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Direct Listing of Indian Companies on GIFT IFSC International Stock Exchange: The Income Tax Perspective



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Introduction: Recalling the historic feat of his company Infosys, becoming the first Indian company to get listed on Nasdaq USA Stock Exchange in 1999, the Infosys cofounder Shri Narayan Murti has remarked, "It was a small step for Nasdaq, but a giant **LEAP** for Indian IT (industry)". Back then in 1999, Infosys has to take the more tedious and stringent route of the American Depository Receipts (ADRs), for Nasdaq listing, as there was no regulatory framework for Direct Listing ecosystem in India.

Another interesting anecdote pertains to the Vedanta Chairman, Shri Anil Aggarwal. He has once shared that he had to cycle for hundred kilometers with his foreign investors, to Oxford, to enable finances for his company Vedanta, to become the first Indian company, to get listed on the London Stock Exchange in 2003.

However, fortunately for the modern age entrepreneurs and founders, the global capital markets, the global investors and the global investments are not that 'seven overseas' far away and are accessible in India only, and they are not required to run from pillar to post in any foreign jurisdictions, thanks to the recent revolutionary and path breaking initiatives of the Government of India and the Ministry of Corporate Affairs (MCA), enabling the Direct Listing of the equity shares of the listed and unlisted Indian public companies, in the GIFT IFSC International Stock Exchanges, in Gujarat

Recent Developments: On 24.01.2024, in pursuance of the powers conferred under section 5 and 23 of the Companies (Amendment) Act, 2020, the MCA has issued the 'Companies (Listing of Equity Shares in Permissible Jurisdictions) Rules, 2024' (hereinafter referred to as the MCA LEAP Rules) and the Ministry of Finance, Department of Economic Affairs has amended the 'Foreign Exchange Management (Non-debt Instruments) Rules, 2019', (hereinafter referred to as 'the amended FEMA NDI Rules') and has notified the 'Direct Listing of Equity Shares of Companies Incorporated in India on International Exchanges Scheme, 2024'.

Interestingly, the abbreviated form of the newly notified Rules, by the MCA, i.e., the Companies (Listing of Equity Shares in Permissible Jurisdictions) Rules, 2024, are also now being popularly referred to as '**LEAP**'.

The above notified MCA LEAP and FEMA NDI Rules, together, provide an all-embracing regulatory framework to enable Indian public companies to issue and list their shares in permitted international exchanges. Currently, the framework allows unlisted public Indian companies to list their shares on an international exchange. SEBI is in the process of issuing the operational guidelines for listed public Indian companies. The international stock exchanges at GIFT-IFSC under the regulatory supervision of IFSCA namely, India International Exchange and NSE International Exchange have been, currently, prescribed as permitted stock exchanges under the Rules and the Scheme.

Eligible Companies: Rules 4 of the MCA LEAP Rules provides that an Indian public company, having no partly paid-up shares, and not prohibited as per Rule 5, is an eligible entity for direct listing of its equity shares in GIFT IFSC International Stock Exchange in Gujarat. Rule 5 stipulates that Indian public company having negative networth or which has defaulted in payment of dues to any bank or public financial institution or secured creditor or which has defaulted in filing of an annual return or financial statement, is not allowed to directly list its shares in GIFT IFSC, under the scheme.

Eligible Shareholders: The amended FEMA NDI Rules provide that the equity shares of the Indian public company directly listed in the GIFT IFSC International Stock Exchange can be purchased or sold only by the 'permissible holder'. It also stipulates that the permissible holder can't be the resident person in India. In other words, only a non-resident can buy or sell the equity shares of the public company, directly listed on the GIFT IFSC International Stock Exchange and the resident Indian is not allowed to do the same. It is pertinent to mention here that the eligibility criteria for a person to be considered as a resident Indian or a non-resident Indian, in the Direct Listing scheme, is governed by the FEMA rules and not by the Income Tax Act. However, it is another thing that practically the said criteria may be overlapping with the difference that the FEMA rules prescribe minimum stay of more than 182 days in India in the preceding financial year, whereas the Income Tax Act prescribes a minimum stay of 182 days in India in the current financial year, for a person to be considered as a Resident Indian.

Relevance of the IFSC in GIFT City Gujarat: The International Financial Service Centre (IFSC) as envisaged under the Indian context is a jurisdiction that provides financial services to non-residents and specified resident institutions, in foreign denominated currency other than Indian Rupee (INR). India's first IFSC in GIFT city Gujarat is not exactly a foreign destination but is a special economic zone (SEZ) that offers many incentives and benefits akin to a foreign jurisdiction.

The IFSC in GIFT City Gujarat houses the entire capital market ecosystem, in the form of two International Stock Exchanges namely India International Exchange Limited ("India INX") set up by Bombay Stock Exchange and NSE IFSC Limited ("NSE IX") set up by National Stock Exchange, clearing corporations, depository, intermediaries and the banking infrastructure.

