FME & AIF TAX GUIDE

TAXATION OF FME AND AIF IN GIFT IFSC — A VERIFIED STATUTORY GUIDE

Under the Income Tax Act, 2025 (as substituted by the Finance Act, 2026, w.e.f. 1 April 2026)

CS Prashant Kumar | Company Secretary & Compliance Officer
Global Horizons Capital Advisors (IFSC) Private Limited

INTRODUCTION

GIFT IFSC has emerged as India's flagship platform for international fund management, banking, insurance, and capital markets activity — and its tax architecture is one of the most distinctive features of that platform. The Income Tax Act, 2025, read with amendments carried through the Finance Act, 2026, materially strengthens this architecture, most notably by extending the income tax exemption available to IFSC units from ten years to twenty years.

This guide sets out the tax position applicable to Fund Management Entities and Alternative Investment Funds operating from GIFT IFSC, examined provision by provision against the Act itself. The objective is to give promoters, fund managers, and their advisors a precise, statute-grounded reference — not a restatement of general market commentary, but a working document that cites the operative section for every position taken, so that it can be relied upon directly in structuring, financial modelling, and client advisory.

A few positions in this guide will depart from commonly circulated summaries of the GIFT IFSC tax regime — most significantly on the treatment of Minimum Alternate Tax, which is often described as fully exempt for units claiming the income tax deduction under Section 147. On a close reading of the Act, that is not quite right: the deduction reduces the rate of MAT applicable to IFSC units to 9% on the default tax regime — but where the FME has additionally elected the Section 200 concessional regime, MAT is excluded entirely, and a genuine zero-tax outcome on qualifying income becomes achievable. Both positions, and the precise conditions attached to each, are set out in full in Part A below.

The guide is organised in five parts: taxation at the FME level — including, now, the position of investors and shareholders holding equity in the FME itself — taxation at the AIF/fund level (covering both the pass-through regime for Category I and II AIFs and the fund-level regime for Category III, with a consolidated investor-level table), the interaction between the two through anti-avoidance provisions such as GAAR, POEM, and transfer pricing, a consolidated rate table for quick reference, and a closing set of structuring takeaways.

PART A — TAXATION AT THE FME LEVEL

A.1 The Core Benefit — Section 147 Deduction

Section 147(1) of the ITA 2025 provides a deduction equal to 100% of income to:
(a) a scheduled bank or foreign bank having an Offshore Banking Unit in an SEZ; or
(b) a "Unit" of an International Financial Services Centre.

The FME, where structured and registered as an IFSC unit, falls under clause (b).

Duration — Section 147(2)(b): As substituted by the Finance Act, 2026, the deduction is available for twenty consecutive tax years out of a block of twenty-five tax years, beginning from the relevant tax year, at the option of the assessee. This is a genuine, verified expansion — the provision prior to substitution allowed only ten consecutive years out of fifteen.

Relevant tax year — Section 147(6)(a)(ii): the tax year in which permission or registration under the IFSCA Act, 2019 was obtained. This is the anchor for the 25-year block — register early.

Conditions — Section 147(4): the deduction is allowed only if the assessee furnishes, along with the return of income, (a) an accountant's report in the prescribed form certifying correctness of the claim, and (b) a copy of the IFSCA permission or registration.

Anti-abuse condition — Section 147(5): for units commencing operations on or after 1 April 2026, the deduction is available only if the unit is not formed by splitting up, reconstruction, reorganisation, or transfer of a business already in existence in India. This is a materially important condition for FMEs being set up by existing domestic asset managers — the GIFT IFSC entity must not be a mere relocation of an existing Indian business; it must reflect genuine new operations. Whether a particular restructuring amounts to splitting up, reconstruction, or transfer of an existing business within the meaning of Section 147(5) is ultimately a question of fact, to be assessed on the specific circumstances of each case rather than by reference to any bright-line test in the Act.

What income qualifies — Section 147(3): income from the approved business activities of an IFSC unit. For an FME, this covers management fees, performance fees/carried interest, advisory fees connected with approved fund management activity, and capital gains, to the extent such capital gains form part of the approved business income of the IFSC unit. Not every capital gain earned by the FME is automatically covered — only gains arising in the course of, and connected to, the approved business activity qualify. Income unconnected with approved IFSC activity does not qualify and is taxed at normal rates.

The Section 147 deduction discussed above determines what income escapes tax under the normal computation — but a separate question, addressed in this section, is whether that same income can still trigger a minimum tax floor through MAT.

A.2 Minimum Alternate Tax (MAT) — Two Distinct Positions Depending on Regime Election

This is the single most important correction in this guide. More precisely, there are two correct positions depending on whether the FME has elected the Section 200 concessional regime — and conflating them is the most common modelling error in this space.

