AIFs in GIFT City

SEP 2020

GUJARAT INTERNATIONAL FINANCE TEC-CITY

International Financial Services Centre

Content

International Financial Services Centre (‘IFSC’)

Globally, Financial Centres are locations with an agglomeration of participants in banking, asset management, insurance and financial markets with venues and supporting services for these activities.

The world has witnessed the transformation of New York, London, Singapore, Hong Kong and Tokyo as Global Financial Centres. Recently, there has been a spurt of newer Financial Centres in Dubai, Malaysia, Kazakhstan and few other countries.

IFSC in India at Gujarat International Finance Tech City (‘GIFT City’)

The Government of India (‘GoI’) had launched India’s first IFSC in Gujarat at GIFT City in April 2015.

With the launch of the IFSC at GIFT City, the GoI had taken the first step to bring financial services transactions which are relatable to India, back to India.

> “My vision is that in ten years from now, GIFT city should become the price setter for at least a few of the largest traded instruments in the world, whether in commodities, currencies, equities, interest rates or any other financial instrument.” The concept of IFSC is simple but powerful. It aims to provide on-shore talent with an offshore technological and regulatory framework. This is to enable Indian firms to compete on an equal footing with offshore financial centres.“
>
> **Shri Narendra Modi, Hon’ble Prime Minister of India**
>
> http://pib.nic.in/newsite/PrintRelease.aspx?relid=156240

The core objectives for developing an IFSC in India are outlined below -

a. To realise the vision of the Government of India to emerge as a major economic power by facilitating development of strong base of International Financial Services in the country.

b. To position IFSC as a world-class zone for the long-term provision of office/service accommodation and high technological, economical and commercial infrastructure.

c. Facilitate the implementation of the Government’s strategy for the development of a financial hub in the South Asian sub-continent.

GIFT IFSC has been ranked third in the latest edition of Global Financial Centres Index 22 (GFCI)-London. It is ranked third in the list of the GFCI report which has 15 centres that are likely to become more significant in the next few years.

> “There has been a constant call to attract offshore fund managers (who invest in India, but operate from an offshore location), by encouraging them to shift their fund management and administration to India. In this context the Committee has made suggestions for a suitable tax and regulatory framework for the domiciliation of AIFs in International Financial Services Centers in India.”
>
> **Shri. N.R. Narayana Murthy, Chairman - Alternative Investment Policy Advisory Committee**
>
> https://www.sebi.gov.in/reports/reports/jan-2018/3rd-report-submitted-by-alternative-investment-policy-advisory-committee-_37460.html

GIFT IFSC is being developed on 886 acres of land consisting of a Multi Service Special Economic Zone (‘SEZ’) with IFSC on 261 acres and a domestic Finance Centre on the remaining.

The world class infrastructure development at GIFT City has won many awards and accolades from reputed forums.

Three year after inception, the GIFT IFSC is operational with 12 leading Indian banks and One foreign bank clocking foreign currency business transactions of US$ 26 billion plus, Insurance business worth US$ 30 billion, establishment of Medium Term Note program by leading Indian issuers of US$ 51 billion on IFSC exchanges and a daily average trading volume of over US$ 4 billion between the two International Exchanges located in GIFT IFSC.

Legal framework for units in IFSC

Regulations	Regulator
Special Economic Zones Act, 2005	Board of Approval headed by the Secretary, Department of Commerce
IFSC Authority Act, 2019	**IFSC Authority**
RBI's guidelines for setting up of IFSC Banking Units (IBU) by banks	Reserve Bank of India
SEBI (International Financial Services Centres) Guidelines, 2015	Securities and Exchange Board of India
• IRDAI [Registration and Operations of IFSC Insurance Offices (IIO)]Guidelines, 2017 • IRDAI (International Financial Service Centre Insurance Intermediary Offices) Guidelines, 2019	Insurance Regulatory and Development Authority of India
• FEMA (International Financial Services Centre) Regulations, 2015 • FEM (Foreign Currency Accounts by a Person Resident In India) Regulations, 2015 • FEM (Transfer or issue of Foreign Security) Regulations, 2004	Reserve Bank of India
Income-tax Act, 1961	Central Board of Direct Taxes
Goods and Services Tax Law	Central Board of Indirect taxes and Customs

Participants in IFSC

Banks
(regulated by the RBI)

