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TAX Direct Taxes

Saskia Bonenberger
Executive Director
WTS India

Dear Reader,

The election in Delhi is over, but everybody is curiously waiting for the New Budget, which is about to come in some days and which will be an important milestone for the new Government.

Silently the government made in relation to a second Vodafone judgement one important step towards investor´s security in planning. It is an important step. It removed uncertainty in transfer pricing on share valuation and especially those investors who adopted a wait and watch policy before infusing further equity into Indian operations will have a clear perspective now. The interesting fact is here, that the Cabinet decided to accept the order of the Mumbai High Court not only in the case of Vodafone India, but also orders of other courts, Income Tax Appellate Tribunals (ITAT) and Dispute Resolution Panel (DRP) in cases of other taxpayers where similar transfer pricing adjustments have been made and the courts, ITAT, DRP have decided in favor of the taxpayer. You will find this judgement in the present India Journal.

The other very well known first big Vodafone case ended with a retrospective amendement of Income Tax Act. The question, when and if this law is applicable are still to be answered by the courts. Here a clarification in the Income Tax Law is highly desired for clarity. It is very much expected that the the threshold for taxing indirect share transfer will be fixed by 50 % of their total asset base. This approach is very much in line with the recommendations of the Schome Committee. In the next march edition of India Journal we will have clarity on that.

You will find two more judgements on direct taxes and a lot about FEMA. Very interesting are here the regulations concerning remittance of salary for EXPATS in India. Enjoy the reading!

Yours sincerly

Saskia Bonenberger

I. No levy of interest u/s 234B for non-payment of advance tax by non-residents |

Author: Jatinder Singh, New Delhi

A controversy created due to a Judgement of Hon'ble High Court of Delhi in the case of DIT Vs. Alcatel Lucent USA, Inc regarding levy of interest on the payee, where tax was deductible but not withheld by the payer, has been dealt with in a recent decision of the High Court of Delhi pronounced on 12th January, 2015, in the case of Director of Income-tax International Taxation Vs. GE Packaged Power Inc.

The decision in the case of Alcatel Lucent had resulted in the Appellate Authorities upholding the levy of interest under section 234B of the Indian Income-tax Act, 1961, even where the payer did not discharge his obligation to withhold tax, especially in respect of tax payers liable to tax within the jurisdiction of the High Court of Delhi.

The decision in the case of GE Packaged Power Inc., has taken a different and correct view than that in ALCATEL case.

The High Court has held that ALCATEL case is a decision turning upon its facts and wide observations made therein, and is limited to circumstances of that case.

The High Court has affirmed that primary liability for deducting tax is that of the payer and the payer will be an 'assessee in default', on failure to discharge its obligation to deduct tax. No interest is however leviable on the payee u/s 234B, even where payee files tax return declaring 'NIL' income.

This view is supported by another decision of the Delhi High Court in the case of Director of Income Tax vs. Jacabs Civil Incorporated and Mitsubishi Corporation and other High Courts including of Bombay, Uttaranchal.

This decision will support the contentions of taxpayers for non-levy of interest, in all pending Appellate matters up to the A.Y. 2011-12, especially in the jurisdiction of Delhi.

However, with effect from A.Y.2012-13, as per the amended provisions, interest is now leviable on the payee where tax is not deducted by the payer, and the payee does not make payment of advance tax. Both the payer and payee as such are now liable to pay interest, for their respective defaults. The High Court has affirmed that primary liability for deducting tax is that of the payer and the payer will be an 'assessee in default', on failure to discharge its obligation to deduct tax. No interest is however leviable on the payee u/s 234B, even where payee files tax return declaring 'NIL' income.

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II. Reimbursement of salary to a foreign company on account of seconded employees to be taxable under Article 7 | *Author: Sapna Gupta, New Delhi*

In a recent decision in the case of Morgan Stanley International Incorporated vs. DIT, the Mumbai Tribunal has held that the payment made by the Indian entity to the assessee on account of reimbursement of salary cost of the seconded employees will be considered under Article 7 of the DTAA.

