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91st Year

ज्ञानं परमं बलम्

A Monthly Journal of

The Chamber of Tax Consultants

THE CHAMBER'S JOURNAL

Vol. VI | No. 9 June 2018

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

NRI–FEMA, Taxation and other Compliances

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Membership & Public Relations Committee

Full day Seminar on Direct Taxes Conclave held on 9th June, 2018 at Nashik

Shri Ajay R. Singh, inaugurating the Seminar by lighting the lamp. Seen from L to R: CA Anish Thacker, CA Manoj Shah, Faculties, CA Pravin Kulkarni, CA Kishore Birari

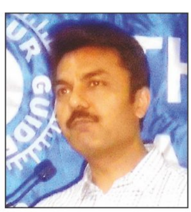
Dignitaries at the inaugural session

Shri Ajay Singh, President giving opening remarks. Seen from L to R: S/Shri CA Anish Thacker, CA Manoj Shah, Faculties, CA Pravin Kulkarni & Shri Ranjan Chavan, President TAPN, Nashik

CA Pravin Kulkarni, welcoming President and Faculties. Seen from L to R: S/Shri Anish Thacker CA Manoj Shah, Faculties, Ajay Singh, President, CTC and Shri Ranjan Chavan, President, TAPN, Nashik

Faculties

CA Anish Thacker



CA Manoj Shah

CA Bhadresh Doshi

CA Devendra Jain

Section of Audience

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THE CHAMBER OF TAX CONSULTANTS
3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai – 400 020
Phone : 2200 1787 / 2209 0423 / 2200 2455
E-Mail: office@ctconline.org • Website : http://www.ctconline.org.

The Chamber's Journal

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***READER'S SUGGESTIONS AND VIEWS**: We invite the suggestions and views from readers for improvement of The Chamber's Journal. Kindly send your suggestions on office@ctconline.org.*

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Editorial

Lord Meghnad Desai, a well-known author and economist, in his book titled "Politic Shock" has given a bleak picture of the economic growth in the recent years. According to him, the growth, of late, has been jobless growth. He has not given an optimistic picture of the future as well. The expansion of economic activity is a fact, but if it doesn't provide means of livelihood or it is going to deprive some of their livelihood, then it is a very serious matter. At times, one may view technology as a spoiler rather than as an enabler. Technology will make a difference to a person as a spoiler or as an enabler if the person is prepared to improvise the ways in which he conducts himself. As professionals, for us it is very important to improvise ourselves to adopt technology if we don't want to become obsolete. In the book titled "The Second Age Machine Age" by Erik Brynjolfsson and Andrew Mcafee, at page 90 have described the things which are going to happen. I find it appropriate to quote the same:

"The advances we've seen in the past few years, and in the early sections of this book – cars that drive themselves, useful humanoid robots, speech recognition and synthesis systems, 3D printers, Jeopardy! – champion computers-are not the crowning achievements of the computer era. They're the warm-up acts. As we move deeper into the second machine age we'll see more and more such wonders, and they'll become more and more impressive.

How can we be so sure? Because the exponential, digital and recombinant powers of the second machine age have made it possible for humanity to create two of the most important one-time events in our history: the emergence of real, useful artificial intelligence (AI) and the connection of most of the people on the planet via a common digital network.

Either of these advances alone would fundamentally change our growth prospects. When combined, they're more important than anything since the Industrial Revolution, which forever transformed how physical work was done."

The present issue of the Chamber's Journal brings out a special story on NRI, FEMA, Taxation and Other Compliances. It is a very important issue where eminent professionals have contributed on various topics. I am grateful to all of them for sparing their valuable time for the sake of the Chamber's Journal. I thank all the contributors to this issue.

K. GOPAL
Editor

From the President

Dear Members & Readers,

"EXCELLENCE IS NEVER AN ACCIDENT; IT IS THE RESULT OF HIGH INTENTION, SINCERE EFFORT, INTELLIGENT DIRECTION, SKILLFUL EXECUTION AND THE VISION TO SEE OBSTACLES AS OPPORTUNITIES"

I shall always cherish forever that it was a wonderful term and it was made possible only because of your support and love for the Chamber. Every beginning has an end. And every end is a new beginning. It's a relentless cycle seen in every aspect of our lives. The time has come for me to welcome the new President-elect Mr. Hinesh Doshi and his team.

I FEEL privileged to have the opportunity to serve this institution. I truly feel that the 12 months of my tenure have been very fulfilling, which has not only given me the opportunity to gain valuable experience but also in successfully completing the various endeavours in co-ordination with all the professional brothers working in different facet of practice .

In last 12 months, there has been transformative and pioneering work done at CTC, which is unprecedented in quality and scale. The Website of the Chamber has been revamped and new features have been added to make it more user-friendly. This year CTC has achieved highest Membership growth of 3739 as on 31-3-2018 and 3943 as on 1st June, 2018 which has been possible through the web based payment gateway, which has not only reduced paper work tremendously but has also eased the workload of the CTC staff in maintaining the records and providing immediate confirmation to members.

This year the concentration was more on the uniqueness of the contents of the programme for the benefit of the profession at large, some of them being Workshops and Seminars in the areas of Real Estate Laws (3 days), Insolvency and Bankruptcy Code 2016, 3 days workshop on FEMA, Anti Abuse Provisions under Income-tax, GST Workshop, Benami Law etc.

Work is often a source of dissatisfaction for people because in their desire to get ahead, they often lose touch with their family and values which are internal sources of power. In today's fast techno savy world family, values and culture play a very important role. At Chamber in order to keep the same alive we have conducted various meetings in SAS series focusing on work-life balance for a professional. We also had an interesting session on "The power of balance" by Sadhu Amrutdas. We believe in values and personal bonding which is CTC's core strength.

This year too, Webinars on various subjects of professional interest have been successfully conducted with a view to reach large number of members at distant locations all across the country whereby interaction with members has also been taken to next level.

NEW INITIATIVES

Some of the new initiatives adopted: New columns in The Chamber's Journal : GST Legal Update, GST Gyan, GST Recent Judgments, Corporate Law-Recent Developments, In Focus (A Column on Accounting and Auditing), Technovation (A Column on Information Technology). Initiating and Launching of E-Journal.

Keeping in pace with needs of our members we have started New Study Circles on the subjects of Capital Markets and Information Technology. We believe in overall development and growth of professionals and CTC provides the platform for the same.

Started independent Committees for Students and I.T. Connect thereby having 14 vibrant Committees having 324 core group members.

EXPANDING ITS WINGS :

CTC has formed a New Study Group at Pune with a view to cater the members at this neighbouring town in more effective manner.

CTC has been regularly conducting various programmes for outstation members at Solapur, Rajkot, Vapi, Aurangaba, Kolhapur. However this year CTC has expanded its wings to new cities like Indore, Raipur, Goa, etc. Many of our programmes have been covered by media at these locations.

The CTC's 4th International Study Tour to Mauritius, organised by International Tax Committee was a perfect blend of engrossing technical sessions and enjoyable recreational activities with a record participation of 57 delegates.

This year CTC has organised 3 successful Residential Refresher Courses at Udaipur, Amritsar and Indore (on 21st to 25th June) with participation by large number of professionals. Udaipur Indirect tax RRC had a record participants of 220 delegates which is highest till date in all RRC. Even the International Tax committee RRC at Indore which is planned in June 21st to 25th is not lacking behind where it has registered 200 delegates till date which is one of the highest participants. Same was the case with our general RRC at Amritsar.

PARADIGM SHIFT

"Women belong in all places where decisions are being made... It shouldn't be that women are the exception." Justice Ruth Bader Ginsburg

Emphasising on the gender neutral approach of the Chamber, for the first time after a gap of many years two women members were inducted in the Managing Council supported with the highest number of female participants in the core group .

To bring more awareness, a programme on "Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013" was specially dedicated to women .

STUDENT INITIATIVE

Taking the Tax Moot Court to the National level by holding 45th Sir Jamshedji Kanga and Dr. Y. P. Trivedi National Tax Moot Court Competition (jointly with the Government Law College and in association with Rotary Club of Bombay) in which 60 participants from 20 reputed law colleges across the country participated actively.

Organising First Debate Competition for students jointly with H. R. College, Mumbai was a grant success.

This year we had 2 orientation programmes spread over 3 days for CA articles and students in central and western suburb. Thereby providing opportunity to learn and develop their skills and knowledge through these programmes.

REPRESENTATION

Successful Writ Petition before Hon. Delhi High Court challenging the validity of Income Computation and Disclosure Standards (ICDS), thereby once again rising to the cause of taxpayers of the country.

Numerous effective representations before the Hon. Union Finance Minister, State Finance Minister, Revenue Secretary, GST Council Secretariat, Chairman CBDT, Dy. Governor of RBI and Commissioner of GST. The representations made by the Chamber have been fruitful in addressing many difficulties faced by the taxpayers and professionals.

CTC this year had planned some unique publication on PMLA, FEMA law and practice and Landmark decision on Indirect taxes having relevance in GST regime. These are research based publications.

We are determined to improve ourselves to meet the needs and expectations of members. As a team, we will continuously strive to provide quality programmes and make effective representation for members and society at large.

Before ending let me acknowledge gratitude towards my team . My task would have been much more difficult if it were not for the support and advice of my colleagues I would like to thank all my team members who regularly contributed their unique superstar ideas, which helped us to outperform in all areas . I very much appreciate the council members' confidence and trust in me. I owe much to my other core group members and friends from sister organisations who have always brought me their support whenever I needed them.

I would like to convey my appreciation to Mr. Hitesh Shah, Manager, Ms. Manisha Sr. Accountant, Savita accountant, Suresh, Anand, Jaydeep and other CTC staff, whose dedication and contribution has been the core and strength in the development of CTC. I sincerely wish and hope that this culture of dedicated hardwork, and spirit of teamwork will continue to flourish in the coming years and the CTC will grow to greater heights with lots of accomplishments in the years to come.

The Special Story for the month is on "NRI – FEMA, Taxation and other Compliances". I thank all the authors for sparing their valuable time and for their contribution to the Chamber's Journal for this month.

My sincere appreciation to Editorial Team and Journal Committee members for coming out with Special Stories on various topics during the year and also adding new columns to the Chamber's Journal.

As for me, one part of a very challenging and illuminating experience is coming to an end, one that I will treasure for the rest of my life. In closing, let me say that "I have run with perseverance and have finished the race". Whether I have finished the race successfully or not is not for me to say - I will leave it to my colleagues and my constituent members to be the judge.

Thank you all for everything .

Surround yourself with people who have dreams, desire and ambition; they 'll help you push for, and realise your own.

Jai Hind.

AJAY R. SINGH

President

v

Chairman's Communication

Dear Readers,

The Reserve Bank of India in its latest Monetary Policy has hiked interest rate by 25 basis points for the first time in four and half years. First time after the current Government came to power. Concerns over inflationary pressure stemming from rising commodity price were behind this decision. The likely shift in interest rate cycle will make loans more costly for borrowers. On the other hand depositors could fetch higher interest on their deposit with banks.

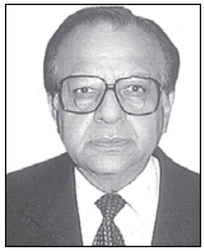
Financial results of all the Nationalised Banks for March 2018 have been the worst in the past several years . Except for nominal profit by two nationalised banks all others have declared huge losses and cumulatively it runs into thousands of crores. The root cause of this huge loss is the mounting NPAs. The Finance Minister has set up a committee to examine the merger of smaller banks into bigger banks as well as to examine the possibilities of setting up Asset Reconstruction Company (ARC) which would acquire stressed assets. The idea of setting up separate ARC has not gone well with the experts in banking because the Government will have to spend huge money to acquire these assets. In fact one of the experts has said that the Government has run out of ideas to salvage the situation. Moreover while writing this communication, there is a news that six more banks (including two large banks with which some of the banks are proposed to be merged) have been put under PCA (prompt corrective action). So one will have to wait and watch as to what measures are taken by the Government. In fact the problem is so grave that unless Government takes drastic measures, the situation would go from bad to worse. The Government will have to think out of box, to address this very serious issue.

India's overseas population is the largest in the world with about **16 million** people from India living outside the country, according to UN survey of 2015 on international migrant trends. With ever increasing population of NRIs, taxation, FEMA compliance and other regulatory compliances in respect of NRIs have gained significant importance over a period of time. Considering its importance, the committee has designed this issue which covers all the aspects of compliance which are relevant for NRIs. I am sure the members would find this issue useful and will find a permanent place in their library.

My colleagues CA Paresh P. Shah, CA Rajesh P. Shah, CA Naresh Ajwani, CA Manoj Shah and Vice President Hinesh Doshi have put in lot of effort in designing this issue. But for their effort, this issue would not have been possible. Sincere appreciation for their efforts. I thank and compliment all the authors for agreeing to write articles, sparing their valuable time and sharing their knowledge on such an important subject despite their very busy schedule. The Committee has also introduced a new column – Technovation from the month of May, 2018 which would cover latest developments in information technology space relevant for professionals. The column would be authored by my colleague CA Dinesh Tejwani. Appreciation for his initiative in starting this new column as well as agreeing to contribute for the same.

This is the last issue for the current term. I thank and place on record my sincere appreciation for unstinted support of the Vice-Chairman Bhadresh Doshi, all the convenors Bhavik Shah, Mandar Telang and Toral Shah and all the members of the Journal Committee. But for their active participation, support and valuable suggestions, the twelve issues for the year would not have been possible. My hearty thanks to the Editor K. Gopal and the entire Editorial Board for their support and guidance throughout the year.

VIPUL K. CHOKSI
Chairman – Journal Committee

CA Dilip Thakkar & CA Rajesh P. Shah

Over View of FEMA – FERA to FEMA

I. Introduction

1) All of us know about FERA 1973, but very few are aware about Foreign Exchange Regulations Act, 1947. Introduced in India for the first time as a temporary measure at the time of Second World War in 1939 through Defence of India Rules. It was made into a permanent feature through Foreign Exchange Regulations Act, 1947 (FERA) which was basic but very vague. Lot of issues were left to interpretation both by Regulations & Professionals.

2) Because of the experience gained over more than 26 years, FERA appeared in its new avtar in the form of Foreign Exchange Regulations Act, 1973 (FERA) which came into force on 1st January, 1974. It was more precise with proper definitions but remained draconian and a criminal law.

   The law as it stood then was more on the regulatory aspect. Everything was controlled by RBI. Literally for every remittance other than imports of goods prior approval was required above a threshold limit.

   FERA was introduced at a time when foreign exchange (Forex) reserves of the country were low, Forex being a scarce commodity. FERA therefore proceeded on the presumption that all foreign exchange earned by Indian residents rightfully belonged to the Government of India and had to be collected and surrendered to the Reserve Bank of India (RBI). FERA primarily prohibited all transactions not permitted by RBI.

   The Act came into force, to regulate foreign payments, securities, currency import and export and purchase of fixed assets by foreigners.

   FERA in its existing form became, therefore, increasingly incompatible with the change in economic policy in the early 1990s. While the need for sustained husbandry of foreign exchange was recognised, there was an outcry for a less aggressive and more mellow enactment, couched in milder language.

3) Because of the reforms process which started in 1991, FERA started losing its hold and gradually the law started looking more redundant. It was felt that a more liberal law was required to attract more foreign investments into the country. Hence a completely overhauled new law called,

Foreign Exchange Management Act, 1999 (FEMA) came into force on 1st June, 2000. This is more of a civil law, more liberal, more relaxed and much less draconian. The focus shifted from 'regulations' to 'management'. The main objective of the Act is to facilitate foreign trade and to encourage systematic development and maintenance of forex market in the country

4) Let us compare the Preambles of erstwhile FERA 1973 and present FEMA 1999 which will clearly bring out the shift from 'Regulations' to 'Management'.

   a) *Preamble of FERA, 1973*

      An Act to consolidate and amend the law regulating certain payments, dealings in foreign exchange and securities, transactions indirectly affecting foreign exchange and the import and export of currency for the conservation of the foreign exchange resources of the country and the proper utilisation thereof in the interests of the economic development of the country.

   b) *Preamble of FEMA, 1999*

      An Act to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.

5) FEMA is administered by the Reserve Bank of India (RBI) and enforced by the Enforcement Directorate (ED). A unique feature of present FEMA is the Compounding Process under the Act which is precise and time bound. Now, offences of technical nature which are not intentional can be compounded by RBI at a reasonable fee without having to go to ED which can levy a substantial penalty and without being time bound. One very important outcome of the compounding process is that it regularises the past and does not leave a trail of contravention under the Act. Moreover, it is settled by payment of a 'Fee' which is not a 'Penalty'.

6) FEMA Act is a very small Act with only 49 sections carved into total seven chapters, out of which 12 sections deal with the operational part while the remaining 37 sections cover penalties, contravention, appeals, adjudication and so on. It is mainly governed by Notifications and Circulars issued by RBI and approved by the Government as per the inbuilt authority under the Act itself. RBI had a very practical & useful practice of issuing Master Circulars every first July which was a compilation of all circulars issued during the past year on each important topic under the Act. Of late, the said practice is discontinued and now RBI issues Master Directions as and when required. RBI also notifies Frequently Asked Questions (FAQs) and its own interpretations on them.

7) One important aspect of FEMA is that many things under the Act are put on automatic route and/or delegated to banks who are Authorised Dealers. RBI has published a list of the Banks which are recognised as Authorised Dealers (AD) and any act done through an AD is as good as done with the permission of RBI.

II. Practical issues

1) One unique feature of FEMA is that there is less emphasis or importance on the nationality of a person and more on the 'origin' of the person. India is a unique country which relaxes several provisions in the case of 'Persons of Indian Origin' (PIO) who were issued PIO cards. Now, the same is converted into OCI cards meaning 'Overseas Citizens of India' which is a lifetime visa for those Indians who have changed their nationality.

OCI is also valid for such foreign citizens to engage in gainful employment in India and it does not require them to register with the Foreigners Registration Office (FEO) even if their stay in India exceeds continuous 180 days. For many provisions of FEMA, the concept of Indian origin goes back to three generations, the person himself, his parents & his grand parents from both sides, father & mother.

2) Similarly, because of the definition of a 'Person Resident in India' (meaning a Resident), even a foreigner can qualify as a Resident if he comes to India for taking up employment in India. In that case, such a foreigner can acquire immovable property in India. A recent Notification dated 26th March, 2018 issued by RBI has made quite a few changes without changing the definitions etc in the Act itself.

   a) For example, Non-Resident Indian (NRI) means a person resident outside India who is a citizen of India. Earlier, it also included a foreign citizen who is of Indian origin.

   b) Overseas citizen of India (OCI) means a person resident outside India who is registered as an Overseas Citizen of India Cardholder under Section 7(A) of Citizenship Act, 1955. This has made a very subtle distinction. Earlier NRI would include a person of Indian origin. No more now, unless he holds OCI card. For example, there are many Indians who have acquired foreign nationality and do not hold OCI card as they will take a specific visa to come to India in 5-8 years. They will now not qualify as NRI and as a consequence will be treated as foreigners and will not enjoy benefits given to persons of Indian origin.

3) **Few Examples of Relaxation from FERA to FEMA**

A Possession of foreign currency or foreign coins by any resident in India up to such limit as the RBI may specify.

A Foreign currency account held or operated by such person or class of persons that the RBI may specify along with the ceilings for such holding/operation.

A Foreign exchange acquired from employment, business, trade, vocation, services, honorarium, gifts, inheritance or any other legitimate means up to such limits as the Reserve Bank may specify.

A Pre-1947, acquisitions/holdings/gifts/inheritance with the permission, or in accordance with directions of the RBI.

4) Sections 5 and 6 point out that convertibility of the rupee into other currencies will be free with regard to current account transactions than capital account transactions. Loans, investments and all transactions which create new liabilities (including contingent liabilities), or add to assets outside India or alter the existing foreign assets or liabilities of a `person' resident in India, are capital account transactions. Acquisition of assets or accretions to liabilities in India of a person not resident in India will be treated in the same manner. The RBI will specify under sub-section (3) of section 6, the classes of capital account transactions which are permissible and the limits up to which foreign exchange may be `admissible' for such transactions.

Current account transactions are those not so depicted as capital account transactions. In particular, they include payments made in the course of day-to-day business, short-term banking and credit facilities, interest on loans, net income from investments, remittances for living expenses of parents, spouse and children being abroad and expenses in connection with foreign travel, education and medical care of parents, spouse and children. Section 5 makes it clear that a resident may sell or draw foreign exchange to or from any authorised persons (specified banks), if such a sale or drawal is a current account transaction, subject to any reasonable restrictions prescribed for such transactions by the Centre.

5) One more peculiarity of FEMA is the meaning of 'Non Repatriation'. In a few circumstances, a non repatriable investment does not necessarily mean that its income and capital is completely non repatriable. RBI considers NRI's investment in India on non repatriation basis as akin to domestic investment. Now, income arising out of such investment gets credited to NRO bank account of NRI which is considered as non repatriable account. However, RBI permits such current income credited to NRO account, repatriable without limit, net of Indian taxes. Similarly, sale proceeds of such investment, which is also credited to NRO account, is repatriable to the extent of USD one million, net of taxes, each financial year.

6) The recent Notification dated 7th November 2017 issued by RBI as FEMA 20(R)2017-RB on Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 has made quite a few significant changes governing the subject apart from it being a very comprehensive Regulation.

This new Regulation read with A. P. (DIR Series) Circular No. 6 dated 20th October 2016 issued by RBI, dealing with 'Review of Sectoral Caps and Simplification of Foreign Direct Investment (FDI) Policy' makes a significant departure concerning meaning of Real Estate Business. Para 3(k) reads as follows:

"Real Estate Business" shall mean dealing in land and immovable property with a view to earning profit therefrom and does not include development of township, construction of residential / commercial premises, roads or bridges, educational institutions, recreational facilities, city and regional level infrastructure, townships. **Further, earning of rent income on lease of the property not amounting to transfer, will not amount to "real estate business".**

This is a significant departure from earlier policy according to which, earning of rent income on lease of property was considered as real estate business and hence prohibited. Hence, earlier foreign investment was permitted in real estate development, but after development, such property can only be sold, it was not permitted to be given on lease. Now, it is so permitted. It is a very significant relaxation but only in case of inbound investment. The definition or meaning of real estate business concerning outbound investment does not permit even now, earning income from rent by leasing such property.

Professional bodies have made representation to RBI to remove such anomaly in the one way relaxation of meaning of real estate business and have requested RBI to adopt the same meaning for outbound investment. It is still under consideration by RBI.

7) Another important feature of FEMA is the Liberalised Remittance Scheme (LRS). When it was introduced for the first time with an yearly limit of US $ 25,000 in February 2004, RBI had stated that now the Act deals with management of foreign

exchange and not its regulation, hence RBI gave to each Resident individual (including a minor) to invest outside India up to US $ 25,000 every financial year on automatic route basis. This limit has undergone changes in the amount permitted over the years and now presently, the limit is US $ 2,50,000 every financial year.

Once significant incident has happened in between. Such limit was US $ 1,25,000 in financial year 2014-15. During the announcement of Monetary Policy in February 2015, the Governor of RBI announced that it has been decided to increase the limit to US $ 250,000. The concerned persons who had already availed of remittance of US $ 125,000 in that year rushed to invest further US $ 125,000 up to the increased limit of US $ 250,000 & remitted further the balance amount before 31st March, 2015. Even the Authorised Dealers relying on the announcement by the Governor of RBI, permitted such further remittance under LRS.

However, for some unknown reasons, RBI issued the required Notification increasing the limit from US $ 125,000 to US $ 250,000 only in May 2015, i.e. after 31st March, 2015. Now ED has issued notices/summons to such individuals and banks for remitting foreign exchange in excess of the limits. One does not understand whether the announcement of the Governor of RBI, which is in public domain, is to be believed or the delay in RBI issuing the notification. The principle is that an authority cannot take advantage of its own lapse/delay.

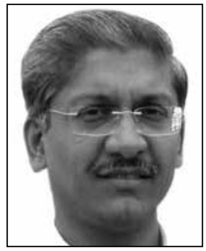
7) Another very important and significant aspect of FEMA is that unlike Taxation Laws, any amendment of FEMA Act, or Rules & Regulations thereunder is **NEVER** having retrospective effect. This is a very practical & welcome aspect of FEMA.

III. Way forward

1) Many years back, RBI had formed a committee known as 'Tarapore Committee' under the leadership of Mr. Tarapore, a seasoned & experienced Dy. Governor of RBI then to submit Report on Roadmap to make Indian Rupee fully convertible. Some professional bodies had opportunity to appear before that Committee and had made valuable suggestions in the method to make Indian Rupee fully convertible and consequently to abolish exchange controls under FERA/ FEMA. To my knowledge, that was the only committee which submitted its Report within stipulated time of three months without seeking any extension. That Committee had suggested that if our foreign exchange reserves reach certain limit (which was very law compared to present foreign exchange reserves of US $ 424 billion) and a certain amount of law inflation, to qualify the Indian Rupees to be made free of controls. The persons who appeared before the Tarapore Committee on behalf of the professional bodies, gave example of U.K. and Singapore, who abolished exchange control overnight at one stroke in 1978-79 and see how fast they have progressed as international financial centres. However, even though now our foreign exchange reserves have reached US $ 424 billion, an all time high, our country has not still done away with foreign exchange controls.

The time will come when India will be complete a country with 100% convertibility and no Foreign Exchange Law exist.

❍❑❍



CA Naresh Ajwani

Residence of an Individual under FEMA and Income-tax laws

1. Background

Residential status is the starting point to determine:

- The extent to which a person is regulated for cross-border transactions; and
- The extent of the income-tax liability.

Two laws where residential status is most relevant are Income-tax Act (ITA) and Foreign Exchange Management Act (FEMA). There is a tendency to mix up the concepts of the two laws which leads to confusion. In this article, the focus will be:

i) To understand the meaning of "residence" under FEMA and tax laws.

ii) To understand differences under both laws and reasons for the same.

iii) Practical issues.

This article covers residential status of an individual. Other persons' residential status is not covered.

2. Basic difference between Income-tax and FEMA law

2.1 Understanding the purpose of residential status under both laws will help to understand the issues better. FEMA and ITA have different purposes.

Under Income-tax law, the purpose is to determine taxability of income. It is a revenue law. The income is determined for the full year. If a person is a resident, his global income is taxable in India. If a person is a non-resident, only his Indian income will be taxable. Income earned and received outside India is not taxable in India. For earning income, no approval is required under the Income-tax Act. Income tax law is only concerned with taxable income and the tax thereon.

FEMA is a regulatory law. There are regulations for undertaking transactions. For example, if non-resident wants to keep deposits in bank accounts in India, he has to consider Deposit Regulations. Under these regulations, only NRIs can keep the deposits in NRE / FCNR accounts. Other non-residents (Non-NRIs) cannot keep deposits in such accounts. Or if an Indian resident wants to borrow from a bank in

USA, he has to consider loan regulations. There are several restrictions on residents wanting to avail of loan from a non-resident. Hence it is necessary to know the residential status at the time of undertaking a transaction. One cannot wait for the year to be completed and then know whether he can do a transaction or not. If that were the situation, then there will be several difficulties.

Example 1

A person comes to India for taking a job on 1st May 2018. Under FEMA he becomes a resident from the day he comes to India. As a resident he can do several transactions. But as a non-resident, there will be restrictions. If such a person had to wait till 31st March 2019 to know whether he is a resident or *vice-versa*, there will be difficulties.

Therefore under FEMA, a person's residence is from a particular date. Under Income-tax the residential status is for a full year. This a fundamental difference between residential status as per Income-tax Act and FEMA.

2.2 The meaning under the ITA is based on number of days stay in India. Purpose and intention have almost no relevance (except as discussed later).

Under FEMA, the purpose and intention of stay in India is relevant. Number of days stay is only one of the factors which can help to determine the status.

Example 2

A foreigner comes to India for tourism. He falls ill and has to stay longer. This results in his stay exceeding 182 days in a year. Such a person will become a resident under the ITA.

The person has not come for undertaking employment or business in India. Nor does it amount to a situation where his stay in India is uncertain. He will go back once he is better. Under FEMA, such a person will be a non-resident.

More details are discussed later.

3. Different categories of residence under ITA

3.1 Under ITA, a person can be a (i) Resident, (ii) Non-Resident or (iii) Resident but not Ordinarily Resident.

As a non-resident, a person can be a (i) Non-Resident Indian (NRI) or (ii) Non-NRI (outright foreigner).

3.2 Under FEMA, a person can be a (i) Resident, (ii) Non-Resident or (iii) Not Permanently Resident.

As a non-resident, a person can be a (i) Non-resident Indian (NRI), (ii) Person of Indian Origin (PIO), or (iii) Non-NRI/PIO (i.e. outright foreigner).

3.3 Different categories of residential status give different rights under FEMA. Under ITA, tax treatment is different for different categories of residential status.

3.4 The meaning of NRI / PIO is discussed in details by another author in another article. It is not discussed here in details.

4. Residence under ITA

4.1 Residence is defined under S. 6(1). It is the number of days which determine the residential status. If any of the two conditions are satisfied, the person will be considered as an Indian resident.

i) A person stays in India for 182 days or more in a year (S.6(1)(a)).

OR

ii) A person stays in India for 60 days or more in a year;

and

Stays for 365 days or more in the preceding four years (S.6(1)(c)). (Cumulative conditions).

This second test (which includes 365 days test) is generally forgotten by many people. It is a common belief amongst many people that if a person stays outside India for more than 181 days (more than half the year), he is a non-resident. This is a misconception.

4.2 The definition is to determine "residence". Therefore the converse of the conditions is the meaning of "non-resident". A client will most of the times come and ask you "what should I do to become a non-resident?" We need to apply the converse test. If any of the following conditions are satisfied, a person will be a non-resident.

i) A person stays in India for less than 60 days.

OR

ii) A per stays in India for less than 365 days in the preceding four years;

and

Stays for less than 182 days in the relevant year (cumulative conditions).

4.3 Employment outside India of Indian citizen

4.3.1 For an Indian citizen who is resident in India and he leaves India for the purpose of employment outside India, relief is provided in *Explanation* 1(a) to S.6(1). The number of days up to which a person can stay in India and still be a non-resident is increased to 181 days. In other words, if the person leaves India for employment in a year, even if he is India for up to 181 days in that year, he will be considered as a non-resident. The condition of 365 days in the preceding four years becomes irrelevant. S.6(1)(c) is equivalent to S.6(1)(a).

Similar relief has also been provided for Indian citizen who leaves India as a member of ship crew. This is discussed in para 7 below.

4.3.2 Some issues with reference to employment

i) It is not necessary that once the person goes for employment, he has to stay continuously outside India in the relevant year. What is relevant is that the person should "leave" for employment. Once having left India for employment, he can come back to India for visit, vacation or work. As long as his stay in the entire year is less than 182 days, he will be a non-resident.

ii) It is not necessary that the day he lands abroad, he should begin employment. He has to "leave" India for employment. Then he can commence his employment after a few days / weeks. However he cannot leave India in "search" of employment and then claim the relief. Even if gets employment later, it will be difficult to say that he "left India for employment". It means that he should have an employment contract ready before he leaves. See point (iv) below for more details.

iii) It is not necessary that if he leaves India for employment that should be his first departure from India. For example, a person could have gone abroad in June and July 2017 for 45 days. He comes back and then leaves India on 30th October 2017 for employment abroad. He continues to stay abroad till 31st March 2018. In this situation his number of days abroad will be 197. He will be a non-resident for FY 2017-18.

iv) One must appreciate that one has to establish that there is a proper employment. Following will help in establishing that the employment is *bona fide*:

– Employment Contract.

– Employment visa (by whatever name called. The visa should permit the person to work.)

– Regular deposit of salary in his bank account.

– Salary certificate.
– Income-tax returns in the country of employment showing salary income.

The above is a guide. It does not mean that all the above should be there. Essentially one has to establish the fact that he had gone for employment.

v) Having left for employment, is it necessary that the employment should continue? The section nowhere provides that employment should continue. However if a person leaves Indian for employment abroad in August 2017 and leaves the employment in Sept 2017, he will be challenged on the *bona fides* of employment.

Consider another illustration where the person leaves India in April 2017 on employment, and leaves his employment in December 2017 and comes back to India. His stay in India is less than 181 days. Such a person will be considered as a non-resident.

Thus one will have to look at the facts which lead to employment, those which lead to termination of employment, etc.

4.3.3 "Year" in which person leaves for employment:

Should a person who wants to claim relief for employment abroad, leave for employment in the relevant year, or he could have left for employment in an earlier year?

For example, a person leaves India for employment in November, 2016. He is in India for more than 182 days in FY 2016-17. For FY 2017-18, he continued to be employed outside India. His stay in India in FY 2017-18 was less than 182 days but was more than 60 days. In this situation, will a person be considered to be a non-resident for FY 2017-18?

This issue arises due to the language in Explanation 1(a) to S. 6(1). The relevant extract is reproduced below:

> *In the case of an individual,—*
>
> *Being a citizen of India, who leaves India in any previous year ..... for the purposes of employment outside India, the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted;*

See the underlined words above. It states that a person who leaves India in any previous year, the relief will apply in relation to that year.

In the case of M. P. Konanhalli 55 ITD 266 (Bangalore ITAT), it was held that the person will be entitled to relief if he left in that relevant year. If he left India in an earlier year for employment, he will not be entitled to the relief. Similarly in case of Manoj Kumar Reddy (Bangalore ITAT 132 TTJ 328), it was held that person should have left India in the year in which relief is claimed.

If one looks at the purpose of *Explanation* 1(a), it is to provide relief for employment abroad. It should not matter whether the person leaves India in that year or the earlier year. However the Tribunal decisions have taken a different view.

4.3.4 Self-employment

If a person goes abroad for his own business / profession, will such a person get any relief for employment? In the case of O. Abdul Razak (337 ITR 350 Kerala High Court 2011) it was held that employment includes "self-employment". Subsequent Tribunal decisions also have taken a similar view. With due respect, I cannot agree with the judgment. The Kerala High Court decision relies in CBDT Circular No. 346 dated 30-6-1982 which states as under:

> *"7.3 With a view to avoiding hardship in the case of Indian citizens, who are employed or engaged in other avocations outside India, the Finance Act has made the following modifications in the tests of residence in India :—"*

Difference between employment and business is well-known. In my view the circular cannot travel beyond the law.

4.4 Visit to India

4.4.1 For an Indian citizen or a Person of Indian Origin (PIO) who is outside India, relief is provided for visit to India (*Explanation* 1(b) to S.6(1)). Under S.6(1)(c), the number of days up to which a person can stay in India and still be a non-resident is increased to 181 days. In other words, if the person visits India in the previous year, even if he is in India for up to 181 days, he will be considered as a non-resident. The condition of 365 days in the preceding four years becomes irrelevant. S.6(1)(c) is equivalent to S.6(1)(a).

This relief is not available to an outright foreigner.

In general parlance the above relief is considered as a relief for NRIs. However there is no mention of "NRI" in *explanation* 1(b). It only states that relief will be available to an Indian citizen and PIO. NRI is defined in Section 115C(e). Please refer to para 4.4.3 below for more discussion.

The meaning of PIO has been given in *explanation* to section 115C(e). A PIO means a person who himself, or either of his parents, or either of his grandparents, was born in undivided India.

Thus foreign citizens up to 3 generations can be considered as NRIs.

There is no reference to spouse of a person. Under FEMA, in some situations, a spouse of a PIO is also considered as a PIO.

4.4.2 Meaning of visit to India

Relief is available to a person who is on a visit to India. "Visit" has not been explained. One has to give a common meaning. Visit means going to a place for a short stay – to go to the place and come back. How "short" has not been stated. There is no condition about the number of visits also. Legally if a person makes even one visit to India in a year, the condition is satisfied.

The decision is the case of Mrs. Smita Anand (42 taxmann.com 366 (AAR - New Delhi) throws some light. In this case, an employee came back to India after her foreign employment was over. She was in search of another job. Her stay in India was less than 182 days but was more than 60 days in the year in which she returned to India. The ITAT held that the person cannot be considered to be on a visit to India. The person's job has ended. She has returned to India. It cannot be termed as a visit. Hence the relief for visit to India was denied to her. This shows that visit means that the person has not come to stay back in India. She has come with the intention of returning, and actually returns to India. She has to establish that she had a plan to go back even before she came to India.

Manoj Kumar Reddy's case (132 TTJ 328 Bangalore Tribunal) also has observed that the use of the phrase "a visit" applies to all visits. Hence even if the person has come for one or more visits to India in a year, but his last visit is such that he comes for settling down in India, then the relief in *explanation* 1(b) will not be available.

However the judgment also provides that for the purpose of counting the days for S. 6(1)(c), the days of visit to India will be excluded! The High Court has also accepted this argument in an appeal filed by the department (12 taxmann.com 326 Kerala High Court).

4.4.3 Being a non-resident prior to coming on a visit to India

The section nowhere states that a person should be a "non-resident" in order to claim relief under *explanation* 1(b) (visit to India). It simply states that a person who is "outside India" can get the relief.

As stated in para 4.4.1 above, the *explanation* 1(b) also does not refer to an NRI. The definition in S. 115C(e) states that an NRI means an individual .... who is a non-resident. If *explanation* 1(b) had referred to an NRI, then one could clearly conclude that a person should be a non-resident and an NRI / PIO. Explanation 1(b) however refers to an Indian citizen and PIO.

Let us see an example. There can be cases where a person has settled abroad. He has set up his business abroad. He never takes up employment abroad. Later he takes up foreign citizenship. His family also moves and stays abroad. He however regularly visits India. His visits to India are such that his stay in India in the preceding 4 years is more than 365 days. His stay in the relevant year is more than 59 days but less than 182 days. He could not have got relief under *explanation* 1(a) (leaving for employment outside India). In such a case, the person legally never becomes a non-resident, although he is now very much "outside India". In such a case, will the person be entitled to relief of a "visit" to India under *explanation* 1(b)? In substance such a person should be entitled to the relief.

Explanation 1(b) was introduced in the year 1989. NRIs represented that they were being invited to invest in India. They have to therefore come to India to look after their investments. The 60-day period was too short. Hence the limit was initially raised to 90 days. Subsequently it was raised to 150 days and now it is 181 days. CBDT Circular No. 554 dated 13-2-1990 and 684 dated 10-6-1994 state that the relief has been provided so that NRIs can maintain their "non-resident" status. Considering the intention given in the circulars, it is clear that relief for a visit to India is available to a person who is a non-resident. Only then he qualifies for relief for visit to India.

4.5 Days of arrival and departure

One issue which comes up is regarding the day of arrival and departure. Should such days be considered as "in India" or "outside India"? In Advance Ruling No. 7 of 1995 (223 IT 462), it has been held that both the days – arrival and departure – will be considered as in India.

There is a contrary view given in an old Tribunal decision of Jaipur Bench (No. 1230 of 1985 dated 22-8-1986 (ITO vs. Dr. R. K. Sharma) which has held that the day of assessee's arrival has to be excluded for the purpose of counting the number of days in India. Normally a day should mean a day of 24 hours and a part of a day should be excluded. This was keeping in line with section 6 of General Clauses Act. There are other decisions also to this effect.

Manoj Kumar Reddy's tribunal judgment states that the day of arrival has to be excluded. Fausta C. Cordeiro Tribunal judgment also provides the same view (24 taxmann.com 193 (Mum ITAT).

For practical purposes and to avoid undue controversy, one may plan on a conservative basis and count both days as "in India".

5. Residence under FEMA

5.1 Residence under FEMA has been defined u/s. 2(v)(i) of FEMA. A person is considered as an Indian resident if he has been in India in the preceding financial year for more than 182 days. This is provided in the main limb.

Then there are two exceptions in clauses (A) and (B). Exception means, even if a person is resident due to the fact that he was in India for more than 182 days in the preceding year, he will be a non-resident if he satisfies conditions in any of the exceptions in clause (A) or clause (B). Clause (A) is for persons leaving India. Clause (B) is for persons coming to India. Let us discuss the two clauses separately.

5.2 Persons leaving India – Clause (A)

If a person leaves India for any of the following purposes, he will not be a resident. He will be a non-resident. The purposes are:

– for taking up employment outside India; or

– for carrying on any business outside India; or

– for any purpose which indicates his intention to stay outside India for an uncertain period.

5.3 Persons coming to India – Clause (B)

5.3.1 Clause (B) provides that if a person comes to India for employment, or carrying on business, or for an uncertain period, he will be an Indian resident. However clause (B) is not happily worded. If one analyses technically, the meaning cannot be in line with the intention. Therefore it is analysed more in details.

Section 2(v)(i) with reference to clause (B) has two exceptions. The section is reproduced below only with reference to clause (B).

"(v) "Person resident in India" means—

(i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include—

(A) …

(B) a person who has come to or stays in India, in either case, otherwise than—

(a) for or on taking up employment in India, or

(b) for carrying on in India a business or vocation in India, or

(c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period."

5.3.2 The main limb states that person resident in India does not include … (1st exception). Hence even if a person has been in India for 182 days or more in the preceding year, he will not be included (i.e., not be considered) as a resident if the person is covered by clause (B). Person covered by clause (B) will not be considered as an Indian resident. He will be a non-resident.

Which person is covered by Clause (B)? "That person who comes and stays in India otherwise than …" (2nd exception). Thus there is an exception to exception. They cancel each other.

Thus there are two categories of person in clause (B). The first category of person covered by clause (B) will normally be excluded from the main limb. He will be a non-resident even if his stay in India in the preceding year is more than 182 days in India.

However the second category of person covered by the 2nd exception is excluded from clause (B). Hence he is included in the main limb. Therefore he is a resident.

To put in other words, a person who is covered by 1st exception only, will not be considered as resident. He will be a non-resident. If a person is covered by both exceptions, the second exception will result in converse position of 1st exception. He will be considered as a resident.

The net result is that if a person comes for any of the following purposes, he will be considered as an Indian resident:

– for taking up employment in India; or

– for carrying on any business in India; or

– for any purpose which indicates his intention to stay in India for an uncertain period.

If the person comes to India for any purpose other than the above, he will be a non-resident (as he will be covered by the 1st exception only).

5.3.3 However there is a lacunae in the language. It is explained below:

The main limb refers to a person residing in India for more than 182 days. Then there are two exceptions in clauses (A) and (B). One can fall within the exceptions only if one is covered by the main limb.

If a person has resided in India for less than 182 days, he is not covered by the main limb. He is not a resident. If he is not covered by the main limb, can he be covered by the exceptions (A) or (B)? One can consider the exceptions only if a person is first of all covered by the main limb. If he is not covered by the main limb, he does not have to even consider the exceptions! What difficulties does this interpretation create? Let us consider an example.

Example 3

A person has been a non-resident of India for 10 years. In Nov. 2017, he comes to India on employment. Will such a person be an Indian resident? If yes, from when?

In FY 2016-17 (preceding financial year for 2017-18) he was in India for less than 182 days. First limb is not satisfied. Hence he will continue to be a non-resident for FY 2017-18.

Will such a person be covered by clause (B) and be considered as an Indian resident? As we have seen, if a person does not get covered within the first limb, he cannot even go to that exception. Hence from Nov. 2017 to 31st March 2018 also the person continues to be a non-resident.

Going forward, in FY 2017-18 (preceding financial year for 2018-19) he was in India for less than 182 days. First limb is not satisfied. As we have seen, if a person does not get covered within the first limb, he cannot even go to that exception. Hence for FY 2018-19, he will continue to be a non-resident.

From 1st April 2019 the person will be a resident as in preceding year 2018-19, he would be in India for more than 182 days.

This would mean that the person continues to be a non-resident from Nov 2017 till 31st March 2019 although he has come to India for employment. This will create difficulties. His dealings with Indian residents can amount to violations.

This cannot be the purpose. Therefore one has to consider a logical interpretation discussed in para 5.3.2 above. (Kindly note this controversy is not there for person who leaves India – covered by clause (B)).

5.3.4 Therefore the condition of residing in India for 182 days in the preceding financial year is almost redundant. As we have seen in the earlier para, the purpose of Income-tax and FEMA law is different. If one has to wait for such a long time (17 months in example 3 above) to be considered as an Indian resident, things will become difficult.

5.3.5 Clause (B) can apply in cases where a person has neither come for employment, nor for business nor for an uncertain period. For example a person comes on a holiday in India and falls sick. His stay exceeds 182 days in the preceding year. Now he has not come for employment, or for business or for a certain period. He will go back once the treatment is over. He is covered by the exception to the first limb (clause (B)).

5.4 At this stage it may not be out of place to mention that several NRIs are of the view that the "intention" determines the residential status under FEMA. People would like to stay in India for 8 to 10 months, but state their "intention" is to go back. Hence they claim a status of NRI. This in my submission is not correct. Mere intention does not determine anything. If a person has come for employment or doing business in India, he is a resident. There is no question of intention. It is only if he comes in India under any other situation, the intention comes into picture. Here also it is the facts which should indicate his intention to go back. If he stays in India for more than six months every year say for two years, then the *prima facie* conclusion will be that a person has become an Indian resident.

6. Different residential status under FEMA and Income-tax

Due to different definitions under Income-tax and FEMA, there could be situations, where a person can be a resident under Income-tax Act, and non-resident under FEMA, or *vice-versa*. Some examples are given below:

Example 4

A person who is an Indian resident, takes up a job in the USA in November 2017. From Nov. 17, he has become a non-resident under FEMA. He will be free from FEMA as far as transactions abroad are concerned. However under Income-tax Act, the person will be a resident. His US Salary from Nov. 17 to March 18, will be liable to tax in India – subject to DTA relief.

Example 5

An NRI has FCNR / NRE fixed deposits. He returns to India for good in Nov. 17. Under

FEMA he becomes a resident from Nov., 2017. However under Income-tax Act, such a person is a non-resident for FY 17-18 (assuming that he was in India for less than 365 days in the preceding four years). Under FEMA, such a person can continue his FCNR/NRE fixed deposits until maturity. Is interest which he earns after returning to India taxable? While he can continue the deposits until maturity, for income tax relief, section 10(4)(ii) states that the person should be a non-resident under FEMA. As the person becomes a resident under FEMA, he will lose the primary benefit of exemption from tax. (Other provisions like S. 10(15)(iv)(fa), and chapter XII-A will have to be looked at independently).

This difference in the residential status as per both laws becomes relevant especially in the year of arrival or departure.

7. Persons employed on a ship

7.1 An interesting issue arises in case of persons who are employed on ships. Ships keep travelling to different ports around the world including India.

Under the Income tax Act (Explanation 1(a) to S. 6(1)), if an Indian citizen leaves India in any year as a member of crew of an Indian ship, then instead of 60 days, even if he is India for up to 181 days, he will be a non-resident. CBDT Circular No. 572 dated 3-8-1990 has further clarified that crew members who are already employed on the Indian ship, will also be considered as a non-resident if he is India for up to 181 days. CBDT Circular No. 586 dated 28-11-1990 has further clarified that Indian ships operating beyond Indian territorial waters, will not be considered as operating in India. Thus a person on an Indian ship which is operating outside the territorial waters of India will be considered as outside India. (Indian territorial waters mean a distance of up to 12 nautical miles from the nearest point of appropriate baseline).

7.2 Finance Act, 2015 has inserted *explanation* 2 to S. 6(1). It states that the period of days in India for an "eligible voyage" in case of foreign bound ship leaving India will be determined as per Rule 126.

Rule 126 states that the period between the date of joining the ship and date of signing off that ship will not be considered as period of stay in India.

These days will be considered as per "Continuous Discharge Certificate" issued under Merchant Shipping (Continuous Discharge Certificate-cum-Seafarer's Identity Document) Rules, 2001 made under Merchant Shipping Act, 1958.

Eligible voyage has been explained to mean voyage undertaken by a ship:

i) Where the voyage originates in India, the destination is a port outside India;

ii) Where the voyage originates outside India, the destination is a port in India.

Thus in some situations, where the person has signed on the ship but the ship sails after a few days, the person will be considered as outside India.

7.3 Under FEMA the situation is different. There is a decision reported in 45 Taxman 94 in the case of Paul H. Rodrigues vs. Director of Enforcement. In the decision it has been held that a ship flying an Indian flag is a floating Indian island. Therefore Mr. Paul was an Indian resident. Thus there could be a situation for Indian crew on ships, where the person is considered as "outside India" under Income-tax Act, and "in India" under FEMA.

Such a person can have foreign income which may be tax free as he will be a non-resident. However as he will be a resident under FEMA, he will have to bring all his income in India; he may not be able to open NRE accounts and in general not enjoy facilities available to NRIs.

8. Persons in Nepal

Several persons go to Nepal and claim the status of a non-resident. Legally there is no legal difficulty. If a person is outside India, he can be a non-resident under Income-tax Act and

FEMA (subject to other criteria being fulfilled as discussed above). However there is a practical difficulty. How does one prove that he has been to Nepal? The border between India and Nepal is porous. Further there is no requirement of any passport or visa for travelling to Nepal. It will be useful to make a reference to the decision of Raj Kumar Dhanuka in 252 ITR 205. Though the decision was mainly on the matter of search and seizure, an observation has been made by the Hon'ble High Court that *"Only because there is an open border between India and Nepal and a passport is not required to … … …, it cannot be presumed that anyone who claims to be an Indian national residing in Nepal, is a non-resident India. Simply because it is difficult to prove in such a case whether a person was residing for a particular period in Nepal or India, it does not mean that the claim of a person who claims to be residing in Nepal that he is a non-resident Indian, has to be accepted by the authorities."*

The observations show that the facts have to be proved that a person was staying in Nepal. Preferably the passport should be carried and stamping done. Further there should be utility bills, house tax receipts, receipts for visiting places in Nepal, etc.

9. Intermediate Residential Status

Normally a person is either a resident or a non-resident. However under Income-tax Act, a person can be a "Resident but Not Ordinary Resident". Under FEMA also, a person can be "Not Permanently Resident". These concepts are discussed below.

9.1 Resident but Not Ordinarily Resident (RNOR) under the ITA:

Under Section 6(6), an individual can be a Resident but Not Ordinarily Resident (RNOR) if he satisfies any of the following conditions:

i) If a person is a non-resident for 9 preceding years concerning the relevant year, he can be a RNOR for 1 year.

ii) If a person is a non-resident for 10 years or more, he can be a RNOR for 2 years.

iii) If within the 7 preceding years, his stay in India is for less than 730 days, he will be a RNOR for the relevant year. Thus practically it is possible to be a RNOR for 3 years.

As a RNOR, foreign income received outside India, is exempt from tax. Once the RNOR status period expires, his foreign income will be taxable in India. Some other benefits like tax exemption on foreign currency deposits will be available till a person is a RNOR.

9.2 Not Permanently Resident under FEMA

For a very limited purpose, there is a concept of "Not Permanently Resident" (NPR). NPR means a person who has come to India for employment of a specified duration (irrespective of the period), or for a specific job or assignment not exceeding 3 years.

Under Regulation 4 of Possession and Retention of Foreign Currency Regulations (FEMA Notification No. 9(R) dated 29-12-2015), a NPR can hold foreign currency notes and travellers cheques in India without any limit if the same was acquired while the person was a non-resident. Normally an Indian resident can hold foreign currency up to US$ 2,000 (subject to conditions).

An NPR can also remit his net salary abroad after payment of taxes, contribution to provident fund, etc.

10. Summary

This article deals with some issues. With tax rates being moderate and Government trying to curb extra reliefs for NRIs, one may have to plan the affairs well in advance so as not to fall into avoidable difficulties.

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SS-IX-15

CA Vijay Gupta

Definition of NRIs / PIOs / OCIs under various FEMA Regulations and Case laws under FEMA and Income Tax

Part A: Under FEMA

1. Overview

1.1 The terms Non-Resident Indian ('NRI') / 'Person of Indian origin' ('PIO') / Overseas Citizen of India ('OCI') are specific to the statute to which it / these are to be applied/ referred to. This write-up discusses these terms as applied/ referred to under various Regulations/ Rules [i.e., notifications as to the Regulations issued by Reserve Bank of India ('RBI') under section 47 of Foreign Exchange Management Act, 1999 ('FEMA'), and notifications as to the Rules issued by the Central Government[1] under section 46 of FEMA]; and for limited purpose under the Income-tax Act, 1961.

1.2 These terms are not defined in FEMA; but have been specifically defined / referred to for its application in the relevant Regulation(s).

2.1 Definitions

2.1.1 Under FEMA, a "person resident outside India"[2] means a person who is not resident in India[3]. A "person resident outside India" is also referred to as 'Non-Resident' from FEMA perspective. Like under FEMA 20(R)[4], NRI means an individual[5] resident outside India who is citizen of India[6].

2.1.2 Under FEMA, a 'Person of Indian Origin' ('PIO') means a person resident outside India who is not a citizen of India, and satisfying other prescribed conditions mentioned in the relevant Regulation for being eligible as a PIO.

2.1.3 Under FEMA, an 'Overseas Citizen of India' ('OCI') means an individual resident outside India who is registered as an Overseas Citizen of India Cardholder under Section 7(A) of the Citizenship Act, 1955.

1 As per the Allocation of Business Rules, the Department of Economic Affairs, Ministry of Finance administers FEMA, 1999
2 Section 2(w) of FEMA
3 Section 2(w) of FEMA
4 Section 2 (xxxv) of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017
5 Section 2 (u) of FEMA: The definition of "Person" includes an individual.
6 Under the Citizenship Act, 1955

2.1.4 PIO is no longer a separate category under certain FEMA Regulations viz., FEMA 20(R)[7] and FEMA 21(R)[8]] and has been subsumed to say so as OCI. However, PIO continues to be specifically defined and referred to in FEMA Regulations viz. FEMA 4[9], FEMA 5(R)[10] ad FEMA 13(R)[11]].

2.2 Decoding of definitions

2.2.1 In all these three terms/categories (NRI, PIO & OCI), the important condition is that the individual is a 'person resident outside India'. Under FEMA, a "person resident outside India" means a person who is not resident in India[12]. A person resident in India is specifically defined under FEMA; which definition becomes of paramount importance as in all the three categories on non-residents, each of the specific one must fall outside the definition of 'person resident in India' to qualify as 'person resident outside India'.

2.2.2 Under FEMA, a "person resident in India"[13+14], in the context of an individual, means: a person residing in India for more than one hundred and eighty two days during the course of the preceding financial year but does not include –

(A) a person who has gone out of India or who stays outside India, in either case -

(a) for or on taking up employment outside India,

or

(b) for carrying on outside India a business or vocation outside India,

or

(c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period,

(B) a person who has come to or stays in India, in either case, otherwise than -

(a) for or on taking up employment in India,

or

(b) for carrying on in India a business or vocation in India,

or

(c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period.

2.2.3 Under FEMA, to be treated as a person resident in India, a person has not only to satisfy the condition of the period of stay (being more than 182 days during the preceding financial year – April to March) but has to also comply with the condition of the purpose/ intention of

7 FEMA (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 effective from 7th November, 2017

8 FEMA (Acquisition and Transfer of Immovable Property in India) Regulations, 2018 effective from 26th March, 2018

9 FEMA (Borrowing and Lending in Rupees) Regulations, 2000 effective from 1st June, 2000

10 FEMA (Deposit) Regulations, 2016 effective from 1st April, 2016

11 FEMA (Remittance of Assets) Regulations, 2016 effective from 1st April, 2016

12 Section 2(w) of FEMA

13 Section 2(v) of FEMA

14 As observed by the Division Bench of Karnataka High Court in RBI vs. Jacqueline Chandani [1996] 86 Company Cases 231 that dictionary meaning of resident is not relevant for ascertaining the status under FERA.

stay[15]. Citizenship is not the criteria under FEMA to determine the status of a 'Person resident outside India'/ 'Non-Resident'.

2.2.4 If one goes out of India or who stays outside India for circumstances/reasons mentioned in 'A' above, he becomes Non-Resident under FEMA immediately. The period of stay in India in current financial year or in the preceding financial year has no bearing on such a status. He would be outside the ambit of FEMA as far as overseas transactions are concerned.

