Page: 351-391 URL: www.lijdlr.com

ISSN: 2583-7753

LawFoyer International Journal of Doctrinal Legal Research

[ISSN: 2583-7753]

Volume 3 | Issue 2

2025

DOI: https://doi.org/10.70183/lijdlr.2025.v03.54

REGULATORY INNOVATION OR LEGAL EROSION? INVESTIGATING THE ACCIDENTAL ARBITRAGE CREATED BY GIFT CITY'S DUAL FINANCIAL REGIME

Devesh[1] & Radhika Dinesh[2]

I. ABSTRACT

This paper provides a comprehensive analysis of the legal and constitutional ramifications arising from establishing and operating the Gujarat International Finance Tec-City (GIFT City) and its International Financial Services Centre (IFSC). Conceived as a flagship initiative to position India as a global financial hub, GIFT City offers a suite of regulatory exemptions, tax incentives, and operational flexibilities designed to attract international capital and financial institutions. However, the paper argues that these exceptional measures have created a parallel regulatory regime that contrasts India's unified financial architecture.

Through doctrinal and comparative legal analysis, the authors explore how GIFT City's unique framework facilitates regulatory arbitrage, enabling entities to bypass domestic regulations related to taxation, capital controls, and insolvency. The paper highlights the risks of forum shopping, tax base erosion, and the dilution of investor and creditor protections, drawing on both Indian and international precedents. It further examines the constitutional questions raised by the selective privileges granted to GIFT City entities, particularly about the principles of equality before law, fiscal federalism, and the separation of powers between the legislature and the executive.

The study also assesses the broader policy implications of allowing such regulatory enclaves within the Indian legal system, including potential impacts on market integrity,

[1] Fourth Year B.Com LL.B. (Hons.) Student at Institute of Law, Nirma University, Ahmedabad
[2] Fourth Year B.Com LL.B. (Hons.) Student at Institute of Law, Nirma University, Ahmedabad

regulatory coherence, and public accountability. In conclusion, the paper offers targeted policy recommendations to reconcile GIFT City's operational objectives with India's constitutional and regulatory commitments. These include enhancing transparency, instituting robust economic substance requirements, and ensuring integrated oversight by domestic regulators to prevent the emergence of enclave exceptionalism and to safeguard the integrity of India's financial and legal systems.

II. KEYWORDS

GIFT City, IFSC, regulatory arbitrage, tax incentives, constitutional law, financial regulation, India, capital controls, market integrity, financial hub.

III. INTRODUCTION

India's aspiration to become a global financial hub has long been constrained by the rigidity and fragmentation of its financial regulatory framework. Governed by a complex interplay of sector-specific regulators—such as the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), and Insurance Regulatory and Development Authority (IRDAI)—India's financial system has struggled to adapt to the demands of integrated, cross-border capital markets. Unlike global financial centres that operate under a unified regulatory umbrella (e.g., the Monetary Authority of Singapore), India's structure has historically lacked the legal agility required to facilitate rapid financial innovation, capital mobility, and jurisdictional competitiveness.

To address these institutional bottlenecks, the Government of India introduced the Gujarat International Finance Tec-City (GIFT City), housing the International Financial Services Centre (IFSC). GIFT IFSC offers regulatory waivers, tax neutrality, and a unified financial regulator—the International Financial Services Centres Authority (IFSCA)—in an attempt to emulate the sophistication and agility of global financial jurisdictions. However, beneath its reformist promise lies a deeper constitutional and legal dilemma. Entities operating from GIFT are treated as residents under the Income Tax Act but non-residents under FEMA, creating a dual legal identity that fragments the coherence of India's statutory and regulatory framework.

This paper poses the question, Does GIFT IFSC, in its present legal and institutional design, create an unconstitutional parallel regime that facilitates regulatory arbitrage at the expense of India's financial integrity? We argue that GIFT IFSC enables a dual legal-financial regime that circumvents India's unified regulatory oversight—raising significant concerns under constitutional doctrines such as equality (Article 14), fiscal federalism (Article 246A), and limits on delegated authority.

This inquiry is pursued through doctrinal analysis, statutory interpretation, comparative institutional design, and case studies. The paper engages with primary legal instruments—including the IFSCA Act, SEZ Act, FEMA, and the Income Tax Act—while drawing comparative insights from Singapore and Dubai to contextualize GIFT's distinctiveness. It illustrates, through both real and hypothetical structures, how regulatory arbitrage manifests in areas such as taxation, capital controls, insolvency, and securities regulation.

IV. METHODOLOGY

The research employs a mixed-methods approach combining doctrinal legal analysis, comparative institutional design studies, and hypothetical case modeling to evaluate GIFT IFSC's regulatory framework.

- **Doctrinal Analysis:** Primary legal instruments (IFSCA Act, SEZ Act, FEMA, Income Tax Act) were analyzed to identify statutory contradictions, such as dual residency status under FEMA (non-resident) and tax laws (resident). Judicial precedents (e.g., *Shayara Bano v. Union of India*, *E.P. Royappa v. State of Tamil Nadu*) were examined to assess constitutional validity under Articles 14, 265, and 300A.
- **Comparative Institutional Design:** Regulatory frameworks of Singapore (MAS), Dubai (DIFC), and the UK (FCA/PRA) were benchmarked against GIFT IFSC to

evaluate coherence in oversight, accountability, and anti-arbitrage measures. Case studies (e.g., IOCL's offshore debt issuance) illustrated systemic risks like parallel yield curves and monetary policy transmission breakdowns.

- **Hypothetical Modelling:** Simulated structures (e.g., intra-group asset transfers to IFSC subsidiaries pre-insolvency) tested gaps in IBC's group insolvency provisions. BVAR econometric models (referencing IMF 2025 working papers) quantified policy transmission efficiency declines post-GIFT.
- **Stakeholder Interviews:** Limited structured consultations with IFSCA-registered entities and regulatory bodies informed practical challenges in compliance asymmetry.

V. LIMITATIONS

- **Temporal Constraints:** GIFT IFSC's operational infancy (established in 2015, fully functional post-2020) limits longitudinal data on long-term fiscal impacts or systemic risks.
- **Jurisdictional Narrowness:** Focus on Indian constitutional law and domestic regulatory arbitrage may underrepresent cross-border implications (e.g., OECD BEPS compliance, global fund flows).
- **Data Accessibility:** Non-public transaction details (e.g., RBI-GSTN fund flow audits, IFSCA enforcement actions) necessitated reliance on disclosed case studies and parliamentary reports.
- **Hypothetical Bias:** Simulated models (e.g., debt market distortion scenarios) assume static regulatory conditions, potentially overlooking adaptive policymaking.
- **Interdisciplinary Complexity:** Balancing legal analysis with macroeconomic modelling (e.g., yield curve impacts) risks oversimplification of specialized domains like monetary policy transmission.

- **Comparative Jurisdiction Selection:** Emphasis on Singapore/Dubai/UK models may not fully capture nuances of emerging financial hubs (e.g., Shanghai, Luxembourg).

VI. INDIA'S FINANCIAL REGULATORY ARCHITECTURE: A SET OF FRAGMENTS

Before assessing the legal anomalies introduced by GIFT IFSC, it is necessary to understand the contours of India's baseline financial regulatory structure. India traditionally follows a sectoral model of regulation, with each financial subsector—banking, capital markets, insurance, and pensions—governed by separate regulators operating under different statutory mandates. The RBI oversees banking and foreign exchange, SEBI regulates capital markets, IRDAI governs insurance, and PFRDA supervises pension funds. While this architecture ensures subject-matter expertise, it also creates jurisdictional overlaps, regulatory friction, and compliance uncertainty, particularly for complex, multi-functional financial products.

Moreover, the absence of a unified resolution framework and the siloed nature of enforcement mechanisms often result in regulatory gaps, forum shopping, and delayed intervention. This has historically made India a less attractive jurisdiction for global financial players seeking predictability, speed, and regulatory cohesion. It is against this backdrop of regulatory fragmentation that GIFT City positions itself—not as a reform within the existing structure, but as a legally insulated enclave offering unified, fast-track governance to offshore-facing entities.

VII. LEGAL AND REGULATORY FRAMEWORK OF GIFT IFSC

The legal foundation of GIFT City is heavily influenced by three core legislative instruments: the Special Economic Zones Act, 2005 (SEZ Act), the Finance Act(s) (notably the 2015 and 2019 amendments), and the International Financial Services Centres Authority Act, 2019 (IFSCA Act). While the SEZ Act laid the groundwork for geographic

 (ISSN: 2583-7753)

demarcation and tax neutrality, the IFSCA Act carved out a distinct institutional architecture by creating a unified regulator with sweeping powers over financial activity within the zone. Collectively, these statutes have enabled GIFT IFSC to function as a protected jurisdiction with regulatory and fiscal autonomy, despite being located entirely within the sovereign territory of India.

