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GIFT CITY'S ROLE IN ENHANCING FOREIGN CAPITAL INFLOWS INTO INDIA

As India strides forth into its Amrit Kaal, the country is resolute about achieving the status of a developed nation by 2047.

As per the World Bank, in order to realise this ambitious dream of becoming a developed economy, the domestic economy must expand at an average **annual growth rate of 8%.**[1]

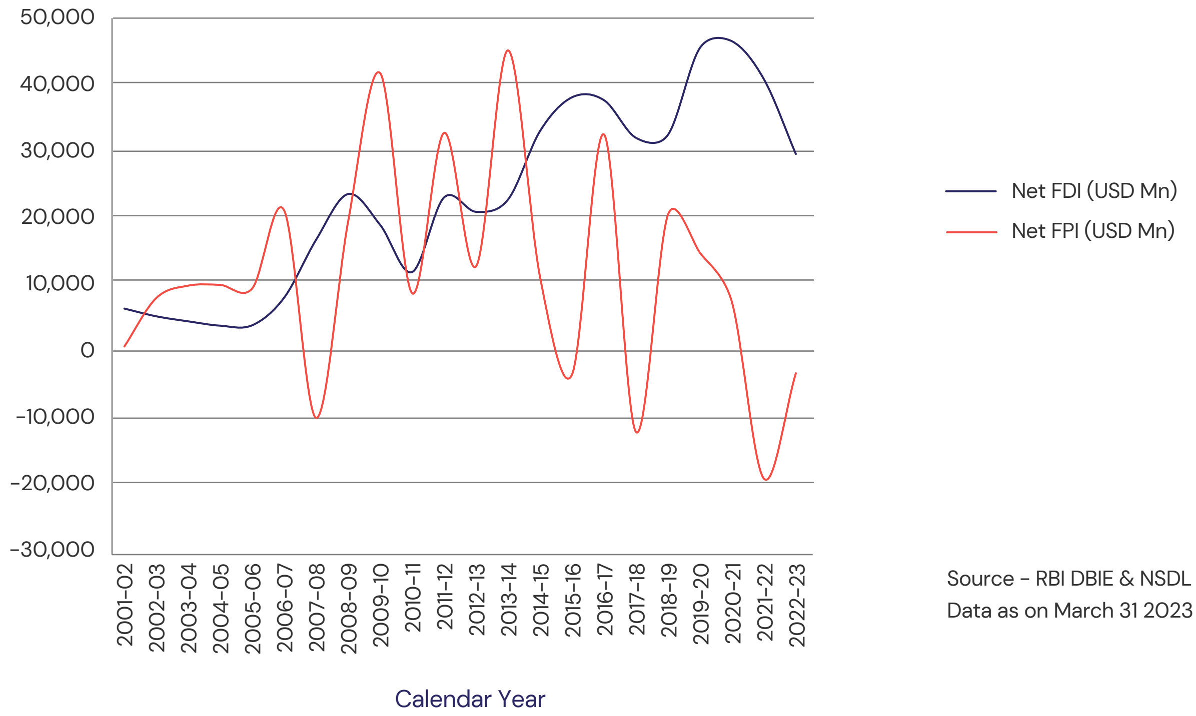
Sustainable foreign investment is a vital catalyst capable of fuelling this steady expansion. Foreign investments can accelerate the domestic economy in an unprecedented manner by attracting global financial resources, boosting access to new technologies and essential skill sets, facilitating employment generation across all sectors, and fostering a competitive business environment.

Over the years, India has been witnessing an increasing trend in foreign investments, via the Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) routes. The Net FDI for CY 2022 being USD 27.9 billion as compared to USD 6 billion in CY 2002[2]. The overall Net FPI trend has turned positive, with net outflows reducing to USD 3 billion in CY 2022, as opposed to an outflow of USD 17.9 billion in the previous year[3]. Since January 2023, we have added Net FPI to the tune of over USD 11 billion.[4] Further, the notional value of outstanding Offshore Derivative Instruments (ODIs) into the domestic economy stood at INR 1.04 trillion as of May 2023[5], growing at an impressive 18% over the last 4 months.