- Indian banks (viz. banks authorised to deal in foreign exchange)
- Foreign banks already having presence in India

Insurance players
(regulated by IRDA)

- Indian Insurer
- Indian Reinsurer
- Indian Broker
- Foreign Insurer
- Foreign Reinsurer

Capital Market Players
(regulated by SEBI)

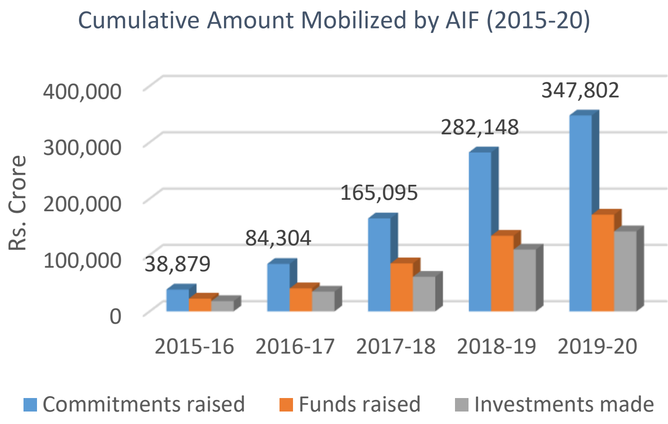
- Stock Exchanges / Commodity Exchanges
- Clearing Corporation, Custodian
- Depositories
- Trading Members, Brokers
- Alternate Investment Fund
- Mutual Fund
- Investment Adviser
- Portfolio Manager

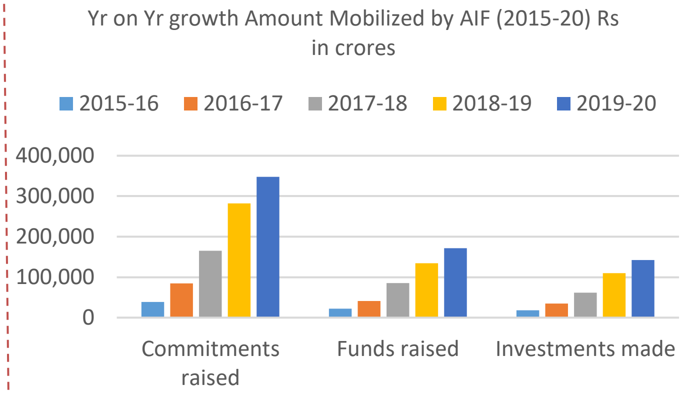
Alternate Investment Funds in India (AIFs)

In 2012, the SEBI introduced AIF Regulations[1] with an intention to regulate unregistered pooling vehicles. It aimed to avoid regulatory gaps and to have a level playing field for all types of funds in India.

Currently, there are more than 600 AIFs registered with the SEBI. As on 31 December 2019, as per the data published by SEBI, the total capital commitment of these AIFs is US$ 49.69 billion out of which the fund raised from investors is US$ 24.53 billion and the amount of investments made is US$ 20.30 billion. These facts clearly demonstrate the potential of AIFs as a pooling vehicle in India.

Considering the success of the AIF regime in domestic market and a with a view to encourage fund regime in IFSC, in 2015, the SEBI had issued detailed guidelines[2] to facilitate and regulate the securities market in India's first IFSC at GIFT City. This guidelines provided the basic framework for AIFs, such as permissible investors, permissible investments, etc.





https://www.sebi.gov.in/statistics/1392982252002.html

Based on the suggestions submitted by AIPAC, on 26 November 2018, the SEBI issued circular[3] specifying the 'Operating guidelines for AIFs in IFSC'.

Journey of Fund regime in IFSC

AIFs in IFSC

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 non-resident investors through Cat I or Cat II AIF, not taxable

06 – July 2019
Exemption from filing income-tax return non-residents investors in Category I or II AIF, subject to conditions

07 – July 2019
Additional tax reforms announced in Budget 2019

08 – August 2019
Permissible investments by AIFs in IFSC expanded and aligned with domestic AIFs

09 – August 2020
Exemption from obtaining PAN to non-resident investor in Category I or II AIF, subject to conditions

10 – September 2020
New tax framework for Category III AIFs in IFSC

1. *SEBI (AIF) Regulations, 2012*
2. *Securities and Exchange Board of India(International financial services centres) guidelines, 2015*
3. *Circular No. SEBI/HO/IMD/DF1/CIR/P/143/2018*

