



**International Financial Services Centre  
(IFSC): New financing opportunities in India**  
The Dbriefs India Spotlight series

Bahroze Kamdin / Russell Gaitonde / Vishal Agarwal  
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# Agenda

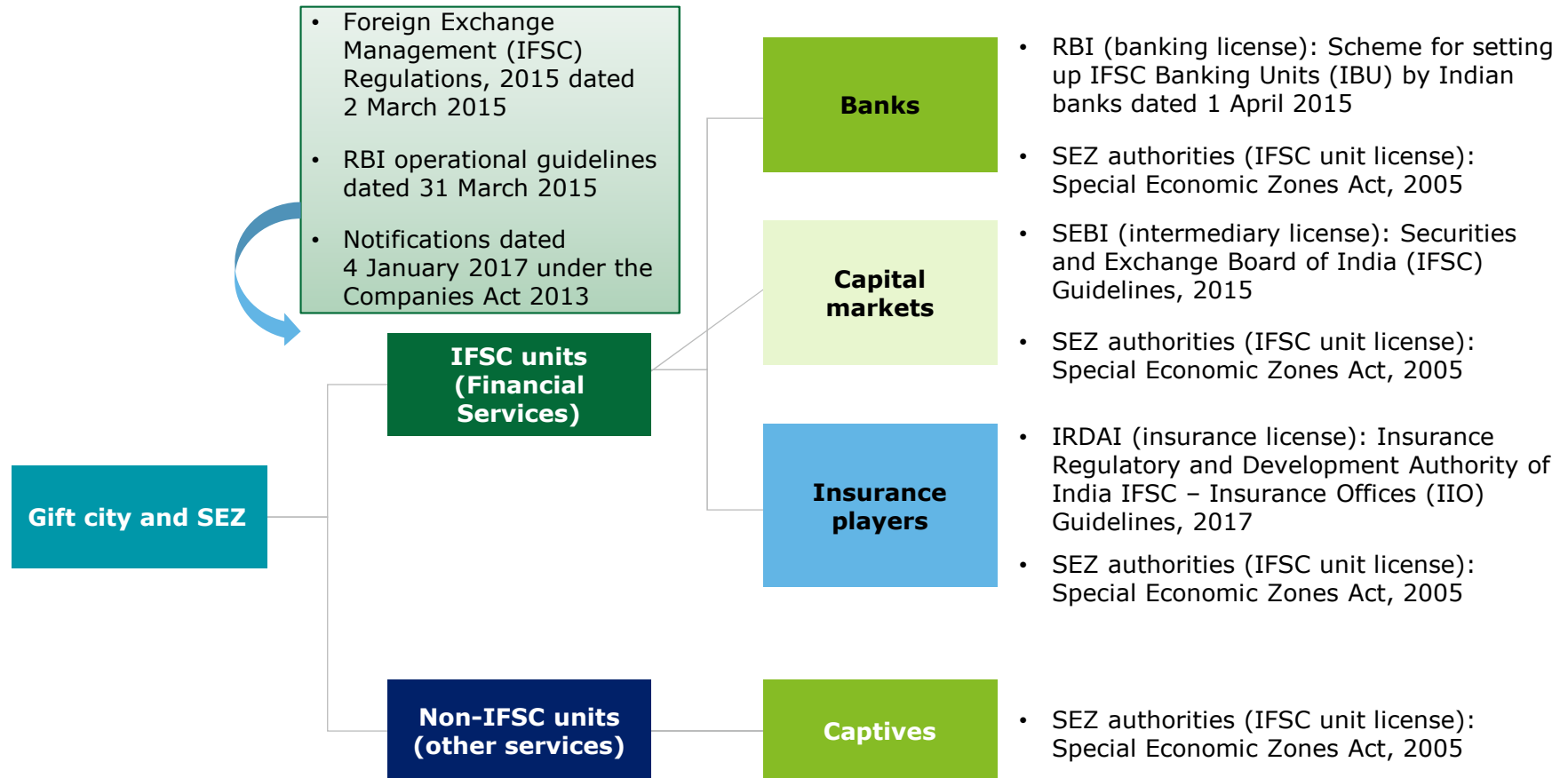
- Background and need for an IFSC in India
- Regulations and tax incentives to international banking units in IFSC
- Regulations and tax incentives to AIF in IFSC
- Concluding remarks
- Questions and answers

