Lex Spectrum
Delivering Quality

TRAVERSING GIFT CITY: NEW FINANCIAL HUB

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Introduction

India, recognized as one of the world's rapidly advancing economies and a significant participant in International Financial Services, aims to broaden its global economic and strategic engagements. To facilitate these endeavours effectively, the establishment of a specialized **International Financial Services Centre** (IFSC)[1] is imperative. In April 2015, the Government of India took the proactive step of initiating the development of an IFSC within the **Gujarat International Finance Tec-City** (GIFT City), designated as a **Special Economic Zone** (SEZ). This initiative is geared towards harnessing India's potential in the international financial services sector.

GIFT City IFSC serves as a pivotal location for creating an efficient platform for both inbound and outbound foreign currency transactions. The Government of Gujarat, through its entity **Gujarat Urban Development Company Limited** ("**GUDCL**"), has established **"Gujarat International Finance Tec-City Company Limited"** ("GIFTCL") to oversee the development and implementation of GIFT City. Spanning 886 acres, GIFT City is an integrated development project with plans to construct 62 million sq. ft. of built-up area, comprising 67% commercial space, 22% residential space, and 11% social space.[2]

GIFT City encompasses a favourable **Multi-Service Special Economic Zone** (SEZ) along with an exclusive **Domestic Tariff Area** (DTA).

GIFT DTA

The GIFT DTA has been conceived to promote the domestic market and enable it to capitalize on the development of the GIFT SEZ. The GIFT DTA has been meticulously designed with seamless infrastructure to ensure the comprehensive advancement of GIFT City as a whole. Although units within the GIFT DTA are treated akin to any other Indian entity, it is acknowledged that ongoing discussions aim to provide special tax incentives to such units. Entities operating within the GIFT DTA are empowered to serve the domestic market and engage in domestic (rupee-denominated) transactions, concurrently benefiting from access to the GIFT IFSC. Additionally, such entities can avail the following advantages:

I. **Proximity to the GIFT IFSC:** GIFT DTA units possess a distinctive advantage in establishing operations in close proximity to the GIFT SEZ and the financial ecosystem of GIFT IFSC. The abundance of funds, investment opportunities, and a multitude of service providers accelerates trade and commerce, with spillover effects benefiting the GIFT DTA due to their close proximity and advanced infrastructure.

II. **Benefits under Gujarat IT/ITeS Policy (2022-27):** The Government of Gujarat has promulgated the IT Policy 2022-27, offering incentives to foster growth of IT/ITeS units by incentivizing major operational expenditure categories. These incentives *inter alia* include (i) reimbursement for the employer's statutory contribution under the Employees' Provident Fund; (ii) one-time support for each new and unique job created in the state of Gujarat; (iii) a 7% interest subsidy on term loans or the actual interest paid, whichever is lower, with a cap of INR 1 Crore per annum; and (iv) reimbursement of the entire amount of electricity duty paid to the Government of Gujarat over a five-year period.[3]

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[1] **IFSC in India:** • *In India, an IFSC is approved and regulated by the Government of India under the Special Economic Zones Act, 2005.• Government of India has approved GIFT City as a Multi Services Special Economic Zone ('GIFT SEZ') and has also notified this zone as India's IFSC. • The launch of the IFSC at GIFT City is the first step towards bringing financial services transactions relatable to India, back to Indian shores.* • IFSC unit is treated as a non-resident under extant Foreign Exchange Management regulations.

[2] "***Gujarat International Finance Tec-City***" Available at: https://assets.giftgujarat.in/downloads/Doing+business+at+GIFT+IFSC_booklet.pdf (Last Visit on 22/01/2023).

[3] ***"FAQs on Gujarat IT/ ITeS Policy 2022-2027"***, Available at: https://www.giftsez.com/documents/pagecontent/FAQs-on-Gujarat%20IT-ITeS-Policy%202022-27.pdf (Visit on 22/01/2023).