2.2.5 On same principle, if an individual returns to India for circumstances/reasons mentioned in 'B' above, he becomes resident in India but subject to complying with the condition of period of stay being more than 182 days during the preceding financial year. After enactment of FEMA, the feature of duration of the physical stay of the person has become conducive criteria and intention is no longer remain the primary factor for determination of "person resident in India"[16].

2.2.6 Under Income-tax Act, presence/ stay in India is important for determination of residential status. It merely considers number of days of stay in India. Under FEMA, circumstances/reasons mentioned in 'A' / 'B' above are important.

2.2.7 Under Income-tax Act, one is either a resident or a non-resident for the entire previous/financial year relevant to assessment year. One cannot be a resident for a part of the year, and non-resident for rest of the year. Under FEMA, status is determined on the date when one applies the provisions of FEMA. Residential status may be different under FEMA and under Income-tax Act for one or more financial year(s).

2.2.8 Under FEMA the threshold is ***more than 182 days*** during the course of the preceding financial year to determine status for a person residing in India. Whereas, under Income-tax Act, the threshold is ***less than 182 days*** in India for a citizen of India, who leaves India in any previous year for the purposes of employment outside India to be treated as resident in India – subject to satisfying other prescribed criteria. Accordingly, a person staying in India for exactly 182 days will be considered as a Resident under Income-tax Act; but will be considered as Non-Resident under FEMA.

2.2.9 If NRI returns to stay in India for an 'uncertain period' he will become a person resident in India. In order to ascertain intention, what is required to be seen is the conduct of the person and the surrounding circumstances[17]. The type of visa granted should clearly indicate the intention to stay in India for an uncertain period to determine his residential status under FEMA.

2.2.10 Students going abroad for studies are treated as NRIs and are eligible for all the facilities available to NRIs under FEMA[18].

15 Press Release of Government of India, Ministry of Finance dated February 1, 2009 - Government's advice on acquiring land by persons residing outside India – "A foreign national who is residing in India for more than 182 days during the course of the preceding financial year for taking up employment or carrying on business / vocation or for any other purpose indicating his intention to stay for an uncertain period can acquire immovable property in India as he would be a 'person resident in India' as per section 2(v) of FEMA, 1999. To be treated as a person resident in India under FEMA, a person has not only to satisfy the condition of the period of stay (being more than 182 days during the course of preceding financial year) but also his purpose of stay as well as the type of Indian visa granted to him to clearly indicate the intention to stay in India for an uncertain period. In this regard, to be eligible, the intention to stay has to be unambiguously established with supporting documentation including visa".

16 Kishore D. Shroff vs. Director, Enforcement Directorate - [2006] 70 SCL 290 (ATFFE - NEW DELHI)

17 Basant Kumar Sharma vs. Government of India dated February 7, 2013

18 A.P. (DIR Series) Circular No. 45 dated December 8, 2003

2.3 Case Laws

2.3.1 *Uncertain period*

Major R. P. Verma vs. Union of India [1998] 17 SCL 35 (DELHI)

The question whether a person has gone abroad to stay for an uncertain period would necessarily depend upon the facts and circumstances of each case. However, the broad proposition that if a person goes abroad but at that time he does not know for how long he is going to stay abroad, that would indicate his intention to stay outside India for an uncertain period, would not be acceptable. This fact by itself would not show intention to go outside India for an uncertain period. To illustrate, one may go abroad either on the business trip or as a tourist but for one or another reason he is uncertain about the period of stay abroad and consequently uncertain about the date of his return, but that by itself would not mean that such a person is a 'person resident outside India'. Likewise, a citizen of India may go abroad to look after his ailing friend or relation with the intention to return to India only after recovery of such ailing person and in fact returns, to India after three months when that person recovers, these persons are not entitled to the status of NRI. The period for which the visa may be issued by the country to be visited is also not relevant. A person may be granted visa for a period of 5 years and when he leaves he may be uncertain about the period of stay abroad but from that itself it is not possible to reach the conclusion that such a person is a 'person resident outside India.

Facts: The appellant is a citizen of India. His mother was a permanent resident of U.K. She had acquired some assets including, shares in British companies. She died in U.K. on 13-5-1995. The appellant had gone to London to look-after his mother when she was ailing. The brother of the appellant has also died and the appellant is the sole inheritor of the assets left behind by his mother. The appellant had stayed in U.K. for about seven and half months before returning to India. For some period the appellant was granted extension of time to hold assets abroad. The appellant has, however, not been granted permission by the RBI to permanently continue to maintain and hold the assets left behind by his mother in England and is required to sell the said assets and repatriate the sale proceeds to India through banking channel. According to respondents, to acquire the status of NRI one year continuous stay abroad is necessary. The appellant beside seeking declaration to be treated as NRI for the limited purpose of holding the assets acquired by him by way of inheritance in UK, has in the alternative, sought the waiver of the condition of one year stay abroad. The appellant has also challenged notification dated 17-7-1992 issued by respondents under section 14 of the Foreign Exchange Regulation Act, 1973 to the extent it imposes the condition of continuous stay abroad for a period of one year, to acquire the status of NRI.

2.3.2 *Intention to stay*

Reserve Bank of India vs. Jacqueline Chandani – [1996] 86 COMP CASE 231 (Karnataka)

If in a given case, a person who is not a citizen of India has come to stay with his or her spouse only for a day or two, it cannot be said that he or she is a person resident in India.

If the intention of the person to stay in India is for an uncertain period, though by the visa that is issued in his favour his stay is permitted only for a certain period, yet it would be a case which falls within the purview of the person who has come with the intention to stay in India for an uncertain period.

Facts: The petitioner was a U.S. citizen and her husband was an Indian citizen staying in India and the visa for the petitioner was being extended from time-to-time right from 1967. Prior to her marriage, all her savings from her earnings had been deposited from time-to-time in the bank account maintained in U.S.A., and she continued to operate the same even after her marriage. She continued to have her U.S.A. citizenship even after her marriage and she registered herself as a foreigner in India under the Foreigner's Act and her visa was being extended from time-to-time. The total period of stay of the petitioner in India during 1967 to 1982 was about thirteen years, whereas her stay outside India was about 17½ months.

2.3.3 The term 'stay' – a short or casual stay

K. Ramullan vs. Commissioner of Income-tax - [2000] 112 Taxman 57 (SC)

The term 'stay' does not denote a short or casual stay; it has to be a stay for taking up employment or carrying on business or a vocation or with the intention of remaining in India for an uncertain period. A mere casual stay or stay for a short period, it would defeat the purpose of having Non-Resident (External) Account. This being the position, the appellant cannot be treated as a person resident in India during the relevant period. Consequently, he will be a person resident outside India within the meaning of section 2(q).

Facts: The assessee, though of Indian origin, had settled down in Malaysia in 1941 and acquired Malaysian citizenship. His wife and children resided in India and he owned some agricultural land, house property and investments in banks in India. For the assessment years 1983-84 and 1984-85, he claimed that the interest accrued on credit balance in his non-resident (external) account could not be included in computing his total income in view of the provisions of section 10(4A). During the period 13-6-1982 to 14-4-1985, he had stayed with his wife in India for undergoing medical treatment.

2.4 Overseas citizen of India cardholder

2.4.1 "Overseas citizen of India cardholder"[19] means a person registered as an Overseas Citizen of India Cardholder by the Central Government under section 7A of the Citizenship Act, 1955.

2.4.2 Section 7A provides for registration of Overseas Citizen of India Cardholder[20] by:

(a) any person of full age and capacity, -

  (i) who is a citizen of another country, but was a citizen of India at the time of, or at any time after the commencement of the Constitution i.e. 26-1-1950; or

  (ii) who is a citizen of another country, but was eligible to become a citizen of India at the time of the commencement of the Constitution Citizenship Act, 1955; or

  (iii) who is a citizen of another country, but belonged to a territory that became part of India after the 15th day of August, 1947; or

  (iv) who is a child or a grandchild or a great grandchild of such a citizen; or

(b) a person, who is a minor child of a person mentioned in clause (a); or

(c) a person, who is a minor child, and whose both parents are citizens of India or one of the parents is a citizen of India; or

(d) spouse of foreign origin of a citizen of India or spouse of foreign origin of an Overseas Citizen of India Cardholder registered under section 7A and whose marriage has been registered and subsisted for a continuous period of not less than two years immediately preceding the presentation of the application under this section. For the eligibility for registration as an Overseas Citizen of India Cardholder, such spouse shall be subjected to prior security clearance by a competent authority in India.

2.4.3 No person, who or either of whose parents or grandparents or great grandparents is or had

19 Section 2(ee) of the Citizenship Act, 1955

20 Section 7A of the Citizenship Act, 1955. Became operational from 2-12-2005

been a citizen of Pakistan, Bangladesh or such other country as the Central Government may, by notification in the Official Gazette, specify, shall be eligible for registration as an Overseas Citizen of India Cardholder under this sub-section.

2.4.4 The existing Persons of Indian Origin (PIO) Cardholders[21] are deemed to be Overseas Citizens of India (OCI) Cardholders. *Vide* Government of India's Gazette Notification No.25024/9/2014-F.I dated 9-1-2015; the PIO Scheme has been withdrawn. It is intimated that *vide* Gazette Notification No.26011/01/2014-IC.I dated 9-1-2015, all PIO Cards issued till 9-1-2015 are deemed to be OCI Card. Consequently, no PIO Card will be issued w.e.f. 9-1-2015.

2.4.5 OCI cannot be equated to Dual Citizenship[22].

2.4.6 Notwithstanding anything contained in any other law for the time being in force, OCI Cardholder shall be entitled to the rights as the Central Government has by notification specified[23]:

(a) grant of multiple entry lifelong visa for visiting India for any purpose;

(b) exemption from registration with Foreign Regional Registration Officer or Foreign Registration Officer for any length of stay in India;

(c) parity with NRIs in respect of all facilities available to them in economic, financial and educational fields except in matters relating to the acquisition of agricultural or plantation properties;

(d) shall be treated at par with NRIs in the matter of inter-country adoption of Indian children;

(e) shall be treated at par with resident Indian nationals in the matter of tariffs in air fares in domestic sectors in India;

(f) shall be charged the same entry fee as domestic Indian visitors to visit national parks and wildlife sanctuaries in India;

(g) parity with NRI in respect of –

  (i) entry fees to be charged for visiting the national monuments, historical sites, and museums in India;

  (ii) Pursuing the following professions in India, in pursuance of the provisions contained in the relevant Acts, namely:- i) doctors, dentists, nurses and pharmacists; ii) advocates; iii) architects; iv) chartered accountants; and

(h) to appear for the All India Pre-Medical test for such other tests to make them eligible for admission in pursuance of the provisions contained in the relevant Acts.

2.4.7 OCI Cardholder shall not be entitled to the rights conferred on a citizen of India[24] -

(a) under article 16 of the Constitution with regard to equality of opportunity in matters of public employment;

(b) under article 58 of the Constitution for election as President;

(c) under article 66 of the Constitution for election as Vice-President;

(d) under article 124 of the Constitution for appointment as a Judge of the Supreme Court;

(e) under article 217 of the Constitution for appointment as a Judge of the High Court;

21 "Persons of Indian Origin Cardholders" means the persons registered as such under notification number 26011/4/98 F.I., dated the 19 August, 2002, issued by the Central Government in this regard.

22 G. Venkatesh vs. Bridge Federation of India [2015 SCC OnLine Mad 10335 / (2015) 4 LW 170 / (2015) 4 CTC 472]

23 Section 7B(1) of the Citizenship Act, 1955

24 Section 7B(2) of the Citizenship Act, 1955

(f) under section 16 of the Representation of the People Act, 1950 in regard to registration as a voter;

(g) under sections 3 and 4 of the Representation of the People Act, 1951 with regard to the eligibility for being a member of the House of the People or of the Council of States, as the case may be;

(h) under sections 5, 5A and section 6 of the Representation of the People Act, 1951 with regard to the eligibility for being a member of the Legislative Assembly or the Legislative Council, as the case may be, of a State; and

(i) for appointment to public services and posts in connection with affairs of the Union or of any State except for appointment in such services and posts as the Central Government may, by special order in that behalf, specify.

2.4.8 As per Hon'ble Supreme Court[25], section 7A of the Citizenship Act, 1955 created as it were a new species called the OCI which appear to be a sub-species of PIOs although Section 7A itself does not use the word PIO. It calls for a greater generational proximity of the OCI with the country of origin than the PIO status does. While the statutory provision governing an OCI can be traced to Article 11 of the Constitution, there is no corresponding statutory status accorded to the PIO. While the above broad features distinguish an OCI from a PIO, the rights that go with either status are dependent on the policy of the Government of India. Thus the gaining of the status of an OCI or a PIO does not guarantee parity of treatment with Indian passport holders. The classification of PIOs and the sub-classification of OCIs is based on intelligible differentia justifying a different treatment *vis-a-vis* Indian passport holders. The very wording of Section 7B of the Act indicates that what is meant to be granted to OCIs is a limited right. Secondly, it is a statutory right and not a fundamental or Constitutional right.

3. Reference of NRI, PIO & OCI under specified FEMA Regulations

3.1 NRI, PIO & OCI have been referred to in the following FEMA Regulations:

Regulation	**NRI**	**PIO**	**OCI**
	Whether referred to?		
FEM (Deposit) Regulations, 2016 - **FEMA 5(R)**:			
- Regulation 2(vi)	Y	–	–
- Regulation 2(x)	–	Y	–
- Explanation to Regulation 2(x)	–	–	Y
FEM (Borrowing and Lending in Rupees) Regulations, 2000 - **FEMA 4** - Regulation 2(b)	Y	Y	–
- Same meaning as defined under FEMA 5(R)			
FEM (Remittance of Assets) Regulations, 2016 - **FEMA 13(R):**			
- Regulation 2 (iii)	Y	–	–
- Regulation 2 (iv)	–	Y	–
- Same meanings as defined under FEMA 5(R)			

25 Karm Kumar vs. Union of India and Ors. [(2010) SCC OnLine Del 2579/ (2010) 172 DLT 521]

Regulation	NRI	PIO	OCI
FEM (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017* **effective from 7-11-2017 - FEMA 20(R)**:			
- Regulation 2 (xxxv)	Y	–	–
- Regulation 2 (xxxvi)	–	–	Y
* Under Schedule 4 of FEMA 20(R) under Regulation 5(4) – relating to Purchase / sale of capital instruments or convertible notes or units or contribution to the capital of an LLP on non-repatriation basis, a Non-Resident Indian (NRI) or an Overseas Citizen of India (OCI), includes a company, a trust and a partnership firm incorporated outside India and owned and controlled by NRIs or OCIs.			
FEM (Investment in Firm or Proprietary Concern in India) Regulations, 2000 **– FEMA 24 - before it was superseded by FEMA 20(R) on 7-11-2017:**			
- Regulation 2(iv)	Y	–	–
- Regulation 2 (vi)[26]	–	Y	–
FEM (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 - **FEMA 20 before 7-11-2017** but w.e.f. 15-2-2016:			
- Regulation 2(viia)	Y	-	Y
FEM (Acquisition and Transfer of Immovable Property in India) Regulations, 2018 **effective from 26-3-2018 - FEMA 21(R)**:			
- Regulation 2(c)	Y	–	–
- Regulation 2(d)	–	–	Y
FEM (Acquisition and Transfer of Immovable Property in India) Regulations, 2000 - **FEMA 21 - before 26-3-2018:**			
- Regulation 2(c)[27]	–	Y	–
FEM (Permissible Capital Account Transactions) Regulations, 2000 – **FEMA 1 –** Regulation 4: Explanation (ii)	Y	-	-

26 'Person of Indian Origin' means a citizen of any country other than Bangladesh or Pakistan or Sri Lanka, if (a) he at any time held Indian passport; or (b) he or either of his parents or any of his grandparents was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955); or (c) the person is a spouse of an Indian citizen or a person referred to in sub-clause (a) or (b). This definition was valid before 7-11-2017 when FEMA 24 was superseded by FEMA 20(R) with effect from 7-11-2017.

27 'A person of Indian origin' means an individual (not being a citizen of Pakistan or Bangladesh or Sri Lanka or Afghanistan or China or Iran or Nepal or Bhutan), who (i) at any time, held Indian passport or (ii) who or either of whose father or mother or whose grandfather or grandmother was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955). This definition was valid before 26-3-2018 when FEMA 21 was superseded by FEMA 21(R) with effect from 26-3-2018.

3.2 Categorisation of a 'Person resident outside India'/ 'Non-Resident' from FEMA perspective as an NRI, PIO & OCI is necessary as different treatments/ exemptions/ restrictions/ investment facilities including in share & securities/ acquisition of immovable properties in India/ borrowings/ lending/ deposit of money with a bank, company, proprietary concern, partnership firm, corporate body, trust or any other person/ loans/ remittance of assets etc., are mentioned in the definitions applicable for the subsisting FEMA Regulations - viz. (i) FEM (Borrowing and Lending in Rupees) Regulations, 2000 - FEMA 4; (ii) FEM (Deposit) Regulations, 2016 - FEMA 5(R); (iii) FEM (Remittance of Assets) Regulations, 2016 - FEMA 13(R); (iv) FEM (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 - FEMA 20(R); and (v) FEM (Acquisition and Transfer of Immovable Property in India) Regulations, 2018 - FEMA 21(R).

3.3 Under FEMA 5(R) [same meanings assigned under FEMA 4 and FEMA 13(R)], 'Non-Resident Indian' ('NRI')[28] means a person resident outside India who is a citizen of India. 'Person of Indian Origin' ('PIO')[29] means a person resident outside India who is a citizen of any country other than Bangladesh or Pakistan or such other country as may be specified by the Central Government, satisfying the following conditions:

(a) Who was a citizen by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955); or

(b) Who belonged to a territory that became part of India after the 15th day of August, 1947; or

(c) Who is a child or a grandchild or a great grandchild of a citizen of India or of a person referred to in clause (a) or (b); or

(d) Who is a spouse of foreign origin of a citizen of India or spouse of foreign origin of a person referred to in clause (a) or (b) or (c).

Explanation: For the purpose of this sub-regulation, the expression 'Person of Indian Origin' includes an 'Overseas Citizen of India' cardholder within the meaning of section 7(A) of the Citizenship Act, 1955 of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955).

3.4 Under FEMA 20(R), and FEMA 21(R), 'Non-Resident Indian' ('NRI')[30, 31] means an individual resident outside India who is citizen of India. 'Overseas Citizen of India' ('OCI')[32, 33], means an individual resident outside India who is registered as an Overseas Citizen of India Cardholder under Section 7(A) of the Citizenship Act, 1955. The existing Persons of Indian Origin (PIO) Cardholders[34] are deemed to be Overseas Citizens of India (OCI) Cardholders till its expiry.

3.5 Under all the above referred five FEMA Regulations [viz., FEMA 4, FEMA 5(R), FEMA 13(R), FEMA 20(R), and FEMA 21(R)], the definition of NRI is similarly defined. The definition of PIO has been aligned to the

28 Regulation 2(vi) of FEMA 5(R)

29 Regulation 2(x) of FEMA 5(R)

30 Regulation 2 (xxxv) of FEMA 20(R). Under Schedule 4 of FEMA 20(R) under Regulation 5(4) – relating to Purchase/ sale of capital instruments or convertible notes or units or contribution to the capital of an LLP on non-repatriation basis, a Non-Resident Indian (NRI) or an Overseas Citizen of India (OCI), includes a company, a trust and a partnership firm incorporated outside India and owned and controlled by NRIs or OCIs.

31 Regulation 2(c) of FEMA 21(R)

32 Regulation 2 (xxxvi) of FEMA 20(R)

33 Regulation 2(d) of FEMA 21(R)

34 "Persons of Indian Origin Cardholders" means the persons registered as such under notification number 26011/4/98 F.I., dated the 19th August, 2002, issued by the Central Government in this regard.

definition similar to an OCI under the Citizenship Act, 1955. The citizens of Pakistan and Bangladesh are not eligible to get OCI registration. Earlier, before FEMA 21 was superseded by FEMA 21(R) effective from 26-3-2018, the citizens of Sri Lanka or Afghanistan or China or Iran or Nepal or Bhutan were not eligible category as PIO. Similarly, before FEMA 24 was superseded by FEMA 20(R) effective from 7-11-2017, the citizens of Sri Lanka were not eligible category as PIO. The subsisting FEMA 21(R), has provided for specified restrictions etc., for persons from Pakistan or Bangladesh or Sri Lanka or Afghanistan or China or Iran or Hong Kong or Macau or Nepal or Bhutan or Democratic People's Republic of Korea (DPRK) in relation to acquisition of Immovable Property for carrying on a permitted activity; acquisition by a Long-Term Visa holder; and prohibition on acquisition or transfer of immovable property in India by citizens of certain countries etc.

3.6 Under FEMA 20(R), and FEMA 21(R) Regulations, to avail exemptions / restrictions / investment facilities including in share & securities/ acquisition of immovable properties in India etc., the individual must have OCI Card; otherwise he/she will not be eligible for categorisation as OCI under these Regulations.

3.7 Under FEMA 5(R), FEMA 4 and FEMA 13(R) Regulations, to avail exemptions / borrowings / lending / deposit of money with a bank, company, proprietary concern, partnership firm, corporate body, trust or any other person / loans / remittance of assets etc., the individual need not have OCI Card; as otherwise he/she will be eligible for categorisation as PIO under these Regulations. Of course, 'Person of Indian Origin' under these Regulations includes an 'Overseas Citizen of India' cardholder.

Part B : Under Income-tax Act, 1961

1. Definition of NRI/PIO

1.1 Under the Income-tax Act, 1961 ('IT Act'), the term 'Non-Resident Indian' ('NRI') has been defined under Chapter XII-A (special provisions relating to certain incomes of non-residents), u/s 115C(e), as - "'Non-Resident Indian' means an individual, being a citizen of India or a person of Indian origin who is not a 'resident'"[35].

Explanation – A person shall be deemed to be of Indian origin ('PIO') if he, or either of his parents or any of his grand-parents, was born in undivided India.

1.2 Under IT Act, three generations up to grand-parents are considered to determine status as PIO. Whereas, under FEMA, both for determining status of PIO & OCI, four generations up to great grand-parents are considered.

1.3 Wherever in the IT Act, any reference to NRI/PIO has been made, the definitions u/s. 115C(e) have been referred to e.g., in section 196A (Income in respect of units of non-residents); in Section 204 (Meaning of "person responsible for paying" under Chapter XVII – collection & recovery of tax).

2. Residential Status

2.1 Under section 6 (Residence in India) also, in the Explanation 1 – in the case of an individual, being a person of Indian origin, reference has been made to the meaning as per Explanation to section 115C(e).

2.2 Matrix for determining residential status of an individual under IT Act (which is different from the criteria mentioned in FEMA):

35 Resident as defined u/s. Sec 2(42) of the Income-tax Act, 1961

<table>
<tr><th colspan="2">Residential Status of an Individual[36] under Income-tax Act, 1961</th></tr>
<tr><th>"RESIDENT IN INDIA"</th><th>"NON-RESIDENT IN INDIA"</th></tr>
<tr><td colspan="2">Basic conditions</td></tr>
<tr><td>An individual is said to be resident in India[37] in any previous year, if he satisfies any one of A or B:</td><td>An individual is said to be non-resident[38] in India in any previous year, if he satisfies both of A and B:</td></tr>
<tr><td>A. Is in India in that year for a period or periods amounting in all to 182 days or more[39],</td><td>A. Is in India in that year for a period or periods amounting in all to less than 182 days,</td></tr>
<tr><td>or</td><td>and</td></tr>
<tr><td>B. Having within the four years preceding that year been in India for a period or periods amounting in all to 365 days or more, is in India for a period or periods amounting in all to 60 days** or more in that year[40].</td><td>B. Having within the four years preceding that year been in India for a period or periods amounting in all to less than 365 days, is in India for a period or periods amounting in all to less than 60 days*** in that year.</td></tr>
<tr><td colspan="2">** Words "60 days" to read as "182 days"[41] - being a citizen of India, who leaves India in any previous year for the purposes of employment outside India, or as a member of the crew of an Indian ship as defined in clause (18) of section 3 of the Merchant Shipping Act, 19584[42].</td></tr>
<tr><td colspan="2">This relaxation is available only for a citizen of India and not for a person of Indian origin.</td></tr>
<tr><td colspan="2">*** Words "60 days" to read as "182 days" - being a citizen of India, or a person of Indian origin[43] within the meaning of Explanation to clause (e) of section 115C, who, being outside India, comes on a visit to India in any previous year[44].

This relaxation is available both for a citizen of India and also for a person of Indian origin.</td></tr>
</table>

36 Sec 2(30) - "Person" includes (i) an individual

37 Sec 2(42)

38 Sec 2(30)

39 Sec 6(1)(a)

40 Sec 6(1)(c)

41 Memo explaining the provisions of Finance Bill 1994: The NRIs who have made investments in India, find it necessary to visit India frequently and stay here for the proper supervision and control of their investments. The Bill, therefore, seeks to amend clause (b) of the Explanation to section 6(1)(c) of the Income-tax Act, in order to extend the period of stay in India in the case of the aforesaid individuals from one hundred and fifty days to one hundred and eighty two days, for being treated as resident in India, in the previous year in which they visit India. Thus, such non-resident Indians would not lose their 'non-resident' status if their stay in India, during their visits, is up to one hundred and eighty one days in a previous year.

42 Explanation (a) to Sec 6(1)(c)

43 A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India.

44 Explanation (b) to Sec 6(1)(c)

If RESIDENT IN INDIA, then find out whether:
Additional conditions (not relevant for Non-Resident)
"RESIDENT AND NOT ORDINARILY RESIDENT" IN INDIA[45] ('RNOR')
Non-resident in India in 9 out of the 10 previous years preceding that year,   **or**   has during the 7 previous years preceding that year been in India for a period of, or periods amounting in all to, 729 days or less.
Alternatively
"RESIDENT AND ORDINARILY RESIDENT" IN INDIA[46] ('ROR')
Resident in India in at least 2 out of the 10 previous years preceding that year,   **and**   has during the 7 previous years preceding that year been in India for a period of, or periods amounting in all to, 730 days or more.
An individual becomes ROR if he satisfies at least one basic condition and both the additional conditions.

3. Specific provisions where FEMA referred

3.1 Section 10(4)(ii) of the IT Act provides that 'in the case of an individual, any income by way of interest on moneys standing to his credit in a Non-Resident (External) Account ('NRE account') in any bank in India in accordance with the Foreign Exchange Management Act, 1999[47], and the rules made thereunder' shall be exempt from income-tax in India. As per Regulation 2(vii) of Foreign Exchange Management (Deposit) Regulations, 2016 - 'NRE account' means a Non-Resident External account referred to in clause (i) of sub-regulation (1) of Regulation 5(1)(i) which provides that an authorised dealer in India may accept deposit under the Non-Resident (External) Account Scheme (NRE account), specified in Schedule 1, from a non-resident Indian. Non-resident Indians (NRIs) and Person of Indian Origin (PIOs) are eligible/permitted to open and maintain NRE accounts[48] with authorised dealers and with banks (including co-operative banks) authorised by the Reserve Bank to maintain such accounts.

3.2 Section 10(15)(iv)(fa) of the IT Act provides that interest payable by a scheduled bank to a non-resident or to a person who is not ordinarily resident within the meaning of section 6(6) on

45 Sec 6(6)(a)

46 Sec 6(1)

47 Rachpal Singh vs. ITO, ITAT Amritsar (SMC) – [2005] 94 ITD 79 – For the purpose of examining whether the person is entitled to exemption u/s 10(4), one has to see the status under FERA (now FEMA) and not under the Income-tax Act.

48 NRE accounts should be redesignated as resident accounts or the funds held in these accounts may be transferred to the RFC accounts (if the account holder is eligible for maintaining RFC account) at the option of the account holder immediately upon the return of the account holder to India for taking up employment or for carrying on business or vocation or for any other purpose indicating intention to stay in India for an uncertain period. Where the account holder is only on a short visit to India, the account may continue to be treated as NRE account even during his stay in India.

deposits in foreign currency [FCNR(B)[49] and RFC account[50]] where the acceptance of such deposits by the bank is approved by the Reserve Bank of India shall be exempt from income-tax. As per Regulation 2(v) of Foreign Exchange Management (Deposit) Regulations, 2016 - 'FCNR(B) account' means a Foreign Currency Non-Resident (Bank) account referred to in clause (ii) of sub-regulation (1) of Regulation 5 - specified in Schedule 2. NRIs and PIOs are eligible to open and maintain these accounts with an authorised dealer.

4. Case Laws

4.1 Involuntary stay in India

CIT vs. Suresh Nanda - [2015] 57 taxmann.com 448 (Delhi)

Involuntary stay in India caused by unauthorised impounding of passport must be excluded for determining his residential status u/s. 6. Each case will have to examined on its own merits in the light of facts & circumstances leading to 'involuntary' stay, if any, in India.

Facts: Assessee ad come to India on 28-9-2006. During the visit to India beginning 28-9-2006 that his passport was impounded by CBI. Further, the passport was released pursuant to Court orders, only on 21-9-2011. Thus, the assessee was in India continuously and uninterruptedly from 28-9-2006 to 21-9-2011. This would mean that he was on Indian soil for 185 days during the financial year 2006-07 (corresponding to assessment year 2007-08) and throughout during financial year 2007-08 (corresponding to assessment year 2008-09). By above account, a strict interpretation and enforcement of the rule contained in section 6(1)(a) would render the assessee a resident. The plea raised, however, is that this would not be just or fair nor in consonance with the intention of the legislature.

The Court observed that the Income-tax Act leaves the choice to the citizen to be in India and be treated as a resident for purposes of taxation or be not in India so as to avail the status of a non-resident. The simple test the muster of which is to be passed is the minimum prescribed period of presence in India in a particular financial year. It naturally follows that the option to be in India, or the period for which an Indian citizen desired to be here is a matter of this discretion. Conversely put, presence in India against the will or without the consent of the citizen, should not ordinarily be counted adverse to his chosen course or interest, particularly if it is brought about under compulsion or, to put it simply, involuntarily.

4.2 Going abroad for the purpose of employment

[2011] 198 Taxman 1 (Ker.) - O. Abdul Razak

The court held that in our view, going abroad for the purpose of employment only means that the visit and stay abroad should not be for other purposes such as a tourist, or for medical treatment or for studies or the like. Going abroad for the purpose of employment therefore means

49 When an account holder becomes a person resident in India, deposits may be allowed to continue till maturity at the contracted rate of interest, if so desired by him. However, except the provisions relating to rate of interest and reserve requirements as applicable to FCNR(B) deposits, for all other purposes such deposits shall be treated as resident deposits from the date of return of the account holder to India. Authorised dealers should convert the FCNR(B) deposits on maturity into resident rupee deposit accounts or RFC account (if the depositor is eligible to open RFC account), at the option of the account holder and interest on the new deposit (rupee account or RFC account) shall be payable at the relevant rates applicable for such deposits.

50 Regulation 4(B) of FEM (Foreign Currency Accounts by a person resident in India) Regulations, 2015 – FEMA 10(R): A person resident in India is permitted to open a RFC account with an AD bank in India out of foreign exchange received or acquired by him by converting assets which were acquired by him when he was a non-resident.

going abroad to take up employment or any a vocation as referred to in the Circular No. 346, dated 30-6-1982, which takes in self employment like business or profession taken up by the assessee abroad.

4.3 'Visit to India'

Return to India after resigning job abroad is not 'visit to India' under *Explanation* (b) to sec. 6(1)(c). If a person returns to India after a long period of absence there is all the more reason he or she will like to go to visit relatives and friends in different places. Those activities are not necessarily indicators of a visit. When the applicant resigns from her employment in China, the reason for return to India does not seem to be only for a visit. In such circumstances it cannot be held that the applicant came to India only for a visit. – [2014] 362 ITR 38 (AAR New Delhi) - *Mrs. Smita Anand, China.*

4.4 'Visit to India' / 'Visitor'/ Work permit visa

[2003] 131 Taxman 477 (CAL.) - Vijay Mallya vs. ACIT

The court observed that relevant part of notice dated 30-11-1995 u/s. 142(1) read as: the 'visitor' as understood in a common parlance is a person who goes or comes to see (person or place) as act of friendship or on ceremony of for curiosity. Having accepted this definition of visitor it is very difficult to treat you as visitor to India and to apply *Explanation (b)* to section 6(1)(c) in your case. You came to India for the purpose of your business for looking after your companies to attend meeting of Board of Directors to pursue or hobby of horse racing and breeding and other serious and profit motivated occupations. In view of this, you cannot be treated as a visitor.... Your indirect contention of having work permit visa and having an appointment offer in financial year 1989-90 is not going to alter the situation. Primarily because the job undertaken is an arrangement in the nature of disguise and is to hoodwink the provisions of Income-tax Act.

Part C : Conclusion

In conclusion, it is hoped that this write-up will provide an insight on terms NRI / PIO / OCI as defined under FEMA for different treatments/ exemptions / restrictions / investment facilities including in share & securities/ acquisition of immovable properties in India / borrowings / lending / deposit of money with a bank, company, proprietary concern, partnership firm, corporate body, trust or any other person / loans / remittance of assets etc. mentioned in the definitions applicable for the FEMA Regulations.

With liberalisation of Foreign Exchange regulations (substantially amended / substituted / relaxed / simplified) specified investment opportunities / structuring options are now available to foreign investors defined as NRI / OCI.

❍❑❍

It is culture that withstands shocks, not a simple mass of knowledge. You can put a mass of knowledge into the world, but that will not do it much good. There must come culture into the blood.

— *Swami Vivekananda*

Sanjay Sanghvi, *Advocate*[1]

Acquisition of Immovable Property in India by Non-Resident Indians and foreign nationals resident in India

A. Introduction

Immovable Property forms one of the prevalent modes of investment, as it creates an asset base for an individual and alludes to a sense of security for the investor. In India, acquisition of immovable property is regulated primarily with the objective of retaining ownership with Indian citizens and to avoid dilution of ownership of property to persons resident outside India. This article provides a comprehensive analysis of the restrictions on purchase of immovable property located in India **("Immovable Property")**, transfer of Immovable Property and repatriation of the proceeds from the sale of Immovable Property by a non-resident Indian **("NRI")** and foreign national resident in India **("FNRI")**, and the income tax implications arising on such transfer.

B. Legal and regulatory aspects under Foreign Exchange Management Act, 1999 ("FEMA")

Section 6(5) of the FEMA provides that a person resident outside India can hold, own, transfer, or invest in any immovable property situated in India if such property was acquired/ held/owned by such person at a time when such person was resident in India or if such person inherits such property from any person resident in India. Further, FEMA empowers the Reserve Bank of India **("RBI")** to frame regulations to prohibit, restrict, or regulate the acquisition or transfer of Immovable Property. In this respect the RBI had first promulgated the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000[2] **("Old Regulations")**. This has recently been replaced by the FEMA (Acquisition and Purchase of Immovable Property Regulations, 2018[3] **("FEMA Regulations")**.Thus, the law regulating the acquisition and transfer of immovable property is presently laid down under FEMA and the FEMA Regulations. We have discussed below the statutory restrictions

1 The author would like to acknowledge the valuable assistance provided by Mr Ankit Namdeo, Senior Associate, Direct Tax Practice, Khaitan & Co.

2 Notification No. FEMA 21/ 2000-RB, dated 3rd May, 2000.

3 Notification No. FEMA 21(R)/2018-RB, dated 26th March, 2018.

on acquisition and transfer of immovable property by an NRI or FNRI.

Types of Immovable Property that can be acquired or purchased

Regulation 3 of the FEMA Regulations provides that an NRI or a person resident outside India registered as an overseas citizen of India cardholder under section 7(A) of the Citizen Act, 1955 **("OCI")** can acquire immovable property in India. However, the nature of immovable property being acquired by way of purchase or gift can be any immovable property which is not: (a) agricultural land; or (b) plantation property; or (c) farm house **("Restricted Properties")**. This restriction as to the nature of the immovable property does not apply in the event that an NRI or OCI acquires an immovable property by way of inheritance from a person resident in India.

Modes of Acquisition by NRIs and OCIs

Under the Old Regulations, separate sets of conditions governed acquisition and transfer of Immovable Property by NRIs and persons of Indian origin[4] **("PIO")**, often leading to inconsistent treatment of NRIs and PIOs. The FEMA Regulations have simplified this by specifying a single set of conditions applicable to both NRIs and OCIs. An NRI or OCI can acquire Immovable Property in any of the following modes:

(a) By way of purchase of any immovable property other than restricted properties;

(b) By way of gift of any immovable property other than restricted properties from a person 'Resident in India' or from an NRI or OCI who qualifies as a 'relative' under section 2(77) of the Companies Act, 2013;

(c) By way of inheritance of any immovable property from any person 'resident outside India' who had acquired it under foreign exchange laws in force at the time of acquisition; and

(d) By way of inheritance of any immovable property from any person 'resident in India'.

Modes of payment for acquisition of Immovable Property

In accordance with Regulation 3 of the FEMA Regulations, any consideration for acquisition of immovable property has to be received in India through banking channels and is subject to payment of all taxes and other duties/ levies in India. Such payment can also be made out of funds held in NRE/ FCNR(B)/ NRO accounts of the NRIs/ OCIs. It is vital to note that there is a restriction under Regulation 3 which specifically prohibits making payments towards acquisition of immovable property in India through travellers' cheque and foreign currency notes or any other mode not provided for under the FEMA Regulations.

Transfer of Immovable Property

In regard to the transfer of immovable property, the old regulations treated transfers by NRIs and PIOs differently. Further, the old regulations made distinctions based on whether the receiver of the property was a resident of India and based on the nature of the property being transferred, namely restricted properties, residential properties or commercial properties. Under the FEMA Regulations, the conditions have also been simplified in this regard, now both NRIs and OCIs are permitted to transfer:(1) any Immovable Property to a person resident in India; and (2) Immovable Property other than restricted properties to an NRI or OCI.

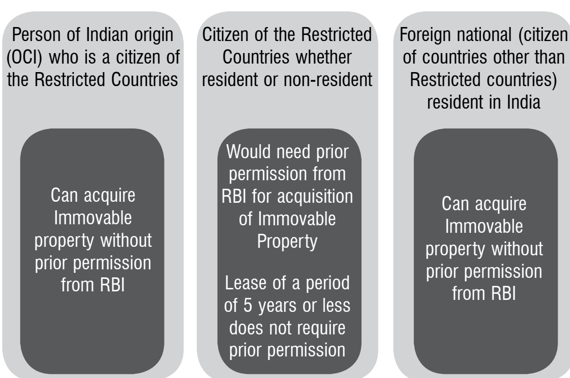
Acquisition of immovable property by foreign nationals

Citizens of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Macau,

4 The PIO scheme was discontinued and the concept of OCI cardholder was introduced in its place.

Hong Kong and Democratic People's Republic of Korea **("Restricted Countries"),** irrespective of their residential status, may acquire immovable property in India only with the prior permission of the RBI, except where such persons are taking the immovable property on lease for a period not exceeding five years. Thus, a FNRI who is a national of any of the restricted countries would not be able to acquire Immovable Property in India without prior permission. However, the FEMA Regulations have now clarified that this requirement will not apply to OCIs even if they are citizens of these restricted countries.

Foreign nationals of non-Indian origin resident in India (except citizens of the Restricted Countries) can acquire immovable property in India without prior permission of the RBI. Further, foreign nationals of non-Indian origin resident outside India can acquire/ transfer immovable property in India, on lease for five years or less and can acquire immovable property in India by way of inheritance from a resident of India. The below chart summarises the regulations in this respect.



Joint acquisitions by spouses of NRIs and OCIs
A person resident outside India who is not an NRI/OCI but is the spouse of an NRI/OCI is now permitted to acquire immovable property located in India, other than restricted properties, jointly with their spouse. To jointly acquire property under this provision, the marriage must have been registered and subsisting for a continuous period of at least two years prior to acquisition and the NRI/OCI spouse must not be otherwise prohibited from acquiring such property. Further, the consideration must be paid only through funds received in India through banking channels by way of inward remittance or funds held in any non-resident account maintained in accordance with the regulations of RBI.

Acquisition by a long-term visa holder
Regulation 7 of the FEMA Regulations provide that a person being a citizen of Afghanistan, Bangladesh or Pakistan belonging to minority communities in those countries viz., Hindus, Sikhs, Jains, Buddhists, Parsis and Christians, who is residing in India and has been granted a long-term visa **("LTV")** by the Central Government may purchase only one residential immovable property in India as dwelling unit for self-occupation and only one immovable property for self-employment. Such acquisition by a LTV holder resident in India is subject to the following restrictions:

(a) The property should not be located in and around restricted/ protected areas so notified by the Central Government or cantonment areas;

(b) Such person should submit a declaration to the Revenue Authority of the district where the property is located specifying the source of funds and that he/she is residing in India on a LTV;

(c) The registration documents of the property should mention the nationality and the fact that such person is on a LTV.

(d) The property of such person may be attached/confiscated in the event of his/ her indulgence in anti-India activities.

(e) A copy of the documents of the purchased property shall be submitted to the Deputy Commissioner of Police **("DCP")**/ Foreigners Registration Office **("FRO")**/ Foreigners Regional Registration Office

("FRRO") concerned and to the Ministry of Home Affairs (Foreigners Division).

(f) Sale of the immovable property so acquired is permissible only after such person has acquired Indian citizenship. However, transfer of such immovable property before acquiring Indian citizenship requires prior approval of the DCP/ FRO/ FRRO concerned.

Repatriation of sale proceeds

A person who has acquired immovable property under section 6(5) of the FEMA when he was resident in India or inherited from a person who was resident in India, cannot repatriate the sale proceeds of such property without RBI approval.

Citizen of a foreign state, not being a PIO or OCI and not being a citizen of Nepal or Bhutan, may repatriate[5] through an authorised dealer bank an amount not exceeding USD 1 million per financial year if the person:

(i) had inherited immovable property from a person referred to in section 6(5) of FEMA;

(ii) had retired from employment in India; or

(iii) is a non-resident widow/widower and has inherited assets from her/ his deceased spouse who was an Indian citizenresident in India.

Further, repatriation of the sale proceeds of immovable property other than restricted properties by NRIs or OCIs are subject to the following conditions:

(a) The immovable property was acquired in accordance with the provisions of the foreign exchange law in force at the time of acquisition or the provisions of FEMA Regulations;

(b) The amount for acquisition of the property was paid in foreign exchange received through normal banking channels or out of the funds held in foreign currency non-resident account or out of the funds held in non-resident external account;

(c) In the case of residential property, the repatriation of sale proceeds is restricted to not more than two such properties.

Under the Old Regulations, such repatriation by NRIs or OCIs was not permitted to exceed: (1) the amount paid for acquiring the immovable property, where such payment was made in foreign exchange received through normal banking channels or out of funds held in a Foreign Currency Non-Resident **("FCNR")** account; or (2) the foreign currency equivalent of the amount paid for acquiring the immovable property, as on the date of payment, where such payment was made from the funds held in a Non-Resident External **("NRE")** account. These limits have been done away with under the FEMA Regulations.

C. Taxability on sale of immovable property

Scope of taxation under section 5 and section 9 of the IT Act

As per section 5 of the IT Act, a non-resident would be subject to tax in India on all income from whatever source if it is received or deemed to be received in India; or if it accrues or arises or is deemed to accrue or arise to him in India. Further, section 9 contains wide source rules as per which certain income is deemed to be sourced in India. It *inter alia* provides that all income arising whether directly or indirectly through or from any property in India or through or from any asset or source of income in India or through the transfer of any capital asset situated in India shall be deemed to arise in India. Thus, any income from 'transfer of any

5 As per regulation 4 of the Foreign Exchange Management (Remittance of Assets) Regulations, 2016 (Notification No. FEMA 13 (R)/2016-RB, dated 01 April 2016).

capital asset situated in India' or 'through or from any asset or property in India' is subject to tax in India in the hands of a non-resident as well, under section 9 of the IT Act.

Applicability of Tax Treaty provisions

Section 90(2) of the IT Act provides that in case of a person who is resident of a country with which the Government of India has entered into a Double Taxation Avoidance Agreement ("DTAA"), then while determining the taxability of such a person, the provisions of the IT Act would apply only to the extent that they are more beneficial than the provisions of the applicable DTAA. Therefore, if the non-resident is eligible for the benefits under the relevant DTAA, the provisions of such DTAA should be considered and applied to the extent they are more beneficial than the provisions of the IT Act.

To align the taxation of transfer with the location where the immovable property is situated, India's DTAAs typically provide that income derived by a resident of a State (for e.g. USA) from immovable property located in other State (i.e. India) may be taxed in that other State (i.e. India). Thus, the DTAA provisions generally provide for taxation of the capital gains arising from transfer of immovable property located in India and therefore the withholding tax obligations discussed below would also apply.

Applicability of tax deduction at source/ withholding tax

Section 194-IA of the IT Act provides that any person being a transferee responsible for paying any sum to a resident transferor for transfer of immovable property shall at the time of credit of any sum to the account of the transferor, or at the time of payment in cash or by issue of cheque or any other mode, whichever is earlier, deduct 1% of such sum as income tax. This withholding is applicable to the transfer of the immovable property where the consideration exceeds INR 5 million. Thus, where the transferor is a 'resident in India' for the purposes of IT Act, any person responsible for paying any sum for transfer of immovable property to such transferor, is required to deduct tax at source at the rate of 1% of such sum. The Purchaser in such case, is required to deposit the amount of tax deducted at source with the government treasury and furnish a certificate in Form 16B towards deposit of such tax, to the seller. This certificate is generated online and the purchaser does not need to obtain tax deduction account number for the purpose of deducting tax under section 194IA of the IT Act.

As against this, where the transferor is a non-resident (including NRIs) the withholding is required under section 195 of the IT Act. Section 195 obligates any person responsible for making payment of any sum to a non-resident which is chargeable to tax in India to deduct tax at the applicable rate. The applicable rate of tax would depend on the period for which the immovable property has been held by the non-resident seller, accordingly the capital gains would be subject to tax at the rate of 20% (plus applicable surcharge and cess) where the immovable property has been held for a period exceeding 24 months, otherwise at the applicable slab rate (maximum rate being of 30%) (plus applicable surcharge and cess). The withholding is applicable on the net capital gains arising from the transfer and not on the whole of the consideration.

In this context it is important to note that the judgments of the Hon'ble Supreme Court ("SC") in the case of *Transmission Corporation of AP vs. Commissioner of Income Tax [239 ITR 587]* and *GE India Technology Cen. (P.) Ltd vs. Commissioner of Income Tax [327 ITR 456]* dealt with the issue of applicability of the provisions contained under section 195 to situations where only a certain portion of the payments being made to a non-resident had an 'income' element which was chargeable to tax in India. It was in this context that the SC had held that if a payer wanted to withhold tax at source not on the gross amount of payment being made by such payer but on a lesser amount which is chargeable to tax in India, then it would be necessary for the payer to make an application under section 195 to the tax authorities and obtain permission for withholding tax at a lower rate on the gross amount. In this respect, it is pertinent to note the judgment of the Hon'ble Supreme Court in the case of GE India Technology wherein while referring to its judgment in Transmission Corporation (supra), the SC observed that where the person responsible for tax deduction is fairly certain, he can make his own determination as to whether the tax was deductible at source and, if so what should be the amount thereof. The Court rejected tax department's contention that Section 195 is a provision by which the department is able to keep track of remittances and hence the Assessing Officer should be approached under section 195(2) of the IT Act in each case where remittance is to be made to a non-resident.

In line with the SC observation, the Central Board of Direct Taxes has clarified in instruction 02/2014 dated 26th February 2018 that an Assessing Officer shall determine appropriate sum/proportion of income chargeable to tax in India to ascertain the tax liability in respect of which the deductor shall be considered to be assessee in default. This instruction further clarifies that the appropriate sum will depend on facts and circumstances of each case depending on the nature of remittances, income component therein or any other fact relevant to determine such appropriate sum.

Having said the above, from purchaser's perspective,it is important that he insists that the Seller procures a computation determining the amount of chargeable capital gains and the applicable capital gains tax thereon, so that the purchase can deduct applicable tax thereon in due fulfilment of his statutory obligation under section 195.

D. Conclusion

Owing to the above restrictions under FEMA Regulations, it is critical that prior to entering into a transaction for acquisition of any immovable property, one assesses the residential status under FEMA. Furthermore, it is vital that this assessment is undertaken at the time of sale/transfer of such property (if any) to be able to comply with the FEMA Regulations. From an income tax perspective, it is vital for a purchaser to assess the residential status of the seller under the IT Act to ascertain the applicable rate of tax for withholding/deduction of tax at source,and should act accordingly, to avoid any adverse consequences such as recovery of taxes due, and interest/penalties, etc.

❍❑❍

How long is this life for? As you have come into this world, leave some mark behind. You the descendants of the most glorious Rishis the world ever saw. "In every one of you lies that Eternal Power", and try to wake it up.

— *Swami Vivekananda*

CA Rajesh L. Shah

Bank Accounts / Fixed Deposits in India by NRIs FEMA and Tax implications on Interest Income

1. NRI/PIO are permitted to open various types of accounts in India or keep deposits with certain persons and are regulated by Notification No: 5 (R)/2016-RB dated 1-4-2016. Earlier deposits were regulated by FEMA 5/2000-RB dated 3-5-2000. Before dealing with the details of Notification No: 5(R), let us first understand the definition of various important terms as per Notification No: 5(R) read with Master Direction:

2. Definitions

2.1 "Deposits" include deposit of money with a bank, company, proprietory concern, partnership firm, corporate body, trust or any other person.

2.2 "Non-Resident Indian (NRI)" means a person resident outside India who is a citizen of India.

2.3 "Person of Indian Origin (PIO)" means a person resident outside India who is a citizen of any country other than Bangladesh or Pakistan or such other country as may be specified by the Central Government, satisfying the following conditions:

a) Who was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955); or

b) Who belonged to a territory that became part of India after the 15th day of August, 1947; or

c) Who is a child or a grandchild or a great grandchild of a citizen of India or of a person referred to in clause (a) or (b); or

d) Who is a spouse of foreign origin of a citizen of India or spouse of foreign origin of a person referred to in clause (a) or (b) or (c)

Explanation: For the purpose of this sub-regulation, the expression 'Person of Indian Origin' includes an 'Overseas Citizen of India' cardholder within the meaning of Section 7(A) of the Citizenship Act, 1955.

2.4 "Relative" means relative as defined in section 2(77) of the Companies Act, 2013.

3. Exemption

Before going into the details of the Notification No: FEMA 5(R)/2016-RB dated 1-4-2016, let us first examine the exemption provided under the said notification:

Regulation 4 provides that Notification shall not apply to

(i) Deposits held in rupee/ foreign currency accounts maintained by foreign diplomatic missions and diplomatic personnel and their family members.

(ii) Deposits held by diplomatic missions, and diplomatic personnel in special rupee accounts namely Diplomatic Bond Stores Account subject to certain conditions prescribed.

(iii) Deposits maintained in foreign currency by diplomatic missions, diplomatic personnel and non-diplomatic staff, who are the nationals of the concerned foreign countries and hold official passport of foreign embassies in India subject to certain conditions prescribed.

(iv) Deposits maintained in rupees with an authorised dealer by persons resident in Nepal and Bhutan.

(v) Deposits held in accounts maintained with an authorised dealer by any multilateral organisation and its subsidiary / affiliate bodies and officials in India of such multilateral organisation of which India is a member nation.

4. Acceptance of deposits by an authorised dealer / authorised bank from persons resident outside India

Authorised dealer / authorised bank can obtain following deposits from NRI/PIO

i. Non-Resident (External) Account Scheme (NRE account)

ii. Foreign Currency (Non-Resident) Account Banks Scheme [FCNR (B) account]

iii. Non-Resident (Ordinary) Account Scheme (NRO account)

iv. Special Non-Resident Rupee Account (SNRR)

5. Salient Features of NRE/FCNR(B)/NRO account are as follows:

Description	NRE Account	FCNR (B) Account	NRO account
Eligibility (who can open the account)	NRI/PIO Individual/entities of Pakistan and Bangladesh shall require prior approval of the Reserve Bank of India		Any person resident outside India for putting through bona fide transaction in rupees
			Individuals/entities of Pakistan nationality/origin and entities of Bangladesh origin require prior approval of the RBI. Individuals of Bangladesh nationality are allowed to open the account provided they hold a valid visa and valid residential permit by FRRO Post Offices in India may maintain savings bank accounts in the names of persons resident outside India and allow

Description	NRE Account	FCNR (B) Account	NRO account
			operations on these accounts subject to the same terms and conditions as are applicable to NRO accounts maintained with an authorised dealer/ authorised bank Foreign national of non-Indian origin visiting India can open NRO account with funds remitted from outside India or from foreign exchange brought into India. Balance in the account can be repaid to the account holder if the account is maintained for less than 6 months and account has not been credited with local funds except for interest accrued
Whether Power of Attorney holder permitted to open the account	No	No	No
Types of Accounts	Savings, current, Recurring, Fixed Deposit	Term deposit	Savings, Current, Recurring, Fixed Deposit
Currency	Indian Rupees	Any permitted currency i.e., a foreign currency which is freely convertible	Indian Rupees
Repatriability	Repatriable		Not repatriable except for all current income Balances in an NRO account of NRIs/ PIOs are remittable up to USD 1 (one) million per financial year (April-March) along with their other eligible assets
Permitted Credit	Credits permitted to this account are inward remittances from outside India, interest accruing on the account, interest on investment, transfer from other NRE/ FCNR(B) accounts, maturity proceeds of		Inward remittance in permitted currency from outside India, legitimate dues in India of the account holder, transfer from other NRO accounts or any

Description	NRE Account	FCNR (B) Account	NRO account
	investments (if such investments were made from this account or through inward remittance) Current income like rent, dividend, pension, interest etc., will be construed as a permissible credit to the NRE account		amount received by the account holder in accordance with the rules or regulations of the Act. Rupee gift/loan made by a resident to a NRI/PIO relative within the prescribed limit under LRS can be credited to NRO account
Permitted Debits	Permissible debits are local disbursements, remittance outside India, transfer to other NRE/ FCNR(B) accounts, investments in India and purchase of immovable property in India		The account can be debited for the purpose of local payments, transfers to other NRO accounts or remittance of current income abroad Apart from these, balances in the NRO account can be repatriated abroad by NRIs and PIOs up to USD 1 million, subject to conditions specified in Foreign Exchange Management (Remittance of Assets) Regulations, 2016. Funds can be transferred to NRE account within this USD 1 million facility
Rate of Interest	As per directions/ instructions issued by RBI		
Loan to account holder	1. ADs are permitted to grant loan (fund or non-fund based) to account holder only for personal use or for making direct investment in India on non-repatriation basis or for acquiring flat in India for his own residential use 2. Loan amount cannot be used for relending or carrying on agriculture/ plantation activities or for investment in real estate business 3. Loan amount cannot be repatriated outside India 4. Repayment of loan can be either by adjustment of deposit or by fresh inward remittances from outside India or from NRO account of the account holder		ADs are permitted to grant loan to account holders in rupees against the security of fixed deposits for personal purpose or for carrying on business activities Loan amount cannot be used for relending or carrying on agriculture/ plantation activities or for investment in real estate business

<table>
<tr><th>Description</th><th>NRE Account</th><th>FCNR (B) Account</th><th>NRO account</th></tr>
<tr><td></td><td colspan="2">5. Premature withdrawal of deposits will not be permitted where loan against such deposits is availed of</td><td></td></tr>
<tr><td>Loan to third parties</td><td colspan="2">ADs can grant loan (fund or non-fund based) to resident individuals/ firms/ companies in India against the collateral of FDs held in NRE account to be utilised for personal purposes

There should be no direct or indirect foreign exchange consideration for the non-resident depositor agreeing to pledge his deposits

Usual norms and considerations for trade/industry will be applicable to such credit facilities

Premature withdrawal of deposits will not be permitted where loan against such deposits is availed of</td><td>Loans/ overdrafts to resident individuals/ firms/ companies in India may be granted against the security of deposits held in NRO accounts for the purpose of meeting borrower's personal requirements and/or business purpose and not for carrying on agricultural/plantation activities or real estate business, or for relending.</td></tr>
<tr><td>Loans outside India</td><td colspan="2">1. ADs may allow their branches/ correspondents outside India to grant loans (fund or non-fund based) to non-resident depositor or to 3rd parties against security of NRE deposit for bona fide purpose

2. Loan amount cannot be utilised for relending or carrying on agricultural/ plantation activities or for investment in real estate business

3. ADs may allow remittances of funds from India for liquidation of the outstanding against security of deposit

4. Premature withdrawal of deposits will not be permitted where loan against such deposits is availed of.</td><td>Not permitted</td></tr>
<tr><td>Change of residential status from non-resident to Resident</td><td>On account holder becoming a person resident in India, NRE should immediately</td><td>On account holder becoming a person resident in India, deposits can be continued</td><td>Upon return of account holder for taking up employment in India or for carrying on business or vocation or for any other purpose indicating intention to</td></tr>
</table>

Description	NRE Account	FCNR (B) Account	NRO account
	redesignate his NRE account as resident accounts or the funds held in these account may be transferred to RFC account If he is on a short visit to India, the account may be continued to be treated as NRE account even during his stay in India.	till maturity. If it is continued till maturity, then except for rate of interest and reserve requirement for all other purpose, such deposits shall be treated as resident deposits from the date of return of the account holder to India FCNR (B) should be converted into resident rupee deposit or RFC account at the option of the account holder	stay in India for uncertain period, NRO account to be redesignated resident rupee account. If the account holder is on a short visit to India, the account may be continued to be treated as NRO account even during his stay in India
Repatriation of funds to N.R. nominee	ADs will transfer funds lying in the NRE account of the deceased to his non-resident nominee. RBI permission will be required by non-resident nominee to remit funds for meeting liabilities of the deceased account holder or for similar other purpose		Amount due/ payable to non-resident nominee from the account of a deceased account holder, shall be credited to NRO account of the nominee with an authorised dealer/authorised bank in India
Joint Accounts	1. NRI/PIO may hold NRE/FCNR account jointly with other NRIs or PIOs 2. NRI/PIO may hold NRE/FCNR account jointly with resident relative on former or survivor basis 3. Resident relative can operate NRE account only as a Power of Attorney holder		1. NRIs and/or PIOs may hold NRO account jointly with other NRIs and/or PIOs 2. NRO account can be held jointly with residents on former or survivor basis

Description	NRE Account	FCNR (B) Account	NRO account
Operations by Power of Attorney holder	1. Operations by Power of Attorney holder is restricted to withdrawals for local payments or remittance to the account holder himself or make investments in India if the account holder is permitted 2. Power of Attorney holder is not permitted to remit outside India to person other than account holder nor to make gifts to a resident on behalf of account holder nor transfer funds from the account to another NRE account		1. Operations by Power of Attorney holder is restricted to withdrawals for permissible local payments in rupees or make eligible investments or remit outside India of the current income net of taxes. While making remittances, the limits and conditions of repatriability will apply 2. Power of attorney holder is not permitted to repatriate funds to person other than account holder himself nor make payment by way of gift to a resident on behalf of the non-resident account holder nor transfer funds to other NRO account
Exchange Rate guarantee	Reserve Bank will not provide exchange rate guarantee to AD for deposits of any maturity		

6. Salient Features of Special Non-Resident Rupee Account (SNRR)

6.1 Any person resident outside India, having business interest in India may open SNRR account with an AD for *bona fide* transactions in rupees, not involving any violation of the provisions of Act, rules and regulations made thereunder.

