

16 July 2021

Attn:

Shri Injeti Srinivas,
Chairperson,
International Financial Services Centres Authority,
GIFT SEZ, GIFT City,
Gandhinagar,
Gujarat - 382355

Dear Shri Srinivas,

Re: ASIFMA-CMTC Submission: Tax issues of operating in IFSC and recommendations for necessary amendments

On behalf of the members of the Asia Securities Industry & Financial Markets Association (ASIFMA)¹ and the Capital Markets Tax Committee of Asia (CMTC)², we are writing to highlight key issues that are being / would be faced by capital market players and investment division of an Offshore Banking Unit from operating in Gujarat International Finance Tec-City (GIFT IFSC) and our recommendations for necessary amendments to overcome such issues.

¹ ASIFMA is an independent, regional trade association with over 145 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

² CMTC is a financial services industry body consisting of a number of banks, investment banks, securities firms and other diversified financial services institutions operating in Asia who are represented through their regional tax directors. The main objects of the CMTC, according to its Constitution, are "to provide a forum for discussion by corporate tax managers responsible for the tax affairs of investment banks, securities firms, banks and other diversified financial services institutions of topical taxation issues in Asia affecting their capital and securities markets and similar activities; ... to keep members informed of up to date information on taxation matters affecting capital and securities markets, and to exchange views on the technical analysis thereof; [and] to represent the interests of its members through acting as the respected voice of investment banks, securities firms, banks and other diversified financial services institutions, and to participate in liaison or advocacy activities on tax matters either directly or indirectly through representation with other groups or societies concerned with or by fiscal matters."

We have attached herewith our submission/ representation on the following key aspects/ issues:

1. Reduction in rate of taxation for interest income in GIFT IFSC for an investment division of an Offshore Banking Unit and Category III AIF;
2. Exemption of dividend income for shareholders of an IFSC company and relax withholding tax requirement;
3. Non-applicability of General Anti-Avoidance Rules provisions for units in the GIFT IFSC including global-in house units;
4. Exemption from applicability of stamp duty for AIF in GIFT IFSC;
5. Allowing Category III AIFs in GIFT IFSC to undertake short sale/ day trading of securities
6. Clarification on permissibility of Category III AIF to trade securities listed on overseas exchange and its characterization;
7. Relaxation in withholding tax requirement on payments made to GIFT IFSC unit claiming tax holiday;
8. Exemption for investors in Category III AIF set-up in GIFT IFSC from filing of return of income and lender to AIF from obtaining PAN and filing of return of income;
9. Clarification that investors investing directly or indirectly in Category III AIF located in GIFT IFSC are exempt from indirect transfer provisions;
10. Directions for OBUs intending to operate as an FPI;
11. Concessional tax rate of 5% on interest income available to FPIs and foreign lenders on interest income should be extended to AIFs set-up in GIFT IFSC; and
12. Need for relief to OBUs and other units in IFSC set up in IFSC from withholding obligation on ODI transactions

ASIFMA and CMTC has been regularly engaged with the Government of India on various tax and policy related matters. Our members look forward to the ongoing consultation on these important issues. For further information, please contact Patrick Pang, ASIFMA Head of Compliance and Tax (ppang@asifma.org) and Patrick Donovan, CMTC Chairperson (patrick-j.donovan@ubs.com).

Yours sincerely,



Patrick Pang
Head of Compliance and Tax
ASIFMA



Patrick Donovan
Chairperson
CMTC

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Issue 1: Reduction in rate of taxation of interest income in GIFT IFSC for an investment division of an Offshore Banking Unit (OBU) and Category III AIF

Background

1. The Indian Government has been encouraging financial services players to undertake business activities from GIFT IFSC and to facilitate that, business friendly tax and regulatory environment is being offered.
2. In line with the said objective, it has also incentivized undertaking portfolio investments from GIFT IFSC, *inter-alia*, through an investment division of an OBU set-up in GIFT IFSC.

Thus, foreign banks can now, *inter alia*, undertake the portfolio investments through their OBU set-up in GIFT IFSC.

Current tax regime on interest income earned by foreign banks being an FPI outside of GIFT IFSC

3. Presently, the interest income earned on investments made by foreign banks under the portfolio investment route, in Indian debt markets, is taxable at the beneficial rate of 10%¹ under the DTAA's entered into with major investing countries like USA, France, Hong Kong, Singapore, etc.

Tax regime on interest income for foreign banks through an OBU in IFSC under the Act

4. As per section 115AD of the Act, interest income earned by specified fund (which includes an investment division of an OBU making FPI investments from GIFT IFSC) is taxable at the rate of 10.92%² on a gross basis.

No tax concession on interest income earned by OBUs on investments made under FPI route

5. As can be noted from the above, section 115AD of the Act provides the rate of 10.92% on interest income for OBUs in GIFT IFSC for the FPI investments in debt securities as opposed to the present tax rate of 10% which some of these foreign banks are eligible for under the respective tax treaties where they continue to make investments from such foreign jurisdictions.

