Deloitte.

# GIFT IFSC: An Evolving landscape

**29 July 2021**

## Contents:

# What is the route through which you currently invest in Indian securities?

(Select one of the options flashing on the right panel to respond)

# AIFs in IFSC - Journey so far

**01 — March 2015**
SEBI issued regulations for AIFs in IFSC

**02 — January 2018**
AIPAC report submitted to SEBI with recommendations for AIFs in IFSC

**03 — November 2018**
Operating Guidelines for AIFs in IFSC issued by SEBI

**04 — May 2019**
Trust allowed to set-up units in IFSC

**05 — July 2019**
Income from offshore investments by NR investors through Category I or Category II AIF, not taxable

**06 — July 2019**
Exemption granted to NR investors in Category I or II IFSC AIFs from filing income-tax return, subject to conditions

**07 — August 2019**
Permissible investments by AIFs in IFSC expanded and aligned with domestic AIFs

**08 — August 2020**
Exemption granted to NR investors in Category I or II AIF from obtaining PAN, subject to conditions

**09 — September 2020**
New tax framework for Category III AIFs in IFSC

**10 — December 2020**
Relaxation in leverage requirements, co-investment and diversification norms

**11 — February 2021**
Tax neutrality offered to lure offshore funds to relocate in GIFT IFSC

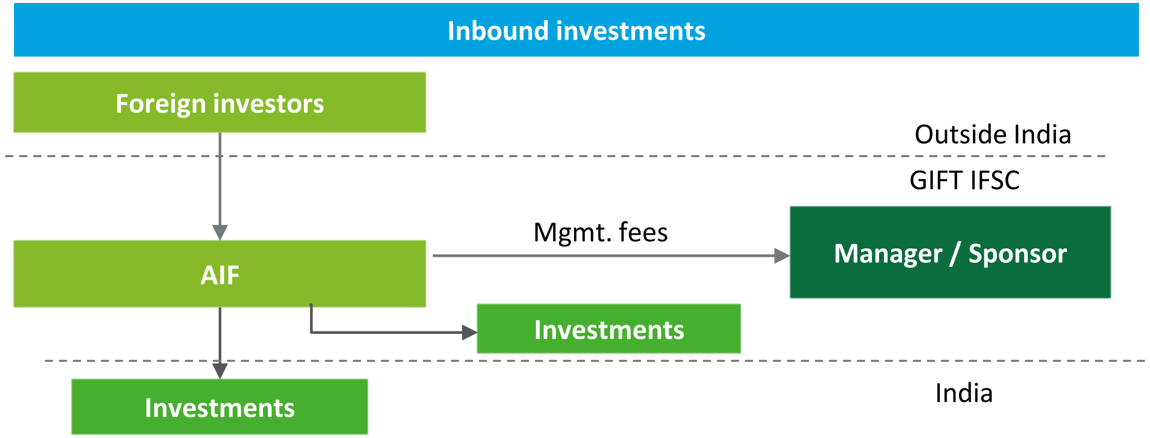
**12 — May 2021**
Exemption granted to NR investors in Category III IFSC AIFs from obtaining PAN, subject to conditions