The statute does not exempt an IFSC unit from MAT merely because it claims the Section 147 deduction — this position holds only where the company remains on the default tax regime and has not exercised the option under Section 200. Section 206 does not provide any adjustment excluding income deductible under Section 147 while computing book profit. Accordingly, unless another specific exclusion applies, book profit continues to include such income.

What the Act provides on the default regime is a reduced MAT rate for IFSC units, not a MAT exemption:

Section 206(1)(b): Minimum Alternate Tax is computed on book profit —

- (i) for a company being a Unit located in an IFSC and deriving its income solely in convertible foreign exchange: 9%
- (ii) for any other company: 14%

Section 206(2)(b)(ii): the corresponding Alternate Minimum Tax (for non-company assessees, e.g., LLP-structured FMEs) is —

(i) for a Unit located in an IFSC deriving income solely in convertible foreign exchange: 9%
(ii) for a co-operative society: 15%
(iii) any other case: 18.5%

Practical consequence: During the years in which an FME claims the Section 147 deduction and its regular tax liability computed under the normal provisions is therefore nil (or very low) on the exempt income, MAT at 9% of book profit can still become payable if book profit exceeds the tax computed under the normal provisions. The FME's effective minimum tax floor during the exempt period is 9% of book profit on the default regime. This must be factored into financial modelling for any FME that has not elected Section 200. Where Section 200 has been validly elected, see A.2.1 below — the MAT floor falls away entirely, and a zero-tax claim on qualifying income is statutorily accurate in that scenario.

This 9% MAT rate is, however, still highly favourable compared to the 14% standard MAT rate (companies) or 18.5% AMT rate (non-corporate entities) applicable outside the IFSC, for those FMEs that remain on the default regime.

Condition for the 9% rate: the unit must derive its income "solely in convertible foreign exchange." An FME earning any material income in INR or from non-foreign-exchange sources risks losing the preferential 9% rate for that year and falling back to the standard rate. This condition should be monitored continuously, not just at year-end, by any FME on the default regime — it becomes moot for an FME that has elected Section 200, since the unit falls outside MAT altogether (see A.2.1).

A.2.1 — Interaction with the Section 200 Election
Section 206(1) carries its own override, at clause (q)(ii): "The provisions of this sub-section shall not apply to a person... who has exercised the option under section 200(5) or section 201(2)."

Section 201, the second limb of this "or," is restricted to domestic companies engaged in manufacturing or production of an article or thing (Section 201(1)) and has no application to an IFSC fund management entity. The operative limb for an IFSC FME is Section 200(5) alone — but since 206(1)(q)(ii) is drafted as an "or," satisfying either limb suffices, and Section 200(5) is fully available and sufficient on its own. The zero-MAT outcome described below therefore depends entirely on the Section 200 election, not on Section 201.

This is not a rate reduction — it is a complete exclusion from MAT for any company that has validly elected the Section 200 flat-rate regime. Read together with Section 200(4) (which preserves the Section 147 deduction notwithstanding the Section 200 election), the combined effect is:

— FME on the default regime, claiming Section 147: MAT applies at 9% of book profit (Section 206(1)(b)(i)) on income derived solely in convertible foreign exchange. The 9% floor genuinely bites here and must be modelled.

— FME that has elected Section 200, claiming Section 147: MAT under Section 206(1) does not apply at all, by virtue of clause (q)(ii). The 9%/14% rate clauses in 206(1)(b) become irrelevant once the company is outside sub-section (1) altogether.

This combination may result in no income-tax liability on qualifying IFSC income, subject to the deduction being fully available, the Section 200 option being validly exercised, and no other provision of the Act applying to bring tax to charge — not the Section 147 deduction alone, and not a reduced MAT floor, but the deduction combined with the Section 200 election and its MAT carve-out. This also tilts the entity-structuring decision for the FME decisively toward a company structure (rather than an LLP), at least until the LLP-side position below is confirmed.

Caveat for LLP-structured FMEs: Section 201 is not a non-corporate provision and has no bearing on LLPs in any event (see above). The actual AMT exclusion for non-corporate assessees is at Section 206(2)(d), and is tied to an election under Section 203(5) or Section 204(2) — not Section 201. An LLP-structured FME seeking to escape AMT entirely (rather than face the 9%/18.5% floor under Section 206(2)(b)(ii)) would need to qualify for, and elect, whichever concessional regime is housed in Sections 203 or 204. This requires independent verification of the Sections 203/204 text to confirm LLP eligibility and conditions before this route is relied upon in structuring — it should not be assumed to mirror the corporate-side Section 200/206(1)(q)(ii) carve-out mechanically. Until verified, the safer structuring assumption is that an LLP-structured FME remains subject to the AMT floor under Section 206(2), even where it claims the Section 147 deduction.

Section 200 has already been introduced above as the mechanism that unlocks the MAT carve-out — this section sets out the concessional regime itself in full, including the conditions and trade-offs attached to electing it.