In the instant case, the assessee, a US Company, providing support services through deputed employees contended that amount received from Indian company was mere reimbursement, without any income element and hence should not be treated as Fee for Technical Service (FTS)/ Fee for Included Service (FIS). Further, the employees were under direct supervision and control of Indian Company and hence 'make available' condition as per DTAA was not fulfilled. The US company also contended that even if it is considered that supervisory P.E. is created, the salary cost should be allowed to be deducted resulting in nil income. On the other side, tax authority's stand was that providing support services by highly qualified deputed personnel should be considered as FIS as per DTAA.

On appeal, the Tribunal, relying upon Centrica India Off-shore decision by High Court of Delhi, held the US Company to be the real employer of deputed employees and accordingly held the same to be constituting service P.E. in India. However, the Tribunal also held that as per provisions of Article 12(6) of the DTAA, provisions of FTS/ FIS will not be applicable once it is established that P.E of foreign company exists in India and accordingly not to be taxed on gross basis.

Further, the Tribunal also held that if the said receipts are to be taxed as business profits, the same is subject to net basis of taxation under Article 7. The reimbursement made by Indian Company would be treated as revenue receipts and salary of deputed employees paid by the US Company would be allowed as deduction and accordingly, there being no element of net profit involved, US Company has no tax liability in India.

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Recent Notifications

I. Acceptance of decision of the Bombay High Court in the case of Vodafone |

Author: Jatinder Singh, New Delhi

In a major decision, the Union Cabinet, chaired by the Prime Minister Shri Narendra Modi has decided to accept the order of the High Court of Bombay in the case of Vodafone India Services Private Limited (Vodafone) dated October 10, 2014. This decision has been termed as a major correction of a tax matter which has adversely affected investor sentiment.

In the impugned case, Vodafone issued shares to its holding company based in Mauritius. The Transfer Pricing Officer disputed the premium at which the shares were issued and held that Vodafone should have issued shares at a much higher premium. The shortfall was treated as income chargeable to tax attracting Transfer Pricing (TP) adjustment. Further, the shortfall was treated as deemed loan to associated enterprise on which notional interest was calculated and charged to tax. In the Writ Petition filed by Vodafone, the High Court of Bombay held that amount received on issue of share capital including premium, is on capital account and not of revenue nature, which can be subjected to tax as income. It also held that the TP provisions will not apply to such transaction, as it does not give rise to any income chargeable to tax.

Based on the opinion of Chief Commissioner of Income-tax (International Taxation), Chairperson (CBDT) and the Attorney General of India, the Cabinet decided not to file Special Leave Petition before the Supreme Court of India against the order of the High Court of Bombay and to accept the orders of Courts/ Income Tax Appellate Tribunal (ITAT)/ Dispute Resolution Panel (DRP) in cases of other taxpayers where similar transfer pricing adjustments have been made and the Courts/ ITAT/ DRP have decided/decide in favour of the taxpayer.

The Cabinet decision will bring greater clarity and predictability for taxpayers as well as tax authorities, thereby facilitating tax compliance and reducing litigation on similar issues. This will also improve the investment climate in the country.

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FOREIGN EXCHANGE MANAGEMENT ACT

I. Security for External Commercial Borrowings | *Author: Shamik Saha, New Delhi*

Under the extant External Commercial Borrowings ("ECB") provisions, it is the borrower of is actually conferred with the option of choosing the type of security to be provided to the overseas lender/supplier.

Based on a review, the Reserve Bank of India ("RBI") has decided that AD Category-I banks ("AD banks") may allow creation of charge on immovable assets, movable assets, financial securities and issue of corporate and /

or personal guarantees in favour of overseas lender/ security trustee, to secure the ECB to be raised / raised by the borrower, subject to the following conditions:

- the underlying ECB is in compliance with the extant ECB guidelines

- there exists a security clause in the Loan Agreement requiring the ECB borrower to create charge, in favour of overseas lender / security trustee, on immovable assets / movable assets / financial securities / issuance of corporate and / or personal guarantee

- No objection certificate, wherever necessary, from the existing lenders in India has been obtained.