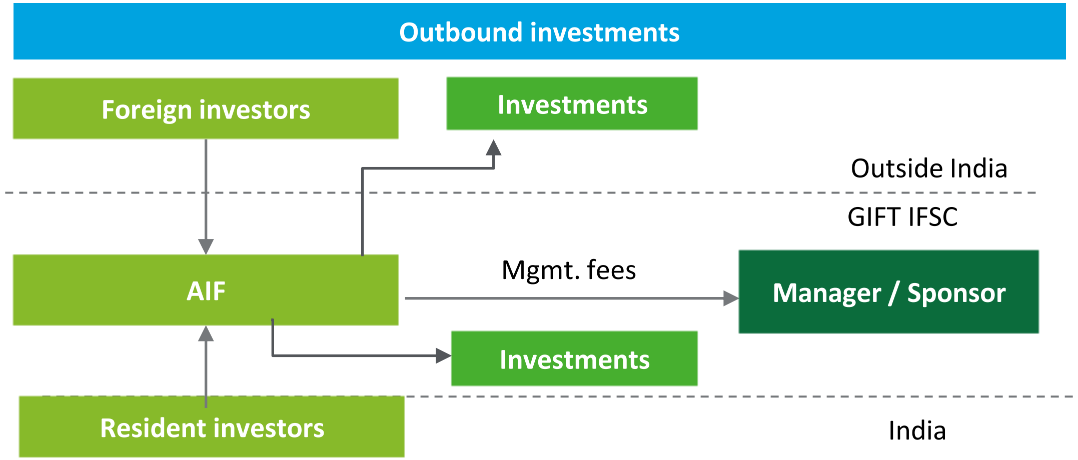
**13 — May 2021**
Indian sponsors permitted to make contribution in AIF under automatic route

**14 — June 2021**
SEBI permits one-time off market transfer of securities by FPI's relocating to IFSC

**15 — June 2021**
Offshore funds relocating to IFSC are exempted from requirement of sponsor commitment in the AIF. This exemption does not apply to new funds being set-up

