GIFT City Express

March 02, 2021

RBI PERMITS RESIDENT INDIVIDUALS TO INVEST UNDER LRS IN GIFT CITY

- RBI permits Indian residents to make remittances to IFSCs under LRS
- The remittance shall be made only for making investments in IFSCs in securities, other than those issued by entities/companies resident (outside IFSC) in India
- Resident individuals may open a Foreign Currency Account (FCA) in IFSCs; any funds lying idle in FCA for up to 15 days shall be repatriated to the domestic INR account.

The Government of India in the past few months has been demonstrating strong intentions to make the International Financial Services Centre ("**IFSC**") in the Gujarat International Finance-Tec ("**GIFT**") City at Gandhinagar, Gujarat a global financial hub. Particularly, the establishment of the IFSC Authority ("**IFSCA**") to act as a unified regulatory authority to develop and regulate financial products, financial services and financial institutions located / performed in the IFSC has helped build investor confidence.

Apart from offering a competitive and collaborative environment to the fund management industry in India, GIFT City is fast emerging as a global financial hub on the back of regulatory reforms from concerned regulators and Government of India. Such advantages coupled along with the world class infrastructure and robust business environment make a strong case for GIFT City to be considered as one of the leading financial hubs of the world, in years to come.

Contributing to the recent spate of measures making GIFT City all the more attractive, the Reserve Bank of India ("**RBI**") vide a notification1 dated February 16, 2021 ("**Notification**") has laid down detailed guidelines permitting resident individuals to make remittances under Liberalised Remittance Scheme ("**LRS**") to GIFT City. The move largely aimed at popularising the GIFT City (India's first IFSC), will also help entities being setup there to attract capital from the Indian diaspora.

STATUS UNDER FOREIGN EXCHANGE CONTROL LAWS

As per the Foreign Exchange Management Act (IFSC) Regulations[2], any financial institution or branch of it operating from GIFT City is treated as a person resident outside India. Further, the regulations also state that nothing contained in any other regulations shall apply to a financial institution or branch of a financial institution set up in an IFSC. Therefore, from the exchange control laws perspective, GIFT City is like an offshore financial centre, except that it situated within territorial jurisdiction of India.

RETAIL PARTICIPATION

Investment in entities established in GIFT City has been limited only to global participants. In the past, various industry participants and stakeholders have proposed allowing retail participation in GIFT City, especially in the banking sector. Moreover, the IFSC International Retail Business Development Committee ("**Committee**") in its report[3] has also laid down three key objectives - boosting job creation, generating additional revenue and most importantly attracting funds to develop infrastructure (especially those operated by Indian diaspora). Accordingly, the Committee recommended permitting investments by resident Indians under LRS route to enable retail participation in IFSC.

In the wake of such requests and recommendations, the IFSCA in November, 2020 while notifying the International Financial Services Centres Authority (Banking) Regulations, 2020[4] ("**Banking Regulations**"), for setting up IFSC Banking Units ("**IBUs**") paved way for LRS investment by resident Indians. Noteworthy herein is that the IFSCA had introduced the same despite facing reservations from the RBI.

As per Regulation 11 (2) of the Banking Regulations, resident Indians, with a net worth of at least USD 1 million, were allowed to open Foreign Currency Accounts ("**FCA**") in any freely convertible currency at IBUs to undertake any permissible current or capital account transactions under LRS route. Notably, under the LRS route banks can freely allow remittances by resident individuals up to $250,000 per financial year for any permitted current or capital account transaction or a combination of both. By the virtue of such an offering, IFSCA paved the way for retail participation in GIFT City for the first time since its inception in 2015.

RESERVATIONS OF RBI OVER LRS IN IFSC

The RBI in the past have had several reservations over allowing the scheme for GIFT City since in its view such a scheme will defeat the primary purpose of setting up an IFSC i.e. attracting foreign investment, and not investments by Indians. Moreover, allowing LRS may lead to unintended consequences of individuals being misled to thinking that they are investing in India thereby losing the natural inherent risk management character. In addition to the aforementioned concerns, RBI was more cynical of round tripping concerns - money that is routed out from the

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country through various channels but is repatriated as foreign investment. For instance, if a resident individual sends money via LRS in GIFT City for the purposes of investing into an Alternative Investment Fund ("**AIF**") setup in GIFT City which in turn invests into India, the same may amount to round tripping.