The Income Tax Perspective: This watershed moment of the evolution of the 'Direct Listing' ecosystem in GIFT IFSC in India, has its fair share of some unassuming but intriguing Income Tax implications both in the hands of the Indian public companies opting for the direct listing of their equity shares on the GIFT IFSC international stock exchanges and the non-resident investors, subscribing to and trading in such directly listed shares. These crucial tax considerations are being discussed and analysed below.

(I) Tax Implications in the hands of Indian Public Companies opting for Direct Listing on GIFT IFSC

(a) Applicability or otherwise of the share valuation norms on issue of shares stipulated in section 56(2)(viib) of the Income Tax Act.

The existing provisions of section 56(2)(viib) of the Income Tax Act, requires the companies, other than the companies in which the public are substantially interested, to issue their equity shares at a value which

should not exceed the Fair Market Value (FMV) of such shares. Further Rule [11UA\(2\)](#) of the Income Tax Rules, prescribes two methods of determining the FMV of the equity shares to be issued by such companies, i.e., (i) absolute Net Asset Value (NAV) method based on carrying amounts of assets and liabilities as per the Balance Sheet, with historical acquisition costs of land and building and (ii) Discounting Cash Flow Method (DCF) method of valuation, based on the projected future revenue potential of such companies.

Section [2\(18\)\(b\)\(A\)](#) of the Income Tax Act includes a public company whose shares are listed in a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956, in the definition of a company in which the public are substantially interested.

In simple words, the existing share valuation norms stipulated u/s 56(2)(viib) read with Rule 11UA(2), mandating the issuance of equity shares by the Indian companies at a value less than or equal to the FMV of such shares, determined either by NAV method or by DCF method are not applicable to the Indian public limited companies whose shares are listed on recognised stock exchanges in India.

It is pertinent to mention here that the eligible public limited companies as per Rules [4](#) and [5](#) of the MCA LEAP rules, will be able to directly list their separate class of equity shares in the GIFT IFSC international stock exchange, and such separate class of directly listed equity shares can be subscribed to only by the non-residents and not by the resident Indians, as per the amended FEMA NDI Rules. Simultaneously these public companies can continue to issue a separate class of equity shares, which are not listed either on domestic Indian recognised stock exchanges or on the GIFT IFSC International Stock Exchange.

In view of the above peculiar yet expected scenario, the important question requiring careful consideration by all the concerned stakeholders is whether such public limited companies, which are otherwise unlisted in the domestic Indian recognised stock exchanges, but which get their separate class of equity shares directly listed in the GIFT IFSC International Stock Exchange, under the LEAP Direct Listing scheme, 2024, will be exempted from the applicability of the above mentioned valuation norms stipulated in section 56(2)(viib) of the Income Tax Act or not.

There is a possibility that the FMV valuation provisions in section 56(2)(viib) will continue to remain applicable to such class of the equity shares of such public limited companies, which represents the domestic unlisted segment and the class of equity shares representing the directly listed segment in the GIFT IFSC international stock exchange, available only to non-resident subscribers, can be made exempted from the applicability of the provisions of section 56(2)(viib) of the Income Tax Act.

But this may then result in two different sets of share valuations for the domestic unlisted class of shares and the GIFT IFSC directly listed class of shares. The issuance of domestic unlisted class of equity shares will have to be made at a value less than or equal to the FMV of such shares based on either the NAV method or the DCF method, as per section 56(2)(viib) of the Income Tax Act read with Rule 11UA(2) of the Income Tax Rules.

On the other hand, clause 6(2) of the FDI NDI amended Rules stipulate that in case of initial listing of equity shares by a public unlisted Indian company on the International Exchange, the price of issue or transfer of equity shares shall be determined by a book- building process as permitted by the said International Exchange and shall not be less than the fair market value under applicable rules or regulations under the Foreign Exchange Management Act, 1999 and the subsequent issuance or transfer of shares for the purpose of listing additional shares post initial listing would be based on applicable pricing norms of the International Exchange and the permissible jurisdiction.

In view of the above, it is desirable and vital that appropriate clarifications and amendments are being made by the Legislature, in the Income Tax Act, in order to redress the above explained practical difficulties concerning the varying share valuations of the two separate classes of equity shares of the Indian public limited unlisted companies opting for the direct listing on GIFT IFSC international stock exchanges.

(b) Tax on Buy Back of Shares: Currently both the listed as well as unlisted companies registered in India, are liable to pay the buyback tax @ 20% u/s 115QA of the Income Tax Act, on the distributed income by the company, on buy back of shares. Distributed income means the consideration paid by the company on buy back of shares as reduced by the amount which was received by the company for issue of such shares. Further, such distributed income is exempt from tax in the shareholders' hand under section [10\(34A\)](#) of the Income Tax Act.