Once the above mentioned conditions are satisfied, the AD bank may permit creation of charge on immovable assets, movable assets, financial securities and issue of corporate and / or personal guarantees, during the currency of the ECB with security co-terminating with underlying ECB, subject to the following conditions

a) Creation of Charge on immovable assets:

- Such security shall be subject to provisions contained in the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000.

- The permission should not be construed as a permission to acquire immovable asset (property) in India, by the overseas lender / security trustee.

- In the event of enforcement / invocation of the charge, the immovable asset / property will have to be sold only to a person resident in India and the sale proceeds shall be repatriated to liquidate the outstanding ECB.

Note: Pursuant to the above, in order to be able to meet the condition of selling only to a person resident in India, it would be necessary for the borrower to become legal owner of the assets.

b) Creation of Charge on movable assets:

- Pledge of shares of the borrowing company held by the promoters as well as in domestic associate companies of the borrower will be permitted. Pledge on other financial securities, viz. bonds and debentures, Government Securities, Government Savings Certificates, deposit receipts of securities and units of the Unit Trust of India or of any mutual funds, standing in the name of ECB borrower/promoter, will also be permitted.

- In addition, security interest over all current and future loan assets and all current assets including cash and cash equivalents, including Rupee accounts of the borrower with AD Category-I banks in India, standing in the name of the borrower/promoter, can be used as security for ECB. The Rupee accounts of the borrower/promoter can also be in the form of escrow arrangement or debt service reserve account.

- In case of invocation of pledge, transfer of financial securities shall be in accordance with the extant FDI/FII policy including provisions relating to sectoral cap and pricing as applicable read with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000.

c) Creation of Charge over Financial Securities:

- Pledge of shares of the borrowing company held by the promoters as well as in domestic associate companies of the borrower will be permitted. Pledge on other financial securities, viz. bonds and debentures, Government Securities, Government Savings Certificates, deposit receipts of securities and units of the Unit Trust of India or of any mutual funds, standing in the name of ECB borrower/promoter, will also be permitted.

- In addition, security interest over all current and future loan assets and all current assets including cash and cash equivalents, including Rupee accounts of the borrower with AD Category-I banks in India, standing in the name of the borrower/promoter, can be used as security for ECB. The Rupee accounts of the borrower/promoter can also be in the form of escrow arrangement or debt service reserve account.

- In case of invocation of pledge, transfer of financial securities shall be in accordance with the extant FDI/FII policy including provisions relating to sectoral cap and pricing as applicable read with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000.

d) Issue of Corporate or Personal Guarantee

- A copy of Board Resolution for the issue of corporate guarantee for the company issuing such guarantee, specifying name of the officials authorised to execute such guarantees on behalf of the company or in individual capacity should be obtained.

- Specific requests from individuals to issue personal guarantee indicating details of the ECB should be obtained

- Such security shall be subject to provisions contained in the Foreign Exchange Management (Guarantees) Regulations, 2000.

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II. Non-resident guarantee for non-fund based facilities entered between two resident entities | *Author: Shamik Saha, New Delhi*

As per the existing Foreign Exchange Management Act, 1999 ("FEMA") guidelines facility of non-resident guarantee is permitted under the general permission route for non-fund based facilities (such as Letters of credit/ guarantees/Letter of Undertaking (LoU)/Letter of Comfort: (LoC) entered into between two people resident in India.

RBI has now clarified that residents that are subsidiaries of multinational companies can also hedge their foreign currency exposure through permissible derivative contracts executed with an AD bank in India on the strength of guarantee of its non-resident grou entity.

