GIFT CITY : HITS AND MISSES (DIRECT AND INDIRECT TAXATION ASPECTS)

The Gujarat International Finance Tec-City ('**GIFT City**') is a planned financial and technology district located in Gujarat, India. GIFT City was designed to be a global financial and business hub and to compete with the International Financial Centres in Dubai and Singapore. GIFT City aims to attract domestic and international investment by offering world-class infrastructure, relaxed regulations, and promoting financial services and technological innovation in India.

GIFT City has been set up as a Special Economic Zone by the Government of India, with the majority of the Processing Area being governed by the IFSC Authority as an International Financial Services Centre ('**IFSC**') to facilitate financial and international trade with various direct and indirect tax exemptions. This includes exemption from taxation on capital gains and zero-rated GST. Additionally, all supplies to the GIFT City SEZ from the Domestic Tariff Area within the district or from any other part in India will be liable to Basic Customs Duty at Nil rate. However, clearances and supplies from the GIFT City SEZ and IFSC will be taxable.

Due to GIFT City being essentially a multi-services SEZ, it has seen high growth in the IFSC with multiple industries and sectors setting up operations within the district to avail of the incentives granted. These include banking and financial services, insurance, asset management, IT and ITES, technology, stock exchanges, etc.

Framework of GIFT City

GIFT City is demarcated in into the GIFT City Special Economic Zone ('**SEZ**') and the Domestic Tariff Area ('**DTA**'). The majority of the units in GIFT City are set up in the International Financial Services Centre which has been established in the SEZ. The SEZ is further demarcated into the Processing Area ('**PA**'), wherein the units which have been granted approval undertake the authorized operations, and the Non-Processing Area ('**NPA**'), which within GIFT City includes not only the necessary support infrastructure to the PA but also residential complexes, hospitals, schools and commercial space to incentivize foreign investment.

The framework of the SEZ area of GIFT City is governed by the Special Economic Zones Act, 2005.[1] Once a SEZ has been established with the approval of the Central Government under Section 3,[2] the Developer who has been granted a Letter of Approval under sub-section (3) may be authorized to undertake authorized operations.

Since the units in GIFT City are essentially units within the IFSC established in the SEZ PA, the following statutory provisions are relevant.

Statutory framework of the SEZ & IFSC units in GIFT City

- Section 6 of the SEZ Act provides that the areas falling within the SEZ may be demarcated by the Central Government or any other authority as follows:[3]

  a. Processing Area for setting up Units for activities being the manufacture of goods or rendering services;
  b. Area exclusively for trading or warehousing process;
  c. Non-Processing Areas for activities other than those specified above.

- It is key to note that GIFT City SEZ has been demarcated into a Processing Area, within which the IFSC is also located and the Non-Processing Area, which serves as an urban residential and commercial infrastructural space to support the Processing Area, IFSC and DTA.

- It is imperative to discuss some important definition clauses that are significant for the SEZ framework of GIFT City.[4] In terms of the definition clause in the SEZ Act, "Unit" is defined in Section 2(zc) to mean:

  a. A unit set up by an entrepreneur in a SEZ, including;
  b. An existing Unit
  c. An Offshore Banking Unit
  d. A Unit in an IFSC

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[1] Special Economic Zones Act 2005

[2] Special Economic Zones Act 2005, s 3

[3] Special Economic Zones Act 2005, s 6

[4] Special Economic Zones Act 2005, s 2

- Section 2(z) defines ‘services’ to mean tradable services covered under the General Agreement on Trade in Services, as may be prescribed by the Central Government for the purpose of the SEZ Act and which earns foreign exchange.

- It is pertinent to note that Section 2(u) of the SEZ Act defines “Offshore Banking Unit” to mean a branch of a bank located in a SEZ which has obtained the permission under Section 23 of the Banking Regulation Act, 1949. This would be applicable to banks located in the GIFT City SEZ as an IFSC unit.

- The scope of “manufacture” is covered by clause (r) to Section 2 of the SEZ Act which includes the following activities:

    a. Make, produce, fabricate, assemble, process or bring into existence, by hand or by machine a new product having a distinctive name, character or use;
    b. Refrigeration, cutting, polishing, blending, repair, remaking, re-engineering;
    c. Agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture, mining.

- The scope of authorized operations of an SEZ is clearly laid out in Section 2(c) of the SEZ Act wherein it is defined to mean operations which may be authorised under sub-section (2) of Section 4 and sub-section (9) of Section 15.

- It is significant to note that the terms ‘import’ and ‘export’ have been specifically defined for the purpose of the SEZ Act in Section 2.

  ‘Import’ is described in clause (o) to mean:

    a. Bringing goods or receiving services in a SEZ by a Unit or Developer from a place outside India by land, sea or air or by any other mode, whether physical or otherwise;
    b. Receiving goods or services by a Unit or Developer from another Unit or Developer of the same SEZ or a different SEZ.

  ‘Export’ is described in clause (m) to mean:

    a. Taking goods or providing services out of India from a SEZ by land, sea or air or by any other mode, whether physical or otherwise;
    b. Supply goods or providing services from the DTA to a Unit or Developer;

c. Supplying goods or providing services from one Unit to another Unit or Developer in the same or different SEZ.

Significantly, Section 7 of the SEZ Act provides that any goods or services:[5]

a. Exported out of the DTA by a Unit in a SEZ or a Developer;
b. Imported into the DTA a Unit in a SEZ or a Developer;
c. Procured from the DTA by a Unit in a SEZ or a Developer;

shall be exempt from the payment of taxes, duties or cess under all enactments specified in the First Schedule, subject to such terms, conditions and limitations as may be prescribed. The enactments in the First Schedule of the SEZ Act include various cesses and additional duties of excise.

- Section 26 further lists out the exemptions, drawbacks and concessions available to every Developer and entrepreneur in an SEZ:[6]

  a. Exemption from any duty of Customs under Customs Act, 1962 (CA) or Customs Tariff Act, 1975 (CTA) or any other law being in force for the time on goods imported into or service provided in SEZ or a Unit to carry on authorised operations and on goods exported from or services provided from a SEZ or a Unit to any place outside India;
  b. Exemption from any duty of excise under Central Excise Act, 1944 or any other law on goods brought from DTA to SEZ to carry on authorised operations;
  c. Drawback or such benefits as admissible from time to time on goods brought or services provided from DTA to SEZ or services provided in SEZ by service providers located outside India to carry on authorised operations;
  d. Exemption from service tax on taxable services provided to carry on authorised operations in SEZ;
  e. Exemption from Security Transaction Tax leviable under Section 98 of the Finance Act, 2004 in case taxable securities transactions are entered into by non-resident through IFSC;

[5] Special Economic Zones Act 2005, s 7

[6] Special Economic Zones Act 2005, s 26

f. Exemption from levy of taxes on sale or purchase of goods other than newspapers under CST if goods meant to carry on authorised operations.