Key AIF Regulations and Guidelines

- **Types of AIFs**

Parameters	Category I	Category II	Category III
Categorisation as per SEBI AIF Regulations	Funds which invest in start-ups or early stage ventures, social ventures, Small and Medium Enterprise ('SMEs'), infrastructure sector or other sectors or areas which GoI or regulator consider as socially or economically desirable (All the above mentioned categories of AIFs are defined in the AIF regulations and investment by such funds are subject to certain restrictions)	Residual category i.e. other than Category I AIF and Category III AIF	Funds which employ diverse or complex trading strategies and leverage including through investment in listed or unlisted securities / derivative.
Examples	Includes - venture capital funds, SME funds, social venture funds, infrastructure funds	Examples - PE Funds, debt funds or funds which have not been granted any specific incentives or benefits	Examples - Hedge funds, funds which trade with a view to make short term gains, open ended funds and which have no specific incentives or concessions
Open or close ended fund	Close ended fund	Close ended fund	Can be open or close ended fund

- **Investment conditions and restrictions**

Parameters	Category I	Category II	Category III
Minimum investment by an investor in AIF:		Same as Category I	Same as Category I
* For employees or directors of the AIF or its manager	USD 40,000		
* For other investors	USD 150,000		
Investment into one investee company	Not more than 25 % of corpus	Same as Category I	Not more than 10 % of the corpus
Investment in other AIF	Investment in Category I AIF permissible	Investment in Category I and II AIF permissible	Investment in Category I and II AIF permissible; Category III not permissible

Key AIF Regulations and Guidelines

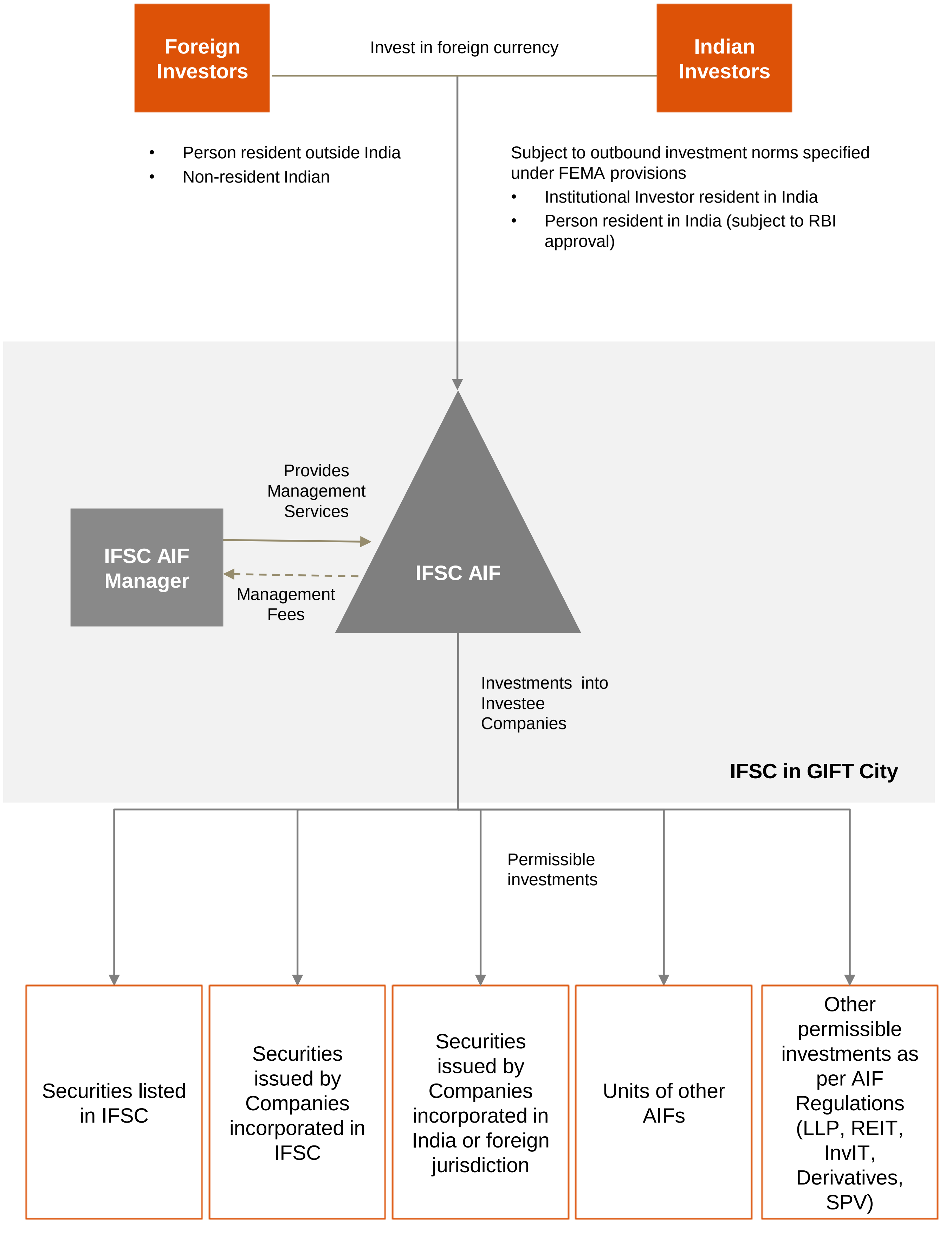
- **Structure and other key requirements**