A.3 Concessional Corporate Tax Regime — Section 200

A domestic company (including a GIFT IFSC FME structured as a company) may elect a flat rate of 22% under Section 200(1), without various deductions, subject to conditions.

Section 200(4) specifically preserves the Section 147 deduction even where the Section 200 option is exercised — confirming that an FME can combine the 22% concessional regime with the Section 147 IFSC exemption. This is an explicit statutory carve-out and should be relied upon in structuring. This combination — the Section 147 deduction surviving the Section 200 election, read with the MAT carve-out at Section 206(1)(q)(ii) — may result in no income-tax liability on qualifying IFSC income, rather than merely a reduced 9% MAT floor — subject to the conditions set out in A.2.1.

Section 200(1)(a)(ii) also explicitly preserves deductions under Sections 146 and 148 even under the concessional regime — meaning the inter-corporate dividend deduction (discussed in Part C below) remains available to an FME-holding company electing Section 200.
The opt
ion, once exercised, is irrevocable for subsequent years (Section 200(6)) and must be exercised before the due date for filing the return (Section 200(5)).

Tax rate where Section 147 deduction is not available (or not claimed) and Section 200 is elected: 22% + surcharge + 4% cess.

A.4 GST Treatment

Management fees and similar services rendered by the IFSC-located FME to an overseas fund generally qualify as zero-rated export of services under the IGST Act, subject to satisfaction of the conditions prescribed for export of services (including receipt of consideration in convertible foreign exchange and the place-of-supply rules). This is not

directly an ITA 2025 provision but is consistent with the GST architecture applicable to IFSC units and should be read alongside the income tax position.

A.5 Dividend Distributed by the FME — Verified Rate

Returning to the income-tax track after the GST digression above, the next question for an FME is the tax position once profits are actually distributed to shareholders. This is a second important correction: Section 207(1), Table item 2 of the ITA 2025 fixes a specific statutory rate of 10% on dividend received from a unit in an International Financial Services Centre, payable by a non-resident (not being a company) or a foreign company. This is a direct statutory rate — it is not merely "a concessional rate available under DTAA," as commonly described; it is the baseline rate fixed by the Act itself, and DTAA benefits (where more favourable) would apply on top of this baseline under the normal treaty-override principles. Plain dividend (not from an IFSC unit) for the same class of recipient is taxed at 20% under the same table (Sl. No. 1).

For resident shareholders of the FME (e.g., an Indian holding company), dividend is taxed at the shareholder's applicable rate — for a domestic company electing Section 200, this works out to approximately 25.17% (22% + 12% surcharge + 4% cess, for income above ₹10 crore).

A.6 Section 148 — Inter-Corporate Dividend Deduction (Verified)

Section 148(1): if the gross total income of a domestic company includes dividend received from another domestic company, a foreign company, or a business trust, the recipient company is allowed a deduction equal to so much of that dividend as does not exceed the dividend it itself distributes at least one month before its own return filing due date under Section 263(1).

Section 148(2): once a deduction is allowed for an amount of distributed dividend in one year, no further deduction can be claimed for the same amount in any other year — this prevents double-counting of the same distribution across years.

This deduction is directly relevant where an Indian holding company receives dividend from a GIFT IFSC FME (a foreign company, if structured outside India, or even if the FME is itself a foreign company for this purpose) and onward-distributes to its own shareholders.

A.7 — Taxation of Investors Holding Equity in the FME (Promoter/PE/VC Exit)

This is distinct from, and should not be confused with, the AIF investor position addressed in B.4. A.5 and A.6 above cover income (dividend) received by an FME shareholder. This section addresses the separate question of capital gains arising when an investor — a promoter, PE/VC investor, or co-shareholder — transfers their equity holding in the FME company itself.

An FME is typically an unlisted company. In the absence of any IFSC-specific override for FME share transfers, the general capital gains provisions apply by reference to holding period and the investor's residential/entity status:

Section 197(1): long-term capital gains (holding period exceeding 24 months for unlisted shares) are taxed at 12.5%, without indexation.

Section 197(4): for a non-resident (not being a company) or a foreign company, long-term capital gains on unlisted shares of a closely-held company are computed without giving effect to Section 72(6) — this is the provision dealing with foreign exchange fluctuation adjustment on cost/sale consideration for non-resident sellers and needs to be read carefully

in any specific exit, since it directly affects the computed gain where the original investment and the exit proceeds are both in foreign currency.

Section 196(1): short-term capital gains (unlisted shares held 24 months or less) do not fall within the STT-linked 20% rate under 196(1)(b), since unlisted shares are not transacted on a stock exchange and therefore cannot attract STT — such gains are taxed as ordinary business/other income at the assessee's applicable slab or corporate rate, not at a special capital gains rate. This is a meaningfully different outcome from the AIF Cat III specified-fund STCG treatment in Part B and should not be assumed to carry the same concessional rate.