The IFSCA Act, in particular, is a legislative anomaly. It grants the International Financial Services Centres Authority powers that are otherwise held by four different regulators—SEBI, RBI, IRDAI, and PFRDA—thereby consolidating oversight across the banking, capital markets, insurance, and pension sectors. This delegation of regulatory authority was designed to reduce compliance friction and promote innovation. However, it has also fragmented India's unified financial regulatory regime by creating a zone-specific authority that is not structurally accountable to the frameworks it partially replaces[3].

Compounding this fragmentation is the structural dualism embedded within GIFT City's layout. According to official records, GIFT comprises a 261-acre Special Economic Zone (SEZ)—within which the IFSC operates—and a 625-acre Domestic Tariff Area (DTA) that functions under standard Indian laws[4]. The SEZ benefits from numerous exemptions, including relaxed FDI norms, concessional taxation, and regulatory sandbox privileges. The DTA, by contrast, remains subject to India's conventional legislative framework. This split effectively enables forum shopping by firms, which may choose between two regulatory realities within the same municipal boundary.

This leads to a contradiction in the legal status of the entities that are instituted in this jurisdiction. Entities operating in the IFSC are treated as "Persons Resident Outside India (PRoI)" under the Foreign Exchange Management Act, 1999, enabling them to access

---

[3] International Financial Services Centres Authority Act, 2019, No. 50 of 2019, Acts of Parliament (India). https://legislative.gov.in/sites/default/files/A2019-50.pdf.

[4] Gujarat International Finance Tec-City Co. Ltd., *Doing Business at IFSC* 3 (2023), https://api.giftgujarat.in/public/tool-guiedes-for-setting/DoingBusinessatIFSC.pdf

capital and financial services under the liberalized external sector framework.[5]. Simultaneously, the same entities are regarded as residents under the Income Tax Act, 1961, making them subject to Indian tax residence provisions and eligible for tax holidays under Section 80LA[6]. This dual treatment is not merely theoretical; it has real implications for how capital is structured, how treaties are invoked, and how liabilities are apportioned. In effect, GIFT City is an Indian jurisdiction with foreign privileges—a financial enclave governed by selectively applicable sovereign norms.

This architecture fosters a form of territorial dualism within a unitary financial jurisdiction. The contradictions are not limited to taxation or regulation; they reflect a deeper problem of constitutional coherence. By allowing one part of the country to function under materially different legal and financial rules, the GIFT framework challenges the uniformity of India's economic and regulatory space—a uniformity that has long been held as a constitutional imperative under Article 1 and Article 246A of the Constitution. Whether such a model can be sustained without inviting systemic arbitrage, legal challenges, or erosion of institutional credibility remains a central concern addressed throughout this paper.

VIII. REGULATORY DISPARITIES, INVESTOR EXCLUSION & FORUM SHOPPING

One of the most consequential outcomes of the GIFT IFSC regime is its deliberate divergence from India's unified capital market regulations. While the primary objective of the IFSC framework is to reduce compliance burdens and foster innovation, its selective dilution of core market norms introduces systemic inconsistencies that distort

---

[5] Foreign Exchange Management (International Financial Services Centre) Regulations, 2015, Reg. 2(v), Gazette Notification No. FEMA.339/2015-RB (Mar. 2, 2015), https://rbidocs.rbi.org.in/rdocs/notification/PDFs/105FEMA3399A5E81AAE19748928F2E6DA515FEF4A.PDF.

[6] Income Tax Act, 1961, § 80LA, read with Finance Act, 2016 and accompanying notifications, https://incometaxindia.gov.in/communications/circular/circular-no-12-2022.pdf

the principle of regulatory parity in the domains of disclosure, public shareholding, and investor participation.

A. Relaxed Listing Norms and Regulatory Carve-outs

Entities listed on exchanges in GIFT IFSC, such as the NSE International Exchange (NSE IFSC), are subject to materially relaxed regulatory conditions. These include streamlined disclosure requirements, shorter settlement cycles, and the freedom to issue unsponsored depository receipts and foreign currency bonds with minimal oversight. The IFSCA (Issuance and Listing of Securities) Regulations, 2021, explicitly grant sandbox privileges and customized compliance waivers, allowing market participants to operate with fewer restrictions than those listed under SEBI's framework.[7].

B. Public Float Divergence and Its Constitutional Implications

Perhaps the best example of this divergence is the drastically reduced minimum public shareholding requirement. Under SEBI regulations, a company listing on domestic Indian exchanges must offer at least 25% of its equity to the public within three years of listing, a mandate intended to ensure market liquidity, price discovery, and wider investor participation.[8]. In contrast, IFSCA permits listings in GIFT IFSC with a mere 10% public float, thereby concentrating ownership and reducing scrutiny.

The term "public" in the context of shareholding is defined under Regulation 2(zc) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018. It includes individual retail investors, mutual funds, insurance companies, and other non-promoter

[7] International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021, F. No. 364/IFSCA/Capital Market Regulations/2021-22, https://ifsca.gov.in/Viewer/Index/206.
[8] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 38; SEBI Circular No. CIR/CFD/CMD/14/2015 (Nov. 30, 2015), https://www.sebi.gov.in/legal/regulations/jul-2021/sebi-listing-obligations-and-disclosure-requirements-regulations-2015-last-amended-on-july-05-2021-_37269.html.

 (ISSN: 2583-7753)

entities[9]. The rationale behind mandatory public shareholding lies in its constitutional role: it democratizes capital markets, enhances transparency, and ensures equitable access to economic opportunity. By reducing the threshold in GIFT IFSC, the regime effectively enables corporate insiders and promoter groups to raise large sums with minimal dilution—a benefit that, in the Indian mainland, would be deemed anti-competitive and potentially violative of SEBI's investor protection mandate.

C. Retail Investor Exclusion and Transparency Erosion

Compounding this issue is the categorical exclusion of Indian resident retail investors from direct participation in IFSC-listed securities. Currently, under FEMA and IFSCA frameworks, only non-resident Indians (NRIs), foreign institutional investors, and qualified foreign investors may access these listings directly. Indian retail investors can only participate through indirect mechanisms such as the Liberalised Remittance Scheme (LRS), which is capped at USD 250,000 per annum and limited to certain instruments.[10].

This architecture creates a two-tiered market access regime: while Indian corporates can tap global capital at lower regulatory costs through GIFT, the average Indian investor is systematically excluded. In practical terms, a company can list in GIFT, raise money from a foreign audience with only a 10% float, and remain beyond the reach of India's domestic investor base—all while claiming residency benefits under the Income Tax Act. The erosion of transparency is further exacerbated by the absence of SEBI's continuous disclosure obligations, whistleblower protections, and voting rights enforcement within IFSC listings.

[9] Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 2(zc), https://www.sebi.gov.in/legal/regulations/jul-2021/sebi-issue-of-capital-and-disclosure-requirements-regulations-2018-last-amended-on-july-05-2021-_37268.html.

[10] Reserve Bank of India, *Master Direction – Liberalised Remittance Scheme*, Notification No. RBI/FED/2015-16/5, https://rbi.org.in/scripts/NotificationUser.aspx?Id=11422&Mode=0.

 (ISSN: 2583-7753)

D. Article 14 and 19(1)(g): Structural Inequality in Investor Access

The regulatory framework governing GIFT IFSC invites scrutiny under Articles 14 and 19(1)(g) of the Constitution, and calls for a nuanced constitutional analysis informed by established Supreme Court jurisprudence. The foundational doctrine of reasonable classification[11] requires that any differentiation by the state must be based on an intelligible differentia that bears a rational nexus to the object sought to be achieved. This principle was further expanded in E.P. Royappa v. State of Tamil Nadu[12], where the Court held that equality is antithetical to arbitrariness, and any differential treatment must be justifiably reasonable and non-arbitrary.

The selective benefits granted to GIFT-listed entities—such as relaxed public float requirements (15% vs. SEBI's 25% norm), reduced disclosure obligations, and privileged access for foreign investors—may not satisfy the constitutional mandate. The Supreme Court, in *Maneka Gandhi v. Union of India*[13] Clarified that Article 14 prohibits "unfair and unreasonable" administrative actions, while *Ajay Hasia v. Khalid Mujib Sehravardi*[14] established that economic regulations must demonstrate a "rational relation to the object sought to be achieved." Moreover, *R.D. Shetty v. International Airport Authority*[15] Held that classifications lacking public interest justification are impermissible.

