a wide margin, even allowing for the fact that those figures are not strictly comparable. Domestic managers and LPs, meanwhile, remain few. On RQ2, onshore Category I and II funds no longer face a seriously hostile regulatory or tax regime. What raises the cost and risk of forming funds at home, and tilts foreign LPs toward offshore and IFSC vehicles, is the frequency of rule changes, the number of regulators involved and years of doubt over how fund income is classified. On RQ3, domestic institutions are scarce because pension funds, insurers and banks may invest only small, conditional amounts, and because the capital that does flow comes mostly from HNIs and family offices. Changing this will require ceilings that step up with governance standards, neutral tax treatment and an end to disruptive changes in the rules.

Above all, the paper shows that the barriers are interlinked. The shortage of domestic institutional money is the largest of them, and tax and regulatory uncertainty deepen it, so tackling any one barrier on its own is unlikely to succeed. The most credible path to a private-capital market in proportion to India's economy is a coordinated programme. It would be led jointly by SEBI, the Ministry of Finance, the RBI, IRDAI, PFRDA and IFSCA, and would move in stages from quick administrative fixes to deeper structural reform.

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Appendix A: Regulatory comparison matrix (preliminary coding)

Key: F marks a favourable position, N a neutral one and R a restrictive one, each judged against the median of the six jurisdictions under the Appendix C rules. NC means the author could not confirm the position from the sources collected, so the cell was left uncoded. The grid is a first pass by one coder and is intended for independent double-coding. A dagger (†) indicates jurisdictions coded in part from the author's general knowledge.

Table A1

Preliminary coding of six jurisdictions on eight dimensions

Dimension	India	US†	UK / EU†	Singapore	China†	GIFT City
Fund authorisation	N	F	N	F	N	F
Manager authorisation	N	N	R	N	N	N
Investor eligibility	R	N	N	F	R	N
Leverage and investment restrictions	R	F	N	F	R	N
Reporting and disclosure	N	N	R	N	N	N
Manager obligations	R	N	R	N	N	N
Tax treatment of the fund	N	F	N	F	NC	F
Tax treatment of investors	N	N	N	F	NC	F

Note. The coding is preliminary and illustrative. India, Singapore and GIFT City cells rest on the sources behind Tables 2 and 3, while other cells rely partly on general knowledge. The grid is not a scored index and should not be aggregated.

Appendix B: Data sources, definitions and retrieval log

Table B1

Data sources and definitions

Metric	Definition	Source	Period	Retrieved
M1 to M3	AIF commitments raised, funds raised and investments made, INR trillion (net basis for funds raised and investments)	SEBI AIF statistics (SEBI, 2026) as reported by Business Standard (2026a) and Cafemutual (2026a, 2026b, 2026c)	Dec 2024 to Jun 2026	7 Oct 2026
GDP (India)	Provisional nominal GDP, INR 346.36 lakh crore	MoSPI (2026), reported by Outlook Business	FY 2025–26	7 Oct 2026
M4 (India)	Annual PE-VC investment or deployment, USD billion: 36, 44 and 60.7	Bain & Company and IVCA (2026a); McKinsey & Company (2026); EY-IVCA via Entrepreneur India (2026)	Calendar 2025	7 Oct 2026
M4 (US, UK)	PE deal value (US plus VC deal value), USD	PitchBook (2026); Fortune (2026); KPMG (2026)	Calendar 2025	7 Oct 2026
GDP (comparators)	Nominal GDP, USD: India 4.125 tn, US 30.616 tn, UK 3.959 tn	IMF WEO October 2025 (IMF, 2025), values as compiled by third-party statistics site	Calendar 2025	7 Oct 2026
M5	Funds raised divided by commitments raised	Derived from M1 and M2	Mar and Jun 2026	n.a.
M6	Domestic investors' share of funds raised, Category I and II AIFs	Practitioner reports of SEBI data (Treelife, 2026a; MNCL, 2026)	Mar 2024; Sep 2025	7 Oct 2026
M7	Domestic GPs' share of PE deployment	McKinsey & Company (2026)	2023–25	7 Oct 2026
Legal texts	Statutes, regulations, directions and master circulars	See Appendix D	Various	7 Oct 2026

Note. All retrieved on 7 October 2026. Secondary-source figures should be verified against primary releases before submission.