Indirect transfer (Section 9(10)) — not directly applicable here. Section 9(10) is concerned with a non-resident transferring shares/interest in a foreign entity that derives substantial value from underlying Indian assets. A direct transfer of FME shares (where the FME itself is the Indian/IFSC entity, not a foreign entity holding Indian assets) is a direct transfer, not an indirect one, and Section 9(10) has no application on these facts. This needs to be stated explicitly in the guide to avoid readers wrongly importing the C.4 discussion (which deals with fund/SPV-level indirect transfers) into the FME-share-transfer context.

Withholding — where the seller is a non-resident, the buyer is required to withhold tax at the rate applicable to the capital gains computed above, under the Act's TDS provisions for payments to non-residents (the new Act's equivalent of Section 195). This is a buyer-side compliance obligation independent of the seller's own filing position, and a Tax Residency Certificate plus Form 10F (or equivalent prescribed forms under the new Act) should be obtained from the seller before remittance to support any treaty-rate claim.

DTAA position — most of India's tax treaties (Mauritius being the historically relevant one for fund structures, though largely grandfathered post-2017; Singapore, Netherlands, and others more typically used for direct FME equity now) allocate capital gains taxing rights to the country of residence of the seller in many cases, subject to LOB and beneficial ownership conditions under the treaty and MLI. This is treaty-specific and must be checked investor-by-investor — no blanket statement is safe here.

The following table consolidates the unit holder–level position discussed above, including the relocation provision addressed separately at B.6 below.

Table — Investor-Level Taxation, All Situations

Investor type	What's being taxed	Rate	Section / basis
Non-resident — AIF Cat III unit holder	Income/gains from specified fund units	Exempt (Nil)	Schedule VII Sl. No. 9
Resident/Non-resident — AIF Cat I/II unit holder	Pass-through income (character preserved)	As applicable to underlying income head	Section 224(1), (5)
AIF Cat I/II unit holder — redemption within 12 months	Loss pass-through	Disallowed for that period	Section 224(2)(b)
Non-resident shareholder of FME	Dividend received	10%	Section 207(1) Table Sl. 2

Resident shareholder of FME (domestic company, Section 200-opted)	Dividend received	~25.17% effective (22% + 12% surcharge + 4% cess)	Section 200(1), general slab/surcharge
Non-resident shareholder of FME	LTCG on transfer of FME shares (held >24 months)	12.5%, no indexation; FX adjustment per 197(4) re: Section 72(6)	Section 197(1), (4)
Resident shareholder of FME (individual/company)	LTCG on transfer of FME shares (held >24 months)	12.5%, no indexation	Section 197(1)
Any shareholder of FME	STCG on transfer of FME shares (held ≤24 months)	Taxed as ordinary income at slab/corporate rate — no special STCG rate (unlisted, non-STT)	Section 196(1)(b) does not apply; general computation
Non-resident shareholder of FME	Indirect transfer exposure	Not applicable — this is a direct transfer, not indirect	Section 9(10) inapplicable on these facts
Buyer of FME shares from non-resident seller	Withholding obligation	At rate applicable to computed capital gains; treaty rate if TRC/Form 10F provided	TDS provision equivalent to Section 195

Having addressed both income and capital gains at the FME level — including the FME's own shareholders — the guide now turns to the second principal layer of the GIFT IFSC structure: taxation of the AIF itself and its unit holders, which operates under an entirely separate statutory architecture.

Bottom Line — Can an IFSC Entity Achieve Zero Tax?

Yes. As established across A.1 to A.3 above, a company-structured IFSC entity can reduce its income-tax liability on qualifying IFSC income to nil, including full exclusion from MAT, where it combines a valid Section 147 deduction with a valid Section 200 concessional-regime election, on income genuinely connected to its approved IFSC business activity, and where the entity has real operating substance to withstand GAAR and POEM scrutiny (Part C). Falling short on any one of these conditions — most commonly, remaining on the default tax regime without electing Section 200 — means MAT continues to apply, at 9% of book profit. This conclusion applies to the FME's own qualifying business income; the separate questions of dividend taxation (A.5–A.6) and capital gains on a transfer of FME equity itself (A.7) follow their own distinct rules, set out above, and are not affected by this MAT/Section 147/Section 200 analysis. The position for LLP-structured FMEs remains an open verification item (see A.2.1).

PART B — TAXATION AT THE AIF / FUND LEVEL

B.1 The Statutory Basis — Two Separate Regimes

GIFT IFSC AIFs (typically structured as Trusts) fall into one of two entirely separate tax regimes under ITA 2025, depending on the category:

- Category I and Category II AIFs → pass-through taxation under Section 224

- Category III AIFs (the "specified fund" regime) → fund-level taxation under Section 210, read with the Schedule VII exemptions

These are structurally different regimes, not variations of the same provision. Getting the categorisation right at the outset is the single most important fund-structuring decision from a tax perspective.

