THE REGULATORY FRAMEWORK OF INTERNATIONAL FINANCIAL SERVICES CENTERS IN INDIA: AN ODE TO COMMERCIAL JOY

Akshay Douglas Gudinho[*]

ABSTRACT

The concept of International Financial Services Centres (IFSC) was introduced in India in 2007 by the High Power Expert Committee's report on making Mumbai an International Financial Centre (MIFC report).[1] Historically speaking, the MIFC report provides that London originated as the first IFSC augmented *inter alia* by the rapid growth in technology and the free flow of capital across borders; this ushered in the age of universal capital convertibility. Disrupted by the two World wars, New York rose to the pedestal as the dominant IFSC. The historical account in the MIFC report provides a market oriented explanation of an IFSC over IFSCs developing as strategic infrastructural projects that serve as investment hubs primarily for the derivative market of foreign securities.

The first legal enactment for IFSCs in India was announced in the 2016-17 budget speech where the Honourable Finance Minister, Mr. Arun

[*] LL.B. Candidate, III Year, Symbiosis Law School, Pune.

[1] Ministry of Finance, Govt. of India, *The High Powered Expert Committee (HPEC) on Making Mumbai an International Financial Centre*, *available at* https://dea.gov.in/sites/default/files/mifcreport.pdf (last visited Sep. 20, 2018).

Jaitley, provided tax concessions to units operating in IFSCs.[2] The said concessions have been included in the Finance Act, 2018. IFSCs are initiatives to incentivize the exchange of foreign securities in India where the financial services sector accounts for 5% of the GDP.[3] Gujarat International Finance Tech (GIFT) in Gandhinagar, Gujarat holds the title of the first IFSC to be set up in India. Apart from tax incentives and regulatory exemptions, an IFSC can be best described as a commercial haven catering essentially to non-residents in commodities of foreign currencies.

It is thus an exemplification of Ease of Doing Business policy for those who intend to operate in the form of an IFSC. The paper shall be restricted to the regulatory framework and the benefits of setting up businesses in an IFSC. The paper shall not deal with the potential success or failure of the GIFT initiative.

1. DEFINING INTERNATIONAL FINANCIAL SERVICES CENTRES

The International Monetary Fund (IMF) summarizes the definition of an IFSC or an Offshore Financial Centre (OFC) as having a; (i) primary business orientation towards non-residents; (ii) favourable regulatory requirement; and (iii) low or zero taxation schemes.[4] Asserting the limitations embedded in the aforementioned definition, the IMF has

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[2] Ministry of Finance, Govt. of India, *Budget 2016-17, Speech of Arun Jaitley, Minister of Finance*, India Budget 41, *available at* https://www.indiabudget.gov.in/ub2016-17/bs/bs.pdf (last visited June 10, 2018).

[3] *Genesis, about GIFT*, GUJARAT INT'L FINANCE TECH-CITY, http://www.giftgujarat.in/genesis (last visited June 14, 2018).

[4] Ahmed Zorome (IMF Working Paper), *Concept of Offshore Financial Centers: In Search of an Operational Definition*, 4 (2007).

proposed a macro economical definition: "An OFC is a country or jurisdiction that provides financial service to non-residents on a scale that is incommensurate with the size and the financing of its domestic economy."[5]

This proposed definition provides for the OFC status of a country as a ratio of the net exports of financial services to the Gross Domestic Product of the country. As majority of the IFSCs do not provide balance of payments statistics, the IMF has proposed a proxy indicator based on the stock options: "OFCs are characterized by a proportionally high level of portfolio investment assets because they are home (legal domicile) to a large number of primarily custodian entities, which hold and manage securities on behalf of clients residing outside the OFC."[6]

In case of IFSCs in India, the Special Economic Zone Act, 2005, does not provide a comprehensive definition. It merely holds that an IFSC is one that has been approved by the Central Government.[7] Nevertheless, the Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI) and the Insurance Regulatory and Development Authority of India (IRDA) have provided regulations, circulars and notifications which more or less encapsulate the features of an IFSC.

2. THE FRAMEWORK OF INTERNATIONAL FINANCIAL SERVICES CENTRES IN INDIA

[5] Special Economic Zone Act, 2005, 31 Gazette of India, § 2(q) & § 18(1).
[6] Dipesh Shah, *How can India become a Global Financial Centre?*, https://www.weforum.org/agenda/2016/02/how-can-india-become-a-global-financial-centre/ (last visited July 24, 2018).
[7] Special Economic Zone Act, 2005, § 2(q) & § 18(1).