Overview of IFSC framework

To facilitate the development and oversight of financial products, financial services, and financial institutions situated within the GIFT IFSC in India, the Central Government enacted **the International Financial Services Centres Authority Act, 2019 ("IFSCA Act")**. Under the authority granted by the IFSCA Act, the IFSCA functions as a unified regulatory body and is authorized to wield powers concerning services, products, and institutions within the GIFT IFSC that would typically fall under the purview of the RBI, SEBI, IRDAI, and PFRDA. Furthermore, it is stipulated that the IFSCA shall exclusively exercise all powers exercisable by the respective financial sector regulators (namely, RBI, SEBI, PFRDA, and IRDAI) under their respective acts and regulations insofar as the regulation of financial products, financial services, and financial institutions permitted in the GIFT IFSC is concerned.

Foreign Exchange Management Act, 1999:

Upon establishment in the GIFT IFSC, a financial institution attains the status of a person resident outside India, and transactions between such an entity and another non-resident are not subject to restrictions under the Foreign Exchange Management Act, 1999 ("FEMA"). A financial institution operating in the GIFT IFSC conducts its business in foreign currency, and ordinary course transactions in India are regarded as dealings with a person resident outside India. Recognizing a GIFT IFSC unit as a non-resident for FEMA purposes ensures that investments made by a person resident outside India in a GIFT IFSC unit are exempt from FEMA provisions.

A GIFT IFSC unit is classified as a person resident outside India for FEMA purposes, and any investment made by such a unit in a domestic entity is treated as FDI. Compliance with pricing guidelines, reporting requirements under the Foreign Exchange Management **(Non-debt Instruments) Rules, 2019 ("NDI Rules")** for equity investments, adherence to parameters under the **Foreign Exchange Management (Borrowing and Lending) Regulations, 2018,** and the **RBI Master Direction No. 5** titled '*External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorized Dealers and Persons other than Authorized Dealers*' for debt raised from recognized non-resident entities (collectively referred to as the "**ECB Framework**"), and adherence to parameters under the **Foreign Exchange Management (Debt Instruments) Regulations, 2019 ("FEMA Debt Regulations")** for debt investments by Foreign Portfolio Investors are mandated.

Resident individuals are permitted by the RBI to make remittances under the **Liberalized Remittance Scheme ("LRS")** for investments in GIFT IFSC units in the form of securities, excluding those issued by entities or companies resident in India, subject to applicable LRS conditions.

Banking Sector:

The International Financial Services Centres Authority (Banking) Regulations, 2020 ("IFSCA Banking Regulations") clarify that Indian banks (including those wholly owned by foreign banks incorporated in India but excluding cooperative banks) and foreign banks established outside India are authorized to establish their **IFSC Banking Units ("IBU")** in the GIFT IFSC. IFSCA Banking Regulations provide regulatory flexibilities for IBUs, allowing the maintenance of prudential ratios, such as minimum capital, liquidity coverage ratio, and net stable funding ratios, solely at the parent entity level. With this regulatory flexibility, IBUs can introduce innovative products such as non-deliverable forwards, aircraft leasing and financing, investing in India as **Foreign Portfolio Investors ("FPI")**, and participating in operations on the **International Bullion Exchange ("IBE")**—activities that cannot be directly undertaken in India. The Union Budget for the financial year 2023-2024 has further expanded opportunities in the banking sector in GIFT City by permitting acquisition financing through IBUs of foreign banks, wherein offshore derivative instruments are recognized as valid contracts. India Exim Finserve IFSC Private Limited, a subsidiary of EXIM Bank, has been established in the GIFT IFSC with the aim of enhancing trade refinancing and export competitiveness of Micro, Small, and Medium Enterprises ("MSMEs").