B.2 Category I and II AIF — Pass-Through under Section 224
Section 224(1): income received by, or accruing to, a unit holder of an "investment fund" out of investments made by the fund is chargeable to tax in the unit holder's hands in the same manner as if the unit holder had made the investment directly.

Section 224(10)(a) — Definition of "investment fund": a fund established or incorporated in India as a trust, company, LLP, or body corporate, granted a certificate of registration as a Category I or Category II AIF, and regulated under either (i) the SEBI (AIF) Regulations, 2012, or (ii) the IFSCA (Fund Management) Regulations, 2022 [the Act's drafting still refers to the 2022 Regulations by name; this should be read as referring to the regulations as currently in force, i.e., the 2025 Regulations].

Key operative features of the pass-through regime:

Section 224(6): the total income of the investment fund itself is charged to tax at the rates specified in the Finance Act (if the fund is a company or firm) or at the maximum marginal rate (in any other case, which would include a Trust). This applies only to business income computed at the fund level — see below.

Section 224(2)(a): a loss arising to the fund under the head "Profits and gains of business or profession" is carried forward and set off at the fund level — it does not pass through to investors.

Section 224(2)(b): all other losses are ignored for pass-through purposes if the relevant units have not been held for at least 12 months by the unit holder. This is a critical planning point: investors who redeem within 12 months lose access to fund-level loss pass-through entirely for that period.

Section 224(5): income paid or credited by the fund retains the same character in the hands of the unit holder as it had at the fund level (capital gains remain capital gains, interest remains interest, etc.).

Section 224(7): undistributed income is deemed to be credited to the unit holder on the last day of the tax year, in the proportion the unit holder would have been entitled to receive it — meaning deferral of actual distribution does not defer the tax incidence at the investor level.

Important nuance — business income does not pass through. Where the AIF earns business income (as opposed to capital gains or investment income), that income is taxed at the fund level at the maximum marginal rate and is excluded from the pass-through computation under Section 224(2)(a). Whether a fund's trading activity constitutes "business income" or "capital gains" is a facts-and-circumstances determination and is one of the most litigated questions in Indian fund taxation — the investment mandate, holding period policy, and trading frequency should all be documented with this characterisation risk in mind.

B.3 Category III AIF — The "Specified Fund" Regime (Section 210 + Schedule VII)

Category III AIFs are not covered by Section 224. They fall under a separate, fund-level taxation regime built around the statutory term "specified fund".

Definition — Schedule VII, Note 1(g): a "specified fund" includes a fund established in India as a trust, company, LLP, or body corporate, located in an IFSC, which —

(A) has been granted a certificate of registration as a Category III AIF and is regulated under the SEBI (AIF) Regulations, 2012 or the IFSCA (Fund Management) Regulations [2022, per the Act's text — read as currently in force]; or

(B) has been granted a certificate as a retail scheme or ETF under the IFSCA Fund Management Regulations; and

(C) all units other than those held by a sponsor or manager are held by non-residents — subject to a tolerance: where a unit holder subsequently becomes resident under Section 6, the fund does not lose specified fund status provided resident-held units do not exceed 5% of total units issued, subject to further prescribed conditions.

This 5% tolerance threshold is a materially useful, and frequently overlooked, relaxation — it gives some headroom for an investor's residency status changing mid-investment without automatically disqualifying the fund.

Tax Rates at the Fund Level — Section 210(1):

Nature of Income	Rate for Specified Fund
Income in respect of securities (interest, dividend — other than units)	10%
STCG not chargeable to STT under Section 196	30%
STCG chargeable to STT under Section 196	20%
LTCG not under Section 198	12.5%
LTCG under Section 198 (listed equity/units, exceeding ₹1,25,000)	12.5%

(For comparison, a Foreign Institutional Investor — not a specified fund — is taxed at 20% on interest/dividend income, but the STCG and LTCG rates are identical to those applicable to a specified fund.)

Section 210(2): these rates apply only to the extent the income is attributable to units held by non-residents (excluding a permanent establishment of such non-resident in India) — reinforcing the structural requirement discussed above.

Schedule VII exemptions (Sl. Nos. 1–4) — available to a "specified fund":

1. Income from transfer of capital assets on a recognised stock exchange in any IFSC — exempt, where consideration is in convertible foreign exchange and income is attributable to non-resident-held units.
2. Income from transfer of securities other than shares of an Indian-resident company — exempt, same conditions.
3. Income from securities issued by a non-resident (where the securities are not issued by that non-resident's Indian PE, and the income otherwise does not accrue in India) — exempt.
4. Income from a securitisation trust chargeable under "Profits and Gains of Business or Profession" — exempt, same conditions.

Net effect: A specified fund is taxed at the fund level on (a) Indian equity-related capital gains at 12.5%/20%/30% depending on category and STT status, and (b) Indian-source interest and dividend at 10%. All other income — offshore securities, non-resident-issued debt, derivatives not falling within the above categories — is exempt at the fund level, provided it is attributable to non-resident unit holders.

