International Finance Services Centre

- CA Paresh P. Shah

1. Introduction:

1.1 Through a series of policy changes and economic reforms, the Government of India has sought to invigorate our financial sector by setting up India's first International Finance Services Centre (**'IFSC')** at GIFT City, Gandhinagar, Gujarat. The aim of establishing and promoting IFSC is to create a world-class financial structure that could rival its counterparts in London, Singapore, Dubai, etc. IFSC seeks to ensure that various sophisticated and complex financial transactions that are currently carried out outside India shall be carried out from the Gift City by the same overseas financial institutions and overseas branches / subsidiaries of Indian financial institutions. It is important and indispensable in the long run that offshore financial transactions are brought onshore not only for their financial implications but also for various strategic purposes. It is also important to bring financial service experts sitting offshore and operating outside India back here so that India can also be promoted as a talent hub.

1.2 A framework for setting up of an International Finance Services Centre (**'IFSC')** is provided under the Special Economic Zones Act, 2005. IFSC has been envisioned as an area for financial service providers to offer financial services / products to customers in foreign currencies. Units or entities in an IFSC are treated as 'persons resident outside India' for the purposes of the exchange control laws of India.

1.3 GIFT City is being developed as a global financial and IT services hub to rival globally benchmarked financial centres. It is India's only approved IFSC, having been demarcated as a Special Economic Zone ("**SEZ**").

1.4 An IFSC caters to customers outside the jurisdiction of the domestic economy. These centres are 'international' in the sense that they deal with the flow of finance and financial products/services across borders which includes banking, insurance, asset management, and a well-structured, fully developed capital market for debt, equities, commodities as well as derivatives.

1.5 The different kinds of business activities that can be undertaken in IFSC include:

i. Aircraft Operating Lease
ii. Alternative Investment Fund
iii. Ancillary Service Provider
iv. Banks

v. Bullion Trading/Clearing Members
vi. Clearing Corporations
vii. Custodian
viii. Depository
ix. Depository Participants
x. Finance Company
xi. Global In-house Centre
xii. Insurance Intermediaries
xiii. Insurance/Reinsurance Companies
xiv. Investment Adviser
xv. Portfolio Manager
xvi. Stock Brokers
xvii. Stock Exchanges

1.6 The special status of IFSC makes it an attractive proposition for pooling and managing global capital by way of Alternative Investment Funds (**‘AIFs’**). All three categories of AIFs i.e. Category I, Category II and Category III can be set up in an IFSC, including fund of funds.

2. Overview of regulatory regime for IFSC:

2.1 The International Financial Services Centres Authority (**‘IFSCA’**) has been established in April 2020 under the International Financial Services Centres Authority Act, 2019 as a unified regulator in order to promote ease of doing business in IFSC and provide world class regulatory environment.

The regulatory powers of the following four financial services regulators in India have been vested in IFSCA with respect to regulation of financial institutions, financial services and financial products in the IFSC making it a unified regulator:

- Reserve Bank of India (RBI),
- Securities & Exchange Board of India (SEBI),
- Insurance Regulatory Development Authority of India (IRDAI), and
- Pension Fund Regulatory Development Authority of India (PFRDAI)

2.2 The process of setting up of a new company or LLP in GIFT City would be subject to Regulation 7 of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 (**‘ODI Regulations’**), in light of the status of entities in IFSCs being of a person resident outside India. Given the nature of fund management activity, under Regulation 7, an Indian party engaged in financial services sector is permitted to set up an overseas joint-venture or a subsidiary subject to certain conditions, including the requirement to procure regulatory NOCs from the relevant financial services regulator in India and overseas.