Further, the method of discharge of liability by the non-resident guarantor under the guarantee and the subsequent repayment of the liability by the Principal debtor shall continue to be governed, as hitherto and accordingly, non- resident guarantor may discharge the liability by

- payment out of rupee balances held in India or
- by remitting the funds to India or
- by debit to his FCNR/NRE account maintained with an authorised dealer in India.

In such cases the non-resident guarantor may enforce his claim against the resident borrower to recover the amount and on recovery he may seek repatriation of the amount if the liability is discharged either by inward remittance or by debit to FCNR/NRE account. However, in case the liability is discharged by payment out of rupee balances the amount recovered can be credited to the NRO or NRSR account of the non-resident guarantor.

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III. Overseas Direct Investments by proprietorship concern / unregistered partnership firm in India | *Author: Shamik Saha, New Delhi*

Rbi has decided to review the policy framework for Overseas Direct Investments ("ODI") by a properietorship/concern/ unregistered partnership firm in India with respect to the changes in the definition / classification of exporters as per the Foreign Trade Policy ("FTP") of the Ministry of Commerce and Industry ("MoCI"), Goovernment of India ("GoI") issued from time to time.

Hence, keeping the changes in consideration, following revised terms and conditions are required to be complied with for considering the proposal of ODI, by a properietorship concern / unregistered partnership firm in India, by the RBI under the approval route:

- The proprietorship concern / unregistered partnership firm in India is classified as 'Status Holder' as per the FTP issued by the MoC&I, GoI, from time to time;

- The proprietorship concern / unregistered partnership firm in India has a proven track record, i.e., the export outstanding does not exceed 10% of the average export realisation of the preceding three years and a consistently high export performance;

- The AD bank is satisfied that the proprietorship concern / unregistered partnership firm in India is KYC (Know Your Customer) compliant, engaged in the proposed business and has turnover as indicated;

- The proprietorship concern / unregistered partnership firm in India has not come under the adverse notice of any Government agency like the Directorate of Enforcement, Central Bureau of Investigation, Income Tax Department, etc. and does not appear in the exporters' caution list of the RBI or in the list of defaulters to the banking system in India; and

- The amount of proposed investment outside India does not exceed 10 per cent of the average of last three years' export realisation or 200 per cent of the net owned funds of the proprietorship concern / unregistered partnership firm in India, whichever is lower.

It may be noted that in order to have a statutory back-up for the above, RBI has substituted the existing Regulation 19A in Foreign Exchange Management (Transfer or issue of Any Foreign Security) Regulations, 2004 as under:

"19A. Overseas Direct Investments by Proprietorship Concern / Unregistered Partnership Firm in India A proprietorship concern or an unregistered partnership firm in India, satisfying the criteria for Overseas Direct Investment as prescribed by the Reserve Bank from time to time, may set up / acquire a Joint Venture (JV) / Wholly Owned Subsidiary (WOS) outside India with the prior approval of the Reserve Bank.", vide Notification No. FEMA. 325/RB-2014 dated November 12, 2014, which came into effect from Jan 5, 2015.

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IV. Depository Receipts Scheme | *Author: Shamik Saha, New Delhi*

A new scheme called 'Depository Receipts Scheme, 2014 ("DR Scheme, 2014") for investments under ADR/GDR have been notified by the Central Government effective from December 15, 2014 which provides for repeal of extant guidelines for Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993 except to the extent relating to foreign currency convertible bonds.

The salient features of the new scheme are:

- The securities in which a person resident outside India is allowed to invest under Schedule 1, 2, 2A, 3, 5 and 8 of Notification No. FEMA. 20/2000-RB dated 3rd May 2000 shall be eligible securities for issue of Depository Receipts in terms of DR Scheme 2014;

- A person will be eligible to issue or transfer eligible securities to a foreign depository for the purpose of issuance of depository receipts as provided in DR Scheme 2014.

- The aggregate of eligible securities which may be issued or transferred to foreign depositories, along with eligible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such eligible securities under the extant FEMA regulations, as amended from time to time.