¹ For the purposes of our discussion in this note, we have not considered the concessional rate of 5% (plus applicable surcharge and cess) prescribed under section 194LD of the Act (which is available until 30 June 2023) for FPI investors on interest income on certain specified cases, being a uniform rate applicable to all investors.

² Highest applicable surcharge rate (i.e. 5%) and health and education cess (i.e. 4%) applicable to a foreign company has been considered

6. As you would appreciate from above, from a tax rate perspective, there is no incentive for foreign banks, being investment division of an OBU, to shift their portfolio investment activities from foreign jurisdiction to GIFT IFSC. In addition to above, given that most of these foreign banks have well established offices and set-up in foreign jurisdiction they would need to incur additional cost for shifting its investment operations from such foreign jurisdiction to GIFT IFSC which in absence of any tax concession or otherwise will discourage them to do so.
7. Thus, in order to encourage foreign banks to shift their portfolio investment activity especially in debt securities into GIFT IFSC, it is imperative that the tax rate on interest income is further reduced to make it more competitive when compared to the tax rate provided under some of the tax treaties. A reduced tax cost should likely result in an increased investment activity, which would effectively promote higher inflow of foreign funds in the Indian capital markets enhancing both liquidity and tax collection on account increased interest income.

Recommendation

8. In light of the above, in order to encourage foreign banks to shift their portfolio investment activity in GIFT IFSC, it is recommended that the rate of taxation of interest income under GIFT IFSC be reduced to 5% (plus applicable surcharge and cess) for investment division of OBUs as well as for other units in GIFT IFSC (such as Category III AIFs).

Issue 2: Exempt dividend income for shareholders of an IFSC company and relax withholding tax requirement

Background

1. Prior to the Finance Act, 2020, a domestic company declaring, distributing or paying dividends was subject to additional income-tax at the rate of 15% (excluding surcharge and cess) and the said dividend income was not taxable in the hands of the shareholders.
2. To provide tax incentive on dividend income distributed by the units in GIFT IFSC, section 115-O(8) was introduced by the Finance Act, 2016. The dividend declared, distributed or paid by a GIFT IFSC unit was not subject to DDT and also exempt in the hands of shareholders under the Act. The same was in line with the treatment accorded by similar International Financial Centre in Dubai, Singapore, etc.
3. The Finance Act, 2020 provided for the sunset of DDT regime and effective 1 April 2020, the dividend income is taxable in the hands of shareholders. Therefore, the Finance Act, 2020 shifted the incidence of tax from the payer of dividend to the recipient of such dividend.
4. However, due to possible oversight, no specific carve out was made for the dividend income earned by shareholders of the company, being a unit in GIFT IFSC.
5. The operations of GIFT IFSC are at a very nascent stage. At this juncture, the exemption of dividend income distributed or paid by a GIFT IFSC unit, in the hands of shareholders would be very critical.
6. The success of a GIFT IFSC depends upon it being on par with other International Financial Centres located in Dubai, Singapore, etc., where the dividend is not subject to DDT and also exempt from tax in the hands of shareholders.

Recommendation

7. In order to provide tax incentives on dividend income distributed by the units in the GIFT IFSC and to offer a level playing field comparable with offshore financial jurisdictions, the earlier exemption should be restored with respect to dividend income in the hands of shareholder of a company, being a GIFT IFSC unit.
8. Exemption should also be provided from any withholding tax on such dividend income.

Issue 3: Non applicability of General Anti-Avoidance Rules (GAAR) provisions for units in the GIFT IFSC including global-in house (GIC) units

Background

1. GIFT IFSC has been set-up mainly to bring to India all financial services transactions related to India that were till now being carried out from another countries like Singapore, Hong Kong, Dubai and London. It extends to the entire Financial Services spectrum including Banking, Capital Markets, Insurance, Asset Management and other ancillary services.
2. In their developmental role, the IFSCA has been inviting various industry participants to set up a unit in GIFT IFSC. The Act also provides various tax incentives for GIFT IFSC units such as - 10 year tax holiday for units; exemption from transfer of specified securities; concessional rate of MAT/ AMT, etc.
3. However, the Act also contains provisions relating to GAAR wherein taxpayers could be denied tax exemption/ incentives if a transaction (or a step in it) is considered to have been entered into with the main purpose to derive tax benefit.
4. It is possible that one of the main purposes of moving to GIFT IFSC may be the tax exemption (especially given the fact that some business may be moving from Mauritius / Singapore where it enjoys certain tax exemptions).
5. The provisions of GAAR are drafted in wide manner and confers wide discretionary powers on the Indian Revenue Authorities. As a result, there is an exposure that the GAAR provisions can be invoked against taxpayers who have set up a unit in GIFT IFSC and are eligible for tax incentives.