The regulatory framework for IFSCs in India is designed: (i) to capture the capital from foreign securities market in the country itself; and (ii) to incentivize companies to set up operations within an IFSC. With regards to the first point, due to Indian investment in foreign IFSCs and an absence of an IFSC in India, India stands to lose $50 billion annually which will grow to $120 billion in 2025.[8] With regards to the latter one, companies set up in IFSCs do project a higher growth rate of capital as compared to those which function outside. For example, the first two IBU's set up in GIFT, reported transaction of more than $100 million within a span of 50 days.[9]

There are primarily five regulatory guidelines governing the framework of an IFSC in India. They are:

I. The SEBI (International Financial Services Centres) Guidelines, 2015, (2015 Guidelines);

II. The Ministry of Corporate Affairs notification providing exemptions to Specified Public Companies operating within an IFSC;

III. The RBI notification on International Banking Units (IBUs) operating in an IFSC;

IV. The Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 (FEMA 20); and

V. The Insurance Regulatory and Development Authority of India {Registration and Operations of (International Financial Services

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[8] Dipesh Shah, *International Financial Services Centre: Here's why late-starter India must make it a success*, FINANCIAL EXPRESS, https://www.financialexpress.com/opinion/international-financial-services-centre-heres-why-late-starter-india-must-make-it-a-success/365884/ (last visited July. 24, 2018).

[9] *supra* note 6.

Centres) Insurance Offices (IIO)} Guidelines, 2017 (2017 Guidelines).

2.1. SEBI (INTERNATIONAL FINANCIAL SERVICES CENTERS) GUIDELINES, 2015

The 2015 guidelines[10] apply to financial institutions[11] desirous of organizing a stock exchange, a clearing corporation or a depository.[12]

However, a stock exchange, clearing corporation or depository operating in an IFSC must function through a subsidiary of a stock exchange, clearing corporation or depository, in India or foreign jurisdiction, where at least 51% of the paid up share capital is held by the parent stock exchange, clearing corporation or depository subject to the minimum net worth requirement.[13]

2.1.1. Exemptions in case of Stock Exchanges and Clearing Corporations

Unlike other stock exchanges, every recognized stock exchange operating in an IFSC is not required to credit 25% of its profits every year to the fund of the recognized clearing corporation which clears and settles trades executed on that stock exchange. Similarly, every depository operating in an IFSC is not required to credit 25% of profits every year to

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[10] S.E.B.I. (International Financial Services Centers) Guidelines, 2015, *available at* https://www.sebi.gov.in/legal/guidelines/mar-2015/sebi-international-financial-services-centres-guidelines-2015_29457.html.
[11] *Id.*, ¶ 2(d).
[12] *Id.*, ¶ 3(1).
[13] *Id.*, ¶ 4 (1) (2) & (3); ¶ 5 (1) (2) & (3).

the investor protection fund.[14] This proves cheaper for an investor as the fees aligned to trading (like transaction fees, listing Fess, registration fees, etc.) on a stock exchange operating in an IFSC are likely to reduce in comparison to stock exchanges outside India.

Previously, the clearing corporations were permitted to invest their own funds as well as funds in the Core Settlement Guarantee Fund only in fixed deposits or central government securities and liquid schemes of debt mutual funds. Such funding has been extended to triple-A rated Foreign Sovereign Securities. This provides a wider range of securities for investors to invest in. This however cannot exceed 10% of the total investible resources, excluding funds lying in the Core Settlement Guarantee Fund.[15]

2.1.2. Issue of Capital

Companies, domestic or of foreign jurisdiction, can list and trade their securities in a Stock exchange of an IFSC.[16] All categories of exchange-traded products identified in the stock exchanges of Financial Action Task Force (FATF)/International Organization of Securities Commissions (IOSCO) compliant jurisdictions are eligible for trading in a Stock exchange of an IFSC. This includes Masala bonds provided that they are listed in a stock exchange of a FATF/IOSCO compliant

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[14] *Id.*, ¶ 6 (1) & (2).

[15] S.E.B.I. Circular No. SEBI/HO/MRD/DRMNP/CIR/P/2018/82 (May 21, 2018), *available at* https://www.sebi.gov.in/legal/circulars/may-2018/investment-of-own-funds-excluding-funds-lying-in-core-settlement-guarantee-fund-by-clearing-corporations-in-international-financial-services-centre-ifsc-_39009.html.

[16] S.E.B.I. (International Financial Services Centers) Guidelines, 2015, ¶ 11.

jurisdiction. However, a person resident in India is not permitted to invest in rupee denominated bonds except to the extent permitted by the RBI.[17]

SEBI may even provide certain relaxations with listing agreement obligations where the issuer is already in compliance with the listing agreement for securities apart from debt securities listed on the Stock exchange in an IFSC.[18] Thus, an investor in a stock exchange operating in an IFSC need not undergo the arduous task of ensuring listing agreement compliances. However, guidelines or clarifications with regards to relaxations with listing agreement obligations need to be provided by the Government.