# Inbound and Outbound investment fund structures

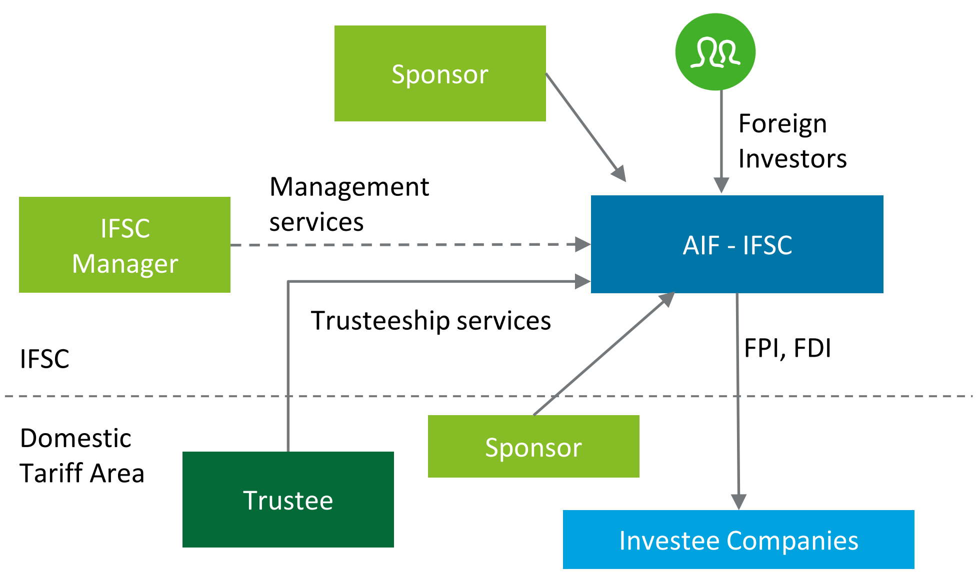


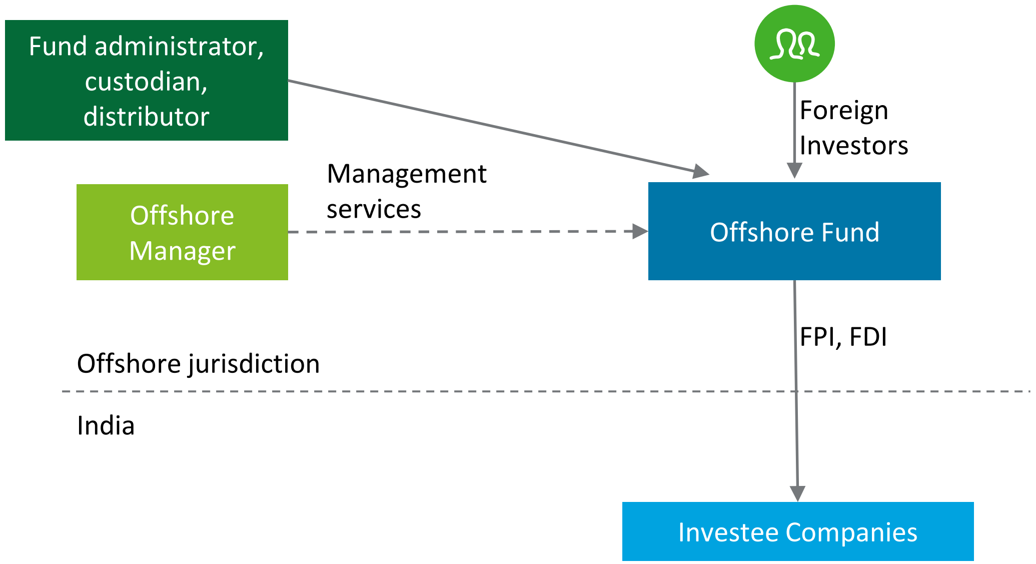

| Parameters | Inbound Investments | Outbound Investments |
|---|---|---|
| **Investment strategy** | • Investments in Indian / foreign securities and securities listed in IFSC | • Investment in securities outside India and listed securities in IFSC |
| **Investor mix** | • Persons resident outside India;<br>• Non-resident Indians and Overseas Citizens outside India<br>• Where Investments in India are made under FPI route, NRI / OCI restrictions prescribed under FPI route will apply | • Persons resident outside India<br>• Institutional investors resident in India under the appropriate exchange control regulations (e.g ODI investments by mutual funds)<br>• Resident individuals in India, under LRS, subject to conditions |
| **Regulatory route** | • Investment in India would be made under FPI / FDI / FVCI route and therefore subject to conditions / restrictions applicable in these routes<br>• If investments are to be made under FPI / FVCI route, requisite registrations would need to be obtained | • No restriction on investment in foreign securities (i.e no condition of India connection and no SEBI approval required as applicable for domestic AIFs) |
| **Sponsor contribution** | • Category I / II AIF – Lower of 2.5% of corpus of USD 750k<br>• Category III AIF - Lower of 5% of corpus of USD 1.5 million<br>• Sponsor contribution by Indian entities permitted under automatic route subject to compliance with ODI Regulations, For instance, having net profit for previous 3 years, registered with the regulator, compliance with capital adequacy prudential norms etc. | |
| **Investment Manager** | • Investment Manager entity needs to be located in IFSC and needs to be registered with as well as regulated by IFSC Authority<br>• Investment Manager entity can be a new company / LLP set up in IFSC or it can be a branch of Indian Investment Management entity | |

# Category III AIF set up in IFSC vs. offshore fund

**Fund set-up in IFSC**




**Fund in popular offshore jurisdictions**




- Funds are prevalently set up as a Trusts and a Trustee is appointed
- Mandatory to set-up Investment Manager entity in IFSC
- Waiver of Sponsor commitment in case of relocation of offshore fund to IFSC
- Appointment of custodian (Cat I/II AIF only if corpus > USD 70 million)
- Cost efficiency in setting-up of fund in IFSC compared to other overseas jurisdictions

- Fund administrator to be appointed in Mauritius
- Funds in popular offshore jurisdictions are set up as a corporate entity
- Appointment of resident director in the Fund in certain jurisdictions
- Manager can be set-up outside home country in certain jurisdictions (E.g. Mauritius, Ireland, Luxembourg etc.)
- No Sponsor commitment
- Required to appoint a custodian, administrator, distributor generally