Recommendation

6. As you would appreciate from the above, an exposure to applicability of GAAR brings in uncertainty to the eligibility to tax incentives which are provided by Government to promote GIFT IFSC. To bring certainty on taxability of income of a GIFT IFSC unit, exemption should be granted from applicability of GAAR provisions while claiming the various tax exemptions/ incentives/ deductions as provided under the provisions of the Act for GIFT IFSC units and the investors in such GIFT IFSC units.

Issue 4: Exemption from applicability of stamp duty for AIF in GIFT IFSC

Background

1. As per the Indian Stamp Act, 1899 and the Amendments made to it thereafter, stamp duty is applicable on issuance or transfer of privately placed AIF units (including for an AIF in GIFT IFSC) at prescribed rates.
2. A specific exemption from stamp duty has been provided for transactions which are undertaken on the GIFT IFSC exchange and depositories established in GIFT IFSC. However, as discussed above, there is no specific exemption from stamp duty for units issued and transferred by an AIF in GIFT IFSC.
3. It is pertinent to note that similar International Financial Centre in Dubai, Hong Kong do not have stamp duty.
4. Further, as per the FAQs on the Indian Stamp Act, 1899 Amendments and Rules made thereunder, redemption of mutual fund units are not subject to stamp duty on the basis that the same is not a transfer nor an issue nor a sale. However, the FAQs are silent on non-applicability of stamp duty on redemption of AIF units.

Recommendation

5. In order to provide parity with transactions undertaken on the GIFT IFSC exchange and other foreign jurisdictions, stamp duty should not be applicable on unlisted securities, *inter alia*, privately placed AIF units upon issue or transfer or redemption in GIFT IFSC.
6. Exemption from applicability of stamp duty should also be provided on fund documentation of the AIF executed in GIFT IFSC such as contribution agreements, loan agreements, investment management agreement, etc.

Issue 5: Allowing Category III AIFs in GIFT IFSC to undertake short sale/ day trading of securities

Background

1. Currently, as per the SEBI FPI Regulations, 2019 read with the Operating Guidelines, an FPI is allowed to transact in the securities in India only on the basis of taking and giving delivery of securities purchased or sold (except derivatives; SLB or any other framework specified by the SEBI).
2. Thus, FPIs are not allowed to short sell/ undertake day trading in Indian market which are otherwise permitted for Category III AIF registered with SEBI and domestic companies in the Indian market.
3. A Category III AIF in GIFT IFSC would also be restricted to undertake short sale/ day trading of securities in the Indian market by virtue of the FPI Regulations. This could result in impacting the volume of trading activity of such players in the Indian market.

Recommendation

4. To provide parity to the Category III AIFs in GIFT IFSC, it should be permitted to undertake short sale/ day trading of securities in the Indian market which are presently allowed to Category III AIFs registered with SEBI and domestic companies.

Necessary reporting framework should be formed for designated custodian banks to report all transactions pertaining to short sale/ day trading of securities by Category III AIFs in GIFT IFSC.

Issue 6: Clarification on permissibility of Category III AIF to trade securities listed on overseas exchange and its characterization

Background

1. Regulation 22(3) of SEBI (IFSC) Guidelines, 2015 permit AIF in GIFT IFSC to invest in –
 - i) securities listed on GIFT IFSC;
 - ii) securities issued by companies incorporated in GIFT IFSC; and
 - iii) securities issued by companies belonging to foreign jurisdictions.
2. The Regulation do not expressly permit Category III AIF in GIFT IFSC to trade in securities listed on overseas exchange. The AIF in GIFT IFSC may invest in international markets as part of its investment objectives.
3. Section 2(14)(b) of the Act creates a fiction that any securities held by Foreign Institutional Investor which has invested in accordance with the regulations made under SEBI Act, 1992 shall be considered as 'capital asset'.

Recommendation

4. In order to facilitate unfettered access to securities traded on overseas exchange, clarification should be provided to permit Category III AIF to trade in international markets in addition to GIFT IFSC and Indian exchanges. This would enhance investments and capital market flows between India and other countries.
5. It should be clarified that all investments made by Category III AIF (also a SEBI registered FPI) in securities listed on the GIFT IFSC exchange, overseas exchanges and the Indian mainland exchanges should qualify as a 'capital asset' and thus, gains/ losses from the same should be clubbed being part of one integrated business conducted from an unit in GIFT IFSC i.e. set-off against each other for the purpose of determining total income from Indian income-tax perspective.