Robust data as mentioned above clearly exemplifies India's attractiveness as a global investment hub. Further, with the Union Budget announcing tax sops for ODIs issued from Gujarat International Finance-Tec (GIFT) City, there has been a visible rise in their popularity.

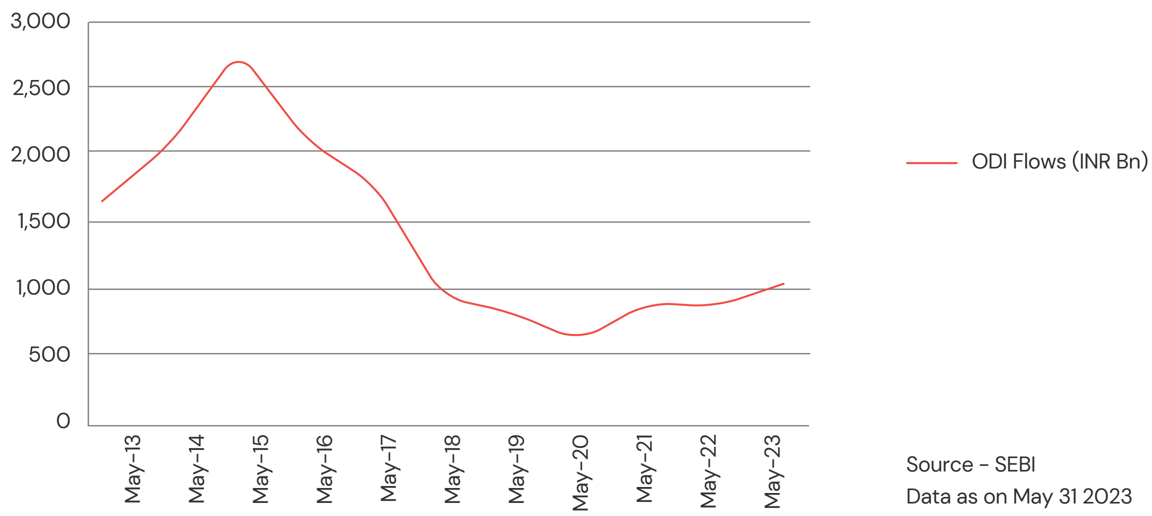
[1] https://www.globaltimes.cn/page/202208/1273149.shtml
[2] https://dbie.rbi.org.in/DBIE/dbie.rbi?site=statistics
[3] https://dbie.rbi.org.in/DBIE/dbie.rbi?site=statistics
[4] https://www.fpi.nsdl.co.in/web/Reports/Yearwise.aspx?RptType=6
[5] https://www.sebi.gov.in/statistics/fpi-investment/odis-&-pns/odis-&-pns.html

Net FDI & Net FPI Inflows (USD Mn)



Source - RBI DBIE & NSDL
Data as on March 31 2023

ODI Flows to India (INR Bn)



Source - SEBI
Data as on May 31 2023

Currently, foreign investment into India is predominantly routed either through FDI or through vehicles like mutual funds, pension funds, and hedge funds that invest in the Indian market. Other routes also include portfolio investments from non-resident Indians and persons of Indian origin, global depository receipts, venture capital, and private equity.

In this scenario, **GIFT City acts as a key catalyst** for accelerating foreign investment flows into India with several fund management entities already registered in the jurisdiction.

Some of these include the funds set up by leading Indian BFSI entities such as Aditya Birla Sun Life AMC, Edelweiss Alternative Asset Advisors Limited, Kotak Investment Advisors Limited, Mirae Asset Investment Managers (India) Private Limited, Nippon Life India Asset Management Limited, Nuvama Asset Management Limited, and SBI Funds Management Private Limited. GIFT City also acts as an investment gateway for large offshore institutional investors such as ADIA, GIC, Temasek & Canadian Pension Funds[6].

Several funds registered at GIFT City cater to domestic & international HNIs, UHNIs, and institutions; for instance, Aditya Birla Sun Life AMC has launched India's maiden global equity FoF domiciled in GIFT City - ABSL Global Emerging Market Equity Fund (IFSC). Similarly, there are a rising number of funds that are either in existence or being setup to cater exclusively to international investors. Some of these names include Airavat Global Technology Fund NR[7] and Alchemy India Long Term Fund.