Capital Markets Sector:

The International Financial Services Centres Authority (IFSCA) (Capital Market Intermediaries) Regulations, 2021, hereinafter referred to as the "**IFSCA Capital Market Regulations**," became operative on October 18, 2021, thereby supplanting the SEBI Guidelines. These regulations delineate the regulatory requisites for the registration, obligations, responsibilities, inspection and enforcement pertaining to various categories of capital market intermediaries. Notably, the GIFT IFSC is home to two globally recognized stock exchanges: the IFSC Limited and NSE IFSC Limited. These exchanges, subject to oversight by the IFSCA, offer investors extended trading hours across a spectrum of financial market products, encompassing index and single stock derivatives, commodity derivatives, currency derivatives, and debt securities. The IFSCA Capital Market Regulations align practices in the capital markets within the GIFT IFSC with global standards observed in well-established overseas capital market jurisdictions. Furthermore, registered capital market intermediaries under these regulations are permitted to engage in cross-border business in both Indian and foreign capital markets. Given the advantageous tax incentives and the supportive environment within the GIFT IFSC, various capital market intermediaries have significant opportunities to establish their operations in the GIFT IFSC.

Funds:

The IFSCA (Fund Management) Regulations, 2022, hereinafter referred to as the "**IFSCA Fund Regulations**," establish a comprehensive framework governing diverse fund management activities within the GIFT IFSC. These activities encompass various types of private investment funds, special situations funds, mutual funds, hedge funds, portfolio management services, exchange-traded funds, family offices, **real investment trusts ("REITs")**, and **infrastructure investment trusts ("InvITs")**. The IFSC Fund Regulations introduce a unified registration approach for multiple fund activities, regulating the fund manager rather than the funds themselves. Depending on the type of fund management activities proposed within the GIFT IFSC, an entity must obtain prior authorization from the IFSCA to function as a **Fund Management Entity ("FME")**. To meet substance requirements in the GIFT IFSC, individuals exercising influence or control over the management of the investment portfolio and initiating proposals on portfolio composition must be located in the office of the FME in the GIFT IFSC, with all decision-making flowing from the GIFT IFSC.

The IFSCA Fund Regulations categorize registrations on a risk-based approach, including (i) Authorized FMEs investing through venture capital schemes, (ii) Registered FMEs (Non-Retail) investing through restricted schemes and providing portfolio management services, and acting as investment managers for private placements of investment trusts, and (iii) Registered FME (Retail) capable of launching retail schemes, exchange-traded funds (ETFs), public investment trusts, and undertaking all activities permitted for Authorized FMEs and Registered FMEs (Non-Retail). Venture capital schemes are considered Category I Alternative Investment Funds ("AIFs"), while restricted schemes are divided into three categories similar to Category I / II / III AIFs under the Securities (Alternative Investment Funds) Regulations, 2012 ("SEBI AIF Regulations"), depending on the type of investments sought.

Unlike AIFs, FMEs in the GIFT IFSC can borrow money or engage in leveraging activities without limits, subject to certain conditions. In contrast to domestic Category I and II AIFs, which are restricted in their investments in one investee company, and Category III AIFs, which face limitations on investments in one investee company, FMEs in the GIFT IFSC are exempt from such restrictions. This allows FMEs to function similarly to **Special Purpose Vehicles (SPVs)** and make single investments if the terms of a deal necessitate it. Additionally, amendments to the regulatory and taxation framework facilitate the relocation of offshore funds to GIFT City. For example, the requirement of a continuing interest by the manager or sponsor has been made voluntary in the case of relocating offshore funds to the GIFT IFSC, and tax neutrality has been provided for such relocations.

Insurance Sector:

To elucidate the procedures for registering and conducting the business of insurers and reinsurers within an IFSC under the regulatory ambit of the International Financial Services Centres Authority Act, 2019, the IFSCA promulgated the **IFSCA (Registration of Insurance Business) Regulations, 2021 ("IFSCA Insurance Business**

Regulations"). These regulations supplant the IRDAI (Registration and Operations of International Financial Service Centre Insurance Offices **("IFSC Insurance Offices") Guidelines, 2017**. The IFSCA Insurance Business Regulations are applicable to various entities, including (i) Indian insurers or reinsurers, (ii) foreign insurers or reinsurers, (iii) branch offices of foreign insurers, (iv) public companies or wholly-owned subsidiaries of insurers or reinsurers, insurance cooperative societies, and (v) body corporates incorporated under the laws of any country outside India, excluding private companies.

