

Daily Tax Report ®

India's First Tax-Friendly Jurisdiction Eyes Tax Perks for Boost

By Shefali Anand

Deep Dive

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- India's GIFT City offers tax breaks to lure companies
 - Aim is to compete with business-friendly Singapore, Dubai
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For years, the government in India has been promoting the Gujarat International Finance Tec-City, or GIFT City—in the home state of Indian Prime Minister Narendra Modi—and within that the International Financial Services Centre, or IFSC, as the next international hub of finance.

But the district is struggling to attract companies in part due to its nascent social infrastructure and tax perks that aren't as generous as they could be.

"If you want to promote IFSC, entities operating from there should be given more tax benefits, their tax compliance costs should be reduced to minimum, and they should not be put through excessive scrutiny," said Ravi Sawana, Mumbai-based joint partner at the law firm Lakshmikumaran & Sridharan.

The Modi-led government has announced fresh tax breaks every year to make the financial center an attractive destination for companies from different industries. In the union budget that Parliament passed last month, the government plans to give a tax exemption for income received by non-residents from portfolio investments, and from royalty and interest for leasing a ship, subject to certain conditions.

Tax practitioners say more can be done.

"The needle has moved considerably," said Dinesh Kanabar, chief executive officer of Dhruva Advisors LLP, a tax consultancy. However, for GIFT City to become the next Singapore or Dubai, "We have a long way to go," he said.

Sitting on the Fence

Many companies are waiting for others to move there and see how they fare.

"It's bit of a chicken and egg situation," said Sunil Badala, partner at KPMG India. "There are several clients who are still sitting on the fence, just waiting for others to make the move."

GIFT City IFSC, which opened in 2015, offers lighter regulatory constraints for foreign companies and investors than elsewhere in India. The IFSC is considered “foreign territory” under foreign exchange rules. However, entities in the IFSC are considered tax residents in India.

One of the biggest tax benefits for entities in the IFSC is that they receive exemptions from income tax for 10 consecutive years within the first 15 years of inception. However, it is unclear if India’s tax officials might consider setting up shop in the IFSC to enforce general anti-avoidance rules, according to Sawana.

GAAR provisions come into play if a tax official believes that a particular transaction was set up with the main purpose of obtaining a tax benefit. In recent years, Indian tax officials have actively gone after companies under these provisions. Since the tax benefits are a big part of the attraction of GIFT IFSC, the industry wants assurance that it will not later draw scrutiny from Indian tax officials under GAAR, said Sawana.

“Without an express mention, it can lead to litigation,” he said.



Bull statue at the India International Exchange (INDIA INX) building operated by India International Clearing Corp., a subsidiary of BSE Ltd., in Gujarat International Finance Tec-City (GIFT City).

Photographer: Dhiraj Singh/Bloomberg

Sector-Specific Tax Breaks

Investors are looking for sector-specific tax exemptions, amendments, and incentives, practitioners said.

Consider the case of privately pooled funds, which invest in Indian companies and other securities. India divides these “alternative investment funds” into three categories. The first two categories of funds, which include venture capital funds and private equity funds, have a pass-through status and don't pay tax. Investors of the funds pay tax on their gains or income from the funds. The third category of AIFs, which includes hedge funds, have to pay both capital gains and income taxes.

However, a committee established in February by the IFSC has recommended regulation that all types of funds be taxed at the fund level.

If this proposal is accepted by regulators, provisions of India's Income-tax Act of 1961 “with respect to the taxation of alternative investment funds set up in GIFT City will have to be appropriately amended,” said Ipsita Agarwalla, a member in the international tax practice at the law firm Nishith Desai Associates. She said the clarity would be good for funds and investors.

For instance, the law would need to enable all IFSC-based funds to be taxable at the fund level, and it would need to provide exemptions to non-resident investors.

Funds also need clarity on the requirements of locating in the city, Agarwalla said. Like in other tax-friendly jurisdictions, the IFSC in February proposed rules for what constitutes a substantial presence.

The draft rules appear to require that key investment professionals be based in GIFT City, said Agarwalla. “This requirement seems to be onerous and not aligned with practicalities, especially given the work-from-home scenario,” she said.

Meanwhile, she said that if India provides a tax exemption to sovereign wealth funds investing in a GIFT-based fund, it would greatly boost the fund business in GIFT.

Many funds are exploring the option of setting up shop in GIFT City, Agarwalla said. “There are two-three key regulatory and tax incentives that we need, then I think the fund regime can really take off,” she said.

Setting Up Shop

Although the idea to build GIFT City started in 2007, the IFSC wasn't operationalized until 2015. Built on an 886 acre-parcel of land, the city is around a 40-minute drive from Ahmedabad, Gujarat's largest city and cultural center. A metrorail is being built to connect the two cities

Within GIFT City premises, several glass-and-steel office buildings have come up, and residential apartment buildings are under construction. But it lacks the social infrastructure and buzz of India's major cities, like the financial capital Mumbai, and many companies and their employees aren't keen to move to what is seen as a remote area.

Still, some companies have made the move with an eye to the future.

Vman Aero Services LLP, a Mumbai-based aviation company, launched its first aircraft leasing unit in GIFT City last year. The Hongkong and Shanghai Banking Corp. Ltd. (HSBC) inaugurated its international banking unit in January 2021, while German bank Deutsche Bank plans to do so this year, according to a bank spokesperson.

About 275 entities are registered in the IFSC, including two stock exchanges, investment funds, and insurance firms, according to a GIFT City spokesman. A banking unit in the city follows rules laid out by the IFSC Authority, rather than the Reserve Bank of India, which regulates banks in the rest of India.

HSBC, which counts India as one of its largest markets, set up an international banking unit in GIFT last year. The unit operates as a branch of its Hong Kong-based bank, and offers companies in India the ability to raise foreign currency loans and to hold foreign currency deposits at the branch.

"The main driving force was the products we can offer, and how convenient it can be to our customers," said Ranjan Bhattacharya, chief of staff, HSBC Bank India.

Law firm Cyril Amarchand Mangaldas also opened its GIFT City office last year to cater to companies operating from there. S.R. Patnaik, partner and head of taxation at Cyril Amarchand, said that more can be done to attract companies from different sectors to GIFT City.

"It is imperative that the government considers inclusion of more products or services into India's IFSC and provide a smooth pathway to new investors proposing to enter India," he said.

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