- The SEZs are provided a Single Window Clearance under the SEZ Act, 2005. Under Section 15, the Development Commissioner and the Approval Committee shall approve the proposal of any person who intends to set up a Unit for carrying on the authorised operations in a SEZ. In terms of sub-section (9) to Section 15, the Development Commissioner may grant the Letter of Approval to the person to set up a Unit to undertake such operations as are authorised and mentioned in the Letter of Approval.[7]

- It may be noted that in terms of Section 17 of the SEZ Act, the application for setting up and operation of an Offshore Banking Unit in a SEZ may be made to the Reserve Bank of India, which may also notify the terms and conditions for the same.[8]

- An International Financial Services Centre (only one per SEZ) may be set up in an SEZ with the approval of the Central Government in terms of Section 18 of the SEZ Act read with Notification No. D. 12/25/2009-SEZ dated 08.04.2015,[9] which provides the procedure for setting up an IFSC unit in SEZs. The validity of the LOA which may be issued by the Development Committee is initially 1 year which may be extended by the DC for a further period of not more than 2 years. However, once the unit commences service activities, the LOA is valid for 5 years from such date and the NFE obligations must be fulfilled in terms of Rule 53 of the SEZ Rules.

INCENTIVES OFFERED

Many economies have employed tax incentives strategically to entice foreign sources of capital investment. One key approach is to offer preferential tax rates or tax holidays to foreign investors.[10] By reducing the tax burden on profits generated from their investments,

[7] Special Economic Zones Act 2005, s 15

[8] Special Economic Zones Act 2005, s 17

[9] Special Economic Zones Act 2005, Notification No. D. 12/25/2009-SEZ, 08.04.2015

[10] Alina Cristina, 'The Effectiveness of the Tax Incentives on Foreign Direct Investments' 2012 (1) JPAFL <https://www.jopafl.com/uploads/THE-EFFECTIVENESS-OF-THE-TAX-INCENTIVES-ON-FOREIGN-DIRECT-INVESTMENTS.pdf> accessed on 04 October 2023

governments can make their jurisdictions more attractive for foreign businesses. This can lead to an influx of foreign capital, stimulating economic growth and job creation.[11]

The Indian government has more or less touched upon the above methods to incentivize capital investment from abroad, by offering the following incentives to the units set up in the IFSC GIFT City. Some of the indirect and direct tax incentives that have been offered to the units located in IFSC have been discussed as under:

1. **Zero-rated inward supplies**: The inward supplies of goods are services to GIFT City are zero-rated in terms of Section 16 of the Integrated Goods and Services Tax Act, 2017.[12]

2. **Nil Basic Customs Duty ('BCD')**: The BCD for inward supply of goods imported for authorized operations within the GIFT City has been reduced to *nil.*

3. **Custom duty draw-back**: The benefit of drawback of customs duty can be availed by the SEZ units in GIFT City on goods brought into the SEZ for authorised operations.

4. ***Nil* GST on services rendered**: No GST payment on services received by SEZ units in GIFT City or by offshore clients in the IFSC.

5. **Supply deemed as export**: The supply of goods or services by an Export Oriented Unit or a Software Technology Park to a SEZ unit in GIFT City is regarded as an export and eligible to claim deemed export benefits under the Foreign Trade Policy.

6. **Exemption from sales tax**: Exemption from Central Sales Tax on the inter-state procurement of goods for authorized operations by the units in GIFT City SEZ.

7. **Exemption from excise duty:** The excise duty payment has been exempted on domestic procurement for authorized operations in the SEZ units in GIFT City.

8. **Similar benefits as SEZ units**: The IFSC units in GIFT City are eligible for all benefits and concessions available to a Special Economic Zone.

[11] Erick Okoth, 'Effects of Tax Incentives and Subsidies on Economic Growth in Developing Economies' 2023 7(7) IJRISS < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4532631> accessed on 04 October 2023

[12] Integrated Goods and Services Tax Act 2017, s 16

9. **No GST on security transactions**: GST payment has been exempted on the transactions undertaken in the exchanges in the IFSC.

10. **Tax holiday**: The key tax advantage that GIFT City IFSC provides is an income-tax holiday for 10 consecutive years, within a block of 15 years, beginning from the previous year in which the requisite statutory approvals were obtained. This exemption has been envisaged in Section 80LA of the IT Act.[13] This results into huge tax savings especially when compared to the existing tax rates for foreign companies (40%) and domestic companies (25-30%).

11. **Minimum Alternate Tax ('MAT')**: The rate of MAT has been reduced to the rate of 9% as compared to 15% of the book profits of any other companies. This has been discussed later in detail.[14]

12. **Long-term capital gains**: Sub-section 3 of Section 112A of the IT Act provides an exemption from long-term capital gains tax arising from any transaction undertaken on a recognized stock exchange located in an IFSC, in foreign currency, irrespective of payment of securities transaction tax ('**STT'**) on the same.[15]

13. **Short-term capital gains**: The second proviso to Section 111A extends the benefit of the concessional tax rate of 15% on short-term capital gains to the transactions undertaken through a recognised stock exchange located in an IFSC, in foreign currency, even where no STT is payable.[16]

14. **Concessional tax on interest income**: As per the first proviso to Section 194LC, the interest income received by a non-resident arising from long-term or rupee-denominated bonds, listed on a recognised stock exchange in an IFSC is taxable at the concessional rate of 4%. It is pertinent to note that this is subject to a sunset clause of 30th June 2023.[17]

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[13] Income-tax Act 1961, s 80LA

[14] Income-tax Act 1961, s 115JB(7)

[15] Income-tax Act 1961, s 112A(3)

[16] Income-tax Act 1961, s 111A

[17] Income-tax Act 1961, s 194LC, 194LS(2)(ib)

Further, the Finance Act, 2023 has inserted a second proviso to Section 194LC(1) to clarify that the interest income payable to a non-resident arising from bonds issued after this date and listed only on a recognised stock exchange in the IFSC, are taxable at the rate of 9%.[18]

15. **Interest income exempt**: Clause (ix) of Section 10(15) of the Act provides an exemption to the interest payment received by a non-resident from a unit located in an IFSC with respect to money borrowed by it on or after 1st September 2019.[19]

16. **Beneficial tax rate for dividend received**: The Finance Act, 2023 has added a proviso to Section 115A(1), providing that the dividend income received by a non-resident from a unit set up in an IFSC shall be taxable at the concessional rate of 10%.[20]

17. **Additional tax benefits offered to banking units set up in IFSC**: As per Section 10(4E) of the IT Act, a non-resident is granted an exemption on income generated from the transfer of non-deliverable forward contracts, offshore derivative instruments, or over-the-counter derivatives executed with an offshore banking unit ('OBU') within an IFSC, provided all specified conditions are met.[21] It is interesting to note that earlier, this exemption was only with respect to transfer of non-deliverable forward contracts. The scope of this exemption has been extended by the government vide Finance Act, 2023, through which offshore derivative instruments and over-the-counter derivatives instruments were also brought within the ambit of Section 10(4E).