# Setting the context

# Background

- **The Special Economic Zones Act, 2005**
- **Report dated 10 February 2007 of the high powered expert committee, ministry of finance, government of India** on “making Mumbai an International Financial Centre”
  - Leader in information technology
  - Hinterland advantage
  - Human capital
  - Location
  - Democracy and rule of law
  - Strong securities markets and advanced trading platforms
- **Finance minister’s speech while tabling the union budget 2015**

# Regulatory framework



# Financial activities in IFSC

<b>Banking</b>	<ul style="list-style-type: none"><li>• Deal with the flow of finance and financial products/services across borders</li><li>• With resident for deployment of funds and with non-resident entities for both raising of resources and deployment of funds</li><li>• Provide banking services to the units of the IFSC</li></ul>
<b>Capital markets</b>	<ul style="list-style-type: none"><li>• Stock and commodity exchanges</li><li>• Clearing corporation</li><li>• Depository</li><li>• Intermediaries (stock broker, sub-broker, merchant banker, underwriter, mutual funds, alternative investment funds, etc.)</li><li>• Fund accounting</li><li>• Investment services</li><li>• Custodial services</li><li>• Trust services etc.</li></ul>
<b>Insurance</b>	<ul style="list-style-type: none"><li>• General/life insurance</li><li>• Co-insurance</li><li>• Reinsurance</li><li>• Captive insurance etc.</li></ul>

# Global financial centres index

Centre	Rank	Rating
New York	1	790
London	2	773
Hong Kong	3	771
Singapore	4	762
Shanghai	5	761
Tokyo	6	757
Beijing	7	748
Dubai	8	740
Shenzhen	9	739
Sydney	10	738
<b>Gift city- Gujarat</b>	<b>66</b>	<b>624</b>

- GFCI 26 compiled covering 114 international financial centres
- Ranking is an aggregate of indices on the five key parameters
  - Business environment
  - Financial sector development
  - Infrastructure factors
  - Human capital
  - Reputation and general factors
- Index provides sub-rankings in the main areas of financial services
  - Banking
  - Investment management
  - Insurance
  - Professional services
  - Government
  - Regulation

Source: The Global Financial Centres Index 26 (GFCI 26)  
(September 2019)

# Key relief for IFSC units

- Reliefs under company law
- Regulatory reliefs to units in IFSC
- Direct tax benefits
  - Tax holiday – 10 year period
  - Income and dividend distribution tax exemption
  - CTT/STT not leviable
  - Capital gains exemption for sale of specified securities on the stock exchange in IFSC
- Indirect tax benefits – customs and GST
- Stamp duty exemptions