B.4 Investor-Level Position — Specified Fund (Schedule VII, Sl. No. 9)

Schedule VII, Sl. No. 9 is explicit and unambiguous: any income accruing, arising, or received by a unit holder of a specified fund, or on transfer of units of a specified fund, is not included in total income — meaning it is wholly exempt at the investor level, with "Nil" as the condition (no further conditions attached to this particular exemption, unlike most other entries in the Schedule).

This confirms the position previously described: since tax has already been collected at the fund level under Section 210, the non-resident investor receives distributions and exits entirely tax-free in India, with no further compliance trigger.

The following table consolidates the unit holder–level position discussed above for both AIF categories.

Table — AIF Unit Holder–Level Taxation, All Situations

AIF Category	Unit holder type	Nature of income/gain	Rate	Section / basis
Cat I / II	Resident or non-resident	Capital gains, interest, dividend (pass-through, non-business income)	As applicable to the underlying income head, as if investor held the asset directly	Section 224(1), (5)
Cat I / II	Resident or non-resident	Business income earned by the fund	Not passed through — taxed at fund level at Maximum Marginal Rate	Section 224(6)(b), 224(2)(a)
Cat I / II	Any unit holder, units held ≤12 months	Loss pass-through (other than business loss)	Disallowed for that period — investor cannot offset	Section 224(2)(b)
Cat I / II	Any unit holder, units held >12 months	Loss pass-through (other than business loss)	Allowed, same character as at fund level	Section 224(2)(b), read with 224(5)
Cat I / II	Any unit holder	Undistributed income at fund year-end	Deemed credited and taxed in investor's hands regardless of actual distribution	Section 224(7)
Cat III (Specified Fund)	Non-resident unit holder	Income/gains from the fund or on transfer of units	Exempt (Nil) — tax already collected at fund level	Schedule VII Sl. No. 9
Cat III (Specified Fund)	Resident unit holder (within 5% tolerance)	Income/gains from the fund or on transfer of units	Not covered by Sl. No. 9 exemption (which is non-resident specific) — taxed per general provisions applicable to the resident investor;	Schedule VII Sl. No. 9 (scope), general Act provisions

			needs independent check, see caveat below	
Cat III (Specified Fund)	Non-resident unit holder, relocation scenario	Capital gains on shares of Indian-resident company received via fund relocation (original fund → resultant fund)	Excluded from total income, to the extent attributable to non-resident-held units	Schedule VII Sl. No. 10

B.5 STT Exemption on IFSC Exchange Transactions
Separately from the fund-level and investor-level rates discussed above, one structural feature of trading on a GIFT IFSC exchange deserves its own mention, since it affects how those capital gains rates are actually accessed in practice.

Section 196(3): the requirement that STT be paid for concessional STCG treatment under Section 196(1) does not apply to a transaction undertaken on a recognised stock exchange located in an IFSC where consideration is paid in foreign currency. Section 198(4) contains the parallel provision for LTCG under Section 198.

This means transactions on GIFT IFSC exchanges in foreign currency get the STT-paid concessional rate treatment automatically, without actually paying STT — a genuine, verified, and significant structural advantage confirmed directly in the statute, not merely a regulatory administrative practice.

B.6 Relocation of Offshore Funds — Schedule VII, Sl. No. 10
Capital gains on transfer of shares of an Indian-resident company by a "resultant fund" or "specified fund," where those shares were originally transferred from the offshore "original fund" (or its wholly-owned SPV) to the resultant fund as part of a relocation, and where such gains would not have been chargeable to tax had the relocation not occurred, are excluded from total income — to the extent attributable to non-resident-held units, in the manner prescribed.

This confirms the relocation tax-neutrality principle, grounded directly in the Schedule rather than as a separate standalone provision — a useful point of statutory precision for advisory purposes.

PART C — INTERACTION WITH THE FME / PROMOTER LEVEL

Everything discussed so far in Parts A and B describes the benefits available under the Act as drafted. This Part addresses the separate question of when those benefits can be challenged or denied by the tax authorities — starting with the General Anti-Avoidance Rule.

C.1 GAAR — Sections 178 to 184
Section 179(1): an "impermissible avoidance arrangement" is one whose main purpose is to obtain a tax benefit and which —

(a) creates rights/obligations not ordinarily created between arm's length parties;
(b) results in misuse or abuse of the Act's provisions;
(c) lacks commercial substance, or is deemed to lack commercial substance under Section 180; or

(d) is carried out by means not ordinarily employed for bona fide purposes.

Section 179(2): a rebuttable presumption — if the main purpose of any step in an arrangement is to obtain a tax benefit, the entire arrangement is presumed to be for that purpose, irrespective of the overall purpose. The burden shifts to the assessee to rebut this. Section 180(1) elaborates "lack of commercial substance," including round-trip financing, accommodating parties, offsetting elements, disguising the true ownership/source of funds, location of an asset/transaction/residence without substantial commercial purpose beyond the tax benefit, and absence of any significant effect on business risk or net cash flow apart from the tax benefit.