# Tax exemptions & reliefs - Category III AIFs in IFSC

| Particulars | Key considerations |
|---|---|
| Fund level (where all investors are non-residents) | • Category III AIFs are taxable at the fund level i.e. fund would be regarded as the taxpayer under the Indian tax law<br>• No tax on gains arising from transfer of derivatives, bonds, RETIs / INVITs and any security other than shares of Indian companies<br>• Gains from shares of Indian companies are taxable at domestic Indian tax rates (10%/15%/30%)<br>• No tax on income from foreign securities<br>• No capital gains tax on transfer of specified securities traded on the IFSC stock exchanges<br>• An AIF may explore a position that gains from transfer of equity shares of Indian companies should be regarded as business income and therefore not subject to tax for 10 years under the tax holiday<br>• Concessional tax rate : (a) 10% for dividend and other income from Indian securities;<br>(b) 4% for interest on specified bonds listed on the IFSC stock exchange |
| Income in the hands of foreign investors | • Income exempt in the hands of the foreign investors<br>• No capital gains tax on transfer of units of the fund |
| PAN and Tax Return | • Foreign investors exempt from obtaining PAN in India, subject to conditions. While there is no specific clarity that the non-resident investors are exempt from filing tax returns, investors can choose not to file tax returns since the investors would not have any taxable income |
| Management fee | • Tax holiday for 10 out of 15 years on management fee<br>• Concessional rate of MAT / AMT of 9 percent<br>• MAT not applicable if IM entity is set up as a company and opts for the new concessional tax regime<br>• No GST applicable on services rendered in IFSC |
| Other aspects | • Exemption from STT / CTT / stamp duty in respect of transactions carried out on the IFSC exchanges |

# Why set up a fund in IFSC instead of popular offshore fund jurisdictions

**1**

Category III AIF set up in IFSC would provide capital gains tax exemption on non-equity securities on the same lines as a fund set up in Mauritius, Singapore, Ireland and many other jurisdictions

**2**

Concessional tax rate of 10% on dividend and other income from securities

**3**

GAAR provisions - Substance would be blessed by IFSC Authority

LOB and MLI PPT clauses under tax treaties not relevant

**4**

Moderate to significant cost saving in operating a fund in IFSC as compared to foreign jurisdictions

**5**

Significant tax saving (direct tax and GST) on investment management / advisory fees

**6**

No direct / indirect tax exposure on carry accruing to Investment Manager or Sponsor in IFSC

# Implications on relocation of offshore funds to IFSC

## Original Fund or its wholly owned SPV

- A fund established/incorporated/ registered outside India, which collects funds from its members for investing it for their benefit and:
  - is a non-resident;
  - is a resident of a country or a specified territory with which India has signed a tax treaty or a specified association
  - its activities are subject to investor protection regulations in its home country

**Transfer of assets on or before 31 March 2023**

**Relocation**

**Consideration in the form of shares or units or interest in the resultant fund**

## Resultant Fund

- Fund established / incorporated in India in the form of a trust or a company or a limited liability partnership
- granted a certificate of registration as a Category I/ II or III AIF
- located in IFSC

**Exemption from mandatory Sponsor/Manager commitment**
-Exemption does not apply to new funds set-up in IFSC

**Continuation of grandfathering benefits under the treaties**

**Exemption from capital gains on transfer of capital assets**

**SEBI has permitted off-market free of cost transfer of securities**

**Period of holding of securities of the original fund to continue**

**No requirement to obtain PAN for non-resident investor investing in a fund having only non-resident investors**

**Cost of acquisition of securities to remain unchanged**

# AIFs in IFSC vs domestic AIFs

**Tax certainty**

- Certainty on classification of income arising to IFSC AIF
- No requirement for non-resident investors in IFSC AIF to obtain PAN and file tax returns

**Leverage permitted**

No restrictions on leverage provided:

- Appropriate disclosure in PPM
- Consent of the investors
- Comprehensive risk management framework in in place