Issue 7: Concessional tax rate of 5% on interest income available to FPIs and foreign lenders on interest income should be extended to AIFs set-up in GIFT IFSC

Background

1. Under section 194LD of Act, interest income arising to FPIs from following securities is subject to a lower tax rate of 5% (plus surcharge and cess):
 - Government securities;
 - Corporate bonds where the rate of interest does not exceed 500 bps of the applicable base rate of State Bank of India
2. Under section 194LC of Act, interest income arising to foreign lenders on ECB loans and rupee denominated bonds is subject to a lower tax rate of 5% (plus surcharge and cess) provided the ECB guidelines are met.
3. Though Category III AIFs set up in GIFT IFSC have been extended tax treatment of an FPI with certain additional benefits, the 5% tax rate on interest income has not been extended to them.
4. Unlike foreign lenders, there is no concessional tax rate provided in the Act for Category I and Category II AIF to invest in Indian debt securities.

Recommendation

5. In line with benefits extended to FPIs and foreign lenders, the concessional tax rate of 5% should also be extended to interest arising to AIFs (all categories) set up in GIFT IFSC from their investments in mainland India.

Issue 8: Need for relief to OBUs and other units set up in GIFT IFSC from withholding obligation on ODI transactions

Background

1. Under section 195 of the Act, any person responsible for paying to non-resident, any interest or any other sum chargeable to tax, is required to deduct tax at source at rates in force.
2. In terms of section 5 and section 9 of the Act, the following income of non-resident is taxable under the Act:
 - Income accruing or arising in India or deemed to be accrue or arise in India;
 - Income received or deemed to be received in India
3. Where an FPI entity set up outside India enters into a ODI contract with another non-resident, there is no need for such FPI entity to withhold taxes since the income of the ODI subscriber does not accrue or arise in India and nor is it received in India. Also, such income of non-resident is also not deemed to accrue or arise or received in India.
4. If an FPI entity set up in GIFT IFSC enters into an ODI contract with a non-resident, there is a possibility of the income of non-resident being regarded as accrued or arisen in India. If that is so, the FPI entity set up in GIFT IFSC would need to withhold tax on such income under section 195 of the Act and non-withholding would render such FPI to be “assessee in default” under the Act and the tax, interest and penalties would devolve on the FPI.
5. Likewise, the ODI subscribers entering into ODI contracts with OBUs and other units set up in GIFT IFSC would be exposed to Indian tax implications.
6. Unlike foreign lenders, there is no concessional tax rate provided in the law for Category I and Category II AIF to invest in Indian debt securities.

Recommendation

7. In line with benefits extended to FPIs set up outside India in respect of ODI transactions with another non-resident, there should be no need for OBUs and other units set up in GIFT IFSC to withhold taxes on income from ODI transactions under section 195 of the Act.

Issue 9: Relaxation in withholding tax requirement on payments made to GIFT IFSC unit claiming tax holiday

Background

1. As per section 80LA of the Act, income of a unit in a GIFT IFSC from its approved business shall be entitled to a tax holiday of 100% of such income for any 10 consecutive years [at the taxpayer's option], out of 15 years, beginning from the year in which permission was obtained.
2. Even though business income is eligible for 100% deduction for the GIFT IFSC units, payment made to such GIFT IFSC unit are subject to withholding tax [e.g. where an AIF pays investment management fee to AIF manager set-up in GIFT IFSC, the AIF would be required to undertake withholding tax obligations in the absence of any specific carve out under the Act].
3. This leads to an increase in compliance burden and working capital constraints for the GIFT IFSC unit who may need to apply to the income-tax department for a nil withholding tax certificate under section 197 of the Act or claim the withholding tax as refund even though the business income is eligible for 100% deduction as explained above.

Recommendation

4. In order to avoid onerous compliance burden on the GIFT IFSC units and smooth business functioning, payment of any income to GIFT IFSC units being eligible for deduction under section 80LA should not be subject to withholding tax under the provisions of the Act.

Issue 10: Exemption for investors in Category III AIF setup in GIFT IFSC from filing of return of income and lender to AIF from obtaining PAN and filing of return of income

Background

1. Under the Act, Category III AIFs in GIFT IFSC are subject to fund level taxation. Also, as per section 10(23FBC) of the Act, any income accruing or arising to or received from the Category III AIF in GIFT IFSC or on transfer of its units is exempt from tax in the hands of investors.
2. Tax on the investors' income is already collected by way of payment of taxes by a Category III AIF in GIFT IFSC. As a result, there is no tax revenue leakage for the Indian Revenue Authorities.
3. The CBDT vide its Notifications³ has exempted non-resident investors of a Category I and II AIF located in the GIFT IFSC, from the requirement of obtaining PAN and filing return of income in India, subject to fulfilment of certain conditions.
4. Recently, the CBDT vide its Notification⁴ has granted an exemption to eligible foreign investors investing in the specified securities and non-resident investors/ unit holders of Category III AIFs located in the GIFT IFSC from the requirement of obtaining a PAN subject to satisfaction of prescribed conditions. However, the Notification does not extend the exemption to such investors from filing of return of income in India.
5. Further, non-resident entities lending to the AIF in GIFT IFSC should also be granted an exemption from the requirement of obtaining PAN and filing return of income in India since the interest income earned by such lenders would be exempt under section 10(15)(ix) of the Act.