Section 181: consequences include disregarding or recharacterising steps, treating the arrangement as not having been entered into, and disregarding accommodating parties.

Practical implication for GIFT IFSC FME/AIF structures: the FME must have demonstrable independent commercial substance — real office presence in the IFSC, a genuinely operating fund management function, documented investment decision-making, and arm's length inter-entity dealings. A structure whose only discernible purpose is shifting Indian-sourced fee or investment income into the IFSC tax shelter, without operational substance, is squarely at risk under Sections 179-181.

C.2 POEM — Section 6(10)

Beyond the GAAR risk addressed above, a related but distinct residency question can independently unravel the IFSC tax position — where effective management of the FME actually occurs.

Section 6(10)(a)(ii): a company is resident in India if its place of effective management (POEM) is in India in that tax year.

Section 6(10)(b): POEM is "the place where key management and commercial decisions necessary for the conduct of business of the company as a whole are, in substance, made." If the FME's investment committee or board effectively takes its decisions in India — even informally, through Indian-based promoters directing strategy — the FME risks being treated as India tax-resident, which would negate the entire IFSC tax architecture (Section 147 deduction is predicated on the entity being a Unit established in the IFSC, but residency itself is a separate gating question that interacts with treaty eligibility, withholding, and worldwide income taxation).

Practical safeguard: board and investment committee meetings, and documented decision-making, should occur physically within the IFSC. Indian promoters should participate in an advisory, non-decision-making capacity only, with this distinction clearly minuted.

C.3 Transfer Pricing — Sections 161 to 165

Even where GAAR and POEM risk are both well-managed, related-party pricing remains a continuous, separate compliance obligation that auditors and tax authorities scrutinise independently.

Section 161(1): income from an international transaction between associated enterprises must be computed having regard to the arm's length price.

Section 162(1)(a)(ii)/(iii): entities are "associated enterprises" where one holds, directly or indirectly, 26% or more of the voting power in the other, or where any common person/enterprise holds 26% or more in each.

Section 163: an "international transaction" includes transactions between associated enterprises where at least one is a non-resident — covering, for example, management fees paid by an overseas fund to the GIFT IFSC FME, or fees paid by the FME to an Indian advisory entity, where common promoter control exists.

Practical implication: where the Indian promoter group controls both the GIFT IFSC FME and the offshore/onshore fund, every fee arrangement, cost allocation, and intercompany loan between them must be benchmarked at arm's length and supported by contemporaneous transfer pricing documentation. This is a continuous compliance obligation, not a one-time exercise.

C.4 Indirect Transfer — Section 9(10)

The final layer of anti-avoidance risk operates not at the FME or fund level directly, but at the point an investor exits — through the indirect transfer provisions.

Section 9(10)(a) and (b): an asset or capital asset being shares/interest in a foreign company or entity is deemed situated in India if it derives, directly or indirectly, substantial value from Indian assets — defined as Indian asset value exceeding ₹10 crore and representing at least 50% of the entity's total asset value.

Section 9(12): a specific carve-out exists for eligible fund managers situated in an IFSC — fund management activity carried out through such a manager does not, by itself, constitute a business connection in India for the fund, nor does it render the fund India-resident, provided prescribed conditions (Schedule I) are satisfied. This is directly relevant where a GIFT IFSC FME manages an offshore fund investing in Indian assets — the safe harbour protects the offshore fund from being treated as having an Indian taxable presence solely because its manager operates from the IFSC.

Practical implication for the GIFT IFSC AIF/FME complex: where the underlying fund (whether the GIFT IFSC AIF itself, or an upstream offshore fund managed by the GIFT FME) holds Indian assets exceeding the above threshold, transfers of interests in that fund by non-resident investors could be caught by Section 9(10) unless the investor falls within an applicable exclusion (e.g., the FPI Category I/II exclusion under Section 9(g)) or the gains otherwise fall within an exempt category discussed in Part B above.

PART D — CONSOLIDATED RATE TABLE

The rates and provisions discussed across Parts A through C are consolidated below for quick reference — this table should be read alongside the narrative sections above, not as a standalone summary, since several rates are conditional on elections (Section 200) or structural facts (residency of unit holders, regime opted) discussed only in the prose.