**Investments through segregated portfolio and AIFs in India**

- Co-invest in a portfolio company through a segregated portfolio by issuing a separate class of units
- Terms shall not be unfavorable to other investors under common portfolio
- Permitted to invest in an AIF registered with SEBI in India

**Portfolio diversification**

- No investment restrictions in single investee company unlike domestic AIFs
- Domestic AIFs have restriction of 25% of investible funds (Cat. I and II AIFs) and 10% of investible funds (Cat III AIFs)

**Investments in mutual funds**

- Permitted to invest in units of schemes launched by mutual fund from FATF compliant jurisdictions including India

**No restriction on overseas investment**

- No restriction on overseas investments for IFSC AIFs unlike domestic AIFs ( which are subject to conditions like maximum investment of 25% of corpus, USD 1500 million, overseas entity with Indian connection )

**Investment restrictions**

- FPI / FD / FVCI I related restrictions and compliance requirements would apply for IFSC AIF unlike domestic AIFs which are owned / controlled from India

# Service tax ruling on recovery of expenses and carried interest by VCF from contributors 1/2

## CESTAT, Bangalore's ruling in ICICI Econet Internet and Technology Fund & Others [2021-VIL-278-CESTAT-BLR-ST]

**Mutuality of interest between the VCF & Contributors**

- Principle of mutuality is violated as VCF:
  - Involved itself in commercial activities & used discretionary powers to benefit a certain class of investors
  - Paid huge amounts by way of performance fee & carried interest to the AMC/ nominees, thus acting in a manner which was beyond the interest of the contributors
  - Reserved certain powers to utilize the dividends/ profits in a manner which could ultimately benefit entities which are not the contributors
- VCF can hence no longer be treated as a trust for taxation purpose

**CESTAT's ruling**

**Performance fee & Carried interest**

- Any amount retained out of income distributable to subscribers is nothing but charge or fee for services
- Carried interest is neither interest nor return on investment. It is a portion of the consideration retained by the VCF for the services rendered to the investors & is passed on, in the disguise of return on investment to a specified class of investors being the AMC/ nominees
- VCF structure was devised in such a manner that the AMC/ nominees would get huge sums of money in the guise of performance fee or carried interest, with the twin motives of benefitting the AMC/ nominees at the expense of the contributors & avoiding taxes

**Service tax is applicable**

# Service tax ruling on recovery of expenses and carried interest by VCF from contributors 2/2

- Exposure under the Income-tax Act that carried interest may be characterized as ‘Profits & gains of business or profession’ instead of ‘Capital gains’
- Analyze whether GST will apply on all categories of expenses (on application of principles of composite supply) or whether it will apply in respect of categories that are “cash expenses”
- In the latest Budget, specific provision has been inserted retrospectively under GST to do away with the doctrine of mutuality. However, the same has not yet been made effective
- Disclosures in the PPM with respect to risk emanating from the ruling?
- Impact on LLP-employee fund structures?
- Applicability of Transfer Pricing regulations ?

# What is your view on the current regulatory framework in IFSC?

(Select one of the options flashing on the right panel to respond)

# Indian tax implications for fund set up in IFSC vs select offshore jurisdictions

| Type of income | Luxembourg | Ireland | Singapore | Mauritius | IFSC |
|---|---|---|---|---|---|
| Taxability of capital gains on sale of equity shares in India | Taxable | Taxable | Taxable | Taxable | Taxable |
| Capital gains on sale of other securities in India (including derivatives, bonds, AIF units, mutual fund units etc.) | Taxable (since funds don't get access to treaty) | Exempt under treaty | Exempt under treaty | Exempt under treaty | Exempt under Indian tax law |
| Tax on Interest from G-secs and qualifying bonds | 5% | 5% | 5% | 5% | 10% / 5% if section 194LD applies |
| Tax on interest from other securities | 20% | 10% | 15% | 7.5% | 10% |
| Dividend | 20% | 10% | 15% | 15% | 10% |
| Location of fund manager | Can be outside Luxembourg# | Can be outside Ireland# | Singapore (in case of VCC) | Can be outside Mauritius | Mandatorily in IFSC* |
| Risk of litigation under GAAR / MLI | Not applicable | Moderate to high | Moderate to high | Moderate to high | Low |