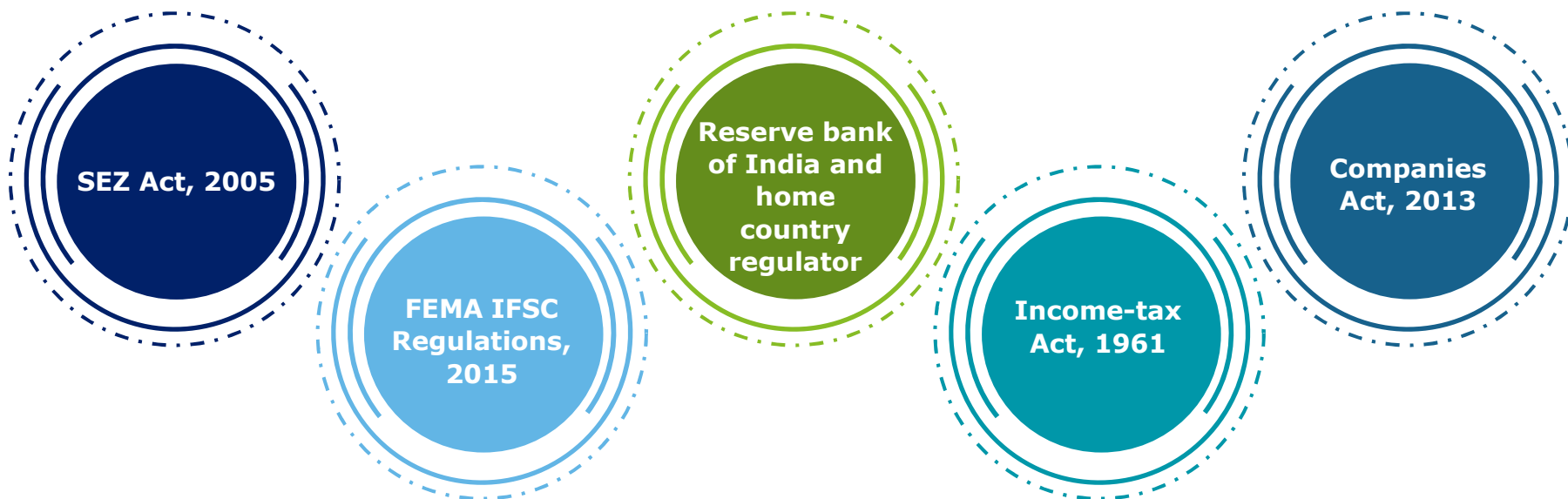
# Polling question 1

Would a foreign company be inclined to do its banking with an international banking unit set up in the IFSC in India?

- Yes
- No
- Partially
- Not sure
- Need to wait and watch

# Banking in IFSC

# Regulatory framework for IFSC – banks



# Banking regulations

## Eligibility criteria

- **Indian banks** – public and private, authorized to deal in foreign exchange will be eligible to set up IBUs
- **Foreign banks** having presence in India will only be eligible to set-up IBUs
- Eligible banks can set-up only **one** IBU in each IFSC

## Licensing considerations

- Indian banks and foreign banks are required to obtain **prior permission of RBI**. Additionally, specific permission from the **home country regulator** to set-up IBUs of foreign banks
- IBU of an Indian bank will be treated at par with a foreign branch of an Indian bank
- Applications of foreign bank will be considered on the basis of the extant **guidelines of setting up a branch in India**. Also, to seek a **regulatory comfort (in writing) from home country's regulator** for banks presence in IFSC, in particular on provisions pertaining to capital and liquidity/LOLR support

## Capital considerations

- Parent Bank to provide **minimum capital of US\$ 20 million or equivalent** in any foreign currency to its IBU
- Regulatory capital to be maintained on an **on-going basis at the parent bank's level**
- Additionally, IBU of a foreign bank to submit a half-yearly certificate confirming the aforesaid, received from the parent to RBI. The parent bank will also be required to provide a letter of comfort for extending financial assistance, as and when required, in the form of capital/liquidity support to IBU. **No liquidity support or LOLR support** will be available to IBUs from RBI
- Need to comply with applicable **prudential norms**

# Banking regulations

## Lending considerations

- The liabilities of the IBU are **exempt from both Cash Reserve Ratio (CRR)** – 4 percent, and **Statutory Liquidity Ratio (SLR)** – 18.5 percent, requirements
- **Credit concentration norms** in case of IBUs
  - 5 percent of parent bank's Tier 1 capital for single borrower
  - 10 percent of parent bank's Tier 1 capital for a borrower group
- Loans and advances of the IBU will **not** be considered for computing priority sector lending obligations
- Deposits of IBUs will **not** be eligible for deposit insurance in India
- The IBUs are **not** allowed to participate in domestic call, notice, term, forex, money and other onshore markets, and domestic payment systems
- The IBUs are required to maintain **separate Nostro accounts with correspondent banks** distinct from those of other branches in India

## Others

- IBU can become a **trading member of an exchange in the IFSC** for trading in interest rate and currency derivative segments subject to conditions
- IBU can become a **professional clearing member of the exchange in the IFSC** for clearing and settlement in any derivative segments subject to conditions
- IBUs will be required to follow **Know Your Customer (KYC), Combating of Financing of Terrorism (CFT) and other Anti-Money Laundering (AML)** instructions issued by the RBI

# Permissible activities

## Source of funds: from overseas only

- Borrowing in foreign currency with original maturity > 1 year
  - From non-residents
  - From overseas branches of Indian banks
- Short term borrowings from banks within prescribed RBI limits
- IBUs cannot raise liabilities from retail customers and HNIs

## Application of funds: to resident and non-resident clients

- ECBs
- Funding of overseas JV/WOS of Indian companies
- Loan syndication
- Buyer's credit
- Factoring/forfaiting of export receivable
- Open foreign currency accounts for units operating in the IFSC and for non-resident institutional investors to facilitate their investment transactions
- Underwriting of INR denominated bonds issued overseas by Indian entities
- Permissible derivative transactions including structured products; RBI approval for offering any other derivative products
- Bank guarantees and short term loans to IFSC stock broking/commodity broking entities subject to prescribed conditions