Recommendation

6. In order to provide a level playing field and tax parity amongst the Categories of AIF, an exemption from filing of return of income should be granted to non-resident investors of Category III of AIF in GIFT IFSC who do not have any other India sourced income. Similarly, non-resident lenders to a Category III AIF in GIFT IFSC should be granted an exemption from obtaining PAN and filing return of income if such lender does not have any other India sourced income.

³ Notification no. 58/2020 dated 10 August 2020 for PAN and Notification no. 55/2019 dated 26 July 2019 for return of income.

⁴ Notification no. 42/2021 dated 4 May 2021

Issue 11: Clarification that investors investing directly or indirectly in Category III AIF located in GIFT IFSC are exempt from indirect transfer provisions

Background

1. Under the provisions of clause (i) of sub-section (1) of section 9 of the Act, transfer of shares or interest in an offshore company which derives, directly or indirectly, its value substantially from the assets located in India could be subject to indirect transfer provisions in India. This could give rise to debate on whether transfers at offshore level could be taxable in India on the basis of indirect transfer provisions.
2. Category III AIF in GIFT IFSC are subject to fund-based taxation and its investors are exempted from tax on any income accruing or arising to or received from the Category III AIF or on transfer of its units. Since, the tax is being recovered at the fund level, the same income should not be taxed again to the non-resident investors at the offshore level on the basis of indirect transfer.

Recommendation

3. As per CBDT Circular⁵, non-resident investors investing in a Category I or II AIFs in India have been exempted from indirect transfer provisions on account of redemption or buyback of its share or interest held indirectly (i.e. through upstream entities registered or incorporated outside India) in the Category I or II AIF, if such income accrues or arises from or in consequence of transfer of shares or securities held in India by Category I or II AIF and such income is chargeable to tax in India.
4. Further, the non-resident investors investing directly or indirectly in the Category I FPI are outside the purview of indirect transfer provisions.
5. In order to avoid confusion and uncertainty and to bring parity, it should also be clarified that the investments made by non-resident investors, directly or indirectly, in the Category III AIF located in the GIFT IFSC shall not be subject to the indirect transfer provisions.

⁵ CBDT circular dated 28/2017 dated 7 November 2017

Issue 12: Directions for OBUs intending to operate as an FPI

Background

1. The IFSCA has issued the International Financial Services Centres Authority (Banking) Regulations, 2020 [IFSC Banking Regulations] on 18 November 2020 laying the framework for banks to set-up units in GIFT IFSC.
2. As per para 13(7) of the IFSC Banking Regulations, a banking unit (including an investment division of an OBU) may operate as an FPI in the GIFT IFSC without a separate registration if the parent bank of the banking unit is registered with SEBI as an FPI. For this purpose, the investment division of OBU would be required to file an intimation with the IFSCA in the prescribed form and manner.
3. Further, the IFSCA vide Circular⁶ provided instructions and clarifications on circulars issued under the IFSC Banking Regulations. As per point 4(a) of the Annex to the said Circular, it has been provided that detailed directions on banking units acting as an FPI shall be issued separately. In this connection, no directions have been issued at present.
4. Until such guidelines are issued, the investment division of OBU set-up in GIFT IFSC will not be able to operate as an FPI and consequently will not be able to invest in the Indian capital markets.

Recommendation

In view of the above, we request you to kindly issue the detailed directions mentioned in the said Circular to enable an investment division of OBU set-up in GIFT IFSC to commence business as an FPI such that existing OBUs/ proposed OBUs which intend to operate as an FPI can take necessary steps and commence their operations as soon as possible.

⁶ F.No.110/IFSCA/Banking Regulation/2020-21/7 dated 24 December 2020

Glossary

Abbreviation	Full Text
Act	Income-tax Act, 1961
AMT	Alternative Minimum Tax
AIF	Alternative Investment Funds
CBDT	Central Board of Direct Taxes
DTAAs	Double Taxation Avoidance Agreements
DDT	Dividend Distribution Tax
ECB	External Commercial Borrowings
FPI	Foreign Portfolio Investor
FPI Regulations	SEBI (Foreign Portfolio Investor) Regulations, 2019
FAQ	Frequently Asked Questions
GIC	Global-in house
GAAR	General Anti-Avoidance Rules
GIFT	Gujarat International Finance Tech City
IFSC	International Financial Services Centre
IFSCA	International Financial Services Centre Authority
IFSCA Banking Regulations	International Financial Services Centres Authority (Banking) Regulations, 2020
IFSCA Act	International Financial Services Centre Authority Act, 2019
MAT	Minimum Alternate Tax
OBU	Offshore Banking Unit
ODI	Offshore derivative instrument
PAN	Permanent Account Number
Rules	Income-tax Rules, 1962
SEBI	Securities Exchange Board of India
SEBI (IFSC) Guidelines, 2015	SEBI (International Financial Services Centres) Guidelines, 2015
SEBI (AIF) Regulations, 2012	SEBI (Alternative Investment Funds) Regulations, 2012
USA	United States of America