# in certain jurisdictions

* Law allows either sponsor or manager to be in IFSC

# Setting up of new Fund/Relocation of offshore funds to IFSC

| | |
|---|---|
| 1 | Identification of office space in GIFT City for AIF, Manager and obtaining NOC from GIFT SEZ |
| 2 | Application to SEZ authorities (Development Commissioner, Kandla SEZ) for AIF, Manager and obtain letter of approval |
| 3 | Setting-up Fund entity (Trust, Partnership, Company), Investment Manager entity or a branch of domestic AIF Manager entity |
| 4A | Finalization of Fund documents required as part of application for AIF license such as Private Placement Memorandum (capturing commercials of offshore fund), Form A and relevant documents i.e. Investment Management Agreement, Contribution Agreement (capturing relocation details) |
| 4B | Application for Permanent Account Number |
| 5 | Application to IFSCA for AIF license |
| 6 | Application for FPI license |
| 7 | In case of relocation, existing FPI to approach local custodian for one-time ‘off-market’ transfer of its securities to the resultant Fund |
| 8 | In case of relocation, once the securities are transferred from offshore fund to IFSC fund, surrender of FPI license, winding up of the fund in offshore jurisdiction and intimation of winding up to  Indian tax authorities |

# Open tax issues

| | |
|---|---|
| **Substance requirements** | • Objective conditions currently not codified in law |
| **Multiple schemes for inbound / outbound investments** | • Can an AIF form separate schemes for inbound and outbound investments within the same umbrella Trust |
| **Set-off and carry forward of losses in case of relocation** | • No provision for carry forward of losses from offshore fund to in IFSC fund in relocation |
| **GAAR** | • No carve out provided in GAAR provisions for funds/entities set up in IFSC |
| **Tax on dividend income** | • Investment Management company in IFSC would need to withhold tax on dividends distributed to shareholders since post abolition of DDT regime, no exemption has been extended on dividends distributed by IFSC units |
| **Tax withholding / collection at source** | • Tax withholding may be required by IFSC unit on income paid to non-resident counterparties in relation of offshore derivative instrument contracts (ODI)<br>• In absence of exemption from withholding, IFSC AIF would need to withhold tax on payments made to other IFSC units such as Investment Manager even though such other IFSC units would be covered under tax holiday |
| **Indirect transfer tax** | • No clarity in the law that investors in Category III AIF in IFSC (specified fund) would be exempt from indirect share transfer tax provisions |
| **Tax on interest income** | • Can the AIF set up in IFSC qualify for lower taxes rate of 5% on interest from Indian G-secs / corporate debt securities ? |
| **Section 9A conditions** | • Expected relaxation from section 9A conditions for an IFSC manager managing offshore fund |

# Variable Capital Company structure (VCC)

# Report of the Expert Committee on Feasibility of VCC

## Background

VCCs combine the advantages of the Trust, LLP & Company structures, while dispensing with some of their key limitations

The entities are called: VCCs in Singapore, Open-ended Investment Companies in the UK & Open-ended Fund Companies in Hong Kong

Features of a desirable Fund structure:

- Need for certainty & clarity for investors
- Effective segregation & ring fencing of different pools of asset; ability to issue different classes of shares
- Ability to distribute proceeds from the sale of investments
- Alterations to the funds' capital structure without regulatory approvals
- Freedom to choose the appropriate accounting standards applicable to funds with different characteristics; the ability to wind up quickly
- Maintaining confidentiality of investor information & keeping overall cost low

IFSCA set up the Expert Committee to examine the Singapore VCC structure & suggest a framework for enhancing the competitiveness of the GIFT IFSC. The Committee furnished its report in May 2021