70 funds have been registered at GIFT City, and have garnered **capital commitments worth USD 15.7 billion** as on date[8].

$15.7 Bn
Commitments raised

70
Registered funds

In fact, GIFT City, known as the gateway to India, boasts an International Financial Services Centre (IFSC) focused on enabling the development and regulation of financial products, services, and institutions at the centre. As India's only approved IFSC, which permits transactions in all foreign currencies, the IFSC at GIFT City is fast emerging as the preferred route for all inbound and outbound investment to India.

Designated as a location capable of offering the same ecosystem advantage as other major offshore financial hotspots, GIFT City is cementing India's stature as a global hub of financial and technological development.

The myriad enablers prevalent at GIFT IFSC include ease of registration, less stringent regulatory requirements, a bank account with free movement of foreign currency in USD account, etc.

As a result of these regulatory enablers, funds have now begun redomiciling from other offshore jurisdictions to GIFT City.

Alchemy Investment Management LLP's India Long Term Fund became the first fund to redomicile from Mauritius to GIFT City in May 2023; with several other funds set to follow suit[9].

As the IFSC at GIFT City develops a compelling India-based ecosystem for new age businesses across the domestic and global landscapes, the enabling regulations at GIFT City are efficiently attracting foreign funds necessary for fuelling the domestic economy. The journey of a 1000 miles has just begun, but it has begun with a resounding thump, promising a stupendous voyage for the future-ready Indian economy.

[6] Eleveight Research & GIFT IFSC
[7] https://www.thehindubusinessline.com/markets/airavat-capital-launches-global-technology-fund-at-gift-city/article66989843.ece
[8] Eleveight Research & GIFT IFSC
[9] https://indianexpress.com/article/business/alchemy-investment-management-migrate-offshore-fund-gift-ifsc-8589393/

GIFT City
An Offshore Oasis for Indian GPs

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The last decade has seen unprecedented growth in India's financial services sector.

The financial services sector is expected to employ over 7 million people by 2023[10] , has contributed to 5.5% of the Gross Domestic Product (GDP) in FY-22[11] and has an estimated market capitalization of over US$ 200 billion.[12]

Recognising India's substantial potential for growth and global recognition in this sector, the Hon'ble Finance Minister Mr. Arun Jaitley while presenting the Union Budget for the year 2015-16, announced the establishment of Gujarat International Financial Tec-City ("**GIFT City**"), in Gujarat as India's first International Financial Service Center ("**IFSC**"). The IFSC in GIFT City is intended to become a global financial hub, starting with bringing to Indian shores those financial services transactions that are currently carried on outside India by overseas financial institutions and overseas branches /subsidiaries of Indian financial institutions. In order to achieve this objective, the International Financial Services Centres Authority ("**IFSCA**"), along with the Central Government, has been working tirelessly to create a legal, regulatory and tax framework in GIFT City on par with jurisdictions like the US, Singapore and Mauritius.

Fund Management Regulations

With the objective of creating a fund management regime on par with global standards, on April 19, 2022 IFSCA notified[13] the International Financial Services Centres Authority (**Fund Management**) Regulations, 2022 ("**FM Regulations**"). The FM Regulations, like those in other leading fund management jurisdictions, regulate the fund manager instead of the fund.

These regulations streamline compliances and allow managers the ability to set up co-invest structures and undertake leverage, which is currently not permitted under the SEBI (Alternative Investment Fund) Regulations, 2012 ("AIF Regulations") for Category I and Category II AIFs.

Moreover, the diversification requirements which apply to SEBI regulated AIFs are not applicable to funds set up in the IFSC at GIFT City ("IFSC Funds"), thereby allowing managers to invest more than 25% of the fund's corpus in a single portfolio company.

This ability to co-invest, undertake leverage and invest more than 25% of the fund corpus in a single portfolio company is not only on par with global standards but also in line with global LP and GP expectations.