    Furthermore, the Finance Act 2023 has proposed substitution of Section 10(4G), wherein the income derived by a non-resident from a portfolio of securities, financial products, or funds managed or administered by a portfolio manager on behalf of the non-resident shall be exempted.[22] This exemption applies when the account is

[18] Income-tax Act 1961, s 194LC(1), 194LS(2)(ic)

[19] Income-tax Act 1961, s 10(15)(ix)

[20] Income-tax Act 1961, s 115A(1)

[21] Income-tax Act 1961, s 10(4E)

[22] Income-tax Act 1961, s 10(4G)

maintained with an OBU in an IFSC, as long as the income accrues outside India and is not deemed to arise within India.

18. **Exclusion for deemed gift provisions**: The deemed gift rules outlined in Section 56(2)(viib) of the IT Act[23] do not apply to excess share premium received by an Indian Company from a Category I or Category II Alternate Investment Fund regulated under the IFSC Act.

19. **Aircraft and Ship Leasing**: As per Section 10(4F), any royalty income of a non-resident on account of lease of aircraft which is paid by a unit located in an IFSC is exempt from tax.[24] Further, Section 80LA of the IT Act provides exemption from tax to capital gains arising to a unit located in IFSC on transfer of an aircraft or aircraft engine, which was leased by it to any domestic company which is engaged in the business of operation of aircraft prior to such transfer.[25]

    The Central Board of Direct Taxes (‘**CBDT**’) vide a recent notification[26] has provided relief by way of exemption from tax withholding obligations on dividend payments in the case of IFSC units primarily engaged in the business of leasing aircraft. Lastly, any capital gains arising from transfer of aircraft or aircraft engine leased by IFSC unit to a domestic company are 100% exempt, as per the terms of Section 80LA(2)(d), provided that the unit commences its operations in the IFSC before 31st March, 2024.

    One of the most recently introduced incentives offered in this regard is under Section 10(34B), which provides that dividend income of a unit of IFSC, primarily engaged in the business of leasing of aircraft, from a company being a unit of any IFSC, which is also primarily engaged in business of leasing of aircraft, is exempt from tax.[27]

20. **No PAN or tax payment requirement for non-residents**: Rule 114AAB which was notified vide the Income-tax (19th Amendment) Rules, 2020 exempts all non-residents

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[23] Income-tax Act 1961, s 56(2)(viib)

[24] Income-tax Act 1961, s 10(4F)

[25] Income-tax Act 1961, s 80LA

[26] Central Board of Direct Taxes, Notification No. 52 of 2023 dated 20.07.2023

[27] Income-tax Act 1961, s 10(34B)

from the mandatory requirement of obtaining a permanent account number ('**PAN**'). Therefore, a non-resident, who has invested in Category I or II alternative investment fund ('**AIF**') located in IFSC, is not required to obtain PAN, if it does not earn any other income in India during the previous year. Further, the non-resident must furnish requisite details and documents to such AIF as prescribed under the Rules.

21. **STT and other exemptions**: Units located in IFSC are eligible for various state subsidies with respect to lease rental, provident fund contribution, electricity charges etc. Further, even the investors enjoy exemption from STT, CTT and stamp duty in respect of transaction carried out on the stock exchanges located in IFSC.

HITS AND MISSES

To incentivize foreign investments, the corporate income-tax rate on the income of investment companies set up in the GIFT City has been reduced significantly. While several companies have already set-up or applied to set up a branch or subsidiary in the GIFT City, others are critically contemplating starting operations in the GIFT City. However, there are some challenges that still need to be addressed, which are causing some apprehensions, resistance and slowdown, owing to uncertainties and short period of the tax benefits.

1. Hit: Zero rated supplies to SEZ & refund of IGST

Section 16(1) of the Integrated Goods and Services Tax Act, 2017 ("IGST Act") states that "zero rated supply" means any of the following supplies of goods or services or both, namely:[28]

(a) export of goods or services or both; or
(b) supply of goods or services or both for authorised operations to a Special Economic Zone developer or a Special Economic Zone unit.

On the basis of the above, it can be understood that when the DTA or the SEZ units make supply of goods or services to any unit in GIFT City, including the IFSC units, the said supply will qualify as zero-rated supply.

Further, Section 16(3) of the IGST Act states that a registered person making zero rated supply shall be eligible to claim refund under either of the following options, namely:

[28] Integrated Goods and Services Tax Act 2017, s 16

(a) he may supply goods or services or both under bond or Letter of Undertaking, subject to such conditions, safeguards and procedure as may be prescribed, without payment of integrated tax and claim refund of unutilised input tax credit; or

(b) he may supply goods or services or both, subject to such conditions, safeguards and procedure as may be prescribed, on payment of integrated tax and claim refund of such tax paid on goods or services or both supplied.

Section 16(3) of the IGST Act was amended w.e.f. 01.10.2023 to state that a registered person making zero rated supply shall be eligible to claim refund of unutilised input tax credit on supply of goods or services or both, without payment of integrated tax, under bond or Letter of Undertaking, in accordance with the provisions of Section 54 of the Central Goods and Services Tax Act, 2017[29] or the rules made thereunder, subject to such conditions, safeguards and procedure as may be prescribed.

It follows from the above that any zero-rated supply in GIFT City can be made under bond and LUT to claim refund of unutilised input tax credit, or the supply can be made on payment of IGST which can then be claimed as refund later on, subject to fulfilment of respective conditions in the CGST Rules, 2017 for the same.

Miss: Lack of clarity on GST payments in GIFT City under RCM

While the units in the GIFT City IFSC benefit greatly from the zero rated supplies, there is still an lack of clarity with respect to the payments of GST under Reverse Charge Mechanism (RCM) by any SEZ unit for services procured from the DTA, and the eligibility to claim refund or input tax credit therein.