Level	Item	Verified Rate	Section
FME	Income tax on eligible IFSC income (during exempt window)	100% deduction	Section 147(1), (2)(b)
FME	MAT — IFSC unit (income solely in convertible FX), default regime	9% of book profit	Section 206(1)(b)(i)
FME	MAT — IFSC unit having validly elected Section 200	Nil (MAT inapplicable)	Section 206(1)(q)(ii)

FME	MAT — any other company	14% of book profit	Section 206(1)(b)(ii)
FME	AMT — IFSC unit (non-company), default regime	9% of adjusted total income	Section 206(2)(b)(ii)(I)
FME	AMT — any other case	18.5%	Section 206(2)(b)(ii)(III)
FME	AMT exclusion via concessional regime election — LLP structure	Pending verification — Sections 203/204 eligibility for LLPs not yet confirmed	Section 206(2)(d), cross-ref Sections 203(5)/204(2)
FME	Concessional corporate rate (if §147 not claimed)	22% + surcharge + cess	Section 200(1)
FME	Dividend to NR — from IFSC unit	10%	Section 207(1) Table Sl.2
FME	Dividend to NR — general	20%	Section 207(1) Table Sl.1
AIF Cat I/II	Fund-level tax (pass-through; business income only)	Maximum Marginal Rate	Section 224(6)(b)
AIF Cat III (Specified Fund)	Interest/dividend income	10%	Section 210(1) Table Sl.1(b)
AIF Cat III	STCG — STT paid (via §196)	20%	Section 210(1) Table Sl.3
AIF Cat III	STCG — STT not paid	30%	Section 210(1) Table Sl.2
AIF Cat III	LTCG	12.5%	Section 210(1) Table Sl.4/5
AIF Cat III	Other income (offshore securities, NR-issued debt, etc.)	Exempt	Sch. VII Sl. 1-4
Investor — Cat I/II	Pass-through — character preserved	As applicable to underlying income	Section 224(1), (5)
Investor — Cat III	Income/gains from specified fund	Exempt (Nil)	Sch. VII Sl. 9
Indian Co (general)	LTCG on unlisted shares >24 months	12.5% (no indexation)	Section 197(1)
Indian Co (general)	STCG (listed equity, STT paid)	20%	Section 196(1)

The following key takeaways translate the rate table above into the structuring decisions promoters and fund managers actually need to make.

PART E — KEY TAKEAWAYS FOR STRUCTURING

The Section 147 deduction is real, verified, and has been genuinely expanded to 20 of 25 years — this remains the single most powerful feature of the GIFT IFSC framework. On the default regime, it reduces the MAT rate to 9% rather than eliminating it. But where the FME has elected Section 200, MAT is excluded entirely under Section 206(1)(q)(ii) — making the Section 200 election, not the 147 deduction alone, the decisive factor for whether income-tax liability on qualifying income can be reduced to nil. Financial models should branch

explicitly on regime election rather than applying a uniform 9% MAT floor across all FME structures.

Verify whether Sections 203 and 204 extend an AMT-exclusion mechanism to LLP-structured FMEs equivalent to the Section 200/206(1)(q)(ii) carve-out available to companies. Section 201 has no bearing on this question — it is restricted to domestic manufacturing companies and has no application either to IFSC fund management activity or to LLPs. Until Sections 203/204 are confirmed, the safer structuring assumption is that an LLP-structured FME remains subject to the AMT floor under Section 206(2)(b)(ii) even where it claims the Section 147 deduction — making a company structure the more reliably tax-efficient choice for an FME pending this verification.

The Category I/II versus Category III distinction is not cosmetic — it determines whether tax is collected at the fund level (Cat III) or passed through to investors (Cat I/II). For a fund targeting purely non-resident, high-turnover or derivative-heavy strategies, the Category III/specified fund route, with its investor-level exemption under Schedule VII Sl. No. 9, is generally the more efficient structure. For a fund with a mixed resident/non-resident investor base running a long-only or VC-style strategy, Category I/II pass-through is the only viable route, since Category III specified fund status requires non-resident unit holding (subject only to the narrow 5% tolerance).

The STT exemption on GIFT IFSC exchange transactions is statutorily confirmed (not merely administrative) and automatically confers STT-paid-equivalent concessional capital gains rates — a genuine structural alpha source for high-turnover strategies.

GAAR, POEM, and Transfer Pricing risk are not theoretical add-ons — they are the primary lines of attack available to Indian tax authorities against IFSC structures lacking genuine substance. Documented decision-making within the IFSC, arm's length inter-entity pricing, and demonstrable operational substance at the FME level are not optional extras; they are the price of admission for the tax benefits to hold up on audit.

Prepared by: **CS Prashant Kumar**
Company Secretary & Compliance Officer
Global Horizons Capital Advisors (IFSC) Private Limited
Mobile: +91-9821008011
Email: prashant.kumar@global-horizons.in

Disclaimer: This guide is based on a direct reading of the Income Tax Act, 2025 as available to the author, including amendments by the Finance Act, 2026. Every section number and rate cited has been cross-checked against the statutory text. However, tax law is subject to interpretation, future amendment, and judicial pronouncement. This guide is for professional reference and educational purposes only and does not constitute legal or tax advice. Readers must seek independent professional counsel before acting on any position discussed herein.