2.3 For operating as an AIF, a fund is required to procure registration from the IFSCA. AIFs in IFSC are governed by specific guidelines and regulations issued by SEBI for setting up of AIFs in GIFT City. The SEBI (IFSC) Guidelines, 2015 read with the main operating regulations viz. SEBI (Alternative Investment Funds) Regulations, 2012 ("**AIF Regulations**") and the Foreign Exchange Management (IFSC) Regulations, 2015 are the primary sources of regulation for AIFs in an IFSC. Special dispensations have been granted to AIFs in IFSCs to equip them with higher operational flexibility while maintaining tax efficiency. Thus, all extant SEBI regulations applicable to non-IFSC AIFs, unless specifically dispensed for IFSC AIFs, are also applicable to IFSC AIFs.

3. Key Tax benefits for units in IFSC:

The Income-tax Act, 1961 contains the following provisions wherein special benefits, exemptions and deductions are allowed to non-residents dealing with units located in IFSC or to the units located in an IFSC:

3.1 Exemptions under Section 10 to non-residents dealing with a unit of IFSC:

a) Section 10(4D): Income of a non-resident being specified fund (i.e. AIF Category III located in IFSC or investment division of an Offshore Banking unit located in IFSC registered as Category-I FPI which has commenced its operations on or before March 31, 2024) -
    i. Transfer of specified securities listed on IFSC exchanges is not treated as transfer as provided in Section 47(viiab). Gains accruing thereon are hence not chargeable to tax in India. Specified securities include Bonds, GDRs, Foreign currency denominated bond, Rupee-denominated bond of an Indian company, Derivatives, Unit of a Mutual Fund, Unit of a business trust, Unit of AIF and Foreign currency denominated equity share of a company;
    ii. Income from transfer of securities (other than shares in a company resident in India) or any income from securities issued by a non-resident (not being a permanent establishment of a non-resident in India) and where such income otherwise does not accrue or arise in India
    iii. Income earned by investment division of Offshore Banking unit (i.e. banking unit of a non-resident) in IFSC from a securitisation trust, which is chargeable under

the head business income, is exempt from tax, to the extent that such income is attributable to such investment division of an Offshore Banking unit in IFSC

b) Section 10(4E): Income of non-resident from transfer of non-deliverable forward contracts entered into with an offshore banking unit of an IFSC referred under section 80LA(1A);

c) Section 10(4F): Income of non-resident by way of royalty or interest, on account of the lease of an aircraft in a previous year, which is paid by a unit of IFSC referred under section 80LA(1A).

3.2 Exemption in respect of Interest on borrowings:
Where a unit located in IFSC has borrowed money on or after 01-09-2019 from a non-resident, interest received or receivable in respect of such borrowings shall be exempt in the hands of such non-resident under Section 10(15)(ix).

3.3 Tax Holiday under Section 80LA:

Where Gross Total Income (GTI) of an assessee, being a unit of an IFSC, includes any income from the business for which it has been approved for setting up in such centre, the assessee shall be eligible to claim deduction under Section 80LA being 100% tax exemption for 10 consecutive years out of 15 years. The IFSC Unit has the flexibility to select any 10 years out of 15 years block.

3.4 No restriction on section 80LA deduction:

An assessee opting for a concessional tax regime under Section 115BAA, Section 115BAC and Section 115BAD are not allowed to claim deductions prescribed under the heading "C.—Deductions in respect of certain incomes" of chapter VI-A. However, a person having a unit in IFSC is allowed to claim deduction under section 80LA even if it has opted for payment of tax at a concessional tax rate prescribed under these provisions.

Similarly, Section 115A provides special tax rates in respect of the certain income earned by a non-resident (not being a company) or a foreign company. However, no deduction can be claimed from such income under Chapter VI-A. A unit of an IFSC is not restricted from claiming deduction under section 80LA from such income.

3.5 Concessional tax rate on transfer of specified securities:
Section 112A and Section 111A provides concessional tax rates in respect of capital gains arising from the transfer of specified securities subject to certain conditions, *inter-alia*, the

transaction being subject to the Securities Transaction Tax (STT). This condition has been relaxed where the transfer is undertaken on a recognised stock exchange located in any IFSC and the consideration for such transfer is received or receivable in foreign currency.