As is evident from Section 16(3) of the IGST Act extracted above, the benefit of zero-rating is available to the 'supplier' only. Section 5(3) of the IGST Act[30] prescribes that the recipient of the zero-rated supply covered under RCM will be treated the person liable for the payment of GST; however, the provision does not stipulate that such person will be treated as a 'supplier'. Hence, it can be inferred that a IFSC unit receiving services under RCM will not be treated as

[29] Central Goods and Services Tax Act 2017, s 54

[30] Integrated Goods and Services Tax Act 2017, s 5

a 'supplier'. In such a scenario, the IFSC unit may not be able to claim the benefit of zero-rating under Section 16.

It can be noted from the CBIC Clarification dated 15.12.2018[31] that a SEZ unit recipient of RCM services is required to pay IGST on procurement of supplies on which GST is required to be paid by the recipient. However, since the above clarification was issued as FAQ by the CBIC, it can be interpreted as being merely clarificatory in nature and not binding.

The Maharashtra Authority for Advance Ruling in ***M/s. Portescap India Private Limited*** reported at ***2021-VIL-464-AAR***[32] wherein it was ruled that the applicant SEZ unit is liable to pay GST under reverse charge mechanism on procurement of renting of immovable property services from Seepz Special Economic Zone Authority (Local Authority) which are covered by the RCM Notification. Therefore, IFSC units in GIFT City procuring such services may also be liable to pay GST on notified RCM supplies received from the DTA to the SEZ area.

However, in terms of Section 16(3) of the GST Act read with the clarification issued by the TRU of the CBIC vide F. No. 334/335/2017-TRU dated 18.12.2017,[33] it can be understood that where the intention of the legislature is not to tax supplies to a SEZ unit, the GST paid on RCM on services received is to be remitted as the benefit of zero-rating can be claimed by execution of bond or LUT.

Due to the contrary two positions as aforementioned, there is lack of clarity for IFSC units in the GIFT City SEZ on whether the zero-rating benefit should be availed by submitting a LUT for RCM supplies received, or whether GST should be discharged in order to avoid litigation.

The CBIC or Development Commissioner for GIFT City should issue a clarification or a notification to clarify the payment of GST on notified RCM supplies received by units in the SEZ and the IFSC, and whether such GST can be claimed as input tax credit. The same can be brought out vide a provision of law as well to clarify whether zero-rating is applicable to RCM supplies as well.

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[31] Central Board of Indirect Taxes and Customs, Clarification, 15.12.2018

[32] *M/s. Portescap India Private Limited* 2021-VIL-464-AAR

[33] Central Board of Indirect Taxes and Customs – Tax Research Unit, Clarification, 18.12.2017

2. Hit: Greater opportunities for the IFSC in GIFT City in case of transition of SEZ to DESH under proposed bill

It is pertinent to note that *inter alia,* the SEZ Scheme was challenged by the USA in 2018 before the World Trade Organization (WTO) under the Subsidies and Countervailing Measures Agreement (SCM Agreement),[34] to which India is also a signatory. The challenge was on the ground that the export subsidies to SEZ consist of exemptions and deductions from customs duties and other taxes in violation of the special and differential treatment provisions of Article 27 of the SCM Agreement. The WTO panel held against India and found that for the exemptions and deductions under the SEZ Scheme, there was a financial contribution by India in the nature of foregone revenue and benefit conferred on the recipient being contingent upon export performance in violation of the SCM Agreement.

In this regard, the Ministry of Commerce in 2018 set up the Baba Kalyani Committee to revamp the SEZ Scheme to provide recommendations for solutions to issues including the lack of investments once the tax holiday in SEZs ended, leading to less than half of the land approved for PA being utilized. Another issue which may be faced by units in the GIFT City SEZ is that since duty is attracted on DTA sales, the benefit of duty free imports is available only for a few inputs incorporated in the finished product.

Currently, the Government of India has proposed a draft to replace the SEZ framework with DESH under the Development of Enterprise and Service Hubs Bill, 2022. The proposed framework under the DESH Bill is as follows:

a. The DESH Bill aligns itself with Section 47 of SEZ Act – for incentives:

   - Deferral/exemption from BCD on imports in a Hub/Unit
   - Exemption from BCD on exports from a Hub/Unit to place outside India
   - Exemption from excise duty on supplies from DTAs to Hub/Unit
   - Drawback/other benefits on time-to-time basis on supplies from DTAs to Hub/Unit by providers outside India

[34] The WTO Agreement on Subsidies and Countervailing Measures 1995

- Exemption from taxes/duties/cess as under the enactment specified in the Fourth Schedule
- No direct tax exemptions under the Income-tax Act, 1961 have been proposed in the Bill, presumably to ensure compliance with the WTO model.

b. Enterprise & Services Hub

- A Development Hub includes Enterprise Hub, Services Hub & existing SEZs.
- Special requirements as prescribed are designated for Hubs to be notified as Enterprise (manufacture) or Services.

c. Position of SEZs: Existing SEZs are deemed to have been notified & established under the DESH Act itself as a Development Hub for application of provisions.

d. Section 6 of DESH Bill – Integrated Development Hub Board can notify any area as Development Hub for discharge of its functions on satisfaction of conditional factors/guiding principles:

- Generation of additional economic activity
- Creation of employment opportunities
- Promotion of investment from doemstic and foreign sources
- Promotion of innovation and investment in R&D
- Development of infrastructure facilities
- Integration with global supply/value chains & maintenance of manfuacturing and export competitiveness
- Maintenance of sovereignty-integrity of India,s ecurity of State & friendly relations with foreign states
- Creation of global centres for data and service destinations
- Other such relevant principles as may be considered

It can be understood from the above that if the GIFT City SEZ transitions to a DESH model, the legislative intent of attracting more foreign investment and diversifying the industries to be set up in the SEZ will greatly increase the business activities in the IFSC units as well.

Miss: Subsidies based on export performance & direct tax benefits absent

The draft DESH Bill has not proposed to continue or extend any of the subsidies which are conferred on SEZ units on the basis of their export performance to the DTA or otherwise, presumably to be WTO compliant. Further, no benefits under the direct taxation laws of India are present.

In this regard, if GIFT City transitions into a Development Hub, the above existing benefits may no longer be made available after an initial relaxation period. Hence, the velocity of new foreign investment and migration to GIFT City may reduce.