[10] https://facilities.aicte-india.org/KARMA/ssc-documents/BFSI%20Sector%20Skill%20Council%20Of%20India.pdf
[11] https://www.mospi.gov.in/sites/default/files/press_release/PressNoteNAD_28feb23final.pdf
[12] https://giftsez.com/giftcoltd.aspx#:~:text=It%20employs%20over%203%20million,to%20400%20billion%20by%202020.
[13] Vide Notification No. IFSCA/2021-22/GN/REG024, dated 19th April, 2022, published in the Gazette of India, Extraordinary, Part III, Sec.4, vide No. 32, on 20th April, 2022, with effect from 19th May 2022.

IFSC Funds on par with Offshore Funds

As per the Foreign Exchange Management (International Financial Services Centre) Regulations, 2015 all entities set up in the IFSC are treated as non-residents under India's foreign exchange control regulations ("**FEMA**"). This means that IFSC Funds, unlike SEBI-regulated AIFs, are permitted to freely invest outside India, and investment by global LPs into the IFSC Fund is not subject to FEMA.

However, status as a FEMA non-resident also means that any investment by the IFSC Fund into Indian portfolio entities would need to be made in accordance with FEMA under the FDI, FPI or FVCI entry routes, and any contributions from Indian resident LPs to the IFSC Fund would be subject to the Foreign Exchange Management (Overseas Investment) Rules, 2022, which provides a preferential framework for investment into GIFT City.

That being said, the IFSC at GIFT City continues to remain an Indian jurisdiction for all other legal and tax purposes.

Taxation in GIFT City IFSC Fund, Fund Manager and LPs

IFSC Fund - IFSC Funds can take advantage of the same pass through provisions available for SEBI-regulated Category I and Category II funds under section 115UB of the ITA. In other words, the fund itself is seen as a pass-through entity and tax is levied as if the LP had directly invested into the underlying portfolio investments.

Fund Manager - A fund manager set up in the IFSC at GIFT City can avail a 100% deduction on management fees (ie business income) for any 10 consecutive years out of a period of 15 years, beginning with the year in which the requisite permission for the operation of the IFSC unit was obtained.14 Such management fees should also not be subject to GST.

Global LPs - Income received by non-resident investors from investment made outside India by the IFSC Fund should not be subject to tax in India. Whereas income received from investments made in India should be taxable in the hands of such investors on pass through as per provisions of the ITA or relevant tax treaty, whichever is more beneficial. Exemption from obtaining PAN and filing income tax returns is also available to non-resident investors, subject to certain conditions.

Indian LPs – All income received by Indian resident investors should be taxable in the hands of such investors on a pass-through basis as per the provisions of the ITA.

Key Benefits for Indian GPs

In a typical fund structure where Indian GPs intend to raise money offshore and have a global investment strategy, the fund is generally set up in one of several fund friendly jurisdictions like Singapore or Delaware (depending on LP comfort).

While this structure allows the GP the ability to target non-Indian investments and provides LPs the comfort of not having to invest into India (which is often seen as a administratively cumbersome and tax inefficient jurisdiction), it also exposes the offshore fund to tax residency in India.

This is because under the ITA, a company's tax residency is determined by its place of effective management ("POEM"). In the case of an offshore fund being managed by GPs sitting in India, tax authorities could take the position that the offshore fund's POEM is actually in India, thereby potentially subjecting the fund's global income to double taxation – first, under Indian tax laws, and again under the tax laws of its host jurisdiction. This risk is typically mitigated by the GPs setting up an advisory entity to provide non-binding advisory services to the offshore fund for which advisory fees are charged on a cost-plus basis. Income tax is then paid by such advisory entities on the marked up advisory fees.