However, permitting such facilities in IFSC will ensure that a level playing field is provided to the banks operating in an IFSC. For instance – a bank's Singapore branch was allowed to handle the LRS money but the same bank's IFSC branch had no such leverage leading to disparity at the same level. Such a bar had often been a cause of concern for the banking sector in IFSC, especially when other offshore financial centres such as Singapore or Mauritius had no such restrictions. Moreover, such facility has the potential to increase retail participation from India in the GIFT City which was also subsequently reiterated in the Committee report. Furthermore, the round tripping concerns of RBI could also be well alleviated by the fact that the Indian government is firmly in control of the IFSC unlike an offshore jurisdiction.

Nevertheless, IFSCA while approving the Banking Regulations had provided for adequate checks and balances in the form that only qualified investors were allowed to avail such facilities with 'qualified investors' being defined as an individual with a net worth of USD 1 million. The provision of threshold was intended to ensure that such persons are better informed of the risks associated with the investments and financial products on offering.

RBI FORMALLY PERMITTING LRS ROUTE

LRS has not only contributed a significant pool of money to investments in offshore jurisdictions and globally focussed funds (traditionally managed by fund managers operating from offshore financial centres like Singapore, Hong Kong, and London) but also led to the shifting of the fund management income, brokerage income, and other ancillary support services income abroad. While reviewing the extant guidelines on LRS, the RBI in its bid to address such concerns has decided to permit resident individuals to make remittances under LRS to IFSCs set up in India under the Special Economic Zone Act, 2005.

However, while bringing on parity RBI had provided an additional layer of checks and balances. The Authorised Dealer Category – I banks are allowed to offer such facilities to the resident individuals, subject to the condition that the remittance is made only for the purposes of undertaking investments in IFSCs in securities, other than those issued by entities/companies resident (outside IFSC) in India. In this regard, the resident individuals are allowed to open a non-interest bearing FCA in IFSCs. However, any funds lying idle in the account for a period upto 15 days from the date of its receipt into the account shall be immediately repatriated to domestic INR account of the investor in India.

ANALYSIS

Such a move by RBI should be welcomed, both by the investors and the units being set up in the GIFT City. Notwithstanding the fact that resident individuals were earlier allowed to invest in offshore markets through the LRS route, the current scheme will offer them more flexibility and comfort since the fund in all geographical terms will be set up and managed in India.

Given the significant contribution of LRS each year, the Notification will provide a much needed impetus to the AIFs being setup in GIFT City, especially when now they can pool capital both from offshore and resident individuals. Particularly, High Net-worth Individuals ("**HNIs**") and family offices will be the primary beneficiaries of such scheme being extended to resident individuals.

Further, considering that AIFs in IFSC are conventionally managed by Indian fund manager, HNIs will have the added logistical and psychological comfort as compared to routing out investments in a far off country such as Mauritius or Singapore. One can expect more such innovative structuring in the near future. For example, investments into an AIF set up in GIFT City can now invest Indian HNI money outside India without any restrictions and prior approvals (as in the case of a domestic AIF) as long as the AIF does not utilise the funds for investment into India. This opens up structuring opportunities for Indian fund managers raising funds from Indian and foreign investors and who are likely to operate dual investment strategies of investment into and outside India. Of course, non LRS investments may still not be permitted into an AIF set up in GIFT City.

The RBI has provided an adequate layer of safeguard in the form that the resident individuals can only avail the LRS route for the purposes of making restricted investments. In other words, a resident individual is not permitted to open an FCA to fund his/her expenses, travel or education abroad which has traditionally been the intention behind opening a FCA. The RBI while subjecting LRS facilities to such conditions has ensured that the Notification serves the purpose of helping companies raise money in foreign currency. Accordingly, to alleviate fears of capital flight, any unutilised amount in an FCA needs to be repatriated to the domestic INR account within 15 days. Notably, under the extant LRS regime resident individuals remitting funds can retain, reinvest the income earned on the investments and as such are not required to repatriate the funds or income generated out of investments. Especially when units setup in GIFT City are treated as persons resident outside India[5], such flexibility should have been also extended to resident individuals investing in GIFT City. Nonetheless, with this Notification, RBI seems to have struck a right chord with both the investors and the entities looking to setup in GIFT City.

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You can direct your queries or comments to the authors

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[1] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12029&Mode=0.
[2] Regulation 5 of Foreign Exchange Management (International Financial Services Centre) Regulations, 2015.
[3] https://ifsca.gov.in/Viewer/ReportandPublication/1.
[4] https://ifsca.gov.in/Viewer/Index/116.
[5] Regulation 3, Foreign Exchange Management (International Financial Services Centre) Regulations, 2015.

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