# Income-tax benefits

## For lenders:

- **Income-tax exemption** on interest income payable by IBU to a **non-resident** for monies borrowed **on or after 1 September 2019**
- Previously, such income was taxable at rates ranging from 5 percent to 20 percent

## For borrowers:

- Borrowers **not required to withhold any tax on interest payments** made to IBU

## For IBUs:

- **Income-tax holiday benefit:** 100 percent tax deduction of income for a period of 10 consecutive years, within a block of 15 years
- **New concessional tax rate benefit:** Indian banks can opt for the concessional 25.17% tax rate, even after claiming the aforesaid income-tax holiday benefit for its IBU
- **MAT concessions**
  - Indian Banks that opt for the aforesaid concessional 25.17% tax rate would **not** be subject to MAT
  - In all other cases, Books Profits of an IBU would be subject to a concessional MAT rate of 9%, until perpetuity
- **Exemption from levy of DDT (20.56 percent) for Indian banks**
  - Indian banks can claim DDT exemption on dividends attributable to the profits earned by an IBU
- **GAAR implications** to be analyzed in relation to Assignment/transfer of loans and activities from an overseas branch to IBU (i.e., inbound), and vice-versa (i.e., outbound) especially towards the end of 10 year tax holiday benefit

# Transfer pricing and indirect tax benefits

## Transfer pricing

- **Domestic TP provisions** could be applicable to the transaction between **Indian bank and IBU** (as the IBU will be claiming tax holiday benefits), if the total value of these specified domestic transactions during a FY exceeds INR 200 million. Accordingly, where applicable, these transactions ought to be undertaken at arm's length
- Transactions between branches of a foreign bank and an IBU of the foreign bank i.e., transaction between two non-residents, will **qualify as an international transaction**. Accordingly, TP provisions will be applicable and the transaction ought to be remunerated at arm's length in accordance with the Indian transfer pricing regulations
- IBU will be required to comply with the requisite transfer pricing compliances

## Indirect tax benefits

- **Exemption from payment of custom duties** in case of import of goods/capital goods for setting-up the IBU
- **Exemption from payment of GST** in case of import of service from the HO or other branches located across the globe
- **Inward supplies for authorised operations to be treated as zero-rated** i.e., GST would not be applicable. This could lead to substantial savings in cost as opposed to a normal bank set-up in the DTA, which has to reverse 50 percent of the input tax credit