2.1.3. Exemptions to the Formation of Companies

According to the 2015 guidelines, an intermediary had to form a company to provide financial services relating to the securities market in an IFSC. However, the formation of a company for an intermediary and its international associates trading in an IFSC is no longer required.[19] Similarly, an IFSC Banking Unit set up in an IFSC is permitted to act as a trading member of an exchange or a professional clearing member of a clearing corporation in an IFSC without forming a separate company.[20]

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[17] S.E.B.I. Circular No. IMD/HO/FPIC/CIR/P/2017/003 (Aug. 31, 2017), *available at* https://www.sebi.gov.in/legal/circulars/aug-2017/securities-and-exchange-board-of-india-international-financial-services-centres-guidelines-2015-amendments_35776.html.

[18] S.E.B.I. (International Financial Services Centers) Guidelines, 2015, ¶ 20.

[19] SEBI Circular No. SEBI/HO/CIR/P/2017/85 (July 27, 2017), *available at* https://www.sebi.gov.in/legal/circulars/jul-2017/securities-and-exchange-board-of-india-international-financial-services-centres-guidelines-2015-amendments_35452.html.

[20] SEBI Circular No. SEBI/HO/MRD/DSA/CIR/P/2017/34 (Apr. 27, 2017), *available at*

This proves feasible for intermediaries providing financial services within an IFSC as they no longer need to bear the additional cost of forming a company only to operate in an IFSC. However, an entity of Indian or foreign jurisdiction in order to act as a trading member of a stock exchange or a clearing member of clearing corporations in an IFSC, has to form a separate company in an IFSC.[21]

2.2. RELAXATIONS FOR PUBLIC COMPANIES OPERATING IN IFSCS

The Ministry of Corporate Affairs has provided for certain exceptions, modifications and adaptations for Specified Public Companies (SPCs) operating within an IFSC.[22] The SPCs are provided with extensions for regulatory compliances, exemptions in issuing securities and are not needed to fulfil mandatory norms which apply to non-SPCs.

2.2.1. Relaxation in Capital Instruments

The issuance of capital instruments by an SPC and voting rights accruing therefrom are not subject to the Companies Act, 2013 (2013 Act) unless the Articles of the Company provide for the same.[23] This permits SPCs managing capital instruments to function to an extent far beyond the compliance norms maintained under the 2013 Act. To illustrate, even if a

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https://www.sebi.gov.in/legal/circulars/apr-2017/securities-and-exchange-board-of-india-international-financial-services-centres-guidelines-2015-ifsc-banking-units-ibus-acting-as-trading-member-or-professional-clearing-member-on-stock-exchang-_34767.html.

[21] SEBI Circular No. SEBI/HO/MRD/DSA/CIR/P/2017/117 (Oct. 17, 2017), *available at* https://www.sebi.gov.in/legal/circulars/oct-2017/securities-and-exchange-board-of-india-international-financial-services-centres-guidelines-2015-amendments_36289.html.

[22] Ministry of Corporate Affairs Notification No. F. No. 3/1/2015-CL.I (Jan. 4 2017), *available at* http://www.mca.gov.in/Ministry/pdf/IFSC_Public_04012017.pdf.

[23] *Id.*, ¶ 13 & 14; Companies Act, 2013, § 43 & § 47.

company consists of more than 1000 security holders, it does not need to set up a Stake Holders Relationship Committee.[24]

Private Placement

Section 23 of the 2013 Act[25] maintains private placements as a means for private and public companies to issue their securities. The 2013 Act provides that private placement is an issuance of securities to a number of persons that cannot exceed fifty at a time.[26] Further, the 2013 Act prohibits fresh offers to subscription to securities by private placement even if allotments to previous offers have not been completed, withdrawn or abandoned.[27] However, SPCs can make fresh offers for subscription to securities by private placement even if allotments to previous offers have not been completed, withdrawn or abandoned.[28]

This proves beneficial to SPCs as they can offer their securities to a wider number of persons than the mandate of fifty persons. By implication, a private placement for SPCs has a similar end that a public offer through prospectus seeks to achieve. Given that SPCs are public companies, they can avoid the issue of a prospectus to make a public offer and can make multiple fresh offers for subscription to their securities by private placement itself. SPCs do not face liability in this regard as they are not required to maintain a record of the names of the persons who they

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[24] *Id.*, ¶ 49; Companies Act, 2013, § 178.
[25] Companies Act, 2013.
[26] *Id.*, § 42 (2).
[27] *Id.*, § 42 (3).
[28] *supra* note 22, ¶ 11; Companies Act, 2013, § 42 (3).