3.6 Tax on dividend:

Dividends declared, distributed or paid on or before 30th March 2020 by a domestic company, being a unit located in IFSC, to its shareholders was not chargeable to tax either in the hands of the company or the shareholders as per provisions of Section 115-O. However, after the abolition of the dividend distribution tax under Section 115-O with effect from 1st April 2020, dividend income distributed by Company in IFSC is to be taxed in the hands of the shareholder.

3.7 Reduced rate of MAT and AMT:

A concessional MAT and AMT rate of 9% shall be applicable to the assessee, being a unit or a company, located in IFSC deriving its income solely in convertible foreign exchange.

3.8 Benefits available to certain specified funds located in IFSC:

3.8.1 Pass-through status to AIFs regulated under IFSC Authority Act, 2019

Category-I and Category-II Alternative Investment Funds regulated under the IFSC Authority Act, 2019 are provided pass-through status under the Income-tax Act as per Section 115UB *read with* Section 10(23FBA) and Section 10(23FBB).

3.8.2 Following benefits are available to certain Category III Alternative Investment Funds and investment division of offshore banking unit, located in IFSC:

a) Exemption in respect of certain income under Section 10(4D) as discussed in Paragraph 3.1(a) above;
b) Concessional tax rates prescribed under Section 115AD;
c) Non Applicability of AMT provisions;
d) Exemption under Section 10(23FF) in respect of income in the nature of capital gains
e) Any income accruing or arising to or received by a unit-holder from such specified fund or on the transfer of units in such fund, shall be exempt from tax under Section 10(23FBC).

3.9 Lower rate of TDS under Section 194LC:

Section 194LC provides for deduction of tax at source at a reduced rate of 4% if interest is payable in respect of monies borrowed from a source outside India by way of issue of any long-term bond or rupee-denominated bond on or after 01-04-2020 but before 01-07-2023, which is listed only on a recognised stock exchange located in IFSC.

3.10 Relaxation from the filing of return of income:

The CBDT has exempted a non-resident or a foreign company from the requirement of filing a return of income if it has any income from any investment in Category-I and Category-II Alternative Investment Fund (AIF) set up in an IFSC located in India subject to fulfillment of certain conditions.

3.11 Relaxation from obtaining or Quoting PAN:

As per Section 139A *read with* Rule 114AAB, a non-resident, not being a company, or a foreign company, shall not be required to obtain and quote PAN subject to fulfillment of certain conditions. One of such conditions is assessee has made an investment in Category-I or Category-II AIFs located in IFSC and income from such investment is the only income.

Similarly, where a non-resident entered into a transaction in a capital asset referred under Section 47(viiab), he shall not be required to obtain and quote PAN subject to fulfillment of certain conditions. One of such conditions is that such capital assets are listed on a recognized stock exchange located in any IFSC.

4. Budget 2022 - Key Announcements & Tax benefits for units in IFSC:

GIFT City is being developed as a global financial and IT Services hub, a first of its kind in India, designed to be at par or above with globally benchmarked financial centres. GIFT's Master Plan facilitates Multi Services Special Economic Zone (SEZ) with International Financial Services Centre (IFSC) status, Domestic Finance Centre and the associated Social infrastructure. "GIFT SEZ Limited" has been formed by Gujarat International Finance Tec-City Company Limited (GIFTCL) for the development of Multi Services SEZ at Gandhinagar with the prime focus being the development of IFSC and allied activities in SEZ.

The purpose of setting up the GIFT City is to develop a world-class smart city that becomes a global financial hub with the development of an IFSC. GIFT City is a central business hub with state-of-the-art infrastructure and first of its kind operational smart city in India. GIFT City is home to domestic and international, financial services and IT/ ITES sectors.

It is the intention of the City to attract the offshore service provider/s who are employed by the Indian multinationals, Overseas Offices of the Indian Residents or their Branches and the International Players who has an appetite for such Services. Also in few cases International Regulator's compliance will also be accepted. A complete treatment available to these service seekers will be established in Gift City under the legal and the regulatory framework.