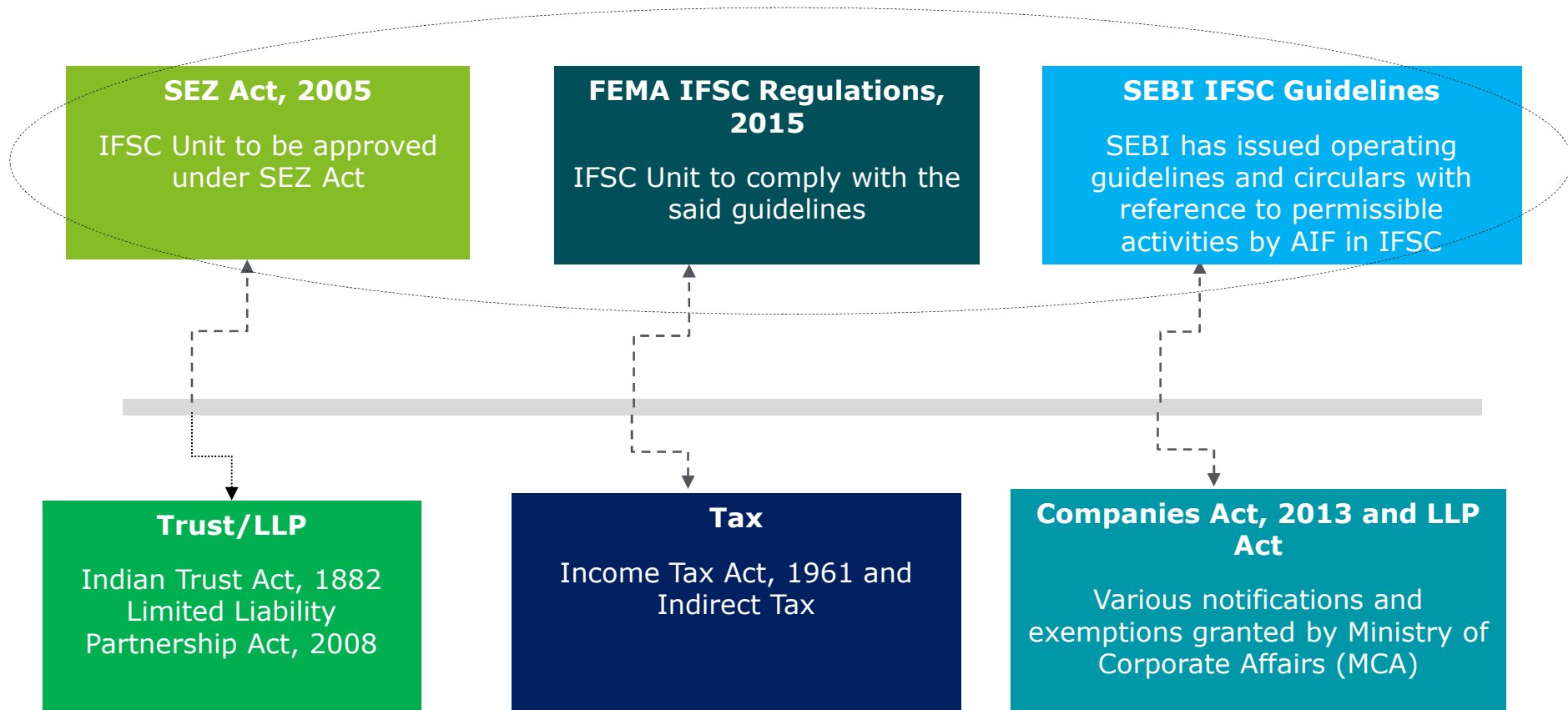
## Polling question 2

Would Indian corporates borrow from IBU rather than from foreign lenders from overseas jurisdictions?

- Yes
- No
- Partially
- Not sure
- Need to wait and watch

# Setting up an AIF in IFSC

# Regulatory framework for Alternative Investment Fund (AIF) - IFSC



# SEBI (IFSC) guidelines for AIF

Sr. no.	Particulars	Remarks
1	Form of fund	Any fund established or incorporated in IFSC in the form of <ul style="list-style-type: none"> <li>• A trust or</li> <li>• A company or</li> <li>• An Limited Liability Partnership (LLP)</li> </ul>
2	Eligible investors	<ul style="list-style-type: none"> <li>• Persons resident outside India</li> <li>• Non-resident Indians</li> <li>• Institutional investors resident in India who are eligible under Foreign Exchange Management Act, 1999 (FEMA) to invest in offshore funds subject to permissible outward investment conditions; and</li> <li>• Persons resident in India and eligible under FEMA to invest in offshore funds, having minimum net worth of USD 1,000,000 during the preceding financial year and subject to LRS</li> </ul>
3	Permitted investments	<ul style="list-style-type: none"> <li>• Securities which are listed in IFSC</li> <li>• Securities issued by companies incorporated in IFSC; and</li> <li>• Securities issued by companies belonging to foreign jurisdiction or incorporated in India</li> </ul>
4	Sponsor/manager	<ul style="list-style-type: none"> <li>• Sponsor or Manager can set up branch in IFSC for the same or can incorporate a subsidiary company or an LLP</li> <li>• Sponsor or Manager to be set up in IFSC shall need to incorporate a company or LLP in the IFSC</li> </ul>
5	Routes of investments	<ul style="list-style-type: none"> <li>• Foreign Direct Investment (FDI)</li> <li>• Foreign Venture Capital Investor (FVCI)</li> <li>• Foreign Portfolio Investor (FPI)</li> </ul> In accordance with applicable FDI policy/FEMA guidelines issued by GOI and RBI in this regard