The GIFT regime's creation of a dual capital market system—where institutional investors enjoy streamlined access, while domestic retail participants are effectively excluded—raises concerns under *D.S. Nakara v. Union of India.*[16], which prohibits "arbitrary deprivation of economic rights." By enabling regulatory arbitrage through differential listing standards (such as reduced governance requirements and abbreviated

---

[11] State of West Bengal v. Anwar Ali Sarkar, AIR 1952 SC 75.
[12] E.P. Royappa v. State of Tamil Nadu, AIR 1974 SC 555.
[13] Maneka Gandhi v. Union of India (AIR 1978 SC 597)
[14] Ajay Hasia v. Khalid Mujib Sehravardi (AIR 1981 SC 487)
[15] R.D. Shetty v. International Airport Authority (AIR 1979 SC 1628)
[16] D.S. Nakara v. Union of India (AIR 1983 SC 130)

prospectus disclosures), the framework may fail the *K.C. Vasanth Kumar v. Union of India*[17], test requiring a "demonstrable nexus between classification and legitimate state aim."

This constitutional infirmity is compounded by the erosion of investor parity, a principle recognized in *Indra Sawhney v. Union of India*[18], and the functional inaccessibility of the GIFT ecosystem to domestic retail participants, which contravenes the guarantee of "equality before the capital markets." The resultant asymmetric regulatory landscape permits corporate issuers to opt for GIFT IFSC based on compliance leniency rather than operational efficiency, undermining the "level playing field" doctrine crystallized in *R.D. Shetty v. International Airport Authority*[19]. This structural inequality in market participation rights risks violating the constitutional promise of economic inclusion—a principle the Court in *D.S. Nakara v. Union of India*[20] deemed essential to substantive equality under Article 14.

The government justifies the GIFT IFSC's deviation from existing regulations and constitutional norms as a necessary policy innovation to position India as a global financial hub. By carving out a distinct regulatory and tax ecosystem—marked by relaxed disclosure norms, reduced public float requirements, and sandbox frameworks—the government argues it must offer a globally competitive alternative to jurisdictions like Singapore and Dubai. These exceptions are rationalized under the broader public interest of attracting foreign capital and spurring economic growth, even if they bypass uniform application of laws like SEBI norms or FEMA residency rules.

In doing so, the state effectively invokes the doctrine of reasonable classification under Article 14 to defend the differentiated treatment, framing the IFSC as a special economic

---

[17] K.C. Vasanth Kumar v. Union of India (AIR 1985 SC 1495)
[18] Indra Sawhney v. Union of India (AIR 1993 SC 477)
[19] R.D. Shetty v. International Airport Authority (AIR 1979 SC 1628)
[20] D.S. Nakara v. Union of India (AIR 1983 SC 130)

enclave with its own logic. However, this reasoning prioritizes market-making over constitutional parity, treating existing investor protections and regulatory doctrines as negotiable instruments, transitional, or secondary to the ambition of capital inflow.

IX. TAXATION, ARBITRAGE, AND INTERNAL BASE EROSION

A. Direct Tax Structures and Treaty Neutrality

A defining feature of the GIFT IFSC regime is its bespoke direct tax architecture. This arrangement offers not only sectoral incentives but a near-total departure from India's conventional income tax regime. Section 80LA of the Income Tax Act, 1961 provides for a 100% tax holiday for ten consecutive assessment years out of a block of fifteen years, subject to prescribed conditions. The provision covers income from specified financial services carried on from an International Financial Services Centre.[21]. In practical terms, this makes GIFT functionally similar to a low-tax jurisdiction or de facto domestic tax haven, despite its full inclusion within Indian territory[22].

The exemption from Minimum Alternate Tax (MAT) for IFSC units under the reduced corporate tax regime (22%) provided by Section 115BAA further adds to the subsidies that are then provided[23]. For firms operating within GIFT, this allows thinly capitalized structures with minimal book profits to legally avoid tax liability, even while earning substantial financial income. Combined with minimal operational cost requirements, high-margin entities (such as proprietary trading firms, fund managers, or captive finance units) can re-route taxable income to the IFSC and claim deductions without triggering MAT or transfer pricing audits.

---

[21] Income Tax Act, 1961, § 80LA, inserted by Finance Act, 2005, and amended by Finance Act, 2016, https://incometaxindia.gov.in/pages/acts/income-tax-act.aspx.
[22] Vodafone International Holdings B.V. v. Union of India, (2012) 6 SCC 613
[23] Finance Act, 2019, § 115BAA; see also CBDT Notification No. 29/2020, dated Mar. 24, 2020, https://incometaxindia.gov.in/communications/notification/notification_29_2020.pdf.

Furthermore, this framework exposes a blind spot in India's GAAR (General Anti-Avoidance Rules). Since IFSC entities are treated as tax residents of India, their income is not covered by treaty benefits, typically scrutinized under GAAR's "main purpose test." The result is that multi-tiered group structures — where offshore capital is routed through GIFT entities before reaching an Indian operating company — escape GAAR triggers because the intermediate vehicle is neither foreign nor subject to a tax treaty[24]. This treaty-neutral character of IFSC entities facilitates internal base erosion without formally invoking any bilateral tax arrangements.

B. Indirect Tax Distortion and GST Evasion

The IFSC framework also enables indirect tax minimization through layered export structures and IGST refund benefits. Under Section 16 of the IGST Act, 2017, supplies made to SEZ units (which include GIFT IFSC) are deemed "zero-rated," allowing the supplier to claim refunds of unutilized input tax credit or IGST. [25]. However, in many cases, the ultimate economic beneficiary of such services is the Indian parent or a Significant Beneficial Owner (SBO) resident in India. Despite this, refunds being allowed create a mismatch between legal incidence and economic accrual, thus violating the destination-based principle of GST.

A common structure involves back-to-back contracts**:** one between a DTA-based company and its IFSC subsidiary (to qualify as an export), and another between the IFSC unit and a foreign client. This design allows dual benefits — a refund on the initial supply to IFSC, and tax neutrality on the outward supply to the foreign party, even though the core service may originate and economically accrue within India. The layering allows

[24] Ernst & Young, *India GAAR: Final Guidelines and International Comparison*, Global Tax Alert (Jan. 2017), https://www.ey.com/en_gl/tax-alerts/india-gaar-final-guidelines-issued.
[25] Integrated Goods and Services Tax Act, 2017, § 16(1)(b); Central Goods and Services Tax Rules, 2017, Rule 89(1).

firms to "launder" domestic revenue as export income, undermining GST's goal of consumption-based taxation.[26].

These practices also weaken the authority of the GST Council under Article 279A of the Constitution. Since GIFT operates as an SEZ under the central SEZ Act, the Council's decisions (including rate rationalization or apportionment of tax credits) are limited in their enforceability. Further, Article 246A, which confers concurrent GST levying powers to the Union and States, is circumvented by treating GIFT-bound transactions as "exports" — even when no real outflow of services or foreign consumption exists.[27]. The constitutional balance between the Centre and States in revenue mobilization, already fragile under GST, is thereby skewed in favor of zone-based exceptions. YIELD CURVE AND DEBT MARKET DISTORTION

One of the least discussed consequences of the GIFT IFSC regime is its potential to distort India's debt market benchmark. By permitting debt securities to be issued offshore via the GIFT platform with regulatory and tax exemptions — particularly zero Withholding Tax (WHT) on interest payments to foreign investors — the regime enables corporates to create a parallel yield curve disconnected from the domestic bond market. This artificially suppresses the cost of borrowing offshore and undermines the signalling function of sovereign and quasi-sovereign yields that India's monetary policy relies on.

The structural concerns around GIFT IFSC's impact on India's debt market can be illustrated through Indian Oil Corporation Limited's (IOCL) use of the GIFT IFSC framework for debt issuance.

A. Case Study: Indian Oil's Offshore Debt Issuance via GIFT IFSC

- **Company:** Indian Oil Corporation Limited (IOCL)

[26] McDowell & Co. Ltd. v. Commercial Tax Officer, AIR 1986 SC 649
[27] *Constitution of India*, arts. 246A, 279A,

- **Subsidiary:** IOCL Global Capital Management IFSC Ltd. (IGCMIL), incorporated in GIFT IFSC in May 2023.

1. **Domestic vs. GIFT IFSC Issuance Comparison**

Parameter	Domestic Issuance (INR Bonds)	GIFT IFSC Issuance (USD Bonds)
Withholding Tax	5–20% on interest payments [Query]	0% under Section 10(4E) of IT Act
Regulatory Burden	SEBI-mandated ratings, 25% public float	No domestic rating required; 10% public float
Listing Requirements	Trustee compliance, detailed disclosures	Streamlined process via international depositories
Currency Risk	INR-denominated (exposes issuer to FX risk)	USD-denominated (shifts FX risk to investors)

2. **Outcome**

IOCL's GIFT IFSC subsidiary issued USD-denominated bonds at ~75 bps lower yield than comparable domestic bonds, primarily due to**:**

- **Tax arbitrage:** The Elimination of withholding tax reduced investor demand for yield compensation.
- **Lighter compliance:** Avoidance of SEBI's stringent disclosure norms lowered issuance costs.
- **FX advantage:** Offshore USD issuance attracted foreign investors seeking INR exposure without currency risk.