Subsequently, in 2022, the IFSCA introduced the **IFSCA (Investment by IFSC Insurance Office) Regulations, 2022**, establishing the regulatory framework and processes governing investments in financial and infrastructure assets by an **IFSC Insurance Office ("IIO")** in the GIFT IFSC. As per the IFSCA Insurance Business Regulations, foreign insurers and reinsurers have the option to establish branch offices or subsidiaries as IIOs to conduct insurance or reinsurance business from the GIFT IFSC. Indian insurance and reinsurance companies, including foreign reinsurance branches (FRBs) registered with IRDAI, can also establish branch offices to conduct insurance or reinsurance business from the GIFT IFSC. Importantly, foreign insurers or reinsurers establishing IIOs as branches are not required to maintain onshore assigned capital, as the assigned capital of $1.5 million can be retained in their home jurisdictions. Additionally, no onshore solvency requirement is imposed on IIOs in the GIFT IFSC, as the assigned capital solvency margin must be maintained in their home jurisdictions. IIOs, with a focus on targeting body corporates and high-net-worth individuals, benefit from greater flexibility in terms of market access, investment norms, regulations, and product structures compared to their Indian counterparts.

<u>Listing of equity shares in permissible jurisdictions) Rules, 2024:</u>

The Ministry of Corporate Affairs have notified the Companies (Listing of equity shares in permissible jurisdictions) Rules, 2024 on January 24, 2024. With this the government has formally given effect to the much-anticipated Direct Listing Scheme.

“Direct Listing of Equity Shares of Companies Incorporated in India on International Exchanges Scheme” (the Direct Listing Scheme) is specified in Schedule XI of Foreign Exchange Management (Non-debt Instruments) Rules, 2019. The Scheme provides an overarching framework for issuing and listing of equity shares of public Indian companies on international exchanges in a permissible jurisdiction. Prior to this, Indian companies were not allowed to issue or list equity shares abroad.

As on the date of the notification of the said rules, the permissible jurisdiction is International Financial Services Centre in India and permitted stock exchanges are India International Exchange and NSE International Exchange.

Which all companies allowed under the said Scheme?

(1) All unlisted public companies (subject to certain exceptions as per the rules); and

(2) Listed public companies (SEBI is in the process of issuing the operational guidelines for listed public Indian companies)

This policy initiative extends significant flexibility to public Indian companies, enabling them to access both the domestic market for capital raising in ₹ and the international market at IFSC for capital raising in foreign currency from global investors.

<u>Tax Framework for IFSC:</u>

The GIFT City is proposed and projected to be a taxneutral enclave for businesses. A brief summary of the tax incentives provided in the GIFT City is provided below:

Particulars	Units in IFSC	Investors

<table>
<tr><td>Income-tax</td><td>➢ 100% tax exemption for 10 consecutive years out of 15 years[4];
➢ MAT / AMT @ 9% of book profits applies to Company / LLP as a unit in IFSC. MAT not applicable to companies in IFSC opting for new tax regime;[5]
➢ Dividend income distributed by Company in IFSC to be taxed in the hands of the shareholder.</td><td>➢ Interest income paid to non-residents-
• Monies lent to IFSC units not taxable;
• Long Term Bonds & Rupee Denominated Bonds listed on IFSC exchanges taxable at lower rate of 4%.

➢ Transfer of specified securities listed on IFSC exchanges by a non-resident or Category III AIF located in IFSC not treated as transfer - Gains accruing not chargeable to tax in India;

➢ Specified securities include Bond, GDR, Foreign currency denominated bond, Rupee-denominated bond of an Indian company, Derivatives, Unit of a Mutual Fund, Unit of a business trust, Unit of Alternative Investment Fund and Foreign currency denominated equity share of a company.</td></tr>
<tr><td>Goods and Services Tax</td><td>➢ No GST on services –
• received by unit in IFSC;
• provided to IFSC / SEZ units or Offshore clients.