- The eligible securities shall not be issued to a foreign depository for the purpose of issuing depository receipts at a price less than the price applicable to a corresponding mode of issue of such securities to domestic investors under FEMA.

- It is to be noted that if the issuance of the depository receipts adds to the capital of a company, the issue of shares and utilisation of the proceeds shall have to comply with the relevant conditions laid down in the Regulations framed and Directions issued under FEMA.

- The domestic custodian shall report the issue/transfer of sponsored/unsponsored depository receipts as per DR Scheme 2014 in 'Form DRR' as given in Annex (enclosed as Annexure – I) within 30 days of close of the issue/ program.

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V. Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) Regulations, 2000- Remittance of salary | *Author: Shamik Saha, New Delhi*

The extant policy as laid down in Regulation 7(8) of the Foreign Exchange Management (Foreign Currency Account by a Person Resident in India) Regulations, 2000 regarding remittance of salary reads as under:

"A citizen of a foreign state, resident in India, being an employee of a foreign company or a citizen of India, employed by a foreign company outside India and in either case on deputation to the office/branch/subsidiary/joint venture in India of such foreign company may open, hold and maintain a foreign currency account with a bank outside India and receive the whole salary payable to him for the services rendered to the office/ branch/subsidiary/joint venture in India of such foreign company, by credit to such account, provided that income-tax chargeable under the Income-tax Act, 1961 is paid on the entire salary as accrued in India.

" RBI has since reviewed the above and has decided that the facility shall also be available to an employee who is deputed to a 'group company' in India.

The amendment has been incorporated by substituting the existing regulation 7(8) as under:

"A citizen of a foreign State, resident in India, being an employee of a foreign company or a citizen of India, employed by a foreign company outside India and in either case on deputation to the office/ branch/ subsidiary/ joint venture/ group company in India of such foreign company may open, hold and maintain a foreign currency account with a bank outside India and receive the whole salary payable to him for the services rendered to the office/ branch/ subsidiary/ joint venture/ group company in India of such foreign company, by credit to such account, provided that income tax chargeable under the Income-tax Act,1961 is paid on the entire salary as accrued in India." Further, the term 'company' referred in the said above mentioned regulation will include 'Limited Liability Partnership' as defined in the LLP Act, 2008.

It may be noted that the above liberalisation extends the remittance facility to an employee covered by Regulation 7(8), even while on deputation to a 'Group Company' in India of a foreign company. It is seen that the term 'Group Company' has NOT been specifically defined for the purpose.

It is hoped that the definition of 'Group Company' as incorporated in Regulation 2 (iva) of the FEM (Transfer or Issue of Security by a person resident outside India) Regulations, 2000 applies to the above provision also

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VI. External Commercial Borrowings (ECB) Policy – Simplification of Procedure | *Author: Shamik Saha, New Delhi*

As a measure of simplification of the existing procedure for rescheduling/restructuring of ECBs and in supersession of paragraph 3 (a) of A.P. (DIR Series) Circular No. 33 dated February 09, 2010, paragraphs 3 (a) and (b) of A.P. (DIR Series) Circular No. 75 dated February 07, 2012 and provisions contained in the A.P. (DIR Series) Circular No. 128 dated May 09, 2014, RBI has decided to delegate powers to the designated AD banks to allow:

- Changes / modifications (irrespective of the number of occasions) in the draw-down and repayment schedules of the ECB whether associated with change in the average maturity period or not and / or with changes (increase/decrease) in the all-in-cost.

- Reduction in the amount of ECB (irrespective of the number of occasions) along with any changes in draw-down and repayment schedules, average maturity period and all-in-cost.

- Increase in all-in-cost of ECB, irrespective of the number of occasions.

However, this is subject to the designated AD bank ensuring the following:

- Revised average maturity period and / or all-in-cost is / are in conformity with the applicable ceilings / guidelines; and

- The changes are effected during the tenure of the ECB.