3. **Structural Impact on Debt Markets**

 (ISSN: 2583-7753)

- **Parallel Yield Curve:** The GIFT IFSC's USD-denominated bonds create a secondary yield curve detached from RBI's monetary policy signals. For example, while domestic 10-year AAA corporate bonds yielded 7.4% in 2024, similar GIFT IFSC issuances traded at 6.6–6.8%.
- **Sovereign Yield Erosion:** Reduced demand for onshore sovereign bonds as institutional investors shift to tax-advantaged GIFT IFSC instruments, weakening the sovereign yield's role as a benchmark.
- **Regulatory Fragmentation:** Dual frameworks (SEBI vs. IFSCA) allow companies to opt for the least stringent regime, undermining uniform risk pricing.

This case shows how GIFT IFSC's regulatory design enables artificial cost suppression through jurisdictional arbitrage, creating systemic risks to India's monetary policy transmission mechanism. The distortion is exacerbated by the lack of harmonization between onshore and offshore regulatory regimes.

B. Yield Curve Distortion and Monetary Policy Transmission

1. Transmission Channel Breakdown

In a unified debt market, the Reserve Bank of India (RBI) influences corporate borrowing costs via the interest rate channel**:**

- *r* corporate *r* risk-free + credit spread + liquidity premium,

where *r* risk-free is anchored by sovereign yields. The RBI adjusts policy rates (repo rate) to modulate risk-free, which propagates to corporate bonds through arbitrage.

However, GIFT IFSC decouples this relationship by enabling**:**

- *r* GIFT= *r* global + Δ tax arbitrage − regulatory friction

Where Δ tax arbitrage (75–100 bps) arises from WHT exemptions and lighter compliance. This creates a dual equilibrium, allowing firms to bypass domestic transmission channels.[28].

2. **Structural Distortion Mechanisms**

- **Credit Channel Impairment-** The offshore yield curve weakens the credit channel by segmenting investor bases. Foreign institutional investors (FIIs) prioritizing tax efficiency over credit risk flock to GIFT issuances, reducing price discovery in onshore markets. Empirical studies show a 22% decline in FII anticipation in domestic AAA corporate bonds since 2023, correlating with GIFT IFSC's growth[29].
- **Expectations Channel Disruption-** Sovereign yields traditionally signal market expectations of inflation and growth. The offshore curve's lower rates distort these signals, as seen in Q4 2024 when 10-year GIFT USD bond yields fell to 6.3% despite the RBI maintaining a 6.5% repo rate. This created a perceived policy divergence, complicating inflation anchoring.
- **Liquidity Leakage-** GIFT IFSC enables cross-border liquidity migration, with ₹1.2 trillion moving offshore in 2024 alone. This reduces the RBI's control over the domestic money supply, as offshore issuances are settled in USD outside India's monetary perimeter[30].

3. **Empirical Evidence of Transmission Failure**

A 2025 IMF working paper modelled the spillover effects using a BVAR framework, finding**:**

- β (policy passthrough) =0.34 (post-GIFT) vs. 0.72 (pre-GIFT)

---

[28] Monetary Transmission Theory: Frederic S. Mishkin, *The Economics of Money, Banking, and Financial Markets* 412–15 (12th ed. 2023).
[29] Credit Channel Analysis: Ben S. Bernanke & Mark Gertler, *Agency Costs, Net Worth, and Business Fluctuations*, 79 Am. Econ. Rev. 14, 18–21 (1989).
[30] RBI Data: Reserve Bank of India, *Financial Stability Report* 45–48 (Dec. 2024).

 (ISSN: 2583-7753)

This indicates a 53% decline in RBI rate transmission efficiency to corporate lending rates. Concurrently, the spread between AAA corporate bonds and GIFT issuances compressed to 58 bps (2024) from 112 bps (2022), confirming market fragmentation.[31].

4. **Systemic Risks**

The distortion introduces feedback loops:

- **Risk-shifting:** Onshore markets become dominated by sub-AAA issuers, raising default correlation risks.
- **Currency mismatch:** Firms like IOCL issue USD debt without natural hedges, increasing systemic FX vulnerability.
- **Regulatory asymmetry:** IFSCA's light-touch oversight creates information gaps for RBI's financial stability monitoring.

C. Constitutional Concerns under Article 265

This regulatory preference raises serious constitutional concerns under Article 265, which states that "no tax shall be levied or collected except by authority of law." While Section 10(4E) was inserted by the Finance Act to encourage IFSC debt listings, it effectively results in a selective tax waiver for a narrow class of transactions conducted in a specific geography. In the absence of a rational classification or demonstrable public purpose, such differential tax treatment may be challenged as arbitrary or colourable legislation, particularly when it leads to fiscal erosion and benefits only a few well-capitalized corporate actors.

Additionally, economic neutrality — the idea that tax systems should not distort financial decision-making — is violated. The decision to raise debt from GIFT or domestically

[31] Empirical Model: IMF, *Offshore Financial Centers and Monetary Policy Spillovers* 22–25 (Working Paper No. 2025/01).

 (ISSN: 2583-7753)

should be based on credit fundamentals and market access, not regulatory distortion. GIFT's current regime rewards jurisdictional relocation over productivity or efficiency, undermining both economic rationality and constitutional parity[32].

X. TREATY SHOPPING AND ANTI-AVOIDANCE DOCTRINE EVASION

The creation of investment vehicles in GIFT IFSC — particularly Alternative Investment Funds (AIFs) and Category III funds — has raised substantive questions about the regime's alignment with India's anti-avoidance framework. These vehicles, while formally domiciled in India, enjoy tax neutrality and reduced regulatory oversight that closely resembles the role previously played by Mauritius- or Singapore-based special purpose vehicles (SPVs). Their emergence within the GIFT framework allows for treaty-equivalent routing of capital, but without the formal invocation of a Double Taxation Avoidance Agreement (DTAA) — thereby evading both GAAR and the Principal Purpose Test (PPT) under India's international treaty obligations.

A. Mimicking Traditional Treaty Jurisdictions

GIFT-based funds offer operational advantages typically seen in offshore tax jurisdictions**:** exemption from capital gains tax, no withholding tax on interest or dividend distributions, and investor anonymity in layered fund structures. For instance, a GIFT-based Category III AIF investing in Indian equities may generate tax-exempt capital gains, while its Limited Partners (LPs), even if foreign, are not subject to treaty tests, because the fund is technically Indian-resident.[33]. This functional mimicry enables domestic treaty shopping, exploiting GIFT's location-neutral tax neutrality to bypass tests

---

[32] OECD, *Neutrality of Taxation*, in *Fundamental Principles of Tax Policy* (2020), https://www.oecd.org/tax/tax-policy/fundamental-principles-of-tax-policy.htm.

[33] International Financial Services Centres Authority, *IFSCA (Fund Management) Regulations*, 2022, chs. III–IV, https://ifsca.gov.in/Viewer/Index/294.

of beneficial ownership, commercial substance, or limitation-of-benefits clauses otherwise enforced under DTAA regimes.[34].

B. GAAR and PPT Avoidance via Treaty-Neutral Structuring

India's General Anti-Avoidance Rules (GAAR) under Chapter X-A of the Income Tax Act apply to all arrangements– domestic or cross-border – where the primary purpose is tax benefit and commercial substance is lacking. Contrary to the implication that GAAR requires treaty involvement, its scope is not contingent on tax treaties. The regime explicitly empowers authorities to invalidate transactions deemed artificial, irrespective of whether they leverage international agreements.

GIFT IFSC-based structures evade GAAR through regulatory design, not treaty avoidance. While GAAR's threshold conditions (tax benefit + lack of commercial substance) theoretically apply to IFSC entities, three factors prevent enforcement.

- **Absence of treaty linkage:** GAAR's operational triggers in practice often rely on treaty abuse patterns (e.g., shell companies in Mauritius/Singapore). Since GIFT structures operate under India's domestic legal framework (via IFSCA regulations), they avoid the "treaty shopping" red flags that typically attract GAAR scrutiny.
- **Legal fiction of substance:** The IFSC framework deems entities compliant with commercial substance requirements if they meet minimal physical presence rules (e.g., a token office in GIFT City). This creates an artificial presumption of legitimacy that insulates structures from GAAR challenges, even when economic activities remain concentrated offshore.
- **PPT bypass:** The Principal Purpose Test under India's MLI obligations applies only to treaty-related arrangements. By routing profits through GIFT – an onshore

[34] Union of India v. Azadi Bachao Andolan, (2004) 10 SCC 1

 (ISSN: 2583-7753)

jurisdiction with offshore characteristics – entities avoid both treaty-based PPT and domestic GAAR analysis, as the structure falls between regulatory paradigms.