## SEBI(IFSC) guidelines for AIF (Cont'd)

Sr. no.	Parameters	Remarks
6	Minimum corpus requirement	<ul style="list-style-type: none"> <li>At least USD 3 million</li> </ul>
7	Minimum investment value	<ul style="list-style-type: none"> <li><b>From an Investor:</b> not less than USD 150,000</li> <li><b>From employees or Directors:</b> USD 40,000</li> </ul>
8	Continuing Interest	<ul style="list-style-type: none"> <li>For Category I and II, Manager or Sponsor to have a continuing interest of at least               <ul style="list-style-type: none"> <li>– 2.5% of corpus or</li> <li>– USD 750,000 whichever is low</li> </ul> </li> <li>For Category III AIF               <ul style="list-style-type: none"> <li>– 5% or</li> <li>– USD 15 million whichever is low</li> </ul> </li> </ul>
10	Custodian	<ul style="list-style-type: none"> <li><b>Category I and Category II:</b> Mandatory to appoint a custodian if corpus of AIF exceeds USD 70 million</li> <li>Mandatory appointment of custodian for <b>Category III AIF</b></li> </ul>

# Taxation

## DDT and MAT

- If a AIF is set up as a company in IFSC, Dividend Distribution Tax (DDT) shall not be applicable on distribution of surplus to Investors by AIF
- Further, AIF set up as a company in IFSC shall be chargeable with Minimum Alternate Tax (MAT) Alternate Minimum Tax (AMT) @ 9% subject to certain conditions



## Tax holiday (Section 80LA)

- Tax holiday available to units located in IFSC for 10 years
- 100% deduction of income from business for any 10 out of 15 years at the option of the tax payer



## Capital gains and transaction taxes

- Transfer of Bonds, Global Depository Receipts (GDRs), rupee denominated bonds and derivatives by non-residents shall not be taxable on recognized stock exchanges located in IFSC
- No Securities Transaction Tax (STT) or Commodities Transaction tax (CTT) on transactions entered into by any person on recognized stock exchange/ association located in IFSC



### • Key Considerations

- Applicability of Section 80LA tax holiday owing to tax pass-through status of Category I and II AIFs?
- Whether tax holiday is applicable only to those AIFs which lose tax pass-through status owing to business income?
- Applicability of section 80LA tax holiday for Category III AIFs set up as a trust?
- Fund Manager in IFSC – set up as a company or LLP. What will be Income tax and GST implications?