invite to subscribe to their securities.[29] However, the SPCs will have to allot the securities within sixty days of each fresh offer to subscribe to securities by private placement.[30]

Loan, Guarantee or Security

The 2013 Act mandates that a company cannot give a loan, guarantee or security with a loan, and acquire by way of subscription, purchase or otherwise, to an extent exceeding 60% of its paid-up share capital, free reserves and securities premium account, or 100% of its free reserves and securities premium account, whichever is more. An SPC however by an ordinary resolution can even give a loan, guarantee or security in connection with a loan, and acquire by way of subscription, purchase or otherwise, exceeding the aforementioned limits.[31] However, this is subject to the following conditions: (i) no body corporate has invested money in the share capital of the SPC; (ii) its borrowing are less than twice of its paid up share capital or 50 crores, whichever is lesser; and (iii) there is no default in repayment on such borrowing.[32]

This provides an alternative to SPCs which are in debt to approach other SPCs for loans instead of banking units that operate within an IFSC. This can prove fruitful as IFSC banking units are not eligible for RBI bail outs as the lender of the last resort.

[29] *supra* note 22, ¶ 11; Companies Act, 2013, § 42 (7).
[30] Companies Act, 2013, § 42 (6).
[31] *supra* note 22, ¶ 55; Companies Act, § 186 (2) & § 186 (3).
[32] *supra* note 22, ¶ 19; Companies Act, § 67.

Furthermore, the 2013 Act mandates that a company cannot invest through more than two layers of investment except in the two following cases: (i) a company acquiring any other company incorporated outside India if the latter company has investment subsidiaries beyond two layers as per the laws of the foreign country; (ii) a subsidiary company has any investment subsidiary for the purposes of complying with any law, rule, or regulation.[33] However, an SPC is even permitted to make an investment with more than two layers of investment.[34] Thus, SPCs are not prohibited from enhancing their commercial footprint to more than two layers of investment through a number of subsidiaries or subsidiaries of subsidiaries.

Equity Options

Sweat equity are equity shares issued by a company to its directors or employees at a discount for their technical know-how or any other kind of value additions to the company. The 2013 Act mandates that at least one year has to pass since the company has commenced business in case it intends to issue sweat equity shares.[35] However, to issue sweat equity options to its directors and employees, SPCs are not required to complete one year from the date of commencement of business before issuing the same.[36] Thus, even start-ups that have gone public and operate in an IFSC are eligible to issue sweat equity options.

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[33] Companies Act, § 186 (1).
[34] *Id.*; *supra* note 22, ¶ 54.
[35] Companies Act, § 2(88).
[36] *Id.* § 54(1)(c); *supra* note 22, ¶ 15.

Further, SPCs can issue further capital to its equity shareholders (rights shares) and provide a time period lesser than the 15-30 day period after which the offer is deemed to be rejected subject to a special resolution.[37]

An Employee Stock Option (ESOPs) is an option given to directors, officers and employees of a company to purchase shares of the company at future date at a pre-determined price.[38] The 2013 Act mandates that a special resolution needs to be passed in case a company wants to provide ESOPs.[39] However, in case of SPCs providing ESOPs, only an ordinary resolution is required.[40] This enables an SPC to retain its directors, officers or employees of key importance with greater ease as compared to non-SPCs which must pass a special resolution to provide such a stock option.

Public Deposits

The only conditions imposed on SPCs for accepting public deposits is that it should not exceed 100% of its aggregate paid-up shared capital and free reserves, and the details of such monies are submitted to the Registrar.[41] This provides SPCs, in comparison to non-SPCS, with a procedurally easier mechanism to ensure a larger capital reserve to meet fund requirements.

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[37] *supra* note 22, ¶ 17; Companies Act, § 62 (1) (a).
[38] Companies Act, § 2 (37).
[39] *Id.* § 62 (1) (b).
[40] *supra* note 22, ¶ 18; *Id.* § 62 (1) (b).
[41] ¶ 20; § 73 (2) (a) to (e).

