FPIs' flight to GIFT City hits air pocket; IFSCA seeks clarity on tax

IFSCA seeks clarity from I-T to clear the decks for more FPIs to re-domicile in GIFT City IFSC

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Under The Current Provisions For Relocation, The Resultant Fund Is Allowed To Issue Units To The Original Foreign Fund Or Investors

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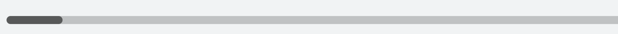
0:00 / 5:01  1x

The International Financial Services Centres Authority (IFSCA), a regulatory body, has sought greater clarity from the income tax (I-T) authority on tax implications for

foreign portfolio investors (FPIs) looking to re-domicile in Gujarat International Finance Tec-City (GIFT City), said people in the know.

The I-T department's stance is critical to facilitating the migration of these funds from other overseas jurisdictions to GIFT City, they added.

"In the regulation, there is a grey area on the taxation of the 'carried interest' of managers of these funds. Consultations are on between IFSCA and the I-T authorities," informed a source.

'Carried interest' is when a manager takes incentives or units from funds, besides fees. In many cases, the units issued to the manager of a foreign fund at the time of relocation are to be transferred to the manager of the alternative investment fund (AIF) in the International Financial Services Centre (IFSC).

Experts said such transfers could result in 'deemed income' implications under Section 56(2)(x) of the I-T Act for the manager.

"The exemption provision plays a crucial role in promoting the onshoring of offshore funds. Several funds await this clarification as their migration to IFSC presents significant cost advantages," said Suresh Swamy, partner, Price Waterhouse & Co. LLP.

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AIFs set up at an IFSC are required to be registered as FPIs to invest in the Indian market and securities.

Currently, the norms for transferring funds from overseas to IFSC have been classified as tax-neutral events, implying no tax outgo on the change in domicile.

Under the current provisions for relocation, the resultant fund is allowed to issue units to the original foreign fund or investors.

Upon relocation, the foreign fund manager will not be involved in the activities of the AIF in IFSC, and a separate manager who is registered as a fund management entity (FME) with the IFSCA will be required. Presently, there are about 70 FMEs registered with the IFSCA.

"The clarification stating that AIF managers in IFSC will not be subject to taxation, whether on allotment of units by the AIF in IFSC or transfer of units issued to the manager of the foreign fund during relocation to the AIF manager in IFSC, will bring much-needed clarity and encourage these funds to confidently proceed with their migration," said Swamy.

Upon relocation, FPIs are to avail of cost and tax benefits. Besides, shifting to GIFT City offers a better regulatory regime as opposed to being domiciled in countries that are on the Financial Action Task Force grey list.

In the past month, two funds have migrated from countries like Mauritius, taking the total number of FPIs registered at IFSC to 15. The two funds that have migrated to date have not had any issues with 'carry'.

"The effort is to first bring new funds to GIFT City while also providing a window for the domestic-centred funds set up in other jurisdictions to migrate back. This clarity will help funds migrate that have no business being in those offshore jurisdictions other than for tax, cost, or structural benefits," said a person with direct knowledge of the matter.

In the recent past, regulations around the relocation of offshore funds to the IFSC have seen several amendments to make them more attractive.

"With no additional documentation and prior approval requirements, the availability of one-time off-market transfer, permission to IFSC FPIs to issue participatory notes, tax exemption on income earned from such offshore derivatives instrument contracts with IFSC banking units, and no taxation on derivatives exposure of certain FPIs, the

government has given persuasive reasons for FPIs situated in conventional jurisdictions to set up operations in GIFT City," said Prakhar Dua, leader, financial services and regulatory practice, Nishith Desai Associates.

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Transfer is a tax-neutral event but grey area on 'carried interests'
Foreign fund manager cannot be involved with the AIF in IFSC, so they need to transfer units to IFSC-registered managern Transfer of units deemed income implications under Section 56(2)(x) of I-T Act for the fund manager

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