

## ERGO

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### TIME FOR FUND MANAGERS TO GO THE 'GIFT' WAY: IFSC AIFS MADE MORE ATTRACTIVE

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#### Harmonisation of investment norms for IFSC AIFs with onshore AIFs

The Securities and Exchange Board of India (SEBI), vide its circular SEBI/HO/IFSC/CIR/P/2019/91 dated 9 August 2019 (Circular) extended a magnanimous helping hand to alternative investment funds (AIFs) set up in the International Financial Services Centre (IFSC) regime by harmonizing the provisions governing investments by AIFs incorporated in IFSC with those provisions regarding investments applicable for domestic AIFs.

With the rapid development of the IFSC regime as a deemed foreign jurisdiction offering vibrant opportunities for the proliferation of fund set-up and fund management activities in the Gujarat International Finance Tec-City (GIFT City), stakeholder representation to SEBI regarding the alignment of the investment restrictions applicable to onshore AIFs and IFSC AIFs has been very spirited recently. These active representations to regulators with regard to the IFSC regime is also catalysed by an increased interest of financial service sector players such as fund managers, insurance companies, brokerage firms, merchant banks, investment banks, etc. to set up branches in the GIFT City, owing to a steady stream of taxation relaxations post the 2019-2020 budget.

The Circular now permits AIFs incorporated in IFSC to make investments as per the provisions of the SEBI (Alternative Investment Fund) Regulations 2012 (AIF Regulations) and the guidelines and circulars issued thereunder, including the operating guidelines for AIFs in IFSC. Based on our understanding of the Circular, we have summarised, hereinbelow, the principal changes that will be applicable to IFSC AIFs regarding the application of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 (TISPRO Regulations) and the SEBI (Foreign Portfolio Investors) Regulations 2014 (FPI Regulations):

Criterion	Pre Circular Position	Post Circular Position
<i>Applicability of foreign portfolio investor (FPI), foreign direct investment (FDI) or foreign venture capital</i>	For any investment in onshore entities, IFSC AIFs could only invest under the FDI, FVCI or the FPI routes and would hence be subject to relevant investment restrictions in accordance with the applicable investment	IFSC AIFs will now only be required to comply with the investment restrictions applicable to AIFs under the AIF Regulations.

<i>investor (FVCI) investment restrictions</i>	regime, which would be applicable to ISFC AIFs in addition to the investment restrictions applicable to AIFs under the AIF Regulations.	However, please note that for Category III IFSC AIFs having foreign investment, the requirement to only invest in such securities that are permissible to be invested into by FPIs will continue to apply for such IFSC Category III AIFs.
<i>Investment limits</i>	To the extent IFSC AIFs were investing into onshore investee entities under the FPI Regulations, such investments were capped at "10% of the total paid-up equity capital of an investee company".	Now, depending on the category of the IFSC AIF, such IFSC AIFs may invest up to "10% or 25% (as may be applicable) of its investable funds or corpus in a single investee company" - which could translate to being more than 10% of the paid up equity capital of an investee company.
<i>Non-resident Indian (NRI) participation</i>	Given that IFSC AIFs had to seek FPI registration for investment (e.g. investment in listed Indian securities) the restriction on participation of NRIs (both on individual and aggregate levels) for FPIs would also become applicable to IFSC AIFs.	There is no restriction on participation of NRIs in IFSC AIFs (both on individual and aggregate levels). This should allow greater flexibility for IFSC AIFs to tap into the NRI market.
<i>Choice of securities for investment</i>	Owing to the FPI conditionalities applicable to IFSC AIFs, Category I and Category II IFSC AIFs were only permitted to invest in securities which were permissible for investment by FPIs.	All securities which are permissible for investment by AIFs will also be permissible for investment by IFSC AIFs. However, for Category III IFSC AIFs, the universe of permissible investment securities will stay limited to such securities that are permissible for investment by FPIs as per Schedule 8 of the TISPRO Regulations.
<i>Leverage</i>	Owing to the restrictions on FPIs from creating any charge on underlying securities, even IFSC AIFs (specially Category III IFSC AIFs) were restricted from creating any charge in underlying securities, thereby limiting the scope of leverage activities of such IFSC AIFs.	Subject to the leverage limits applicable to AIFs under the AIF Regulations, there will be no restrictions on creation of charge on underlying assets for IFSC AIFs, therefore promoting more flexibility in leverage activities of IFSC AIFs.

**Exemption from filing income tax returns for non-resident investors investing in IFSC AIFs**

Further, in another much-awaited development on the tax front, the Central Board of Direct Taxes (CBDT), vide its notification No. 55/2019, dated 26-07-2019 has exempted non-residents earning income from AIFs set up in IFSC from the requirement of filing

of return of income under section 139 of the Income-tax Act 1961 (IT Act). The exemption is available subject to fulfilment of certain conditions, namely:

- Non-resident has earned income from an IFSC AIF located in India;
- Such income (in respect of filing income tax returns) is the only income of such non-resident which is taxable in India;
- Tax due on such income has been deducted and deposited to the credit of Central Government in accordance with section 194LBB (i.e. compliance with the withholding obligation under the said section); and
- no notice under section 142(1) or section 148 or section 153A or section 153C of the IT Act has been issued to such non-resident person for filing of return of income.

In light of the above changes introduced in relation to IFSC AIFs combined with the other existing incentives available for units set up in IFSC, GIFT City has clearly started making a compelling case for investment managers to seriously consider setting up IFSC based AIFs in India for their overseas investors. It appears that the policy push is palpably in the direction to promote IFSC and that the government and the policy makers are willing to take go the extra mile to make IFSC regime more conducive for investment managers.

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