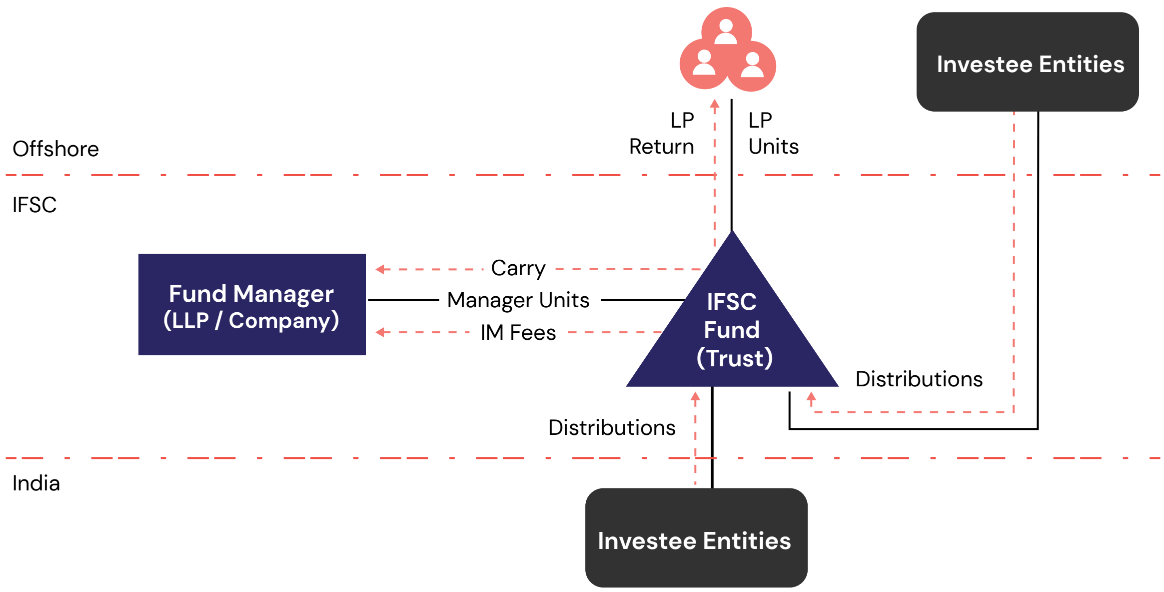
[14] Section 80LA, Indian Income-tax Act, 1961

The fact that an IFSC Fund is treated as both a resident for tax purposes and a non-resident for FEMA purposes provides a unique opportunity for Indian GPs to take advantage of a regulatory framework akin to what they would fund in any prominent offshore fund jurisdiction, while eliminating the risk of double taxation as the IFSC Fund will only qualify as a tax resident of India.

Indian GPs setting up in IFSC would also have the benefit of lower set up and operational costs as well as closer physical proximity to the fund, and relatively faster registration timeline as compared to most other offshore jurisdictions like Singapore or Mauritius.

Basic IFSC Fund Structure

A typical IFSC Fund structure is as follows:



The above IFSC Fund structure is ideal for Indian GPs having a global investment strategy and intending to raise money entirely from offshore LPs - whether they be institutional, individuals, corporates, or family offices. In the event that an offshore GP is also part of the management team, he / she can capitalise the manager without any FEMA restrictions.

However, if funds are intended to be raised from India, a master feeder structure or co-invest structure is generally preferred. While offshore LPs pool their contributions into the IFSC Fund, Indian LPs can contribute directly into the SEBI-regulated AIF.

These structures are advantageous as they mitigate any potential FEMA restrictions around Indian LPs investing in an offshore fund which invests back into India (ie. roundtripping). They also enable Indian LPs to invest freely into the fund structure at the AIF level, whereas if they had to invest at the IFSC Fund level, they would be subject to investment caps under FEMA (ie. USD 250,000 under LRS route for individuals and 50% of net worth for entities).

Conclusion

From introducing the FM Regulations which are at par with global standards, to significant tax incentives under the ITA, to a preferential treatment of investments made into GIFT City under the OI Rules, the Government has taken substantial steps towards making GIFT City an enticing jurisdiction for fund managers. While over 50 funds have already registered in GIFT City, as the IFSC's credibility and LP comfort grows in the next few years it won't be surprising to see many more fund managers take advantage of this low cost alternative to jurisdictions like Delaware, Singapore, and Mauritius.

Utsav Shah

Principal Officer & Head GIFT IFSC
Aditya Birla Sun Life AMC Limited

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Aditya Birla Sun Life AMC Ltd (ABSLAMC) is amongst the first AMCs to set up a fund in GIFT IFSC. Can you share your experience in GIFT City?