Since the buy back tax u/s 115QA is applicable on the buy-back of shares both by listed and unlisted companies, therefore it can be safely concluded that the said buy-back tax will be applicable on the buy-back of both the two separate classes of equity shares of the public company opting for the direct listing, viz. the domestic unlisted segment and the directly listed GIFT IFSC segment. However, again the computation of the amount of distributed income may pose practical problems, on account of the above discussed (in point no.1) varying share valuation criteria for these two separate classes of shares.

(c) Deduction of Withholding Tax on Dividend Income of Non-Resident Shareholders: The Indian Public companies will be liable to deduct withholding tax @20% u/s 115A(1) read with section [195](#) of the Income Tax Act, or at the more beneficial rate as per the applicable DTAA, subject to the fulfilment of the prescribed conditions, on the Dividend income, if any, arising in the hands of the non-resident shareholders, on the directly listed shares of such public companies on GIFT IFSC.

(II) Tax Implications in the hands of Non-Resident Investors/ Subscribers of Directly Listed Shares in GIFT IFSC

(a) Taxability of Capital Gains: By virtue of section [47\(viiab\)\(d\)](#) of the Income tax Act, any transfer of notified securities made by a non-resident on a recognised stock exchange located in an IFSC and where the consideration for such transactions is paid in foreign currency, is not regarded as 'transfer' so as to attract the capital gain tax. Similarly, section 10(23FF) of the Income Tax Act exempts any capital gains income arising in the hands of non-resident investors on transfer of "foreign currency denominated equity shares of a company" undertaken on a recognised stock exchange located in IFSC and where the consideration for such transaction is paid or payable in foreign currency. Since the directly listed equity shares of Indian public companies on GIFT IFSC will also be denominated in foreign currency, like the shares of foreign companies, thus the exclusion from the definition of 'transfer' u/s 47(viiab)(d) and the exemption u/s 10(23FF) will also be applicable on any capital gain income arising in the hands of the NRI investors, on account of transfer of such directly listed shares of Indian public companies on GIFT IFSC.

(b) Taxability of Dividend: Currently any Dividend income arising in the hands of non-resident investors on investments in Indian company shares, is taxable at the rate of 20% under section [115A/115AD](#) of the Income Tax Act, or as per the applicable DTAA rate, on the fulfilment of the prescribed conditions.

However, as per section 115AC of the Income Tax Act, dividends received on Global Depository Receipts (GDRs) are taxed at a concessional rate of 10% in the hands of non-residents. Also, the dividend income received by Category III Alternate Investment Funds (AIFs) set up in in IFSC is also taxed at a concessional tax rate of 10% under section 115AD of the Act. Similarly, dividends issued by units physically located in IFSC units to non-resident shareholders is taxable at the concessional rate of 10% under section 115A(1)(A) of the Act.

However, currently it is not clear as to whether any similar concessional tax rate of 10% will also be provided for the dividend income arising in the hands of non-resident shareholders, on the directly listed shares of Indian companies on GIFT IFSC international stock exchanges. In the absence of any such specific provision in the Income Tax Act, currently, the higher tax rate of 20% as per section 115A/115AD may be applicable subject to the applicability of beneficial DTAA rates.

(c) Requirement of Obtaining Indian PAN and Return Filing by NRI Investors Subscribers of Directly Listed Shares in GIFT IFSC

The eligible non-resident investors are not required to obtain an Indian PAN if such investors do not earn any income in India, other than the income from transfer of a capital asset referred to in section 47(viiab) of the Income Tax Act, as per Rule [114AAB](#) of the Income Tax Rules, 1962.

Thus, the non-resident investors only earning the exempt capital gain income on the transfer of directly listed shares of Indian public companies on GIFT IFSC, will not be required to obtain Indian PAN and file their returns of income in India.

However, the non-resident investors earning any dividend income on such directly listed shares of Indian public companies on GIFT IFSC, will be required to obtain an Indian PAN and also file their returns of income in India, as per section 115A(5), if they want to avail the benefit of deduction of lower withholding tax rate on their dividend income as per the applicable DTAA, vis-à-vis the higher domestic withholding tax rate of 20% u/s 115A(1) of the Income Tax Act.

Concluding Remarks: The enabling ecosystem for the Direct Listing of equity shares of Indian public companies on GIFT IFSC, International Stock Exchanges, is indeed a revolutionary and path-breaking initiative of the Government of India, aimed at unlocking the global opportunities by enhancing the Indian companies' ability to access global funds, diversify their investor base, increase their visibility and provide opportunities for better valuations, and thereby marching towards the objective of making India a Developed Country by 2047. The public Indian companies will have the flexibility to access both markets i.e. domestic market for raising capital in INR and the international market at IFSC for raising capital in foreign currency from the global investors.

However, in order to boost the interest and confidence of all the stakeholders concerned including the participating Indian public companies and the non-resident global investors, towards the said Direct Listing Scheme, it is essential and desirable that the above discussed and analysed critical and vital income tax aspects, are also being timely addressed by the concerned policy makers and the legislators.