2.2.2. Relaxations Provided to Auditors

Notice for appointment of an auditor of an SPC can be sent to the Registrar within 30 days unlike within 15 days for non-SPCs.[42] Unlike non-SPCs, an individual auditor who has completed one term of five consecutive years and an audit firm which completed two terms of five consecutive years can be re-appointed as auditors without a gap of five years from the completion of the tenure. Further, even if the audit firm whose tenure has expired has common partners in another audit firm, the latter audit firm can be appointed without a gap of 5 years from the completion of the former audit firm's tenure.[43]

In case of removal of an auditor of an SPC or a non-SPC, prior Central Government approval is required. However, in case of SPCs, if the Central Government fails to reply within 60 days of the submission of the application for removal, the approval is deemed to have been given and the SPC can appoint a new auditor in a general meeting.[44] In case of non-SPCs, there is no period prescribed for the Central Government to provide its reply on the said application. Furthermore, an SPC does not need to form an Audit Committee.[45] Also, an SPC is at liberty of conducting an internal audit. In the absence of a mention in the Articles, the internal audit is not mandatory for it.[46]

2.2.3. Relaxations Provided to Directors

[42] ¶ 33; § 139 (1).
[43] ¶ 34; § 139 (2).
[44] ¶ 35; § 140 (1).
[45] ¶ 48; § 177.
[46] ¶ 32; § 138.

The SPCs are required to hold the first Board of Directors (BOD) meeting within 60 days from the date of incorporation and the meetings are to be held at least once on a half yearly basis. Whereas, non-SPCs have to hold first BOD meeting within 30 days and they have to hold four meetings in a year without a gap of more than 120 days.[47]

There are no restrictions on the numbers of directors that can be appointed in the BOD of an SPC.[48] The only condition is that there must be one director who has stayed in India for a period of not less than 182 days in the previous calendar year. However, this is applicable to the financial years succeeding the financial year in which the SPC is incorporated.[49] Furthermore, an SPC need not appoint an independent director on its BOD.[50] A director of an SPC is not mandated to retire by rotation at the general meeting.[51]

2.2.4. Extended Powers of the Board of Directors

Resolutions passed by BOD in exercise of its powers are not needed to be submitted to the Registrar.[52] In case of resignation of a director, the BODs have the option of not intimating the Registrar and of not including a mention of such resignation in the report of directors laid

[47] ¶ 46; § 173 (1).
[48] ¶ 36; § 149 (1).
[49] ¶ 37; § 149 (3).
[50] ¶ 38; § 149 (4) to § 149 (11), § 149 (12) (i) & 149 (13).
[51] ¶ 40; § 152 (6) & (7).
[52] ¶ 27; § 117 (3) (g) & §179 (3).

in the general meeting of the company.[53] Further, The BOD of an SPC can convene an extra-ordinary general meeting within or outside India.[54]

2.2.5. Remuneration to the Managing Directors

Restrictions imposed on remuneration payable to the managing director are not applicable to the managing director of an SPC. For example, the 2013 Act maintains that a managing director shall not be paid remuneration in case of absence or inadequacy of profits. However, whether or not a resolution has been passed to the contrary effect, the managing director can be paid remuneration even in time of losses. However, the BODs do retain the power to restrict such payment if a resolution is passed to that effect.[55]

2.2.6. Liberty of the Articles of Association

The Articles of an SPC have wide powers of exemption as certain provisions of the 2013 Act apply unless the Articles mention otherwise.

a) Conducting meetings

In providing notice for a general meeting, the company is mandated to give at least a 21 days' notice, and any notice prescribing less than 21 days' notice would require the 95% of the vote of the members entitled to vote at the meeting. In case of SPCs, the Articles can provide that no consent from the members entitled to vote is necessary. Similarly, the quorum, chairman, and proxies can also be altered by the Articles from

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[53] ¶ 44; § 168 (1).
[54] ¶ 24; § 100 (1).
[55] ¶ 59; § 197.

what is required by the 2013 Act. The restrictions on the voting rights and the extent of such restriction can also be altered by the Articles beyond what is prescribed in the 2013 Act.[56]

b) Exempting special resolutions

The BOD need not get the consent of the company by a special resolution to sell, lease, or dispose of an undertaking of the company's undertakings; to invest in trust securities; to borrow money in excess of its aggregate paid-up share capital and free reserves; and to remit or give time for repayment of debt due from a director.[57]

2.2.7. Other Relaxations

Corporate Exemptions

An SPC does not need to follow secretarial standards specified by the Indian Institute of Company Secretaries in India.[58] An SPC does not need to undertake Corporate Social Responsibility activities for a period of five years from the commencement of its business.[59]

Permissible Extent of Transactions

The extent of transactions a subsidiary or an associate company of an SPC in an IFSC is wider as compared to that of non-SPCs as no Board Resolution is required for such companies to enter into related party

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[56] ¶ 25; § 101 to §107 & §109.
[57] ¶ 51; § 180.
[58] ¶ 29; § 118 (10).
[59] ¶ 31; § 135.

transactions.[60] Members can even vote by a special resolution to give effect to a contract or arrangement entered by the company with such a subsidiary or associate company in an IFSC.[61]