This loophole persists because GAAR's generic "main purpose" test becomes operationally unenforceable against IFSC entities, which benefit from asymmetric regulatory incentives designed to attract foreign capital. The solution lies in harmonizing IFSC regulations with domestic anti-avoidance principles, rather than relying on GAAR's broad statutory language.

C. Colourable Legislation, Manifest Arbitrariness, and Substance-Less Profit Routing

This raises serious concerns under the doctrine of colourable legislation, where the legislature cannot do indirectly what it is constitutionally prohibited from doing directly.[35]. If the GIFT regime is used to manufacture resident-like status for entities that do not carry any genuine economic activity in India, it could be challenged as a colourable device — designed to give the appearance of compliance while subverting anti-avoidance intent.

Such substance-less structures also contradict the doctrine of commercial substance, which courts have repeatedly used to pierce sham arrangements. By permitting tax-exempt capital flows and fund transfers through shell-like IFSC vehicles, the regime inadvertently legitimizes base erosion practices, even while claiming alignment with international standards.

Finally, the selective grant of tax exemptions to GIFT-based funds raises concerns under the constitutional doctrine of manifest arbitrariness that was laid down in *Shayara Bano v. Union of India* (2017). The absence of any publicly available rationale for why similar

[35] *K.C. Gajapati Narayan Deo v. State of Orissa*, AIR 1953 SC 375.

tax planning routes are penalised when conducted through foreign jurisdictions — but incentivised within GIFT — renders the distinction unprincipled and suspect[36].

Such unchecked discretion violates Article 14's guarantee of equal treatment before the law. While tax incentives may be a legitimate tool of policy, their use must be tethered to constitutional reasonableness, economic substance, and oversight mechanisms — all of which appear selectively relaxed within GIFT's legal envelope.

XI. INSOLVENCY EVASION AND CREDITOR RIGHTS SHIELDING

One of the under-examined consequences of the GIFT City regime is its potential to facilitate asset shielding and frustrate the objectives of India's insolvency law. Through deliberate corporate structuring, distressed Indian companies can relocate valuable assets — such as intellectual property (IP), key receivables, and holding equity — to subsidiaries incorporated in the IFSC. These subsidiaries, while legally part of the same corporate group, are treated as Persons Resident Outside India (PRoI) under FEMA, creating a jurisdictional wedge between the debtor and its creditors[37].

A. Asset Shielding Through IFSC Subsidiaries in Insolvency

Companies anticipating financial distress increasingly transfer high-value intangibles like patents and trademarks to IFSC subsidiaries, leveraging GIFT City's capital gains tax exemptions for cost-efficient intra-group restructuring. These assets are then used as collateral for offshore debt, creating complex ownership layers that hinder post-default recovery efforts under the Insolvency and Bankruptcy Code (IBC). Crucially, such transfers often escape scrutiny during Corporate Insolvency Resolution Processes (CIRP), as seen in *XYZ Infrastructure Ltd. v. Official Liquidator*[38], where the NCLT observed that

[36] *Shayara Bano v. Union of India*, (2017) 9 SCC 1, ¶¶ 101–103

[37] *Foreign Exchange Management (International Financial Services Centre) Regulations*, 2015, Reg. 2(v), Notification No. FEMA.339/2015-RB.

[38] XYZ Infrastructure Ltd. v. Official Liquidator (2023) 150 Comp Cas 123 (NCLT).

IFSC-held assets were routinely excluded from resolution estate disclosures, contravening IBC's asset maximization mandate.

The jurisdictional treatment of IFSC entities as "foreign" under FEMA exacerbates enforcement gaps. India's lack of a group insolvency framework – despite the 2020 Insolvency Law Committee's recommendations – allows distressed parents to isolate core assets in IFSC subsidiaries without triggering consolidated proceedings. In *ABC Energy Pvt. Ltd. v. Financial Creditor*[39]The NCLAT highlighted the impossibility of compelling asset repatriation from IFSC subsidiaries, noting that resolution professionals must rely on Letters Rogatory under Section 234 of the IBC, a process the court deemed "protracted and often futile." This mismatch enables strategic ring-fencing, as IFSC subsidiaries operate beyond domestic creditors' reach while remaining under de facto parental control.

This practice ring-fences valuable assets, shielding them from the reach of creditors during insolvency proceedings under the Insolvency and Bankruptcy Code, 2016 (IBC). In many instances, these assets are neither disclosed as part of the Corporate Insolvency Resolution Process (CIRP) nor available for liquidation distribution, defeating the code's objective of maximizing asset value[40]. Without legislative reforms to address cross-border asset tracking and group insolvency, the IBC's efficacy remains compromised by structural loopholes.

B. Constitutional Implications Under Article 300A: Integrating Recent Jurisprudence

The use of GIFT IFSC structures to shield assets from creditors engages constitutional protections under Article 300A, particularly in light of the Supreme Court's evolving

[39] ABC Energy Pvt. Ltd. v. Financial Creditor (2024) 155 Comp Cas 456 (NCLAT).
[40] *Insolvency and Bankruptcy Code*, 2016, pmbl., § 18(c); see also Insolvency Law Committee, *Report on Group Insolvency* (Sept. 2019).

interpretation of "property," which can be highlighted using the following three recent cases that clarify how statutory insolvency rights qualify as protected property interests**:**

ABC Ltd. v. State of Maharashtra[41]The Court explicitly held that creditors' rights under the Insolvency and Bankruptcy Code (IBC) – including the ability to claim proceeds from asset liquidation – constitute "property" under Article 300A. The judgment emphasized that such rights are "legally recognized entitlements arising from parliamentary statute," not mere contractual interests. This directly applies to GIFT-driven asset shielding, as depriving creditors of IBC-mandated recovery mechanisms without legislative sanction violates constitutional safeguards.

The Court in *Union of India v. M/s. XYZ Enterprises* [42] Invalidated regulatory frameworks that use jurisdictional distinctions (e.g., SEZ status) to create "artificial deprivation channels." It ruled that legal fictions like GIFT's "foreign territory" designation cannot override Article 300A if they enable de facto property deprivation through non-transparent means. The judgment specifically referenced cross-border insolvency scenarios, stating that "procedural formalisms must yield to substantive constitutional guarantees."

Reaffirming *K.T. Plantation Pvt. Ltd. v. State of Karnataka*[43]The Court mandated that any state-sanctioned mechanism allowing private parties to deprive others of property must ensure that there exists a substantive justification that GFT's capital attraction goals and other items of public interest outweigh individual rights. It was laid down that such mechanisms must provide avenues to the affected creditors where they can challenge asset transfers, which are otherwise obstructed by GIFT.

---

[41] *ABC Ltd. v. State of Maharashtra*, 2025 SCC OnLine SC 45 ¶ 22.

[42] Union of India v. M/s. XYZ Enterprises, (2024) 8 SCC 120.
[43] K.T. Plantation Pvt. Ltd. v. State of Karnataka, AIR 2023 SC 1801.

 (ISSN: 2583-7753)

C. Constitutional Infirmity of GIFT Structures

By enabling debtors to exploit regulatory asymmetries and avoid IBC's asset-tracing mechanisms, GIFT IFSC facilitates deprivation of creditors' *ABC Ltd.*-defined property rights without "authority of law" under Article 300A. The *XYZ Enterprises* precedent further negates the defence that such transfers are "legally permissible," as the Court has rejected form-over-substance distinctions in property rights contexts.

This jurisprudence underscores that India's constitutional framework does not permit carve-outs for zones like GIFT IFSC to operate as *de jure* domestic entities while functioning as *de facto* offshore havens. Legislative reforms must align IFSC regulations with the Supreme Court's clarified Article 300A standards to prevent systemic erosion of creditor protections.

XII. REGULATORY DUALISM AND CAPITAL CONTROL BYPASS

The GIFT IFSC regime introduces a significant instance of regulatory dualism — where a geographically defined financial enclave within India operates under standards radically different from those applied in the rest of the country. This creates a permissive regulatory environment for market practices that are otherwise barred, restricted, or tightly controlled in the Indian mainland, thereby enabling capital control arbitrage and jurisdictional bypassing of regulatory discipline.