The Government of India can provide a longer period of transition for existing IFSC units in the GIFT City SEZ to avail direct tax and export duty benefits to ensure that there are no precipitative consequences. The same can be achieved by a graded rate structure spread across ten to fifteen years to maximize the present potential of the foreign investment being made in GIFT City.

3. Hit: Maximized cross-border trade and investment in IFSC Banking Units

As part of the multi-services SEZ framework for GIFT City, the Banking Units set up in the IFSC are treated as non-residents for the purpose of foreign exchange impact and certain tax laws.

By providing exemption from direct tax, STT, CTT, stamp duty and GST payments on the services and transactions undertaken, the banking units in the IFSC are able to undertake investment, trade and lending operations to maximize turnover with the BSE, NSE and Bullion exchanges within the IFSC also availing the aforesaid exemptions. This has been facilitated further vide the IFSC Authority assuming power over other regulators such as the Development Commissioner, RBI, SEBI, etc. over the operations undertaken within the IFSC.

Miss: Irregularities in developing GST laws in India

While there is a comprehensive exemption from GST on the transactions carried out by banking units in the GIFT City IFSC, it is pertinent to note that the various issues and irregularities faced by businesses within the DTA under the still developing GST regime will eventually be faced by such IFSC units.

This includes the issue of payment of GST on notified RCM supplies as detailed above, the mismatch in form GSTR-2A and GSTR-3B of the IFSC unit due to errors in form GSTR-1

filed by a DTA supplier for non-exempt import of goods or services as well as the changing position of law as is being propounded by the higher judiciary in India.

Banking units in IFSC need to be covered holistically under a Policy Circular or Notification to prescribe the extent to which the dynamic GST laws in India will impact them. This will enable greater clarity to the businesses and minimize the chances of litigation.

The jurisdictional GST Commissionerate may also issue a trade notice or instruction mentioning that notices will not be issued to banking units in the GIFT City IFSC on account of the legislative intent to provide exemptions and incentivize foreign investment, and that the issues pending clarification or judicial interpretation will be deemed to be settled in favour of the assessees. The banking industry may make representations in this regard to the jurisdictional GST Commissionerate as well as to the IFSC Authority.

4. Hit: 100% tax deduction under Section 80LA of IT Act

Sub-section 1A of Section 80LA deals with the tax deductions available to the units of an IFSC. It states that a deduction of 100% of income will be allowed for any ten consecutive AYs, out of the first fifteen years starting from the year in which the requisite permissions were obtained by that assessee.[35] However, it is pertinent to note that this deduction is only with respect to the incomes specified in sub-section 2 of Section 80LA.

Sub-section 2 states that for the purpose of sub-section 1A, income means the income which is derived *"from any Unit of the International Financial Services Centre from its business for which it has been approved for setting up in such a Centre in a Special Economic Zone"*. Therefore, for a unit in IFSC to take benefit under this Section, it must first prove that the income against which such deduction is claimed, has been earned from its "approved business".[36]

A. Miss: No clarity on scope of income from 'approved business'

[35] Income-tax Act 1961, s 80LA(1A)

[36] Income-tax Act 1961, s 80LA(2)

At this juncture, it becomes relevant to examine what the scope of "approved business" entails- does it cover income classifiable in any of the heads of income, or does it only cover income classifiable as 'profits and gains of business or profession' ('**PGBP'**)?

The prevailing jurisprudence on the scope and meaning of 'business' under the IT Act is divided in the sense that there are largely two positions that have been promulgated by the Indian courts and tribunals.

Firstly, in the case of ***CIT v. Chugandas & Co***.,[37] the Hon'ble Apex Court observed that business income is segregated into different categories solely for the purpose of calculating total income. This segregation does not alter the fundamental nature of income, which remains as a component of the business itself. Therefore, income in the form of capital gains, dividends, etc., generated in the course of business, would still be categorized as business income, even if they are classified differently for tax calculation. This position has been followed by various courts and tribunals, including by the Karnataka High Court in the case of ***Nandi Steels Ltd. v. ACIT***.[38]

The other position that has been elucidated by the Indian courts is that PGBP is conceptually different from capital gains, as per the scheme of the IT Act. The Hon'ble Apex Court in the case of ***CIT v. Express Newspapers Ltd***.[39] enunciated that while PGBP arises from business operations, capital gains arise from the sale of a capital asset. Merely because capital gains stem from assets used in the business, it does not automatically classify them as business profits.

Therefore, there is a high possibility that the department may only allow deduction with respect to income classifiable under the head of PGBP. At this juncture, it is relevant to understand whether the income earned by the funds from their investments, such as capital gains, dividends, and interest, can be categorized under PGBP to avail tax exemptions under section 80LA of the IT Act.

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[37] CIT v. Chugandas & Co. [1965] 55 ITR 17 (SC)

[38] Nandi Steels Ltd. v. ACIT [2021] 128 taxmann.com 267 (Karnataka)

[39] CIT v. Express Newspapers Ltd. [1964] 53 ITR 250 (SC)

While there is no universally applicable principle to determine whether income from securities sales qualifies as capital gains or business income, reference may be made to a CBDT Circular[40] which provides some certain guidance for making this determination. As per the Circular, accounting treatment of the transaction; tax treatment of that income is earlier years; intention of the taxpayer behind the transaction; and the magnitude and ratios of purchase and sales are the relevant conditions that must be considered.

Therefore, units set up in IFSC should be able to avail the deduction under Section 80LA if they can demonstrate, based on the aforementioned principles, that the buying and selling of securities were conducted with the intent of engaging in systematic business activities, aligning with the accounting treatment and transaction frequency.[41]

B. Miss: Whether deduction is available only to the income attributable to the unit?

It is clear from the reading of Section 80LA(1) of the IT Act that the deduction is eligible in respect of income from the unit set-up in IFSC. However, there may be situation where certain income accrues to a person on account of operations undertaken by the head-office, as also the unit located in IFSC. Accordingly, in terms of the Section 80LA(1), the deduction will be available only in respect of the income which is attributable to the operations undertaken by the unit located in IFSC.

Accordingly, a question which needs to be addressed is that how the profits attributable to the IFSC unit should be determined. This is because the provisions of Section 80LA do not provide any mechanism for profit attribution. Further, there is no requirement in the provision for maintaining separate accounts for the IFSC unit.

In past, there have been similar situations where the relevant provision of the IT Act did not provide for manner of profit attribution. In such cases, it has been judicially upheld that for computing the taxable income/ exemption, the quantum of profits attributable to the business unit are required to be determined. In such situations, Courts have held that profits should be attributed based on the operations carried out by the respective unit.