2.3. RBI NOTIFICATION ON INTERNATIONAL BANKING UNITS

RBI has issued regulations for International Banking Units ("IBUs") in an IFSC.[62] The regulations are divided into two parts: (i) setting up of IFSC IBUs by Indian Banks; and, (ii) setting up of IFSC IBUs by foreign banks. The notification applies to public and private sector banks eligible to deal in foreign exchange which intend to form an IBU in an IFSC, and foreign banks which already have a presence in India.[63]

The Regulations mandate that the parent bank must have a minimum capital of 20 million USD whether it is an Indian or foreign bank.[64] In case of a parent Indian bank, the branch it sets up in an IFSC is treated as a foreign branch of that bank.[65] The IFSC IBUs are not permitted to deal in domestic payment systems and onshore markets.[66]

The incentive in setting up an IBU in an IFSC is that it is not bound by the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio

[60] ¶ 2; § 2 (76) (8).
[61] ¶ 57; § 188 (1) Second Proviso.
[62] R.B.I. Notification No. RBI/2014-15/533DBR.IBD.BC.14570/23.13.004/2014-15 (May 17, 2018) *available at* https://rbidocs.rbi.org.in/rdocs/notification/PDFs/FNIBU010415CIRN.PDF.
[63] *Id.* annex I, 2.1 & annex II, 2.1.
[64] *Id.* annex I, 2.3 & annex II, 2.3.
[65] *Id.* annex I, 2.2.
[66] *Id.*

(SLR) requirements issued by the RBI.[67] Further, priority sector lending obligations on the parent company of Indian or foreign jurisdiction are not applicable to an IFSC IBU as the loans and advances of an IBU are not considered as the net bank credit of the parent company.[68]

However, there are certain restrictions placed on IFSC IBUs which do not apply to other banks. Firstly, IFSC IBUs are not eligible for deposit insurance[69] and liquidity support is not available to IFSC IBUs from the RBI.[70] Secondly, IFSC IBUs are not permitted to open current or savings account except foreign currency current accounts of units operating in IFSCs and of non-resident institutional investors.[71] Such account holders are not provided a cheque facility so all transactions in the said accounts have to be done by bank transfers.[72] This could prove cumbersome for the retail banking sectors of banks that open branches in an IFSC. It may not prove feasible for a customer as banks operating outside IFSCs do offer retail services that are not as restrictive as that mandated for IFSC IBUs. Lastly, IFSC IBUs are not permitted to raise any liabilities from retail customers including High Net Worth Individuals.[73]

[67] *Id.* annex I, 2.4 & annex II, 2.4.
[68] *Id.* annex I, 2.12 & annex II, 2.12.
[69] *Id.* annex I, 2.13 & annex II, 2.13.
[70] *Id.* annex I, 2.14 & annex II, 2.14.
[71] *Id.* annex I, 2.6 (v) & annex II, 2.6 (v).
[72] *Id.*
[73] *Id.*

2.4. THE FOREIGN EXCHANGE MANAGEMENT (TRANSFER OR ISSUE OF SECURITY BY A PERSON RESIDENT OUTSIDE INDIA) REGULATIONS, 2017 (FEMA 20).

FEMA 20,[74] consolidates the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 and Foreign Exchange Management (Investments in Firms or Proprietary Concern in India) Regulations, 2000. It regulates the entry routes (automatic or Government), the sectorial caps, and the conditions governing transactions between Foreign Portfolio Investors (FPIs), Non-Resident Indians (NRIs), Overseas Citizens of India (OCIs), Persons Resident Outside India (PROI), and venture capitalists. RBI has deemed a financial institution or a branch of a financial institution operating in an IFSC as a PRIO.[75]

The benefits of extending FEMA to IFSCs are fivefold. Firstly, a FPI is no longer an intermediary under the 2017 guidelines. This means that FPI's are not required to attain further approval for trading in an IFSC provided that they already have been registered by SEBI.[76] Secondly, SEBI has permitted Segregated Nominee Account Structures (SNAS) for foreign investors investing in IFSCs where their investments shall be

[74] Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017, Notification No. FEMA 20(R)/ 2017-RB (Nov. 7, 2017), *available at* https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11161&Mode=0.

[75] R.B.I. Notification No. FEMA. 339/2015-RB (Mar. 2, 2015), *available at* https://rbi.org.in/scripts/FS_Notification.aspx?Id=9636&fn=2&Mode=0.

[76] S.E.B.I. Circular No. IMD/HO/FPIC/CIR/P/2017/003 (Jan. 4, 2017), *available at* https://www.sebi.gov.in/legal/circulars/jan-2017/guidelines-for-participation-functioning-of-eligible-foreign-investors-efis-and-fpis-in-international-financial-services-centre-ifsc-_33955.html.

routed through Segregated Nominee Account Providers (providers).[77] The Providers are required to be registered in a stock exchange or a clearing corporation for providing SNAS services. The Providers are required to conduct due diligence of their end users as well as KYC (Know Your Customer) compliance. This ensures a vetting system for FPIs investing in a stock exchange of an IFSC.