# Comparative table

## Overseas fund/AIF – India/IFSC – AIF

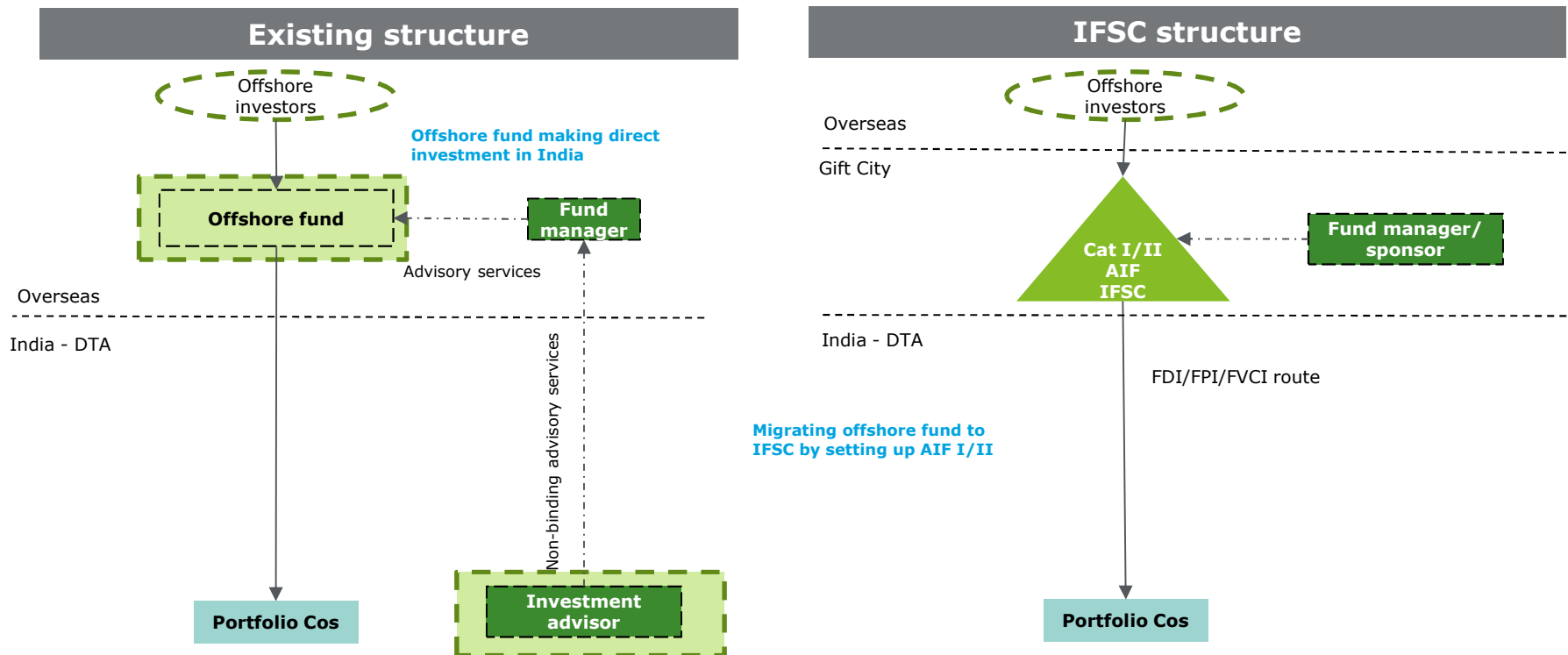
Parameters	Overseas Fund	AIF-India	IFSC-AIF
<b>Registration with SEBI</b>	<ul style="list-style-type: none"> <li>Not-Mandatory</li> </ul>	<ul style="list-style-type: none"> <li>Mandatory</li> </ul>	<ul style="list-style-type: none"> <li>Mandatory</li> </ul>
<b>Investment as FDI in India</b>	<ul style="list-style-type: none"> <li>Sectoral limits will apply</li> </ul>	<ul style="list-style-type: none"> <li>No-sectoral limit</li> <li>(If Fund Manager is Indian owned and controlled) – however, single entity investment restriction would apply</li> </ul>	<ul style="list-style-type: none"> <li>Sectoral limits will apply including single entity investment restriction</li> </ul>
<b>Investment as FPI in listed securities</b>	<ul style="list-style-type: none"> <li>Possible – to take separate SEBI registration</li> </ul>	<ul style="list-style-type: none"> <li>Possible – no separate SEBI registration required</li> </ul>	<ul style="list-style-type: none"> <li>Possible – no separate SEBI registration required</li> </ul>
<b>Investment as FVCI in unlisted debt securities – Optionally Convertible Debentures (OCD)/ Optionally Convertible Preference Shares (OCRPS)</b>	<ul style="list-style-type: none"> <li>Not-possible unless registered as FVCI with SEBI</li> </ul>	<ul style="list-style-type: none"> <li>Not applicable</li> </ul>	<ul style="list-style-type: none"> <li>Possible – no separate SEBI registration required</li> </ul>
<b>Overseas investment</b>	<ul style="list-style-type: none"> <li>Not applicable</li> </ul>	<ul style="list-style-type: none"> <li>Permissible – subject to conditions</li> </ul>	<ul style="list-style-type: none"> <li>Permissible</li> </ul>