6.2 SNRR account shall carry the nomenclature of the specific business for which it is in operation.

6.3 Operations in SNRR account should not result in the account holder making available foreign exchange to any person resident in India against reimbursement in rupees or in any other manner.

6.4 SNRR account shall be non-interest bearing.

6.5 Debits/credits should be specific/ incidental to the business to be done by the account holder.

6.6 AD to ensure that the balances are commensurate with the business operations of the account holder.

6.7 Operations in SNRR account should be in accordance with the provisions of rules and regulations made thereunder.

6.8 Tenure of SNRR should be concurrent to the tenure of the contract/period of operation/ the business of the account holder to the maximum of 7 years.

6.9 No operations in the account should be permitted after 7 years from the date of opening of the account.

6.10 Balance in SNRR account shall be eligible for repatriation.

6.11 Transfer from SNRR to NRO is not permitted.

6.12 All transactions in SNRR account will be subject to payment of applicable taxes in India.

6.13 On the account holder becoming resident, SNRR account may be designated as resident rupee account.

6.14 In case of death of account holder, amount due/payable to non-resident nominee shall be credited to NRO account of the nominee with as AD/authorised bank in India.

6.15 Transactions in SNRR accounts shall be reported to RBI.

6.16 RBI permission will be required for opening of SNRR accounts by Pakistan and Bangladesh nationals and entities incorporated in Pakistan and Bangladesh.

ACCEPTANCE OF DEPOSITS BY PERSONS OTHER THAN BANKS

7. Acceptance of Deposits by Companies/body corporate from NRI/PIO

A company incorporated in India (including a NBFC registered with RBI) shall not accept deposits from NRI or PIO on repatriation basis. It may however renew the deposits it had accepted deposits in accordance with Schedule 6 of the Deposit Regulations.

8. Acceptance of deposits by a Company/body corporate/ proprietary concern/partnership firm on non-repatriation basis

A proprietorship concern or a firm in India or a company incorporated in India (including NBFC) may accept deposits on non-repatriation basis from NRIs or PIOs subject to the following conditions:

(a) In case of company, deposits may be accepted either under private arrangement or under public deposit scheme.

(b) If deposit is accepted by NBFC, it should be registered with RBI and should have obtained the required credit rating as per guidelines issued by RBI.

(c) Amount of deposits shall not be allowed to be repatriated outside India.

(d) Maturity period of deposits shall not exceed 3 years.

(e) Interest Rate:

  (i) NBFC accepting deposit – guidelines/directions issued by RBI.

  (ii) Other companies – shall not exceed ceiling rate prescribed from time to time under Companies (Acceptance of Deposit) Rules, 2014.

(f) Amount of deposit shall be received by debit to NRO account only. Further amount of deposit shall not represent inward remittances or transfer of funds from NRE / FCNR(B) accounts into the NRO accounts.

(g) Proprietorship concern/firm/company accepting deposits shall comply with all other laws.

(h) Deposit amount shall not be utilised for re-lending (other than NBFC), agricultural/ plantation activities, real estate business, investing in any other concern, firm or a company engaging/proposing to engage in agricultural/plantation activities or real estate business.

9. Acceptance of deposits by issue of Commercial Paper by an Indian company

9.1 An Indian company may accept deposits by issue of Commercial Paper to a NRI/PIO/ Foreign Portfolio Investor registered with SEBI subject to the following conditions:

(a) Issue is in compliance with Non-Banking Companies (Acceptance of Deposits through Commercial Paper) Directions, 1989 issued by RBI and also any other law.

(b) Payment for issue of Commercial Paper is received by issuing company by:

 (i) Inward remittance from outside India through normal banking channels or

 (ii) Funds held in deposit account maintained by a NRI/PIO in accordance with the regulations made by RBI in this regard.

(c) Amount invested in Commercial Paper shall not be eligible for repatriation outside India.

(d) Commercial Paper shall not be transferable.

TAXABILITY OF INTEREST INCOME

Now let us discuss about the taxability of interest income on various types of deposits discussed above:

1. Interest on NRE deposit

1.1 Interest income on NRE deposit is exempt under section 10(4)(ii) of the Income Tax Act, 1961. Exemption is available on NRE deposit complying with the Foreign Exchange Management Act, 1999 and the rules made thereunder.

1.2 Section 10(4)(ii) further provides that individual is a person resident outside India as defined in section 2(w) of FEMA or is a person who has been permitted by RBI to maintain the account.

1.3 Here it may be noted that as per Schedule I of Notification No: 5 (R)/2016-RB dated 1-4-2016, NRE account should be re-designated as resident account or the funds held in these accounts may be transferred to RFC account at the option of the account holder immediately upon the account holder becoming resident.

1.4 Another issue that may arise is if the person becomes resident in India and satisfies the conditions of section 2(v) of Foreign Exchange Management Act, 1999 but is a Non-Resident or NOR as per Income-tax Act, whether interest income on NRE deposit will be taxable of exempt.

1.5 As per section 10(4)(ii), interest income on NRE deposit is exempt if the deposit is in accordance with the Foreign Exchange Management Act, 1999 and the rules made thereunder. As per Schedule I of Notification No: 5(R)/2016-RB dated 1-4-2016, NRE account has to be immediately redesignated as resident account or transfer the amount to RFC account upon the return of account holder to India for taking up employment or for carrying on business or vocation or for any other purpose indicating intention to stay in India for an uncertain period i.e., a person becomes a resident as per section (v) of Foreign Exchange Management Act, 1999. Reading both Income-tax Act, 1961 and Foreign Exchange Management Act, 1999, person is not permitted to continue NRE account and if the account is continued, it will be violation of FEMA and interest income on NRE deposit will not be exempt and will be liable to tax. Amritsar Tribunal in the case of *Rachhpal Singh vs. ITO reported in [2005] 94 ITD 79* upheld the above view and held that for claiming exemption u/s. 10(4), residential status of a person has to be seen under FERA, 1973 and not Income-tax Act, 1961. Although the judgment was with reference to FERA, the analogy will equally apply to the new regime of Foreign Exchange Management Act, 1999.

1.6 Section 10(4)(ii) states that deposits in NRE account should be in accordance with Foreign Exchange Management Act, 1999 and the rules made thereunder. If deposits in NRE account is violating any provision of the Foreign Exchange Management Act, 1999, then exemption u/s. 10(4)(ii) will not be available as held by Madhya Pradesh High Court in the case of *CIT vs. Purshottam Khatri reported in [2006] 155 Taxman*

399. Although the judgment was with reference to FERA, the analogy will equally apply to the new regime of Foreign Exchange Management Act, 1999.

1.7 However, Delhi Tribunal in the case of *ACTI vs. Ravinder Bedi reported in [2010] 3 taxmann.com 767* while remanding the case to ITO observed that residential status of the assessee is to be seen with respect to the provisions under the Income-tax Act and not with respect to the provisions under FEMA.

2. Interest on FCNR deposit

2.1 Interest income on FCNR deposit is exempt under section 10(15)(iv)(fa) of the Income-tax Act, 1961. Exemption is available to person who is Non-Resident or Not Ordinary Resident within the meaning of section 6(6) of the Income-tax Act, 1961. Further conditions to avail exemption is that acceptance of deposits by bank is approved by RBI.

2.2 Unlike section 10(4)(ii) which refers to residential status under Foreign Exchange Management Act, 1999, section 10(15)(iv)(fa) refers to residential status under Income-tax Act, 1961.

2.3 Here it may be noted that under FEMA, FCNR deposit can be continued till the date of maturity. Exemption u/s. 10(15)(iv)(fa) will be available as long as the assessee is Non-Resident or Not Ordinary Resident. The year in which the assessee becomes resident, exemption u/s. 10(15)(iv)(fa) will not be available.

2.4 Exemption under section 10(15)(iv)(fa) is available to a person who is non-resident or to a person who is not ordinary resident. Here the section refers to non-resident i.e., non-resident may be individual, firm, company, etc., unlike in section 10(4)(ii) where exemption is available only to individual.

2.5 Section 10(15)(iv)(fa) refers to interest on deposit, therefore if interest is received on loan, exemption will not be available under section 10(15)(iv)(fa) as was held by Delhi Tribunal in the case of *Standard Chartered Grindlays Pty. Ltd. reported in [2017] 80 Taxmann.com 99*

3. Interest on NRO deposit

3.1 Interest on NRO deposits is taxable in India and will be subject to TDS @ 30.90% or 31.20% from AY 2019-20.

3.2 NRI can file return of income and claim credit of the tax deducted. If income of NRI is below taxable limit or taxed at lower rate, then he will be entitled to refund from Income tax for the tax deducted on his interest income from NRO account.

3.3 NRI can also claim benefit of DTAA which India has signed with various countries and claim exemption from tax or be taxed at lower rate if DTAA is beneficial subject to complying certain conditions viz. TRC, Form 10F, etc.

4. Interest on deposits with Indian Companies issued by the Indian Companies

Taxability of the interest on deposits with Indian companies will be same as discussed under para interest on NRO deposits.

CONCLUSION

NRI PIO should comply with the notification relating to deposits in letter in spirit. NRI/PIO should take care particularly when they either become resident or non-resident. If due care is not taken NRI/PIO may have to face stiff penalties.

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CA Manoj C. Shah & CA Viral V. Satra

Borrowing and Lending to/from NRIs – FEMA

The present framework of exchange controls in India, consist of basic legislation (Foreign Exchange Management Act, 1999) and Regulations, Rules, Directions and Circulars issued under the Act.

1. Background

In August 1994 India accepted Article VIII of the Articles of agreement of the International Monetary Fund and became fully convertible on the current account. Since India is fully convertible on the current account, all current account transactions (barring a small list of restricted items) are permissible. In case of capital account transactions, only the transactions which are explicitly enabled under the guidelines are allowed, remaining require specific approvals under FEMA.

"Capital Account transaction" is defined under section 2(e) of FEMA as 'a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6.

Thus, the transaction of borrowing from Non Resident or giving Loan to Non-Resident by Resident Indian would partake the character of a Capital Account Transaction. While the former results in creating liability in favour of Non-Resident and latter results in creation of overseas assets against Non-Resident. It is interesting to observe that even creation of 'contingent liability' also results in emergence of Capital Account Transaction. So therefore, Resident Indian giving Guarantee or standing as Guarantor for debt raised by Non-Resident would result in Capital Account Transaction.

Every capital account transaction is governed by a specific Notification in addition to the provisions of the FEM Act and Directions. Section 6(3) of FEMA specifies the classes of capital account transactions which are regulated by RBI. FEMA Notification No. 1/2000-RB dated 3-5-2000 contains the list of permissible capital account transactions as well as list of prohibited capital account transactions.

Any borrowing or lending in foreign exchange in whatever form or by whatever name called and any borrowing and lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India is a Capital Account Transaction and is subject to Notification and Directions as prescribed by RBI.

2. Governing provisions

The transactions of lending and borrowing between residents of India and Non-Resident Indians are regulated by Reserve Bank of India. Borrowing and Lending in Foreign Exchange is governed by clause (d) of Section 6(3) of FEMA read with Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000 notified vide Notification No. FEMA 3/2000-RB dated May 3, 2000 and Master Direction No. 5/2015-16.

Transactions of borrowing and lending in Rupees are governed by clause (e) of Section 6(3) of FEMA read with Foreign Exchange Management (Borrowing and Lending in Rupees) Regulations, 2000 notified *vide* Notification No. FEMA 4/2000-RB dated May 3, 2000 and Master Direction No. 6/2015-16.

3. Difference between Borrowing in Foreign Exchange and INR

The difference between Borrowing in Foreign Exchange and Borrowing in INR is that, in case of foreign currency borrowing, the exchange risk is borne by Indian Borrower. Whereas in the case of INR borrowings, exchange risk is to be borne by overseas lender. Thus obligation to repay loan by Indian Resident would be in convertible foreign exchange in case of borrowings in foreign currency. Even though, borrowed funds would get converted in INR at prevailing exchange rate on repatriation on the date of borrowing.

4. Borrowings from NRIs in Foreign Exchange

The theme revolving around provisions pertaining to borrowing in foreign currency is to permit borrowings for long-term tenure with proper monitoring of end use so that borrowed funds are utilised for capacity expansion, manufacturing etc., instead for trading or speculative purposes. The borrowing provisions also provide for interest restrictions so that unwarranted risky borrowing is not raised by Indian borrowers. Further, the purpose of permitting long-term borrowing is to thwart or absorb the short term currency fluctuations taking place in world economy and impacting Indian rupee. The policy on foreign currency borrowing popularly known as External Commercial Borrowings (ECB) requires strict compliance by borrower. Since the scope of this article is restricted to borrowing from NRI, the detailed guidelines in respect of ECB is not considered in the article.

4.1 Borrowing in foreign currency by resident Indian from NRI Close Relatives – Regulation 5(6) of FEMA Notification No. 3 – FEM Borrowing Or Lending in Foreign Exchange) Regulations, 2000 dated 3rd May, 2000

Regulation 5 prescribes modes of borrowing and lending by persons other than Authorised Dealer. Sub-Regulation 6, refers to borrowings by Resident Individuals in foreign currency from close relatives outside India. The amount of loan shall not exceed US D 2,50,000 or its equivalent. The cap of US D 2,50,000 is *qua* borrower Resident Indian thus the total of amount of borrowings from all overseas relatives put together shall not exceed US D 2,50,000. The provisions apply to Resident Individual in India and such individual can be Non Indian Citizen also. Even such Non Indian Citizen can borrow from his overseas close relatives.

It is surprising to note that, the scope of 'Close relative' is as per Section 6 of Companies Act 1956 and not Companies Act, 2013.

The foreign currency loan from overseas close relatives is subject to following conditions:

- Minimum maturity period of loan shall be one year.
- Loan shall be free of interest.
- Amount of loan to be received by inward remittance through normal banking channels or by debit to NRE/FCNR account of NRI.

There are no end use restrictions on borrowings by resident individuals from overseas close relatives. The resident borrower can use the funds for his personal requirements or for his own business or make investment in capital of company or partnership firm or any proprietorship concern out of the borrowed funds. However, borrowed funds cannot be used for capital account transactions prohibited under FEMA Notification No. 1 (Permissible Capital Account Transactions) i.e. in business of Chit Funds or Nidhi Company or agricultural or plantation activities or in real estate business and construction of farm houses or trading in Transferable Development Rights. Except for the prohibited activities, resident borrower can freely use the funds for any purposes without any restrictions.

Since the borrowing is in foreign currency, at the time of repayment, Resident Borrower can approach its Authorised Dealer (Bank) to provide him with relevant foreign currency to effect remittance towards repayment of loan. It would be prudent for Resident borrower to obtain FIRC (Foreign Inward Remittance Certificate) from his/her banker clearly specifying the purpose as "Loan from Relative" at the time of receipt of foreign currency loan.

4.2 External Commercial Borrowing (ECB) by Indian Companies from NRI Shareholders

External Commercial Borrowings (ECB) are commercial loans by eligible Indian Companies from recognised persons residents outside India. ECBs can be in form of loan including bank loans, securitised instruments, buyers credit, suppliers credit, Foreign Currency Convertible Bonds (FCCBs), Foreign Currency Exchangeable Bonds (FCEBs) and Financial Lease. The list of eligible lenders includes in addition to International Banks & Financial Institutions even Foreign Equity Holder.

Thus, any Indian Company covered in the list of Eligible Borrowers under any of the three Tracks can borrow in form of External Commercial Borrowings (ECB) from its overseas Foreign Equity Holder who can be NRI.

The framework of raising loans through ECB comprises three tracks:

Track I	Medium-term foreign currency denominated ECB with minimum average maturity of 3/5 years
Track II	Long-term foreign currency denominated ECB with minimum maturity of 10 years
Track III	Indian Rupee Denominated ECB with minimum maturity of 3/5 years

However, in case of borrowing by Indian Company from foreign equity holder the minimum average maturity is five years.

Who is Foreign Equity Holder?

If lender is direct foreign equity holder he/she must hold minimum 25% direct equity holding of Indian Company and in case of indirect foreign equity holder, such NRI must hold minimum 51% indirect equity in Indian Company.

End Use:

RBI *vide* A.P. (DIR Series) Circular No. 25 dated April 27, 2018 has rationalised end use provisions for ECBs. Accordingly, the amounts so borrowed under any Track now can be used for all purposes except for following:

- Investment in real estate or purchase of land except when used for affordable housing as defined in Harmonised Master List of Infrastructure notified by Government of India, construction and development of SEZ, industrial parks/integrated townships.
- Investment in capital markets.
- Equity Investment.

Further, for ECBs raised under Track I and Track III, funds cannot be used for (1) Working Capital purposes (2) General Corporate Purposes and (3) Repayment of loans. However, in case ECBs are raised from direct and indirect foreign equity holders and minimum average maturity of loan is five years, loan funds can be used for all the three purposes.

Indian Company also cannot borrow ECB for the purpose of on lending for any of the above activities.

All in Cost Ceilings

For ECBs under Track I and Track II, the all in cost ceiling shall be 450 basis points per annum over 6 months USD LIBOR or applicable benchmark rate for respective currency. While for Track III it will be 450 basis points over the prevailing yield of the Government of India securities of corresponding maturity.

Penal interest for default or breach of covenants should not be more than 2 per cent over and above the contracted rate of interest.

Further, the term 'all in cost' includes rate of interest, other fees, expenses, charges, guarantee fees whether paid in foreign currency or Indian Rupees (INR) but does not include commitment fees, pre-payment fees/charges, withholding tax payable in INR.

Additional Requirements

If ECB is from direct equity holders, the individual ECB limits will also be subject to ECB liability: Equity Capital ratio requirement. The ECB liability of the borrower (towards all outstanding ECBs and the proposed one) towards the foreign equity holder should not be more than 7:1. This ratio will however not be applicable if total of all ECBs raised by the entity is up to US D 5 million or equivalent.

4.3 Guarantee given by NRI on behalf of person resident in India

The definition of Capital Account Transaction does not include contingent liability of a person resident outside India. Section 6(3)(j) however refers to giving of guarantee by a person resident outside India. Therefore, even though the definition does not mention about guarantee transaction, it is in nature of a Capital Account Transaction. Further, even Schedule II of FEMA Notification No.1, includes in the list of Capital Account Transaction guarantee given by a person resident outside India to any person resident in India.

Accordingly, a person resident outside India can give guarantee to resident creditor of person resident in India. Person resident outside India includes both NR and NRI. Therefore, even NRI can give guarantee on behalf of person resident in India. Such guarantee does not require any prior approval of RBI or any reporting to RBI. In case guarantee is invoked and the NRI guarantor has to pay the resident creditor, the resident shall reimburse the amount not exceeding rupee equivalent of the amount paid by the NRI guarantor (Refer Regulation 2A of FEMA Notification No. 16).

5. Lending to NRIs in Foreign Exchange

5.1 Whether loan in foreign currency can be given to NRI relative by resident individual under LRS?

While Regulation 8B of FEMA Notification No. 4 only refers to Rupee loan, the issues that requires deliberation is whether loan in foreign currency can be given to NRI/OCI relatives under LRS. Like Regulation 8B, there isn't any specific regulation dealing with foreign currency lending to NRI relatives. However, the reference to lending is also found in Master Direction on LRS and paragraph 6(v) with respect to loan to NRI reads as under:

Extending Loans including loans in Indian Rupees to Non-resident Indians (NRIs) who are relatives as defined under Companies Act 1956.

One may therefore interpret the above phrases as –

Permitting loan in foreign currency as well as in Rupees. The further support to this contention can be drawn from AP (Dir Series) Circular No. 50 dated February 11, 2016 which prescribes purpose code for remittance and Item No. 11 of Point No. 3(i) of the circular refers to *'Others' such as loan to NRI close relatives and health insurance*. Since this circular pertains to code for remittance and one of the purposes being 'Loan to NRI close relative', it is amply clear that loan can be given to NRI (close) relative. The Master Direction refers to the term 'relative' whereas the AP Dir Series Circular refers the term as 'Close Relatives', however there is no significant difference in meaning between the two terms.

So it can be inferred that loan in foreign currency can be given to NRI relative. It is interesting to note that the scope of the term 'Relative' is defined for borrowings from NRI relatives, the scope of the term is not explicitly defined while lending to NRI relative. However, as a conservative interpretation one may adopt the same definition of Relative as per Companies Act, 1956 as is provided for borrowing from NRI relatives.

6. Borrowings from NRIs in rupees

6.1 Borrowing by persons other than companies from NRIs on non-repatriation basis – Regulation 4 of FEMA Notification No. 4

A person resident in India not being a company incorporated in India can borrow in Indian rupees from a NRI or a person of Indian origin resident outside India. Since borrowing by Resident Indian is in Indian Rupees, the repayment proceeds of the loan shall be credited only to NRO Account even though funds might have been remitted from foreign bank account or NRE Account.

What are the conditions to be satisfied?

- The amount can be received by way of inward remittance from outside India or by debit to NRE/NRO/FCNR account of the NRI.
- Period of loan shall not exceed three years.
- Rate of interest on loan shall not exceed two percentage points over the bank rate prevailing on the date of availment of loan.
- Payment of interest and repayment of loan can only be done by credit to lender's NRO account.
- The amount borrowed shall not be allowed to be repatriated outside India. (However, under US D One Million Scheme, funds lying in NRO Account including repayment of non-repatriable loan can be repatriated)

End Use restrictions:

As per Regulation 6 of Notification No. 4, following are End Use Restrictions.

(1) The borrowed funds cannot be used for any purpose except in his own business of the borrower other than –

- business of Chit fund or
- Nidhi company or
- Agricultural or plantation activities or real estate business or construction of farm houses or
- Trading in Transferable Development Rights

Further, the borrowed funds shall also not be used for any investment (in capital or otherwise) in any company or partnership firm or proprietorship or any other entity and such borrowed funds cannot be used even for relending.

The Regulation uses the term 'Person' Resident in India and 'Person' is defined in FEMA which includes Individual, firm etc. So an Individual Resident in India is permitted to borrow in Indian Rupees from NRIs/OCIs (who need not be relatives). Further, the Regulations states that borrowed funds shall be used in his own business giving indication that Individual is eligible to borrow. However, the second restriction of not using the funds for investing in capital of Company, Partnership firm or proprietorship concern makes it difficult for an Resident Individual to use it for business purpose and restricts the end use only for personal purpose or for portfolio investment. However, borrower can be partnership firm or proprietorship concern and such entity can directly borrow from NRI/OCI subject to above referred terms of tenure, interest etc.

There are no reporting requirements for borrowing in rupees.

Practical Issues with respect to Rupee Borrowing

Since there are no reporting requirements either by the borrower or by NRIs or by ADs, the contraventions with respect to tenure or rate of interest etc., do not get noticed by RBI while acceptance, interest payment or repayment of loan. However, recent compounding order of RBI reveal the fact that when NRIs make request for transfer of funds from NRO account to NRE account, the ADs of NRIs are asking for source of credit in NRO Account and in case where it shows credit on account of repayment of loan, the ADs do make detailed enquiry and if conditions of rupee borrowings are not satisfied, ADs on their own are seeking approval of RBI for crediting such sums to NRE account. RBI in such cases have issued notices to Resident Borrower giving them option of approaching compounding for contravention of conditions not being complied with respect to rupee borrowing.

Hence, even though there are no reporting compliances to be carried out at the time of borrowing or repayment loan, proper care must be taken to see that all conditions are complied with.

6.2 Borrowing by Indian companies from NRIs – Regulation 5 of FEMA Notification No. 4:

An Indian Company can borrow from NRIs/OCIs by issue of Non Convertible Debentures (NCDs). The borrowing can be on repatriation or non-repatriation basis.

What are the conditions to be satisfied?

- Issue of NCD is to be made by way of public offer.
- Indian Company shall not carry on agricultural/plantation/real estate business/trading in transferable development rights or shall not be Chit Fund or Nidhi Company.
- Rate of interest shall not be more than three per cent of the prime lending rate of State Bank of India.
- The maturity period of NCDs shall not exceed 3 years.

6.3 Can Indian Company borrow in rupee from NRIs?

Borrowing by Indian Company from NRIs other than by way of issue of NCDs is as such not allowed. Despite the fact that in terms of Companies Act, 2013, Indian Companies can borrow from individuals who are Shareholders or Director, however, in case of NRI shareholders or directors, under FEMA INR borrowing by Indian Companies in INR is permitted only under Track III of ECB or by way of issue of NCDs to NRIs.

Rupee borrowing in form of ECB under Track III will lead to compliances of ECB regulations like reporting of ECB, obtaining LRN, complying with all in cost ceilings, end use, minimum average maturity etc.

Other than above referred types of borrowings in INR, NRI shareholder cannot lend money to Indian companies. There have been cases where borrowing companies have been charged with compounding fees.

6.4 Investment by NRI or PIO in form of deposits in indian proprietorship/ firm/company – Schedule 7 of FEMA Notifiction No. 5(R)

A proprietorship or partnership firm or a company in India can accept deposits from NRIs or PIOs on a non-repatriation basis. The maturity period of deposits shall not exceed 3 years.

The amount of deposit can be received only by way of debit to NRO account of NRI only. Thus, the amount of deposit shall not be received by way of fresh inward remittance from outside or transfer of funds from NRE/FCNR account to NRO account of the NRI (substituted by FEMA Notification No. 121/2004-RB dated July 10, 2004 – FEM (Deposit)(Amendment) Regulations, 2004.) Accordingly, the amount that can be placed with Companies as Deposit gets restricted up to balance in NRO Account as on the date July 10, 2004.

Other Conditions

- In case of Company, the deposits shall be accepted either under private arrangement or under public deposit scheme.
- If accepting company is NBFC the rate of interest payable on deposits shall be in conformity with guidelines issued by RBI for such companies.
- In other cases the rate of interest payable on deposits shall not exceed the ceiling rate prescribed from time to time under Companies (Acceptance of Deposits) Rules, 2014.

7. Lending to NRIs in rupees

7.1 Lending to NRI relatives by Resident Individual in Rupees – Regulation 8B of FEMA Notification No. 4:

A resident individual can give loan in rupees to NRI relative. The amount of loan so given shall be within limit of Liberalised Remittance Scheme (LRS) per financial year available to resident individual.

What are the conditions to be satisfied?

- Loan shall be interest free.
- Minimum maturity of loan is one year.
- Loan funds shall be utilised for meeting borrower's personal requirements or for his business purposes in India.
- Loan amount shall not be used for business of chit fund or Nidhi Company or agricultural or plantation activities or real estate business or construction of farm houses or transfer in Transferable Development Rights.
- Loan amount shall be credited to NRO account of the NRI relative.
- Repayment of loan shall be made wither by way of inward remittance through normal banking channels or by debit to NRO/NRE/FCNR account of NRI relative.

7.2 Rupee Loans to NRI employees of Indian Body Corporate

A body corporate registered or incorporated in India may grant rupee loan to its employees who is NRI. Such loan shall be utilised either for personal purposes including purchase of house property in India. The funds shall not be used for Nidhi, Chit Fund, agriculture, real estate trading, trading in TDRs etc. Repayment of loan shall be from NRO/NRE/FCNR account or from inward remittance from outside India. Lender shall not accept repayment from any other source.

7.3 Loans in rupees to NRIs by Authorised Dealers (ADs)

In addition to above referred lending to NRIs relatives, Authorised Dealers can grant rupee loan to NRIs against security of shares or immovable property held in the name of NRI borrower [Regulations 7(A) & (B)]. Such borrowed funds would be subject to end use restrictions of not investing in the business of chit funds, Nidhi Company real estate business or construction of farm house, trading in Transferable Development Rights (TDRs). Borrowed funds can be utilised for NRI's personal requirements or for his own business purposes (it is clear that business should be in India as Loan cannot be remitted outside India nor it can be credited).

Further, ADs can grant rupee loan for any purpose as per the policy laid by the Board of Directors. The restrictions referred for the loan against security and immovable property will also apply to such loans. [Regulation 7 (C)]

In addition, ADs can grant rupee loans to NRI employees of Indian companies for acquiring shares under ESOP. Such loan should not exceed 90% of purchase price or ₹ 20 lakh per NRI employee, whichever is lower. The amount shall be directly paid to the Company and should not be credited to the borrower's non-resident accounts in India. [Regulation 7(D)].

NRIs can also avail housing loan from ADs or Housing Finance Institution for acquiring residential accommodation in India. [Regulation 8].

8. Continuance of rupee loan given to resident on becoming NRI – Regulation 10 of FEMA Notification No. 4

Loans given by a person resident in India to another person resident in India can be continued by the (NRI turned) lender at his option unless the same are repaid by the borrower. Further, in case of repayment of loan by the borrower the same shall be made by credit to the NRO account of the lender.

9. Continuance of rupee borrowings/ overdraft from authorised dealer/ authorised bank on becoming NRI – Regulation 9 of Notificatio No. 4:

An ADs or Authorized Bank may allow continuance of loan/Overdraft based on its commercial judgment with the condition of period of loan not to exceed the original term fixed at the time of granting loan and repayment has to be made from NRO/NRE or by inward remittance from outside India through normal banking channel.

Since there is no specific reference for continuance of borrowing other than taken from ADs, it needs to be studied whether other private borrowings by Resident who turns NRI can be continued or not. One may interpret that wherever the provisions provide for granting loans to persons who are already NRIs, such loans may be continued if taken while person was resident Indian. (e.g. loans from Relatives and loan from Employer). (Refer paragraphs 7.1 & 7.2 above).

10. To conclude with

The provisions of borrowing and lending from/to NRI/OCI are not so dynamic like the provisions of Foreign Direct Investment or Overseas Direct Investment which keep pace with changes taking place in Indian economy impacting balance of payments and are highly responsive and reflective to needs business and industry. However, the loan transactions with NRIs have close connection with Liberalised Remittance Scheme for resident individuals and repatriation scheme under US D 1 million scheme for NRIs and therefore it is necessary that proper compliance of borrowing and lending provisions is maintained to avoid delay in remittance of funds from India under 1 Million scheme.

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CA N. C. Hegde & CA Mallika Apte

Taxation of NRIs – Including Chapter XIIA and Implications under GAAR & PMLA for Residents becoming NRIs

1. Introduction

International mobility is increasingly becoming a way of life as individuals, particularly millennials, aspire for the best education and career opportunities, and an enhanced quality of life. Deputations are a natural extension of the globalised economy and the available pool of talent plus cost advantage has made India a hotspot of outbound deputation. All of this has contributed to the growing number of Indians relocating overseas, popularly known as non-resident Indians (NRI). According to the United Nations Department of Economic and Social Affairs' data[1], India has the largest diaspora in the world with 17 million Indian-born persons residing abroad as of year 2017.

Further, India's positioning as one of the fastest growing economies in the world, its huge potential as a consumer market and the administration's continued efforts at improving the investment climate, has promoted its popularity as an investment hub for NRIs. Multiple opportunities are available to individual investors today, ranging from direct investments in businesses, stocks, real estate, portfolio-managed services, etc. This, coupled with the other inherited or acquired assets that such NRIs hold in India, may constitute sources of Indian income. The present article discusses the tax treatment provided under the Income-tax Act, 1961 (ITA) in relation to the various types of Indian income arising to NRIs.

2. Residence in India

The scope of taxable income and the charge of income-tax under the ITA hinges on the residential status of the taxpayer. Section 6 of the ITA lays down tests for establishing residence in India and recognises three categories of individual taxpayers, viz. (1) Resident and ordinarily resident (2) Resident but not ordinarily resident (3) Non-resident. These tests are based on physical presence in India during the previous year comprising the twelve months from 1st April to 31st March.

An individual is said to be "resident" in India in any previous year if he:

- Is in India in that year for an aggregate period of 182 days or more; or

1 The International Migration Report 2017 dated 18th December 2017

- Having within the 4 years preceding that year, been in India for a period of 365 days or more, is in India in that year for an aggregate period of 60 days or more.

The period of 60 days referred to above, stands extended to 182 days in the following cases:

- Where an Indian citizen leaves India in any year as a crew member of an Indian ship or for the purposes of employment outside India;
- Where an Indian citizen or a person of Indian origin (PIO)[2], who being outside India, comes on a visit to India.

Further, in terms of section 6(6), an individual, who qualifies as a resident based on the above tests, is said to be "not ordinarily resident" in India in a previous year if he has been a non-resident in India in 9 out of the 10 preceding previous years, or he has during the 7 preceding previous years, been in India for period(s) aggregating in all to 729 days or less.

A "non-resident" is simply defined as a person who is not a "resident" i.e., one who does not satisfy either of the basic tests of residence discussed above.

3. NRI-Meaning under the ITA

Section 115C(e) of the ITA defines an NRI to mean an Indian citizen or a PIO who qualifies as a non-resident in India for the relevant previous year.

4. Scope of total income and charge of Income-tax under the ITA

Section 4 read with section 5(2) of the ITA provides that a non-resident shall be chargeable to tax in India during a previous year on all income from whatever source derived, which is received or is deemed to be received in India by or on behalf of such person or which accrues or arises or is deemed to accrue or arise to him in India during such year.

In the above context, the word "receipt" of income refers to the first occasion when the recipient gets the money under his own control and it is the first receipt that determines the year and place of receipt for the purposes of taxation. Once an amount is received as income, any remittance or transmission of the amount to another place does not result in 'receipt' at the other place[3].

Income is said to "accrue" when the rendering of services or the other activities indulged in, are effected to bring into existence a right to enforce payment from a third party[4].

Further, the expressions 'deemed to be received'/ 'deemed to accrue' mean deemed by the provisions of the Act to be so received or accrued[5].

The taxability of the various heads of income arising to an NRI, has been discussed hereunder.

4.1 Income from salary

Salary income is taxable in India if it is towards services rendered in India or is received in India. The Finance Act, 2018 has provided that with effect from assessment year (AY) 2019-20, a standard deduction of ₹ 40,000 or the salary amount, whichever is less, shall be allowed in computing salary income. Further, section 10(6)(vi) of the ITA exempts remuneration received by a foreign citizen as an employee of a foreign enterprise for services rendered during his short stay in India, subject to the following conditions:

- The foreign enterprise is not engaged in any trade or business in India;

2 A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in undivided India – Explanation to section 115C(e) of the ITA

3 Keshav Mills Ltd. [1953] 23 ITR 230 (SC)

4 Parikh Petro Chemicals Agencies (P.) Ltd. [2002] 81 ITD 18 (Mum ITAT)

5 Keshav Mills Ltd. [1953] 23 ITR 230 (SC), Jai Parkash Om Parkash Co. Ltd. [1961] 41 ITR 718 (Pun. HC)

- The employee's stay in India does not exceed 90 days in the aggregate during the year; and
- Such remuneration is not deductible from the employer's income chargeable under the ITA.

In the case of non-resident seafarers, the Central Board of Direct Taxes (CBDT) has clarified *vide* Circular No. 13/2017 dated 11th April 2017, that salary accrued for services rendered outside India on-board a foreign going ship, shall not be included in the total income merely because the said salary has been credited to the Non-resident External (NRE) account maintained by the seafarer with an Indian bank. Based on the said Circular, Courts[6] have held that salary credited to the non-resident seafarer's NRE bank account in India was not taxable where such salary related to services rendered outside India.

In another case[7], an assessee employed with RIL was deputed as Country Manager to Kurdistan, Iraq and for the purpose of his employment in Iraq, he had received salary which was credited to a bank account in India. The assessee had stayed outside India for 203 days during the relevant year.

The ITAT observed that as the assessee had not stayed in India for more than 182 days, he was not a resident in terms of section 6(1) of the ITA. It further observed that receipt of salary in a bank account in India and taxes deducted by the employer cannot be determinative of taxability in India. Section 5(2) does not envisage that the income received by a non-resident for services rendered outside India can be reckoned as part of total income in India. The ITAT thus held that the salary of the NRI assessee could not be taxed in India.

4.2 Income from house property

An NRI shall be liable to tax on rental income received from a house property situated in India.

Taxable income from house property shall be computed after allowing standard deduction and deductions for property tax paid and interest on home loan.

4.3 Income from business or profession

Income arising to an NRI from a business connection in India or from a business set up in India, is taxable in India.

In an interesting ruling[8], the Kerala High Court recently held that where an NRI assessee purchased agricultural land, levelled it and sold it at a higher price, the transaction of sale of land amounted to an 'adventure in the nature of trade' and, thus, profit arising from the transaction was taxable as 'business income'. In the instant case, the assessee claimed that the land being an agricultural land, income arising on its sale, was exempt from tax. The Court noted that the assessee did not obtain the Reserve Bank of India (RBI)'s permission under Rule 47 of the Foreign Exchange Management (Acquisition & Transfer of Immovable Property in India) Regulations, which prohibits acquisition of agricultural land by an NRI. It further observed that the fact that the assessee had levelled the land and enhanced its saleability was also an indication of his intention to resell the land even when he purchased it.

Further, the ITA contains special provisions[9] for taxation of a non-resident's income from specified businesses viz., shipping, exploration of mineral oil, operation of aircraft, royalty and fees for technical services (FTS) connected to a fixed place in India.

6 Smt. Sumana Bandyopadhyay [TS-281-HC-2017(Cal.)], Tarun Kumar Sarkar [2017] 166 ITD 125 (Kol ITAT), Arnab Bose [2017] 166 ITD 404 (Kol. ITAT)

7 Pramod Kumar Sapra [2017] 167 ITD 596 (Del. ITAT)

8 V. A. Jose [2018] 252 Taxman 386 (Ker. HC)

9 Sections 44B, 44BB, 44BBA, 44DA

There are also special provisions in relation to business deductions for executive and general administration expenditure incurred outside India, actual cost for depreciation on an asset brought into India by a non-resident and on an imported capital asset acquired on deferred payment terms or out of a foreign loan.

4.4 Capital gains

The gains arising to an NRI on the transfer of a capital asset situated in India, are chargeable to tax in India. Depending upon the holding period of the capital asset being transferred, the resultant capital gain would be classified either as short-term or as long-term. In order to qualify as long-term capital gain (LTCG), the asset should be held for more than the period specified as under:

- Listed securities (*inter alia* shares), units of the Unit Trust of India or of an equity-oriented fund, zero coupon bonds: 12 months
- Unlisted shares, immovable property: 24 months
- Other assets: 36 months

In terms of the first proviso to section 48 of the ITA, capital gains arising on transfer of shares or debentures of an Indian company are to be computed by converting the cost of acquisition, expenses on transfer and the sale consideration into the same foreign currency as was initially used for the purchase of those assets and the gains so computed in such foreign currency, are to be reconverted into Indian currency. The benefit of indexation is not available.

Section 10(38) of the ITA allowed exemption in respect of the LTCG arising on transfer of equity shares of a company or unit of an equity-oriented fund or unit of a business trust, provided that the sale took place on or after 1st October 2004, and was chargeable to Securities Transaction Tax (STT). Short-term capital gains arising under similar circumstances is taxed at a concessional rate of 15% under section 111A of the ITA.

Effective AY 2019-20, the Finance Act, 2018 has withdrawn the exemption under section 10(38) and introduced a new section 112A to provide that LTCG exceeding ₹ 1 lakh, arising from transfer of an equity share in a company or a unit of an equity-oriented fund or a unit of a business trust, shall be taxed at 10% (without indexation) if:

- In case of equity shares, STT has been paid on both acquisition and transfer
- In case of unit of an equity-oriented fund or unit of a business trust, STT has been paid on the transfer

Further, capital gains shall be exempt if investment is made in specified assets[11] *inter alia* a residential house. The Finance (No. 2) Act, 2014 amended the exemption provisions[12] with effect from 1st April 2015 to provide that the new residential house must be situated in India. The Gujarat High Court[13] has held that prior to the said amendment, the only condition stipulated was investment in a residential house; hence, capital gains exemption would be allowable to an NRI assessee who utilised the proceeds arising from sale of a plot in India to purchase a house in the USA.

It is also pertinent to note the indirect transfer provisions of the ITA, where under transfer of shares of a foreign company deriving substantial value from assets located in India, shall be deemed as transfer of an asset located in India and hence chargeable to capital gains tax. These provisions shall apply *inter alia* if the value of the Indian assets exceeds ₹ 10 crore.

10 Sections 44C, 43, 43A

11 Sections 54, 54B, 54D, 54EC, 54F, 54GB

12 Sections 54, 54F

13 Leena Jugalkishor Shah [2017] 392 ITR 18 (Guj HC)

4.5 Income from other sources

The following investment income arising to an NRI is exempt from tax subject to the applicable provisions[14]:

- Interest on credit balance in NRE bank account
- Interest paid by a scheduled bank on RBI-approved foreign currency deposits, on balance in Foreign Currency Non-Resident and Resident Foreign Currency bank accounts
- Dividend from an Indian company

Further, while the Gift Tax law was repealed long ago, provisions concerning gift transfers were introduced in section 56 of the ITA. Section 56(2)(x) provides that any person receiving money, immovable property or other property viz. securities, jewellery, archaeological collection, work of art or bullion from another person without consideration, or for a consideration which is less than the fair market value/stamp duty value of such property by specified amount, is liable to tax on such receipt. Certain receipts, *inter alia* from a relative or on the occasion of marriage or under a will or by way of inheritance, have however been exempted from tax.

4.6 Deductions under Chapter VI-A[15]

Deduction is allowable from the gross total income for payments made *inter alia* towards life insurance premium, home loan principal, children's tuition fee, health insurance premium, interest on loan taken for higher education, donations to certain charitable institutions, etc.

4.7 Special provisions for taxation of certain incomes of NRI

Investment income and LTCG from foreign exchange assets.

Chapter XIIA of the ITA comprising sections 115C to 115-I, prescribes concessional rate of tax in relation to the investment income and LTCG arising to an NRI from assets (viz. shares, debentures, deposits, Government security) acquired with convertible foreign exchange. Bonus shares and shares received as gift shall also qualify for the special provisions if the original purchase was made in convertible foreign exchange[16].

Investment income (other than dividend) is taxable at the rate of 20%* on gross basis, whereas LTCG is taxable at a reduced rate of 10%*. The LTCG is however exempted from tax if the sale proceeds are reinvested in specified manner.

If the NRI elects, the special provisions shallcontinue to apply to his investment income (even after he becomes a resident) until such time that the assets are transferred or converted into money. Likewise, an NRI may elect not to be governed by the special provisions for any year.

Dividend, Interest, Royalty & FTS:

Section 115A of the ITA provides for gross basis taxation, *inter alia* of the following income:

Nature of income	Rate of tax (%)*
Dividends other than dividends referred to in section 115-O	20
Interest on foreign currency lending to the Government/ Indian concern	20
Interest on lending by way of ECB/ RDBO[17] to Indian company/ business trust	5
Royalty or FTS not connected to a fixed place in India	10

*plus applicable surcharge and education cess

14 Sections 10(4)(ii), 10(15)(iv)(fa), 10(34)

15 Sections 80C, 80D, 80E, 80G, 80TTA

16 Shashi Parvatha Reddy [2017] 167 ITD 587 (Hyd. ITAT)

17 Lending by way of External Commercial Borrowing/ Rupee Denominated Bond before 1st July 2020

Income of non-resident sportsmen or entertainers

In terms of section 115BBA, income arising to a non-resident entertainer/non-resident sportsman, being foreign citizen, from a performance in India/participation in India in any sport or advertisement or contribution of articles relating to sport, shall be taxable on gross basis at 20%.

4.8 Tax rates, surcharge and cess under the ITA

The income tax rates applicable for AY 2019-20 are:

Income	Tax rate (%)
Up to ₹ 2,50,000	NIL
₹ 2,50,001 to ₹ 5,00,000	5
₹ 5,00,001 to ₹ 10,00,000	20
Above ₹ 10,00,000	30

Where applicable, tax computed at the above rates shall be increased by a surcharge as under:

Income	Surcharge rate (%)
₹ 50,00,001 to ₹ 1,00,00,000	10
Above ₹ 1,00,00,000	15

Health and Education Cess of 4% shall be applied on the aggregate of income tax and surcharge.

4.9 Relief under Double Taxation Avoidance Agreement (DTAA)

The taxation as discussed above, is subject to DTAA entered into by India with various countries i.e., the provisions of the DTAA would override those of the ITA, to the extent they are more beneficial to the assessee. To enable DTAA benefit, a non-resident is required to provide a certificate of tax residency (TRC) from his home country and prescribed information[18], to the extent not covered in TRC.

4.10 Requirement to furnish Permanent Account Number (PAN)

Section 206AA provides that failure to furnish PAN to the payer of income shall entail tax deduction at a higher rate. However, relaxation has been allowed to non-residents in receipt of interest, royalty, FTS or capital gains, if prescribed[19] details and documents are furnished to the deductor. In any event, section 206AA cannot override a beneficial DTAA rate[20].

4.11 Compliances

An NRI would be liable to pay advance tax if his tax liability after considering credit for taxes deducted at source (TDS), exceeds ₹ 10,000. Default in or deferral of payment of advance tax may attract interest under section 234B and section 234C.

Further, he is also obligated to furnish a return of income (ROI) if:

- Taxable income exceeds the maximum amount that is not liable to tax i.e. ₹ 2,50,000
- Refund has to be claimed of any TDS or taxes paid
- Loss has to be carried forward

A ROI is however not necessary if the NRI's total income for the year comprises only of specified[21] income and appropriate tax has been withheld at source.

18 Rule 21AB of the Income-tax Rules, 1962 and Form 10F

19 Name, e-mail & contact number, TRC, address & Tax Identification Number in the home country – Rule 37BC of the Income-tax Rules, 1962

20 Danisco India (P) Ltd. [2018] 301 CTR 360 (Del. HC), Nagarjuna Fertilizers & Chemicals Ltd. [2017] 185 TTJ 569 (Hyd. ITAT SB)

21 Sections 115A(5), 115BBA(2), 115G

5. Implications under the General Anti-Avoidance Rule (GAAR)

With effect from AY 2018-19, the GAAR under Chapter XA comprising sections 95 to 102 of the ITA, shall come into play when the main purpose of an arrangement is to obtain a tax benefit exceeding ₹ 3 crore. The consequence would be that the arrangement would be declared as an impermissible avoidance arrangement which would lead to denial of tax benefit or DTAA benefit. Clarifications[22] have been issued *inter alia* that GAAR will not interplay with the taxpayer's right to select a method of implementing a transaction and shall not be invoked if tax avoidance is sufficiently addressed by the Limitation-of-benefits clause in the DTAA. However, given its wide scope and further that it would override any beneficial DTAA provision, there is anxiety among the taxpaying community that GAAR may be misused as a tool to maximise tax revenue.

While the manner in which GAAR is actually applied by the tax authorities remains to be seen, the "purpose" of the transaction will be central to its evaluation. Consider the case of Mr. X, an Indian citizen and a resident in India. He holds investments in shares of foreign companies. During the previous year 2018-19, he travels and stays abroad for significant period(s) such that he acquires the status of a non-resident in India for such year. While overseas, he disposes his foreign holdings and earns substantial capital gains. Under the circumstances, Mr. X would derive a tax benefit by way of the tax saved on the foreign capital gains owing to his 'non-resident' status under the ITA. He could hence be questioned under GAAR. However, if Mr. X's travel and stay abroad is for the purpose of his business or employment outside India and further if the sale of the foreign investments is with a view to fund such overseas business, etc. he would have a case to contend that GAAR is not applicable.

Further, offshore derivative instruments include participatory notes, an instrument widely used by NRIs to invest in the Indian securities markets through registered Foreign Institutional Investors (FII). Concerns were raised whether GAAR would apply as participatory notes are believed to promote infusion of black money into the Indian system. In this regard, Rule 10U of the Income-tax Rules, 1962 provides that GAAR shall not apply to a non-resident in relation to his investment by way of offshore derivative instruments or otherwise, directly or indirectly, in a FII. Further, the CBDT has clarified[23] that GAAR shall not apply to foreign portfolio investors if their jurisdiction is based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit.

6. Implications under the Prevention of Money Laundering Act, 2002 (PMLA)

Money laundering occurs when money earned through illegitimate means ('proceeds of crime') is camouflaged to bring it as earned/originated through legitimate sources. The PMLA was enacted to combat money laundering, to confiscate property derived from, or involved in money laundering and to punish the offenders.

The definition of 'money laundering' under the PMLA is widely-worded to cover any kind of dealing with the proceeds of crime. Further, the term 'proceeds of crime' is defined to include any property obtained directly or indirectly as a result of criminal activity relating to a 'scheduled offence'[24], or the value of any such property. The Finance Act, 2018 has modified the definition of proceeds of crime to ensure that domestic properties can be attached in case such proceeds are parked abroad.

The offence of money laundering is thus inextricably linked to a scheduled offence. The Finance Act, 2018 has brought corporate frauds under section 447 of the Companies Act, 2013, within the ambit of scheduled offence.

The Financial Intelligence Unit - India (FIU-IND) receives, processes and disseminates information relating to financial transactions and the

22 CBDT Circular No. 7/2017 dated 27th January 2017

23 CBDT Circular No. 7/2017 dated 27th January 2017

24 Offence *inter alia* under the Indian Penal Code, 1860, Narcotics Drugs and Psychotropic Substances Act, 1985, Prevention of Corruption Act, 1988 SEBI, Customs Act, 1962, SEBI Act, 1992, Copyright Act, 1957, Trade Marks Act, 1999, Information Technology Act, 2000, trans-border crimes, etc.

Enforcement Directorate (ED) is responsible for investigating the money laundering offences based on the information passed on to it by the FIU-IND. On completion of the investigation, a complaint is filed before the Special Court, where the trial for the offence takes place.

The PMLA requires regulated entities like banks, financial institutions, intermediaries, etc., to carry out client due diligence while undertaking financial transactions. Accordingly, the RBI has issued the Know Your Customer Direction, 2016 (KYC Direction)[25] in terms of which, an NRI is required to furnish his PAN or Form 60, recent photograph, a certified copy of passport or other document issued by the home country/ foreign embassy in India, containing details of his identity and address, and a declaration that he is not eligible for enrolment of Aadhaar[26]. The KYC details initially acquired, are required to be periodically updated based on the risk categorization of the client.

The regulated entities are required to maintain a record of transactions undertaken (*inter alia* of cash and suspicious transactions) and to report the same to the FIU – IND. As per recent news reports[27], suspicious overseas remittances by NRIs and irregular fund movements in their bank accounts have come under the scanner of the ED. Accordingly, notices have been issued under the PMLA for scrutinising bank transfers involving unknown sources of earning, remittances exceeding permissible limits, trading of land, suspected round-tripping, gifts into Non-Resident Ordinary accounts, etc.

7. Recent developments

News reports[28] state that in the wake of the recent financial scams by high net-worth NRIs, the CBDT has formed a five-member committee to oversee the tax implications of high net-worth individuals who leave the country and settle abroad. The idea is to evaluate the tax risks such migrations pose and devise a policy response accordingly.

Additionally, the Government has enacted the Fugitive Economic Offenders Ordinance, 2018, to help freeze and confiscate the assets of economic offenders fleeing India to escape the reach of law. Such economic offenders will be tried under the PMLA.

Further, the Unique Identification Authority of India has clarified that NRIs and PIOs are not required to link their bank accounts and other services with Aadhaar, as the linking requirement is only for those who are eligible to enroll for Aadhaar. Aadhaar as an identity document can be sought only by a 'resident' and NRIs, PIOs are not eligible for Aadhaar enrolment.

8. Closing remarks

While the NRI pool represents a little over 1% of India's population, it is a crucial cog in the wheel of India's development. In its recent Migration and Development Brief[29], the World Bank reported that India retained the top position as recipient of foreign remittances with its diaspora sending about USD 69 billion back home last year. The NRIs also stimulate the economy in other ways, for example, they bring technical and domain expertise to domestic start-ups and often act as angel investors. With a little commitment and some creative thinking, the Government could make it more attractive for its diaspora to step up participation in India's development.

Further, while the ITA does contain some special provisions for taxation of NRI income, measures may be considered to ease things in certain areas, illustratively, rationalisation of the tax refund process if the NRI does not have an operative bank account in India, parity with residents for the purpose of TDS applicability (e.g.: a resident individual is liable for TDS on rental income only if it exceeds ₹ 180,000 per year, while an NRI is liable for TDS on the whole of the rental income without any minimum exempted threshold). Also, tightened visa norms and immigration policies by foreign countries will likely impact the Indian work force in those countries. Returning NRIs should be mindful of the ITA provisions while organising their financial affairs.