Parameters	Category I	Category II	Category III
Form	• Trust • Company • Limited liability partnership • Body corporate	Same as Category I	Same as Category I
Tenure per scheme	Minimum 3 years. Extension of term is possible subject to condition	Same as Category I	Not Applicable
Minimum corpus requirement for each scheme of the AIF	USD 3,000,000 [For Angel funds - USD 750,000. Criteria specified for angel investor investing into Angel fund in IFSC is as follows: a. individual investor with net tangible assets of at least USD 300,000 (excluding value of his principal residence). b. body corporate with net worth of at least USD 1.50 million.]	Same as Category I	Same as Category I
Borrowing of funds / leverage	Not permitted to borrow or engage in leverage directly or indirectly except for temporary funding requirements (subject to conditions with respect to no of times in a year and quantum specified by SEBI)	Same as Category I	Permitted with the consent of investors and subject to to a maximum limit specified by SEBI)
Appointment of custodian	Sponsor or Manager of Category I - AIF has to appoint a custodian for securities, if the corpus exceeds USD 70 million	Same as Category I	Mandatory to appoint custodian irrespective of size of corpus

- **Requirements for Sponsor/Manager**

Parameters	Category I	Category II	Category III
Continuing interest of manager or sponsor (not as waiver of fees)	Lower of: • 2.5% of corpus • USD 750,000	Same as Category I	Lower of: • 5% of corpus • USD1,500,000

Typical framework of AIFs in IFSC



Tax framework

A. For AIFs and its investors

a. Category I and II AIF

- Category I and Category II AIF have tax pass-through status for Indian income-tax purposes (except for business income, which is taxable in the hands of the AIF for which 100% tax holiday can be claimed for a period of 10 consecutive years out of a block of first 15 years).

- Investors are taxed on income arising from investments made by the AIF as if the investments were made directly by them.

- Income accruing or arising or received by non-resident investors from offshore investments through a Category I and II AIF is not taxable in India.

- Investors can claim losses (other than business loss) of AIF on pass through basis, provided the units of such AIF are held for a period of 12 months or more. However, any business loss can be carried forward only at the AIF level.

- Exemption has been provided to non-resident investors from filing return of income, provided they earn income only from investments made in a Category I or Category II AIFs in IFSC and tax has been deducted on the distribution made by such AIFs to non-resident investors. Further, such non-resident investors are also exempted from obtaining PAN in India.

- To the extent beneficial, the investors can avail the tax treatment in accordance with the Tax-treaty, subject to satisfaction of Tax-treaty eligibility conditions.

b. Category III AIF

- Category III AIFs are subject to fund level taxation.