# Key considerations for setting up AIF in IFSC

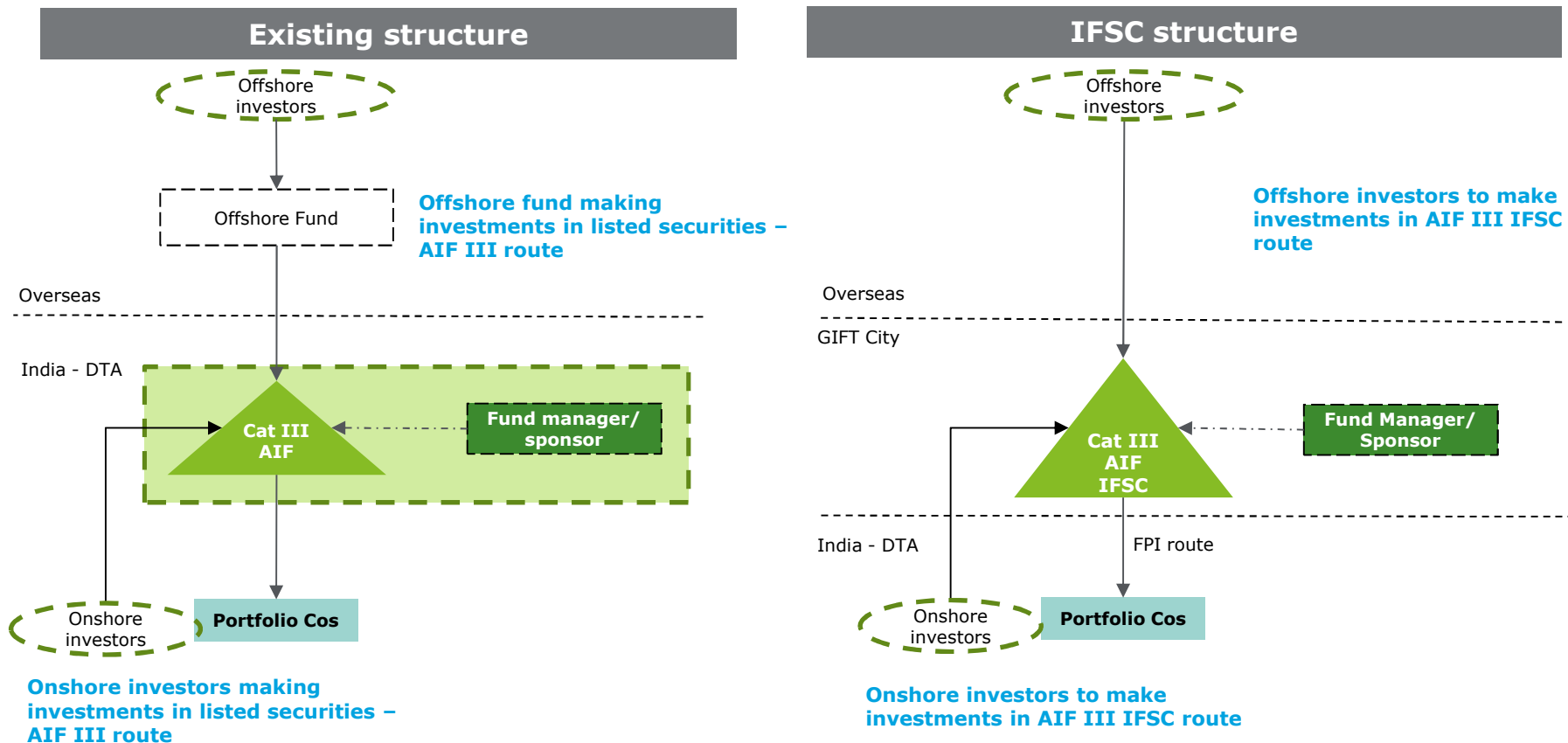
- Offshore funds which traditionally were based in Mauritius, Singapore, and Cayman Islands, for investments into Indian assets under the FDI, FVCI, and FPI routes, have an option to explore IFSC AIF regime
- Domestic and overseas fund managers setting up funds for investments outside India, which are raising commitments from overseas investors and/or Indian investors may also find the IFSC AIF regime attractive
- Domestic and overseas fund managers who are setting up regional funds to invest in India and overseas can evaluate IFSC as an option
- Offshore fund managers could use the IFSC vehicles as feeder funds to invest in offshore funds



# Structure 1: offshore fund and fund manager



# Structure 2: Category III AIF and fund manager



## Polling question 3

Would we see more of AIF being set-up in IFSC?

- Yes
- No
- Partially
- Not sure
- Would wait and watch

# Concluding remarks

- Unification of regulator
- NSE, SGX receive Sebi, MAS approval for creating trade link at gift city
- Regulatory roadmap for making India a hub for aircraft financing and leasing activities
- Onshoring of reinsurance business
- DR issues through IFSC exchanges
- Rupee derivatives (with settlement in foreign currency) to be traded in IFSC

## Polling question 4

Do you see major foreign and Indian financial sector participants establishing presence in the IFSC?

- 100%
- 0%
- 50%
- 60-75%
- Need to wait and watch
- Not sure

# Questions and answers

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# Contact information



**Bahroze Kamdin**  
Tax Partner  
Deloitte Mumbai, India  
bkamdin@deloitte.com



**Russell Gaitonde**  
Tax Partner  
Deloitte Mumbai, India  
rgaitonde@deloitte.com



**Vishal Agarwal**  
Tax Partner  
Deloitte Mumbai, India  
agarwalvishal@deloitte.com

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