Thirdly, the onus of ensuring regulatory reporting compliances no longer falls on the resident. FEMA 20 maintains that reporting compliances falls on the PROI.[78] However, this does not prove cumbersome as the RBI has subsumed eight of the reporting requirements in one single master form to be filled online with effect from August 1, 2018.[79] RBI has even permitted late reporting compliance subject to a late payment fee.[80]

Fourthly, FEMA 20 necessitates an expedited process for the issuance of shares of an Indian company upon purchase. In case of a branch of a financial institution operating in an IFSC purchasing shares of an Indian company, the said shares need to be issued within 60 days instead of 180 days from the date of receipt of payment or is refunded within 15 days from the same date in case of failure of issuance.[81] Lastly, FEMA 20 has also permitted transfers from PROI to another PROI even in

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[77] S.E.B.I. Circular No. SEBI/HO/MRD/DRMNP/CIR/P/2018/83 (May 24, 2018), *available at* https://www.sebi.gov.in/legal/circulars/may-2018/segregated-nominee-account-structure-in-international-financial-service-centre-ifsc-_39042.html.

[78] Regulation 13 (4) (a) 2, n. 65.

[79] R.B.I. Notification No. RBI/2017-18/194A.P (DIR Series) Circular No.30 (June 7, 2018), *available at* https://rbi.org.in/Scripts/NotificationUser.aspx?Id=11297&Mode=0.

[80] Regulation 13.2., n. 65.

[81] *Id.* sch. I, 2. (2).

cases of liquidation, merger, demerger, and liquidation of foreign companies which was not permitted in the 2000 Regulations.[82]

2.5. THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY OF INDIA (REGISTRATION AND OPERATIONS OF INTERNATIONAL FINANCIAL SERVICES CENTERS INSURANCE OFFICES (IIO)) GUIDELINES, 2017

The 2017 Guidelines[83] permit foreign and Indian insurance offices to conduct their business within an IFSC. The said guidelines apply to the branch office of an Indian or foreign insurer or reinsurer transacting in direct insurance and reinsurance business operating in an IFSC known as International Financial Services Centre Insurance Office (IIO).[84] The IIOs are not permitted to carry on other business apart from insurance and reinsurance.[85] The IIOs, Indian or foreign, conducting insurance and reinsurance businesses can transact within the IFSC, from others SEZs and outside India.[86] The IIOs can also conduct insurance business in the Domestic Tariff Area of the SEZ.[87]

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[82] *Id.* regulation 10 (1) Explanation.
[83] Insurance Regulatory and Development Authority of India {Registration and Operations of International Financial Services Centers Insurance Offices (IIO)} Guidelines, 2017, *available at* http://www.dhc.co.in/uploadedfile/1/2/-1/IRDAI%20-%20Registration%20and%20Operations%20of%20International%20Financial%20Service%20Centre%20Insurance%20Offices%20%20IIO%20Guidelines,%202017.pdf.
[84] *Id.* Guideline 4 (b) r/w 5(b) & (c).
[85] *Id.* Guideline 6 (b).
[86] *Id.* Guidelines 6 (c) & 6 (e) (i).
[87] *Id.* Guideline 4 (e).

The Indian IIOs in comparison to the foreign IIOs are benefitted from setting up branches in an IFSC as the minimum capital requirement is INR. 10 crores.[88] However, for foreign IIOs, the minimum capital requirement is INR. 100 crores in case of life or general insurance business, and INR. 200 crores in case of reinsurance business.[89]

3. Tax Benefits in International Financial Service Centres

Apart from regulatory relaxations, the cost of investment in an IFSC is relatively cheaper as tax exemptions are galore, thus incentivizing commerce in an IFSC. The Income Tax Act, 1961, maintains that a unit[90] located in an IFSC which derives its income solely in convertible foreign exchange is chargeable at 9% of Minimum Alternate Tax instead of 18.5% chargeable otherwise.[91]

A transaction in a stock exchange in an IFSC where the consideration is in foreign currency is subject to Short Term Capital Gains Tax but is not subject to Securities Transaction Tax (STT).[92] Similarly, Long Term Capital Gains Tax is applicable to IFSCs but STT is exempt.[93] However, Global Depositories, rupee denominated bond of an India company, or a derivative made by a non-resident in a stock exchange of an IFSC has now