Appendix C: Coding scheme and decision rules for the doctrinal-comparative analysis

This study did not collect interview data, so no interview protocol is included. The coding scheme below governs the doctrinal analysis in Sections 6 and 7 and Appendix A.

Table C1

Decision rules for coding

Dimension	Favourable (F)	Neutral (N)	Restrictive (R)
Fund authorisation	No approval of the fund vehicle; notification only	Registration or filing with a defined short timeline	Prior approval or comment process of indefinite or long duration
Manager authorisation	Exemptions for small or specialist managers	Registration with proportionate conditions	Full licensing with substantial capital and personnel conditions
Investor eligibility	Defined by sophistication, with low or no minimum ticket	Sophistication test plus moderate minimum ticket	High minimum ticket or narrow permitted categories
Leverage and investment restrictions	Set by contract	Disclosure-based with some limits	Statutory caps and concentration limits
Reporting and disclosure	Light, event-based	Periodic regulatory returns	Frequent, detailed, multi-regulator reporting
Manager obligations	General fiduciary duty	Defined conduct requirements	Prescriptive requirements on remuneration, depositary or due diligence
Tax treatment of the fund	Tax-neutral or exempt for qualifying funds	Pass-through with some conditions	Fund-level tax or significant uncertainty
Tax treatment of investors	Neutral with simple compliance	Neutral with moderate compliance	Complex compliance or uncertainty of characterisation

Note. Each rule is judged against the six-jurisdiction median, and unclear cases receive N with a flag. A second coder should apply the rules separately, with any differences settled through discussion.

Appendix D: SEBI, RBI and other instruments used

Table D1

Legal instruments cited in the analysis

Date	Instrument	Subject
21 May 2012	SEBI (Alternative Investment Funds) Regulations, 2012 [†]	Base framework: Categories I, II and III
Finance Act 2015	Section 115UB, Income-tax Act, 1961	Pass-through for Category I and II AIFs
20 Jul 2024	Amendment to AIF Regulations, with circular of 19 Aug 2024	Migration of legacy venture capital funds to Category I; period extended to 19 Jul 2026
19 Dec 2023; 27 Mar 2024	RBI circulars on regulated entities' investment in AIFs	Restrictions on investment in AIFs with downstream debtor exposure; later replaced
8 Oct 2024	SEBI circular on due diligence in AIFs	Measures supplementing RBI evergreening rules (as described in Chambers, 2025)
2025 (Finance Act)	Amendment to section 2(14), Income-tax Act, 1961	Securities held by investment funds are capital assets, AY 2026–27 onward
29 Jul 2025	RBI (Investment in AIF) Directions, 2025	10% individual and 20% aggregate caps on regulated entities
8 Sep 2025; 9 and 10 Sep 2025	SEBI (AIF) (Second Amendment) Regulations, 2025; circulars	Co-investment schemes; angel fund framework
18 Nov 2025; 8 Dec 2025	SEBI (AIF) (Third Amendment) Regulations, 2025; circular	Accredited Investors Only Funds; LVF minimum from ₹70 crore to ₹25 crore
Dec 2025	PFRDA master circulars on investment guidelines	Category I and II AIF access for NPS schemes
1 Apr 2026	Income-tax Act, 2025	Replaces the 1961 Act; section 224 mirrors section 115UB
10 Jul 2026 (in force 14 Jul 2026)	SEBI (AIF) (Second Amendment) Regulations, 2026	First-scheme fee waiver; 10-working-day filing; AIOF exemption from SEBI comments
2022	IFSCA (Fund Management) Regulations, 2022 [†]	Fund management framework in GIFT City

Note. Compiled from the sources cited in the text. [†] Date or detail from the author's background knowledge; verify against the SEBI or IFSCA primary text.