# Recommendations of the Expert Committee

## Incorporation and Sub-funds

- Separate legal identity having capacity to contract, hold property, perpetual succession, ability to sue & be sued
- Variable share capital
- Multiple sub-funds within the VCC
- Separate scheme document & separate class of shares for each sub-fund
- Segregated assets & liabilities for each sub-fund
- No restrictions on Issue, redemption, buy back, capital reduction

## Payment of dividend, Financial statements

- Dividends out of capital & profits
- Separate financial statements to be maintained of each sub-fund

## Mergers Amalgamations, Winding up

- Merger / amalgamation to be based on the scheme document with the approval of majority investors
- Resolution, liquidation, winding up, to be based on the IBC provisions & the scheme document
- Power to Central Government to notify any provision of the Companies Act, 2013, as applicable

## Re-domiciliation and Tax

- Re-domiciliation should be introduced in the IFSC
- Each sub-fund deemed as a separate 'person' - to obtain separate PAN & file separate tax return
- Mergers & acquisitions of VCCs/ sub-funds should be tax neutral

# AIF vs. Proposed VCC

| | Category III AIF | Proposed VCC and its sub-funds |
|---|---|---|
| Structure | Typically set up as a standalone trust which may have multiple schemes that are not freely tradeable | Should be set up as either a standalone fund company or an umbrella fund company having sub-funds structured as public or privately traded sub-fund. The shares of public sub-fund may be listed and freely tradeable |
| Additional scheme (portfolio) or sub-funds | Besides a scheme (common portfolio) of minimum corpus of INR 200 million, can have segregated portfolios subject to disclosure in the Private Placement Memorandum | VCC should be able to set up one or more sub-funds, without the prior approval of the Registrar of VCC. On the creation of new sub-funds, IFSCA should suo-moto intimate about the sub-fund to the Registrar |
| Segregation of assets & liabilities | While AIF documents typically provides for contractual segregation of assets & liabilities in each portfolio, there is still an exposure as the AIF Regulations does not clarify clear segregation of assets and liabilities for each segregated portfolio | VCC should specifically provide for segregation of the assets & liabilities of sub-fund. This means that:<br>• The assets of a sub-fund cannot be used to discharge the liabilities/ claims against the VCC or its other sub-fund<br>• Income accruing to the sub-fund must be distributed to the investors of that sub-fund or re-invested by that sub-fund, & loss incurred by a sub-fund must be absorbed by that sub-fund alone<br>• Each sub-fund is bankruptcy remote from the insolvency proceedings initiated in respect of another sub-fund |
| Nature of securities | Being a trust, it can only issue units | Should be allowed to issue all types of instruments i.e. shares, debentures etc. as may be permitted by its constitution documents |
| Rights of investors | No specific clarity is provided in this respect under the AIF Regulations except for investors' consent for any material changes in the Fund` | Rights will be restricted to the affairs of the relevant sub-fund. investors of the sub-fund should have voting rights only with respect to that sub-fund. In case there are any decisions at the VCC level which could impact all the sub-funds, then the investors of all sub-funds could have voting rights with respect to that decision |
| Separate Fund Manager | No separate Fund Manager is allowed for each scheme or segregated portfolio of the AIF | The VCC Act must allow flexibility for each sub-fund to have a separate Fund Manager, if the responsibility for the conduct of each Fund Manager is undertaken by the VCC (through the directors or its Fund Manager) |
| Income-tax | Tax uncertainty in view of trust taxation principles and technically each scheme is not a separate legal person | There should be tax certainty on classification of income as well as taxability of VCC and the sub-funds. Each sub-fund to be deemed as a separate 'person' and be eligible to qualify as tax resident of India |

# Do you plan to setup presence in IFSC?

(Select one of the options flashing on the right panel to respond)

**Thank you!**

Kindly spare a minute to help us with your valuable feedback for today’s session…

For any queries, please feel free to write to us at intax@deloitte.com