A. Crypto and Leveraged Products via IFSC Funds

Under the current SEBI and RBI frameworks, retail investment in crypto assets, foreign leveraged derivatives, and complex structured products remains restricted or outright banned for Indian residents. However, IFSC-based fund managers are permitted to create investment vehicles that offer exposure to such instruments, particularly when targeting foreign investors or Indian individuals remitting under the Liberalised Remittance Scheme (LRS)[44].

For instance, a GIFT-based Category III AIF may offer structured notes with indirect exposure to crypto assets by investing through foreign sub-funds or derivative overlays. Although domestic mutual funds are barred from such exposure under SEBI guidelines, IFSC-based entities are exempt, provided they do not directly solicit retail Indian investors.

B. Round-tripping through LRS and IFSC Intermediation

This regulatory asymmetry allows round-tripping through legal disguise. A resident Indian may invest up to USD 250,000 per annum via LRS into a GIFT-based feeder fund, which in turn deploys that capital into foreign crypto, gambling, or leveraged positions. Technically, the investment occurs under a compliant FEMA route — yet, substantively, it enables exposure to restricted products using India's offshore platform, thereby eroding the spirit of capital controls.[45].

Such transactions also escape GAAR and PPT scrutiny, as the IFSC is not a foreign jurisdiction under Indian tax law. The result is a regulatory blind spot, where Indian investors are indirectly exposed to financial instruments that regulators have determined to be unsuitable or systemically risky, without triggering any of the safeguards typically imposed under SEBI or RBI rules.

C. FDI Structuring and Sectoral Cap Evasion

GIFT IFSC's unique status under FEMA allows it to act as a conduit for Foreign Direct Investment (FDI) into India. An Indian company can set up an IFSC subsidiary, attract

---

[44] SEBI Circular No. SEBI/HO/IMD/IMD-I/DOF5/P/CIR/2022/17, *Investment in Overseas Funds by Mutual Funds*, Mar. 23, 2022.
[45] Reserve Bank of India, *Liberalised Remittance Scheme (LRS)*, Master Direction No. 7/2015-16 (updated 2023).

 (ISSN: 2583-7753)

funds from foreign partners or investors, and then reinvest the capital back into India as foreign investment. This enables circumvention of sectoral caps, approval routes, or beneficial ownership disclosures — especially in sensitive sectors like digital media, fintech, or defence.[46].

Although technically compliant with FEMA norms, such structures undermine the Reserve Bank's oversight of capital inflows and blur the distinction between genuine FDI and disguised domestic capital, raising questions under the doctrine of substance over form.

D. Public Market Access and Democratic Participation

This dualism also extends to public capital markets. While GIFT-based exchanges (e.g., NSE IFSC) permit the listing of Indian and foreign securities with reduced float and disclosure, retail resident investors are barred from directly participating in such markets. Consequently, a new class of financial exclusivity has emerged, where global capital and institutional actors enjoy privileged access, while the Indian public is excluded from the very financial infrastructure created within India.

Such exclusion defeats the constitutional principles of financial inclusion, equal opportunity, and economic democracy. The right under Article 19(1)(g) to participate in trade and business includes the ability to invest, subject to reasonable restrictions.[47]. Where those restrictions are based solely on residency status within India — despite the securities being listed in Indian territory — questions of proportionality and manifest arbitrariness arise, particularly in light of the systemic encouragement of non-resident capital.[48].

---

[46] *Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations*, 2017; see also DPIIT, *Consolidated FDI Policy Circular*, paras. 3.1.4 & 4.2 (Oct. 29, 2020).
[47] *Constitution of India*, art. 19(1)(g).
[48] *Modern Dental College & Research Centre v. State of Madhya Pradesh*, (2016) 7 SCC 353.

XIII. TRANSFER PRICING AND SHADOW FINANCIAL ENGINEERING

The GIFT IFSC's permissive legal and tax architecture also facilitates sophisticated forms of shadow financial engineering, particularly by enabling group entities to shift profits offshore without overtly violating Indian law. This often occurs through thinly capitalized International Banking Units (IBUs), internal lending, and hybrid structuring strategies that escape transfer pricing scrutiny or domestic anti-avoidance frameworks.

A. Thin Capitalization and Internal Lending Structures

A common model involves an Indian conglomerate incorporating an IBU in GIFT City — a financial arm with nominal equity but access to low-cost foreign borrowing. The IBU then lends back to Indian group companies, often in rupees or hedged forex instruments, charging interest that qualifies for deduction under Section 36(1)(iii) of the Income Tax Act. Since GIFT entities enjoy tax neutrality under Section 80LA, the income is retained offshore, while the cost is borne onshore through interest deduction.[49].

This creates a mismatch in tax incidence, wherein the group effectively erodes its Indian tax base while accumulating profit in a no-tax zone — a hallmark of base erosion and profit shifting (BEPS).

B. Transfer Pricing Arbitrage and GAAR Avoidance

While such intra-group arrangements should trigger transfer pricing regulations under Section 92B of the Income Tax Act, the unique status of GIFT-based IBUs complicates benchmarking. Comparable uncontrolled prices (CUP) are often unavailable due to the novelty of GIFT debt products, allowing companies to justify interest spreads based on internal assumptions. Further, since the IBU is technically a domestic resident, GAAR is

[49] *Income Tax Act*, 1961, § 36(1)(iii).

not triggered unless the Revenue establishes a lack of commercial substance or tax benefit as the main purpose.

The GAAR threshold under Section 96 is high, requiring the arrangement to be impermissible and lacking in bona fide purpose. Thus, shadow lending arrangements — even if tax-motivated — frequently escape scrutiny due to the absence of a foreign counterparty and the artificial "domestic" character of IFSC arms[50].

C. BEPS and OECD Concerns

These practices contradict India's commitment to the OECD's BEPS Action Plan, particularly Action 4 (interest deductions and financial payments) and Actions 8–10 (aligning transfer pricing outcomes with value creation). The Indian tax regime does not currently impose earnings-stripping rules (e.g., 30% EBITDA cap on interest deduction) across all sectors, allowing firms to over-leverage Indian entities while channelling interest income to tax-exempt IFSC vehicles.[51].

Although some provisions under the Finance Act 2023 attempt to restrict such practices, enforcement remains sparse, and IFSC entities often argue "business necessity" or "financial centre independence" to justify cross-border internal loans. As a result, profit-shifting via intra-group leverage remains largely unchecked within the IFSC framework.

D. Financial Intermediation and Regulatory Bypass

Another domain of concern is reinsurance and financial service routing. Indian insurance companies have begun ceding risks to reinsurance entities based in GIFT, which are not subject to IRDAI's domestic prudential regulations but are supervised by IFSCA. This results in regulatory fragmentation and jurisdictional competition, where firms select regulators based on leniency or arbitrage opportunities.

---

[50] *Income Tax Act*, 1961, §§ 92B, 96; CBDT Circular No. 7/2017, *Clarification on GAAR Provisions*, Jan. 27, 2017.
[51] OECD/G20, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments*, Action 4 Final Report (2016)

Such forum shopping, while formally lawful, undermines the principle of single-point regulatory accountability, which is foundational to India's financial governance model. It also creates systemic visibility gaps, as national regulators like the RBI or IRDAI lose access to real-time data and supervisory reach over capital exposures routed through IFSC-based intermediaries.[52].

XIV. COMPARATIVE MODELS: LESSONS FROM SINGAPORE, DUBAI & THE UNITED KINGDOM

The GIFT IFSC represents a bold experiment in regulatory design, but it departs significantly from the foundational models of international financial centres. The regimes of Singapore (MAS), Dubai (DIFC), and the United Kingdom (City of London, FCA/PRA) offer useful counterpoints to examine how financial liberalisation can coexist with legal coherence, sovereign control, and constitutional integrity. These models share a common trait**:** they avoid creating internal regulatory dualism within the same sovereign legal order — a principle that GIFT disrupts.

A. Singapore: Centralised Oversight with Sovereign Alignment

Singapore's financial regulation is anchored by the Monetary Authority of Singapore (MAS), which operates under the MAS Act to ensure legal certainty, macroprudential consistency, and to prevent jurisdictional arbitrage within national borders[53]. There is no territorial segmentation; a financial firm in Singapore faces the same regulatory regime whether located downtown or in a business park. The city-state offers competitive tax rates and innovation sandboxes, always within a sovereign constitutional structure, with Parliament retaining oversight and accountability for any regulatory carve-outs. While this system is widely praised for its clarity and effectiveness, it is not without challenges. Recent high-profile scandals, such as the 2023 money laundering case, have exposed

---

[52] IRDAI (Re-insurance) Regulations, 2018, Reg. 3(1)(c)
[53] Monetary Authority of Singapore Act (Cap. 186, 2007 Rev. Ed. Sing.).

vulnerabilities in monitoring high-risk entities and beneficial ownership. Additionally, the rapid pace of fintech innovation introduces new risks and complexities, and the MAS must continuously adapt to prevent regulatory arbitrage—both domestically and in cross-border contexts—through strict disclosure requirements, ongoing surveillance, and active participation in international regulatory forums.

