UPDATES

Budget 2021 - Tax Incentives For International Financial Services Centre (Part 4)

04 March 2021

This update covers:

We have seen a considerable push from the government to make the International Financial Services Centre (**IFSC**) in GIFT City, a global financial hub. With the Finance Bill, 2021 (**Bill**), a slew of measures have been proposed to boost business activity in IFSC. We discuss some of these developments below.

Budget 2021 seeks to incentivize a host of activities undertaken in IFSC such as setting up of investment divisions of offshore banking units in IFSC, relocation of offshore funds in India, aircraft leasing activity in IFSC etc.

1 Promotion of offshore fund management from IFSC

A Business connection is a form of taxable presence in another country, similar to the Permanent Establishment (**PE**) concept under tax treaties. Business connection provisions under the Income Tax Act (**ITA**) seek to determine income deemed to accrue or arise in India.
Generally, the concept of 'business connection' under the ITA is much broader than the concept of PE.

Section 9A of the ITA was however introduced to provide for a specific carve out from the application of these business connection provisions, subject to the taxpayer fulfilling certain conditions enumerated therein (**Carve out Conditions**). The Bill now provides that the government may notify relaxations in the fulfillment of one or more of such Carve Out Conditions for an eligible investment fund or its eligible fund manager, if the fund manager is located in an IFSC and has commenced operations on or before 31 March 2024. Thus, the full import of this provision would only be determined once the Government actually notifies the relaxations that would be available to the eligible fund manager located in IFSC.

2 Promotion of setting up of investment divisions in IFSC by offshore banking units

Under Section 47(viiab) of the ITA, the transfer of a capital asset being specified bonds or GDRs, rupee denominated bonds of an Indian company, derivatives or other notified securities by a non-resident on a recognized stock exchange located in an IFSC is not treated as a taxable transfer (provided the consideration for the transfer is payable in foreign exchange). Section 10(4D) of the ITA further exempts income accrued or arising to a '***specified fund***' (being a category-III Alternative Investment Fund (**AIF**) located in an IFSC of which all the units are held by non-residents (other than units held by a sponsor or manager)) as a result of a transfer referred to in Section 47(viiab) of the ITA.

The Bill proposes to extend the scope of Section 10(4D) to provide that the exemption will also be available for any income accruing or arising to an 'investment division of offshore banking unit' (to the extent attributable to it and computed in the prescribed manner).

Further, the Bill proposes to amend the definition of '***specified fund***' to include 'investment division of an offshore banking unit' which has been granted a category III AIF registration, subject to the fulfilment of prescribed conditions. Additionally, 'investment division of offshore banking unit' is proposed to be defined as an investment division of a banking unit of a non–resident located in an IFSC and which has commenced operations on or before the 31 March 2024.

The Bill also proposes to extend the concessional tax rates provided under Section 115AD of the ITA to such investment division of an offshore banking unit in the manner applicable to a 'specified fund'. The provisions of Section 115AD will apply to the extent of income that is attributable to the investment division of such banking unit as a Category-III portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio investors) Regulations, 2019, calculated in the prescribed manner.

3 Incentivizing aircraft leasing activity

The Bill proposes that any income of a non-resident by way of royalty on account of lease of an aircraft paid by a unit of an IFSC would be tax exempt. This provision is subject to certain prescribed conditions.

The Bill also proposes to amend Section 80LA of the ITA to provide exemption from tax to capital gains arising to a unit located in IFSC on transfer of aircraft or aircraft engine which was leased by it to a domestic company engaged in the business of operation of aircraft prior to such transfer. This provision is also subject to certain prescribed conditions.

4 Facilitating relocation of foreign funds to IFSC

The Bill proposes to insert a new Section 10(23FF) in the ITA exempting from capital gains tax certain incomes in case of relocation of a foreign fund to India.

'Relocation' is proposed to be defined as the transfer of assets of the original fund to a resultant fund on or before 31 March 2023, where the consideration for the transfer is discharged in the form of shares or units or interest in the resulting fund to the shareholder or unit holder or interest holder of the original fund, in the same proportion in which shares or units or interest were held by such shareholder or unit holder or interest holder in the original fund.

In this regard, 'original fund' is proposed to be defined as a fund established or incorporated or registered outside India, which collects funds from its members and invests them for their benefit and fulfils prescribed conditions. 'Resultant fund' is proposed to be defined as a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership which fulfils prescribed conditions.

The Bill proposes exemption from capital gains tax of the following incomes in case of relocation of a foreign fund to India:

a. income arising to or received by a non-resident, which is on account of transfer of shares of a company resident in India by the resultant fund and such shares were transferred from the original fund to the resultant fund in relocation, if capital gains on such shares were not chargeable to tax had the relocation not taken place.

b. income arising from any transfer, in relocation, of a capital asset by the original fund to the resultant fund.

c. income arising from any transfer by a shareholder or unit holder or interest holder, in a relocation, of a capital asset being a share or unit or interest held in the original fund in consideration for the share or unit or interest in the resultant fund.

5 Additional amendments to Section 80LA

Section 80LA provides a tax holiday in respect of certain incomes of specified offshore banking units and IFSC units. An amendment has been proposed to Section 80LA to provide that deduction under Section 80LA would also be available to an IFSC unit if it is registered under the International Financial Services Centre Authority Act, 2019. This amendment would effectively remove the requirement of the unit obtaining permission under the relevant law for the purposes of availing the tax holiday. Instead, registration under the International Financial Services Centre Authority Act, 2019 would suffice.

These amendments will take effect from 1 April 2022.

Our detailed updates on key tax proposals across different areas can be accessed through the links below:

1 Implications for InvITs and REITs

2 Rationalisation of Equalisation Levy provisions

3 Impact on mergers and acquisitions

4 Tax incentives for International Financial Services Centre

5 Key tax proposals for housing sector

6 Key tax proposals for employees

7 Other key proposals

8 Key indirect tax proposals