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[40] Central Board of Direct Taxes, Circular No. 6 of 2016 dated 29.02.2016

[41] Srinivasan Narayanaswamy v. ACIT [2017] 84 taxmann.com 66 (Chennai Trib.)

In the case of ***CIT, Bombay v. Ahmedbhai Umarbhai***[42] a company, resident in British India, owned oil mills within British India while carried on manufacturing facilities at a mill in Raichur, Hyderabad which was a princely state. The manufactured products were sold partly in Hyderabad and partly in Bombay. The Hon'ble Supreme Court held that the entire profits should not be attributed to the state from where sales were made. Rather, the profits should be attributed between the state of sale and manufacturing state corresponding to the operations carried out from the respective states.

Similarly, in the case of ***Anglo-French Textile Co. Ltd. v. CIT***[43] the Hon'ble Supreme Court considered the extent of operations carried out from the state as a reasonable basis of attributing profits.

Also, in the context of claiming deductions under section 80IA and 80I, the Tribunal/ AAR have observed that only the profits attributable to the undertaking should be claimed as a deduction. For computing the profits, the eligible unit should be considered as a separate unit. Also, in case any common expense has been incurred by the Head Office which also benefits the eligible unit, said common expense should also be allocated to the eligible unit based on certain reliable ratio.[44]

In this background, it is imperative to note that there may be situations wherein a company may set up a unit located in IFSC but doesn't carry out its major operations there. In other words, a unit is the IFSC may have minimal level of operations, while the business operations are actually carried out by an already existing company, located outside the IFSC. In this case, the company may try to shift its profits to the IFSC unit to claim a higher tax benefit. This conundrum is aggravated by the fact that neither the IT Act nor any other IFSC regulation lay down any threshold for minimum operations to be carried out by the unit in IFSC to claim the benefit under Section 80LA.

It is further pertinent to appreciate that unlike Section 115BAB, Section 80IA etc., of the IT Act there is no condition under Section 80LA that in order to claim the tax deduction, the

[42] CIT, Bombay v. Ahmedbhai Umarbhai & Co. [1950] 18 ITR 472 (SC)

[43] Anglo-French Textile Co. Ltd. v. CIT [1953] 23 ITR 101 (SC)

[44] National Fertilizers Ltd., In re [2005] 142 Taxman 5; Assistant Commissioner of Income-tax Circle-8(1) Mumbai v. Asea Brown Boveri Ltd. [2007] 14 SOT 18 (Mum.)

business should not be formed by splitting up or reconstruction of an already existing business. In such cases, the Indian courts have relied upon the extent of operations, transfer or personnel, decision making powers etc. to determine whether the new company was formed by splitting up or reconstruction of an existing business. Therefore, in practicality, a threshold has been set for the minimum level of operations that the new unit must carry out, in order to be eligible to claim the benefit under these Sections.

Therefore, in absence of a threshold for minimum operations under Section 80LA of the IT Act, only the profits which are attributable to the unit located in IFSC commensurate to the operations carried out from said unit should be considered for the purpose of deduction under the Section. However, it must be noted that Section 80LA does not provide for any profit attribution mechanism for in this regard. Therefore, there is a need for clarity in laws with respect to these issues.

5. Miss: No clarity on application of transfer pricing provisions

As per the scheme of the IT Act, every international transaction as defined in Section 92B and every specified domestic transaction (‘**SDT’**) as defined in Section 92BA must be undertaken in accordance with the arm’s length price (‘**ALP**’).[45] In order to analyse whether transfer pricing provisions would be applicable to units set up in IFSC, it is imperative to understand the residential status of these units in India first.

Under the SEZ Act, a unit set up in an IFSC is treated as a non-resident person and enjoys benefits accordingly. Even under the Foreign Exchange Management Act, 2002 (‘**FEMA’**), units in an IFSC enjoy the benefits akin to a non-resident under exchange control provisions. However, units in IFSC have not been given the status of a non-resident under the scheme of the IT Act. It appears that the IT Act treats the units set up in IFSC as normal residents, and subsequently, grants various exemptions, sum of which have been discussed above.

Therefore, since the units in IFSC are not ‘non-residents’ for the purpose of IT Act, the transactions undertaken by it with a unit outside IFSC will not be considered an ‘international transaction’ under Section 92.

[45] Income-tax Act 1961, s 92

However, there is no clarity on whether this transaction could come within the scope of SDT. At this juncture, it is pertinent to note that generally, domestic transactions are not subject to transfer pricing provisions, and it is only when Section 92BA specifically covers a transaction within its scope, the transfer pricing provisions become applicable. Therefore, as long as there is no specific inclusion of transactions undertaken by a unit set up in IFSC, transfer pricing provisions would not apply.

Section 92BA of the IT Act defines SDT to include, *inter alia,* transactions referred to in Section 80A, where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of twenty crore rupees.[46] Provisions of Section 80IA(8) of the IT Act provides that inter-unit transfer of goods or services to/ from eligible unit (i.e. unit claiming profit linked deduction) must be undertaken at market prices.[47]

It is to be noted that for an inter-unit transaction to qualify as SDT, provisions of Section 80IA(8) of the IT Act should be applicable to the relevant provision under which deduction is being claimed. For instance, provisions of Section 80IA(8) of the IT Act have been specifically made applicable by to the provisions of section 80IC, 80IC, 80ID, 80IE and 10AA of the IT Act. As a result, the inter-unit transactions undertaken by units claiming deductions under said sections qualify as SDT and hence are required to comply with the transfer pricing provisions. In respect of Section 80LA of the IT Act, the provisions of Section 80IA(8) of the IT Act have not been made applicable. As a result, the inter-unit transactions undertaken between the GIFT city unit and its head office shall not qualify as SDT under clause (v) of Section 92BA of the IT Act and the transfer pricing provisions shall not be applicable.

It is further imperative to discuss the transactions covered in Section 80A of the IT Act which are also included in the realm of SDT under Section 92BA of the IT Act. Section 80A(6) of the IT Act covers inter-unit transactions of transfer of goods or services undertaken by units claiming any of the profit linked deduction under Section 80H to 80TT of the IT Act.[48] Section 80LA is also covered in the scope of said section. Accordingly, it can be alleged that the inter-unit transaction undertaken by IFSC unit falls within the scope of Section 80A(6) and hence,

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[46] Income-tax Act 1961, s 92BA

[47] Income-tax Act 1961, s 80IA(8)

[48] Income-tax Act 1961, s 80A(6)

qualifies as a SDT. However, a view can be taken that the same shall not be covered within the scope of Section 80LA. This is because of the following reasons:

- The way Section 80A(6) of the IT Act is worded, it applies only to those sections where the 'profits and gains of the unit/ undertaking' are eligible for deduction. Under Section 80LA, deduction can be claimed for 'income' of the unit. Since the term 'income' has different connotation than the term 'profits and gains of unit/ undertaking', Section 80A(6) should not apply.