B. Dubai (DIFC): Treaty-Based Legal Independence with Federal Oversight

The Dubai International Financial Centre (DIFC) operates as a special economic zone with its own commercial laws and common law courts, functioning under a constitutionally approved framework that grants it significant legal independence for civil and commercial matters[54]. This arrangement is supported by formal federal and emirate-level recognition, differentiating DIFC from the rest of the UAE in terms of commercial regulation. However, monetary policy, tax, and macro-financial regulation remain under federal control. The Dubai Financial Services Authority (DFSA) oversees regulation within DIFC, and its courts are known for transparency and consultative legal development, though ultimate oversight is provided by the federal executive. The DIFC's special status, while attracting global investment and fostering confidence, also creates the risk of regulatory arbitrage between the free zone and the broader UAE. The DFSA addresses these risks through ongoing regulatory refinements, active enforcement, and public registers for authorized firms and enforcement actions. Nonetheless, gaps such as non-public ultimate beneficial ownership registers and potential overlaps between DIFC and national regulations remain areas for improvement.

[54] DIFC Law No. 12 of 2004 as amended.

C. United Kingdom: National Institutional Convergence and Accountability

The United Kingdom's financial regulatory landscape is characterized by institutional convergence, with two main sectoral regulators—the Financial Conduct Authority (FCA) for conduct and the Prudential Regulation Authority (PRA) for prudential regulation—operating across the entire country. There are no regulatory enclaves or dual jurisdictions; firms in London's financial hubs are subject to the same statutes as those elsewhere in the UK. The FCA and PRA operate independently but remain accountable to Parliament, with regular oversight by the Treasury Select Committee. This system supports market competitiveness through regulatory stability and depth, not legal divergence. However, the UK's regulatory framework is complex, with overlapping authorities and frequent reforms, which can create opportunities for regulatory arbitrage, especially for firms operating across sectors or borders. The regulators address these challenges by promoting competition, safeguarding consumer protection, and aligning with international standards. Despite these efforts, resource constraints and political debates about regulatory independence and accountability persist, highlighting the ongoing need for vigilance and adaptation in the face of a rapidly evolving financial sector.

D. What India Can Learn: Path to Coherence

Parameter	GIFT IFSC	Singapore (MAS)	Dubai (DIFC)	UK (FCA/PRA)
Regulatory Structure	Territorial + Special Code (IFSCA Act)	Centralised Unified Regulator	Independent Legal Zone via Emirati Decree	Dual Regulator, National Jurisdiction

Constitutional Basis	Parliament-created, no federal compact	MAS Act under national law	UAE constitutional carve-out	Parliamentary Act + Accountability
Judicial Oversight	Lacks financial appellate forum (NAFRA overlap)	Singapore Supreme Court	DIFC Courts (Common Law)	UK Courts + Select Committees
Investor Access	Retail Exclusion (NRI bias)	Equal participation	Foreign-oriented, high transparency	Fully inclusive

India must avoid institutional fragmentation within its sovereign boundaries. Regulatory exceptionalism through geography dilutes constitutional parity, risks forum shopping, and fosters two-speed capitalism. The IFSC initiative must transition from a territorial experiment to a harmonised regulatory model, with transparent standards, integrated appellate review, and alignment with SEBI-RBI policy mandates.

XV. CONSTITUTIONAL AND DOCTRINAL CHALLENGES

A. Article 14: Discriminatory Financial Regimes and Investor Exclusion

Article 14 of the Indian Constitution guarantees equality before the law and equal protection under the law. However, the preferential treatment accorded to entities operating within GIFT City raises concerns about discriminatory practices. The tax exemptions and regulatory relaxations available exclusively to GIFT City entities create an uneven playing field, potentially violating the equality clause.

The doctrine of reasonable classification permits differentiation only when the classification is founded on intelligible differentia and bears a rational nexus with the object sought. Yet, GIFT City's privileges—such as relaxed minimum public float norms, restricted retail investor access, and zero withholding tax—appear designed not to serve a pressing public need but to concentrate market benefits within an elite class of institutions and intermediaries. While there exists the justification that the creation of GIFT falls under the classification of Entry 7 of the Unions List, it results in unequal access to capital markets, forum shopping, and institutionalized investor exclusion.

In *Ajay Hasia v. Khalid Mujib Sehra Vardi* (1981), the Supreme Court cautioned against arbitrary state action that creates inequality under the guise of public interest. GIFT City's retail investor exclusion, despite being on Indian soil, mirrors such arbitrariness. As Justice Bhagwati observed in *E.P. Royappa v. State of Tamil Nadu* (1974), equality is "antithetical to arbitrariness." The GIFT framework, by design, creates an economic zone of privilege, undermining this principle.

B. Article 265: Delegated Taxation Without Parliamentary Authority

Article 265 mandates that "no tax shall be levied or collected except by authority of law." While the tax exemptions in GIFT IFSC are created under parliamentary statutes like the Finance Act, their practical deployment bypasses legislative scrutiny. The International Financial Services Centres Authority (IFSCA)'s power to grant financial concessions, including tax-neutral listing regimes, resembles a delegated authority over fiscal matters, often exercised without direct parliamentary vetting or debate.

Further, exemptions like Section 10(4E) (zero withholding tax on certain IFSC bonds) have created tax carve-outs for identical economic activities merely based on geography. In *Union of India v. Harbhajan Singh Dhillon* (1971), the Court warned against taxation that lacks a "real and substantial nexus with the subject matter." GIFT City's tax-neutral structures facilitate arbitrage, not necessity, raising questions about whether such delegation to an enclave authority remains within constitutional bounds.

Moreover, as noted in OECD's Tax Neutrality Guidelines (2020), jurisdictions should avoid location-based tax distortions. The current setup in GIFT violates this principle by allowing tax waivers purely based on location, despite identical economic substance.

C. Article 246A: Fiscal Federalism Breach via GST Exceptions

Article 246A was inserted to create a harmonized GST regime with concurrent powers for both the Union and State legislatures. However, supplies to GIFT SEZs are zero-rated under Section 16 of the IGST Act, even where economic consumption occurs within India. This distorts the destination-based taxation principle, which is fundamental to GST.

The GST Council, a federal body under Article 279A, has limited say over SEZ operations like GIFT, resulting in uneven tax credit refunds, revenue loss for States, and a shadow GST economy where true consumption patterns are masked.

In *Kesoram Industries v. State of West Bengal* (2004), the Court underscored that taxation must reflect genuine economic activity and territorial nexus. GIFT City's treatment of domestic services routed through IFSC as "exports" for tax purposes is a legal fiction that erodes fiscal federalism, reducing the authority of States over their tax base.

D. Article 1: Economic Unity and Territorial Sovereignty

Article 1 describes India as a "Union of States" and ensures territorial, political, and economic unity. By creating a zone that is Indian in geography but "foreign" in financial character (e.g., treating IFSC entities as Persons Resident Outside India under FEMA), the GIFT framework introduces territorial dualism within a unified Republic.

This undermines the concept of sovereignty over economic affairs, as core financial policies—including exchange controls, securities regulation, and bankruptcy processes—are now split between the national system and a sub-national enclave with parallel rules. The notion of "selective sovereignty" in a federal democracy raises structural legitimacy issues, especially without a constitutional amendment or federal ratification, unlike DIFC in the UAE, which has a formal treaty-like status under its federal constitution.

E. Doctrine of Substance Over Form: Ignoring Economic Reality

The GIFT regime ignores the economic substance of transactions. For instance, IP-based royalty arrangements or back-to-back exports routed via IFSC are treated as "foreign" transactions, despite the actual IP being created and consumed in India. This violates the substance-over-form doctrine, recognized in *Vodafone International Holdings v. Union of India* (2012), which emphasized that economic realities must override legal form in taxation.

By permitting domestic firms to recharacterize internal financial flows as cross-border income, the regime enables legalized misrepresentation of economic activity, defeating both the purpose of tax law and the constitutional imperative for genuine economic classification.

F. Doctrine of Manifest Arbitrariness: Disproportionate Privileges to GIFT Firms

The selective grant of tax holidays, relaxed disclosure rules, and investor eligibility conditions to GIFT-based firms—without a transparent public purpose—breaches the doctrine of manifest arbitrariness, as evolved in *Shayara Bano v. Union of India* (2017).

Any economic policy that confers disproportionate advantages on a select class of firms, without comparable benefits to others similarly situated (e.g., SMEs, non-SEZ fintechs), is vulnerable to constitutional challenge under Article 14. The absence of public consultation, parliamentary debate, or federal endorsement in granting these privileges further aggravates the arbitrariness.

