The Indian Journal for Research in Law and Management
Open Access Law Journal – Copyright © 2026
Editor-in-Chief – Dr. Muktai Deb Chavan; Publisher – Alden Vas; ISSN: 2583-9896

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THE TRANSITION OF ALTERNATIVE INVESTMENT FUNDS (AIFS) FROM TRUSTS TO LLPS: ANALYZING THE 2026 CONVERSION FRAMEWORK AND REMAINING INVESTOR CONFIDENTIALITY FRICTION

~Drishti Shukla

INTRODUCTION

Alternative Investment Funds (AIFs) have now begun to play a significant role in the private capital markets of India, providing investments into start-up businesses, infrastructure, private equity and venture capital, distressed assets and other niche investment avenues.[1] Acknowledging these difficulties, the regulatory changes included in 2026 have provided a clear framework for converting eligible AIFs from trusts to Limited Liability Partnerships (LLPs).[2]

THE TRADITIONAL TRUST STRUCTURE OF AIFS

Trusts have been the preferred mode of formation of AIFs in India since the SEBI (Alternative Investment Funds) Regulations, 2012 were introduced.[3] Generally, a trust-based fund has the following components:

- An employer setting up the fund.
- A trustee who has the legal title to the assets of the fund.
- A person who makes investments as a manager.

[1] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Gazette of India, Extraordinary, Part III, § 4 (May 21, 2012) (India).
[2] Limited Liability Partnership Act, No. 6 of 2009 (India).
[3] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, reg. 3.

- Beneficiaries representing investors.

Separation of ownership and management enables professional fund managers to manage the pooled investments, while the trustees protect investor interests by overseeing the management through their fiduciary role.

THE EMERGENCE OF LLPS AS AN ALTERNATIVE INVESTMENT VEHICLE

Limited Liability Partnership is a hybrid of the characteristics of partnerships and the companies.[4] It offers a separate legal personality along with great flexibility in the governance of its affairs by way of contract.

LLPs have a number of benefits for an investment fund:

- Flexible governance arrangements.
- Simplified decision-making.
- A clearly established right of partners.
- Limited liability protection.

Partnership structures are being increasingly adopted by international investment funds in tax havens like Singapore, U.K. and a number of financial centres, as they offer flexibility without losing regulatory accountability.

UNDERSTANDING THE 2026 CONVERSION FRAMEWORK

The 2026 conversion framework outlines a standardized procedure that qualified trust-based AIFs can follow to convert into LLPs without losing investors' stakes or subjecting itself to regulatory scrutiny.

Typically, the conversion chain consists of:

- Approval from the unit holders according to governing documents.
- Consent of Trustees for transfer of property.

[4] Limited Liability Partnership Act, No. 6 of 2009, §§ 3–14 (India).

- Registration of LLP under relevant corporate law.
- Modification of the fund documents.

This is a mechanism that is more structured and reduces the impact on existing investments, and maintains trust of investors.

GOVERNANCE ADVANTAGES OF LLP-BASED AIFS

One of the main purposes of the conversion framework is the greater efficiency of governance. Trust structures may share authority between a number of distinct entities, which can lead to overlapping authority.

1. GREATER CONTRACTUAL FLEXIBILITY

Management rights, profits sharing, voting rights, the exit mechanisms and dispute resolution procedures can be tailored to commercial needs, rather than being prescribed by the statute.[5]

2. REDUCED ADMINISTRATIVE COMPLEXITY

Unlike trusts, where a number of trustees, sponsors, and investment managers need to coordinate, LLPs have an operational structure that concentrates control. LLPs have an operational structure that centralizes control of the operations, which reduces the delay caused by coordinating between multiple trustees, sponsors, and investment managers.

REGULATORY CONSIDERATIONS DURING CONVERSION

The conversion process provides operational benefits, but there is still full regulatory compliance.

Fund managers need to make sure that conversion does not beget a compromise of:

- Investment objectives.
- Risk management systems.

[5] Limited Liability Partnership Act, No. 6 of 2009, §§ 23–24 (India).

- Investor rights.
- Valuation methodologies.

Despite the legal structure adopted by the fund, SEBI is continuing to exercise supervisory powers.

TAX IMPLICATIONS OF CONVERSION

One of the most important issues associated with the conversion framework was the issue of tax neutrality.[6]

Transfer of fund assets to an LLP presents interesting questions about:

- Capital gains taxation.
- Stamp duty liability.
- Smoothness of tax pass-through.
- Carry-forward of losses.[7]

If there are legislative protections that maintain continuity, then a transfer may not result in a taxable transfer event. But there is confusion about transactions that don't meet the statutory requirements.

THE OTHER OBSTACLE: INVESTOR CONFIDENTIALITY

The confidentiality of the investors maybe the most discussed issue surrounding the 2026 conversion framework, given its operational advantages. Conventional (informal) trust relationships are generally highly private and limit the extent of information that can be made public about the beneficiaries.

While these disclosures have legitimate regulatory purposes based on anti-money laundering, financial integrity and market transparency concerns, investors often raise concerns related to the protection of commercially sensitive information.[8]

[6] Income-tax Act, No. 43 of 1961 (India).
[7] Income-tax Act, No. 43 of 1961, ch. VI (India).

STRIKING A BALANCE BETWEEN TRANSPARENCY AND PRIVACY

A strategy for good regulation needs to be a compromise between two conflicting goals. Financial rules need transparency to stop money laundering, tax evasion, financial abuse, and financial misconduct.[9]

However, uncertainty still remains as to:

- Public disclosures' scope.
- Access to beneficial ownership information.[10]
- Cross-border information sharing.
- Treat investors' agreement in confidence.

Investor confidence would be greatly enhanced with more regulatory clarity.

CHALLENGES THAT CONTINUE AFTER CONVERSION

The conversion framework is an important step forward in regulatory reform, but there are still some issues in practice that need to be addressed. The contractual arrangements with lenders, custodians, portfolio companies and counterparties may have to be renegotiated after conversion.[11]

There are limitations on the provisions included in legacy trust documents that can be easily translated into LLP governance. Other factors such as operating systems, compliance manuals, accounting systems and reporting systems can also undergo significant change.

THE FUTURE OF LLP BASED AIFS IN INDIA

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[8] Prevention of Money-laundering Act, No. 15 of 2003 (India).

[9] Prevention of Money-laundering Act, No. 15 of 2003 (India).

[10] Companies Act, No. 18 of 2013, § 90 (India).
[11] Indian Contract Act, No. 9 of 1872 (India).

The transition to LLP based AIFs is part of India's general efforts to modernize its financial regulatory framework and bring the Indian investment framework in line with international investment frameworks.[12]

When done well, LLPs can offer fund managers greater governance flexibility, more efficient use of resources, more certainty around contracts, and regulatory oversight.

Future reforms will centre on:

- Greater tax certainty.
- Harmonized disclosure standards.
- Digital compliance mechanisms.
- Simplified conversion procedures.

This would make investments in India more attractive in the international market for alternative investments.

CONCLUSION

The circularity framework for 2026 forms a major paradigm shift in AIF regulatory framework in India, allowing the trust-based AIFs to convert to LLP format without the basic investment structure being impacted.

But conversion isn't enough to solve all the legal issues. The biggest sources of contention are privacy of the investors, who value it when it comes to commercially sensitive data and transparency that is being demanded by regulators.

[12] Securities and Exchange Board of India Act, No. 15 of 1992 (India).