Thus if one is engaged in the financial Sector then such a unit in the Gift City will also require approval under the regulator's guideline as applicable in their case and if it is engaged in to information Technology Services then they will be subjected to SEZ regulations only.

To bolster activities in IFSC and to promote it as a global financial hub, additional measures have been introduced which should make the IFSC proposition further attractive.

4.1 Tax proposals:

4.1.1 Amendment to Section 10(4E): Currently, exemption is provided to non-residents from income from transfer of non-deliverable forward contracts entered into with an offshore banking unit. It is now proposed to extend the exemption under the said clause to non-residents on transfer of offshore derivative instruments or over-the-counter derivatives entered into with an Offshore Banking Unit of an IFSC, referred to in subsection (1A) of section 80LA

4.1.2 Amendment to Section 10(4F): Similar to exemption from income from royalty or interest on account of aircraft leasing as currently available, it is now proposed to extend the exemption to income earned by a non-resident in the nature of royalty or interest on account of lease of ship from IFSC unit as referred to in sub-section (1A) of Section 80LA, if the unit has commenced its operations on or before the 31st March, 2024. It is also proposed to define "ship" to mean a ship or an ocean vessel, an engine of a ship or an ocean vessel, or any part thereof.

4.1.3 Proposed insertion of new clause (4G) in Section 10: This clause proposes to provide exemption to any income received by a non-resident from portfolio of securities or financial products or funds, managed or administered by any portfolio manager on behalf of such non-resident, in an account maintained with an Offshore Banking Unit, in any IFSC, referred to in subsection (1A) of section 80LA, to the extent such income accrues or arises outside India and is not deemed to accrue or arise in India
Sec 80 LA is the main provision according the benefits to the unit in Gift City, the tax exemption for 10 consecutive financial years out of 15 years as selected by the Unit Holder.

4.1.4 Amendment to Section 80LA(2)(d): In addition to the income arising from the transfer of an asset being an aircraft, income arising from transfer of ships which was leased by an IFSC unit is proposed to be exempted subject to the condition that the unit has commenced operation on or before the 31st day of March, 2024.

4.1.5 Amendment to the Explanation to clause (viib) of Section 56: Presently, specified fund means Category I or Category II AIF which is regulated under the SEBI (AIF) Regulations, 2012. With the setting up of the IFSCA, it is now proposed to provide that specified fund shall also include Category I or a Category II AIF which is regulated under the International Financial Services Centres Authority Act, 2019.

4.2 Other key announcements in FM's speech during Budget 2022 presentation:

4.2.1 World-class foreign universities and institutions will be allowed in the GIFT City to offer courses in Financial Management, FinTech, Science, Technology, Engineering and Mathematics free from domestic regulations, except those by IFSCA to facilitate availability of high-end human resources for financial services and technology. Presently, a large number of Indian students seek education abroad thereby utilizing precious foreign exchange. Availability of world class universities in GIFT City may instead help such students to access quality education from within India and also lead to the development of a large pool of qualified academicians imparting knowledge in India.

4.2.2 An International Arbitration Centre will be set up in the GIFT City for timely settlement of disputes under international jurisprudence. The centre could be on the lines of the Singapore International Arbitration Centre, or the London Commercial Arbitration Centre. Currently, a large number of arbitration cases involving Indian entities or businesses are adjudicated in Singapore, London or similar which could instead utilize the services of the proposed International Arbitration Centre. This development would also usher in world-class legal services in India and improve India's image as provider of best-in-class arbitration services.

4.2.3 Services for global capital for sustainable & climate finance in the country will be facilitated in the GIFT City. This is going to provide further thrust for 'Green Finance' at the IFSC. Climate finance refers to local, national or transnational financing, drawn from public, private and alternative sources of financing, which seeks to support mitigation and adaptation actions that will address climate change. Major financial resources and large-scale investments are required to significantly reduce emissions. To address this need, the Budget announces the Government's intention to facilitate the presence in IFSC of global players in 'green' projects and climate finance.