[88] *Id.*. Guideline 8 (a) (i).
[89] *Id.* Guideline 8(a) (i) First proviso r/w Insurance Act, 1938, 4 The Gazette of India, § 6(1).
[90] *See* §2 (zc), n. 6.
[91] Income Tax Act, 43 The Gazette of India, § 115 JC (4), (1961). Inserted by the Finance Act, 13The Gazette of India, §38, (2018).
[92] *Id.* § 111-A
[93] *Id.* § 112-A (3).

been exempted from capital gains tax itself.[94] Further, no tax is chargeable on distributed profits on the total income of a company which is a unit of an IFSC.[95]

The gross total income accruing from a unit in an IFSC or an IBU in an IFSC is deductible up to 100% for five consecutive years beginning with the assessment year relevant to the previous year the banking company intending to operate in an IFSC attains the prior approval of the RBI and 50% for five consecutive years thereafter.[96] Thus, units set up in IFSCs offer tax deductions for up to ten years.

Lastly, NRIs now possess a tax benefit in having deposits in an IFSC IBU as no Tax Deductible at Source (TDS) needs to be deducted by an IFSC IBU for interest paid on deposit made by and borrowing from an NRI.[97]

4. CONCLUDING REMARKS

Regulatory compliances are going to be simplified even further for units operating in an IFSC. The 2018-19 budget speech suggests the need for a unified regulator to make IFSCs in India more

[94] *Id.* § 115-JC (4).
[95] *Id.* § 115-O (8).
[96] Income Tax Act, 43 The Gazette of India, § 80-LA (a) & (b), (1961). Inserted by the Finance Act, 28The Gazette of India, (2016) r/w Banking Regulation Act, 10 The Gazette of India, § 23 (1), (1949).
[97] Income Tax Act, 43 The Gazette of India, § 197-A (1D) (a) & (b), (1961).

competitive with offshore IFSCs.[98] To summarize, units in an IFSC are to benefit *inter alia* on primarily 4 commercial points:

4.1. Cost Cutting

Following exemptions and deduction reduces the cost of investment in an IFSC in comparison to units operating outside an IFSC: reduced fees for trading on a stock Exchange in an IFSC; exemptions to intermediaries to form companies within an IFSC; exemptions from corporate social responsibilities; and lowered tax rates.

4.2. Capital Availability

The wider range of securities offered to an investor investing in an IFSC stock exchange; offering fresh subscription to securities through private placement even though allotments to previous offers have not been completed, withdrawn or abandoned; procedural relaxations in terms of providing inter-corporate loans; regulatory relaxations in accepting public deposits; exemptions to IFSC IBUs from CRR, SLR requirements, and priority sector lending obligations; and a lower minimum capital requirements for India IIOs as compared to foreign IIOs, provides for a larger corpus of capital for investors, SPCs, IFSC IBUs, and Indian IIOs to utilize for funding and investment requirements.

4.3. Retaining Key Personnel

[98] Arun Jaitely, Budget 2018-19, Speech of Arun Jaitley, Minister of Finance, India Budget 20 (July 2, 2018), https://www.indiabudget.gov.in/ub2018-19/bs/bs.pdf.

Relaxations in providing sweat equity options and ESOPs, retaining auditors or an audit firm even after the completion of the term, and payment of remuneration to managerial directors even in case of inadequacy or absence of profit; and the fact that directors need not retire by rotation at the general meeting or independent directors need not be appointed enables SPCs to retain key personnel in the company.

4.4. REGULATORY RELAXATIONS

Regulatory relaxations expedite execution of transactions, reduce compliance obligations and increase the powers of the SPCs and their directors. In case of IFSCs, these relaxations *inter alia* extend to listing agreements; internal audits; compliances with respect to the Registrar; compliances with respect to FEMA; company meetings; powers of the BODs to sell, lease, or dispose of the undertakings of the company; and powers of SPCs to enter into related party transactions.

5. CRITICISMS

There are certain points of contention that still need to be addressed in light of the exemptions provided to units operating in an IFSC. Firstly, exemptions provided to auditors operating in an IFSC vitiate the guidelines enumerated in the Corporate Governance Voluntary Guidelines, 2009, which calls for rotation of auditors to maintain independency from the firm. Secondly, exemption of a special resolution required for the BOD to sell, lease, or dispose of an SPC undertaking can lead to collusion in pursuance of private gain. This is especially in light of the exemption of a Board resolution provided to a subsidiary or an associate company of an SPC in an IFSC to enter into related party transactions. Lastly, exempting IFSC IBUs from SLR and CRR requirements may be risky to individuals having deposits in IFSC IBUs in case of unforeseen circumstances. If the reserves of an IFSC IBU fall, the same cannot be replenished by the RBI as a lender of the last resort.