25 RBI Master Directions DBR.AML.BC.No.81/14.01.001/2015-16 dated 25 February 2016 (updated as on 20th April 2018)
26 NRI/ PIO is not eligible to obtain Aadhaar number under the Aadhaar law
27 The Economic Times and Money control News dated 12th March 2018
28 Business Today dated 6th April 2018 and Indian Express dated 11th May 2018
29 The Economic Times dated 23rd April 2018.

CA Nilesh M. Kapadia

Returning NRIs – Tax and FEMA implications

A Non-Resident Indian (NRI) returning to India, may have certain queries relating to compliances to be done on return, both under FEMA and Income-tax Act.

NRI under Income-tax Act

In the case of a person who is a citizen of India or a person of Indian origin who is outside India visits India in any year he would be regarded as an NRI if his total stay in India is less than 182 days in the relevant tax year. Alternately, if he is not physically present in India for 60 days or more and 365 days or more in the four financial years prior to that financial year then he is also considered to be an NRI. The tax year is calculated from April 1 to March 31.

There is another category of non-resident Indians, known as 'Not Ordinarily Resident' (NOR). One can become an NOR either if his stay in India in the 7 financial years immediately preceding that financial year is less than 729 days or if he was a Non-Resident for 9 of the 10 financial years immediately preceding that financial year.

A resident other than an NOR is generally referred to as an Ordinary Resident (ROR).

In case an Indian citizen or a person of Indian origin visits India in any tax year, the above mentioned period of 60 days is replaced by 182 days.

Under FEMA

There are different regulations giving different meanings to the term nonresident.

Under the following regulations, i.e.

– FEM (Deposits) Regulations, 2000 (since superseded by FEM (Deposits) Regulations, 2016;

– FEM (Remittance of Assets) Regulations, 2000 (since superseded by FEM (Remittance of Assets) Regulations, 2016);

– FEM (Borrowing & Lending in Rupees) Regulations, 2000

a non-resident means a person resident outside India who is a citizen of any country other than Bangladesh or Pakistan, or such other country as may be specified by the Central Government,satisfying the following conditions:

(a) Who was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955); or

(b) Who belonged to a territory that became part of India after the 15th day of August, 1947; or

(c) Who is a child or grandchild or a great grandchild of a citizen of India or of a person referred to in clause (a) or (b);

(d) Who is a spouse of foreign origin of a citizen of India or spouse of foreign origin of a person referred to in clause (a) or (b) or (c)

Explanation: for the purpose of this sub-regulation, the expression 'Person of Indian Origin' includes an 'Overseas Citizen of India' cardholder within the meaning of Section 7(A) of the Citizenship Act, 1955.

Under the FEM (Investment in Firm or Proprietary Concern in India) Regulations, 2000, "he" means a citizen of any country other than Bangladesh or Pakistan or Sri Lanka, if (a) he at any time held Indian passport; or (b) he or either or his parents or any of his grand-parents was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955); or (c) the person is a spouse of an Indian citizen or a person referred to in sub-clause (a) or (b).

Under the FEM (Acquisition and Transfer of Immovable property in India) Regulations, 2000 "he" means an individual (not being a citizen of Pakistan or Bangladesh or Sri Lanka or Afghanistan or China or Iran or Nepal or Bhutan), who (a) at any time held Indian passport; or (b) who or either of whose father or mother or whose grandfather or grandmother was a citizen of India by virtue of the Constitution of India or the citizenship Act, 1955 (57 of 1955).

The term 'Overseas Citizen of India (OCI)' means an individual resident outside India who is registered as an Overseas Citizen of India Cardholder under Section 7(A) of the Citizenship Act, 1955

As such, the returning Indian needs to ascertain his status under the respective regulation to determine his ability to hold or transfer the respective asset class.

Holding / transferring overseas assets under FEMA

<u>Assets abroad: Sec 6(4)</u>

- A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

<u>Bank acounts</u>

- Redesignation of NRO/NRE/FCNR accounts in India – He needs to redesignate such accounts opened while he was a non-resident to a resident account.
- He can continue to hold his Foreign bank accounts covered under Sec 6(4)
- Can take benefit of RFC acount in respect of balances held in foreign currency accounts in India at the time of becoming a resident.

<u>Shares and Securities</u> – He can continue to hold the same, as being covered u/s. 6(4) (discussed later).

<u>Immovable property</u> – Held outside India can be continued to be so held as being covered u/s. 6(4).

<u>Insurance policy</u>

- Can continue to hold life/general insurance policy outside India. No permission required for payment of premium. However, maturity proceeds to be repatriated within 7 days.

<u>Partner in firm or proprietor of concern</u>

- It is advisable to take RBI permission to continue being partner/proprietor of foreign firm/concern, in the absence of a general approval for the same.

<u>Other Movable assets</u> – There is a doubt whether these are covered u/s. 6(4).

Section 6(4) of FEMA

In terms of sub-section 4 of Section (6) of FEMA, a person resident in India is free to hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

Sub-section 4 of Section (6) of FEMA covers the following transactions:

- Foreign currency accounts opened and maintained by such a person outside India when he was resident outside India;
- Income earned through employment or business or vocation outside India taken up or commenced while such person was resident outside India, or from investments made while such person was resident outside India, or from gift or inheritance received while such a person was resident outside India;
- Foreign exchange including any income arising therefrom, and conversion or replacement or accrual to the same, held outside India by a person resident in India acquired by way of inheritance from a person resident outside India.
- A person resident in India may freely utilise all their eligible assets abroad as well as income on such assets or sale proceeds thereof received after their return to India for making any payments or to make any fresh investments abroad without approval of Reserve Bank, provided the cost of such investments and/or any subsequent payments received therefor are met exclusively out of funds forming part of eligible assets held by them and the transaction is not in contravention to extant FEMA provisions.

What an NRI should do on return to India?

On return to India, you should designate your accounts in your bank as domestic resident accounts or transfer the balance in your NRE/FCNR accounts to Resident Foreign Currency (RFC) accounts, if you so desire. FNCR accounts can be continued till the date of maturity and upon maturity can be converted to RFC accounts.

Tax Implications on return

The taxability of the overseas income (such as rental income from property outside India, capital gains, bank interest, dividends, etc.) arising out of assets (such as bank accounts, stock market/securities, life insurance policies, loans, company deposits, debentures, bonds, residential properties, etc.) held outside India largely depends on residential status in India.

As an NRI returning to India one may try to sell his overseas assets while he is still a NOR or NRI who returns to India. As a NOR or NRI return, if he sells any overseas assets while continuing to be a non-resident under the tax laws, and also receives the sale proceeds outside India, he does not have to pay any taxes in India. If you need to buy a house in India out of the sale proceeds, you can first receive the sale proceeds in an overseas bank account and thereafter remit part or whole of the proceeds back to India without creating any Indian tax liability.

Tax implications post return

For income received or deemed to be received or accruing or arising in India during the previous year, both ROR and NOR/NRI are fully taxable.

For income which accrues or arises outside India and received outside India in the previous year from any other source, for ROR is fully taxable, while for NOR/ NRI is not taxable.

For income which accrues or arises outside India and received outside India during the preceding previous years and remitted to India during the previous year, both ROR and NOR/ NRI are not taxable.

Interest on NRE accounts is exempt from tax under section 10(4)(ii) of the Income-tax Act. Such exemption is available only while the depositor is a non-resident under FEMA, but even later, if he is permitted to hold such an account by the Reserve Bank of India. Many non-residents do not redesignate their NRE accounts as resident accounts even after returning back, and becoming residents. Such continuation is not with approval of the Reserve Bank of India, and hence the exemption under section 10(4)(ii) is not available for such interest. However, the balance in NRE accounts may be converted into RFC account.

Interest on FCNR accounts is exempt under section 10(15)(iv)(fa) while the depositor is NR or NOR. The balance in FCNR account may also be converted into RFC account. The FCNR account may be continued as such till its maturity, and converted into RFC account on its maturity. However, interest on FCNR account will become taxable post the depositor becoming a resident after returning to India.

Subject to the above exceptions, income on overseas assets (such as property, shares or securities) held after the NRI becoming a resident is taxable in India. However, in that scenario, India will be the country of residence and the foreign country will be the country of source. Hence, the taxability of such income will be governed by the Double Tax Avoidance Agreement, if any, between India and that country. For instance, under most treaties, the right to tax income from immovable property is vested in the country where the property is located. Hence, income from such property will be taxable in that country alone, and not in India. Nonetheless, the NRI will need to disclose such income in his return of income filed in India, and claim exemption under section 90 for the same. For income by way of interest or dividends, the treaties generally provide a limited taxing right to the source country, and India being the country of residence will give credit for taxes paid in the overseas jurisdiction.

Resident Foreign Currency (RFC) Account

Such accounts can be opened by individuals singly or jointly. For joint accounts, the same can be jointly with eligible persons (including resident relatives), on former or survivor basis. The account can be in any form, i.e., savings account, current account or term deposit account. Interest and tenure of such accounts may be decided by the banks.

Permitted Credits to RFC account

- Foreign exchange received by him as pension/superannuation/other monetary benefits from overseas employer
- Foreign exchange realised on conversion of the assets referred to in Sec 6(4) of FEMA
- Gift/inheritance received from a person referred to in Sec 6(4) of FEMA
- Foreign exchange acquired before July 8, 1947 or any income arising on it held outside India with RBI permission
- Foreign exchange received as proceeds of LIP claims/ maturity/ surrendered value settled in forex from an Indian insurance company
- Balances in NRE/ FCNR(B) accounts on change in residential status

Permitted Debits

- There are no restrictions on utilization in / outside India

Interest on RFC accounts is also exempt under section 10(15)(iv)(fa), till the depositor is NRI or NOR. In other words, the exemption will be lost upon the depositor becoming a resident in India.

FATCA reporting

Foreign Account Tax Compliance Act and agreement between India and USA has mandated reporting of income of persons liable to tax in USA (which includes not only US residents but also US citizens, whether or not residents) by the Indian Government to the US tax authorities. For this purposes, Indian banks, depositories and other reporting entities obtain declarations from their clients about their tax status. Hence the returning Indians should take care to correctly disclose their tax status to such entities, so that correct reporting is done by the Indian tax authorities. Further, the NRI should also note to file his tax returns in the overseas jurisdiction, as the obvious intention is to match the income being reported in the source country.

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CA Hinesh Doshi & CA Aarti Karwande

Cross border secondment of employees – Tax and FEMA (Inbound)

1. Background

Mobility of labour across national borders is the need of the hour for various organisations to meet the desideratum of customised skills and expertise in the wake of globalisation and exchange of talent and manpower across the globe.

This results in frequent secondment or deputation of employees from or to countries other than the one in which employee had originally continued service. Moving to a foreign country often proves challenging, not only for the employee but also for the sender and receiver organisations. Coming to terms with a new regulatory system is one of the most significant factors contributing to this challenge.

At present there are approximately 244 million migrants around the world, representing 3.3 per cent of the global population as per World Migration Report 2018 issued by the International Organisation for Migration (IOM). Working in India means participating in one of the fastest-growing and most diverse economies worldwide. The official data from International Labour Organisation shows 3,90,000 emigrants for work in India from abroad in 2017.

Coverage of this article

1. Introduction to secondment
2. Indian taxation: An overview
3. Dependent Personal Services
4. Factors to be considered for Secondment
5. Corporate Tax issues
6. Practical considerations for secondee
7. Relevant matters under FEMA, 1999

Few of the magnitude of concerns while planning secondment of employees include:

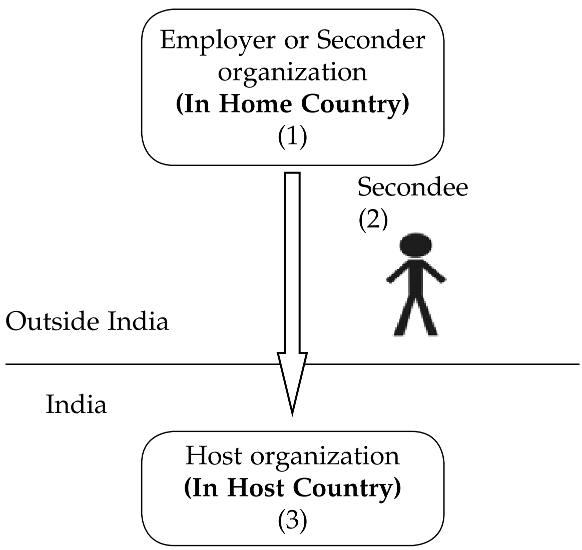
1. Dynamism in the status of employer-employee relationship
2. Nature and duration of the assignment
3. Deciding the organisation on whose payroll employee is to be held post deputation
4. Control & supervision over the employee and several related issues.

Let us first understand the concept of Secondment and a few terms associated with the same.

1.1 Secondment refers to

At common parlance, secondment of employees refers to a situation when a staff contractually employed by one company is sent/transferred to another company to perform certain work specifically assigned to them.

There are generally three parties (1,2,3 depicted below) to a classic inbound secondment agreement into India depicted hereunder:



A secondment agreement executed by the parties contains the detailed terms and conditions of the arrangement between the employer and the host.

The company and the seconded employees have to specifically take into consideration various issues like:

- Tax issues in the home and host countries,
- Host country regulations & compliances such as:
  - a) immigration laws
  - b) foreign exchange regulations
  - c) social security norms
  - d) other labour laws risks
  - e) Risk of permanent establishment ('PE')

1.2 Economic Employer vs. Legal Employer

In this arrangement, there are virtually two (or more) employer organisations created for the particular employee. An understanding of the role of each employer is vital in structuring the whole arrangement such as to minimise regulatory and other hurdles.

Economic employer	Legal employer
• Is in the host country • Pays costs related to the day-to-day maintenance of the employee • Reimburses cost of salary paid to secondee by the seconder entity	• Is in the home country • Substantial recruiter of the employee • Provides pension and other social security benefits • Pays salary to the secondee and claims reimbursement from host country organisation

IDS Software Solutions vs. ITO [2009] 122 TTJ 410 (Bang. ITAT) – In favour of the assessee

In this case, though the US Co was the employer in a legal sense but:

i. the services of the employee had been seconded to the assessee

ii. the assessee was to reimburse the emoluments

iii. it controlled the services of the employee

It was the assessee which for all practical purposes was the employer. Accordingly, the salary reimbursed to the US Co was not chargeable to tax in India.

Centrica India Offshore Private Limited vs. CIT SLP dismissed by SC on 10th Oct, 2014 – Against the assessee [Ref: (2014) 364 ITR 336 (Delhi HC)]

The Apex Court held that the reimbursement by the Indian entity of seconded employees' salaries and costs amounts to Fees for Technical Services and is liable to be taxed in India.

It was held that even though the control and supervision of the seconded employees rested with Centrica India (economic employer), their presence in India will be treated as a Service PE of the Overseas Entity. Accordingly, reimbursement of the employee costs is liable to be treated as taxable service income arising from such Service PE (and not merely a reimbursement of salary) on which tax is to be deducted by Centrica India while making the payments.

Abbey Business Services (India) Pvt. Ltd. [2012]53 SOT 401 (Bang ITAT) – In favour of the assessee

In another case, Abbey Business Services, with similar facts as those of Centrica India Offshore Pvt. Ltd., the Tribunal took a different view and held that the Indian company is the **real employer.** The difference in facts of this and the Centrica case above was that Abbey's secondment agreement contained two clauses, described below, which led to the Tribunal to declare the Indian entity as the employer.

i. Reimbursement was calculated on the basis of the time utilised and was bereft of profits, and

ii. Number and qualifications of the employees was determined by the secondee company.

1.3 Expatriate vs. Secondee

Although used interchangeably in the parlance of cross-border employment arrangements, there exist subtle differences between the terms "Expatriation" and "Secondment" as enunciated hereunder:

Particulars	Expatriation	Secondment
Meaning	The expatriate employee is recruited specifically for the assignment or is sent by the employer to work abroad	The seconded employee is already working for the company and is sent abroad for a limited period
Duration	Expatriation may last a year or a lifetime; no time limit exists	The authorized length of secondment varies depending on variety of factors specific to each case
Employment contract	The employment contract (with Home Unit) is suspended during expatriation and a new employment contract is signed with Host Unit for the period of expatriation	No new employment contract is signed with Host Unit. Secondment functions as an addendum to original employment contract.
Disbursement of Salary	The remuneration is normally paid (and charged to) by Host Unit	Remuneration continues to be paid by Home Unit (or charged to Home Unit)
Reporting entity	The employee reports to Host Unit	The employee reports to Home Unit. However, this may be subjective for each contract

1.4 Stewardship vs. Deputation

Oxford dictionary defines "Stewardship is the job of supervising or taking care of something, such as an organisation or property". A steward is a person whose responsibility it is to take care of something.

Deputation, as per the aforesaid dictionary means "a group of people appointed to undertake a mission or take part in a formal process on behalf of a larger group".

2. Indian taxation : An overview

2.1 Recent Updates in taxation

Filing the Income Tax return

- For the FY 2017-18 (AY 2018-19), non-residents have to mandatorily file their returns in either ITR-2 or ITR-3 instead of the simpler ITR-1 form used until FY 2016-17.
- The new ITR-2 form requires reporting of at least one foreign bank account with IBAN (International Bank Account Number) and SWIFT details of the Bank if they do not hold a bank account in India in which refund, if any, may be credited by the tax department.
- This ITR also requires declaration of foreign assets acquired outside India by Non-Resident or Resident but not ordinarily Resident (RNOR) if and only if income from such assets is derived during the FY.

Recent Permanent Establishment and TDS issues

***Addl. DIT (International taxation) vs. Marks & Spencer Reliance India Pvt. Ltd. TS-178-HC-2017 (Bombay HC)* – In favour of assessee**

In a significant ruling, the Bombay High Court issued an order concluding that payments made under a secondment agreement were reimbursements of expense, not technical service fees and, therefore, was not subject to Indian withholding tax under the India-UK tax treaty. It was determined that the assistance provided by the seconded employees to JV Co did not include "making available" skills or technical knowledge and, therefore, the payments made by JV Co could not be considered FTS under the treaty.

***Burt Hill Design Private Limited vs. Deputy Director of Income Tax [2017] 164 ITD 697 (Ahmedabad-ITAT)* – In favour of assessee**

In this case, the Ahmadabad Tribunal ruled that reimbursement made by an Indian company to a foreign company towards the cost of employees seconded by it to the Indian company does not attract tax withholding in India.

***Samsung Electronics Co. Ltd. vs. DCIT (International Taxation) [2018]-TII-91-INTL (Del. ITAT)* – In favour of the assessee**

It was held that where there was neither any business conducted by assessee - (Korean company) nor any income was derived through activities of employees seconded in India, there could have been no fixed place PE of assessee in India.

Assessee had two wholly owned subsidiaries in India i.e., SIEL and Samsung R&D. Expatriate employees, seconded to SIEL were only discharging duties of Indian subsidiary company towards Korean holding company and whatever benefits that were derived by Indian subsidiary were offered to tax in India. It was held that such activity did not constitute a PE under Article 5(4)(d), (e) and (f) of India-South Korea DTAA.

Further, as there is no provision for service PE in India-South Korea DTAA, no question of Service PE would arise in this matter. Also, there was no proof as to any management activity of the Korean company being conducted in India. Thus, there could have been no fixed place PE of assessee constituted through these expatriate employees.

***Ms. Flughafen Zurich AG vs. Deputy Director of Income Tax [TS-96-ITAT-2017](Bang- ITAT)* - Against the assessee**

The Bangalore Tribunal has ruled that payments made to a non-resident entity towards the cost of employees seconded by it to an Indian entity qualifies as Fees for Technical Services (FTS) and attracts tax in India. Even if the secondment period is long, the Tribunal held that the seconded employees continued to have an employer-employee relationship with the company in the home country and not in the Indian company.

Comments

It is advisable that taxpayers should maintain appropriate agreements and relevant documentation to support the position that payments for seconded employees are reimbursements of costs and are not Fees for Technical Services. Care must be taken to structure these arrangements in such a way as to minimise the risks posed in light of the above judgments. Vigilant planning of secondments can help taxpayers in substantially obviating such exposure.

2.2 Residential status

This is one area, which can have a large number of issues cutting across a complex set of facts in real life secondment scenarios. Taxation in India is based on the residential status of a person and not on citizenship. Determining the residential status for each year of deployment is of vital importance not only under the Act but also under the DTAA.

2.2.1 Taxability of income under the Income-tax Act, 1961 ('The Act')

Taxation undergoes variation based on the residency status of the individual in each financial year.

Particulars	**Resident & Ordinary Resident (ROR)**	**Resident but Not Ordinarily Resident (RNOR)/Non-resident (NR)**
Income accrued/deemed to accrue in India (Section 5 & 9)	Taxable in India	Taxable in India
Income received/deemed to be received in India (Section 5)	Taxable in India	Taxable in India
Income accrued and received outside India	Taxable in India	Not taxable in India unless it is derived from a business controlled in India or profession set up in India.

Residential status is determined solely based on his or her physical presence in India regardless of the purpose of stay. Below is a simplified criteria for determining residency of an individual under Section 6 of the Act:

Resident [Section 6]

Resident & Ordinary Resident (ROR) [Sec. 6 (1), 6(6)(a)]	***Resident but Not Ordinarily Resident (RNOR) [Section 6(6)]***
(a) He was in India for a period or periods totalling in all to 182 days or more during relevant previous year. OR (b) He was in India for a period or periods totalling in all to 60 days or more during relevant previous year and 365 days or more during four previous years preceding the relevant previous year. And	(a) He was in India for a period or periods totalling in all to 182 days or more during relevant previous year OR (b) He was in India for a period or periods totalling in all to 60 days or more during relevant previous. year and 365 days or more during four previous years preceding the relevant previous year. And

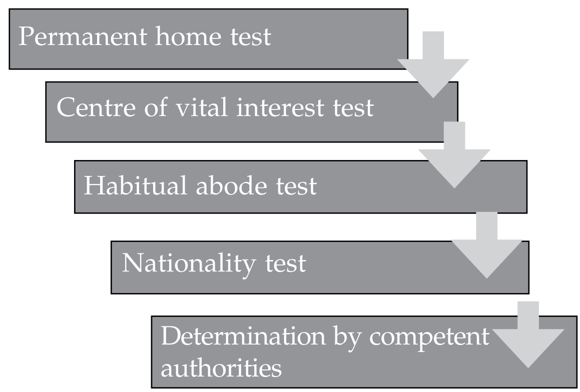
Resident & Ordinary Resident (ROR) [Sec. 6 (1), 6(6)(a)]	*Resident but Not Ordinarily Resident (RNOR) [Section 6(6)]*
Subsequent conditions (i) Must be resident of India (by fulfilling at least one of two above mentioned tests) in at least 2 out of 10 previous years preceding the relevant previous year. And (ii) Must have stayed in India for 730 days or more during 7 previous years preceding the relevant previous year.	Subsequent conditions (i) Was non-resident in India in 9 or 10 previous years out of 10 previous years preceding the relevant previous year. OR (ii) Was in India for less than 730 days during 7 previous years preceding the relevant previous year.

Non- Resident [Section 2 (30)]
Under Section 2(30) of the Income Tax Act, 1961 an assessee who does not fulfill any of the two subsequent conditions given above for ROR would be regarded as "Non-Resident" assessee during the relevant previous year.

2.2.2 Under the DTAA
Article 4(1)-RESIDENT, United Nations Model Tax Convention (UN Model), on basis of which treaties with various countries have been entered into by India , lays down as under:

"For the purposes of this Convention, the term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political sub-division or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein."

However, if an expatriate employee is deemed resident of both the treaty countries under the respective country's domestic tax law, the Tie-breaker rules as per Article 4(2) of the UN model shall apply:



3. Dependent Personal Services (DPS):

The general rule under Article 15 of the UN Model with respect to income from DPS is that the remuneration may primarily be taxed in the country where the employment is exercised.

Notwithstanding this general rule, an exemption from source taxation applies if all of the following three conditions are met:

a) the employee is present in the source country for 183 days or less in any 12-month period commencing or ending in the fiscal year concerned; and

b) the remuneration is paid by, or on behalf of, a non-resident employer; and

c) the remuneration is not borne by a permanent establishment or a fixed base of the non-resident employer, which is situated in the source country.

A special rule applies under Article 15 for remuneration from employment exercised aboard ship or aircraft in international traffic, or a boat engaged in inland waterways transport. Such remuneration may be taxed in the country in which the place of effective management of the transport enterprise is situated (or in the country of residence of the enterprise, where that formulation is used in the treaty).

A few issues which might arise in dealing with DPS include:

– the nature of services rendered;

– determination of residential status of the employer;

– quantification of income derived from each of the countries;

***Director of Income-tax (International Taxation) vs. Maersk Co. Ltd. [2013] 351 ITR 366 (Uttarakhand HC)* – In favour of assessee**

In this case, Danish employees were seconded to India [Dependent personal services] for a period not exceeding 183 days. Salary was paid by the non-resident company and not borne by the PE or fixed base in India. In view of provisions of Article 16 (corresponding to Article 15 of the UN model) of the Treaty read with Section 9 of the Act, remuneration paid to Danish nationals was taxable in Denmark and not in India as it was not borne in India.

4. Other factors to be taken into consideration for each secondment assignment

Below are few important aspects to be taken care while planning movement of secondee to India:

4.1 Short stay exemption

A secondee may be on a business visit, a short-term assignment or on a long-term assignment. Section 10(6)(vi) of the Act provides tax exemption for services rendered in India if:

a) The foreign enterprise is not engaged in any trade or business in India;

b) The employee's stay in India does not exceed in the aggregate a period of ninety days in the previous year;

c) Such remuneration is not liable to be deducted from the income of the employer chargeable under the Act.

***Commissioner of Income-tax vs. Bharat Heavy Electricals [2001] 252 ITR 218 (Delhi HC)* – In favour of the assessee**

Assessee, a Government undertaking, obtained services of two experts of NEL of UK, with Government's approval. They rendered services in India on remuneration. ITO held that amount remitted to NEL was not actually paid to employees as remuneration but was paid to NEL itself directly for technical services rendered by foreign experts and said amount was taxable. However, the two experts were found (by the Tribunal) to be employees of a foreign concern which was not doing any business in India and amount was not paid to foreign concern for technical services but for payment to two experts whose services were requisitioned. It was held by Tribunal and upheld by HC that said amount was exempt from tax under section 10(6)(vi).

4.2 Tax Residency Certificate (TRC)

Non-residents seeking tax treaty benefits are mandatorily required to produce a verified TRC with prescribed particulars from the Government of the Treaty partner country according to section 90(4) of the Act. Here, care needs to be taken for the difference between the Indian tax year (March to April) and calendar year (Jan-Dec.) followed in many other countries. It is to be noted that submission of the TRC containing prescribed particulars is a necessity, but not sufficient condition for availing benefits of the DTAAs.

It is to be noted that Form 10F is allowed to be filed by the non-resident as a self-declaration in absence of the TRC.

4.3 Foreign Tax Credit (FTC)

FTC works towards ensuring that the taxpayer is not being taxed on the same income by the home and host country. FTC can be availed in accordance with the provisions of either the relevant DTAA or Section 91 of the Act (if no DTAA exists). Rules for claiming FTC have been notified under Rule 128 w.e.f. 1-4-2017 which have been briefly captured as under:

1. FTC is to be allowed in the year in which the income corresponding to such tax has been offered to tax in India;
2. FTC shall be available against the amount of tax (including Minimum Alternate Tax under section 115JB of the Act), surcharge and cess payable under the Indian tax laws but not against interest, fee or penalty;
3. FTC shall not be available if the foreign tax is in dispute;
4. FTC shall be computed separately for each source of income derived from a particular country;
6. FTC shall be the lower of, tax payable on such doubly taxed income under the Indian tax laws and the taxes paid out of India.

Form 67 is a crucial document that is mandatorily required to be furnished in order to claim FTC on or before the due date of filing the original return of income. Online submission of Form 67 encrypting it with a Digital Signature certificate or Electronic Verification Code along with the below mentioned documents is mandatory.

1. A statement of:
   - foreign income offered to tax
   - foreign tax deducted or paid on such income in Form No. 67
2. Certificate or statement specifying the nature of income and the amount of tax deducted therefrom or paid by the taxpayer:
   - From the tax authority of the foreign country
   - from the person responsible for the deduction of such tax
   - signed by the taxpayer
3. Proof of taxes paid outside India

4.4 Hypothetical tax deduction (Hypo tax)

The need for tax neutrality from the perspective of the secondee gives rise to the concept of an estimated notional tax, which is equivalent to the tax, the expat would pay had he remained in the home country with that level of salary. Relevant up/down calculations are then made based on actual salary and tax rates for the concerned period and the differential amount between estimate and actual amount is paid/collected from the employee.

***CIT vs. Dr. Percy Batlivala [2010-TIOL- 175] (Delhi HC)* – In favour of assessee**

The employment contract bore that the US Company (employer) would bear the tax liability of the assessee on deputation to India. In this case, the total tax liability in India was lower than that in USA and the department claimed to tax the difference amount as Hypo tax. The HC however ruled that this differential amount had never accrued to the secondee in India and thus no question of law arises.

***Jaydev H. Raja [2013] 357 ITR 293 (Bom. HC)* – In favour of assessee**

Assessee was a resident but not ordinarily resident individual and an employee of a foreign company. He earned salary income of ₹ 77 lakhs in India on which tax was payable at maximum rate amounting to ₹ 35 lakhs. He was entitled to receive the same as reimbursement from the employer. Assessee had included ₹ 35 lakhs to his salary income of ₹ 77 lakhs and offered ₹ 113 lakhs (round figure) to tax. Total tax liability of the assessee amounted to ₹ 50 lakhs which was borne by the assessee. It was held that the balance tax amounting to ₹ 15 lakhs paid by the assessee out of the salary income (not reimbursed by the company) could not be added to that income of the assessee.

***Roy Marshal vs. ACIT (2008-TIOL-567-ITAT-MUM)* – In favour of assessee**

The assessee is a foreign national resident in India during the previous year. As per the contract, employer was to bear liability to the extent of excess taxes payable in India as against that in his home country. Assessing Officer took view that 'hypothetical taxes', should also form part of salary income. Taking reference of *Jaydev Raja vs. DCIT (supra)* it was held that no deduction was actually claimed by assessee on account of hypo-tax and accordingly the addition by the Department ought to be deleted.

***ITO vs. Lukas Fole [2009] 124 TTJ 965 (Pune-ITAT)* – In favour of assessee**

The ITAT laid down the principle that for the purpose of computation of income of secondee in India, hypothetical tax is to be reduced from the tax perquisite of the employees and not from their basic salary.

4.5 Overseas Social Security and Pension Contributions

Any foreign national holding foreign passport (international worker) coming to India to work for an Indian establishment to which the Employees Provident Funds and Miscellaneous Provisions Act, 1952 applies, is required to contribute to the Employee's Provident Fund in India. However, international workers (IW) coming from a country with which India has a social security agreement (SSA) and he is contributing to the social security of the home country and enjoys the status of a detached worker is excluded from this requirement provided he obtains a certificate of coverage (COC) from the home country.

Following are the updates in <u>Withdrawal provisions</u> for inbound employees as per Notifications and Circulars issued:

- IW from SSA country:
  - Provident fund: On completion of Indian assignment
  - Pension fund: Early lump sum withdrawal possible
  - Withdrawal in Indian bank account, overseas bank account and 'through the employer'
- IW from non-SSA country:
  - Provident fund: On retirement from service or attaining 58 years of age, whichever is later
  - Pension fund: Early lump sum withdrawal not possible
  - Withdrawal only in Indian bank account

Currently India's Social Security Agreements are operational in nineteen countries – France, Germany, Switzerland, Belgium, South Korea, Denmark, Netherlands, Luxembourg, Sweden, Finland, Czech Republic, Norway, Hungary, Austria, Australia, Japan, Portugal, Canada and the latest to be signed the SSA with Brazil in 2017 which will be in force from a date in 2018 (not yet notified).

***Yoshio Kubo vs. CIT [2013] 357 ITR 452 (Delhi HC)* – In favour of assessee**

M/s. Sony Corporation of Japan (SCJ) deputed its employee to work in India and also bore his taxes arising in India. On contentions raised by the Department in the employee's case, the Delhi HC ruled as under:

1. On social security, pension and medical insurance contributions by employer:

   These amounts assure not a present benefit but future benefit to the employee, only in the event of a contingency. This amount does not vest in the employee and is not taxable perquisites.

2. Regarding assessability of TDS refunds:

   Amounts are paid directly by the employer to the Government over and above the tax due on the salary. These do not, in any case, accrue to the assessee and are not taxable in his hands.

***ACIT vs. Harashima Naoki Tashio [2010] ITA No. 4634 (Delhi ITAT)* – In favour of assessee**

In case of a foreign national, working as employee of Indian Co., employer's contribution towards social security, health insurance, etc. in Japan was held not liable to tax in the hands of the employee in India as it was made under statutory provisions of Japan. It did not give any vested right to the employee in the year of contribution and it was a contingent benefit dependent on an event beyond the control of the employee. Therefore, the amount contributed by the employer was not treated as a taxable perquisite in the hands of the employee.

***Gallotti Raoul vs. ACIT [1997] 61 ITD 453 (Mum ITAT)* – In favour of assessee**

Assessees were French nationals working in India - In terms of French legislation, every French national was under an obligation to affiliate with social security organisation and contribute certain percentage of salary irrespective of the place of employment. Social security charges were tax deductible in France. Assessee was paid salary after deduction of social security charges. It was held that contribution made to these charges could be deducted while computing salary income of assessee as social security organisation has overriding charge and assessee has no domain over it.

4.6 *Per diem* allowance

The employees also receive a *per-diem* allowance over and above the normal home country salary. Section 10(14)(i) of the Act read with Rule 2BB(1)(b) of the Income-tax Rules, 1962 exempt any allowance whether granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty. It is to be noted that the exemption is available only to the extent to which the expense is actually incurred.

Caution: The allowance must be granted as a reimbursement and not as personal advantage

***CIT vs. Goslino Mario (2000) 241 ITR 312 (SC)* – In favour of assessee**

In case of *Per Diem* allowance, it was held that where the employees were required to stay away from their homes, daily allowance given to them to incur expenditure, **wholly, necessarily and exclusively for the purpose of duties and such expenditure was in nature of reimbursement,** the same will be excluded from the net cast by the Act.

4.7 Tax on Non-monetary perquisites – Exempt in the hands of employee

A plain reading of section 10(10CC) of the Act is as - *"in the case of an employee, being an individual deriving income in the nature of a perquisite, not provided for by way of monetary payment, within the meaning of clause (2) of section 17, the tax on such income actually paid by his employer, at the option of the employer, on behalf of such employee, shall not be included in total income."*

***Yoshio Kubo vs CIT [2013] 357 ITR 452 (Delhi HC)* – In favour of assessee**

M/s. Sony Corporation of Japan (SCJ) deputed its employee to work in India and also bore his taxes arising in India. On contentions raised by the department on taxability of non-monetary perquisites, the Delhi HC rule as under:

1. Taxes paid by employer on employee's behalf:

   Amounts paid directly by the employer to discharge its employees' income tax liability are exempt in the hands of employee u/s. 10(10CC)and are to be excluded from his income calculation.

2. Regarding grossing up

   Where tax is deposited in respect of non-monetary perquisite, it is exempt under section 10(10CC) and multiple stage grossing up is not applicable.

***RBF Rig Corpn. LIC (RBFRC) vs. ACIT [2007] 109 ITD 141 (Delhi ITAT) (SB)* – In favour of Assessee**

Payment of tax on behalf of employee at option of employer is a non-monetary perquisite fully covered by section 17(2)(iv) . Thus, it is exempt under section 10(10CC) and is not liable to be included in total income of employee. Taxes paid by employer can be added only once in salary of employee and thereafter, tax on such perquisite is not to be added again.

5. Corporate tax issues

5.1 Permanent Establishment (PE) exposure for overseas employer

The overseas employer runs a risk of triggering PE exposure in the host country depending on the period of presence, nature of work performed and the text of contract with the host country which could lead to unwarranted tax and compliance issues. Various judicial precedents in this matter need to be verified so as to examine its relevance with reference to nature of services performed, applicability and interpretation of the Act and DTAA for resemblance and accordingly structure the secondment contract to minimise the tax and regulatory implications.

***Assistant Director of Income-tax vs. E-Funds IT Solution Inc. - [2017] 399 ITR 34 (SC)* – In favour of assessee**

E-Funds India, the Indian arm of the assessee's group rendered back office support services for the USA based assessee for which it received remuneration at arm's length price. The High Court decided the issue in favour of the assessee after which the tax department filed an appeal to the SC. The SC after considerable arguments of both parties observed:

Fixed place PE

A fixed place at the disposal of the foreign entity is required to attract this type of PE which was not found in the present case.

Service PE

Article 5(2)(l) of the India -US DTAA requires an enterprise to furnish services within India through personnel. The Indian company rendered only auxiliary operations to facilitate services outside India which did not give rise to PE.

Agency PE

The Indian entity was not authorised to conclude contracts on behalf of the assessee. Hence there is no question of forming an agency PE in India.

***ADIT (IT) vs. Bay Lines (Mauritius) [2018] ITA No. 1181 (ITAT-Mum.)* – In favour of assessee**

The Tribunal laid down that where activities of assessee's sole agent in India were not devoted exclusively on behalf of assessee as it also did work on behalf of other principals and earned a substantial part of its income from them, it was not an exclusive agent of assessee and, accordingly, it did not come under purview of definition of dependent agent as defined in article 5(5) of DTAA between India and Mauritius. Thus, assessee was not having any PE in India and therefore it was not taxable as per Article 7 of the DTAA.

***ACIT (IT) vs. Valentine Maritime (Gulf) LLC [2017] 166 ITD 1 (Mumbai - ITAT)* – In favour of assessee**

The assessee based in Abu Dhabi had entered into a contract with Indian company to provide services of personnel and survey services. It submitted that it did not have PE in India as each of its contracts were for a period less than 9 months. However, Assessing Officer considered the combined period of all projects undertaken by the non-resident company to determine. The learned ITAT held that the actual period of two unconnected projects undertaken by a foreign company could not be combined so as to determine its PE in India.

***GE Energy Parts Inc. vs. ADIT (International tax) [2017] 56 ITR (T) 51 (Delhi ITAT)* – Against the assessee**

It was observed that expatriates deputed in India undertook core marketing and sales activities of the overall GE group from GE's liaison office. Thus, Indian liaison Office constituted assessee's fixed place PE.

Further, since GE India, comprising of secondees from overseas GE entities had the authority to conclude contracts on behalf of GE overseas, GE India constituted dependent agency PE.

***Morgan Stanley & Co. [2007] 292 ITR 416 (SC)* Against the assessee**

In Morgan Stanley's case, the Supreme Court concluded that the US company did not have a PE in India on most accounts, except that if personnel are deputed to India, then the deputees are likely to constitute a 'service PE' in India. In this case, the court examined the consequences of Morgan Stanley sending personnel to India on stewardship (Supervision of operations) and deputation and concluded that as regards stewardship, no 'service PE' will exist, whereas deputation will result in a 'service PE'.

Further, under Indian transfer pricing laws, international transactions with associated enterprises are required to be at an arm's length price which will debar further tax consequences and attribution of profits.

5.2 Risk of Double Taxation for the entities involved

Many a times, the home country employer continues to pay the salary to the seconded employees on behalf of the host country employer and claims reimbursement for the same from the host country organisation. It is worth observing that the same amount of money is brought into the tax net - once in the secondee's hands as salary accrued/received in India and as payment to foreign entity for services rendered by their employee. This results in duplication of taxes and is a grave loss to the taxpayer. Further, even if the withholding tax (WHT) is deducted and the net tax liability of the Foreign entity is nil or refundable, the actual receipt of this WHT amount back to the foreign entity is not easy to obtain. Ultimately, it leads to unnecessary sacrifice of money. Thus, it is very important to take care of the tax structure for all the parties concerned, as a single loophole may lead to enormous cost and litigations.

***DCIT vs. Mahanagar Gas Ltd. [2016] 158 ITD 1016 (Mumbai – ITAT)* – In favour of assessee**

Since technical services of US company employees had been seconded to assessee who was to reimburse (on cost basis) their emoluments, it was the assessee which for all practical purposes was the employer and, therefore, salary reimbursed could not be considered as 'fees for technical services' for purpose of section 194J (TDS on professional services).Accordingly, no TDS was required to be withheld under that section.

***Intel Corporation vs. Deputy Director of Income-tax,(International Taxation) [2016] IT(TP)A No.1486/Bang/2013 (Bang ITAT)* – Against the assessee**

Where assessee, US company received certain sum from its Indian subsidiary on account of salary costs of its seconded employees, since all secondees were rendering expert managerial services to Indian subsidiary and further, the assessee US company was the legal employer of secondees, sum received by assessee was clearly F.T.S. taxable in India.

***Commissioner of Income tax vs. Eli Lilly & Co. (India) (P.) Ltd [2009] 312 ITR 225 (SC)* – Against the assessee**

1. If any payment of income chargeable under head 'Salaries' falls within section 9(1)(ii) i.e. Salary earned in India for services rendered in India, then TDS provisions would stand attracted.

2. Whether home salary payment made abroad to expatriate employees by foreign company can be held to be 'deemed to accrue or arise in India' would depend upon in-depth examination of facts in each case.

3. Where such salary payment made by foreign company abroad is for rendition of services in India and no work is found to have been performed for foreign company, such payment would certainly come under the purview of TDS.

6. Practical considerations for the Seconded Employee:

6.1 Considerations before arrival in India

- Immigration: A foreign national visiting India for employment should apply for a valid visa before he arrives. Expats can either apply for an employment visa or business visa depending on their requirement to legally work in India – no separate work permit will be needed.

Particulars	Employment visas	Business visas
Eligibility	To work for an organisation registered in India	For expats who want to conduct business in India or those not on Indian company payroll
Scope of work	Relocating to India on either an intra-company transfer or with a guaranteed offer of employment	Applicants usually work on behalf of a foreign company for a limited time
Documents required	• Proof of contract • Professional Qualification proof	• Letters from the sponsoring organisation • Details of the local Indian organisation doing business with
Validity of Visa	2-5 years	6 months or more
Application Form	Local Indian Embassy or a VFS Global private processing agency appointed by the Indian authorities to process visa applications	
Extensions and renewals	From Indian Ministry of Home Affairs or an secondee's local Foreign Regional Registration Office (FRRO)	

- Contract: One should be employed as a full-time employee under an employment contract setting out in clear terms the remuneration or salary and the non-cash benefits (perquisites) to which the secondee will be entitled.

- The taxability of each allowance, perquisite and other considerations from both the employers need strict perusal as to their taxability or otherwise in India.

6.2. Considerations after arrival in India

6.2.1 A glimpse of requirements

Requirements	Form to be filled	Periodicity
Foreigners' Regional Registration Office (FRRO)	Apply online https://indianfrro.gov.in /frro/ menufrro.jsp	Within 14 days of arrival. To be renewed periodically
PAN application	Form 49AA	One time
Tax payments (personal income)	Challan 280	15th June, 15th September, 15th December, 15th March
Income Tax return (ITR)	Commonly used returns for secondees are ITR-2 and ITR-3. However, it is advisable to select ITR depending on source of income each year	31 July
Social security	Done by the employer	Monthly
Income tax clearance certificate	Form 30A	Before departure

6.2.2 *Bank Account:*

- **In India**

  Under clause 5(1)(iii) of the FEM(Deposit) Regulations, 2016 notified *via* Notification No.5(R)/2016-RB dated 1st April, 2016, an expatriate is permitted to open a NRO Bank account with an Indian Bank or Indian branch of a foreign bank in India to credit his/her Indian earnings or receive funds from abroad, even though their residential status may be Person not resident in India.

  Upon becoming a person resident in India (PRI), a regular savings account bank can be opened.

- **Outside India**

  As per clause 5(F)(8)(i) of the FEM (Foreign currency accounts by a person resident in India) Regulations, 2015 notified via notification No. FEMA 10(R)/2015-RB dated 21st January 2016, *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, subject to payment of taxes, as applicable in India.*

6.3 Annual Tax return of the employee

- A tax return has to be filed by the secondee within the due date of 31st July, following the end of the relevant tax year *(The Indian tax year runs from 1st April to 31st March)*

- Penalty for non-filing: A penalty of ₹ 5.000 is attracted if the filing is done between 31st July and 31st December. Thereafter the penalty will be a maximum of ₹ 10,000.

  This is applicable only if the Total income for that year exceeds INR 500,000.

- Wherever necessary, exemption or claims should be backed by valid documentation. Returns need to be filed online from the website https://www.incometaxindiaefiling.gov.in

- Revision of return: In case of errors of for any other valid reason, this return is allowed to be revised within 2 years from the end of the relevant tax year on and from the year 2017-18.

6.4 Considerations while departing from India

6.4.1 Tax clearance certificate

- As a non-domiciled individual in India, the secondee is required to obtain a no objection certificate (NOC) from the Indian tax authorities at the time of leaving the country post completion of work contract.
- An undertaking by the employer needs to be furnished to the authorities assuming liability for tax if any, due from the secondee.
- Such NOC may be required at the port of departure by the immigration authorities.
- Procedure for making application:

  a) One has to apply for NOC in Form 30A. This form requires the employer or the person through whom the secondee has earned income in India, to act as a guarantor to pay the taxes payable by the person leaving India, under the Income-tax Act.

  b) The liability of the guarantor will extend to the amount of tax determined as payable on the income earned during the period of employment under the employer.

  c) The NOC in Form 30B is issued on receipt of Form 30A and has a period of validity specified therein.

6.4.2 Tax Refunds for departing secondee

- Few banks process refunds (through their tax pool account) for secondees who leave India and not having any bank account in India. A SWIFT message with KYC details of the beneficiary (from the Beneficiary's overseas bank) and specified documents are required to be submitted to an eligible Indian Bank who then collects and converts the refund into desired currency and remits it into the secondee's home country bank after deducting a service charge.
- As per Circular: No. 707, dated 11-7-1995, in certain cases, an employee to whom refunds are due has already left and has no bank account in India by the time the assessment orders are passed, the refund can be issued to the Indian employer as the tax has been borne by it. The non-resident assessee is required to duly give an authorisation in this regard.

  Also refer recent updates in point 2.1 in case of refund.

7. Foreign Exchange Management Act, 1999 ('FEMA')

FEMA regulations also need to be looked into to determine the ability to receive, retain and/or remit the salary outside India as well as at the time of opening a bank account in India. The key to this is to determine the residential status of the expatriate employee under FEMA, which contains a definition different from that under the Income-tax Act, 1961 ('the Act').

7.1 Residential status

FEMA makes clear distinction between resident and non-resident. Person resident in India means the following [Section 2(v) of FEMA]:

A person residing in India ("PRI") for more than 182 days during the course of preceding financial year. However, it does not include a person who:

- has gone out of India or who stays outside India for employment outside India or carrying on business or vocation outside India or for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period.

- has come to or stays in India, in either case, otherwise than
  - (a) He has come for or taking employment in India
  - (b) For carrying on business or vocation in India
  - (c) For any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period

Summarizing: 'Person resident in India' includes persons of India (except those staying abroad for work or business or other purpose) and foreign persons who come to India or stay in India for employment, carrying out business or other purpose. Even office, branch or agency can be 'person'.

One major distinction between. Income tax and FEMA provisions is that "purpose of stay" is not relevant in income tax unlike for FEMA.

7.2 Possession of foreign exchange by a person resident in India but not permanently resident therein

As per Regulation 4 of FEM(Possession and retention of Foreign currency), Regulations, 2015 , persons resident in India but not permanently resident (means a person resident in India for employment of a specified duration not exceeding three years) therein may possess without limit foreign currency in the form of currency notes, bank notes and traveller's cheques, if such foreign currency was acquired, held and owned by them when they were resident outside India and has been brought into India in accordance with the regulations made under FEMA i.e., after making declaration when required.

7.3 Holding assets outside India

As per Section 6(4) of FEMA, 1999, a PRI may hold, own, transfer or invest in:

i) foreign currency

ii) foreign security

iii) any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India. Further, no RBI permission is required to be obtained by PRI for making payments or fresh investments abroad from the income or sale proceeds of assets exclusively held outside India.

Conclusion

Based on the rulings cited in this article, following critical issues are to be taken care of while executing the secondment agreement:

a. The extent of responsibility, indemnity and risk borne by each of the employers.

b. Right to terminate or modify the conditions of secondment employment.

c. Authority to instruct, supervise and level of control on the secondee's work.

d. Whether the Indian company has exclusive control on the place of employment?

e. The ratio of reimbursement by host to h``ome country organisation of salary, allowances and other costs belonging to the secondee-whether this reimbursement includes an element of profit?

f. Exact nature of services rendered-the skill and expertise required for the same and the quantum of benefits received to each organisation.

g. Period of secondment and probability of requiring an extension beyond the period stipulated.

h. Is the secondment agreement a "contract for service" or a "contract of service?"

Needless to say, utmost caution is necessary in drafting the secondment agreement as otherwise an unintended obligations for the Indian company may be created in light of various judicial precedents.

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CA Parizad Sirwalla

Cross-border deputation of employees – Outbound assignees

1. Introduction

Deputations and secondments are a natural result of the globalised economy. The requirement to have the right personnel with the fitting skill-set at the right location necessitates the need of deputation of employees. Over the past two decades, there has been a surge in assignment of Indian nationals outside India by multinational companies and corporate houses who are looking to increase their global footprint (especially software/technology companies).

Cross border movement of employees outside India leads to a host of issues related to taxation, social security, exchange control, immigration etc., which requires careful examination.

2. Different types of deputation arrangements

Organisations have various assignment arrangements depending upon business requirements which can be broadly categorised as under:

- ***Payroll/permanent transfer***
  Under this arrangement, the home entity transfers the payroll of the employee to the host entity. The legal employment is severed with the home entity and a new employment is taken up with the host entity.

- ***Secondment arrangement - long-term or short-term***
  Under such arrangement, the home entity retains the character of being the legal employer and the host entity is regarded as the effective economic employer. Payroll of the employee may continue in the home country (with or without a recharge to the host entity) along with certain assignment allowances being paid in the host country. The employee normally works wholly and exclusively under the direction, control and supervision of the host entity, which controls and benefits from the employee's day-to-day work and bears the costs, risk and responsibilities associated with it.

- **Business travellers/commuters**
  Such employees travel to different entities of the same group across the globe for short duration of time typically ranging

from a few weeks to a few months. Payroll of such employees continues to be processed in the home country and typically an allowance with pre-defined limits (*per-diems* etc.) are provided in order to meet expenses for food, lodging and other incidental expenses in the host location.

3. Residential Status

As per the Income-tax Act, 1961 ('the Act'), the taxability of an income is determined basis the residential status in India during a particular Financial Year ('FY' – 1st April to following 31st March). Residential status is determined basis the physical presence of an individual in India in the relevant FY and previous ten FYs.

Different types of residential status as per the Act are:

Resident

An individual qualifies to be a Resident in India in case he fulfils any one of the following basic conditions:

- Present in India for a period of 182 days or more in a FY; or
- Present in India for 60 days or more in current FY and 365 days or more during the four FYs immediately preceding the relevant FY.

Exceptions

The second basic condition of 60 days is substituted by 182 days in following two scenarios:

- A citizen of India leaves India during a FY for the purpose of employment outside India;
- A citizen of India or person of an Indian origin, who being outside India, comes to India on a visit during a FY.

Non-Resident ('NR')

An individual who does not fulfil any of the aforesaid basic conditions qualifies as a NR.

Resident is further categorised into 2 categories:

Resident and Ordinarily Resident ('ROR')

In case both the following additional conditions are fulfilled, the individual would qualify as a ROR:

- He has been a Resident in India in at least two FYs out of the ten FYs immediately preceding the relevant FY; and
- He has been in India for 730 days or more during seven FY immediately preceding the relevant FY.

Not Ordinarily Resident ('NOR')

In case any one of the aforesaid additional conditions is not fulfilled, the individual would qualify as a NOR.

Few issues for consideration in this regard are discussed below:

1) Whether an outbound assignee deputed outside India for an assignment can be termed as leaving India for the purpose of employment for the purpose of 182 days substitution?

In order to qualify for the exception of 182 days substitution in the FY of departure from India, an outbound assignee is required to fulfil the criterion of "leaving India for the purpose of employment". This phrase has not been defined/explained under the Act. Therefore, in common parlance it can be wide enough to cover the following situations:

- an employee leaving India for taking up an assignment with his existing employer (e.g., on deputation);
- an Indian employee leaving India for taking up a new employment, with a new employer.

The exception does not restrict itself to a new employer-employee relationship coming into existence, else, the explanation would have probably used the words "to take-up a new employment outside India". Hence, it may be possible to contend that the benefit of the extended stay up to 181 days in India in the year of departure would be available in case of assignment overseas. The nature of work done and intent may be more important in identifying whether the employee left India for the purpose of employment. It is advisable for the employers to maintain appropriate documentation like secondment agreement, work permit, passport entries/stamps etc. Ordinarily, a business traveller may not qualify for this exception.

In support of the above contention, reliance can be placed on the below judicial pronouncements:

- *British Gas India (P) Ltd.- AAR [2006] 155 Taxman 326*
- *ITO vs. Abbott Laboratories (P) Ltd. - Mumbai ITAT [1989] 31 ITD 183*
- *ITO vs. K.Y. Patel - Mumbai ITAT [1990] 33 ITD 714*

2) Interpretation of the terms "visits", for the purpose if 182 days substitution?

The term "visits" has not been expressly defined under the Act and is hence a matter of subjective interpretation. Based on legislative history, the intention seems to be to include only visits to India, to oversee personal investments, meet relatives, medical reasons, casual visits, leave, etc. Accordingly, frequent work visits to India may not strictly qualify as "visit" and the benefit of extension to 182 days may not be applicable. However, certain judicial precedents such as *CIT vs. Suresh Nanda (2013), High Court Delhi (35 taxmann.com 199)* have held that test of residence will be determined only on the basis of number of days of stay in India and not by the intention or interpretation adopted. However, this position remains litigious and may need to be argued based on his factual situation and documents.

4. Taxability of Salary Income

Under a typical cross-border deputation arrangement, where salary is received in India and services are rendered overseas, the primary issue is in respect of taxability of such salary in India.

Taxability under the Act

As per Section 5(2)(a) of the Act, any income (derived from any source whatsoever) which is received in India by a NR is taxable in India. Hence, based on a plain reading it can be construed that if salary is received in India, the same should be taxable in India.

However, an alternate view prevailing is that, Section 5(2) of the Act starts with the expression "subject to the provisions of this Act". As per the charging Section 15 of the Act, salary is taxable on due/accrual basis except in cases where the salary is paid in advance or arrears, which is taxable on receipt basis.

In case of outbound assignees (who qualify as a NR), it can be argued that the salary income, albeit received in India, cannot said to be accrued/due in India as they are physically working outside India and accordingly, exempt in India. Reliance can be placed on the following judicial pronouncements amongst others:

- *Texas Instruments (India) (P.) Ltd. [2018] 90 taxmann.com 353*
- *DIT vs. Sri Prahlad Vijendra Rao – Karnataka High Court [2011] 51 DTR 95*
- *Bholanath Pal vs. ITO – Bangalore ITAT ITA No. 10 (Bang) 2011*
- *Ranjit Kumar Bose vs. ITO- Kolkata ITAT – [1986] 18 ITD 230*
- *Arvind Singh Chauhan vs. ITO- Agra ITAT – ITA No. 319 and 320/Agr/2013*

The aforesaid interpretation may be challenged by the tax authorities (especially at the lower levels) depending upon actual facts and circumstances of the each case.