Other tax issues

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Issue 1: Non-applicability of TCS and TDS provisions to an AIF in GIFT IFSC

Background

1. Section 206(1H) of the Act provides that a seller is required to collect tax at source (TCS) from buyer when he receives any consideration for sale of any 'goods' of the value or aggregate of such value exceeding INR 5 million in any tax year. The rate of TCS shall be 0.1% (1%, where PAN is not furnished by the buyer) of the sale consideration exceeding INR 5 million.
2. The term 'seller' is defined as a person whose total sales, gross receipts or turnover from the business carried on by him exceeds INR 100 million during the tax year immediately preceding the tax year in which the sale of goods is carried out.
3. Further, TCS provisions shall not be applicable where the buyer is liable to deduct taxes on the payment being made to the seller and has actually deducted such taxes.
4. Section 194Q of the Act provides that every person (whose total sales/ turnover/ gross receipts from business exceeds INR 100 million during the financial year immediately preceding the financial year under consideration), on purchase of goods, shall now be liable to deduct TDS at the rate of 0.1% (5% in case the seller does not have a PAN) on payments made to a resident seller of a sum exceeding INR 5 million. The said amendment is applicable from 1 July 2021.
5. However, TDS provisions shall not be applicable where:
 - Transaction is subject to TDS under any other provision of the Act; and
 - Transaction is subject to TCS under the provisions of the Act, other than TCS on sale of goods which was introduced from 1 October 2020 [section 206(1H) of the Act].
6. The said provisions have caused a lot of ambiguities. One of the key issues that emanate out of the provisions are the coverage of the term 'goods' as the same is not defined under the Act. If a person relies on Central Goods and Services Tax Act, 2017, then shares and securities may not be treated as 'goods'. However, there is a concern that the Indian Revenue authorities may rely on the definition as per the Sales of Goods Act, 1930 and contend that shares and securities will be covered within the definition of the term 'goods' for TCS and TDS purposes.
7. While the guidelines issued vide CBDT circulars¹ to exclude transactions in securities and commodities traded on recognised stock exchanges or cleared and settled through recognised clearing corporations from the ambit of TCS and TDS provisions was a welcome step to avoid the wide impact of this provision on stock market transactions,

¹ Circular No. 17/2020 dated 29 September 2020 [For TCS] and Circular No. 13/2021 dated 30 June 2021 [For TDS]

the question with regard to the off-market shares and securities transactions and transactions in unlisted shares and securities continues to remain and in fact has been magnified.

8. Further, various press reports have noted that the TCS implications could also arise both at the time of issue as well as redemption of units by an AIF. In this regard, we wish to highlight that issue of units should not be regarded as 'sale' of units as it is a primary subscription of units in the AIF by an investor. Further, redemption of units at the time of distribution of proceeds would be consequent to an underlying transaction of sale/ income generated that would be separately already be covered in the tax net and reported by the AIF/ investors in their return of income. Further, redemption of units results in cancellation/ extinguishment/ destruction of the units and hence, should not be considered as 'sale' of units to be subjected to the provisions of TCS.

Recommendation

9. While the intent of introduction of the TCS and TDS provisions has typically been to facilitate tracking of transactions, this may end up increasing costs as well as the compliance burden and could be chaotic for AIFs to manage.
10. Circular 13 of 2021 clarifies that section 194Q of the Act shall not apply in case of purchase of goods from a seller who is wholly exempt from income tax under the Act, e.g. section 10 entities. Similarly, Section 206C(1H) will also not apply in cases where the buyer is wholly exempt from income tax under the Act. In this relation, we request that it is clarified that the TDS and TCS provisions should not apply to AIFs completely.
11. Notwithstanding the above request and where the same is not acceptable, similar to the FAQs on the Indian Stamp Act, 1899 Amendments and Rules made thereunder wherein it is clarified that redemption of mutual fund units are not subject to stamp duty (on the basis that the same is not a transfer nor an issue nor a sale), it should be clarified that issue and redemption of units by an AIF should not be regarded as 'sale' of goods.

Issue 2: Exemption for AIF in GIF IFSC from furnishing Form 15CA/ CB for distributions to non-resident investors

Background

1. As per section 195(6) read with Rule 37BB of the Rules, any person making a payment (whether or not the sum is chargeable to tax) to a non-resident is required to furnish Form 15CA and Form 15CB, wherever applicable.
2. Given this, it may be construed that the AIF in GIFT IFSC may be required to furnish Form 15CA and Form 15CB² for effecting each distribution to the non-resident investors and lenders. This will lead to an increase in compliance burden for the AIF in GIFT IFSC.
3. The operations of GIFT IFSC are at a very nascent stage and it is only recently that they have started picking up scale. At this juncture, exemption from such compliances which would require substantial time and processes of the IFSC unit would be very critical especially given that the distribution of income to the non resident investors in and AIF and interest payment to lenders is exempt from income-tax.