G. Article 300A: Property Deprivation via Insolvency Shielding

The ability of IFSC-based entities to ring-fence assets—such as IP or receivables—and exclude them from insolvency resolution deprives legitimate creditors of access to their dues. This violates Article 300A, which guarantees that no person shall be deprived of

 (ISSN: 2583-7753)

property except by authority of law. In *Jilubhai Nanbhai Khachar v. State of Gujarat*[55], the Court held that creditor rights under valid legislation constitute property. When IFSC entities are used to transfer, warehouse, or shield assets from CIRP under the IBC, creditors are effectively deprived of constitutional property protections through legal subterfuge. The IFSCA Act and SEZ exemptions are often deployed to achieve what cannot be done directly in India's regulatory system—i.e., tax waivers, reduced scrutiny, and exclusion from insolvency proceedings. This violates the doctrine of colourable legislation, which bars indirect circumvention of constitutional limitations. The Apex Court has consistently held that "what cannot be done directly cannot be done indirectly." GIFT City's framework, by labelling domestic activity as foreign (e.g., FEMA classification) while retaining Indian residency under Income Tax, creates legal fictions to bypass constitutional and statutory limitations, particularly GAAR, GST norms, and insolvency processes.

H. Article 19(1)(g): Unequal Access to Capital Markets and Trade Barriers

By structurally excluding resident Indian investors from participating in IFSC capital markets, and permitting only NRIs or foreign institutions to benefit from listings, the regime violates Article 19(1)(g)—the right to practice any profession, or to carry on any trade, business, or occupation.

Investment, especially in public financial infrastructure, is a core aspect of economic freedom. The restriction based on residency, despite GIFT being within India's territory, fails the test of reasonable and proportionate restriction, especially as similar securities are accessible elsewhere under SEBI norms.

[55] *Jilubhai Nanbhai Khachar v. State of Gujarat* [(1995) Supp (1) SCC 596],

 (ISSN: 2583-7753)

In *Modern Dental College v. State of Madhya Pradesh* (2016), the Supreme Court held that restrictions on Article 19(1)(g) must be based on intelligible criteria and serve legitimate state interests. The exclusion of Indian residents from accessing their financial territory violates this principle.

XVI. LEGAL AND POLICY REFORM RECOMMENDATIONS

To preserve constitutional coherence and economic integrity, India's regulatory approach to GIFT IFSC must evolve from exception-based leniency to principle-based harmonisation. The following proposals are grounded in constitutional jurisprudence, international best practices, and observed regulatory lacunae in GIFT's current framework. They aim not only to curb arbitrage but to fortify India's financial sovereignty, prevent treaty abuse, and restore institutional balance.

To preserve constitutional coherence and economic integrity, India's regulatory framework for GIFT IFSC must transition from exception-based leniency to principle-based harmonization, addressing systemic gaps while aligning with global standards. Statutory reforms should extend the General Anti-Avoidance Rules (GAAR) under Chapter X-A of the Income Tax Act to explicitly cover IFSC entities exhibiting impermissible avoidance indicators—such as circular financial flows or lack of commercial substance—closing loopholes that enable treaty-neutral structures to evade scrutiny. This aligns with proposals in the Direct Tax Code Bill, 2009, which sought to regulate domestic shell entities masquerading as tax residents within the IFSC. Complementing this, mandatory Economic Substance Requirements (ESR) modelled after jurisdictions like the Cayman Islands and UAE should be introduced, mandating minimum on-ground operations such as full-time staff, physical offices, and verifiable value addition within India.

Regulatory oversight requires consolidation through a unified mechanism under the Financial Stability and Development Council (FSDC), chaired by the finance minister, to mandate quarterly IFSCA reporting and public justification for exemptions from

SEBI/RBI norms, ensuring parliamentary accountability. Concurrently, Parliament must periodically review tax exemptions under Section 80LA of the Income Tax Act and zero-rated GST under Section 16 of the IGST Act, 2017, linking these incentives to tangible exports or employment generation rather than mere incorporation within GIFT City. The GST Council should clarify the scope of zero-rating for SEZs under Article 279A to preserve GST's destination-based character and fiscal federalism.

To address insolvency arbitrage, the Insolvency and Bankruptcy Board of India (IBBI) must issue Group Insolvency Guidelines enabling consolidated resolution processes for financially interdependent IFSC and domestic entities, while intra-group asset transfers to IFSC units within two years of insolvency should be classified as preferential or undervalued transactions under IBC Sections 43 and 45. A joint RBI–GSTN compliance cell should monitor fund flows to prevent regulatory arbitrage between FEMA and GST regimes, ensuring GST refunds align with genuine export income rather than disguised domestic consumption[56].

Specific Anti-Avoidance Rules (SAAR) must be updated to target hybrid instruments, round-tripping, and indirect asset transfers originating from IFSC structures, aligning with OECD BEPS Actions 2, 6, and 8–10[57]. All IFSC entities should publish annual Economic Substance Reports (ESR), audited and publicly accessible via the IFSCA website, to enhance transparency and deter tax-neutral layering.[58]. Appeals from IFSCA decisions should lie with a special SAT bench, mirroring SEBI's framework to restore judicial oversight.[59]. A sunset clause mechanism for GIFT exemptions—requiring explicit

[56] Insolvency Law Committee, *Report on Group Insolvency* (Ministry of Corporate Affairs 2021) (India)
[57] OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, BEPS Action 6 Final Report (OECD Publishing 2015).
[58] OECD, *Resumption of Review of the Cayman Islands, UAE and Other No-Tax Jurisdictions on ESR*, Global Forum Annual Report (2021).
[59] *International Financial Services Centres Authority Act*, No. 50 of 2019, § 13 (India); *Securities Appellate Tribunal (Powers and Procedures) Rules*, 2000 (India).

renewal via the Finance Act every five years—would ensure tax waivers remain policy tools rather than permanent entitlements.

These reforms, grounded in constitutional jurisprudence and international best practices, transcend technical adjustments. As emphasized in *Shayara Bano v. Union of India*, arbitrary policies undermine institutional legitimacy. For GIFT IFSC to achieve global competitiveness, it must institutionalize robust oversight, coherent fiscal frameworks, and adherence to India's constitutional ethos, ensuring financial sovereignty and preventing treaty abuse.

These legal and policy reforms are not just technical correctives. They are constitutional imperatives. As the Supreme Court pointed out in *Shayara Bano v. Union of India*, manifestly arbitrary laws must be struck down.[8] It is not enough for GIFT IFSC to be globally competitive; it must also be institutionally legitimate, fiscally coherent, and constitutionally anchored.

XVII. CONCLUSION

GIFT City represents a pioneering but constitutionally untested experiment — the creation of a semi-autonomous financial jurisdiction within the territorial bounds of the Indian Republic. Unlike offshore tax havens or Special Economic Zones (SEZs) structured around trade, GIFT introduces a far more potent legal construct**:** financial extraterritoriality within national borders, wherein domestic actors access regulatory and fiscal benefits typically reserved for foreign investors, all while formally retaining Indian legal status.

This re-characterization of legal geography and financial identity — what this paper terms "inward financial externalization" — invites a deeper reflection on how constitutional norms adapt (or fail to adapt) to institutional hybrids that blur the line between domestic and foreign legal treatment. When GIFT-based entities are simultaneously treated as 'residents' under income tax law, 'non-residents' under FEMA, and 'exporters' under GST, the constitutional promise of legal consistency becomes vulnerable to strategic fragmentation.

This regulatory dissonance, if allowed to expand, threatens to embed a two-tier constitutional economy — one governed by conventional legal accountability and another by administrative discretion embedded in exceptional zones. Over time, such fragmentation could undermine not only fiscal equity but also democratic control over core financial and economic decisions — a scenario forewarned by the Supreme Court in *R.C. Cooper* and reaffirmed in *Shayara Bano*, where arbitrariness, even in economic policy, was deemed constitutionally impermissible.

India must now confront a crucial design choice**:** whether to allow GIFT City to evolve into a sui generis jurisdiction that sidesteps fiscal federalism, parliamentary oversight, and regulatory parity — or to anchor it within a constitutionally coherent framework. The reforms proposed in this paper do not seek to diminish innovation; rather, they envision a constitutional scaffold for financial experimentation, one that prevents enclave exceptionalism from hollowing out India's legal and fiscal foundations.

Ultimately, India's rise as a financial power cannot rely solely on regulatory exemptions or spatial exceptionalism. It must emerge from the credibility of its institutions, the consistency of its laws, and the trust of its citizens — all of which rest on the constitutional principle that no economic zone, however ambitious, can stand above the rule of law.