On the other hand, outbound assignees qualifying as a ROR would be subject to taxation on their worldwide income including salary earned for services rendered outside India, subject to necessary relief under applicable Double Taxation Avoidance Agreement ('DTAA' or 'Treaty').

Taxability under the DTAA

Section 90(2) of the Act provides that the DTAA shall prevail over the Act if they are more beneficial to the taxpayer. Accordingly, an assignee who is deputed outside India can claim relief under the relevant clauses of the applicable DTAA.

Where the assignee qualifies as a 'Resident of the host country', he may be eligible for relief under Dependent Personal Services article, with respect to taxable salary in India, subject to the prescribed conditions.

Article 16 (Dependent Personal Services) of India-USA DTAA has been reproduced hereunder for the purpose of illustration:

> *"1. Subject to the provisions of Articles 17 (Directors' Fees), 18 (Income earned by Entertainers and Athletes), 19 (Remuneration and Pensions in respect of Government Service), 20 (Private Pensions, Annuities, Alimony and Child Support), 21 (Payments received by Students and Apprentices) and 22 (Payments received by Professors, Teachers and Research Scholars), salaries, wages, and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contacting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.*
>
> *2. …..*
>
> *3. …."*

In view of aforesaid Article, salary received in India by an outbound assignee can be considered as non-taxable in India, if the following conditions are satisfied:

- The individual is the resident of the host country as per the treaty; and
- The individual exercises employment in the host country.

To claim any relief under the Treaty, the assignee is required to obtain a Tax Residency Certificate ('TRC') issued by the tax authorities of respective host country in which such assignee is a resident for the relevant FY.

Further, it is pertinent to note that the commentary to OECD Model Tax Convention 2010 on Article 15 "Income from taxation of Income from Employer" states as follows:

> *"...the general rule as to the taxation of income from employment (other than pensions), namely, that such income is taxable in the State where the employment is actually exercised. Employment is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid….."*

On the other hand in case where an assignee qualify as a resident of India under the Treaty, exemption under Article 16(1) would not be available. However, foreign tax credit (FTC) for taxes actually paid in the host country on the doubly taxed salary may be claimed in India.

Article 25 (Relief from Double Taxation)of India-USA DTAA has been reproduced hereunder for the purpose of illustration:

1 …..

2. (a) Where a resident of India derives income which, in accordance with the provisions of this Convention, may be taxed in the United States, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the United States, whether directly or by deduction. Such deduction shall not, however,

> *exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the United States.*

With effect from 1st April 2017, FTC Rules have been introduced, prescribing the procedure to claim credit of any foreign tax paid against Indian tax liability on the doubly taxed income. To substantiate FTC claim, details of doubly taxed income and the corresponding foreign tax deducted/paid, in Form 67, along with supporting documents (like certificate from foreign tax authority or the employer or proof of tax payment) are required to be filed alongside the tax return.

Tax equalisation and hypothetical tax

The employer may choose to protect the outbound assignees against the adverse tax impact on account of international assignment in host location by way of tax equalisation wherein hypothetical taxes are recovered from the employee via payroll and tax liability arising in home as well as host location are borne by the employer. Hypothetical tax is a notional tax, which is an estimate of the amount of tax that an assignee would have paid, had he continued to be employed in his home country and not gone on an international assignment. The hypothetical tax is often limited to the tax on salary and the other employment related income, but sometimes includes personal investment income as well. Typically, a tax equalisation settlement calculation is prepared by an employer, either at the end of relevant FY or after the completion of international assignment, to compare the estimated hypothetical tax recovered *vis-à-vis* hypothetical tax that should have been recovered. Such calculation results either in a balance owed to the employer by an assignee or *vice-versa*.

There is no specific provision under the Act which supports that hypothetical tax essentially reduces the taxable income of an assignee in India. Following judicial precedents amongst others, support the position that net salary arrived after reduction of hypothetical tax should be taxable in India.

- *CIT vs. Jaydev H. Raja (Mumbai High Court, ITA No. 87 of 2000);*
- *Yusiho Kubo and Others vs. CIT (Delhi High Court, ITA No. 441/2003 and other appeals) [2013]*

Taxability of per-diems

Employees on overseas assignments (especially business travellers/commuters) are generally provided with a *per diem* allowance to meet ordinary daily expenses such as meals, travel, laundry, boarding and other such miscellaneous costs. The taxability of such payments in India is governed by Section 10(14) of the Act read with Rule 2BB of the Income-tax Rules, 1962 ('Rules'). As per the Act, *per diems* can be claimed exempt upon fulfilment of specified conditions, one of them being that the employee should be on 'tour' and other being that he has actually spent the allowance wholly, necessarily and exclusively in performance of official duties.

Whether an assignment qualifies as "tour" or "transfer" for the purpose of this exemption, is a collective evaluation of underlying facts and circumstances. Also, whether an employer is required to obtain actual expenditure proof incurred by the employee to verify the claim as against a self-declaration by the employee supported by the fact that the *per diem* meets the test of "reasonableness" is a vexed issue and there are judicial precedents both in favor and against. Therefore it is prudent for the employers to analyse their *per diem* policies and the process followed for verification of actual expenses in light of conflicting rulings (including recent ruling of Hyderabad High Court in the case of *Sun Outsourcing Solutions Pvt. Ltd vs. CIT [2018] 92 taxmann.com 339)* on said issue.

5. Withholding tax on Salary Income

Section 192 of the Act provides that any person responsible for paying any income chargeable under the head "Salaries" shall, at the time of payment, deduct income tax on the amount payable. The provisions of said section is clear that only when an income is chargeable to tax under the head "Salaries", then the tax should be deducted at source at the time of payment thereof. In other words, it can be said that in case the salary is not chargeable to tax in the hands of employee in India, there should be no obligation on the employer to deduct tax at source on the same.

As discussed in preceding paras, salary received in India for the service rendered overseas can arguably be considered non-taxable in India as per the applicable provisions of the Act or the Treaty, as the case may be. Accordingly, it may be contended that since the salary is not chargeable to tax in the hands of the outbound assignee, there should be no requirement to deduct the tax at source by the employer at the time of payment of salary in India.

It may be noted that claiming treaty relief at withholding tax stage has not been expressly provided under the Act. However, following Advance Rulings throw some light on the principles/guidelines to claim such relief at the withholding tax stage.

- *British Gas India Pvt. Ltd. – AAR [2006] 155 Taxman 326*
- *Texas Instruments (India) (P.) Ltd[2018] 90 taxmann.com 353*
- *Hewlett Packard India Operations Pvt. Ltd. [2018] 91 taxmann.com 473 [AAR No. 1217 of 2011]*

The AAR held that treaty relief for both NR and ROR employees could be considered by the employer while determining withholding taxes. Although AAR has pronounced favourable rulings, it must be noted that the Revenue authorities may have arguments against the claim of tax treaty relief for NR and ROR employees at the withholding tax stage. Hence, employers who consider implementing treaty relief at the withholding stage, should be cognizant of the risks involved, exercise adequate due diligence and also maintain appropriate documentation.

6. Key Tax compliances in India

(a) Tax Clearance Certificate

As per Section 230(1A) of the Act, any person domiciled in India at the time of departure, shall furnish Form 30C along with other requisite details to Income tax Authorities.

(b) Advance tax

Every person having income on which the tax liability (net of tax deducted at source) exceeds INR 10,000, is liable to pay advance tax as per the prescribed installments.Non-payment of the advance taxes per the above installments attract interest liability.

(c) Tax return filing

An employee has to file a tax return in India if he has taxable income in India exceeding the basic exemption limit.

Further, as a ROR, an employee would also be required to declare his foreign assets in India, under the prescribed schedule in the tax return form.

The prescribed disclosure schedules/ requirements are broadly as under:

- Details of all Indian bank accounts (name and IFSC code, account number and type of account) held at any time during relevant financial year. Dormant accounts are excluded.
- Schedule AL: Details of specified assets, financial assets and corresponding liabilities are to be disclosed in case the total income of an individual exceeds INR 50 lakh. Guidelines have been specified for valuation of such assets and liabilities.
- Schedule FA: ROR assignees are obligated to furnish details of their assets held

outside India (both as an owner and as a beneficiary) such as per specified disclosure guidelines.

It is important that employees are cognisant of such disclosure requirements as non-disclosure or inaccurate disclosure may have their Income-tax return being either considered as a defective return or picked up for revenue audit.

(d) Quoting of Aadhaar

It is now mandatory to link the PAN and quote Aadhaar in the tax return forms, barring a few exceptions such as where assignee is a non-resident in India in the FY or is a foreign citizen.

7. Other corporate tax issues

Cross-border deputations and inter-company recharge of salary costs may also throw up various corporate tax (permanent establishment), inter-company withholding tax, transfer pricing and indirect tax implications, which would need to be looked into both from a home and host country perspective.

8. Social Security (Provident Fund) regulations

Another key aspect which should be evaluated while deputing employees overseas is the contribution towards Provident Fund ('PF') in India which is governed by the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPF Act) and administered by Employee Provident Fund Organisation ('EPFO').

With effect from 1st October 2008, a new category of workers called International Worker (IW) was introduced which includes an Indian employee having worked or going to work in a foreign country with which India has entered into a Social Security Agreement (SSA) and being eligible to avail the benefits under social security programme of that country, by virtue of the eligibility gained or going to gain, under said SSA. An SSA (also known as Totalisation Agreement) is a bilateral agreement to protect the social security interests of workers posted from one country to another country. Indian employees, who are posted to other countries by their Indian employers without terminating the contract of employment, are required to continue to make PF contributions in India. On account of the international assignment undertaken, they may also be required to make social security contribution in the host country as per the relevant applicable law. Ordinarily, such employees do not derive any benefit from such contributions made outside India on account of restrictions on withdrawal and stipulations pertaining to duration of stay. Being a reciprocal arrangement, a SSA is intended to provide for avoidance of double coverage, i.e., coverage under the social security law of both the home and host country through detachment benefit.

A Certificate of Coverage or a Detachment Certificate is a document that must be obtained by an IW so as to avail the benefits under the applicable SSA. A COC is issued in the employee's home country by the social security authority (by EPFO in India) in accordance with the provisions of the relevant SSA. The COC acts as a proof of detachment, pursuant to which exemptions from the applicable social security compliances in the host country are allowed.

Currently, India has effective SSAs with Belgium, Finland, Netherlands, France, Germany, Sweden, Hungary, Austria, Switzerland, Czech Republic, Japan, Portugal, Denmark, Norway, Republic of Korea, Luxembourg, Canada, Australia and Quebec.

Different scenarios with respect to outbound assignees and applicability of PF in India/social security coverage in host country are enumerated below per the EPFO guidelines:

Sr. No.	Country with which India has an effective SSA	COC obtained from EPFO or not	Remarks on contribution to home country (India) and host country social security
1.	Yes	Yes	India – PF contribution would continue during the term of assignment Host country – Exempt
2.	Yes	No	India – In case, any salary being processed/ disbursed in India – PF contribution on such salary Host country – Applicable contribution as per social security scheme.
3.	No	Not Applicable	Similar to S. No. 2 above

As regards an Indian outbound assignee, EPFO has clarified that an Indian employee who, having been an IW as per the EPF Act and who returns to work in India will not be considered as an IW post completion of an overseas assignment. Further, the EPFO has also launched a new facility for online generation of COC for Indian workers (holding an Indian passport) going to work in countries with which India has SSA.

It should however be borne in mind that continuity of payroll in India for the purpose of continuing PF contributions may have other consequences from a corporate tax exposure, inter-company withholding perspective, which should be evaluated.

9. Foreign Exchange Regulations

While an overseas assignment may take care of tax and other aspects, it cannot be complete until relevant foreign exchange regulations have been appropriately examined and considered. As per the provisions of Foreign Exchange Management Act,1999 ('FEMA'), an individual qualifies to be a Person Resident Outside India ('PROI') as soon as he leaves India for taking up employment. There is no clarity or explanation on the interpretation of the phrase 'for taking up employment'. Generally short term visits/tour may not qualify.

A PROI is not eligible to hold resident bank accounts in India. Therefore, an outbound assignee qualifying as PROI is required to re-designate his savings bank account in India as a Non-Resident Ordinary ("NRO") account in consultation with his bankers. The balance in NRO account is partially repatriable i.e., all current income and up to USD one million per FY. From an Income-tax perspective, interest income from NRO account is taxable in India. All other accounts such as depository accounts and investment accounts would also need to be redesignated to non-resident accounts. There would also be certain restrictions on the investments that the assignees can make in India, till such time that they qualify as PROI. The assignee may open a Non-Resident External ("NRE") account from inward remittances, which is freely repatriable. Interest income from NRE account is not taxable in India

To conclude, cross-border employees aid seamless sharing of desired knowledge and skills across the globe. However, diverse jurisprudence coupled with dynamic tax and regulatory environment continues to create a dilemma for corporates deputing labour overseas. Actual roles and responsibilities of the assigned employees along with underlying documentation assumes significant importance in determining tax and regulatory implications.

Indian entities should assess the impact of the income-tax and regulatory risks, both in the home and host countries, on their existing and proposed assignment arrangements to strike a balance between commercial viability and impact of such arrangement on the employees.

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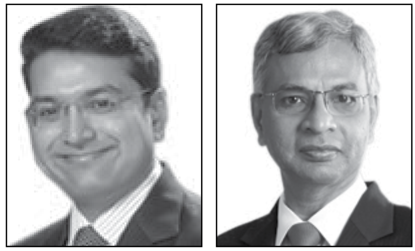

CA Sanket Shah & CA Ashok Shah

Exchange of Information, FATCA/CRS, PMLA, KYC for Banks

Since the world has become increasingly globalised and cross-border activities have become the norm, the tax administrations across the world are wanting to work together to ensure that the taxpayers pay the right amount of tax to the right jurisdiction. The tax administrations are gearing up with the necessary legal, administrative and IT tools for verifying the compliance by their taxpayers. The enhanced co-operation between tax authorities through Automatic Exchange of Information (AEOI) is crucial in bringing national tax administration in line with the globalised economy.

The Foreign Account Tax Compliance Act (FATCA)

The Foreign Account Tax Compliance Act (FATCA), which was passed as part of the Hiring Incentives to Restore Employment (HIRE) Act, generally requires that Foreign Financial Institutions (FII) and certain other Non-Financial Foreign Entities (NFFE) report on the foreign assets held by their U.S. account holders or be subject to withholding on withholdable payments. Internal Revenue Service (IRS) of U.S is responsible for overlooking the working of FATCA.

The HIRE Act also contained legislation requiring U.S. persons to report under IRS Form 8938, depending on the value, their foreign financial accounts (FFA) and foreign assets once they reach a threshold. The current threshold limits are as follows:

	Taxpayer living in United States		**Taxpayer living abroad**	
	On the last day of the tax year	**Anytime during the tax year**	**On the last day of the tax year**	**Anytime during the tax year**
Unmarried	$ 50,000	$ 75,000	$ 200,000	$ 300,000
Married filing jointly	$ 100,000	$ 150,000	$ 400,000	$ 600,000
Married filing separately	$ 50,000	$ 75,000	$ 200,000	$ 300,000

Specified domestic entities	Total value of assets was more than $50,000 on the last day of the tax year, or more than $50,000 at any time during the tax year.

To facilitate this move, the IRS has asked to enter into Inter-Governmental Agreement (IGA) with foreign countries which helps the process to be monitored. This, intentionally, will in turn help in maintaining the nature of exchange or business very clear and transparent between the US and the IGA countries.

IGA between India and USA is being treated in effect from 30th June, 2014, however it came in force with effect from 31st August 2015. Around 113 nations including India have entered into an IGA complying with FATCA.

It provides that the Indian FIs will provide necessary information to the Indian tax authorities, which will then be transmitted to the USA periodically. Under the IGA, India will receive information, similar to the U.S., about Indian FFIs situated in the US through a regulatory agreed as the Automatic Exchange of Information (AEOI) – a clause chosen to be included in IGA while signing of FATCA with India.

India has started receiving information from 1st July, 2014, about Indian FFIs situated abroad adding to the efforts to fight the flow of illegal money into India.

Non-compliance to FATCA will not only affect a U.S. citizen working out of U.S. but also the nations involved. Since IGA is signed by the respective nations with the U.S, a financial institution (FI) has to provide the information of the U.S citizen and the nature of his business to its own Government and then this eventually is provided to the IRS. Example, if a US citizen invests money in ICICI bank in India, then the details of this transaction and account of the US citizen will have to be provided by ICICI bank to the Indian Government who in turn will provide this information to the IRS.

However, if this information is not shared, FATCA entails 30% 'withholding tax' on foreign source income of the FFIs and these FFIs will be termed as non-participating FFIs.

FFIs which have entered an information sharing agreement with the U.S. in accordance with the FATCA can send FATCA letter or notice to the taxpayers. FATCA notice is a form of warning sent to the taxpayers when the FFI is unsure if its client is a U.S. taxpayer, lives in the U.S. or maintains a foreign address in the U.S. Through this letter or notice, the FI tries to investigate its customers to find out if he is compliant with the FATCA laws or not. The FI tries to find out if necessary paperwork with the IRS and the Department of Treasury have been done by the client for FATCA compliance. It also enquires about other reporting requirements including Report of Foreign Bank and Financial Accounts (FBAR) & Schedule B (filed along with Form 1040).

If you are one of the of individuals who have failed to comply with these laws and earned overseas income, then there are two different IRS programmes you can enter to try to get compliant:

- the Offshore Voluntary Disclosure Programme (OVDP) and
- the IRS Modified Streamlined Programme (Domestic and Foreign – based on where the applicant(s) reside).

If you do not comply, your foreign bank and FFI may freeze or even forfeit your account.

Further there are serious problems, if one of these FFIs reports you to the IRS of your non-compliance which would amount to penalties and interest.

On 13 March, 2018 IRS announced it will begin to ramp down the 2014 Offshore Voluntary Disclosure Programme (OVDP) and close the programme on 28 September, 2018.

With the closure of the OVDP programme, IRS with the use of FATCA data is expected to use harsher penalties for non-compliance.

Common Reporting Standard (CRS) on Automatic Exchange of Information (AEOI)

In order to combat the problem of offshore tax evasion and avoidance and hiding of unaccounted money abroad requiring co-operation amongst tax authorities, the G20 and Organisation for Economic Co-operation and Development (OECD) countries working together developed a

Common Reporting Standard (CRS) on Automatic Exchange of Information (AEOI).

The CRS on AEOI requires the financial institutions of the "source" jurisdiction to collect and report information to their tax authorities about account holders "resident" in other countries. This collected information is to be transmitted "automatically' on yearly basis.

The information to be exchanged relates not only to individuals but also to shell companies and trusts having beneficial ownership or interest in the "resident" countries.

India is one of the early adopters of the CRS and has committed to exchange information automatically by 2017 as under:

- First exchange in September 2017 for new personal and entity accounts opened after January 2016 and existing as on December 2015 with certain high balance amount.
- Exchange in September 2018 of pre-existing accounts with low balance amount.

Some of the steps taken by India includes:

- Amendment in section 285BA of Income-tax Act, 1961
- Inserting Rules 114F to 114H and Form 61B by amending Income-tax Rules 1962 to provide a legal basis for the Reporting Financial Institutions (RFIs) for maintaining and reporting information about the Reportable Accounts.

In short, financial institutions in India will identify and report reportable accounts (based on set of parameters) to RBI and it will send this information to tax authorities to share with other countries as per IGA terms.

NRI/ PIO/OCI as beneficial owner of Foreign Portfolio Investors (FPI)

Prevention of Money Laundering Act, 2005 (PMLA) and the Prevention of Money Laundering Rules, 2005 (PMLA Rules) are the principal regulations as regards Know Your Client (KYC) regulations. SEBI through its circular no CIR/ IMD/FPIC/CIR/P/2018/64 dated 10th April 2018 has tightened the KYC under PMLA Rules and has reiterated that neither the Non-Resident Indian (NIR) / Person of Indian Origin (PIO) nor Overseas Citizen of India (OCI) can be Beneficial Owner of FPIs. They can however be promoters of non-investing entity which wishes to have Category II Investment manager of other FPIs.

It may be noted that "Beneficial owner" has to be interpreted in accordance with the detailed guidelines given in SEBI circular as well as criteria provided in Rule 9 of PMLA Rules. BO would be a natural person or persons, who, whether acting alone or acting together, have controlling ownership interest in the FPI or control over the FPI and if a BO cannot be identified in this manner, the senior managing official of the FPI would be construed to be its BO.

Circular specifies that "Look through" principle to be applied for identifying BO so that Real owners/ effective controllers are identified. The circular also specifies that where the FPI is a company or Trust and is represented in India by its service providers, it should provide information of the persons that effectively own or control the FPI. Also, if control is exercised through means such as voting rights, agreements, arrangements etc., it should be specified.

The BO in case of FPI will be determined as follows:

FPI is a company	The beneficial owner is the natural person(s), who, whether acting alone or together, or through one or more juridical person, has a controlling ownership interest or who exercises control through other means. For the purpose of this definition: • Controlling ownership interest means ownership of or entitlement to more than 25% of shares or capital or profits of the company; • Control shall include the right to appoint majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements;

FPI is a partnership firm	The beneficial owner is the natural person(s) who, whether acting alone or together, or through one or more juridical person, has ownership of/entitlement to more than 15% of capital or profits of the partnership.
FPI is a unincorporated association or body of individuals	The beneficial owner is the natural person(s), who, whether acting alone or together, or through one or more juridical person, has ownership of or entitlement to more than 15% of the property or capital or profits of such association or body of individuals.
FPI is a Trust	The identification of beneficial owner(s) shall include identification of the author of the Trust, the trustee, the beneficiaries with 15% or more interest in the Trust and any other natural person exercising ultimate effective control over the Trust through a chain of control or ownership
FPI based in high risk jurisdiction	If the FPI is based in high risk jurisdiction (to be determined in accordance with SEBI Master Circular no. CIR/ISD/AML/2010 dated 31 December 2010), a lower materiality threshold of 10% is to be applied to identified BO instead of 25% / 15% mentioned above

SEBI however has given time till 10th October 2018 to either regularise the FPI structure or close their existing position in Indian securities market. It also mandated that existing structures which were not compliant should not create any fresh position after the end of expiry of derivative contract of April 2018. One of the impact of the circular will be in area where there are more than one FPIs having common BOs and whose aggregate equity holding in India exceeds 10%. Such FPIs will have to regularise itself in accordance with the circular by such date.

Neither the circular nor PMLA rules deal with definition of 'Senior Managing official' & hence there may be unintended consequence if NRI/OCI is a deemed to be a 'Senior Managing official' of a broad-based fund. Similarly there may be questions in regards to family members – whether all of them will be clubbed together and if yes on what basis. Common control issues arises in context of Indian Accounting Standard (Ind As 103) Business Combination – Appendix C, where standard specifies that 'a group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory'. However, whether verbal contract constitute 'contractual arrangement' is always a matter of debate.

SEBI would prefer FPIs to comply with this circular in intent and spirit.

KYC for bank accounts

The Reserve Bank of India (Know Your Customer (KYC)) Directions, 2016 specifies the compliance with PMLA Act and Rules. The directions clearly spells out that Aadhar is applicable for resident Indians and consequently, NRIs are not expected to comply with guidelines relating to linking of Aadhar with their bank accounts. However, it should be noted that as per directions, accounts of Non-Residents are subject to higher level of due diligence by Banks. Though the NRI accounts (other than belonging to politically exposed person) are classified as low/medium risk but it is essential that 'In person verification' (IVP) is carried out before account is opened. Also if the account is operated through Power of Attorney holder, the account will be classified as High Risk and hence NRIs are expected to be patient with the demands of the Banks for regular update on KYC.

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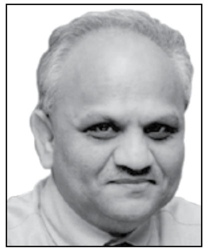

CA Paresh Shah

Taxation and FEMA aspects of Trusts

1. Introduction

India is no stranger to cases where properties are settled upon a person for the benefit of another. The ownership and possession of property coupled with the obligation to use the same or income thereof wholly or partially for the benefits of others is a situation which is familiar to Indians. When any property is transferred to a person with the obligation as aforesaid, a trust comes into existence. The law relating to private trusts was codified by the Indian Trusts Act, 1882 and came into force on 1st March, 1882.

India's economic progress has led to a growing number of Ultra & High Net-worth Individuals and families who are taking active steps towards wealth management and succession planning. While Wills have traditionally been the most commonly used tool by which to distribute wealth to future generations, private trust structures are becoming integral to wealth management and succession planning. Trusts originated at the end of the middle ages as a means of transferring wealth within the family and have remained the characteristic device employed for wealth transmission in situations where the transferor has substantial assets or complex family affairs. In India, private trusts are used to carry out this function of transmission of wealth. Public trusts, on the other hand, may be used to contribute property towards religious and charitable purposes.

Further, the increased relocation of Indian families around the world also poses some unique challenges with respect to transferring wealth across country borders and ensuring tax efficiency. Accordingly, it has become increasingly important to analyze any trust structure from a multi-jurisdictional perspective.

This Article seeks to outline and examine the taxation of different kinds of Trusts under domestic and international tax laws including implications & treatment under Double Tax Avoidance Agreements.

2. Concept and Law of "Trusts"

As per the Indian Trusts Act, 1882 a trust is *"an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him for the benefit of another, or of another and the owner"*.

The person who reposes or declares the confidence is called the "author of the trust" (commonly referred to as a 'settlor'). The person who accepts the confidence is called the "trustee". The person for whose benefit the confidence is accepted is called the "beneficiary".

The subject matter of the trust is called "trust property". The "beneficial interest" or "interest" of the beneficiary is the right against the trustee as owner of the trust property. The instrument, if any, by which the trust is declared is called the "instrument of trust" (commonly known as the 'trust deed' or 'indenture of trust').

The law of trusts thus deals with the area of fiduciary relationships. Between the trustee and beneficiary, the trustee ordinarily is only an owner and possessor in name and does not have a right of beneficial enjoyment. However, between the trustee and the world, the trustee is clothed with all the rights of ownership. A trust is based not on consideration but on the confidence reposed in the person holding the property. When the beneficiaries are the public and the purpose is charitable what comes into existence is a public charitable trust and where the beneficiaries are individuals or other entities with the purpose being specific to the settlor, the trust is a private trust.

Unlike wills which are often challenged before the court, trusts may be executed during the lifetime of the individual. This unique characteristic not only helps to reduce contentious litigation amongst family members, but also allows the individual some control over the family's assets while still safe guarding family wealth against possible liabilities.

3. Use of Trusts for Estate Planning

A private trust offers several advantages in succession planning and asset distribution such as:

- Efficient mode of managing and passing the family assets as it helps create a legal framework for the family assets
- Bypasses the Probate process which is susceptible to frivolous claims and delays in court process
- Safeguards interests of family members including maintenance of members with special needs/disabilities
- Possible to attach conditions to gifts such as on attaining a particular age or fulfilment of the settlor's wishes
- Avoids family disputes over the property
- Helps structure business succession which may be based on a balance of merit and family control, and facilitate philanthropic activities
- Ring-fencing of assets against possible losses due to business liabilities, family related liabilities arising from divorce / maintenance claims, tax claims, re-introduction of estate duty in India, and / or actual or potential creditors
- Having flexibility to have an unbiased and professional, independent person for taking decisions on distribution of wealth to various family members and others
- Allowing professional management as well as cost-effective centralised administrative, investment, record-keeping and property management functions
- Settlor can direct the managing and advisory committees, monitor and advise the trustees on application and management of the trust assets there by enabling a relatively large pool of assets/ investments to be managed under one umbrella
- Trust can help exploiting offshore business opportunities, acquisition of interests and cross-border movement of family members

4. Types of Trusts

Broadly, different trusts may be classified based on mode of creation (express or implied) or purpose (private or public). Such trusts can be further classified based on features such as revocable or irrevocable, discretionary or determinate, or for employee benefit or for pooling of investments, etc.

4.1 Private Trusts

A private trust is created for the benefit of specific individuals i.e., individuals who are defined and ascertained individuals or who within a definite time can be definitely ascertained.

A family trust set up to benefit members of a family is the most common purpose for a private trust. The purpose of the family trust is for the settlor to progressively transfer his assets to the trust, so that legally the settlor owns no assets himself, but through the trust, beneficiaries get the benefit of these assets.

Private family trusts may be set up either *inter-vivos* i.e., during a person's lifetime or under a will i.e., testamentary trust, either orally or under a written instrument, except where the subject matter of the trust is immovable property, the trust would need to be declared by a registered written instrument.

4.1.1 A trust can be set up either as:

a. Revocable: A trust that can be revoked (cancelled) by its settlor at any time during this life

b. Irrevocable: A trust that cannot be revoked and will come to an end only when the term / purpose of the trust has been fulfilled

c. Discretionary: An arrangement where the trustee may choose, from time to time, who (if anyone) among the beneficiaries is to benefit from the trust, and to what extent

d. Determinate: The entitlement of the beneficiaries is fixed by the settlor at the time of settlement or by way of a formula, the trustees having little or no discretion; or

e. Combination trusts namely: Revocable Discretionary / Determinate Trust, or Irrevocable Discretionary / Determinate Trust

Private trusts may also be used as a collective investment pooling vehicles such as mutual funds and real estate investment trusts.

4.2 Public Trusts

A public trust is created for the benefit of the public at large or a section of the public following a particular religion, profession or faith. Thus it is for the benefit of an uncertain and fluctuating body of persons who cannot be ascertained any point of time. A public trust is therefore normally permanent or at least indefinite in duration.

There is no Central Act governing formation and administration of public trusts. But various states such as Bihar, Maharashtra, Madhya Pradesh Orissa, etc., have enacted their own legislations prescribing conditions and procedures for the administration of public trusts. These Acts are more or less similar in nature though there may be certain variations.

A public trust is generally a non-profit venture and if created for charitable purposes is referred to as a charitable trust and if created for religious purposes is referred to as a religious trust. The creation of religious trusts is governed by the personal laws of the religion.

5. Taxation of Private Trusts

Under Section 2(31) of the Income-Tax Act, 1961 ("Act"), person includes -

(i) an individual,

(ii) a Hindu undivided family,

(iii) a company,

(iv) a firm,

(v) an association of persons or a body of individuals, whether incorporated or not,

(vi) a local authority, and

(vii) every artificial juridical person, not falling within any of the preceding sub-clauses.

Explanation.— For the purposes of this clause, an association of persons or a body of individuals or a local authority or an artificial juridical person shall be deemed to be a person, whether or not such person or body or authority or juridical person was formed or established or incorporated with the object of deriving income, profits or gains.

From the above definition, one may observe that a trust is not included in the definition of 'person'. Similarly, Section 6 of the Act, which stipulates conditions regarding residence in India, does not include a 'trust' as it refers to provisions relating to residential status only of individuals (sub-section 1), HUF, Firm or AOP (sub-section 2), Company (sub-section 3) and every other person (sub-section 4). However, as a trust is not included in the definition of a 'person', it does not fall under the provisions of Section 6.

Accordingly, a trust is not a 'person' and cannot be brought within the ambit of the Act. It is only a contractual arrangement and hence, in order to bring it within the tax ambit, the Act has provided for Sections 60-64 and Sections 160-164 to deal with such a situation in the form of representative assessee. As per Section 160(1)(iv), the trustee/s is considered to be representative assessee in respect of income which a trustee receives on behalf of or for the benefit of any person. Section 161 determines the liability of the representative assessee. Section 162 gives a right to a representative assessee to recover the tax paid by him. Section 164 deals with a situation where the share of beneficiaries is unknown. Sections 60 to 63 deal with taxability of income from revocable transfer of assets.

5.1 As per section 161(1), every representative assessee shall be subject to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favour of him beneficially, and shall be liable to assessment in his own name in respect of that income; but any such assessment shall be deemed to be made upon him in his representative capacity only, and the tax shall be levied and recovered from him in the like manner and to the same extent as it would be leviable and recoverable from the person represented by him.

The Hon'ble Supreme Court has in the case of *CWT vs. Trustees of H. E. H. Nizam's Family (Remainder Wealth) Trust*[1] exhaustively dealt with the taxability of trusts in the context of similar provisions under the Wealth Tax Act. It has held that the income with respect to each beneficiary has to be determined separately and for this purpose, the status of the representative assessee i.e., the trustee would be the same as that of the beneficiary. Accordingly, if all the beneficiaries are "individuals", the trustee would also be assessed in the status of "individual". However, if there are more than one beneficiaries, some of whom are individuals and some others being HUF, the trustee would be liable to tax with respect to the income of each beneficiary in the same status in which the beneficiary would be assessable.

5.2 As per Section 161(1A), where any income of the trust includes profits and gains of business, tax shall be charged on the whole of the income at the maximum marginal rate of tax. However,there is a proviso to this sub-section which provides that the tax would not be payable at the maximum marginal rate of tax if the trust is created by Will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust declared by him by will.

In such case where income of the trust includes profits from business, an issue arises as to whether the trustees can be assessed as an Association of Persons ("AOP"). It has been held that they cannot be assessed as an "AOP". In this regard, the Hon'ble Bombay High Court has in the case of *CIT vs. Marsons Beneficiary Trust and*

1 (1977) 108 ITR 555 (SC)

others[2] held that "the beneficiaries have not come together with the object of carrying on business nor have they authorised the trustees to carry on any business. The authority is conferred on them by the settlor. The beneficiaries are mere recipients of the income earned by the Trust. They have not come together for a common purpose. They cannot, therefore be considered as an association of persons or a body of individuals in the same position as the erstwhile partners in Shanmugam's case [1971] 81 ITR 310 (SC)."Accordingly, the trustees cannot be assessed as an AOP even if they carry on business.

5.3 As per section 162, a representative assessee who pays any sum under the Act is entitled to recover the sum so paid from the person on whose behalf it is paid or alternatively can retain any moneys that may be in his possession or which may come to him in his representative capacity.

5.4 As per section 164, where any income is liable to be assessed in the hands of a representative assessee or any part thereof is not specifically receivable on behalf or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part is receivable are indeterminate or unknown, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate of tax. It may be noted that the section talks of relevant income. Accordingly, if 90% of trust income is to be distributed to known persons and 10% of the income is indeterminate then only 10% of the income would be liable to tax at the maximum marginal rate of tax. It has been held in various cases that even in a case where section 164 is applicable, the trust cannot be assessed as an AOP. *[CIT vs. Deepak Family Trust (No. 1)*[3] *; CIT vs. Shri Krishna Bandar Trust*[4]*]*. Accordingly, where the shares of the beneficiaries are indeterminate, the income cannot be assessed in the hands of the beneficiaries and the trustee would be liable to tax on trust income in his representative capacity.

5.5 Keeping the above provisions in view, the taxation of a private trust may be summarized as below:

5.5.1 <u>Irrevocable Specific or Determinate trust:</u> In such a trust, the beneficiaries are identifiable and their shares are determinate, a trustee can be assessed as a representative assessee and tax is levied and recovered from him in a like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him (i.e. the beneficiary). This position remains the same even when the beneficiary is a non-resident and tax would be calculated in a like manner and to the same extent as it would be leviable on the non-resident beneficiary and recovered from the trustee as a representative assessee.

5.5.2 <u>Irrevocable Discretionary trust:</u> In such a trust where the trustee has the power to distribute the income ofa trust at its discretion amongst the set of beneficiaries, the trustee will be regarded as the representative assessee of the beneficiaries and subject to tax at the maximum marginal rate. This position remains the same even when the beneficiary is non-resident as quantification of the beneficiary's share fails and hence the charge to tax in individual beneficiary's name also fails. Therefore, the income of such a trust shall be subject to tax at the maximum marginal rate.

5.5.3 <u>Revocable trust:</u> Such a trust contains provision for the retransfer directly or indirectly of the whole or any part of the income or assets to the transferor or in anyway gives the transferor a right to reassume power directly or indirectly over the whole or any part of

2 (1991) 188 ITR 224 (Bom.)

3 (1995) 211 ITR 575 (Guj.)

4 (1993) 201 ITR 989 (Cal.)

the income or assets. Under Section 61 of the Act, such a transfer is deemed to be revocable and the income thereof is taxable as if it had directly arisen to the settlor. Accordingly, the trust is disregarded for the purposes of tax and the income is taxed in the hands of the settlor. As the settlor is likely to be a resident in case of Indian Trust, the position remains the same whether the beneficiary is a resident or non-resident.

5.5.4 Indian Trust (established under Indian Trust Act) & Foreign Trust (established under Foreign Trust law) with resident and non-resident beneficiaries: Various situations may arise in case of an Indian trust and a Foreign trust with mixed beneficiaries which have been tabulated below:

	Type of Trust	**Taxation of Resident beneficiary**	**Taxation of Non-Resident beneficiary**
1.	Indian Specific Trust	Tax is levied and recovered from trustee as representative assessee in a like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him (i.e., the beneficiary, whether resident or non-resident) subject to applicable tax treaty with the state of residence of the beneficiary. *See Para 5.1.1 above*	Tax is levied and recovered from trustee as representative assessee in a like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him (i.e. the beneficiary, whether resident or non-resident) *See Para 5.1.1 above*
2.	Indian Discretionary Trust	As quantification of the beneficiary's share fails and the charge to tax in individual beneficiary's name also fails, the income of such a trust shall be subject to tax at the maximum marginal rate in the hands of the Trustee as representative assessee *See Para 5.1.2 above*	As quantification of the beneficiary's share fails and the charge to tax in individual beneficiary's name also fails, the income of such a trust shall be subject to tax at the maximum marginal rate in the hands of the Trustee as representative assessee. Treaty of India with state of non-resident beneficiary does not apply. However, state of resident of beneficiary may give credit of tax at the time of distribution of such income taxed at maximum marginal rate. *See Para 5.1.2 above*
3.	Foreign Specific Trust	As the beneficiary is a resident, tax is levied and recovered from him or the non-resident trustee as representative assessee in a like manner and to the same extent as it would be leviable upon and	There is no incidence of tax in India as the beneficiary and trustee are non-resident and the income earned or distributed of the trust has not arisen or accrued in India

	Type of Trust	Taxation of Resident beneficiary	Taxation of Non-Resident beneficiary
		recoverable from the resident beneficiary / non-resident trustee being a representative assessee subject to tax treaty of India with the Foreign state where the trust is formed *See Para 5.1.1 above*	
4.	Foreign Discretionary Trust	1. In case of mixed beneficiaries (i.e., resident and non-resident) as quantification of the beneficiaries share fails and the charge to tax in individual beneficiary's name also fails,the Indian tax authority may tax entire income of trust at maximum marginal rate 2. In case all the beneficiaries are residents, then income of such a trust shall be subject to tax at the maximum marginal rate in the hands of the trustee as representative assessee *See Para 5.1.2 above*	There is no incidence of tax in India as the beneficiary and trustee are non-resident and the income earned or distributed to non-resident beneficiary of such a trust has not arisen or accrued in India

5.6 Distribution as gift under Section 56(2) of the Act

In the case of *Mrs. Sharon Nayak vs DCIT*[5], the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) held that distribution of income by a trust to its beneficiaries would not be construed as amounts received without consideration by the beneficiaries, and hence, section 56(2)(vi) of the Act would not apply to such receipts. It also held that the Tax Officer (TO) had an option to assess the amount received by the taxpayer from various trusts as a beneficiary of such income, either in the hands of the trust or in the hands of the beneficiary. The Tribunal further held that if such option was exercised by the TO and income was taxed in the beneficiary's hands, income would be classified in the hands of the beneficiary in the same manner as it was classified in the hands of the trust.

This decision is in line with the view taken by Mumbai Tribunal in the case of Ashok C. Pratap[6], wherein it was held that the amount received by a beneficiary from a trust (on its dissolution) could not be termed to be without consideration.

6. Taxation of Business Trusts and Investment Funds

Since the economic liberalisation of the economy from the 1990s in India, a new class of Investment Vehicles have emerged and become the structure of choice for undertaking pooled

5 I.T.A No.1594/Bang/2014

6 4615 (Mum) of 2011

investments. These are Venture Funds, Angel Funds, Private Equity Funds, Debt Funds, Mutual Funds, Real Estate Funds, etc. Such Investment vehicles may be in the form of a trust or a company or a limited liability partnership or a body corporate. The form of the vehicle as trust has been the vehicle of choice for most of these investments. It is therefore essential to deal with the taxation of such investment vehicles in this Article.

6.1 Taxation of Business Trusts

The Securities and Exchange Board of India (SEBI) notified the SEBI (Real Estate Investment Trusts) Regulations, 2014 (REIT Regulations) and SEBI (Infrastructure Investment Trusts) Regulations, 2014 (IIT Regulations) on 26th September, 2014 providing a framework for registration and regulation of REITs and IITs, respectively. The Income-tax Act, 1961 (Act) was amended by the Finance (No. 2) Act, 2014 and subsequently to provide a specific regime for taxation of REITs and IITs [which are collectively defined as "Business Trusts" under Section 2(13A)] by the introduction of new Chapter XII-FA viz. "Special Provisions relating to Business Trust". These provisions are specified in section 115UA and sections 10(23FC), 10(23FCA) and 10(23FD) in the Act.

6.1.1 The salient tax implications on Business Trust and on Investor in Business Trust are as under:

Nature of Income	Taxation for Business Trust	Taxation for unit holder
Interest from SPV (i.e. operating entities)	Exempt	Taxable as interest income. Withholding tax to be deducted on distribution (Non-resident – 5%, Others – 10%)
Dividend	Exempt	Exempt
Capital gains earned by REITs on sale of share of SPV	At the rates applicable to capital gains depending on period of holding	Exempt
Capital gains earned by unit holders on sale of REIT units on stock exchange	Not applicable	For unit holders – long-term – 10% in excess of ₹ 1lakh – short-term – 15%
Other income	Maximum marginal rate	Exempt

6.2 Taxation of Investment Funds i.e. Alternate Investment Funds ("AIF"):

6.2.1 The Finance Act, 2015 has incorporated Chapter XII-FB "Special provisions relating to tax on income of investment funds and income received from such funds". These provisions are specified in section 115UB and sections 10(23FBA) / 10(23FBB) in the Act.

6.2.2 As per *Explanation I* to section 115UB, 'Investment Fund' means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund ('AIF') and is regulated under SEBI (AIF) Regulations 2012.

Thus, aforesaid sections will govern the taxation of Category I and Category II AIFs which may be legally structured either as a trust, company or LLP.

AIF III is not covered under these new provisions.

6.2.3 The salient tax implications on AIF and on Investor in AIF are as under:

Nature of Income	Taxation for AIF	Taxation for unit-holder
Income of the Investment Fund, other than income from profits and gains of business	Exempt from tax in the hands of the Investment Fund, as per section 10(23FBA). As per Notification No. 51 dated 24th June, 2015, the income (other than business income) received by the Investment Fund would be exempt from TDS requirement	As per section 115UB(1), such income would be taxable in the hands of the investors on a pass through basis Such income will be taxable in the same manner as if it were the income accruing or arising to, or received by, such investor had the investments, made by the Investment Fund, been made directly by such investor Further, income taxable in investors' hands shall be deemed to be of the same nature and proportion as in the hands of the Investment Fund as per section 115UB(3)
Income in the nature of profits and gains of business or profession	Taxable in the hands of Investment Fund at the maximum marginal rate as per section 115UB(4)	As per section 10(23FBB), the investors shall be exempt from tax on such income in the nature of profits & gains
TDS on income credited or paid to investor	Where any income other than income from profits and gains of business, or where it cannot be treated as that of the same nature as Fund has received, which is credited or paid to an investor by the investment fund, the investment fund shall deduct income-tax at the rate of ten per cent in case of Resident investor and at the appropriate rate in force in case of Non-Resident investor as per section 194LBB	–
Deemed credit to investors	If income accruing to or received by the investment fund is not paid or credited to the investors, such income shall be deemed to have been credited to the investors on the last day of the previous year in the same	Deemed income of the investor with tax credit of tax deducted at source by investment fund.

Nature of Income	Taxation for AIF	Taxation for unit-holder
	proportion in which investors would have been entitled to receive the income had it been paid during the year as per section 115UB(6)	
Loss at investment fund level	If in any year there is a loss at the investment fund level either current loss or the loss which remained to be set off, the loss shall not be allowed to be passed through to the investors but would be carried over at the investment fund level to be set off against income of the next year in accordance with the provisions of the Act as per section 115UB(2)	–
Dividend Distribution Tax or Tax on Distributed Income	The provisions related to Dividend Distribution Tax or Tax on Distributed Income shall not apply to the income paid by the investment fund to the investors.	–

7. Taxation of Cross-border Trusts under Double Tax Avoidance Agreements ("DTAA")

In the current globalized world, assets are held worldwide. Also, family members may be widely dispersed over the world. Therefore, taxation of trust income under domestic tax laws and under DTAA can become very complex depending upon the residential status of the wealth owner / settlor, the location of the assets, the residential status of beneficiaries as well as that of the trustee/s and the location of the trust - in India or outside India.

7.1 Basis of taxation under domestic tax laws

Generally under domestic tax laws, basis could be one of the following -

- Entity level taxation where the Trust itself is taxed on its income and beneficiary is either exempt from taxation or credit of taxes are given to the beneficiary/ies
- Beneficiaries are only taxed, and trust is not taxed
- Beneficiaries pay taxes on the distributed amount and trust pays on the undistributed amount of income
- Jurisdiction of taxation of a trust may be dependent on whether it can be treated as 'Resident' under the tax law of the State which may be based on the following factors:
  - o Place of management/administration
  - o Place where settlor is resident
  - o Place where beneficiary/ies are resident
  - o Location of the assets

7.2 Issues involved in cross-border Taxation under DTAA

The following issues arise and require deliberation whilst deciding the taxation of cross-border flow of income from trusts:

- System of civil law or common law operating in the jurisdiction
- Pass through approach whether permitted
- Who can be regarded as taxpayer, trustee or beneficiary. Reference may be made to Article 3(1)(a) and Article 4(3) of the DTC dealing with definition of person and the residential status of such person
- Maximum tax rate for income of trust, particularly for Discretionary Trust
- Characterisation of distribution to beneficiaries and that of income of the trust
- Who can be regarded as beneficiary under Articles 10, 11, 12 and 23 of the DTC
- Who can be considered as alienator under Article 13 of the DTC

7.3 A table below illustrates the different situations and permutations / combinations:

Settlor / Wealth owner	Location of Assets / Source of income	Beneficiary	Trust / Trustee
Indian Resident	In and outside India	Resident and Non-Resident Indian	Resident and Non-Resident Indian
Non-Resident Indian	In and outside India	Resident and Non-Resident Indian	Resident and Non-Resident Indian

7.4 In such situations, a DTAA has to be resorted to as a particular source of income is taxable in one State – Source State – since the income is effectively connected to that State and the person to whom such income belongs is a resident of the other State – Residence State. Since both the States may seek to tax such income, it may lead to the issue of double taxation. To add to these complexities, certain forms of entities such as trusts are regarded as fiscally / tax transparent by some countries and some others regard it as non-transparent. These different treatments pose challenges with respect to issues such as the taxing rights of the jurisdictions, the person who is liable to tax, determination of the residential status, etc.

7.5 The eligibility and entitlement of fiscally transparent entities to invoke a tax treaty has always been a contentious issue since such transparent entities are generally not treated as 'person' due to the reason that such entities are not required to pay taxes. Rather the tax liability may be assessed in the hands of the members of such entities. The fiscally transparent entity, arguably, cannot be categorised as 'person' in the tax treaty. They are generally covered under the residue category of 'any other entity which is treated as a taxable unit for tax purposes.' Also, the determination of whether a trust or the beneficiary is 'liable to tax' in a particular State may pose challenges and practical difficulties given the different systems used by the countries to impose tax on income from trusts

7.6 Therefore the challenge that is posed by the taxation of income of cross-border trust is whether a trust itself can be taxed as an entity or the tax can be levied from the beneficiaries. In some tax systems (e.g., Hong Kong & Greece) where trust is taxed on its gross / net income, then it can be treated as liable to tax and in such cases normally distributions are not taxed in the hands of the beneficiaries. Even in some other cases, conditions are provided for the favourable treatment wherein trust is taxed on its income and taxes paid by the trust is creditable when subsequent distribution is made from the income already taxed.

7.7 Majority of the tax systems that provide for the taxation of the beneficiaries however treat trust / trustee responsible for payment of taxes on behalf of the beneficiaries. In those cases, trust is a transparent entity and benefits of the treaty may be available to Resident beneficiaries in the other State of registration / formation of the trust. Such a provision is found in many tax systems and treaties currently in operation where beneficiary of a resident State has invested in immovable property of the Source State through a Real Estate Investment Trust registered in Resident State. The Source state seeks to tax income from immovable property in its tax treaty with Resident State under Article 6 which then is a problem for Resident State to give credit at trust level or at the level of beneficiaries / unit holders. Resident State in accordance with its domestic legislation may provide for tax credit through Foreign Tax Credit rules. India does not consider trust as the taxpayer instead trustee is responsible for the payment of taxes on behalf of the beneficiaries in the determinate trust and at the trust level in case of indeterminate (discretionary) trust. In the later case, beneficiaries are not taxed at the time of distribution. In case of revocable trust, beneficiaries are ignored and settlor himself is treated as the tax payer.

7.8 To conclude, a trust is considered as transparent entity in major jurisdictions except for the discretionary trust where distribution is deferred, tax is levied on beneficiaries or on the basis of distribution withholding tax or is on the basis of creditable taxes in the hands of the beneficiaries when tax is paid by trust or the beneficiaries are exempt from the tax when trust is taxed as a taxable entity.

A non-resident beneficiaries of the source State Trust may be entitled to tax credit in his State of residence or in their respective States of Residence in accordance with Resident State tax credit rules, characterisation of the trust formed and registered in Foreign state and definition of person covered in the tax treaty.

8. Trusts under Foreign Exchange Management Act, 1999 ("FEMA")

8.1 Foreign Exchange Management Act, 1999 (FEMA), through various notifications, regulates the transactions between a Person Resident in India ("PRII") and a Person Resident outside India ("PROI"), whether such transactions are capital account transactions [section 2(e) of FEMA] or current account transactions [section 2(j) of FEMA].

8.2 Section 2(e) defines "capital account transaction" as a transaction which (a) alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or (b) alters assets or liabilities in India of persons resident outside India.

8.3 Section 2(j) defines the term "current account transaction" as a transaction other than a capital account transaction. Such transaction includes,

(i) Payments due in connection with (a) foreign trade, (b) other current business, (c) services, and (d) short-term banking and credit facilities in the ordinary course of business,

(ii) Payments due as (a) interest on loans and (b) net income from investments,

(iii) Remittances for living expenses of parents, spouse and children residing abroad, and

(iv) Expenses in connection with (a) foreign travel, (b) education and (c) medical care of parents, spouse and children.

Current account transactions are more specifically covered in Schedule I, II & III of Foreign Exchange Management (Current Account Transactions) Rules, 2000.

8.4 Thus, the residential status and nature of transaction i.e., capital account transaction (e.g. purchase/sale of shares, property) or current account transaction (e.g., remittance of income on shares, property) are the cornerstones of FEMA.

As per the scheme of FEMA, "All capital account transactions other than those permitted are prohibited while all current account transactions other than those prohibited are permitted". Under FEMA, certain types of transactions do not require RBI permission while others either require prior approval of RBI/Government or it is mandatory to inform RBI of the same.

8.5 Under the provisions of FEMA Notification 1 regarding permissible capital account transactions, Schedule II thereto gives general permission to a PROI to, *inter alia* (a) invest in securities, deposits, etc and (b) acquire and transfer immovable property in India by a PROI subject to the transactions being within the limit, if any, specified in the regulations relevant to the transactions.

FEMA Notification 5 specifically deals with bank accounts and deposits by PROI; FEMA Notification 20(R) specifically deals with investment in shares and various financial assets and FEMA Notification 21(R) specifically deals with acquisition and transfer of immovable property in India whether by purchase by inward remittance or by way of gift or inheritance.

8.6 FEMA and the Trust

FEMA does not consider a trust as a 'person'. As per the definition of 'person' in Section 2(u), 'person' includes (i) an individual, (ii) on HUF, (iii) a company, (iv) a firm, (v) an association of persons or a body of individuals, whether incorporated or not, (vi) every artificial juridical person, not falling within any of the preceding sub-clauses, and (vii) any agency, office or branch owned or controlled by such person.

Even the definition of 'person' under Section 2(31) of the Income-tax Act does not specifically include trust as a person and hence it cannot be further treated as resident or non-resident.

Let us now examine whether the provisions of FEMA are attracted at the time of establishment or the formation of the trust i.e., at the time of vesting of trust-property, whether immovable or movable, in the trustees to hold and administer on behalf of the beneficiaries as per the objectives, terms & conditions of the trust as found in the instrument / deed of the trust.

The concept of a trust has been discussed in paragraph 2 earlier and it is evident that a trust is merely an obligation annexed to the ownership of property, such obligation resting upon the "trustee", and granting certain rights and imposing certain liabilities on the trustees, on the settlor of the trust and on the beneficiaries of the trust. The ultimate owner of the trust-property, in case of private irrevocable trust, remains the beneficiary/(ies). However, the legal title to the trust-property is vested in the trustee. Further, FEMA and the Notifications & Regulations thereunder neither specifically permit or prohibit the route of acquiring beneficial ownership in assets in India by a PROI.

Further, it is well-settled in law that vesting of beneficial interest by way of trust is not in the nature of a gift. In a gift, the transaction is directly between the donor and the donee whereby the donee acquires full title and ownership rights of the gift immediately, unlike in a trust where the full title and property rights are transferred to the trustees to act in the interests of the beneficiary as set out in the trust deed, thus it is a conditional settlement in favour of the beneficiary/ies.

Similarly, the trust deed cannot be equated with a will which is a testamentary document that becomes operative only after the death of its author on the happening of which the title to the property vests directly in the inheritor.

Thus, at the most, a trust can be considered as an arrangement between settlor and the trustees as in most cases, beneficiaries are not a party to the arrangement.

Hence, the act of creation of trust is not one of gift or inheritance or legacy, the provisions of FEMA Notification 21(R) regarding acquisition of property in India by a PROI by way of a gift or inheritance or legacy, as the case may be, cannot apply.

A conclusion thus emerges that, at the time of vesting of trust-property located in India to a resident trustee by a resident settlor, the provisions of FEMA are not attracted as the transactions are by and between two residents even though the beneficiaries may be PROIs. This position remains the same irrespective of whether the private trust is revocable, irrevocable, discretionary or determinate as in these cases there is no transfer of property between the settlor and the beneficiaries.

8.7 FEMA and distribution of income & assets of the trust

Let us now examine whether the provisions of FEMA are attracted at the time of distribution of income and assets of the trust. When the trustee declares a distribution of the assets or income of the trust in terms of the trust deed in favour of the beneficiaries, it gives rise to legitimate dues to the beneficiaries who are PROIs. It follows that in case of a distribution of assets or income by the trust, as per the definition of capital account transaction, it alters the assets in India of a PROI thus making it a capital account transaction thereby attracting the provisions of FEMA.

Under the scheme of FEMA, remittance and repatriation of assets and investments in India by PROIs is dealt with by different Notifications on the basis of nature of investment, mode of acquisition, etc. Notification FEMA 13(R) deals with specific situations for remittance of assets in India by PROIs that have not been acquired by way of inward Forex resources. Although total capital account convertibility does not exist under FEMA, there is full convertibility to the extent of USD 1 million per calendar year for NRIs as provided in Regn. 4(2) of the said Notification FEMA 13(R) which provides that NRIs / PIOs may remit an amount, not exceeding US$ 1 million per financial year out of balances held in Non-Resident Ordinary Rupee (NRO) Account / Sale proceeds of assets / the assets acquired by way of inheritance / legacy on production of (a) documentary evidence of in support of acquisition, inheritance or legacy of assets by the remitter.