Recommendation

4. In order to avoid onerous compliance burden on the AIF in GIFT IFSC, remittance of any income from the AIF in GIFT IFSC to non-resident investors and lenders should not be subject to compliance from a Form 15CA/ CB perspective.
5. Arrangements in the form of quarterly/ yearly undertakings with the custody banks in GIFT IFSC may be considered for effecting such remittances to meet with the reporting requirements, if any.

² Form 15CA is a declaration from the remitter detailing the information with regard to the payment being made to a non-resident and Form 15CB is a certificate from an independent chartered accountant certifying the taxability of the proposed payment being made to the non-resident

Issue 3: Rationalisation of MAT rate for units set-up in the GIFT IFSC

Background

1. As per section 80LA of the Act, income of a unit in a GIFT IFSC from its approved business is entitled to a tax holiday of 100% of such income for any 10 consecutive years [at the taxpayer's option], out of 15 years, beginning from the year in which permission was obtained.
2. The present tax concession granted to the IFSC units is lower than what other jurisdictions provide. Dubai provides a tax holiday for 50 years; Labuan has a concessional tax rate of 3% and Singapore grants concessional rate ranging from 5% to 13.5%.
3. The GIFT IFSC unit claiming tax holiday is subject to MAT at 9 percent (plus applicable surcharge and cess) on their book profits. The MAT provision increases the effective tax rate (despite no headline tax considering the tax holiday).

Recommendation

4. It is recommended that the MAT rate applicable to units in the GIFT IFSC be reduced from 9% of the book profits to 5% of the book profits [similar to the MAT rate reduction implemented for Indian corporates]. Further, MAT credit carry forward should also be extended to 20 years.

Issue 4: Relax the condition of "convertible foreign exchange" under MAT/ AMT provisions

Background

1. As per section 115JB(4) read with section 115JC(7) of the Act, where the assessee, is a unit located in a GIFT IFSC and derives its income solely in convertible foreign exchange, MAT/AMT rate shall apply at concessional rate of 9% instead of 15%.
2. GIFT IFSC unit may invest in Indian securities and may earn dividend and interest income which may be paid to its India bank account in Indian rupees.
3. This may result in such units not being able to meet the condition of deriving income solely in foreign exchange. In such a situation, they may have to pay MAT at the full rate instead of the concessional tax rate provided for GIFT IFSC units.

Recommendation

4. The condition of deriving income "solely" in convertible foreign exchange should be relaxed. If a GIFT IFSC unit earns rupee income from permitted business activities as per IFSCA Regulations, it should not result in the unit being subjected to a higher MAT/ AMT.

Issue 5: Clarity on attribution mechanism for income earned by Category III AIF
located in GIFT IFSC

Background

1. Category III AIFs in IFSC are subject to fund level taxation under section 115AD of the Act. Further, any income accruing or arising to or received from the Category III AIF in IFSC or on transfer of its units is exempt from tax in the hands of investors.
2. Section 10(4D) and section 115AD of the Act provides for exemption/ lower tax rates on certain incomes earned by Category III AIF in GIFT IFSC, only to the extent of income that is attributable to units held by non-residents, calculated in the prescribed manner. The computation mechanism for attributing income to the resident and non-resident investors for the purpose of taxation for Category III AIF in GIFT IFSC is yet to be prescribed under the Act.

Recommendation

3. While the new taxation framework for Category III AIFs domiciled in the GIFT IFSC is comparable to taxation regime of Offshore Funds, there is a need to provide clarity on the attribution mechanism for taxing the income earned by the Category III AIF in GIFT IFSC.

Issue 6: Extend the current tax laws of AIFs registered with SEBI to
AIFs registered with IFSCA

Background

1. The current Act provides for a specific tax regime for AIFs which are registered with SEBI.
2. Since the IFSCA Act is now enacted, AIFs set-up in GIFT IFSC shall receive the approval from the IFSCA and not SEBI.
3. This may create certain confusion and uncertainty for the AIFs setup in GIFT IFSC as to determine whether the specified tax regime under the Act shall be extended to such AIFs.

Recommendation

4. In order to avoid confusion and uncertainty, it is recommended to extend the specific tax laws for SEBI registered AIFs to AIFs registered with IFSCA as well.

