

kcmFlash

Transaction Advisory

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Family investment Funds in IFSC: Now a reality!

Snapshot

On 1st March 2023, the IFSC authority issued a clarificatory circular in relation to the Family Investment Fund Regulations. This circular shall have a significantly impact on the choice of the jurisdiction for setting up investment funds to invest in global equities and debt instruments.

The recent circular dated March 1, 2023, issued by IFSC makes certain changes to the definition of a 'single family', alleviating a lot of ambiguity which till now posed a big hurdle in setting up Family Investment Funds (FIFs) by wealthy Indian families in the IFSC jurisdiction. Hence, this ambiguity resulted in large family funds being set up in offshore jurisdictions which were found more lucrative from a tax and regulatory perspective.

This flash seeks to provide a brief overview of these changes and highlights some of the advantages which have resulted because of the circular.

Background

Gift city in Gandhinagar was set up as an IFSC, an SEZ for entities generally providing financial services. Apart from infrastructural and regulatory advantages, it provides lucrative income tax and GST benefits. Income of an IFSC entity is exempt from tax for a period of at least 10 years, and GST for goods/services from India is exempt.

IFSC covers a wide range of services. Amongst that, one interesting benefit is that of an FIF, commonly known as a family office. This is a lucrative way in which a high-net worth family can carry out its investment activities free from tax. Broadly, it requires investment activities to be carried out by a single family, and investment in specified assets.

The key conditions for an FIF are as follows:

- FIF can be set up as a company, trust or LLP.
- Investment to be carried out by a single family.
- FIF to have a minimum corpus of USD 10 Million, within 3 years of registration.

Ambiguity in FIF Regulations

Under the foreign exchange regulations (FEMA), IFSC is considered as an entity outside India. Hence, any investment by a Non-Resident (NR) in an IFSC entity is like an NR investing in another NR, resulting in no implications under FEMA. However, investment by an Indian resident in IFSC is akin to investment by an Indian resident in an NR, which results in implications under the Overseas Investment regulations under FEMA.

In case an Indian individual resident invests in such IFSC/FIF, the investment can be carried out only under the Liberalized Remittance Scheme (LRS), which is currently USD 250,000 per person per financial year. This is an extremely low ceiling limit as compared to the minimum amount of corpus required for an FIF. However, in case the investment is carried out by an Indian resident entity (LLP/Company), LRS limits do not apply. An Indian resident entity can invest up to 50% of its net worth in an IFSC entity.

In case of FIF, a view was prevalent that the investment can be made only by the family members, i.e., only individuals can invest. This effectively made it impossible for Indian residents to avail benefit of FIF – since the only avenue left for them was LRS (i.e., USD 0.25 Mn per person). This view was also limiting for non-residents, as they cannot use a family entity to make investments.

Clarification

It is now clarified vide Circular No. Circular No.333/IFSCA/FIF/2022-23 dated March 1, 2023 that family entities are also entitled to make investments. The term 'Single Family' has been expanded to include proprietor, firm, company, LLP, trust or body corporate (e.g., a foreign company), if the individual or single family members exercises control and holds substantial economic interest.

The term 'substantial economic interest' includes objective as well as subjective criteria. Effectively, single family should have at least 90% of economic interest, mainly via. shareholding or share of profit. The subjectivity is that the substantial economic interest needs to be demonstrated to the IFSC authorities.

Further it has also been provided that apart from the single-family investing in FIF, it may also accept contributions from its employees, directors or other persons providing services to FIF for the limited purpose of granting economic interest to them, which shall be restricted to 20% of profit of FIF. Such persons need to be apprised of the risks of investment in the FIF and also to be provided an exit opportunity from the FIF as per prescribed pricing guideline.

FIF can also set up an additional investment vehicle subject to prior approval of IFSCA and it shall be considered as part of such FIF.

KCM Note

FIF is an extremely potent tool for tax-efficient family investment. This benefit is available to residents as well as non-residents. There are situations where investment via. FIF route is more tax friendly vis-à-vis investment via. UAE, Singapore, Mauritius, etc.

FIF can make investments in India as well as overseas. In case of investment in India by Indian residents, there is a complete exemption. Although even other jurisdictions like UAE have competitive tax laws, Indian FIFs may have an edge for investments managed from India or investments from India. There are flexible structuring options to eliminate withholding tax and repatriation tax (source and resident countries). In case of Indian managed funds, there are other significant advantages like POEM, treaty eligibility, MLI, etc.

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