In view of the above, as the non-resident beneficiaries have not acquired the assets by way of inward remittance of convertible foreign exchange nor by way of gift / inheritance or legacy, the distribution of the same would be done by way of credit to the NRO account, which is permitted being legitimate dues in India of the account holder under para. 3(A)(ii) of Schedule III of Notification FEMA 5(R) that deals with NRO deposit accounts of PROIs. Thereafter, as permitted under Notification FEMA 13(R), remittance of an amount, not exceeding USD 1 million per financial year may be done out of balances held in the said NRO Account.

The above position remains the same irrespective of whether the private trust is revocable, irrevocable, discretionary or determinate.

However, as an abundant caution, since finally at the time of distribution, an asset is transferred in some form, it is advisable for the trustees to approach RBI to make distribution to the non-resident beneficiary.

While making the application, it could be proposed –

i. where remittance is lower than $250,000, that the distribution, being lower than US$ 250,000 freely permitted under the Liberalised Remittance Scheme by PRII (settlor or trustee), may be allowed;

ii. where remittance is higher than US$ 250,000, then distribution, being lower than US$ 1 million, may be allowed as distributed asset, being asset of PROI once distribution (net of taxes) is made,it may be allowed under FEMA Ntf. 13(R) as amended.

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CA Harshal Bhuta & CA Tanvi Vora[2]

Do's and Don'ts for NRIs and Issues relating to PAN, OCI, AADHAAR, PPF and Registration under various regulations for doing business in India[1]

Non-Resident Indians ('NRIs') have always been accorded special status by successive Governments partially due to the huge amount of foreign remittances that they send back home which help in curtailing current account deficit. With the current volatility in rupee in sight, there have been news reports of a fresh issue of NRI bonds to curtail the current account deficit and improve the strength of the rupee[3].

This article focuses on the finer aspects that NRIs need to bear in mind while transacting with persons resident in India ('PRI') and other non-residents concerning Indian property, security, currency & other assets & liabilities in India. This article does not explain the bare regulations since they are expected to be covered under other topics under this special issue on 'NRI – FEMA, Taxation & Other Compliances'.

1. Do's and Don'ts for NRIs

A. Definition of NRI, PIO& OCI under different Regulations in force:

Varying definitions of Non-Resident Indian, Person of Indian Origin ('PIO') along with Overseas Citizen of India ('OCI') have been used under different Regulations issued at different points in time. Till the point in time convergence is achieved between the respective Regulations, it is vital that the respective definition is read when entering into a specific transaction. The difference under respective regulations can be enumerated with the help of a simple example:

Say, a newly married Singaporean Spouse of Indian Citizen wants to open NRE deposit with DBS Bank in India as well as invest in Indian immovable property at Goa. He / she would qualify as PIO under Regulation 2(x)(d) of FEMA Notification 5(R)/2016 dated 01/04/2016 and would be allowed to open NRE deposit a/c instantly with any authorised dealer bank in India even without possessing an OCI card. However, he / she would be unable to register as an OCI cardholder under Section 7(A) of the Citizenship Act, 1955 before completing

1 This article is dedicated to Late Shreyanshbhai Jhaveri, past Core Group Member of CTC who was father-like figure to us and encouraged us for professional advancement throughout our careers.

2 Our colleague Ms. Madhuri Yadav has assisted us in presenting this article.

3 https://economictimes.indiatimes.com/markets/stocks/news/higher-oil-will-widen-cad-rbi-may-issue-nri-bonds-bofa-ml/articleshow/64108116.cms

two years of subsisted and registered marriage and accordingly would not qualify as OCI under FEMA Notification 21(R)/2018 dated 26/03/2018. Thus, he / she wouldn't be able to purchase residential property in India either singly or jointly before completing two years of subsisted and registered marriage.

The benefit hitherto granted to PIO and OCI under different regulations has been spread to one more layer of generation by virtue of revision in the definitions issued under revised Regulations. For example now even great grandchild of a citizen of India qualifies as PIO under FEMA 5(R)/2016dated 01/04/2016 and similarly, qualifies as OCI FEMA Notification 21(R)/2018 dated 26/03/2018 if he / she is registered as OCI cardholder. This should be kept in mind and full benefit should be taken when one undertakes transactions covered within the scope of respective regulations.

Further, maternal as well as paternal lineage both can be considered when one refers to the definition of PIO and OCI under the respective Regulations. Therefore, a Portuguese citizen can benefit under respective Regulations even if his / her great grandfather was a Portuguese Citizen by birth but whose great grandmother was born in Goa and who became a Portuguese Citizen before integration of Goa with India.

B. Bank Accounts in India by NRIs:

NRI / PIO as defined under FEMA Notification 5(R)/2016 dated 01/04/2016 should choose the appropriate bank account in India which suits their requirements based on vital parameters such as:

- o *Repatriability*: Non Resident External Rupee Account Scheme ('NRE') and Foreign Currency (Non-Resident) Account (Banks) Scheme ('FCNR (B)') are fully repatriable in nature whereas Non-Resident Ordinary Rupee Account Scheme ('NRO') is fully repatriable only to the extent of current income that is credited into it. However, balances in NRO a/c can be remitted outside India up to the limit of US $ 1 million per financial year.
- o *Type of account:* NRE a/c and NRO a/c can be opened in any form such as savings, current, recurring or fixed deposit whereas FCNR(B) a/c can be opened only in form of term deposit. Further, NRE a/c and NRO a/c are rupee accounts whereas FCNR(B) is a foreign currency account.
- o *Tenure:* NRO a/c is very similar in nature to resident a/c and thus the tenure of fixed deposit is the same that is applicable to resident accounts. Whereas, NRE FD a/c is for a period between 1 to 3 years though authorised dealers are allowed to accept deposits for greater than three years. FCNR(B) a/c tenure is between 1 and 5 years.
- o *Taxability:* Interest earned from NRE a/c is exempt u/s Sec. 10(4)(ii) of Income-tax Act, 1961 and from FCNR(B) a/c is exempt u/s 10(15)(fa) whereas interest income from NRO a/c is fully taxable at normal rates of tax subject to the provisions of DTAA.
- o *Loans against security of funds:* It may be noted that loans can be availed in India from authorised dealers / banks against security of funds held in all three types of accounts subject to conditions whereas loans outside India are not permitted to be extended in case of NRO a/c.

Benefit should be availed by NRIs and PIOs of the provisions that allow all three types of bank accounts to be:

- o Opened jointly with other NRIs / PIOs;
- o Opened jointly with Resident relatives (as defined e/s 2(77) of the Companies Act, 2013) on a 'former or survivor basis';
- o Operated by Resident relatives as Power of Attorney holders subject to operational restrictions.

The above provisions prove beneficial to those NRIs who delegate the responsibility of handling their own financial matters in India to their close Indian relatives.

NRIs can also become joint holders in resident saving bank account of their resident close relatives on 'either or survivor basis' subject to the various operational conditions importantly including that no contribution of funds should be made by NRIs and that they could operate the account only for and on behalf of the resident relative for making domestic payments. This provision becomes hugely beneficial to dependent elderly Indian parents who have children staying abroad for a long duration.

C. Borrowing and Lending transactions between NRI / PIO and PRI in foreign exchange and Indian Rupee ('INR'):

Transactions of Borrowing and Lending between NRI / PIO and PRI in foreign exchange are restricted to the following:

o It is of utmost importance to take note that Indian companies can avail loan in foreign exchange from NRI / PIO under ECB route only if such NRI / PIO qualifies as 'foreign equity holder' and other conditions under ECB route are satisfied. Apart from this route, Indian company is not allowed to borrow in foreign exchange from NRI / PIO even if such NRI / PIO maybe its director.

o NRI / PIO can lend in foreign exchange to their close relative in India up to a sum of US $ 2,50,000 subject to conditions.

o Residents can also lend in foreign exchange to their NRI / PIO close relatives under Liberalised Remittance Scheme of US $ 2,50,000 for resident individuals[4].

The following are some of the commonly adopted permitted modes of transactions of Borrowing and Lending in INR between NRI / PIO and PRI:

o PRI being an Indian company can borrow from NRI on repatriation or non-repatriation only if the borrowing in INR is by issuance of non-convertible debentures (NCDs) made by public offer. This is the only route under which Indian companies can borrow from NRI / PIO in INR[5]. Apart from satisfaction of other conditions, another important condition is that the borrowed funds should be utilised for own business purpose apart from blacklisted business purposes.

o PRI other than an Indian company (essentially partnership firms, LLPs and individuals) can also borrow from NRI / PIO provided it is availed on non-repatriation basis. Apart from satisfaction of other conditions, the business purpose utilisation condition is similar to above. Hereunder, the individuals availing loan from NRI /PIO need not be their close relatives.

o Lending by authorised dealers in INR to NRIs for own requirements or own business purposes subject to conditions.

o Lending in INR by an authorised dealer or a housing finance institution to NRI/PIO for housing purpose subject to conditions wherein repayment is allowed by even resident relatives of NRI / PIO.

o Residents can lend to their NRI / PIO close relative in INR under Liberalised Remittance Scheme of US$ 2,50,000. Apart from satisfaction of other conditions, such rupee loans should be given by way of crossed cheque / electronic transfer for credit to their NRO a/c only.

4 This interpretation is based upon reading of Para A.6.v of FED Master Direction No.7/2015-16 dated 01/01/2016 (updated as on 02/08/2017) read with Serial number 11 to Para 3.i of A.P. (DIR Series) Circular No. 50 dated 11/02/2016 identified with FETERS Purpose Code S0011.

5 Though deposit can be accepted by Indian proprietorship concern/ firm or company (including NBFC) on non-repatriation basis from existing NRO funds, under Schedule 7 to FEMA Notf. 5(R)/2016 dated 01/04/2016.

D. Gifts from / to NRI / PIO:

Giftsfrom NRI / PIO: Gift by NRI / PIO to PRI is a current account transaction which is freely permitted and not covered under Rules 3, 4 or 5 of Foreign Exchange Management (Current Account Transactions) Rules, 2000. It may be noted that NRIs / PIOs can gift money in INR as well as foreign exchange to their relatives as well as non-relatives (typically close friends). Further, NRIs /PIOs can also gift foreign securities to PRIs under general permission. However, tax effect under Sec. 56(2)(x) of Income Tax Act, 1956 needs to be taken into account alongside compliance with other anti-money laundering laws as well as Foreign Contribution (Regulation) Act, 2000 typically when the gift is made to non-relatives.

Gifts to NRI / PIO: Though gift by PRI to NRI / PIO is a current account transaction, if the gift is intended to be remitted abroad, it involves drawal of foreign exchange and is covered under Rule 5 of Foreign Exchange Management (Current Account Transactions) Rules, 2000 and is subject to restrictions by RBI. Thereunder, a resident individual can remit upto US $ 2,50,000 in one financial year as gift to NRI / PIO. It may be noted that such NRI / PIO maybe a close relative as well as non-relative (typically close friends). Whereas, a resident individual is allowed to make a rupee gift to their NRI / PIO close relative in INR under Liberalised Remittance Scheme of US $ 2,50,000[6]. Such rupee gift should be given by way of crossed cheque / electronic transfer for credit to their NRO a/c only. Since INR gifts cannot be given in any manner other than by credit to NRO a/c, cash gifts to NRI relatives are strictly prohibited even for important Indian traditions and occasions like family weddings or festivals.

E. Export and Import of Foreign and Indian Currency:

Foreign Currency: NRI / PIO can bring along with him / her into India, foreign currency without limit provided he / she files Currency Declaration Form (CDF) if the value of foreign currency in aggregate exceeds US $ 10,000 at any one time or the value of foreign currency notes exceed US $ 5,000 at any one time. At the time of departure from India, he / she can take out of India unspent foreign exchange not exceeding the amount brought into India earlier.

Indian Currency: NRI / PIO may take outside India currency notes of Government of India not exceeding ₹ 25,000/- per person. Similarly, NRI / PIO may bring into India currency notes of Government of India not exceeding ₹ 25,000/- per person. It may be noted that this limit is not per visit and applies as a cumulative limit at all points in time.

F. Acquisition and Transfer of Immovable Property in India by NRIs / OCIs:

RBI has recently issued revised Regulations in this regard *vide* FEMA Notf. 21(R)/2018 dated 26/03/2018. For ease of reference, the modes of acquisition and transfer of immovable property are summarised in the table below:

Particulars	NRI / OCI
Acquisition	
Purchase (other than agricultural land/ farmhouse/ plantation etc) **from**	Resident/ NRI/ OCI [Reg. 3(a)]
Acquire as gift (other than agricultural land/ farmhouse/ plantation etc) **from**	Resident/ NRI/ OCI [Reg. 3(b)] who is a relative

6 Refer FEMA Notf. 237/2012 dated 25/09/2012.

Particulars	NRI / OCI
Inheritance	
Acquire (any IP) as inheritance **from**	a. Any person who has acquired it under laws in force [Reg. 3(c)]; b. Resident [Reg. 3(c)]
Sale	
Sell (other than agricultural land / farmhouse / plantation etc.) **to**	Resident/ NRI/ OCI [Reg. 3(d) & Reg. 3(e)]
Sell (agricultural land / farmhouse / plantation etc.) **to**	Resident [Reg. 3(d)]
Gift	
Gift (other than agricultural land / farmhouse / plantation etc.) **to**	Resident/ NRI/ OCI [Reg. 3(d) & Reg. 3(e)]
Gift (agricultural land / farmhouse / plantation etc.) **to**	Resident [Reg. 3(d)]

NRI / OCI can acquire residential as well as commercial property under this Regulation.

NRI / OCI can give the property on rent & repatriate funds abroad after payment of due taxes.

Care must be taken by NRI / OCI to book any property in India only by making payment by way of foreign inward remittance through banking channels or through NRE / NRO/ FCNR (B) a/c maintained in India. This means that even small payments for booking deposit cannot be made by way of foreign currency notes or traveller's cheque or other modes such as PayPal, Transferwise, etc.

It is important to note that NRI / OCI cannot purchase any agricultural land / farm house / plantation property in India. They can only inherit such properties.

Hitherto, spouse of NRI / OCI could not jointly acquire immovable property in India if he / she hadn't registered as OCI card holder. Now, it is permissible for them to acquire jointly subject to certain conditions.

There is no restriction on the number of properties that NRI/ OCI can purchase in India. However, continuous churning of properties may amount to conduct of real estate business by a proprietary concern and would be prohibited in terms of Reg. 4(b)(iv) of FEMA Notf. 1/2000 dated 03/05/2000.

Further, it may be borne in mind that sale consideration is repatriable only for two properties per lifetime provided the acquisition price would have been paid out of foreign inward remittance through banking channels or through NRE / FCNR (B) a/c maintained in India.

FEMA Notf. 21(R)/2018 dated 26/03/2018 also covers situation of acquisition of immovable properties by PRI under Reg. 9[7]. Therein, it prohibits PRIs being foreign citizens of certain countries from purchasing immovable property in India without permission from RBI although they may be satisfying the tests of becoming PRI.

Further, Reg. 9 also covers situation of acquisition of immovable properties by foreign citizens being PROI. However, there is an

7 Regard may be had to the Press Release dated 31/07/2014 issued by Ministry of Finance stipulating that apart from number of days test for becoming PRI, the foreign national also needs to satisfy his purpose of stay as well as the type of Indian visa granted to him to clearly indicate the intention to stay in India for an uncertain period. Only then can such PRI acquire immovable property in India.

exemption for OCIs from this stringent condition. For example, a citizen of Hong Kong, being PROI is required to obtain RBI permission if he /she wants to acquire immovable in India. However, if such citizen is an OCI Cardholder, then he can freely acquire immovable property in accordance with Reg. 3.

G. Investment in India by NRIs / OCIs:

The various routes available for NRIs / OCIs to make investment in India in accordance with FEMA Notf. 20(R)/2017 dated 07/11/2017 are given below:

Schedule No.	Regulation	Particulars
1	5(1)	Purchase / Sale of capital instruments of an Indian company by a person resident outside India
3	5(3)	Purchase/ Sale of Capital Instruments of a listed Indian company on a recognised stock exchange in India by NRI or OCI on repatriation basis
4	5(4)	Investment on non-repatriation basis by NRI or OCI
5	5(5)	Purchase and sale of securities other than capital instruments by a person resident outside India
6	5(6)	Investment in an LLP
8	5(8)	Investment by a person resident outside India in an Investment Vehicle
10	5(10)	Issue of Indian Depository Receipts

It is important to note here that under all the Schedules dealing with different routes of investment, the consideration should be paid by way of foreign inward remittance through banking channels or through funds held in specified non-resident accounts mentioned respectively. Payment of consideration for purchase through any other mode constitutes a violation.

The brief provisions dealing with transfer of capital instruments by / to NRI / OCI are summarised below.

Regulation	Seller	Buyer	Mode of Transfer
10(2)	NRI / OCI (on Repatriation basis)	Any PROI (including NRI / OCI) (on Repatriation or Non-Repatriation basis)	Sale / Gift
10(3)	PROI (including NRI / OCI) (on Repatriation or Non-Repatriation basis)	PRI	Sale / Gift
10(4)	PRI / NRI / OCI on Non-Repatriation basis	Any PROI (including NRI / OCI) (on Repatriation or Non-Repatriation basis)	Sale
10(5)	PRI / NRI / OCI on Non-Repatriation basis	Any PROI (including NRI / OCI) (only Repatriation basis)	Gift – RBI Approval
10(6)	NRI / OCI on Non-Repatriation basis	Any NRI / OCI on Non-Repatriation basis	Gift

These above provisions should be referred whenever NRI / OCI wants to purchase or sell or gift capital instruments of an Indian company to relatives / non-relatives. For example, if NRI / OCI wants to gift his / her shareholding in Indian company to their resident son, regard should be had to Reg. 10(3) whereas if he/ she wants to gift such shareholding to their non-resident son, then regard should be had to Reg. 10(2) or Reg. 10(6) as applicable.

NRIs & OCIs should avail full advantage available to them under Schedule 4 to FEMA Notf. 20(R)/2017 dated 07/11/2017. The primary advantage offered to investments under Schedule 4 over Schedule 1 and 3 is the absence of sectoral caps and sector-specific conditions for investment into companies operating under a specific sector. Hereunder, the investments are deemed to be treated as domestic investment at par with investments. Hence there are no pricing guidelines prescribed for investments under this Schedule[8]. Further, there are no documentation and reporting requirements too when compared to investments under other Schedules to this Notification.

Previously, transfer from NRI to PROI (other than NRI) was covered under specific permission route which has now been liberalised under Reg. 10(2). As a result, such transfers are allowed to be made subject to adherence to pricing guidelines and documentation and reporting requirements. Similarly, previously investments on non-repatriation basis were not permitted to be converted into investments on repatriation basis as a result of sale without the permission of RBI. This has been liberalised and such cross-over is now permissible under Reg. 10(4).

Investments which were hitherto covered under Schedule 3 under Portfolio Investment Scheme for NRIs & OCIs were also recently fragmented into two Schedules – Schedule 3 pertaining to purchase and sale of capital instruments on recognised stock exchange on a repatriation basis whereas Schedule 4 now covers purchase and sale of capital instruments on stock exchange on a non-repatriation basis. Hence, Schedule 4 now covers purchase and sale of capital instruments issued by a company without any limit either on stock exchange or outside it.

H. Emigrating Indians

Assets in India: Section 6(5) of Foreign Exchange Management Act, 1999 allows a person resident outside India to hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India. Hence the person emigrating abroad need not sell these assets on emigration.

Bank a/cs: The resident bank accounts (saving, current as well as deposit) needs to be converted into NRO a/c on an immediate basis when such person becomes a person resident outside India as defined u/s 2(w) of Foreign Exchange Management Act, 1999. Continuing the residential status of bank accounts constitutes a violation. If the resident maintained foreign currency accounts such as Exchange Earner's Foreign Currency Account or Resident Foreign Currency (Domestic) Account, then the balance in such accounts can be credited into NRE / FCNR(B) a/cs so that such funds remain fully repatriable. Further, it is beneficial for NRIs to transfer funds from NRO a/c to NRE a/c within the limit of $ 1 million per financial year to avail various relaxations granted under NRE a/c scheme. Care should be taken that income earned from outside India should be refrained from credit first into Indian bank account in order to escape avoidable tax on such income in India.

Shares and Securities: Such person should intimate the company, registrar, broker, depository of change in the residential status in order to comply with provisions of FEMA Notf. 20(R) including sectoral caps and avoid violations.

Borrowing and Lending: On change of status of borrower from PRI to PROI, Authorised Dealers are allowed to continue the loan/ overdraft till its original maturity subject to its satisfaction of their commercial judgment. Further, the repayment needs to be out of inward remittance from outside India or from NRE/FCNR(B)/NRO a/c of the borrower.

Insurance Policy: NRI can continue to hold life/ general insurance policy in India. Further, no permission required for payment of premium on such policy.

Partner in firm or proprietor of concern: NRI can continue to remain partner in his / her firm /proprietor of his /her concern. Intimation needs to be given / recorded by NRI about change in status to the firm / proprietary concern. However, any loans given to partnership firm / proprietary concern would henceforth be covered under FEMA Notf. 4/2000 dated 03/05/2000 and accordingly, the conditions therein need to be complied with.

Karta of HUF: NRI can become karta of HUF after change in residential status from PRI to NRI. However, the residential status of HUF under Income Tax Act, 1961 remains uncertain thereof.

Previous Outbound Investments: Individuals being PRI who would have made outbound investment under Reg. 20A of FEMA Notf. 120/2004 dated 07/07/2004 need to intimate to RBI to cancel the Unique Identification Number allotted by RBI for such outbound investment.

Overseas Tax Declarations: NRIs need to declare their Indian financial assets / accounts if required under the overseas domestic laws such as FBAR, etc. Also, they may be required to give declarations in countries where they earn income such as tax residency certificate, FATCA declarations, etc.

Power of Attorney: NRI should give a power of attorney to trusted persons in India so that the POA holder can take care of all matters for and on behalf of the NRI. However, it should be noted that sale of immovable property can no longer be carried out by giving general power of attorney.

DTAA: NRI should take into account the benefit available under respective DTAAs for specific incomes earned. For example, Consideration earned from sale of Indian Mutual Funds is exempt from tax in India under Article 13(5) of India-UAE DTAA.

Documentation trail: NRI should maintain source of income proofs for incomes earned outside India. This would come in handy when source of funds needs to be disclosed for funds credited into NRE / FCNR(B) / NRO a/c from abroad or making payment of consideration for investments into India by way of foreign inward remittance through banking channels. If bank account is maintained jointly in India, then clear segregation of source of funds between self and other NRI is advisable to maintain to aid in deduction of TDS on appropriate amount as well as computation of capital gains in future.

PPF: NRI cannot open or renew PPF a/c in India.

Netting off: NRI should not undertake any 'netting-off transactions' with residents which are specifically prohibited under Sec. 3 of Foreign Exchange Management Act, 1999.

I. Returning Indians:

Assets abroad: Sec. 6(4) of Foreign Exchange Management Act, 1999 allows a person resident in India to hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

Bank a/cs: As mentioned above, PRI who was previously NRI can continue to maintain foreign bank account outside India. However, PRI needs to re-designate NRO / NRE / FNCR(B) a/c into resident accounts. Funds held in NRE & FCNR(B) a/c can also be credited to Resident Foreign Currency a/c. However, no such option has been given for NRO a/c. Further, NRE and NRO a/c need to be re-designated on an immediate basis upon change in residential status whereas FCNR(B) a/c is allowed to be continued till its maturity.

Insurance Policy: PRI can continue to hold life/general insurance policy outside India. No permission required from RBI for payment of premium. However, maturity proceeds to be repatriated to India within 7 days.

Partner in firm or proprietor of concern: It is advisable to take permission from RBI before continuing as partner of an foreign partnership firm or as a proprietor of foreign proprietary concern.

2. Issues relating to PAN, OCI, Aadhaar, PPF and Registration under various regulations for Doing Business in India

A. Issues relating to Aadhaar

Many NRIs have been asked to furnish Aadhaar time and again for availing various services and benefits from the Government.

It may be noted that Section 3(1) of The Aadhaar (Targeted Delivery Of Financial And Other Subsidies, Benefits And Services) Act, 2016 ('Aadhaar Act') entitles only 'resident' to obtain an Aadhaar number by submitting his demographic information and biometric information by undergoing the process of enrolment. Further, as per Section 2(v) of Aadhaar Act', "resident" means an individual who has resided in India for a period or periods amounting in all to one hundred and eighty-two days or more in the twelve months immediately preceding the date of application for enrolment.

It may be noted that the definition of 'person resident in India' u/s Section 2(v) of Foreign Exchange Management Act, 1999 contains its own peculiarities and therefore, a 'person resident in India' under FEMA may not automatically qualify as a resident under the Aadhaar Act. This is particularly important from the viewpoint of Returning Indians.

Most of the NRIs & OCIs may not be eligible for obtaining Aadhaar number. Further, Section 7 of Aadhaar Act stipulates that if an Aadhaar number is not assigned to an individual, the individual shall be offered alternate and viable means of identification for delivery of the subsidy,benefit or service. Therefore not obtaining an Aadhaar number should not be of concern to NRIs and OCIs who are not eligible for it.

B. Issues relating to PAN:

The application form for obtaining PAN by an Indian Citizen contains an optional field for mentioning PAN. This has been expressly stated under Section 139AA of Income-tax Act, 1961. Despite it being optional, certain PAN facilitation centres are not accepting applications from NRIs who may not be eligible for obtaining Aadhaar number as mentioned above. Online application should be opted for under such cases.

Similarly, linking of Bank accounts and PAN number with Aadhaar is required only such person is eligible to obtain Aadhaar.

C. Issues relating to OCI:

There are various benefits of holding OCI card mainly:

- Multiple entry lifelong visa for visiting India for any purpose;

- o Exemption from registration with Foreigners Regional Registration Officer (FRRO) or Foreigners Registration Officer (FRO) for any length of stay in India;
- o Parity with Non-Resident Indians (NRIs) in respect of all facilities available to them in economic, financial, and educational fields **except in matters relating to the acquisition of agricultural or plantation properties;**
- o Registered Overseas Citizen of India Cardholder shall be treated at par with Non-Resident-Indians in the matter of inter-country adoption of Indian children;
- o Registered Overseas Citizen of India Cardholder shall be treated at par with resident Indian nationals in the matter of tariffs in air fares in domestic sectors in India;
- o Registered Overseas Citizen of India Cardholder shall be charged the same entry fee as domestic Indian visitors to visit national parks and wildlife sanctuaries in India;
- o Parity with Non-Resident Indians(NRI) in respect of:-
  - – entry fees to be charged for visiting the national monuments, historical sites and museums in India;
  - – pursuing the following professions in India, in pursuance of the provisions contained in the relevant Acts, namely:-
    - • doctors, dentists, nurses and pharmacists;
    - • advocates;
    - • architects;
    - • chartered accountants;
  - – to appear for the All India Pre-Medical Test or such other tests to make them eligible for admission in pursuance of the provisions contained in the relevant Acts.

Vide Notification number F. No. 26011/01/2014-IC.I. dated 09/01/2015 issued by the Ministry of Home Affairs, merger of PIO card scheme and OCI card scheme was announced. By virtue of this notification, all PIO Cardholders are deemed to be OCI cardholders.

This merger was notified since the PIO cardholders who had settled abroad had been demanding from the Indian Government to enhance the validity of PIO card from 15 years to lifetime so as to place them on par with foreign citizens of Indian origin holding Overseas Citizen of India (OCI) Card Status.

Though all PIO cardholders are deemed to be OCI cardholders, they are supposed to apply for an OCI card in lieu of the PIO Card. The deadline for applying for replacement of PIO cards with OCI cards was first fixed as 17th June 2015. It has been subsequently extended from time to time and the last date for replacement on a gratis basis was fixed as 31st December, 2017. However, the erstwhile PIO cards will be considered as valid document till 30th September, 2018 and applications for replacement are accepted now for a charge. After 30th September 2018, a person travelling on PIO card will be refused immigration at Indian immigration counters.

D. Issues relating to PPF:

NRI is not permitted to open or renew PPF a/c in India.

The Ministry of Finance *vide* notification G.S.R. 585(E) dated 25/07/2003 had amended the Public Provident Scheme, 1968 to allow NRIs to continue to subscribe to PPF till its maturity on non-repatriation basis if a resident became NRI during currency of maturity period of PPF.

Subsequently, Ministry of Finance vide Notification G.S.R. 1237(E) dated 03/10/2017 amended the Public Provident Fund Scheme, 1968 further to stipulate that the PPF a/c shall be deemed to be closed with effect from the day the resident becomes a non-resident and interest with effect from that date shall be paid at the rate applicable to the Post OfficeSaving Account up to the last day of the month preceding the month in which the account is actually closed. This amended proved to be hugely detrimental to the interests to the NRIs since it gained retrospective effect. For example, A resident opens a PPF account on 01/04/2014 and subsequently becomes NRI on 15/06/2014. Before issuance of Notification G.S.R. 1237(E) dated 03/10/2017, such NRI could have continued to contribute to PPF till the end of five year maturity period viz. 31/03/2019. NRI would also have earned PPF interest till the date of issuance of notification. On account of the issuance of notification G.S.R. 1237(E) dated 03/10/2017, such PPF a/c would be deemed to have been closed w.e.f. 15/06/2014. As a result, there was a lot of indecisiveness as to what would happen to the interest earned by such NRI for the period between 15/06/2014 & 03/10/2017. The banks were not allowing NRIs to close down PPF a/c that had matured due to lack of clarity.

Consequently, the Ministry of Finance issued an office memorandum vide. F.No. 01/10/2016-NS dated 23/02/2018 instructing that the previous notification dated 03/10/2017 was to be kept in abeyance. Accordingly, the position under law reverts to notification G.S.R. 585(E) dated 25/07/2003 which allows NRIs to continue to subscribe to PPF till its maturity on non-repatriation basis.

Finally the air has been cleared and the banks have allowed NRIs to subscribe to PPF if it is within the maturity period.

E. Issues relating to Registration under various regulations for doing business in India:

For most of the regulations requiring registration before starting a business, PAN is typically accepted as a proof of identity for NRIs.

Ministry of Corporate Affairs (MCA) has recently introduced SPICe Form INC-32 which is a simplified proforma for incorporating company electronically. EForm SPICe (INC-32) deals with the single application for reservation of name, incorporation of a new company and/or application for allotment of DIN and/or application for PAN and TAN. However, if a foreign national is a subscriber to the MOA and AOA, the form requires submission of valid business visa failing which apostilled MOA & AOA need to be attached. If foreign national is an OCI cardholder, he / she would not have a separate business visa. Further, if such investment is made under Schedule 4 to FEMA Notf. 20(R)/2017 dated 07/11/2017, such investment is ought to be treated as domestic investment. Under such circumstances, regressive conditions such as attachment of apostilled MOA & AOA should be done away with.

Though NRIs do not participate in the social environment of the country, their economic contribution continues to earn them a special place in the affairs of our country. This is evident from the intention of the Government to allow proxy voting in near future to NRIs. The Government policies will continue to favour NRIs and OCIs in the future. To take full benefit of such policies, NRIs and OCIs need to bear in mind the aspects dealt with above in order to prevent any unnecessary hassles in doing business in India.

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Dr. Dilip K. Sheth

Applicability of PMLA to NRIs

SYNOPSIS

Introduction

Newspapers have often reported that an industrialist belonging to a prominent business house acquired the status of a Non-Resident Indian (NRI). The report also reveals that this change of status was made for gaining immunity from the provisions of the Indian laws dealing with foreign exchange, income-tax, etc.

Recently, newspapers reported that a prominent industrialist opted for citizenship of another country. Here also, the purpose was to have the benefit of *"ease of doing business"* offered by the country of which he became a citizen. In this case, the industrialist was unhappy spending enormous time in coping with the compliance of plethora of laws that obstructed his sprawling business in India.

The news mentioned in these two cases should not surprise us since India is ranked fairly low by international rating agencies for the *"ease of doing business"* in India.

The moot question

In the above-mentioned scenario, the moot question that deserves consideration is: *whether NRIs are outside the sweep of PMLA?*

To find answer to this question, a reference may be made to certain antecedent international developments.

The first antecedent development was the political Declarations and Global Programme of Action annexed to the resolution of the UN General Assembly. These declarations were made at its Special Sessions held in February 1990 and June 1998. The latter Declaration called upon the member States to adopt national anti-money-laundering legislation and programme.

Pursuant to the 1998 UN Declaration, the Government of India considered it necessary to implement the spirit of the UN Resolution and the Declaration.

The Statement of Objects and Reasons underlying the enactment of PMLA in 2002 refers to two serious threats.

- Threat to the financial system of the country
- Threat to the integrity and sovereignty of the country.

To deal with these two threats, certain initiatives were taken by the international community.

One such initiative was the establishment of the Financial Action Task Force (FATF). FATF was entrusted with examining the problem of money-laundering and making recommendations. FATF recommendations included the following two significant recommendations.

- declaring money-laundering to be an *extraditable offence*; and
- promoting *international co-operation* in investigation of money-laundering.

These two recommendations were meant to rope in persons such as NRIs who became residents of another country. India and the other member States required international co-operation to investigate such persons and if need be, to extradite them to India.

Financial Intelligence Unit (FIU)

Financial Intelligence Unit (FIU) was established by Government of India in November, 2004. FIU is the central national agency having the following responsibilities.

- receiving, processing, analysing and disseminating the intelligence in respect of suspect financial transactions
- co-ordinating and strengthening the efforts of national and international agencies in pursuit of global fight against money-laundering and related crimes.

As an independent body, FIU reports directly to the Economic Intelligence Council headed by the Finance Minister.

Most of the crimes falling within the offence of money-laundering involving NRIs and the entities controlled by NRIs would be tracked down by FIU and intimated to the Economic Intelligence Council in its periodical reports.

Provisions of PMLA designed to rope in NRIs and entities and assets controlled by NRIs

As PMLA evolved as the law dealing with economic offences, the Government faced certain situations involving NRIs, the entities controlled by them and the assets owned by them outside India. The (then existing) laws were unable to meet such situations. Hence, successive amendments were made to PMLA in 2009, 2013 and 2015 to deal with such situations. The nature of these amendments showed that some amendments were made to deal with the persons who had become residents of another country and the entities and assets controlled by such persons. Some indication to this effect is given by the following definitions incorporated or existing definitions modified by way of amendment to PMLA.

- *"beneficial owner"*: Section 2(1)(fa)
- *"Corresponding Law"*: Section 2(1)(ia)
- *"Offence of cross-border implications"*: section 2(1)(ra)
- *"Payment System Operator"*: section 2(1)(rc)
- *"Proceeds of Crime"*: section 2(1)(u)
- *"Property"*: section 2(1)(v)
- *"Scheduled offence"*: section 2(1)(y)

A review of the abovementioned definitions would show that the same are couched in such language as not to leave any escape route to an Indian who became resident of another country in case he was involved in money-laundering. The following features of these definitions give clear indication to this effect.

– Ultimate ownership or control of the person on whose behalf transaction is conducted [section 2(1)(fa)]

– foreign law corresponding to PMLA to apply [section 2(1)(ia) r.w. 56]

– conduct of a person at a place outside India [section 2(1)(ra)]

– overseas principal of the operator covered by the definition of "payment system operator" [section 2(1)(rc)]

– Property held outside India covered under PMLA if proceeds of crime crystallised therein [section 2(1)(v)]

Offence of Money-laundering

The expression *"offence of money-laundering"* as described in section 3 of PMLA is crucial to the entire scheme of PMLA as it has direct nexus with several important provisions of PMLA.

From the description given in section 3 (as it stood prior to its 2013 amendment), the following persons were considered guilty of the offence of money-laundering.

- The person who directly or indirectly ***attempts to indulge in*** any process or activity connected with the proceeds of crime.
- The person who directly or indirectly ***knowingly assists in*** any process or activity connected with the proceeds of crime.
- The person who directly and indirectly ***knowingly is a party in*** any process or activity connected with the proceeds of crime.
- The person who directly or indirectly ***is actually involved in*** any process or activity connected with the proceeds of crime.

It is possible that NRIs may have unknowingly become involved as a party to such indulgence, assistance, knowingly being a party or actual involvement in any process or activity connected with the proceeds of crime.

The expression "offence of money-laundering" was substantially amended in 2013 to widen its sweep to cover the following persons in additions to the persons already covered by the pre-amended section 3.

- The person who ***conceals*** the proceeds of crime
- The person who ***possesses*** the proceeds of crime
- The person who ***acquires*** the proceeds of crime
- The person who ***uses*** the proceeds of crime

It is possible that NRIs may have unintentionally become a party to concealment, possession, acquisition or use of the proceeds of crime.

If any of these persons and the persons covered by the pre-amended section 3 project or claim the proceeds of crime as untainted property, such person would be guilty of the offence of money-laundering.

The NRIs who perceive that they are outside the sweep of section 3 of PMLA by reason of their becoming NRIs are advised to revisit their perception. It is necessary that they minutely examine the features of following crucial definitions. Such examination would enable them to ascertain whether they would fall outside the parameters of the 'offence of money-laundering' described in section 3 so as to be not liable to the punishment for the offence of money laundering.

- *"proceeds of crime"*: section 2(1)(u)
- *"property"*: section 2(1)(v)
- *"scheduled offence"*: section 2(1)(y)

A review of section 3 that describes the offence of money-laundering as amended in 2013 in the light of the abovementioned definitions leaves no escape route for the person who may be even remotely or indirectly involved in money-laundering.

The persons of the eight types described above who are covered within the parameters of section 3 often include the persons who have changed their status so as to acquire residence of another country without their awareness that certain transaction or activity to which they become parties fall within the description of the offence of money-laundering. However, more often than not, all the ingredients of section 3 are found to exist in the process or activity in which they have participated.

Substantive provisions of PMLA

Section 3 describing the offence of money-laundering is indeed the principal provision that needs to be examined in depth. Likewise, the following substantive provisions of PMLA need to be reviewed in detail to ascertain their implications for the NRI who may be charged with the offence of money-laundering.

Section 4: Punishment for money-laundering

Punishment for the offence of money-laundering is rigorous imprisonment for term ranging from 3-10 years coupled with fine without ceiling. Such punishment is, indeed, effective deterrent to NRIs. Such deterrent is strong enough to make them circumspect and prevent them from becoming a party to any dubious transaction or scheme reflecting bold planning.

Sections 5–9: Attachment and vesting of property in Government

Upon adjudication[1], if a property is found to be involved in money-laundering, the same would be confiscated and vested in the Central Government[2].

Provisional attachment of the property[3] involved in money-laundering is provided to prevent attempts to frustrate confiscation of such property.

The loss of ownership and deprivation of possession of property and consequential inability to monetise the property constitutes real deterrent to the NRIs who may become parties to the scheme and transactions involving money-laundering.

Sections 17–19: Search, seizure and arrest

PMLA confers on the designated officers the powers of search[4] of building, place, vessel, vehicle or aircraft suspected to contain proceeds of crime or records thereof. Likewise, powers to search a person[5] suspected to own or control the proceeds of crime are conferred on the designated officers. The designated officers also have the power to arrest[6] the person believed to be guilty of an offence punishable under PMLA.

The powers of search and arrest[7] are effective deterrents to the NRIs who may have been lured into or fallen prey to the activities that constitute money-laundering.

1. Section 8
2. Section 9
3. Section 5
4. Section 17
5. Section 18
6. Section 19
7. Principles of arrest explained by the Bombay High Court in *Chhagan Chandrakant Bhujbal v. Union [2017] 140 SCL 40 (Bom)*

Sections 23–24: Presumption of inter-connected transactions and reverse burden of proof
Where money-laundering involves two or more inter-connected transactions and one or more transactions is (are) proved to be involved in money-laundering, then, for the following purposes, there is a rebuttable presumption that remaining transactions form part of such inter-connected transactions.

- adjudication
- confiscation
- trial of the money-laundering offence

In any proceeding relating to proceeds of crime, PMLA triggers a rebuttable presumption[8] that such proceeds of crime are involved in money-laundering.

The NRIs may make special note of the reverse burden of proof incorporated in section 24. Such reverse burden is intended to fortify the stringent deterrent measures in PMLA by casting on the person the burden to prove to the contrary.

Section 45:Cognisance of money-laundering offence
According to section 45 of PMLA as originally enacted[9], a person accused of an offence punishable for a term of imprisonment for more than three years cannot be released on bail if:

- the bail application is opposed by the Public Prosecutor; and
- the court is satisfied that there are reasonable grounds for believing that he is guilty of such offence and is not likely to commit any offence while on bail.

Indeed, to the extent of these twin conditions, section 45 has been recently held unconstitutional by the Supreme Court[10].

However, NRIs may note that section 45 still holds the field *de hors* the operation of these two conditions.

Sections 55-61: Agreements with foreign countries and confiscation of property
India has entered into reciprocal agreements with various countries for enforcing the provisions of PMLA and for exchange of information to prevent offence of money-laundering under PMLA or under any corresponding law in force in that country[11].

The NRIs may particularly note that PMLA provides for the issuance of letter of request by the Special Court to a Court or authority outside India for execution of the order of confiscation of property outside India which is the subject-matter of order of confiscation of such property passed in India[12]. In respect of the proceeds of crime parked by NRIs in properties abroad, these two provisions constitute strong deterrent.

Section 63: Punishment for false information, etc.
The provision in PMLA dealing with punishment for giving false information or failure to give information acts as caution to NRIs who may be called upon to furnish information regarding lucrative and bold arrangements involving money-laundering to which they may be parties.

Wide coverage of the Schedule

Contrary to the normal perception of the concept of money-laundering, the definition of *"scheduled*

8. Section 24
9. Also, see: Rajbhushan Omprakash Dixit [W.P. (cri) 363/2018] decided on 19-2-2018; Yogesh Mittal vs. ED [Bail Appl. 1165/2017] (Del.) decided on 16-1-2018
10. Nikesh Tarachand Shah vs. UoI [(W/P (cr) 67/2017 (SC)] decided on 23-11-2017
11. Section 56
12. Section 57

offence" in section 2(1)(y) covers a wide variety of the offences under various other laws, such as, The Indian Penal Code, The Narcotic & Drugs Act, The Arms Act, Prevention of Corruption Act, SEBI, Customs Act, Immigration Act, Passport Act, Foreigners Act, etc.

The scope of the Schedule has further been widened to include the following.

- The offences against the property specified in sections 378-462 of the Indian Penal Code (involving theft, extortion, robbery, receiving stolen property, cheating and criminal trespass).
- The offence of wilful attempt to evade any tax, penalty or interest referred to in section 51 of the Black Money [Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

It is possible that by participating in certain transactions and aggressive schemes, NRIs may fall within the scope of penal provisions of one or more laws specified in the Schedule to PMLA.

Participatory Notes – a tricky investment avenue used by NRIs

P-notes are derivative instruments issued offshore to investors including NRIs who want to bet on the Indian stocks and bonds without registering themselves with Securities and Exchange Board of India (SEBI).

Last year, SEBI attempted to put in place a bar on non-resident Indians (NRIs) and entities owned by them subscribing to participatory notes (P-Notes). Such move was aimed at preventing possible laundering of black money.

SEBI has often expressed its discomfort with NRIs. This is evident from the SEBI FPI Regulations which make NRI ineligible as FPI Investor. Even for a group holding a majority interest in a Category II Foreign Portfolio Investors (FPIs), SEBI Regulations require Category II FPIs to be broad-based. Thus, the minimum number of investors should be 20 and no single investor can hold more than 49%.

Legal experts feel that the concept of NRI itself is a grey area and defining it is crucial for regulators. The concept of who is NRI itself is ambiguous. It ranges from income tax definition based on residency and citizenship laws which include the person of Indian origin and his kith and kin who are born abroad. Defining NRI within this spectrum would be crucial to allow inflow of legitimate money from NRIs who left India several generations ago and are financially well-off.

The legal experts also consider that the prohibition on P-Notes should be strictly enforced to prevent round-tripping of Indian money. The issue of round-tripping of Indian money, particularly when NRIs may have a foreign passport, has always been a concern.

Conclusion

The offence of money-laundering has been comprehensively described and its scope has been widened by successive amendments.

NRIs often unknowingly get caught in the net of money-laundering by participating in lucrative schemes. Such schemes are aggressively marketed by unscrupulous operators who find NRIs easy target for offering dubious investment schemes with the promise of high returns.

A review of the provisions of PMLA referred herein shows that the provisions of PMLA are stringent. The punishment for the offence of money-laundering is harsh. It consists of rigorous imprisonment for the term ranging from 3 to 7 years over and above fine without any cap on it.

Hence, NRIs are advised to take all precautions to ensure that the transactions and activities in which they participate do not even remotely fall within the parameters of money-laundering.

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Dr. Dilip K. Sheth

Constitutional Validity of the provisional attachment of property under PMLA

SYNOPSIS

Facts in issue

In respect of the provisional attachment of property under PMLA, the following issues are important.

- Does PMLA provide two kinds of provisional attachment?
- What is the difference between the two kinds of provisional attachment?
- Is the power of provisional attachment arbitrary, excessive or disproportionate?
- Is the provisional attachment of property Constitutionally valid?

In a recent decision[1], the Delhi High Court has considered all these issues while examining the Constitutional validity of the provisional attachment under PMLA.

In this case, Enforcement Case Information Report (ECIR) was filed against the petitioner. After provisionally attaching the petitioner's property, a complaint stating the facts of such attachment was filed before the Adjudicating Authority.

On receiving the complaint, the Adjudicating Authority issued Show Cause Notice (SCN)to the petition her on the premise that it had reason to believe that the petitioner had committed the offence of money-laundering.

The petitioner filed writ petition challenging the constitutional validity not only of the provisional attachment of his property under the second proviso to section 5(1) but also the constitutional

1. J. Sekar vs. Union of India [2018] 145 SCL 637 (Del.)

validity of the complaint, the SCN and all further proceedings pursuant to ECIR.

Money-laundering offence and punishment

For the purpose of examining the Constitutional validity of the provisional attachment of property under the second proviso to section 5(1), the High Court reviewed the following scheme of PMLA.

The offence of money-laundering is defined in section 3in the following words.

> "Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with proceeds of crime, including its concealment, possession, acquisition, use and projecting or claiming it as untainted property shall be guilty of offence of money-laundering". (Emphasis supplied)

The crucial expression in section 3 is 'proceeds of crime' which is defined in section 2(1)(u)to mean -

> "the property derived or obtained directly or indirectly by any person as a result of criminal activity relating to a scheduled offence or the value of any such property, or where such property is taken or held outside the country, then the property equivalent in value held within the country". (Emphasis supplied).

The offence of money-laundering is punishable with rigorous imprisonment for a term of three years to seven years. If, however, the offence is the one covered under the law relating to Narcotics and Drugs, the term of rigorous imprisonment may extend to ten years.

In addition to the rigorous imprisonment, there is a further liability for fine on which there is no ceiling.

Two parallel proceedings under PMLA

The trial for the offence of money-laundering is conducted before the Special Court which is a Criminal Court. However, PMLA provides simultaneous departmental proceedings by the specified authorities. The departmental proceedings pertain to attachment, adjudication and confiscation.

The Director or other officer who provisionally attaches the property is required to file a complaint before the Adjudicating Authority within thirty days of such attachment stating the facts of such attachment. Thus, the adjudication proceedings start within thirty days of the order of provisional attachment.

Provisional attachment – two kinds

Section 5 of PMLA provides for the provisional attachment of the property believed to be involved in money-laundering. Section 5(1) was substituted w.e.f. 15-2-2013. Prior to its substitution, the charging of a person (whose property is sought to be attached) for having committed a scheduled offence was one of the pre-requisites under section 5(1). This pre-requisite has been dispensed with from 15-2-2013.

There are two provisos to section 5(1).

Under the first proviso, the order of provisional attachment is made where, in relation to the scheduled offence, any of the following steps have been taken.

- a report has been forwarded to a Magistrate under section 173 of the Code of Criminal Procedure 1973 (CrPC);
- a complaint has been filed before a Magistrate or a Court for taking cognisance of the scheduled offence,
- a similar report/complaint has been made/ filed under the corresponding law of any other country.

The first proviso to section 5(1), thus, envisages the provisional attachment taking place after the filing of the report or complaint in the criminal court for the offence of money-laundering. In other words, the provisional attachment of the proceeds of crime and the adjudication process cannot commence before the report or complaint is filed in the criminal court in respect of the offence of money-laundering.

The second proviso to section 5(1) was incorporated in PMLA through the substitution of section 5(1) w.e.f. 15-2-2013. The second proviso begins with the *non-obstante expression, "notwithstanding anything contained in the first proviso … …"*. Thus, the second proviso is intended to override the first proviso. Such overriding is, however, subject to the condition mentioned in the second proviso, viz., that the authorised officer must have reason to believe (to be recorded in writing) that if the property involved in money-laundering is not attached immediately, such non-attachment is likely to frustrate the proceedings under PMLA[2].

Accordingly, pending the filing of the report under section 173 CrPC before the Criminal Court, a provisional attachment can be made under the second proviso to section 5(1) subject to the fulfilment of the aforesaid condition mentioned in the second proviso.

The scope of the provisional attachment under PMLA is very wide

The apprehension harboured about the arbitrariness and excessiveness in the exercise of the power of the provisional attachment under the second proviso to section 5(1) is due to the open-ended expression in the second proviso, viz., *"any property of any person … …"*

Moreover, while examining the scope of the power of provisional attachment of proceeds of crime, the wide definition of 'proceeds of crime' is required to be kept in mind.

Likewise, the term "property is widely defined in section 2(1)(v) to mean <u>any</u> property or assets of <u>every</u> description, whether corporeal or incorporeal, movable or immovable, tangible or intangible' and includes deeds and instruments evidencing title to or interest in, such property or assets, wherever located"(Emphasis supplied).

The *Explanation* to section 2(1)(v) clarifies that "property" includes property of *any kind* used in the commission of an offence under PMLA or any of the scheduled offences.

Section 5(1) is triggered when the person is in possession of any proceeds of crime. Such person need not necessarily be the person who is being tried for the scheduled offences or other PMLA offences. Thus, he may be the person accused of the offence of money-laundering described in section 3, viz., the person who:

- directly or indirectly attempts to indulge or knowingly assists; or
- knowingly is a party to or is actually involved in any process or activity connected with the proceeds of crime; or
- conceals, possesses, acquires or uses;

  and projects or claims the property constituting proceeds of crime as untainted property.

Such person is considered guilty of the offence of money-laundering. While the element of *mens rea* is a pre-requisite, it is possible that the person who commits the offence under section 3 is not facing trial for any scheduled offence.

The first proviso to section 5(1) seeks to restrict the applicability of section 5(1) to the persons facing trial for a scheduled offence. In case of such persons, provisional attachment cannot be made under section 5(1) until a report is filed in the criminal court under section 173 CrPC or cognisance is taken of the scheduled offence by a Magistrate before whom the complaint is filed.

However, the second proviso deals with '*<u>any</u>* property of *<u>any</u>* person'. This '*<u>any</u>* person' could be the person in possession of proceeds of crime, which is likely to be concealed, transferred or dealt with in a manner that would frustrate any proceeding under PMLA. The second proviso, therefore, is consistent with section 5(1) because the person in possession of the proceeds of crime may not be the person facing trial for a scheduled offence. Thus, the scope of the second proviso to

2. See: Sanjay Kumar Choudhary vs. Dy Director, ED (2010) Cr L.J. 1960 (Jhark.)

section 5(1) is wider than the scope of the first proviso section 5(1). This is also evident from the non-obstante expression *"notwithstanding anything contained in the first proviso"* at the beginning of the second proviso.

Thus, there are three categories of persons who fall within the parameters of the second proviso to section 5(1).

First, the person who is not accused of any offence, but who has merely come to possess a property that represents the proceeds of crime[3].

Second, the person against whom complaint is filed for the offence of money-laundering, in whose case the investigation is in progress and the investigating agency has not filed the report under section 173 CrPC.

Third, the person accused of committing the offence of money-laundering against whom the report has been filed under section 173 of CrPC.

Relevant provisions

The Constitutionality of the second proviso was considered by the Delhi High Court[4] by examining the following PMLA provisions pertaining to provisional attachment of the property, adjudication, confiscation and release of the property.

Provisions regarding provisional attachment

Section 5(3) provides that the provisional attachment shall cease to have effect on the expiry of the period specified in section 5(1) (180 days) or on the date when the Adjudicating Authority makes the adjudication order under section 8(2), whichever is earlier.

Under section 5(5), the officer who provisionally attaches the property is required to file a complaint stating the facts of such attachment before the Adjudicating Authority within 30 days of the provisional attachment.

Provisions regarding Adjudication

Under section 8(1), upon receiving the complaint, if the Adjudicating Authority 'has the reason to believe that any person has committed an offence under section 3 or is in possession of the proceeds of crime, the Adjudicating Authority may serve a notice (SCN) of not less than 30 days on such person calling upon him to indicate the sources of his income, earning or assets or by means of which he has acquired the property attached under section 5(1) or seized or frozen under section 17 or section 18.

The SCN would require the noticee to produce the evidence on which he relies and other relevant information and particulars to show cause why all or any of the property 'should not be declared to be the properties involved in money-laundering and confiscated by the Central Government.'

Section 8(2) requires the Adjudicating Authority –

- to consider the reply to the SCN
- to hear the aggrieved person as well as the Director/officer issuing SCN
- to take into account all relevant materials placed on record before the Adjudicating Authority.

After following this procedure, the Adjudicating Authority will record its finding whether all the properties referred to in the SCN are involved in money-laundering.

Confirmation of attachment and confiscation of property

According to section 8(3), if the Adjudicating Authority is satisfied that any such property is involved in money-laundering, it will confirm the attachment of such property and record a finding to that effect. The attachment of such property will continue during the pendency of the criminal proceedings. It will become final after the order of confiscation is passed by the Special Court under section 8(5)/8(7)/58B/60(2A).

3. See: *B Rama Raju vs. Union (2011) 164 Co Cases 149*
4. *J. Sekar vs. Union of India [2018] 145 SCL 637 (Del.)*

Under section 8(4), upon confirmation of the order of provisional attachment, the Director/officer shall forthwith take the possession of property attached.

Release of the attached property

Section 8(5) provides that upon conclusion of the trial, if the Special Court finds that the offence of money-laundering has been committed, it shall order confiscation of the property involved in money-laundering. If it finds to the contrary, then under section 8(6) it shall order the release of the property to the person entitled to receive it.

Safeguards against arbitrary or excessive power of provisional attachment

The main ground of attack on the second proviso to section 5(1) is its alleged arbitrariness. According to the Delhi High Court[5], the mere possibility that a provision may be abused is not a ground to strike it down under article 14 of the Constitution.

While examining the Constitutional validity of a provision, particularly on the ground of possible abuse of the powers thereunder, the Court must be satisfied that there are sufficient safeguards introduced by the legislature in the provision itself. In that regard, if the second proviso to section 5(1) is carefully perused, it will be noticed that there are a number of conditionalities that will have to be satisfied before the power thereunder can be exercised. This is evident from the following safeguards on the exercise of the powers of the provisional attachment under the second proviso.

- The power of provisional attachment can be exercised only by an officer of the rank not below the rank of a Deputy Director and Deputy Director or such officer must be authorised by the Director to exercise the powers.
- The officer must record the reason to believe that
  - the property is involved in money laundering;
  - if not attached immediately, the confiscation proceedings under the PMLA will be frustrated; and
  - such belief is formed on the basis of the material in his possession.
- The fact that the Director will, therefore, have to first apply his mind to the materials on record before recording his reason to believe in writing is certainly a sufficient safeguard to the impulsive invocation of the powers under the second proviso to section 5(1).
- The word 'immediately' also imports a sense of urgency into the situation that warrants exercise of the powers. The reasons to believe, as recorded by the officer must reflect this sense of immediacy that impels the officer to invoke the power.
- Satisfaction must be recorded that the 'proceeds of crime' are likely to be concealed, transferred or dealt with in a manner that might frustrate the confiscation and any other proceedings under the PMLA. This is, therefore, another safeguard as far as the second proviso to section 5(1) is concerned.
- The further safeguards are that the order of attachment by the Director or the Deputy Director is not open-ended. It is only for a period of 180 days to begin with.
- As provided in section 5(3), within 30 days of the provisional attachment, the Adjudicating Authority takes over under section 8(1). Even under section 8(1), the Adjudicating Authority is not supposed to mechanically issue the SCN. The Adjudicating Authority is required to apply its mind and again record its reasons to believe that the person has committed the

5. J Sekar vs. Union of India [2018] 145 SCL 637 (Del.)

offence of money-laundering described under section 3 or he is in possession of proceeds of crime. Here again, two kinds of persons are envisaged: (i) the person who has committed the offence of money-laundering; and (ii) the person who happens to be in possession of proceeds of crime.

