



FUNDS



REGULATORY

SEBI Untangles the Exit: New Rules Provide Smoother Path for Closing Investment Funds

AUTHOR Shrishail Kittad, Deepika Shekhawati

PUBLISHED 11 July 2026

The Securities and Exchange Board of India (SEBI) recently introduced a practical solution to a long-standing headache for fund managers: how to close a fund when small legal or tax issues are still hanging over it. New guidelines issued on June 16, 2026, allow **Alternative Investment Funds (AIFs)** to hold onto certain amounts of money for these unresolved liabilities while significantly reducing the paperwork required to stay registered.

This move is designed to end the “*operational gridlock*” where funds were commercially finished but forced to maintain expensive compliance structures simply because a court case or tax audit was not yet finalized.

Table of contents

- [A Realistic Approach to Fund Closure](#)
- [New Rules for Holding Back Cash](#)
 - [Three Scenarios for Cash Retention](#)
- [The Benefits of Inoperative Fund Status](#)
- [Lifting the Paperwork Burden](#)
 - [Exemptions for Inoperative Funds](#)
- [Moving Toward Final Closure](#)

A Realistic Approach to Fund Closure

For years, fund managers faced a difficult situation where all assets had been sold and almost all money had been returned to investors, yet the fund could not legally shut down. Under previous rules, funds had to follow **rigid timelines** to distribute every last rupee and cancel their registration.

However, real-world problems like pending tax reassessments or ongoing lawsuits often take years to resolve. SEBI has now acknowledged this disconnect, providing a clear path for funds to enter a dormant state that matches their actual economic status.

New Rules for Holding Back Cash

The new framework specifies exactly when a fund can keep some cash after its official life has ended. There are three main scenarios where this is allowed.

Three Scenarios for Cash Retention

1. **Official notice or demand:** If a fund receives an official notice or demand from a tax or regulatory authority, it can retain the necessary amount to cover that potential debt.
2. **Anticipated future dispute:** If a manager expects a future dispute but hasn't received a formal notice yet, they can hold back money if they get approval from investors representing at least **75% of the fund's value**.
3. **Winding-up costs:** Funds can retain small amounts to pay for the actual costs of winding up, though this specific type of retention is limited to a maximum of three years.

The Benefits of Inoperative Fund Status

A central part of this update is the creation of the ‘**Inoperative Fund**’ status. Once a fund receives this tag from SEBI, it is essentially put into a “*regulatory sleep*” mode while it waits for its remaining legal issues to clear up.

To protect investors, SEBI has put strict limits on these funds:

- They **cannot launch any new investment schemes**.
- Managers are strictly forbidden from charging any management fees.
- Any cash held back must be kept in very safe, low-risk, and liquid investments to ensure it is available when it is finally time to pay a debt or distribute the remaining balance to investors.

Lifting the Paperwork Burden

The most immediate benefit for fund managers is the **massive reduction in administrative work**. Funds tagged as “Inoperative” are now exempt from many of the most time-consuming and expensive regulatory tasks.

Exemptions for Inoperative Funds

They no longer need to:

- File limited quarterly activity reports.
- Conduct audits of their Private Placement Memorandums.
- Maintain specialized certifications for their investment teams.

Instead of these constant filings, the manager only needs to submit one **Annual Retention Status Report** by April 30th each year. This single report keeps the regulator and investors informed about how much money is being held and the current status of any pending disputes.

Moving Toward Final Closure

These guidelines apply immediately to all current AIFs and even to older **Venture Capital Funds** registered under 1996 regulations. For managers with funds nearing their end dates, the focus now shifts to identifying any remaining “*tails*” of liability and deciding whether to seek investor consent for retaining proceeds.

The goal is to settle all debts as quickly as possible. Once every liability is paid and the fund’s bank balance reaches zero, the manager must distribute any leftover money and officially **surrender the fund’s registration certificate** to complete the winding-up process.

Related Practice Areas

Regulatory & Compliance Advisory