- The following income earned by the Category III AIF, which are attributable to non-resident investors in the AIF, is exempt from tax:
  - Income on transfer of any securities (other than shares in a company resident in India), including derivatives, debt securities and offshore securities.
  - Income from securities issued by a non-resident (not being a Permanent Establishment) and where such income otherwise does not accrue or arise in India
  - Income from a securitization trust chargeable under the head "profits and gains of business or profession
  - Income on transfer of specified securities listed on a recognised stock exchange located in IFSC where consideration for such transaction is in convertible foreign exchange

- Income on transfer of shares in an Indian company is taxable as follows to the Category III AIF:
  - Short-term Capital Gains - 15% if Securities Transaction Tax paid, else 30%;
  - Long-term Capital Gains - 10%

- Income in respect of securities (such as interest, dividend) is taxable to the Category III AIF at the rate of 10% (5% in case of interest income on certain rupee denominated bonds, Government securities or municipal debt securities referred to in section 194LD)

- Any income accruing or arising to or received from the Category III AIF or on transfer of its units is exempt from tax in the hands of investors.

- Surcharge on certain Long-term Capital Gains, Short-term Capital Gains and dividends earned by the Category III AIF is capped at 15%. Further, the provisions of Alternate Minimum Tax are not applicable to the Category III AIF.

- Exemption from stamp duty, Securities Transaction Tax & Commodities Transaction Tax for transactions carried out on IFSC exchanges.

Tax framework

B. For Manager:

- 100% corporate tax exemption for 10 consecutive years out of block of 15 years (from date of approval from regulator) in respect of income from business carried on in IFSC.
- The Minimum Alternate Tax ('MAT')/ Alternate Minimum Tax ('AMT') rate has been reduced to 9% (as against 18.5%). However, companies in IFSC choosing to opt for new tax regime under domestic tax law shall be exempt from MAT provisions.
- The dividend distributed by Manager may be taxable in the hands of its shareholders under the domestic tax law.
- Supply of services by Manager to AIFs in IFSC is exempt from Goods and Services Tax.
- Interest payable to a non-resident in respect of monies borrowed exempt from income tax.

Key steps for setting up GIFT AIF, GIFT AIF Manager and GIFT AIF Sponsor

1. Apply for availability of name for AIF Manager and/or Sponsor
2. Identification of office space in GIFT City and obtaining NOC from GIFT SEZ
3. Apply for company/LLP incorporation for AIF Manager and/or Sponsor and obtain certificate of incorporation
4. Appointment of a trustee for AIF and registration of trust deed
5. Application to the Development Commissioner of SEZ and obtain letter of approval from SEZ Authorities for AIF, AIF Manager and/or Sponsor
6. Obtain SEBI/IFSC Authority approval for AIF, AIF Manager and/or Sponsor
7. Obtain RBI approval, if required.

Key benefits for AIFs in IFSC:

- Various tax incentives and regulatory exemptions granted
- Lower operating costs, in addition to other subsidies granted by the Gujarat Government
- Availability of skilled resources
- Proximity to the onshore market
- World class infrastructure, unparalleled connectivity and transportation access
- Access to multiple markets from IFSC

Financial Ecosystem for AIFs in IFSC

Gujarat Government State subsidies

<table>
<tr><th colspan="3">State Subsidies Incentives available under IT/ITeS policy of Gov. of Gujarat</th></tr>
<tr><td>Capital Subsidy</td><td colspan="2">Capital subsidy @ 25% of capital expenditure for one-time purchase of Computers, networking and related hardware, subject to a ceiling of Rs. 1 crore</td></tr>
<tr><td>Stamp Duty & Registration / Conversion fee exemption</td><td colspan="2">Wherever cost is incurred 100% reimbursement of Stamp Duty and Registration Fee paid</td></tr>
<tr><td>Electricity duty and subsidy on Power Tariff</td><td colspan="2">100 % Reimbursement of Electricity duty and Re. 1 subsidy on power tariff for a period of 5 years.</td></tr>
<tr><td>Reimbursement of Provident Fund contribution by employer</td><td colspan="2">• 100% of EPF amount paid in case of female employees
• 75% of EPF amount paid in case of male employees</td></tr>
<tr><td rowspan="3">Lease rental subsidy for every 50 sq. ft per employee</td><td>Up to 20 employees</td><td>Rs. 8 per sq. ft.</td></tr>
<tr><td>20 – 100 employees</td><td>Rs. 5 per sq. ft.</td></tr>
<tr><td>Above 100 employees</td><td>Rs. 3 per sq. ft.</td></tr>
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Thank you

Gujarat International Finance Tec-City Company Ltd
Gift House, Block -12, Road 1-d, Zone - I, Gift SEZ, Gift City,
Gandhinagar, Gujarat- 382355
Tel. No. : +91 79 61708300
Visit us on: www.giftgujarat.in