Issue 7: Non-applicability of debt concentration norms for an AIF in GIFT IFSC

Background

1. FPI investment in debt securities could be made under the general investment route or Voluntary Retention Route (VRR).
2. Under the FPI route, minimum average maturity should be of 1 year. Further, short-term investments by an FPI should not exceed 30% of the total investment of that FPI in that category at any point of time. Short-term investments mean investments with residual maturity up to 1 year. Under the VRR route, minimum retention period is of 3 years, or as decided by RBI for each allotment by tap or auction.
3. Under the normal FPI route, investment by any FPI, including investments by related FPIs, shall not exceed 50% of any issue of a corporate bond (condition not applicable in case of exempted securities). Under the VRR route, FPIs can invest in the entire bond portfolio [except in the case of where the demand for more than 100% of amount offered].
4. In case of unlisted NCDs, there is end use-restriction in relation to investment in real estate business, capital market and purchase of land.

Recommendation

5. Considering the practical difficulty in recognizing 'Short-term investments' by an FPI [since investment held for more than 1 year – can become 'short term in the year of redemption thus qualifying as 'Short term investments'] and appropriate regulations of the fund by the GIFT IFSC, it is recommended that minimum maturity condition should not apply for debt investment by the AIF (licensed as FPIs) in GIFT IFSC. Alternatively, minimum retention period should be relaxed for investments by the AIF in GIFT IFSC.
6. To bring parity with the VRR route (except in cases of where the demand for more than 100% of amount offered), it is recommended that Single/ Group investor-wise limits in corporate bonds should not apply even under the general route (i.e. non-VRR) since it becomes unviable to enter into private debt deals where there is requirement of multiple unrelated investors.
7. Considering that AIF in the GIFT IFSC is regulated by the IFSCA, it is suggested that the end use restrictions should not apply where NCDs/ debt instruments of an Indian entity/ IFSC entity/ overseas entity are subscribed by AIF based in the IFSC (licensed as FPIs).

Issue 8: Relaxation for NRI investment in Category III AIFs

Background

1. As per SEBI FPI Regulations, 2019 read with its Operating Guidelines (cumulatively referred to as 'FPI Regulations'), an application for grant of certificate of registration as an FPI shall not be provided to an NRI/ OCI. NRIs/ OCIs can be constituents of the applicant provided they meet conditions specified by SEBI from time to time.

Recommendation

2. The operations of IFSC are at a very nascent stage. At this juncture, lifting the conditions/ restrictions with regard to investment by NRIs/ OCIs in the Category III AIF in GIFT IFSC (even where the same is considered as an FPI) would be very critical to determine the success of the GIFT IFSC and open avenues for NRI investments in AIF in GIFT IFSC.

Issue 9: A separate tax chapter for GIFT IFSC related provisions

Background

1. Currently, IFSC related sections are scattered at various places in the Act.
2. Taxpayers find it difficult to trace, refer and interpret them.

Recommendation

3. For ease of reference and simplicity of the tax law, it is recommended that a separate chapter should be provided within the Act consolidating all the relevant GIFT IFSC related provisions at one place.

Issue 10: Relaxation from requirement for the AIF to have office space in GIFT IFSC

Background

1. Currently, an AIF requires office space in GIFT IFSC in order to obtain approval from SEZ Authority (Development Commissioner).
2. Post the submission of the SEZ application, Unit Approval Committee meeting also reviews the fulfilment of requirement of the office space within 15 to 30 days of application, post which the final Letter of Approval (LOA) is received from the office of Development Commissioner.
3. Given that AIF is a passive investment vehicle and managed by a Manager, generally, as a global practice, AIF does not require separate office space.

Recommendation

4. In line with the global practice for offshore funds and domestic AIFs, the AIF in GIFT IFSC should not be mandated to obtain separate office space in GIFT IFSC.

Issue 11: Relaxation from requirement of locating the Investment Manager in GIFT IFSC

Background

1. Currently, as per the Operating Guidelines for AIFs in GIFT IFSC dated 26 November 2018, a Sponsor / Manager of an existing AIF in India may act as a Sponsor / Manager of an AIF set up in the IFSC by –
 - setting up a branch in the GIFT IFSC; or
 - incorporating a company or limited liability partnership in the GIFT IFSC.
2. However, Sponsor / Manager to be set up in GIFT IFSC is required to incorporate a company or limited liability partnership in the GIFT IFSC.
3. This creates a hurdle for many offshore fund managers to set-up AIFs in GIFT IFSC as they would have to move or redomicile their entire operations, personnel from offshore jurisdictions to GIFT IFSC.
4. Given that there is relaxation on the domicile of the Fund Manager in many jurisdictions such as Mauritius, Ireland, Luxembourg etc., to manage funds set-up in those jurisdictions, a similar benefit should be extended to manage an AIF set-up in GIFT IFSC.

Recommendation

5. In line with the global practice for offshore fund managers to operate from their home or other jurisdictions, AIF in GIFT IFSC should be allowed to be managed by Manager from outside GIFT IFSC.