- Our journey in GIFT City began when we engaged with the IFSCA (International Financial Services Centre Authority) to explore the potential of GIFT City for our International business vertical at ABSLAMC. At that time, we were managing India dedicated strategies through our Singapore Investment Management Entity.
- Upon evaluating GIFT City, we conducted extensive research and analysis, comparing it with our existing fund structures located in Mauritius, Ireland, and Cayman Islands. Based on our findings, we presented our recommendations to the IFSCA. We were pleased to receive positive feedback from IFSCA, which further bolstered our confidence in GIFT City.
- In November 2022, we obtained our Fund Management Entity (Non-Retail) licence, enabling us to establish our presence in GIFT City for our international business vertical. This was a significant milestone for us, as it enabled us to manage India dedicated offshore funds, which were previously managed outside of India, from GIFT City. Additionally, we have plans to launch new India dedicated strategies from GIFT City and offer global investment solutions to both NRI and Indian investors.
- We firmly believe that GIFT City has immense potential to become a world-class fund domicile hub. The proactive approach of IFSCA and their willingness to align regulations with global standards have instilled confidence in us.
- Overall, our experience in GIFT City has been favourable, and we are committed to leveraging the advantages and opportunities presented by GIFT City to further strengthen our international business vertical and serve the needs of our investors.

How can the IFSC-GIFT City be used to channelize investments that are currently made by Indian resident investors, to invest in overseas financial assets under the Liberalised Remittance Scheme?

- Indian investors are increasingly investing globally to diversify across geographies, currencies, and market conditions.
- A resident individual, under the Liberalised Remittance Scheme, can freely remit up to USD 250,000 every financial year for making international investment in an offshore fund.
- Resident Indians remitted a record USD 27.14 billion under the liberalised remittance scheme (LRS) in the financial year ended March 31, 2023. LRS remittance for Deposits and Investments in equity/debt amounted to almost USD 1 billion and USD 1.25 billion respectively[15].
- The regulatory framework governing the IFSC has enabled the establishment of GIFT City-domiciled funds that can invest in global markets. Resident individuals are permitted to invest in these GIFT-domiciled funds.
- By leveraging the advantages of the IFSC-GIFT City, resident Indian investors can effectively utilise the Liberalised Remittance Scheme to diversify their investments in overseas financial assets, while simultaneously contributing to the growth of India's fund management industry.

[15] https://www.rbi.org.in/scripts/BS_ViewBulletin.aspx?Id=18973

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How can the IFSC at GIFT City attract NRI Investments?

- The total population of Overseas Indians is more than 32 million, indicating a significant potential investor base[16].
- India tops the chart as highest receiver of inward remittances with last year observing inflow of USD 107.5 billion during calendar year 2022[17].
- Despite the significant potential of this investor segment, it remains largely untapped, presenting a substantial opportunity given their strong affinity towards their home country.
- Currently NRIs are permitted to invest in Indian markets directly (PIS route) as well as through mutual fund route.
- However, with current complex regulatory framework & issues relating to tax filings, NRIs are gradually wanting to keep their funds in foreign currency and invest through funds domiciled outside India.
- Most of the NRIs prefer to invest into a dollar version of the Fund. This allows them flexibility to diversify their investment as well.
- NRIs now have the option to invest in GIFT domiciled funds, both for India-focused (Inbound) and global (Outbound) investment strategies.
- GIFT City is poised to become a preferred investment destination for NRIs due to its investor-friendly environment and attractive offerings for their investment requirements.

What types of products is ABSLAMC planning to launch from GIFT City?

We are looking to launch an ESG fund which focuses on a combination of traditional financial analysis and analysis of the environmental, social, and governance aspects of the company to identify long-term sustainable investment opportunities. The Fund's strategy would involve working with portfolio companies to improve their ESG standards over time, thereby improving their financial and ESG metrics.

We are also looking to launch a fund-of-fund (FoF) which would be feeding into the units of a leading global value manager, which manages client assets for large institutions around the world.

[16] https://www.bqprime.com/web-stories/indian-diaspora-how-many-indians-live-abroad
[17] https://economictimes.indiatimes.com/nri/invest/how-nri-money-is-bolstering-indias-economy/articleshow/99318136.cms