➢ GST applicable on services provided to DTA.</td><td>➢ No GST on transactions carried out in IFSC exchanges.</td></tr>
<tr><td>Other taxes duties</td><td>➢ State Subsidies – Lease rental, PF contribution, electricity charges.</td><td>➢ Exemption from STT, CTT, stamp duty in respect of transactions carried out on IFSC exchanges.</td></tr>
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<u>Exemptions and Subsidies:</u>

I. <u>Exemptions under the Companies Act, 2013:</u>

(a) CSR provisions not applicable for 5 years from commencement;
(b) Resident director mandatory after first year of incorporation;
(c) Internal audit applicable only if provided in AOA;
(d) No requirement to set up Audit Committee, Nominations and Remuneration Committee;
(e) Limits on Managerial Remuneration not to apply;
(f) IFSC Company can follow same financial year as holding company – No approval required;
(g) EGM at any place within or outside India subject to all shareholders' approval;
(h) Exemption to foreign companies from offering for subscription in the securities, requirements related to prospectus.

II. <u>Special Incentives for IT City / Township, Cloud Ecosystem, Data Centres and R&D institutes</u>

[4] Section 80-LA(1-A) of the Income Tax Act, 1961.
[5] Section 115JB of the Income Tax Act, 1961.

(a)	IT City / Townships-	Capex: One time support of 25% of CAPEX subject to maximum of INR 500m;
(b)	Facilitating infrastructure-	Opex (Rentals): First two years: 50% of monthly rentals subject to a maximum of INR 10k; First three years subsequently: 25% of monthly rentals subject to a maximum of INR 5k;
(c)	Cloud System for CLS-	Capex: One-time support of 25% of eligible CAPEX up to INR 200m;
(d)	Data centre projects-	Capex: One-time support of 25% of eligible CAPEX up to INR 1.5bn Opex: Power tariff subsidy of INR 1/ unit (5 years);
(e)	Establishing R&D institutes-	One-time support of 60% of machinery cost up to INR 50;

III. Other Capex and Opex related subsidies

(a)	Capital Subsidy-	Capital subsidy @ 25% of capital expenditure (one-time) • Upto INR 2000m where gross fixed capital investment by entity exceeds INR 2500m • Upto INR 500m where capital investment is less than INR 2500
(b)	Subsidy for operating expens-	Opex Subsidy @ 15% of operating expenditure (for 5 years) • Upto INR 400m where gross fixed capital investment by entity exceeds INR 2500m • Upto INR 200m where gross fixed capital investment is less than INR 2500m
(c)	Electricity duty reimbursement-	100% Reimbursement of Electricity duty for 5 year
(d)	Reimbursement of Provident Fund contribution by employer-	100% of EPF amount contribution (upto 12%) • 100% for female employees • 75% for male employees
(e)	Interest subsidy-	Interest subsidy (for 5 years) of upto 7% on term loan or actual interest paid, max INR 10 mn per annum
f).	Employment generation incentive-	Reimbursement of 50% of one month employment cost to company (onetime) upto a maximum of INR 50k for men INR 60k for women

LexSpectrum's View

GIFT City has achieved the top position in a recent publication of the Global Financial Centres Index 28 – London, recognizing it as one of the 15 financial centers poised to gain increased significance in the coming years. This ranking serves as evidence of the substantial potential for growth and investment opportunities that GIFT City holds in the near future.

It is crucial to highlight that the Government of India has actively undertaken and continues to implement measures to transform GIFT City into a global business hub. With the Government's proactive involvement, GIFT City currently provides significant incentives and opportunities for investors, and it is poised to offer even more in the future. The Government of India, through the provision of special incentives and exemptions for entities in GIFT City, has aligned the regulatory and business environment at GIFT City with that of leading international financial centers.

The International Financial Services Centres Authority (IFSCA) is consistently evolving by engaging in dialogues and seeking input from industry practitioners, including lawyers and tax advisors. Based on the received feedback, ongoing efforts are being made to refine and adjust the existing framework, aiming to simplify the experience for entities and investors in terms of benefits and opportunities. This ongoing evolution, combined with a dynamic approach to introduce specialized sectors, contributes to the comprehensive and unique nature of the initiative from the Government of India, enhancing the reach and capabilities of GIFT City.

Practice Area: General Corporate

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