- The proceedings before the Adjudicating Authority commence within 30 days of the Adjudicating Authority receiving the complaint under section 5(5). It is implicit in section 5(5) that if, within 30 days, the Director does not file a complaint before the Adjudicating Authority, then the provisional attachment would come to an end.
- Section 8(2) provides that, the Adjudicating Authority is required to:
  - consider the reply to the SCN;
  - hear the aggrieved person as well as the Director/Deputy Director/ Authorized Officer; and
  - take into account all the relevant materials placed on record.

  Such adjudicatory exercise is, thus, an additional safeguard available to the person aggrieved by the order of provisional attachment. Thereafter, there are two possibilities.

  (i) the Adjudicating Authority will confirm the order of provisional attachment, in which case again, the confirmation will last only up to the conclusion of the trial; or

  (ii) the Adjudicating Authority may disagree and not confirm the provisional attachment, in which case, as provided in section 8(6), the property will be released to the person entitled to receive it.
- Thus, the first level of safeguard by way of judicial review of the order of provisional attachment under section 5(1) is the proceeding before the Adjudicating Authority under section 8. This is one more reason to say that the powers of provisional attachment under section 5(1), read with the second proviso are not so wide and uncanalised or arbitrary as to warrant its striking down under Article 14 of the Constitution.
- Moreover, the order of the Adjudicating Authority is appealable before the Appellate Tribunal. Thus, as far as the attachment of proceeds of crime is concerned, the Adjudicating Authority is not the final authority. Appeals can be made to the Tribunal by the person aggrieved by the order of the Adjudicating Authority within 45 days of receiving the adjudication order.

  Section 26(4) requires the Tribunal to give the opportunity of hearing before passing order either 'confirming, modifying or setting aside' the adjudication order.
- Against the order of the Tribunal,second appeal is provided under section 42. This appeal to the High Court would be on 'any question of law or fact' arising out of the order of the Tribunal.
- Sections 43 – 47 of PMLA deal with the trial for money-laundering offence by the Special Court constituted to try the PMLA offences. The order of the Special Court is subject to appeal and revision by the High Court under section 47 of the PMLA read with the corresponding provisions of chapters 29 and 30 of the CrPC.

Communication of reason to believe – a *sine qua non*

The Delhi High Court[6] has laid emphasis on the need to communicate the reason to believe. This is evident from the following gist of the operative part of its decision.

6. J. Sekar vs. Union of India [2018] 145 SCL 637 (Del.)

- There are two reasons to believe, one recorded by the officer passing the order of provisional attachment under section 5(1) and the other recorded by the Adjudicating Authority under section 8(1). Both these reasons to believe should be made available to the person to whom the show-cause notice is issued by the Adjudicating Authority under section 8(1).
- The failure to disclose, right at the beginning, the aforementioned reasons to believe to the notice under section 8(1) would be an illegality and not a mere irregularity. Such failure would vitiate the entire proceedings and render the order of provisional attachment, illegal.
- Under section 8(1), there is mandatory requirement to communicate the reasons to believe to the noticee. On a conjoint reading of section 5(1) and section 8(1), communication of reasons to believe is mandatory to meet the requirement of what the Adjudicating Authority is supposed to do under section 8(2), viz. to consider the reply of the noticee, give him a hearing and take into account all relevant materials placed on record.
- At the stage of issuance of show cause notice under section 8(1), all the relevant material on record which constituted the basis for reasons to believe may not be made available. However, if the noticee demands to see those materials on record, the Adjudicating Authority is bound to make available all those materials on record. Without such access to the material on record, the noticee will be unable to file effective reply. Therefore, there cannot be any denial of access to the noticee of the materials on record.

If there is any sensitive material, it may be redacted before issuing its copies after noting the reasons for such redaction in writing in the file. But even such redacted material will have to be nevertheless shown to the noticee.

Summation

In the light of the aforementioned safeguards on the arbitrary exercise of the power of provisional attachment of property under PMLA, the High Court concluded that there is no arbitrariness vitiating the second proviso to section 5(1). It also held that the second proviso is not excessive and disproportionate so as to render it nugatory. As regards the constitutionality of the second proviso to section 5(1), the Court made the following observations.

- The second proviso to section 5(1) states that the property is 'involved in money-laundering' and section 5(1) states that mere possession of ‘proceeds of crime’ is sufficient. However,there is no conflict between these two expressions. When the description of the offence of money-laundering in section 3 is read with the definition of ‘property’ in section 2(1)(v) and the *Explanation* thereto, it becomes clear that the property which constitutes 'proceeds of crime' is indeed the property involved in money-laundering.
- The reasons to believe at every stage must be noted down by the officer in the file.
- While the reasons to believe recorded at the stage of passing the order of provisional attachment under section 5(1) may not be communicated forthwith at that stage to the person adversely affected, the reasons as recorded in the file must accompany the complaint under section 5(5)filed within 30 days before the Adjudicating Authority.
- A copy of such complaint accompanied by the reasons noted in the file, must be served by the Adjudicating Authority on the person affected by such attachment. The Adjudicating Authority may add his own reasons why he *prima facie* considers that the provisional attachment should continue.

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Kishore Joshi and Prashant Prakhar[1]

Investments by NRIs under Schedule 4 of TISPRO Regulations

Introduction

Non-resident Indians (**"NRI"**) are a group of people who, despite being settled overseas, have been instrumental for economic development of their ancestral home i.e., India. Realising the value of their contributions, Government of India has provided special treatment to NRIs with respect to their investments in India under the extant Consolidated FDI Policy of 2017 (**"FDI Policy"**) and the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 (**"TISPRO Regulations"**) issued by the Reserve Bank of India (**"RBI"**), without losing their status and benefits available as 'non-residents'.

TISPRO Regulations allow NRI investors to invest in India, either on repatriation basis or non-repatriation basis. Investments made on repatriation basis are such investments, sale/maturity proceeds (net of taxes) of which are eligible of being fully repatriated outside India.[2] However, such investments are subject to conditions, as prescribed under Schedule 1 of the TISPRO Regulations, similar to that applicable to any non- resident investor. On the other hand, investments made by NRIs on non-repatriation basis, as prescribed under Schedule 4 of the TISPRO Regulations, cannot be repatriated outside India and hence, such investments are also deemed to be domestic investment at par with the investments made by resident investors.[3]

Definition of NRI

Over the years, the definition of NRI under Foreign Exchange Management Act, 1999 and rules and regulation issued thereunder (**"FEMA"**) has undergone several changes to accommodate evolving definition of Overseas Citizen of India (**"OCI"**) and Person of Indian Origin (**"PIO"**) within its scope. For the purposes of making investments into India, NRIs were originally defined under the Foreign Exchange Management (Deposit) Regulations, 2000

1 Mr. Kishore Joshi is the head of Regulatory Practice at Nishith Desai Associates and Mr. Prashant Prakhar is a senior member of the Regulatory Practice at Nishith Desai Associates.

2 Para 2.13 of the Master Directions – Foreign Investment in India dated January 4, 2018 (updated as on April 6, 2018), available at https://rbi.org.in/scripts/BS_ViewMasDirections.aspx?id=11200

3 Para 3 (ii) of the Press Note 7 (2015 Series)

(**"Deposit Regulations"**) to include a person resident outside India who is a citizen of India or a person of Indian origin.[4] Subsequently, in 2015 the Citizenship Act, 1955 and extant Consolidated Foreign Direct Investment Policy of 2015 were amended to merge the category of PIO cardholder with the category of OCI cardholder.

PIOs are citizens of any country (other than Pakistan, Afghanistan Bangladesh, China, Iran, Bhutan, Sri Lanka and Nepal) who held an Indian passport at any time or who are children or grand-children of an individual who was a citizen of India (after the Constitution of India came into force) or who is a spouse of an Indian citizen or a PIO.[5] PIO cardholders registered as such under Notification No. 26011/4/98 F.I. dated 19.8.2002 issued by the Central Government are now deemed to be 'Overseas Citizen of India' cardholders.

OCI cardholder is a person registered as such by the Central Government under Section 7 (A) of the Citizenship Act, 1955 and includes citizen of any country (other than Pakistan or Bangladesh) who was eligible to become a citizen of India at the time of commencement of the Constitution of India, or was a citizen of India on or any time after the commencement of the Constitution or belonged to a territory that became part of India after August 15, 1947.[6]

Currently, TISPRO Regulations define both the terms (i.e. NRI and OCI) separately to include any individual resident outside India who is a citizen of India, and an individual resident outside India who is registered as an OCI cardholder under Section 7(A) of the Citizenship Act, 1955, respectively.[7] However, for the purposes of the FDI Policy, the term NRI is broad enough to also include the OCI cardholders (including erstwhile PIO cardholders) beside an individual resident outside India who is a citizen of India.[8]

Investments on non-repatriation basis

Under Schedule 4 of the TISPRO Regulations, an NRI or OCI can invest, on non-repatriation basis, in:

(a) the capital instruments (i.e., equity shares, compulsorily convertible debentures, compulsorily convertible preference shares and share warrants) (**"Capital Instruments"**) of an Indian company, without any limit, either on the stock exchange or outside it;

(b) units issued by an investment vehicle (i.e. AIF, REIT or InvIT), without any limit, either on the stock exchange or outside it;

(c) the capital of a limited liability partnership, without any limit; and

(d) convertible notes issued by a start-up company.

In addition to the above, an NRI or OCI is also allowed to invest, by way of contribution to the capital of a firm or a proprietary concern in India.

Further, NRIs or OCIs are now also allowed to make above-said investments, through the companies, trusts or partnership firms that are incorporated outside India and are owned and controlled by NRIs or OCIs.

4 Regulation 2(vi) of Foreign Exchange Management (Deposit) Regulations, 2000 dated May 3, 2000 available at https://rbi.org.in/Scripts/BS_FemaNotifications.aspx?Id=159

5 Ministry of External Affairs, PIO/OCI Card, available at https://www.mea.gov.in/Portal/CountryQuickLink/703_PIO- OCI.pdf

6 Id

7 Regulation 2 (XXXV) and 2 (XXXVI) of Foreign Exchange management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017

8 Para 2.1.32 of the Consolidated Foreign Direct Investment Policy of 2017 (w.e.f. August 28, 2017)

Prohibition on investments under Schedule 4 of TISPRO Regulations

NRIs or OCIs are, however, prohibited to invest in the Capital Instruments or units of a Nidhi company or a company engaged in agricultural/ plantation activities or real estate business or construction of farm houses or dealing in Transfer of Development Rights.

Further, NRIs and OCIs are also prohibited from making investments by way of capital contribution to a firm or a proprietary concern which is engaged in any agricultural/ plantation activity or print media or real estate business.

Benefits available on investments under Schedule 4 of TISPRO Regulations

Schedule 1 of the TISPRO Regulations permit any non-resident investor, including a NRI or a OCI, to invest into the capital instruments of Indian companies on a repatriation basis, subject to certain terms and conditions and filings as prescribed by the RBI. As against this, Schedule 4 of the TISPRO Regulations allows NRIs or OCIs to make investments, on a non-repatriation basis, without any such conditions or filings.

Thus, an NRI or OCI (or the entities owned and controlled by them) can make investment in any sector (except a few, as given herein below), and that too, without any limit, either in a company listed on the stock exchange or a private company. This benefit is available to NRIs or OCIs, primarily because such investment on non-repatriation basis is treated as domestic investment at par with the investment made by a resident Indian.

Additionally, for investments in the capital instruments of an Indian company under Schedule 4 of TISPRO Regulations, no filings of Form FC-GPR or any similar reporting is required. This gives a huge relief to not only the NRI or OCI investor but, to the Indian investee company as well, considering it saves great amount of time and efforts in creating / managing number of documents.

This route has also benefited the Indian economy, as the NRIs or OCIs have been using their monies in their Indian bank accounts, to invest into Indian assets (i.e., capital instruments, debt instruments, real estate, MFs, etc.), instead of repatriating it out of India.

Mode of Investment under Schedule 4 of TISPRO Regulations

The amount of consideration in case of NRI investments on non-repatriation basis may either be paid directly through inward remittance from abroad (through proper banking channels) or out of funds held in Non-Resident External (NRE) / Foreign Currency Non-Resident (Bank) (FCNR(B)) / Non-Resident Ordinary (NRO) account maintained in accordance with the Deposit Regulations.

However, the sale/ maturity proceeds (net of applicable taxes) of such investments shall be credited only to the NRO account of the NRI investor, irrespective of the type of account from which the consideration was paid. Further, the capital appreciation on such investments are also not allowed to be repatriated abroad. However, dividend and interest income will be freely allowed to be repatriated, being of current account in nature.

a) <u>Non-Resident External Account</u>: It is a rupee account that only NRIs (including OCIs) are permitted to open and maintain with the authorised dealers and with banks (including co-operative banks) authorised by Reserve Bank of India (**"RBI"**) to maintain such accounts. These accounts may be maintained in any form viz. savings, current, recurring or fixed deposit account. Credits permitted to this account as inward remittances are: a) interest accruing on the account or on the investment; b) transfer from other NRE/FCNR(B) accounts; and c) maturity proceeds if such investments were made from this account or through inward remittance. The debits allowed from this account are local disbursements, transfer to other NRE/FCNR(B) and investments in India.

b) Foreign Currency Non-Resident (Bank) (FCNR(B)): It is an account maintained only by NRIs (including OCI) in foreign exchange with the authorised dealers and banks authorised by the RBI to maintain such accounts. These accounts can be maintained only in the form of fixed deposits and the conditions related to debit and credit to such accounts shall be same as applicable on the NRE accounts.

c) Non-Resident Ordinary (NRO): These accounts may be maintained by any person resident outside India with an authorised dealer or an authorised bank for the purpose of putting through *bona fide* transaction denominated in Indian rupees. Credits permitted in NRO account are inward remittances from outside India, legitimate dues in India, transfers from other NRO accounts and gift/loan made by a resident to an NRI (including OCI) in Indian rupees. Debits allowed from the NRO account are local payments, transfer to other NRO accounts, remittance of current income abroad or remittance of USD 1 million per financial year (April – March), for all *bona fide* purposes, to the satisfaction of the authorised dealer bank (**"AD Bank"**).

In case of inward remittance received from abroad, upon receipt of such investment amount, the relevant AD Bank seeks a declaration from the investee company as to whether the investor is an NRI or OCI or a company, trust or partnership firm owned and controlled by an NRI or OCI and whether such investment is on a repatriation basis or non-repatriation basis. Based on the declaration given by the investee company, the investment is recorded as on repatriation or on non-repatriation basis and is accordingly processed.

Issues pertaining to investments by NRIs or OCIs (or entities owned and controlled) on non-repatriation basis

NRI investment on non-repatriation basis has often been subject to ambiguities due to its equivocal nature. Prior to Press Note 7 (2015 Series), there had been some ambiguities around whether such investments are subject to the sectoral limits prescribed under the FDI Policy, pricing guidelines prescribed by the RBI or cap on coupon rates (in case of compulsorily convertible debentures), as applicable in case of ordinary foreign direct investment (**"FDI"**) in India by non-residents, including investments by NRIs, on repatriation basis. It was through Press Note 7 (2015 Series) that the Government clarified that all investments by NRIs on non-repatriation basis shall be deemed to be domestic investment at par with the investment made by resident investor and hence, such investment may not be subject to any limits and conditions such as lock-in or minimum capitalization requirements or valuation norms, applicable on other FDI investments.

Subsequently, when the definition of NRI was broadened through Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) (Amendment) Regulations, 2016 to further extend to the companies, trusts, partnership firms that are incorporated outside India and are owned and controlled by NRIs or OCIs, it led to another ambiguity as to when such entities should be regarded as an entity owned and controlled by the NRIs or OCIs. Considering that no specific definition of the phrase 'owned and controlled' has been prescribed in this context, if we were to rely on its meaning within Regulation 14 of the TISPRO Regulation, then any company, trust or partnership firm with 51% of the capital instruments or capital contribution, as the case may be, or the right to appoint majority of the directors or designated partners, as the case may be, or the right to control the management or policy decisions, in the hands of an NRI or OCI and remaining 49% in the hands of other non-residents, would be regarded as an entity owned by a NRI or OCI and can avail all benefits available to an NRI or OCI investing in India on non-repatriation basis.

Another consequence of the above said broad definition of NRI and OCI under Schedule 4 of the TISPRO Regulations is the challenges faced by the authorised dealers or AD Banks responsible for opening NRO accounts, which as per the Deposit Regulations may be maintained by any 'person resident outside India', however, the RBI has generally been conservative about allowing incorporated entities to maintain such NRO accounts. As mentioned above, the sale / maturity proceeds (net of applicable taxes) of all non-repatriable investments has to be credited only to the NRO account of the relevant NRI or OCI investor, irrespective of the type of account from which the consideration was paid. In which case, RBI should make necessary amendments to Deposit Regulations allowing entities owned and controlled by NRIs or OCIs to be able to maintain NRO account with the authorised dealer or AD Bank.

One more hurdle of investing through companies, trusts or partnership firms owned and controlled by NRIs or OCIs, is that currently only NRIs or OCIs are allowed, under the Foreign Exchange Management (Repatriation of Assets) Regulations, 2016, to repatriate out of India, an amount up to USD 1,000,000 (US dollars one million only) per financial year. Hence, even though the investment by NRIs or OCIs under Schedule 4 of TISPRO Regulations was on a non-repatriation basis, they can repatriate up to USD 1,000,000, out of the sale proceeds that get credited in their NRO accounts. This repatriation facility is currently not available, if the investment under Schedule 4 of TISPRO Regulations is made through companies, trusts or partnership firms.

Prior to November 7, 2017, Schedule 4 of the old Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (**"Old TISPRO Regulations"**) allowed an NRI to acquire, on non-repatriation basis, any 'security' issued by a company without any limit either on the stock exchange or outside of it beside investing in the Capital Instrument and units of an investment vehicle. Thus, the Old TISPRO Regulations provided for an option to NRIs to invest in any 'security' in debt instruments, on non-repatriation basis. However, under Schedule 4 of the TISPRO Regulations, an NRI or OCI is allowed to invest on non-repatriation basis only in Capital Instruments or units of an investment vehicle or convertibles notes issued by start-ups or contribution to capital of a limited liability partnership or a firm or proprietary concern. Due to this shift in position of law in the TISPRO Regulations, an NRI can no longer invest in debt instruments, on non-repatriation basis, except in very few listed debt instruments provided in Schedule 5 of the TISPRO Regulations.

Further, investment by NRIs in Non-Convertible Debentures (**"NCDs"**) is allowed under the Foreign Exchange Management (Borrowing and lending in rupees) Regulations, 2000 but, is subject to cumbersome conditions such as NCDs have to be listed, its redemption period must not be less than three years etc.

Since investment on non-repatriation basis is treated at par with domestic investment, the RBI should also consider allowing NRIs or OCIs to investment in debt instruments such as NCDs, without any conditions.

Transfer of shares held on non-repatriation basis

An NRI or an OCI holding Capital Instruments of an Indian company or units of an investment vehicle on non-repatriation basis, may transfer the same by way of sale, either (i) to any person resident outside India who would hold it on repatriation basis, subject to fulfilment of all conditionalities and reporting requirements prescribed under Schedule 1, or (ii) to another NRO / OCI acquiring such investment on non-repatriation basis.

Further, an NRI or an OCI holding Capital Instruments of an Indian company or units of an investment vehicle on non-repatriation basis, may also transfer the same by way of gift to another NRI or OCI without any prior approval of the RBI, provided that donee shall hold it on non-repatriation basis.

However, in case of transfer by way of gift to a person resident outside India, prior approval of the RBI would be required subject to following conditions:

a) the donee is eligible to hold such a security under relevant schedules of these TISPRO Regulations;

b) the gift does not exceed 5 per cent (on cumulative basis) of the paid up capital of the Indian company/each series of debentures/each mutual fund scheme;

c) the applicable sectoral cap on the Indian company is not breached;

d) the donor and the donee are 'relatives' within the meaning in Section 2(77) of the Companies Act, 2013; and

e) the value of security to be transferred by the donor together with any security transferred to any person residing outside India as gift during the financial year does not exceed the rupee equivalent of US $ 50,000.

Reporting Requirements

NRIs or OCIs are not required to file Advance Remittance Form or Form FC-GPR (at the time of making investment into an Indian company) in respect of their investment under Schedule 4 of TISPRO Regulations on non-repatriation basis.

However, considering that such an investment is regarded as a domestic investment at par with an Indian investor, any transfer of the Capital Instruments held on a non-repatriation basis, to a person resident outside India holding such capital instruments on a repatriation basis, has to be reported by filing form FC-TRS. The obligation of reporting of the said transfer to the AD Bank would be on the NRI or OCI, and has to be done within 60 days of transfer of Capital Instruments or receipt / remittance of funds, whichever is earlier.

Conclusion

Special treatment to the NRIs or OCIs investing on non-repatriation basis in accordance with Schedule 4 of the TISPRO Regulations allows such NRIs and OCIs to ring-fence their investments in India and to have the flexibility to invest through different commercially viable structures. Alongside, such investments also provide the much needed leverage for Indian economy to meet its five-year plan. NRIs or OCIs investing on non-repatriation basis should ensure that their investment is rightly recorded in the books of the company and all filings by the investee company thereafter with any regulator is consistent with the records of the company. An error in case of recording of such investment may result in NRI or OCI being deprived of the privileges available to them in case of investment on non-repatriation basis and in some case it may even be subjected to penalties depending on the nature of contraventions.

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Dr. Anup P. Shah, *Chartered Accountant*

Investments in India by NRIs

1. Introduction

India received Foreign Direct Investment (**FDI**) worth US $ 367 billion during the 17-year period of April 2000 to December 2017! This highlights the importance of FDI to the Indian economy. FDI is a much preferred form of foreign investment as compared to other forms, such as, Portfolio Investment, Foreign Institutional Investment, etc. This is because the FDI flows are considered to be relatively more long-term in nature. Non-resident Indians or NRIs (elsewhere in this Journal, the definition of the term NRI has been analysed) are a major contributor to the foreign investment into India. While dealing with the entire gamut of Foreign Investment by NRIs would merit an entire publication by itself, an attempt has been made to highlight the key points for investments by NRIs on a repatriable basis.

2. Regulations governing Foreign Investment by NRIs

2.1 The Foreign Investment Framework in India stands on a three-legged tripod consisting of three Regulations ~ the Foreign Exchange Management Act, 1999 along with its Regulations / Master Directions, the Consolidated FDI Policy, and the Circulars to Authorised Person issued from time to time by the Reserve Bank of India.

2.2 The Foreign Exchange Management Act, 1999 (**FEMA**) is a Central Statute of the Parliament and is the supreme Act when it comes to regulating all foreign transactions in India, including those pertaining to FDI. The FEMA also consists of Regulations notified by the RBI from time-to-time. The relevant Regulations for Foreign Investment are the ***Foreign Exchange Management (Transfer or Issue of Security by Persons Resident Outside India) Regulations, 2017*** issued *vide*, Notification No. FEMA 20(R)/2017-RB dated November 7, 2017 (**"TISPRO Regulations"**). Along with this, the RBI has issued the ***Master Direction – Foreign Investment in India*** issued *vide* RBI/FED/2017-18/60 FED Master Direction No. 11/2017-18 updated as on January 12, 2018.

2.3 The Department of Industrial Policy & Promotion (*"DIPP"*), Commerce Ministry, Government of India frames the Foreign Direct Investment Policy in India which lays down the sectors in which FDI is allowed, the conditions attached and the sectoral caps. It also lays down the sectors in which FDI is Automatic and those in which it requires Approval of the Government of India. The FDI Policy is prepared in the form of the ***Consolidated FDI Policy ("CFDIP")***. The Policy defines FDI to mean investment by non-resident entities in the capital of an Indian company under Schedule 1 of FEMA No.

20(R)/2017-RB. The latest CFDIP is effective from August 28, 2017 and has been updated by Press Note 1 /2018 dated January 23, 2018 issued by the DIPP.

3. Different types of Foreign Investment

3.1 The various types of foreign investment which are possible by an NRI may be enumerated as follows:

(a) ***Foreign Direct Investment*** – This is a repatriable foreign investment which is invested directly in an Indian entity and is governed by ***Schedule 1*** of the TISPRO Regulations. Since this is one of the most prominent forms of foreign investment, it has been analysed in detail in para 4 below.

(b) ***Portfolio Investment*** – A Portfolio Investment Scheme ("***PIS***") is available for NRIs under ***Schedule 3*** of the TISPRO Regulations. There are no sectoral restrictions in this case. The limit for investment on this basis is 5% of the total paid up capital of the investee company per NRI and the aggregate ceiling for all NRIs put together is 10% which can be extended to 24% by passing a special resolution to this effect. Only delivery based buying / selling is allowed under this Schedule. NRIs can open an NRE PIS A/c with a Bank for buying under the PIS and Sale Proceeds from such PIS also credited to this A/c.

Foreign Portfolio Investors or **FPIs** are an important category of investors in the Indian stock markets. These could be classified into Category I, II or III. In the FPI regime, an NRI/PIO is not eligible to make investments / get registered as an FPI. A fund having NRIs as its investors is not prohibited from obtaining registration as an FPI. However, a SEBI Circular dated April, 10, 2018 talks about the Beneficial Owner ("**BO**") of the FPI, i.e., the natural person(s) who ultimately owns or Controls an FPI and should be identified in accordance with Rule 9 of the Prevention of Money - laundering (Maintenance of Records) Rules, 2005. It states that NRIs cannot be the BOs of FPIs. The SEBI has said FPIs that do not meet this criteria cannot take any fresh derivative positions after the expiry of the ongoing contracts. Further, if the funds don't meet the requirement within six months, they will have to unwind all existing positions and exit Indian markets.

(c) ***Non-repatriable FDI*** – Under ***Schedule 4*** of the TISPRO Regulations, only Non-resident Indians can invest in non-repatriable FDI and is dealt with in detail elsewhere in this Journal.

(d) ***Other than Capital Instruments*** – Under ***Schedule 5*** of the FEMA Regulations, NRIs have permission to purchase on a repatriable basis, certain other types of securities, such as Government securities, derivatives, mutual fund units, commercial papers, perpetual debt instruments issued by banks, national pension scheme, etc. It may be noted that unlike FPIs, NRIs are not allowed to invest in the listed / unlisted NCDs / corporate bonds issued by Indian companies.

One popular investment option which the Schedule is silent on is the Public Provident Fund or **PPF**. NRIs cannot open a PPF but what happens to residents who undergo a change of status and become NRIs? On 2nd October 2017, the Department of Economic Affairs, Finance Ministry, Government of India, issued a Notification stating that the PPF account of resident Indians shall be deemed to be closed with effect from the date they become NRIs. A similar amendment was made for the National Savings Certificates (NSC) such certificates were deemed to be encashed on the day when the resident individuals become NRIs. In both the above cases, the interest was to be paid at the rate applicable to the Post Office Saving Account (4% p.a.), from the date of deemed closure/ encashment up to the last day of the month preceding the month in which the same is actually closed/ encashed. However, subsequently, the Department of Economic Affairs released an office memo on February 23, 2018, keeping its earlier notification regarding the NRI's PPF account released on October 2, 2017, in abeyance (or temporarily dismissed). The 2018 notification is silent on the treatment of NSCs.

(e) ***LLPs – Schedule 6*** of the TISPRO Regulations deals with foreign investment by NRIs in a Limited Liability Partnership (**LLP**) which is permissible on an automatic route in those sectors where 100% FDI is allowed and there are no FDI linked performance conditions. Hence, sectors, such as, real estate, trading, financial services, etc., are ineligible for FDI by NRIs in an LLP. A company with FDI engaged in sectors where 100% FDI is allowed and there are no FDI linked performance conditions, can be converted into an LLP on an automatic route basis. Similarly, an LLP with foreign investment and which is engaged in sectors where 100% FDI is allowed and there are no FDI linked performance conditions, can be converted into a company on an automatic route basis.

Investment in an LLP either by way of capital contribution or by way of acquisition/ transfer of profit shares, cannot be less than the fair price worked out as per any valuation norm which is internationally accepted. A valuation certificate to that effect should be issued by a CA or by a practising Cost Accountant or by an approved valuer from the panel maintained by the Central Government. The TISPRO Regulations only permit investment in an LLP only if the consideration is in the form of cash. While the Limited Liability Partnership Act, 2008 allows consideration other than cash, FEMA prohibits the same for NRI investors. Further, Pakistani / Bangladeshi citizens are not allowed to invest in LLPs.

(f) ***Investment Vehicles*** – NRIs (other than Pakistani and Bangladeshi citizens) are permitted to purchase the units of SEBI Registered Investment Vehicles under ***Schedule 8*** of the TISPRO Regulations. This would include investment by NRIs in Alternative Investment Funds (**AIFs**) – Category I, II and III, Real Estate Investment Trusts (**REITs**) and Infrastructure Investment Trusts (**InvITs**). As long as the Sponsor, Asset Management Company and Investment Manager of the Investment Vehicle are owned and controlled by resident Indian citizens, the downstream investment by the Vehicle is treated as domestic investment even if the entire corpus is raised from NRIs.

(g) ***ADRs / GDRs*** – NRIs can transfer shares / convertible debentures in Indian companies to Foreign Depository and receive ADRs / GDRs. The Domestic Custodian can purchase Indian Shares on behalf of Foreign Investors and convert them into ADRs / GDRs. This facility is allowed under ***Schedule 9*** of the TISPRO Regulations. For instance, an NRI can purchase the shares of Infosys Technologies Ltd and convert them into its ADRs which are listed on NASDAQ, USA.

(h) ***IDRs*** – NRIs can purchase Indian Depository Receipts (IDRs), under ***Schedule 10*** of the TISPRO Regulations, issued by foreign companies which are listed on Indian stock exchanges on a repatriation basis. For instance, Standard Chartered Plc has issued IDRs which are listed on the Indian stock Exchanges. A 2-way fungibility is possible, i.e., the IDRs can be converted into shares of the foreign companies and *vice-versa*. Redemption of the IDR into shares is possible only after a 1-year lock-in period.

(i) ***Transfer of Shares*** – Foreign investment by an NRI is also possible by a transfer of shares from a resident to an NRI. The price for transfer in case of unlisted shares must be at or above the fair market value determined as per any internationally accepted pricing methodology. Payment of 25% of the consideration in instalments is allowed subject to certain conditions. Some of the important means in which an NRI can purchase shares are as follows:

  (i) Any person resident outside India (other than an NRI) can sell / gift shares to another NRI on an automatic basis without any adherence to any pricing / reporting guidelines.

  (ii) An NRI can sell / gift shares to another NRI on an automatic basis without any adherence to any pricing / reporting guidelines. However, if the purchase by the NRI under Portfolio Investment Scheme has resulted in a breach of the sectoral caps or the aggregate NRI limits of 24%, then he must sell the instruments so acquired within 5 trading days after settlement to a resident. Such a breach if so rectified is not treated as a contravention of the TISPRO Regulations.

  (iii) A resident can transfer shares held by him to an NRI by way of sale by following the pricing and reporting guidelines in Form Foreign Currency Transfer of Shares (FC-TRS). Further, the applicable sectoral caps / investment limits of the investee company must be borne in mind. The transfer price cannot be at a price lower than the prevailing fair market value of the shares:

  - on the basis of the SEBI guidelines in case of listed companies.
  - determined on an arm's length basis by a SEBI registered Merchant Banker or a Chartered Accountant as per any Internationally Accepted Pricing Methodology in the case of unlisted companies. This could include, discounted cash flow, net asset value, earnings capitalisation, price earning multiple, etc.

(j) ***Gift of Shares to NRIs*** – Interestingly, RBI allows a resident to freely gift to a non-resident a sum of $250,000 under the Liberalised Remittance Scheme but it places great curbs when it comes to gifting of shares from a resident to a non-resident. The restrictions are as follows:

- Prior approval of the Reserve Bank is required for the Gift – this is one of the main conditions. Thus, it is not on an automatic route. The application must mention the reasons for making the gift.
- The donee must be eligible to hold such a security under the FEMA Regulations – i.e., he should not be from Pakistan or Bangladesh.
- The gift should not exceed 5% of the paid up capital of the Indian company or 5% of the series of debentures or each mutual fund scheme.
- The applicable sectoral cap in the Indian company should not be breached by virtue of the gift.
- The donor and the donee should be 'relatives' within the meaning in section 2(77) of the Companies Act, 2013.

- The value of security to be transferred by the donor together with any security transferred to any person residing outside India as gift during the financial year should not exceed the rupee equivalent of US$50,000 – this is the strictest condition and a valuation of the company would be required to be done based on any Method of Valuation.

(k) ***Specified Situations*** – The TISPRO Regulations also permit NRI investors to acquire shares under the following specified situations along with their key conditions given below:

(i) Issue of shares by an Indian transferee company on merger / demerger of an Indian transferor company having NRI investors – provided the scheme has been approved by the NCLT under the Companies Act and the transferee company is not in a sector where FDI is prohibited, e.g., tobacco. Further, the sectoral caps, if any, of the transferee company, should not be breached as a result of the issue.

(ii) Issue of Employee Stock Options (ESOPs) / Sweat equity shares by an Indian company to NRI employees and directors of itself / its holding company / its joint venture or wholly owned subsidiary – provided the scheme is in accordance with the SEBI Regulations for Listed Companies or the Rules framed under the Companies Act, 2013 in case of Unlisted Companies. However, an issue of ESOPs/ sweat equity shares to a citizen of Bangladesh/ Pakistan requires prior Government approval.

(iii) Issue of bonus / rights shares by an Indian company to its NRI investors – provided the original shares have been held with in accordance with the FEMA Regulations. The price of the rights shares offered to NRIs should not be lower than the price offered to resident investors in case of unlisted companies and must be as per the price determined by the company in case of listed companies. Further, NRI shareholders are allowed to issue and apply for additional shares over and above their right entitlements. NRIs may also subscribe for additional shares over and above the shares offered on rights basis by the company and also renounce the shares offered either in full or part thereof in favour of a person named by them.

(iv) Issue of bonus debentures / bonus preference shares by an Indian company to its NRI investors under a scheme of arrangement by capitalising its reserves.

(v) Swap of shares - acquisition of shares of a foreign company by an Indian company in return for issue of shares of Indian company to its NRI shareholders. Irrespective of the amount involved, a valuation will have to be made by a Merchant Banker registered with SEBI or an Investment Banker outside India registered with the appropriate regulatory authority in the host country. The swap is on an automatic route provided the Indian company operates in an automatic route sector.

(l) ***Merger of Foreign Company with Indian Company (Inbound Mergers)*** – When a Foreign Company merges into an Indian Company, the shareholders of the Foreign Company would be allotted shares in the Indian Company. This is also a type of foreign investment by NRIs. The provisions of s.230-232 of the Companies Act, 2013 permit a foreign company to merge with an Indian company. The Ministry of Corporate Affairs (MCA) has amended the Companies (Compromises, Arrangement and Amalgamation) Rules, 2016 (the Rules), to give effect to the above provision. The key provisions of Rule 25A are as follows:

(1) A foreign company / body corporate incorporated in any of the specified jurisdictions may merge with an Indian company. Thus, while the transferor can be a foreign body corporate, the transferee must always be an Indian company. The merger may be done after obtaining prior approval of the RBI and after complying with provisions pertaining to mergers and amalgamations contained in sections 230 to 232 of the Act and the Rules. The Jurisdictions specified are those

   (i) whose securities market regulator is a signatory to International Organization of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with SEBI, or

   (ii) whose central bank is a member of Bank for International Settlements (BIS), and

   (iii) a jurisdiction, which is not identified in the public statement of Financial Action Task Force (FATF) as:

      (a) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or

      (b) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

   For instance, North Korea is a country which has been called upon by FATF in its Public Document to apply counter-measures to protect the international financial system from the on-going and substantial money laundering and terrorist financing risks emanating from the country.

   Thus, two conditions need to be satisfied – one pertaining to membership of the country's market regulator / central bank and the other pertaining to the country's FATF status. Both of these are a must in order for the nation being specified as a permitted jurisdiction.

(2) A valuation for the merger must be carried out by a valuer who is a member of a recognised professional body in the jurisdiction of the foreign company and the valuation must be in accordance with internationally accepted principles on accounting and valuation. A declaration to this effect shall be attached with the application made to the RBI. Permissible methods may include, valuation based on income, cash flow, assets, market prices, comparable cases, etc.

(3) The Indian company shall file an application for the merger before the

National Company Law Tribunal after obtaining the RBI approval. Thus, the merger must comply with the provisions / procedures relating to domestic mergers, e.g., notice to be sent to members and creditors, meetings to be called of members and creditors, process of voting, etc.

The TISPRO Regulations cover a situation where foreign shareholding arises by virtue of merger of two Indian companies but does not envisage a situation of a Foreign Company merging into an Indian Company. Thus, the issue of shares by an Indian Company to foreign shareholders of the Foreign Company would require the Government permission under the aforesaid Regulations. The RBI had issued the **Foreign Exchange Management (Cross Border Merger) Regulations, 2018** dealing with inbound mergers, i.e., cases of cross border mergers where a foreign company merges with an Indian company and the resultant company is an Indian company. These Regulations provide that:

(1) The resultant company may issue or transfer any security to a person resident outside India in accordance with the pricing guidelines, entry routes, sectoral caps, attendant conditions and reporting requirements for foreign investment as laid down in the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017.

(2) Where the foreign company is a joint venture (JV)/ wholly owned subsidiary (WOS) of the Indian company, it shall comply with the conditions prescribed for transfer of shares of such JV/ WOS by the Indian party as laid down in Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004;

(3) Where the inbound merger of the JV/ WOS results into acquisition of the Step down subsidiary of JV/ WOS of the Indian party by the resultant company, then such acquisition should be in compliance with the Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004.

(4) An office outside India of the foreign company, pursuant to the sanction of the Scheme of cross border merger is deemed to be a branch/ office outside India of the resultant company as provided in the Foreign Exchange Management (Foreign Currency Account by a person resident in India) Regulations, 2015. Accordingly, the resultant company may undertake any transaction as permitted to a branch/office under the aforesaid Regulations.

(5) The guarantees or outstanding borrowings of the foreign company from overseas sources which become the borrowing of the resultant company or any borrowing from overseas sources entering into the books of resultant company shall conform, within a period of two years, to the External Commercial Borrowing norms or Trade Credit norms or other foreign borrowing norms.

(6) The resultant company may acquire and hold any asset outside India which an Indian company is permitted to acquire under the FEMA. Such assets can be transferred in any manner for undertaking a transaction permissible under the Act or rules or regulations framed thereunder.

(7) Where the asset or security outside India is not permitted to be acquired

or held by the resultant company under the Act, rules or regulations, the resultant company shall sell such asset or security within a period of two years from the date of sanction of the Scheme by NCLT and the sale proceeds shall be repatriated to India immediately through banking channels. Where any liability outside India is not permitted to be held by the resultant company, the same may be extinguished from the sale proceeds of such overseas assets within the period of two years.

(8) The resultant company may open a bank account in foreign currency in the overseas jurisdiction for the purpose of putting through transactions incidental to the cross border merger for a maximum period of two years from the date of sanction of the Scheme by NCLT.

3.2 The foreign investment in an Indian company is the sum total of all types of investments enumerated above.

4. FDI

4.1 Meaning

4.1.1 FDI means investment by a person resident outside India in the capital of an Indian entity. Thus, the foreign exchange flows directly into the Indian company. The TISPRO Regulations define FDI to mean investment through capital instruments by a person resident outside India in an unlisted Indian company; or investment in 10% or more of the post issue paid-up equity capital of a listed Indian company. In case the existing investment by a person resident outside India in capital instruments of a listed Indian company falls to a level below 10% of the post issue paid-up equity capital on a fully diluted basis, the investment shall continue to be treated as FDI. Thus, foreign investment in an unlisted company is always FDI whereas foreign investment in a listed company > 10% is always FDI. To illustrate, an unlisted manufacturing company issues a 5% stake to an NRI, the entire stake would be treated as FDI. Similarly, a listed IT company issues a 15% stake to an NRI, the entire stake would be treated as FDI. However, if the listed IT company were to issue a 9% stake to NRIs, then the entire stake would be treated as portfolio investment and not as FDI. The difference between the two is one of reporting and pricing. FDI carries with it obligations on the investee company of reporting and pricing as explained below.

4.1.2 Any Non-resident Indian is eligible to invest under the FDI Scheme but citizens of Bangladesh can do so only under the approval route (see below). Further, Pakistanis can invest under the approval route in sectors, other than defence/space, atomic energy. NRIs resident in Nepal and Bhutan can invest on a repatriation basis provided the consideration is received in convertible foreign exchange.

4.1.3 FDI can be bifurcated on the basis of its repatriation qualities into **Repatriable**, i.e., where principal, gains and current income can be freely sent back to the foreign investor and **Non-repatriable,** i.e., where only current income, such as dividend and interest can be sent back from India to the foreign investor. Non-repatriable FDI is allowed for NRIs under Schedule 4 of the TISPRO Regulations.

4.2 Approval

FDI can also be bifurcated on the basis of its approval into **Automatic Route**, i.e., where FDI does not require the prior approval of the Government of India and there is only a post facto filing with the Reserve Bank of India and **Approval Route,** i.e., where the prior approval of the Government of India is required. Whether FDI in a particular company is under Automatic Route or Approval Route, depends upon the Sectoral Policy applicable to that company. After the abolishment of the FIPB, the nodal ministries for different sectors are the approving authority for FDI. For instance, the competent authority for granting FDI approval for defence is the Department of Defence Production, Ministry of Defence, for Trading it is the Department of Industrial Policy & Promotion, for Banking it is the Department of Financial Services, etc.

4.3 Sectors for FDI

4.3.1 The TISPRO Regulations provide that FDI is not permissible in certain sectors. These are, lottery business, gambling / casinos, chit funds, nidhi companies, trading in transferable development rights, tobacco business, sectors not yet opened to private sector (e.g., railways) and real estate business.

The term ***"real estate business"*** has been a very vexed one which has witnessed several controversies. The current definition of the term states that it means dealing in land and immovable property with a view to earning profit therefrom and shall not include development of townships, construction of residential / commercial premises, roads or bridges and REITs. Further, earning of rental income on lease of the property, not amounting to transfer, will not amount to real estate business. Earlier, the RBI had taken a view that renting of property with FDI tantamounts to real estate business, however, the FIPB had, in cases sent to it for approval, taken a view that leasing is not real estate business. This controversy has now been settled. Another recent clarification is that FDI in real estate broking service is not real estate business and is allowed on the automatic route. This also was a controversy with the FIPB taking a view in the past that FDI in real estate broking service amounted to real estate business.

4.3.2 In addition to the above banned list, the TISPRO Regulations provide for sector-specific policy for total foreign investment. Sectoral caps are provided for certain sectors/ activities and for these sectors, the total foreign investment cannot exceed the sectoral/ statutory cap. In the sectors/ activities not listed in the TISPRO Regulations or not prohibited, foreign investment is permitted up to 100% on the automatic route. The sectors which carry sectoral caps for NRI investment, are FM Broadcasting, Uplinking of TV Channels, Print Media, Private Security Agencies, Multi-Brand Retail Trading, Banks, Commodities Exchanges, Power Exchanges, Insurance, and Pension.

Moreover, there are certain sectors, where there are no sectoral caps but there are various performance-linked / other conditions for receiving FDI or there are approvals required before receiving FDI. Some of these sectors, are, agriculture and animal husbandry, mining, defence, broadcasting, civil aviation, construction development, industrial parks, telecom, trading (retail / wholesale/e-commerce), etc. The sector of ***Construction Development: Townships, Housing, Built-up infrastructure*** is particularly interesting. This sector had several conditions attached to it when it was first introduced in the form of Press Note 2/2005 but with the passage of time it has been significantly watered down. Currently, one of the main conditions is a lock-in on exit and repatriation of FDI after 3 years of the investment. However, this condition is not applicable to any investment by an NRI. Hence, any FDI by an NRI in the real estate construction sector can be exited at any time and the FDI can be repatriated at any time.

4.4 Entities for FDI

The next question which arises is that which entities can be selected for receiving the FDI? Is FDI restricted only to companies? The answer is as follows:

(a) Companies, both private and public limited, are the most popular route for FDI. However, Start-up companies have certain relaxations as compared to other companies and it must be recognised as such as per the DIPP Notification.

(b) Partnership Firms / Sole Proprietary Concerns – NRIs are allowed to invest under the automatic route on a non-repatriation basis provided the entity is not engaged in agricultural / plantation or print media or real estate business. They can invest on repatriation basis with prior RBI permission.

4.5 Instruments

4.5.1 One of the questions to be addressed is which instrument would be used for the investment by the NRI? The instruments which are considered for FDI are as follows:

(a) ***Equity Shares*** – the shares must be issued within 60 days of receipt of funds (the FEMA Regulations are now aligned with Companies Act, 2013 since the earlier period was 180 days) else the investee company must refund the Amount. Non-voting Right Equity Shares can also be issued subject to compliance with the conditions under the Companies Act, 2013.

(b) ***Compulsorily Convertible Preference Shares (CCPS)***. Redeemable Preference Shares or Optionally Convertible Preference Shares are not treated as capital and are treated as Foreign Debt. Earlier, there was a cap on the maximum dividend which could be paid but the same has now been removed.

(c) ***Compulsorily Convertible Debentures (CCDs)***. The end-use restrictions and interest-rate applicable to External Commercial Borrowings are not applicable to CCDs. However, they must be converted into shares and Partly-convertible, Non-convertible or Optionally Convertible Debentures are not permissible.

(d) ***Warrants and Partly paid-up shares*** – the shares can be issued under an automatic route provided the price is determined upfront and 25% is paid upfront with the balance within 12 months. Warrants can be issued under the automatic route if the issue is in accordance with SEBI Regulations and 25%is paid upfront with the balance within 18 months. If the balance 75% is not paid then the initial amount is forfeited.

(e) ***Convertible Notes*** – these are allowed as an instrument but can be issued only by Start-up Companies. Thus, FDI can take place through Convertible Notes issued by a Start-up Company. These are initially debt but are either repayable or convertible at the holder's Option. A maximum of 5 years is allowed for exercising the Conversion Option. The issue size is ₹ 25 lakhs or more in a single tranche by the start-up. The equity shares to be issued against the Notes must be as per the applicable Entry Route, Sectoral Caps, Pricing Guidelines.

4.5.2 The RBI has now expressly permitted equity instruments with built-in put and call options. These are permissible in Equity Shares / CCPS / CCDs subject to there being a Minimum 1 year lock-in period or higher if prescribed for Sector. However, any form of assured return / guaranteed returns to the foreign investor is prohibited. The Exit Price must be as per the fair value of shares determined by a SEBI registered Merchant Banker or a Chartered Accountant as per any Internationally Accepted Pricing Methodology in the case of unlisted companies. This could include, discounted cash flow, net asset value, earnings capitalisation, price earning multiple, etc.

4.6 Pricing

The issue price of shares issued under the FDI route must be as per the pricing guidelines specified by the RBI:

- on the basis of SEBI guidelines in case of listed companies.
- not less than fair value of shares determined by a SEBI registered Merchant Banker or a Chartered Accountant as per any Internationally Accepted Pricing Methodology in the case of unlisted companies. This could include, discounted cash flow, net asset value, earnings capitalisation, price earning multiple, etc.

The price/conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the FEMA regulations.

4.7 Reporting

Receipt of FDI carries certain reporting obligations to the RBI by the issuer company. These include, the Advance Reporting Form (**ARF**), the Know Your Client (**KYC**) Report, the Foreign Currency Gross Provisional Return (**FC-GPR**), the Valuation Report and the Compliance Certificate. These must be filed within the prescribed time limits in the specified formats.

4.8 Exit of FDI

The aim of any investment is to make money by exiting. Hence, exit options for FDI by NRIs should be duly considered at the structuring stage itself. Popular routes include, public listing of the investee company, buyback of shares by the investee company from the NRIs, reduction of capital held by the NRIs, buyout of NRI shares by the Indian promoters, voluntary liquidation of the investee company, etc. Each route has its own tax and regulatory considerations which must be duly weighed before arriving at a decision.

5. Remittance and Repatriation

5.1 Dividends on equity shares / CCPS and Interest on CCDs are freely repatriable without any restrictions, irrespective of whether the investment is repatriable or non-repatriable. This repatriation is permissible by the provisions of the Foreign Exchange Management (Current Account Transactions) Rules, 2000.

5.2 In respect of the sale proceeds of shares (net of taxes) sold by an NRI:

(a) if the shares sold were held on repatriation basis, the same may be credited to his NRE /FCNR(B) accounts;

(b) if the shares sold were held on non repatriation basis, the same may be credited to his NRO account.

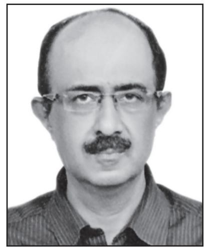
5.3 However, in respect of sale proceeds credited to the NRO A/c, remittance outside India by an NRI, is permissible under the **Foreign Exchange Management (Remittance of Assets) Regulations, 2016** (Notification No. FEMA 13(R)/2016-RB dated April 1, 2016) as well as the Master Direction - Remittance of Assets. An NRI may remit through an authorised dealer an amount, not exceeding USD 1,000,000 (US Dollar One million only) per financial year, out of the balances held in the Non-Resident (Ordinary) Accounts (NRO accounts) / sale proceeds of assets/ the assets acquired by him by way of inheritance/ legacy on production of documentary evidence in support of acquisition, inheritance or legacy of assets by the remitter. If he desires to make a remittance exceeding this limit then he may apply to the RBI for permission.

6. Conclusion

India's Foreign Investment Policy is multi-faceted and is often prone to pulls and tugs from within the system. Is it not strange that for a country which aims to be the cynosure of the global attention and which is constantly vying with China, Brazil, Russia, etc., for foreign investment, India continues to have contrasting stands from Ministries and Regulators on the FDI Policy. FDI loves certainty as explained by Justice Kapadia, in the celebrated decision of *Vodafone International Holdings, 341 ITR 1 (SC):*

"…FDI flows towards location with a strong governance infrastructure which includes enactment of laws and how well the legal system works. Certainty is integral to rule of law. Certainty and stability form the basic foundation of any fiscal system…"

❍❑❍



CA Dinesh Tejwani

TECHnovation

Finance and Accounts: Now a Champion Service Sector

On 15th May 2018, Hon'ble President Shri Ram Nath Kovind launched 12 Champion Services Sectors during 4th Global Exhibition of Services at Mumbai. Earlier, the Government had announced special attention to these 12 Champion Services Sectors (CSS) for promoting their development and realising their potential. These sectors have potential to grow, contribute to India's GDP and create more jobs. The government has allocated a fund of ₹ 5000 crores to activate a plan for realising the full potential of these services.

The share of India's services sector in global services exports grew from 3.1% in 2014 to 3.3% in 2015. With this initiative, a goal of 4.2 % has been envisaged for the year 2022.

Some key statistics about Services Sector in India

These figures taken from the Economic Survey 2017-18, provide a glimpse into the importance of services sector in India's economy.

- The share of Services in India's Gross Value Added is 55.2%
- Out of 32 States, services sector contributes to more than 50% of Gross State Value Added in 15 States.
- Services sector growth is at 8.3% during 2017-18 (7.7% during 2016-17)
- Services exports grew @ 16.2% during April-Sept 2017

This sector has been a major job creator in India as well. For IT-BPM sector a Nasscom report states total people employed at 39.70 lakh. (net addition of 1.05 lakh people during FY 2017-18)

Finance and Accounts Service (FAS)

Accounting and Finance is included in this list of 12 champion services. In the business world, Finance and Accounts Outsourcing (FAO) is a common term to denote these services, so we will refer it as such in the coming paragraphs.

Outsourcing of services began with FAS and this segment continues to grow worldwide. It offers huge benefits to the businesses.

Outsourcing helps reduce operational costs. FAO has been a key instrument in the hands of companies to save between 30% to 50% of their costs.

Outsourcing companies deploy latest technologies. Also highly competitive outsourcing market compels them to deliver superior services for the fear of losing out clients.

Hence outsourced projects deliver efficient results. Most large companies keep a very stringent (e.g 99.9% uptime, 99% accuracy) as part of SLAs.

In addition, companies have access to the specialised talent pool and faster turnaround time

Evolution of FAO from Cost Centre to Strategic Business Partner

- Initially, organisations started outsourcing transactional services to reduce cost. These included general accounting, accounts receivable and payable, payroll, fixed assets and tax compliances
- Later, even judgment-intensive tasks were outsourced. This included Regulatory Reporting and Compliance, Management Reports, Treasury and Risk Management, Budgeting and Forecasting
- Finally, even F&A Strategy is now part of FAO services. This includes Accounting policies and controls, shareholders relations and M&A.

The gamut of FAO service offerings can be understood with the help of following table :

Order-to-Cash	Procure-to-Process	Record-to-Report	Planning and Analysis
• Order capture • Billing/invoicing • Credit management • Accounts receivables • Dispute management • Collections	• Purchase requisition • Purchase order processing • Order management • Expense management • Accounts payable	• General accounting • Account reconciliation • Project/cost accounting • Taxation • Compliance management • Treasury and risk management • Fixed assets accounting • IFRS compliance	• Budgeting/ forecasting • Financial modelling and planning • Trend and variance analysis

Major Companies in India

Prominent service providers in the FAO space are Accenture, Capgemini, EXLService, Genpact, HP, IBM, Infosys, TCS, Wipro, WNS and Xerox ACS. According to a survey by CXI today, during 2017-18 , top 10 FAO locations are

1	India	6	Poland
2	Philippines	7	Hungary
3	New Zealand	8	South Africa
4	Malaysia	9	Canada
5	Ireland	10	Czech Republic

Hence India is a matured FAO market with a large skilled and motivated workforce and great labour arbitrage.

Steps taken by ICAI

The Institute of Chartered Accountants of India is interacting with the Ministry of Corporate Affairs to suggest reforms in accounting and finance to achieve the target of Action Plan for these services.

ICAI has also started making all efforts to promote accounting services in the overseas market. Towards this end, among other things, the institute is signing mutual recognition agreements with a number of accounting institutes of other countries. These arrangements create mobility and professional opportunities for chartered accountants in such overseas markets. Some recent Mutual Recognition Agreements have been signed with CPA Australia, CPA Ireland, South African Institute of Chartered Accountants.

Small Firms and Outsourcing Work

Can FAO work be done only by large companies/firms? The answer is No. Today because of advancement in technology, it is possible even for individuals to get such work from anywhere in the world. Several small and medium size accounting firms now offer FAO services to clients abroad.

Type of work that a small firm can handle includes Book-keeping, Financial Analysis, Bank reconciliation, Accounts Payable Management, Accounts Receivable Management and Tax Preparation. FAO services can be offered to

- Indian units of foreign business entities
- SME businesses abroad
- Accounting firms abroad

Infrastructure and skills required

Broadband and internet costs have come down drastically in India. Hence a good broadband connection, secured server to store data (e.g. Amazon AWS), good English communication skills and proficiency in cloud-based accounting tools is required to start outsourcing work.