- Also, Section 80A(6) of the IT Act applies only to those situations where the relevant profit linked deduction section requires maintenance and audit of accounts of the undertaking/ unit. Since there is no such requirement in Section 80LA, it will not be applicable.

Thus, a position can be taken that the inter-unit transactions need not be reported as specified domestic transaction.

However, going by the scheme and intention of Section 92BA, transaction with the entities which enjoy certain special tax exemptions and deductions are mandated to be done at ALP, to avoid profit shifting. Presently, since the units set up in IFSC clearly enjoy special tax incentives, transactions with them may be included in the scope of Section 92BA. Further, there may be numerous cases wherein the unit set up in IFSC may avail certain support services from units set up outside the IFSC, or vice versa. In such cases, it becomes eminent to undertake such transactions at ALP to prevent profit shifting.

It must be noted that until the government amends Section 92A to include the entities claiming benefit under Section 80LA, the SDT provisions will not apply. It must further be noted that the transactions between units in IFSC and their foreign holding entity and other related persons will still be covered within the scope of 'international transaction' as defined in Section 92B, and therefore, these transactions need to be in accordance with ALP.

6. Hit: Safe Harbour regime under Section 9A

Normally, the profits earned by a company are only taxable in the state in which the company is a resident. However, the concepts of 'permanent establishment' ('**PE**') and 'business connection in India' carve out an exception to this rule.

The term "business connection" has been defined in Section 9 of the IT Act. Essentially, when a foreign entity has a substantial enough presence or engagement in business operations within India, it becomes subject to taxation under the Income Tax Act. The term 'business connection' indicates a significant link or nexus between a non-resident entity and its business activities in India. This connection can arise from various factors such as, *inter alia,* the presence of a physical office, agent, or a dependent agent acting on behalf of the non-resident or engaging in business transactions that generate income within India. The Hon'ble High Court in the case of ***M/s GVK Industries v. ITO***,[49] explained that "*the essence of 'business connection' is the existence of close, real, intimate relationship and commonness of interest between the NRC and the Indian person*."

A business connection denotes a taxable presence in another country, akin to the PE concept outlined in tax treaties. However, the scope of 'business connection' under the IT Act is broader compared to that of PE.

However, Section 9A of the ITA was introduced by Finance Act, 2015 to establish a specific exception from the application of these business connection provisions in respect of units set up in IFSC, contingent upon the assessee meeting certain specified conditions (also known as carveout conditions). The Section further provides that the government may announce relaxations regarding the fulfilment of one or more of these carveout conditions for an eligible investment fund or its eligible fund manager.[50] It is noteworthy that this safe harbour rule applies only if the fund manager is situated in an IFSC and has initiated operations on or before 31st March 2024. Consequently, the actual impact of this provision will only be determined once the government officially announces the relaxations that will be accessible to the eligible fund manager situated in the IFSC.

7. Hit: Reduced MAT rate

Section 115JB of the IT Act deals with the provisions of MAT. It is applicable to companies that, despite having a book profit, pay little or no income tax due to various exemptions, deductions, or incentives provided by the government. MAT ensures that even if a company

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[49] M/s GVK Industries v. ITO (1997) 228 ITR 564

[50] Income-tax Act, 1961, s 9A(8A)

reports substantial book profits but is not liable to pay regular income tax, it must pay a minimum amount of tax.

The tax framework for GIFT City has taken MAT into account as well. The normal rate of MAT prescribed under Section 115JB(1) for domestic and foreign companies is 15% (excluding applicable surcharge and cess) on the book profits of the assessee companies. Section 115JB(7) provides the benefit of a concessional MAT rate of 9% (excluding applicable surcharge and cess) on the book profits of units set-up in the GIFT City, deriving its income solely in convertible foreign exchange.[51] It is pertinent to note that as per Section 115JB(5A), MAT provisions are not applicable to units in IFSC which opt for the new tax regime.

A. Miss: Crossroads with OECD Pillar II recommendations

India is a signatory to the two-pillar plan released by the Organisation for Economic Co-operation and Development ("**OECD**") to reform international taxation laws in order to ensure that multinational companies pay a reasonable share of tax, in whichever jurisdiction they operate in. Pillar I of the OECD two-pillar plan deals with the re-allocation of taxing rights, wherein the source state (i.e., the end-market jurisdiction where the goods and services are consumed) gets the right to tax residual profits earned by a multinational enterprise group, whose annual global turnover exceeds Euro 20 Billion and 10% profitability.

The OECD Pillar II, also known as the Global Anti-Base Erosion ("**GloBE**") proposal, aims to establish a global minimum tax rate for multinational corporations. This is designed to ensure that these companies pay a minimum level of tax regardless of where they operate or report profits.

Under Pillar 2, if a company's effective tax rate in a particular jurisdiction falls below the agreed minimum rate, the home country of that company can impose a "top-up" tax to meet the minimum requirement. This helps prevent profit shifting and tax avoidance strategies that involve shifting profits to low-tax jurisdictions.

As per the existing framework, OCED Pillar II requires multinational enterprise groups whose annual global turnover exceeds Euro 750 Million, to pay minimum 15% tax per jurisdiction,

[51] Income-tax Act 1961, s 115JB(7)

or top-up tax in respect of the low taxed income. It is pertinent to note that the framework also provides for certain exclusions and carve-outs with respect to this.

It is imperative to appreciate that Pillar 2 applies only to large multinational companies, and it aims to prevent profit shifting and tax avoidance by implementing a global minimum tax rate. Therefore, certain entities have been excluded from the scope of Pillar 2. These entities include Small and Medium-sized Enterprises, domestic-only companies, governmental entities, certain pension and investment funds, etc. However, no such exclusion has been provided to companies engaged in the financial services sector.

Pillar II allows jurisdictions to retain autonomy in designing their tax systems, including the choice of having a corporate income tax and setting tax rates. However, it also acknowledges the entitlement of other jurisdictions to apply the principles outlined in this report in cases where income is taxed at a rate lower than a specified minimum. In essence, it does not mandate any jurisdiction to implement a minimum corporate tax rate. Yet, if a jurisdiction's corporate tax rate (often referred to as a low-tax jurisdiction) falls below an agreed-upon minimum rate, it permits other countries to recuperate the remaining tax on income generated within that low-tax jurisdiction.