Further, it has been mentioned that if the lender is an overseas branch / subsidiary of an Indian bank, the changes shall be subject to the applicable prudential norms.

AD banks have been entrusted with power to permit

changes in the name of the lender of ECB after satisfying themselves with the bonafides of the transactions and ensuring that the ECB continues to be in compliance with applicable guidelines.

AD banks are also eligible to allow the transfer of ECB from one company to another on account of re-organisation at the borrower's level in the form of merger / demerger / amalgamation / acquisition duly as per the applicable laws / rules after satisfying themselves that the company acquiring the ECB is an eligible borrower and ECB continues to be in compliance with applicable guidelines. The above said simplification measures shall be applicable for ECBs raised both under the automatic and approval routes, with FCCBs being specifically excluded out.

These changes in the terms and conditions of ECB and / or any other changes allowed by the AD banks under the powers already delegated and / or changes approved by the RBI should be reported to the Department of Statistics and Information Management ("DSIM") of the RBI through revised Form 83 at the earliest, in any case not later than 7 days from the changes effected. While submitting revised Form 83 to the DSIM, the changes should be specifically mentioned in the communication. Further, these changes should also get reflected in the ECB 2 returns appropriately.

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CORPORATE LAW

I. Recent notifications under Companies Act, 2013

❖ Amendment in Companies (Accounts) Rules, 2014

The Ministry of Corporate Affairs through issue of notification dated January 16, 2015 has notified Companies (Accounts) Amendment Rules, 2015 to amend Companies (Accounts) Rules, 2014. The changes introduced by the said amendment rules are as under:

- As per first proviso to Sec 128(1) of the Companies Act, 2013 (hereinafter referred to as "the Act") any company can keep books of account and other relevant books and papers at any place in India, other than its registered office, as may be decided by the Board of Directors, and within seven days of such decision, the company needs to file with the Registrar a notice in writing, giving the full address of that other place. In this context, Form AOC-5 has now been notified, in connection with providing notice to Registrar regarding the address at which books of account have been kept.

- As per Sec 129(3) of the Act, in case a company has one or more subsidiaries, it shall, in addition to its standalone financial statements, also prepare a consolidated financial statement (CFS) of the company and of all the subsidiaries. For the purpose, subsidiaries situated abroad are also normally included. However, consolidation in respect of foreign subsidiaries has now been exempted for the year commencing on or after 1stApril, 2014.

❖Amendment in Companies (Appointment and Qualification of Directors) Rules, 2014

The Ministry of Corporate Affairs through issue of notification dated January 19, 2015 has notified Companies (Appointment and Qualification of Directors) Amendment Rules, 2015 to amend Rule 16 of the Companies (Appointment and Qualification of Directors) Rules, 2014. Through this amendment, the MCA has obviated the need for obtaining / renewal of digital signature certificate (DSC) by a foreign director at the time of his resignation, as required for signing and filing of Form DIR-11 (Notice of resignation of a director to the Registrar). Accordingly, now the concerned foreign director can authorise a practising Chartered Accountant / Company Secretary / Cost &Works Accountant, or any resident director of the company from which he is resigning, to sign and file Form DIR-11 on his behalf.

❖ Amendment in Companies (Corporate Social Responsibility) Rules, 2014

In terms of Rule 4 of the Companies (Corporate Social Responsibility) Rules, 2014, as originally notified under Notification No. G.S.R. 129(E) dated 27th February, 2014, a company undertakes CSR activities:

- through a trust;
- a society;
- a company including Section 8 company established singly by itself or by its holding or subsidiary or associate company.

The above provision has now been extended vide Notification dated 19th January, 2015 to cover:

a company either singly or jointly established along with holding / subsidiary / associate and any other company. Further, any other company may also include the holding /subsidiary / associate of such other company.

Important Dates to Remember

Particulars	Date
Deposit of TDS for the month of February, 2015	March 7, 2015
Deposit of Service Tax for the month of February, 2015	March 5, 2015 (by e-payment – March 6, 2015)

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