While the above framework seems to be straightforward, a dichotomy may arise while taxing the income of multinational enterprises established in the GIFT City. Even though these companies will get a tax holiday in India, their group entity might have to pay the additional top-up tax on the income from operations in India, in line with Pillar II. This situation can be better understood by an example. The Effective Tax Rate for a foreign company having operations in the Gift City may only be 9.83% (which is the MAT rate[52]). This would trigger top-up tax of rate 5.17% with respect to the Indian jurisdiction.

Further, recently the Hon'ble Income-tax Appellate Tribunal has taken a view that MAT provisions do not apply to foreign companies which have a PE in India.[53] In such case, the top-up tax rate with respect to the IFSC unit would become 15%, after the application of GloBE rules.

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[52] Income-tax Act 1961, s 115JB

[53] ACIT v. Credit Suisse AG, [2022] 197 ITD 209

Subjecting the income of these foreign companies ultimately to 15% tax is counter-productive to the intention of the government to provide tax incentives to the units established in GIFT City. The Indian laws are expected to deal with this conundrum only once the OECD rules are implemented. Till then, there is no clarity on how such situations would be dealt with.

B. Miss: Unclear MAT provisions

It is clear from a plain reading of Section 115JB that the MAT provisions only apply to 'companies'. However, there may be situations wherein the unit located in the IFSC is not a company, but, *inter alia,* a branch office of that company. It is a settled position of law that the income from a branch office is taxable in the hands of the company, and not that branch office.[54]

Further, Section 115JB(7) grants the benefit of reduced MAT rate only where the "assessee referred to therein, is a unit" located in IFSC. However, in case of a branch office of a company, the assessee is the company, and not the branch office. In such a situation, an issue may arise whether the benefit of reduced MAT rate will be available to the company or the branch.

A position may be taken that as long as separate books are maintained for the branch office, the company should be allowed to avail benefit of the reduced MAT rate with respect to the income of the branch office. Another possible view is that since the unit is not the assessee, the benefit of reduced MAT rate will not be available at all. Therefore, there is a need for clarity regarding application of MAT provisions in such cases.

FUTURE EXPECTATIONS/ RECOMMENDATIONS

The tax incentives offered within the IFSC serve as a powerful catalyst for attracting foreign investments in India's financial services sector. The measures put forth by the finance minister aim to stimulate transactions with OBUs established in IFSC. Improving tax incentives in a special economic zone like IFSC Gift City can further attract businesses and stimulate economic growth. The authors have identified the following potential improvements in the IFSC framework:

[54] DCIT v. Co-operative Rabobank U.A., [2023] 152 taxmann.com 295 (Mumbai - Trib.); ACIT v. Credit Suisse AG, [2022] 197 ITD 209

a. The jurisdictional GST officers may issue an instruction clarifying the impact of various irregularities under the GST laws on the units set up in the IFSC in GIFT City.

b. The scope, extent and powers of the jurisdictional GST and Customs Commissionerate may be clarified for the purpose of potential litigation or disputes which may be raised regarding the taxation of services or transactions occurring within the units set up in the GIFT City SEZ, since the same qualify as offshore units.

c. A detailed policy note, or a circular may be issued to deal with the graded framework in which the IFSC in GIFT City SEZ will transition to a Development Hub under the proposed DESH Bill.

d. Further clarifications from the CBIC or the IFSC Authority or judicial interpretations is required with respect to the GST payable by units in the GIFT City SEZ on notified RCM supplies and if credit can be claimed on the same.

e. The government may consider increasing the tax holiday period from 10 years, to attract even higher foreign investments in the GIFT City. Further, certainty is a pillar of tax law. The government must provide some certainty as to whether any lower tax rate will be available to the IFSC units post the tax holiday period. It is recommended that the rate of tax for units set-up in the GIFT City should be at par with the IFC peers across the world. The government should further commit that any concessions granted presently shall not be withdrawn in the foreseeable future.

f. There is a need to bring clarity with respect to, *inter alia,* applicability of SDT provisions, profit attribution, the scope of 'income' that is exempt under Section 80LA, minimum threshold of operations to be eligible for deduction under Section 80LA, fund managers constituting a PE in India, application of MAT etc.

g. Parallel benefits of reduced tax rate should be offered to the individuals working in the GIFT City as well. Currently, the individuals physically working in the Gift City are not at par with those working at overseas IFC where the tax rate is comparatively lower. Flexible options for employee stock options plans, relaxed house rent allowance provisions, or relief in tax rate for highly skilled non-resident employees shifting to IFSC may help in enhancing the competitiveness in GIFT City.

h. It is recommended that the government may provide an exemption from withholding tax obligation on the payments made to IFSC units claiming tax benefits, since this income is anyway exempt in the hands of the units. Deduction of taxes at source on this income may put the IFSC units in a disadvantageous position since it creates severe working capital constraints. This will also lead to an increase in the statutory compliance burden for the IFSC units since they may have to apply for *nil* TDS certificate under Section 197 of the IT Act, or later claim refund of such amount.

i. Granting tax benefits to enterprises embracing eco-friendly and sustainable operations not only adheres to international sustainability norms but also entices businesses with a strong commitment to environmental stewardship.

j. The government should consider providing clarity on investor-friendly exits mechanisms with respect to IFSC units. Extending tax advantages to investors when they exit their investments in companies located in IFSC can promote greater participation from venture capital and private equity firms in the zone.

k. GIFT City will need to compete with other more tax-friendly jurisdictions such as Hong Kong (with only a territorial system of taxation – where offshore income is exempt), or Singapore (where offshore income is taxed only if brought into Singapore) or Dubai (where most business activities do not attract any income tax). In this regard, it is recommended that India may adopt territorial system of taxation, wherein the income earned by IFSC units from services rendered outside India should be completely exempt from income tax.

l. The provisions pertaining to General Anti Avoidance Rule (‘**GAAR**’) as envisaged under Section 95 of the IT Act should not apply with respect to the tax benefits and concessions claimed by an IFSC unit or the investors regarding tax concessions provided for their investments or related tax benefits.

It is important for governments to strike a balance between attracting foreign capital and ensuring the benefits extend to the local economy. Therefore, they should carefully design tax incentives to align with their broader economic goals. Regular evaluation and adjustments based on performance and changing economic conditions are crucial to maintaining the effectiveness of these incentives.

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