Most of the clients would be in USA, UK, Australia and Newzealand. So, to begin with, proficiency in accounting software commonly used in these countries is a must. Some of them are Xerox, QuickBooks, Saasu, MYOB.

Online Freelancing Platforms

It will be best to get work from your direct clients / via networking. However, one can try and get work from online platforms as well. There are several online platforms, where businesses post outsourcing work and freelancers negotiate and get that work. The platform stands as a trusted third party.

Few such platforms are Upwork, Outsourcely, FreeLancer, PeoplePerHour, Guru.

On these platforms, initially you may have to start by doing low-value accounting jobs, but after a while, you will start getting high-value jobs.

While transactional work like simple book-keeping may give about 8 to 10 USD per hour, more skilled work like financial modelling and analysis should get you approx 45-60 USD per hour.

One can see even individuals from small cities in India, getting assignments from 25 USD to 5,000 USD from these platforms.

Conclusion

With the convergence of accounting standards, innovation in digital technology and efforts by Government, it is clear that Finance and Accounts services is going to contribute significantly to India's growth.

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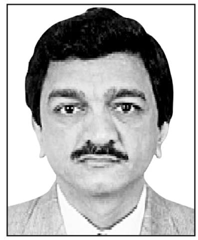

B. V. Jhaveri, *Advocate*

DIRECT TAXES

Supreme Court

S. 40(a)(ia): The amendment to Sec. 40(a)(ia) by the Finance Act, 2010 w.e.f 1-4-2010 which allowed deposit of TDS by the due date of filing the return of income should be interpreted liberally and equitably and be applied retrospectively from the date of insertion of Sec. 40(a)(ia) i.e., with effect from the AY 2005-2006

CIT vs. Calcutta Export Company
Civil Appeal No. 4339-4340 of 2018
Dated 24th April, 2018

1. The facts in the case were that the respondent was a partnership firm who was a manufacturer and exporter of casting materials based out of city of Kolkata. The respondent filed its return of income for the A.Y. 2005-06. The case was selected for scrutiny and the assessment order was passed wherein the A.O. disallowed the export commission charges paid to one M/s. Steel Crackers Pvt. Ltd. on the ground that TDS on the commission amount ought to have been deposited by the respondent before the end of the previous year i.e. 31-3-2005 in terms of provisions of Section 40(a)(ia) of the Act. The respondent had paid the TDS amount on 1-8-2005.

On appeal, the CIT(A) allowed the appeal of the assessee on the ground that commission amount was eligible for deduction under the said Assessment Year.

On further appeal, the ITAT as well as the High Court dismissed the appeal of the Revenue.

Being aggrieved, the Revenue was before the Supreme Court.

2. The Supreme Court considered the provisions of section 40(a)(ia) prior to the amendment made by Finance Act, 2010 and post amendment. The memorandum explaining the amended provision was also considered. Further, the amendment made by Finance Act, 2008 to the said section was also considered. Accordingly the moot question before the Supreme Court was whether amendment introduced through Finance Act, 2010 with effect from 1st April, 2010, which allowed the deposition of TDS on or before due date of filing of return of income, was to be applied prospectively or retrospectively from the date of insertion of provision of section 40(a)(ia), in terms of hardship that may

be caused to the assessee by disallowance of the expenditure and thereby increasing the tax liability for the year.

The Supreme Court held as under:

"24) Thus, the Finance Act, 2010 further relaxed the rigours of Section 40(a)(ia) of the IT Act to provide that all TDS made during the previous year can be deposited with the Government by the due date of filing the return of income. The idea was to allow additional time to the deductors to deposit the TDS so made. However, the Memorandum explaining the provisions of the Finance Bill, 2010 expressly mentioned as follows: "This amendment is proposed to take effect retrospectively from 1st April, 2010 and will, accordingly, apply in relation to the Assessment Year 2010-11 and subsequent years."

"26) TDS results in collection of tax and the deductor discharges dual responsibility of collection of tax and its deposition to the Government. Strict compliance of Section 40(a)(ia) may be justified keeping in view the legislative object and purpose behind the provision but a provision of such nature, the purpose of which is to ensure tax compliance and not to punish the taxpayer, should not be allowed to be converted into an iron rod provision which metes out stern punishment and results in malevolent results, disproportionate to the offending act and aim of the legislation. Legislature can and does experiment and intervene from time-to-time when they feel and notice that the existing provision is causing and creating unintended and excessive hardships to citizens and subject or have resulted in great inconvenience and uncomfortable results. Obedience to law is mandatory and has to be enforced but the magnitude of punishment must not be disproportionate by what is required and necessary. The consequences and the injury caused, if disproportionate does and can result in amendments which have the effect of streamlining and correcting anomalies. As discussed above, the amendments made in 2008 and 2010 were steps in the said direction only. Legislative purpose and the object of the said amendments were to ensure payment and deposit of TDS with the Government."

"27) A proviso which is inserted to remedy unintended consequences and to make the provision workable, a proviso which supplies an obvious omission in the Section, is required to be read into the Section to give the Section a reasonable interpretation and requires to be treated as retrospective in operation so that a reasonable interpretation can be given to the Section as a whole."

"28) The purpose of the amendment made by the Finance Act, 2010 is to solve the anomalies that the insertion of section 40(a)(ia) was causing to the bona fide taxpayer. The amendment, even if not given operation retrospectively, may not materially be of consequence to the Revenue when the tax rates are stable and uniform or in cases of big assessees having substantial turnover and equally huge expenses and necessary cushion to absorb the effect. However, marginal and medium taxpayers, who work at low gross product rate and when expenditure which becomes subject matter of an order under Section 40(a)(ia) is substantial, can suffer severe adverse consequences if the amendment made in 2010 is not given retrospective operation i.e., from the date of substitution of the provision. Transferring or shifting expenses to a subsequent year, in such cases, will not wipe off the adverse effect and the financial stress. Such could not be the intention of the legislature. Hence, the amendment made by the Finance Act, 2010 being curative in nature required to be given retrospective operation i.e., from the date of insertion of the said provision."

The Supreme Court further referred to the following decisions where it was held that new proviso to the section should be given retrospective effect from the inception on the ground that the proviso was added to remedy unintended consequences and supply an obvious omission:

- *Allied Motors (P) Limited vs. CIT [(1997) 224 ITR 677]*

- *Whirlpool of India Ltd., vs. CIT, New Delhi [(2000) 245 ITR 3]*
- *CIT vs. Amrit Banaspati [(2002) 255 ITR 117]*
- *CIT vs. Alom Enterprises Ltd. [(2009) 319 ITR 306]*

The Supreme Court held as under:

"30) Hence, in light of the forgoing discussion and the binding effect of the judgment given in Allied Moters (supra), we are of the view that the amended provision of Sec 40(a)(ia) of the IT Act should be interpreted liberally and equitably and applies retrospectively from the date when Section 40(a)(ia) was inserted i.e., with effect from the Assessment Year 2005-06 so that an assessee should not suffer unintended and deleterious consequences beyond what the object and purpose of the provision mandates. As the developments with regard to the Section recorded above shows that the amendment was curative in nature, it should be given retrospective operation as if the amended provision existed even at the time of its insertion. Since the assessee has filed its returns on 1-8-2005 i.e., in accordance with the due date under the provisions of Section 139 IT Act, hence, is allowed to claim the benefit of the amendment made by Finance Act, 2010 to the provisions of Section 40(a)(ia) of the IT Act."

S. 80-IA(4): Inland Container Depots (ICDs) are Inland Ports and income earned out of these Depots are eligible for deduction u/s. 80IA(4)

CIT vs. Container Corporation of India Ltd. [Civil Appeal No. 8900 of 2012, dated 28th April, 2018]

Brief facts of the case:

(a) M/s. Container Corporation of India Ltd. (CONCOR)-the respondent herein is a government Company and is engaged in the business of handling and transportation of containerised cargo and is under the direct administrative control of Ministry of Railways. Its operating activities are mainly carried out at its Inland Container Depots (ICDs), Container Freight Stations (CFSs) and Port Side Container Terminals (PSCTs) spread all over the country.

(b) The issue in the present appeal was pertaining to the A.Ys. 2003-04 to 2005-06. This issue is with regard to the deduction claimed u/s. 80-IA on the profits earned from the Inland Container Depots (ICDs) and on rolling stocks.

(c) The CIT (Appeals) partly allowed the appeals while rejecting the deduction claimed u/s. 80-IA of the Act.

(d) The Tribunal partly allowed the appeals and held that the deduction u/s. 80-IA can be claimed with regard to the rolling stocks of the company but not with regard to the ICDs.

(e) The Delhi High Court allowed the appeals and held that the Respondent was entitled to claim deduction on the income earned from the ICDs for the relevant period under consideration u/s. 80-IA of the Act.

(f) The only point for consideration before the Supreme Court was whether in the facts and circumstances of the case the Inland Container Depots (ICDs) under the control of the Respondent, during the relevant period, qualified for deduction u/s. 80-IA(4) of the Act or not.

Contentions of the Revenue before the Supreme Court

(g) The activities undertaken by the assessee cannot be said to fall within Explanation (d) of Section 80-IA(4) defining the term infrastructure facility.

(h) The High Court was wrong in placing reliance on the Notification dated 1-9-1998 issued by the Central Board of Direct Taxes (CBDT) to hold that the Respondent is allowed to claim deduction u/s. 80-IA of the Act as the power of the said Board was taken away by the Finance Act, 2001 with effect from 1-4-2002. It was therefore, further contended that in view of the aforesaid amendment, the Notifications issued by the CBDT with regard to treating the ICDs as infrastructure facility were applicable only up to the A.Y. 2002-03.

(i) The ICDs cannot be termed as ports or inland ports within the meaning of section 80-IA(4) so as to allow them to claim deduction under the said section.

Contention of the assessee company (Respondent)

(j) Once the ICDs have been notified validly by the CBDT, by virtue of the powers conferred upon them, the fact that at a later point of time the power was taken away does not put an end to the validity or effect of the notification and as per the relevant section as it stood at the time when the notification was issued, the respondent was eligible for deduction for a period of 10 successive assessment years which covers the A.Ys. 2003-04 to 2005-06 which are the years under appeal.

Their Lordships dismissed the appeals of the Revenue for the following reasons

1. The ICDs function for the benefit of exporters and importers located in industrial centres which are situated at distance from sea ports. The purpose of introducing them was to promote the export and import in the country as these depots act as a facilitator and reduce inconvenience to the person who wishes to export or import but place of his business is situated in a land locked area i.e., away from the sea. These depots reduce the inconvenience in import and export in the sense that it reduces the bottlenecks that are arising out of handling and customs formalities that are required to be done at the sea ports by allowing the same to be done at these depots only that are situated near to them.

2. The term ICDs was inserted in 1983 u/s. 2(12) of the Customs Act, 1962 which defines 'customs port' and by the provisions of Section 7(1)(aa) of the Customs Act,1962 power has been given to the Central Board of Excise and Custom (CBEC) to notify which place alone to be considered as Inland Container Depots for the unloading of imported goods and the loading of export goods by Notification in the official Gazette.

3. With the purpose of boosting country's infrastructure and specially the transport infrastructure, the Finance Act, 1995 which came into effect from 1-4-1996 brought an amendment to the provisions of section 80-IA of the Act.

4. Section 80-IA of the Act talks about deduction in respect of profits and gains from industrial undertaking or enterprises engaged in the infrastructure development etc. The said amendment for the first time brought a provision under which a percentage of profits derived from the operation of infrastructure facility was allowed a deduction while computing the income of the assessee. A ten years tax concession allowed to the enterprises in accordance with the provisions of the Section subject to fulfilment of conditions given therein.

5. The term infrastructure facility had also been defined which at the relevant time stood as follows:

"Section 80-IA(12)(ca): Infrastructure facility means: a road, highway, bridge, airport, port or rail system or any other public facility of similar nature as may be notified by the Board in this behalf in Official Gazette."

The said provision gives the power to the Board to notify certain other enterprises which can avail the benefit of Section 80-IA of the Act, which do not fall within any of the specified categories but carries out activities of similar nature. 14) Further, Central Board of Direct Taxes (CBDT), in exercise of its power u/s. 80-IA(12)(ca), *vide* Notification No.S.O.744(E) dated 1-9-1998 notified ICDs and CFSs as infrastructure facility. In addition to the above, the Finance Act, 1998, which came into effect on 1-4-1999, made a change in the definition of 'Infrastructure facility' as is relevant to the present case. The words 'Inland water ways and inland ports' were added in the definition of infrastructure facility.

6. A noticeable change was further brought by the Finance Act, 2001, which came into effect from 1-4-2002, in the terms that the power of the Board to extend the benefit of the said provisions to any infrastructure facility of similar nature by issuing a Notification was taken away.

7. The argument put forward by learned senior counsel for the Revenue-appellant does not have much force as the said amendment is silent with regard to any effect it would have upon the Notifications issued earlier by the Board in due exercise of its power. Had it been the intention of the legislature that the Notifications issued by the Board earlier are of no effect after 2002-03, it would have had found a place in the said amendment. In the absence of the same, the Notifications which were issued in legitimate exercise of the power conferred on the Board would not cease to have effect after the A.Y. 2002-03.

8. The argument does not hold much weight as the Notification which was issued by the CBDT came into effect on 1-9-1998 i.e., the time when the term 'Inland Port' was not in itself inserted in the provisions of Explanation attached to Section 80-IA(4) of the Act defining the term 'infrastructure facility'. It was inserted through Finance Act, 1998 which came into effect from 1-4-1999. So there seems to be no conflict with the Notification issued by the Board and the fact that the ICDs are Inland Ports or not.

9. The Respondent has been held entitled for the benefit of Section 80IA of the Act much before the Finance Act, 2001 which came into force on 1-4-2002 and exemption for the period of 10 years cannot be curtailed or denied by any subsequent amendment regarding the eligibility conditions under the period is modified or specific provision is made that the benefit from 1-4-2002 onwards shall only be claimed by the existing eligible units if they fulfil the new conditions.

10. Considering the nature of work that is performed at ICDs, they cannot be termed as Ports. However, taking into consideration the fact that a part of activities that are carried out at ports such as custom clearance are also carried out at these ICDs, the claim of the respondent herein can be considered within the term 'Inland Port' as is used in the Explanation.

11. The term 'Inland Port' has been defined nowhere. But the Notification that has been issued by the Central Board

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of Excise & Customs (CBEC) dated 24-4-2007 in terms holds that considering the nature of work carried out at these ICDs they can be termed as Inland Ports. Further, the communication dated 25-5-2009 issued on behalf of the Ministry of Commerce and Industry confirming that the ICDs are Inland Ports, fortifies the claim of the respondent-assessee. Though both the Notification and communication are not binding on CBDT to decide whether ICDs can be termed as Inland Ports within the meaning of section 80-IA of the Act, the appellant herein is unable to put forward any reasonable explanation as to why these notifications and communication should not be relied to hold ICDs as Inland Ports. Unless shown otherwise, it cannot be held that the term 'Inland Ports' is used differently u/s. 80-IA of the Act. All these facts taken together clear the position beyond any doubt that the ICDs are Inland Ports and subject to the provisions of the section and deduction can be claimed for the income earned out of these Depots.

S.80-O : Law on meaning of "technical assistance" discussed and when services can be said to have made available in terms of words "information concerning industrial, commercial or scientific knowledge, experience or skill" used under the said section explained

B. L. Passi vs. CIT Civil Appeal No. 3892 of 2007 Dated 24th April, 2018

1. The appellant filed the return of income for the A.Y. 1997-98 and claimed the deduction u/s. 80-O of the Act on a gross foreign exchange receipt received from Sumitomo Corporation, Japan. The Sumitomo Corporation was interested in supplying dies for manufacturing of body parts to Indian automobile manufacturers and entered into a contract with the Appellant under which the services of the Appellant were engaged by using his specialised commercial and industrial knowledge about the Indian automobile industry. Sumitomo Corporation also agreed to pay remuneration at the rate of 5% of the contractual amount between Sumitomo Corporation and its Indian customers on sales of its products so developed. The Appellant claimed to have supplied to Sumitomo Corporation the industrial and commercial knowledge, information about market conditions and Indian manufacturers of automobiles and also technical assistance as required by the Corporation.

2. The case of the appellant was selected for scrutiny and the A.O. disallowed the claim of the appellant in the assessment order on the ground that the appellant's services do not qualify for the said deduction.

On appeal, the CIT(A) partly allowed the appeal and held that the assessee was entitled to the deduction u/s. 80-O of the Act.

On further appeal by the Revenue, the Tribunal held in favour of the Revenue and reversed the order of the CIT(A).

Being aggrieved by the said decision, the assessee filed the appeal to the High Court at Delhi which was dismissed on 13th December, 2006.

3. On further appeal by the assessee, the Supreme Court while deciding the case considered the bare provisions of section 80-O of the Act. The Court also explored the legislative history of the said section in detail. Thereafter it was also observed that the assessee had not produced any evidence as contemplated by the said section before any of the lower authorities. Further the meaning of the term 'technical assistance' used in the said

section was explored with the aid of the New Encyclopedia Britannica and New Websters's Dictionary. The Apex Court also considered the decisions of *J. K. (Bombay) Ltd. vs. CBDT and Another [(1979) 118 ITR 312 (Del.)]*. Accordingly, the Supreme Court held as under:

"16) The blueprints made available by the Appellant to the Corporation can be considered as technical assistance provided by the Appellant to the Corporation in the circumstances if the description of the blueprints is available on record. The said blueprints were not even produced before the lower authorities. In such scenario, when the claim of the Appellant is solely relying upon the technical assistance rendered to the Corporation in the form of blueprints, its unavailability creates a doubt and burden of proof is on the Appellant to prove that on the basis of those blueprints, the Corporation was able to start up their business in India and he was paid the amount as service charge."

"17) Further, with regard to the remuneration to be paid to the appellant for the services rendered, in terms of the letter dated 25-1-1995, it has been specifically referred that the remuneration would be payable for the commercial and industrial information supplied only if the business plans prepared by the appellant results positively. Sumitomo Corporation will pay to PASCO International service charges equivalent to 5% (per cent) of the contractual amount between Sumitomo and its customers in India on sales of its products so developed. From a perusal of the above, it is clear that the appellant was entitled to service charges at the rate of 5% (per cent) of the contractual amount between Sumitomo Corporation and its customers in India on sales of its products so developed but there is nothing on record to prove that any product was so developed by the Sumitomo Corporation on the basis of the blueprints supplied by the appellant as also that the Sumitomo Corporation was able to sell any product developed by it by using the information supplied by the appellant. Meaning thereby, there is no material on record to prove the sales effected by Sumitomo Corporation to its customers in India in respect of any product developed with the assistance of appellant's information and also on as to how the service charges payable to Appellant were computed."

"18) In view of the foregoing discussion, we are of the considered opinion that in the present facts and circumstances of the case, the services of managing agent, i.e., the appellant, rendered to a foreign company, are not technical services within the meaning of Section 80-O of the IT Act. The appellant failed to prove that he rendered technical services to the Sumitomo Corporation and also the relevant documents to prove the basis for alleged payment by the Corporation to him. The letters exchanged between the parties cannot be claimed for getting deduction under Section 80-O of the IT Act."

"19) Before parting with the appeal, it is pertinent to mention here that it is settled law that the expressions used in a taxing statute would ordinarily be understood in the sense in which it is harmonious with the object of the statute to effectuate the legislative animation. The appellant was a managing agent and the High Court was right in holding the principal-agent relationship between the parties and there is no basis for grant of deduction to the appellant under Section 80-O of the IT Act."

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Purity, patience, and perseverance are the three essentials to success and, above all, love.

— *Swami Vivekananda*

Paras S. Savla, Jitendra Singh, Nishit Gandhi, *Advocates*

DIRECT TAXES

High Court

1. Reopening u/s. 147 – Service of notice u/s. 282 – Notice u/s. 148 served at factory premises on the security guard who was not authorised – Assessee appeared in the proceedings – Reassessment cannot be termed invalid or void for want of proper service

CIT-III vs. Sudev Industries Ltd., ITA No. 805 of 2005, order dt. 31st May, 2018, Delhi High Court

For the Assessment Year (AY) 1995-96, the assessee filed Return of Income declaring "Nil" – income on 15th May, 1997. This return being belated and beyond statutory time was treated as *non est*. Consequently, after recording "reasons to believe" in writing, the AO issued notice dated 11th September, 1998 u/s. 148 calling upon the respondent assessee to file its return for AY 1995-96. The assessee had contended the jurisdiction of the AO. However assessment was completed after making certain additions. The CIT(A) confirmed the reassessment proceedings however, partly allowed the appeal. On further appeal, the Tribunal allowed assessee's appeal on the ground that notice u/s. 148 issued by the AO and addressed to assessee, was not served as per Section 282 of the Act. Service of notice effected on 8th February, 2001 through inspector at the above address was not on any director or any person authorised by the respondent-assessee to receive the notice but on Ajay Pratap Singh, Security Guard. Inspector while effecting service had recorded that the factory was not working and only security guards were present. Service on the security guard, who was not authorised to receive notice, it was held, was invalid and therefore the re-assessment proceedings were entirely void and bad in law. On revenue's appeal, the High Court, held that S.282 of the Act dealt with procedure for service of notice and this provision was enacted to ensure compliance of principles of natural justice and for ease of service, and not for hairsplitting and fault finding. Sub-section (1) to S. 282 had stated that a notice or requisition could be served on the person therein named either by post or as if it were summons issued by a Court under the Code of Civil Procedure, 1908. Clauses (a) to (d) of Sub-section (2) to the said Section refer to whom such notice or requisition may be addressed to in different cases such as in case of a firm or Hindu Undivided Family, a local authority or company, any other association or body of individuals or any other person. In case of a company notice may be addressed to the principal officer. Use of the word "may" in sub-section (2) reflects that this provision is permissive and not mandatory. Therefore, it would not be correct to hold as held by the Tribunal that the notice under S.148 of the Act not being addressed to the principal officer but to the company itself was invalid and completely illegal so as to not confer jurisdiction on the assessing officer. Referring to S.292B, the Court further observed that it was a broad and wide provision which lays emphasis on substance rather than form and that technicalities should not result in invalidating the proceedings, notice, orders, etc. The Court further observed that notice under Section 147/148 had been sent by registered post *vide* receipt No.4896 dated 15th September, 1998 in addition to service by the Inspector of the Income Tax Department. (Though the assessee argued that it never received the notice by post). Secondly, upon service of the said notice, Mr. Rajeev Aggarwal, director of the respondent-assessee had appeared before the Deputy Commissioner of Income-Tax and on request was given a copy of the notice issued under Section 148 of the Act and of the reasons recorded for issue of notice. The third aspect is that the assessee during the assessment proceedings before the Assessing Officer, did not contest or object that notice under Section 147/148 of the Act was not duly served as it was not served on the authorised officer or director or the notice was not addressed to the principal officer. In case, and if, the assessee had taken the said plea, the Assessing Officer had the option to furnish and serve the notice on the director or the authorised representative. There was no occasion for the assessee to object as Mr. Rajeev Aggarwal was duly furnished a copy of the notice. A company being a juristic and a legal person, service cannot be in person on the Company, and has to be effected by sending the notice to the registered office or at the place of business. The Court thus held that the object and purpose of service of notice was to inform and make the company aware that proceedings under Sections 147/148 of the Act had been initiated. Initiation of proceedings under Sections 147/148 of the Act was upon recording of reasons to believe and upon necessary approvals. Initiation to this extent was valid and not disputed and challenged. It was held that the assessment proceedings under Section 147/148 of the Act are not invalid or void for want of proper service of notice.

2. Reopening u/s. 147 – Reopening for deep verification – Reasons recorded for further enquiry not valid – later recitation of mandatory words that he believed that income chargeable to tax has escaped assessment, cannot cure fundamental defect

PCIT vs. Manzil Dineshkumar Shah (R/Tax appeal No.451 of 2018, R/Tax appeal No.457 of 2018, R/Tax appeal No.458 of 2018, order dt. 07th May, 2018)

Assessee an individual and a proprietor of one trading firm, filed its return for AY 2009-10 which was accepted without scrutiny. AO received certain information on bogus purchases basis which he reopened the assessment u/s. 147. In order to issue the notice u/s. 148, he had recorded reasons which included a sentence which read as, '…It needs deep verification'. The Tribunal held that the reassessment was bad in law. On further appeal, the Court observed that even in case where the original assessment is made without scrutiny, the requirement of the Assessing Officer forming the belief that income chargeable to tax has escaped assessment, would apply. Secondly the notice of reopening can be supported on the basis of reasons recorded by the Assessing Officer. He cannot supplement such reasons. And the third principle of law is that reopening of the assessment would not be permitted for a fishing or a roving inquiry. The Court held that the AO recorded that the information required deep verification. In plain terms therefore, the notice was being issued for such verification. Thereafter his later recitation of the mandatory words that he believed that income chargeable to tax has escaped assessment, would not cure this fundamental defect.

3. Accrual of income u/s. 5 – Co-operative bank – method of accounting – when a particular asset is shown to be NPA, the assumption is that it is not yielding any revenue and there is no reason that the assessee be subjected to tax on the alleged notional income, even if it has adopted hybrid system of accounting

PCIT vs. Davangere Urban Co-operative Bank Ltd – [2018] 93 taxmann.com 221 (Karnataka)

The assessee is a Co-operative Society, engaged in banking business. For the impugned assessment year 2010-11, the Assessing Officer proceeded to make addition in respect of interest on non-performing assets (NPAs). However, in appeal by the assessee, the Commissioner of Income Tax (Appeals), Davangere ['the CIT(A)'] deleted such addition by following the decision in the case of *CIT vs. Canfin Homes Ltd. [2012] 347 ITR 382.* Even the Tribunal affirmed the said order on the ground that the issue has been concluded by the decision of the Hon'ble Karnataka High Court. The Department filed further appeal before the Hon'ble High Court against the said order. It was urged before the Hon'ble High Court that as per amended Section 145 of the Act (with effect from 1-4-1997), the income under the head 'Profits and Gains of Business or Profession' has to be computed either under cash or under mercantile system of accounting and subject to accounting standards notified by the Central Government; and, therefore, in the present case, non-accrual of income on NPAs following mixed system of accounting was not permissible. This argument was not accepted by the Hon'ble High Court. High Court relied on the abovementioned decision which held that when the accounts of an assessee clearly state though a particular income is due to him but it is not possible to recover the same, then it cannot said to have been accrued and the said amount cannot be brought to tax. It was further held that the definition of non-performing asset shows that an asset becomes non-performing when it ceases to yield income. Once a particular asset is shown to be a non-performing asset, then the assumption is it is not yielding any revenue. When it is not yielding any revenue, the question of showing that revenue and paying tax would not arise. As per the policy guidelines issued by the National Housing Bank, the income from non-performing asset should be recognised only when it is actually received. Therefore, the contention of the Revenue that in respect of non-performing assets, even though it does not yield any income as the assessee has adopted a mercantile system of accounting, he has to pay tax on the revenue which has accrued notionally was held to be without any basis.

4. Taxability u/s. 45 – Amount received on retirement of a partner as goodwill not taxable – Department cannot raise new argument for the first time

that there was no goodwill in the balance sheet and hence it cannot be treated as goodwill

PCIT vs. R. F. Nagrani – Income Tax Appeal No. 33 of 2016 – Bombay High Court

In this case, the assessee (respondent) received certain sums on his retirement from the partnership firm in which he was a partner. The same was brought to tax by the Assessing Officer. However, the Tribunal had reversed the said order and held that amounts so received by the assessee are not taxable relying on the Judgment of the Hon'ble Jurisdictional High Court in the case of *CIT vs. Riyaz A. Sheikh - [2014] 41 taxmann.com 455 (Bombay)*. The said order of the Tribunal was challenged by the Department in the Hon'ble High Court. The Department had argued that the amount received by the partner on relinquishment of his rights in the firm is taxable since his right as a partner of the firm gets extinguished on his retirement. It was also urged that the amount received by the partner was not on account of goodwill because there is no goodwill in the balance sheet of the partnership firm and to that extent the ratio of Riyaz A. Sheikh (supra) is not applicable. It was further argued that in any case the amounts received by the respondent even if treated as being on account of goodwill will be taxable even when there is no cost of acquisition, in view of amended Section 55 of the Act. The Hon'ble High Court dismissed the appeal holding that the submission that in the absence of goodwill being indicated in the balance sheet of the partnership firm, there could not be no goodwill available to the firm is an issue being urged for the first time before the Court and would therefore not be question arising from the case. It was further held that the issue of cost of acquisition of goodwill will not arise for consideration in the present facts. The question of cost of acquisition being NIL is a matter of computation of capital gains. This issue of computation would only come into play once it is held that the amounts received on account of goodwill by a partner is liable to capital gains tax under the Act and the Court has already decided in the case of Riyaz A. Sheikh (supra), that the amounts received on retirement on account of goodwill by the retiring partner will not be subjected to tax as capital gains in his hands. Further on the second objection that, the order of this Court in Riyaz A. Sheikh (supra) did not properly appreciate the law it was noted that the said order of the Court would have been applied by all authorities within the State to the retiring partners on receipt of goodwill. Further an identical question raised by the Revenue in *CIT vs. Rajnish M. Bhandari [IT Appeal No.2058 of 2012, dated 18-3-2013]* was dismissed by the Hon'ble Court following Riyaz A. Sheikh (supra). In this case, no distinguishing features on facts in the present case have been shown from that existing in the matter of Riyaz A. Sheikh (supra). The submission that the law was not properly appreciated in the above case is not a distinction which would warrant interference. The remedy if any would be an appeal to the Apex Court. As such the Appeal was dismissed. The Department tried to argue that the case of Riyaz Sheikh was not appealed to the Hon'ble Supreme Court due to low tax effect. On this argument, interestingly, the Court held that in the absence of any record from the Department to show that as per the instruction it was not appealed due to low tax effect otherwise the decision is not acceptable to the Department, it could not be so presumed and the said Judgment would continue to be binding.

5. Appellate Tribunal – Orders – Section 254 of the Income-tax Act, 1961 – Order passed by Appellate Tribunal admitting additional evidence without proper application as provided

under the Rules is invalid. [A.Ys. 2009-10 & 2010-11]

Dr. Prannoy Roy vs. Dy. CIT [2018] 93 taxmann.com 328 (Delhi)

The assessee before the Hon'ble Delhi High Court was an individual. The assessee filed the present Writ Petition challenging the order passed by the Delhi Appellate Tribunal wherein the Tribunal admitted the additional evidence filed by the revenue without following the procedures laid down in Rule 29 of the Income-tax (Appellate Tribunal) Rules, 1963. The High Court quashed the order passed by the Appellate Tribunal by observing that the proper procedure prescribed by law has to be followed. In the given circumstances, this naturally means that the Revenue has to move a formal application under Rule 29 of the ITAT Procedure Rules to justify the bringing on record of these additional documents in its possession.

6. Business Income or Capital Gains – Section 28 r.w.s. 45 of the Income-tax Act, 1961 – Compensation received through arbitration award falls under the category of capital receipt – liable to be taxed under Capital Gains

Pr. CIT vs. Aeren R. Infrstructure Ltd. [ITA 235 of 2017 order dated 25-4-2018 Delhi High Court]

The assessee, a private limited company was engaged in the business of real estate and had entered into a consortium agreement with its associates which defined the role, rights and responsibilities. This consortium entered into a transaction with one JMA Buildcom Private Limited for purchase of 10 acres of land for a consideration of ₹ 15 crores. The seller JMA Buildcom defaulted in its commitment within the prescribed and extended time limit. Ultimately, upon parties resorting to the Dispute Settlement Arbitration; a settlement was arrived at and an award was made based upon the parties' eventual settlement. The amount received by the assessee as a part of its entitlement (as consortium) was credited in its books of account as a capital stream. The A.O. while finalising the assessment treated the same as revenue in nature on the ground that the land would have been part of the stock-in-trade. On appeal the learned CIT(A) upheld the action of A.O. On further appeal the Tribunal held that the amount which was intended to be ultimately used as stock-in-trade purposes were immobile and sterilized, hence rendered non-offerable and therefore when received, as part of the arbitration award, fell into the capital stream. The Department being aggrieved preferred an appeal before the Hon'ble Delhi High Court. The Court dismissed the appeal of the department observing that the purpose of the ultimate use of the assessee's land when acquired was rendered irrelevant on account of the seller/JMA Buildcom Private Ltd.. defaulting in its commitment. This rendered the amount expanded by the assessee immobile. The eventual receipt of the amounts determined as compensation/ damages, therefore, clearly fell into the capital stream and not revenue as was contended by the Revenue/appellant in this case.

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> Jealousy is the root of all evil and the most difficult thing to conquer.
>
> — *Swami Vivekananda*

Neelam Jadhav, Neha Paranjpe & Tanmay Phadke, *Advocates*

DIRECT TAXES

Tribunal

Reported Decisions

1. Income from house property – Sec. 23(1)(c) of the Act – It is not necessary to let out the house property during the previous year or prior to it to avail benefits of Sec. 23(1)(c) of the Act

Income Tax Officer- 1(2)(3), Mumbai vs. Metaoxide (P) Ltd. [ITA 4428 & 5771 to 5775/Mum/2018] (Assessment Year : 2008-09 to 2013-14) [2018] 92 taxmann.com 302 (Mum.-Trib.)

Facts

The assessee was a re-seller in chemicals, dyes, solvents, plastics and adhesives. Since there was only one common issue for adjudication in the case of all appeals pertaining to various assessment years, Hon'ble ITAT passed the order by taking the Assessment Year 2012-13 numbered as ITA/Mum/2016 as the base year. For the year under consideration, the assessee had filed its return of income declaring the loss. During the course of assessment proceeding, the learned AO noticed that the assessee had shown income of ₹ 50,229/- under the head Income from House Property. However from the balance sheet of the company, the learned AO found that it was in possession of two flats in a very posh area. The learned AO made independent enquiries and issued notices u/s. 133(6) to various parties and collected information about the fair rent of similar properties located in the same area wherein the assessee had its flat. Based on the said enquiry and information, the learned AO opined that income from house property shown by the assessee was very meager and after invoking the provisions of section 23(1)(a), the learned AO determined the ALV of the flat at higher amount. Aggrieved with the same, the Assessee preferred an appeal before the learned CIT(A). During the first appellate proceedings, the Assessee submitted that as per the rules of the society, the property could only have been let out to corporate entities and not individuals. Therefore, the assessee found it very difficult to get corporate entities as tenant for letting out the said property and the flat remained vacant during the relevant previous year in the light of the same. To buttress its contention, the Assessee relied upon various case laws. The learned CIT(A) allowed the Appeal filed by the Assessee against which the department preferred an appeal before Hon'ble ITAT. Before Hon'ble ITAT, the Ld. DR pointed out that the property under consideration was never let out during this year or any earlier year and contended that there is no application of Sec 23(1)(c) of the Act in the current case. On the other hand, the learned AR reiterated the submission made by the Assessee before the learned CIT(A). After considering the facts of the case and contentions of both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT after perusing the provision of section 23(1)(c) of the Act observed that it is not possible to accept the contention of the learned DR that the property should be actually let out earlier to claim benefits of section 23(1)(c) of the Act. It held that the expression – the property or any part of the property is let as used in clause (c) of section 23(1) does not mean that for availing the benefit of the said sub-clause the property must have been let out earlier and it is sufficient enough if the same is intended to be let out. Hon'ble ITAT relied upon the orders passed by Delhi and Mumbai Benches on the issue under consideration and held in favour of the assessee by dismissing the appeal filed by the department.

Unreported Decisions

2. Depreciation – Section 32 of the Act – No proportionate disallowance is warranted by assuming the cost of land as a part of sale consideration of office premises

M/s. Acube Engineering vs. ACIT 9(1) [ITA No. 8209/Mum/2011] (Assessment Year: 2008-09) dated 13-4-2018

Facts

The assessee is a company, engaged in the business of air-conditioning contractors, consultants and maintenance contractors. The return was filed for the relevant assessment year on 29-9-2008 declaring the total loss at ₹ 1,13,12,620/-. The assessee in its return had claimed the depreciation of ₹ 16,97,606/- on two office premises. During the course of assessment proceedings, the learned A.O. asked the assessee to provide the bifurcation of land and cost of construction of the said office premises. In reply to the said query, the appellant explained that it had paid the sale consideration only in respect of office premises and no separate cost was allocated explicitly towards the land. However the learned A.O. made the proportionate disallowance of depreciation of ₹ 16,97,606/- assuming that the cost of land was embedded in the sale consideration and denied the depreciation to that effect. Aggrieved with the same, the Assessee filed an appeal before the learned CIT(A). On appeal, the learned CIT(A) confirmed the disallowance made by the learned A.O. Being aggrieved by the same, the assessee preferred the appeal before Hon'ble ITAT. After referring the contentions of both the parties, Hon'ble ITAT held as under.

Held

Hon'ble ITAT after referring to the copy of agreement to sale dated 14th September, 2007 between the developer and the assessee in respect of the said office premises observed that the assessee had paid the total consideration for purchase of office premises and no separate price was paid in respect of any land. Thus, the stand of the learned A.O. to disallow the proportionate claim of the depreciation by assuming the cost of land as a part of sale consideration was not correct and the same required deletion. While coming to the said observation, Hon'ble ITAT relied on the decision of its Co-ordinate Bench (Mumbai) in the case of M/s. Bharat Homes Ltd. vs. ACIT [ITA 6792/Mum/2011] and finally held in favour of the assessee.

3. E-filing appeal – Rejection of manual appeal filed in paper form on the observation that the assessee should have filed the same electronically as per Rule 45 of Income Tax Rules, 1962 is incorrect – The technical consideration cannot override substantial justice

All India Federation of Tax Practitioners vs. ITO (E)-1(2), Mumbai [ITA:7134/Mum/2017] (Assessment year 2013-14)

Facts

The assessee is a trust registered u/s. 12A of the Act. The assessment year under consideration is 2013-14. For the said assessment year, the return of income was filed declaring the total income at ₹ 1,87,777/-. The said return was selected for the scrutiny assessment and the assessment order was passed by the learned A.O. u/s. 143(3) on 17-2-2016. Aggrieved with the same, the assessee preferred an appeal before the learned CIT(A) manually in paper form. The said appeal was dismissed by the learned CIT(A) in limine on the observation that the Assessee failed to comply with Rule 45 of the Income Tax Rules, 1962 (hereinafter referred to as "the said rules") and ought to have filed the same electronically. Aggrieved with the order passed by the learned CIT(A), the assessee filed an appeal before Hon'ble ITAT. After listening to both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT noticed that electronic filing of an appeal before the first Appellate Authority was introduced *vide* Rule 45 of the said Rules. However no corresponding amendment was made to the Act. Hon'ble ITAT observed that the appeal in paper form was filed by the assessee within time. It referred to the decisions of Hon'ble Apex Court in cases of *'State of Punjab vs. Shyamalal Murari and others reported in AIR 1976 (SC) 1177* and *Rani Kusum vs. Kanchan Devi, reported in AIR 2005 (SC) 3304*. It came to the conclusion that electronic filing of an appeal is only a technical consideration which cannot override substantial justice. It relied upon the decision of Delhi Bench in case of *"Gurinder Singh Dhillon vs. ITO (ITA No. 6595/Del/16)* and directed the assessee to file a fresh appeal before the learned CIT(A) within a period of ten days from the receipt of the ITAT order. It further directed the learned CIT(A) to pass a speaking order once the assessee complies within the said direction and files an appeal before him with the stipulated time.

4. Exemption: Unbilled revenue in the export turnover is eligible for availing deduction u/s. 10A

M/s. Tech Mahindra R&D Services Ltd. vs. Dy. CIT [ITA No. 4462/Mum/2016], order dated 15-5-2018

Facts

The assessee is engaged in the business of software development in Bengaluru and export thereof and thus is eligible u/s. 10A *qua* the profits as are attributable to the export turnover. For the assessment year under consideration, the return of income was selected for scrutiny assessment. During the course of assessment proceedings, the learned AO observed that the assessee had claimed a deduction u/s. 10A with regard to the unbilled revenue and the same should be excluded from the export turnover for the purpose of computing the deduction u/s. 10A. Before the learned AO, the assessee contended that the work had already been completed with regard to the said unbilled amount and the same was billed and recovered in the next assessment year. Further it was mentioned to the learned AO that the assessee followed this method consistently. However, the submissions of the assessee did not impress on the learned AO and the addition was made to that effect. Aggrieved with the same, the assessee preferred an appeal before the learned CIT(A). However, the learned CIT(A) dismissed the said appeal against which the assessee preferred an appeal before Hon'ble ITAT. On the controversy under consideration, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that the work done but not billed till the year end due to non-completion of certain milestones has been accounted for by the assessee as per the Accounting Standard 9 issued by ICAI. It further observed that the same was billed and received in a subsequent year and the said practice was consistently followed by the assessee. Hon'ble ITAT relied upon the decision of its Co-ordinate Bench in case of *Patni Telecom Solutions P. Ltd. vs. ITO" (ITA No.1988/Hyd/2011)* and concluded that the amount of unbilled revenue should be included in the export as well as the total turnover for the purpose of calculating deduction u/s. 10A of the Act. Accordingly, the appeal of the assessee was allowed.

5. Gift received from a daughter cannot be treated as unexplained cash credit since the source, identity and genuineness of the transaction were proved beyond doubt and the assessee discharged her duties cast u/s. 68 of the Act

Padmalatha Tama vs. ITO [ITA No. 81/Hyd/2017] (Assessment year 2010-11) order dated 23-5-2018

Facts

The assessee is an individual and filed her return of income for the assessment year 2010-11 on 27-7-2010 declaring the total income at ₹ 17,75,810/-. The return was selected for the scrutiny assessment. During the course of assessment proceedings, the learned AO observed that on various dates credits were made to the bank account of the assessee and the assessee was asked to explain the same. In pursuant to the same, the assessee stated that such credits were gifts from her daughter and a confirmation of the daughter to that effect was filed by the assessee. The learned AO further observed that the said confirmation did not contain any income tax details of the loan creditors and concluded that as the assessee had substantial income, there was no necessity to take gifts from the daughter who had no taxable income. The addition of ₹ 17,00,00/- was made to the returned income of the assessee. Aggrieved with the same, the assessee preferred an appeal before learned CIT(A) who in turn confirmed the same addition. The assessee preferred an appeal before Hon'ble ITAT. After hearing both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that, in the fact under consideration, the gifts were received by the assessee from her daughter and the confirmation to that extent was effected and placed on record. Further the said gifts were received through electronic transfer of funds directly to her account. Hon'ble ITAT noticed that as far as the assessee's case is concerned, the assessee explained not only the source of funds but also the source of source of funds. Further identity and genuineness of the cash credits (gifts) were proved. In view of the same, Hon'ble ITAT concluded that the assessee had discharged the onus of proving the identity, creditworthiness and genuineness of the gifts cast upon her u/s. 68 of the Act and accordingly the gifts received from her daughter could not be added to the income of the assessee as unexplained credits. The appeal filed by the assessee was allowed.

6. Penalty – Section 271(1)(C) of the Act – No Penalty u/s. 271(1)(c) is leviable when there is a difference of opinion between the assessee and the assessing officer with regard to heads of income. Taxability of an item of income under a particular head should not result in levy of penalty

ACIT vs. M/s. Sane & Doshi Enterprises [ITA No.1093/Mum/2016] dated 18-5-2018.

Facts

The assessee is a partnership firm and the assessment year under consideration is 2009-10. The return filed by the assessee was selected for scrutiny assessment. During the assessment proceedings, the learned AO observed that the assessee had recorded 'unsold stock of built up premises as stock-in-trade in the books of accounts till Assessment year 2005-06. Thereafter the same was shown as an investment at book value and it had declared long term capital gains arising from the sale of the said premises.

The learned AO was of the view that since the premises sold were out of unsold stock-in- trade, the profits from sales of the same should be treated as business income and added the said profits as business income. Thereafter, the penalty u/s. 271(1)(c) was levied by the learned AO. Aggrieved with the same, the learned CIT(A) held that it was neither a case of concealment nor furnishing inaccurate particulars and the said penalty was deleted. Aggrieved with the order passed by the learned CIT(A), the department preferred an appeal before Hon'ble ITAT. Both the parties placed their contentions before Hon'ble ITAT and relied upon various case laws. After hearing both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that, the basic issue to be decided was as to whether the treatment given by the assessee to the sale proceeds of unsold stock could be treated as furnishing of inaccurate particulars or concealment of income. The flats were never concealed. The explanation filed during the penalty proceedings was a reasonable explanation. Hon'ble ITAT referring to various case laws relied upon by the Assessee held that, the claim was under *bona fide* and a change of gains/profits from "capital gains" to business income did not attract penalty u/s. 271(1)(c) of the Act. It further observed that taxability of an item of income under a particular head should not result in levy of penalty. In the view of aforesaid observations, Hon'ble ITAT dismissed the appeal filed by the department and held in favour of the assessee.

7. Rectification of Mistake – Section 254(2) r.w.r. 34(5) of Income Tax (Appellate Tribunal) Rules, 1963 – the order passed by the ITAT beyond the period of 90 days amounts to mistake apparent from record

Cromption Greaves Limited vs Commissioner of Income Tax – 6 [MA No. 151/Mum/2016 arising from ITA 1994/Mum/2013] (Assessment Year: 2007-08), dated 11-5-2018

Facts

The assessee preferred the Miscellaneous Application before Hon'ble ITAT for the assessment year 2007-08 wherein the assessee requested to recall the order dated 1-2-2016 passed by it. During the course of hearing, the assessee contended that Hon'ble ITAT passed the order beyond the period of 90 days from the date of hearing and thus, the same is required to be recalled for a fresh hearing before a regular bench as per Rule 34(5) of the Income tax (Appellate Tribunal) Rules, 1963 r.w.s. 254(2) of the Income Tax Act, 1961. On the said issue, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that the hearing in appeal No: ITA 1994/Mum/2013 was held on 29-10-2015 and the order was pronounced by it on 1-2-2016 which is beyond the period of 90 days from the conclusion of the hearing. Further Hon'ble ITAT has referred to the decision Hon'ble Bombay High Court in the case of *Shivsagar Veg Restaurant vs. ACIT [2009] 317 ITR 433 (Bom)* and allowed the Miscellaneous Application filed by the assessee. Hon'ble ITAT held that since the order in the present case was pronounced beyond the period of 90 days, it must be recalled in view of Rule 34(5) of Income Tax (Appellate Tribunal) Rule, 1963 r.w.s. 254(2) of the Act. Accordingly, Hon'ble ITAT recalled the matter and directed the Registry to place the appeal in ITA No. 1994/Mum/2013 before a Regular Bench for a fresh hearing.

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CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT

1. Where the Tribunal allowed assessee's claim for nil withholding/ non-taxability in respect of payment made by it for services rendered by personnel of a German company solely relying on an AAR ruling rendered in context of India-Malaysia DTAA (which did not have the FTS clause), the Court remanded the matter back to the Tribunal to examine whether the aforesaid payments amounted to FTS under Article VIIIA of India-Germany DTAA

DIT (IT) vs. Modiluft Ltd – (2018) 93 taxmann.com 180 (Del) – ITA Nos. 772 of 2004 & 15 of 2005 and others

Facts

(i) The assessee leased three aircrafts under the aircraft lease agreement from 'Lufthansa', a German company, on 18.03.1993. Before the said lease agreement, on 15.02.1993, the assessee had entered into agreement for technical support ("the technical support agreement"). In addition, another agreement for provision for flight deck crews ("the flight deck agreement") was also entered into on 05.08.1993.

(ii) The aircraft lease agreement dated 18.03.1993 was approved by the CBDT under section 10(15A) of the Income-tax Act, 1961 (the Act) so as to exempt from tax the payment received by the non-resident under the said agreement.

(iii) The assessee contended that the crew lease/provision of engineers was inextricably linked to the lease of aircrafts and though the agreements were separate, the fact of technical support agreement being entered into prior to lease agreement provided sufficient nexus between the provision of personnel and the lease of aircrafts.

(iv) The AO declined the assessee's request for Nil withholding tax certificate in respect of crew lease payments for engineers on the ground that –

(a) crew lease payment was not covered under section 10(15A) of the Act;

(b) technical support agreement dated 15.02.1993 for providing engineers on lease was not approved under section 10(15A) of the Act

(c) Under the Double Taxation Avoidance Agreement (DTAA) between India and Germany, payments to a non-resident for providing technical personnel is fee for technical service (FTS) and the same is taxable in the country in which they arise i.e., India, in the present case.

(v) On appeal, the CIT(A) and the Tribunal decided in favour of the assessee following the Tribunal's order in the assessee's own case for an earlier year wherein it was held as under:

- Payments under technical support and crew lease agreements were not entitled to exemption under section 10(15A) of the Act because no approval under the said section was granted in respect of the said agreements.
- Both the lease rent and the fee for technical services were business profits of Lufthansa, in as much as the lease of the aircrafts was with the operational staff. Accordingly, relying on the AAR ruling in the case of *Tekniskil (Sendirian) Berhard v. CIT [(1996) 222 ITR 551 (AAR)]* it held that payment made for provision for technical personnel was not taxable in India within the meaning of Article III of the India–Germany DTAA dealing with business profits.

6. Aggrieved, the Revenue filed an appeal before the Hon'ble High Court.

Held

(i) The Court held that the Tribunal's findings in the earlier year were influenced by the AAR ruling in Tekniskil (Sendirian) Berhard (supra), whereas the said ruling was rendered in an entirely different context. In that case the relevant DTAA between India-Malaysia as applicable at the relevant time did not contain the clause for FTS and in that context it was held by the AAR that the FTS arising out of supply of skilled labour were not liable to tax in India in terms of Article 7 as 'Business Profits' on the ground that the assessee did not have a Permanent Establishment (PE) in India in terms of Article 5 of the DTAA.

(ii) It held that, in the present case, in terms of the DTAA, payments made to Lufthansa may not be liable to tax in India in terms of Article III of the DTAA, yet their taxability in terms of Article VIIIA of the DTAA, dealing with 'Fee for Technical Services', was not examined in proper perspective.

(iii) It noted that there was no discussion in the Tribunal's orders as to whether the payments made under the technical support agreement or the crew lease agreements were payment for technical services or not, apart from an *a priori* assumption that the question of taxation does not arise if there is no PE.

(iv) Accordingly, it set aside the Tribunal's order and restored the issue to the file of the Tribunal for reconsideration and rendering specific findings in the context of section 9(1)(vii) of the Act and provisions of the DTAA.

Tribunal Decisions

2. Foreign Tax Credit is allowed in India on proportionate basis

Elitecore Technologies Pvt. Ltd. vs. DCIT [2018-TII-121-ITAT-AHM-INTL] Assessment Year: 2009-10

Facts

(i) During the Assessment Year (AY) 2010-11, the assessee had some receipts from the contract in Singapore and Indonesia. As per the rules of the income tax in those countries, the tax had been deducted on the payment. The assessee therefore claimed the deduction on account of taxes paid in those countries from the income tax payable on the income in India.

(ii) The Assessing Officer (AO) after examining the provisions of Section 90 of the Act and the relevant clauses of India-Singapore and India-Indonesia tax treaties, allowed only part of the tax paid as against full credit of foreign tax deducted claimed by the assessee. For this purpose, he computed proportionate profit on the receipts from these countries and calculated the income which was being taxed again in India.

(iii) The assessee contended that it was not claiming any refund and therefore the method adopted by the AO was not proper. The assessee also provided a separate calculation of the income earned out of those transactions in Singapore and Indonesia and contended that the income so calculated should be taken for proportionate deduction.

(iv) The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

(v) The assessee preferred an appeal before the Tribunal challenging the action of CIT(A) in ignoring the alternate working indicating the profitability of the transactions on which the tax had been deducted in various countries after making allocation of all the expenditure in the ratio of sales turnover while computing the FTC in respect of doubly taxed income. The assessee also challenged the decision, whereby the CIT(A) had ignored the FTC in the form of Tax Deducted at Source (TDS) on interest income earned from its subsidiary company in the U.S. for which there were no borrowings made and thus rejected the assessee's claim to allow the entire FTC on interest on the basis that it was not supported by any corroborative evidence.

Tribunal's decision

The Tribunal referred the decision of the CIT(A). The CIT(A) held as follows:

(i) A perusal of the FTC clauses under the India-Singapore tax treaty and India-Indonesia tax treaty indicates that the amount of tax payable in respect of profit or income arising in that country and subjected to tax both in India and the other country shall be allowed as credit against Indian tax payable in respect of such profits or income in such manner that the credit should not exceed the Indian tax which is appropriate to the profit or income arising in the other country. The provisions show that the credit shall be allowed, which is proportionate to the profit or income arising in that country. Therefore, the approach and method of giving the credit adopted by the AO in respect of the taxes deducted in Singapore and Indonesia is justified and is in order.

(ii) The contention of the assessee that since the treaties are drafted by diplomats and politicians, the interpretations should be done for helping the commercial relations is not acceptable. The provisions of the relevant clauses read with Section 90 of the Act are very clear. There is no ambiguity in the provisions and there cannot be any other interpretation of the relevant clauses. The use of word 'appropriate' in the India-Indonesia tax treaty and the word 'attributable' clarifies everything.

(iii) The assessee has given a working indicating profitability of the transactions on which the tax has been deducted. However, the said working is not acceptable as the overall profit margin of the enterprise has to be looked into for allowing the credit.

(iv) The assessee has claimed that the transactions were of renewal of software licence and sale of new software on which no expenditure has been incurred in the current year as all expenditure were incurred during the phases of development and the same have been charged in earlier year. However, the contentions of the assessee is not acceptable as when the company is taking of several projects at a time and it is not keeping separate accounting in respect of each product project and the profitability is not worked out in respect of each project or product. Therefore, the global profitability has to be adopted for computing the proportionate profit.

(v) The assessee has claimed that the transactions were sale of incremental software license, sale of new software, AMC for software and interest income. An alternate working indicating the profitability of the transactions on which the tax has been deducted in Indonesia, Ukraine and USA after making allocation of all the expenditure in the ratio of sales turnover has been submitted by the assessee. Since the facts of the present case are identical to the order passed by the CIT(A) for AY 2009-10, the findings given there would also be applicable for this year as well. Therefore, the working of FTC adopted by the AO is in order and the same has been upheld.

(vi) Further, the assessee has claimed that in case the FTC is not allowed, the deduction should be allowed under Section 37 of the Act in respect of the tax for which the FTC is not given by the AO as it is a business expenditure for the assessee. Similar claim was made by the assessee in preceding AY 2009-10, wherein the CIT(A) allowed the assessee's claim. Thus, following earlier decision of CIT(A), the decision of AO in restricting the FTC to a specified amount is being confirmed and balance amount is allowed as deduction under Section 37 of the Act.

(vii) The Tribunal referred the decision in the assessee's own case i.e., *Elitecore Technologies (P.) Ltd. vs. DCIT [2017] 77 taxmann.com 149 (Ahd)* on the identical issue in preceding AY 2009-10 wherein Co-ordinate Bench of the Tribunal held as follows:

(a) The allocation of proportional deductions can be justified in some situations, such as when business operations are somewhat evenly or even in a significant manner, spread over the residence and source jurisdiction, but that's not the case in the present scenario. In the present case, the Tribunal was dealing with a situation where a major portion of income is a somewhat passive income, even though in the nature of business receipt, and as such, to that extent, allocation of all the expenditure incurred by the assessee, in respect of such earnings, will not be justified.

(b) As regards the income from maintenance contracts, the related costs have already been allocated and the AO has not pointed out any infirmity on the same.

(c) The tax credit for both the jurisdictions is to be computed separately but in a similar manner, as is provided in the respective treaties. So far as the tax credit in respect of Indonesian receipts is concerned and in view of Article 23(1) of the applicable tax treaty, the income tax is required to be computed on proportionate basis. In the absence of any other method having been pointed out, only the way in which be so done is by apportioning the actual tax paid under MAT provisions, in the same ratio as double taxed profit to the overall profits.

(d) As for the tax credit in respect of Singaporean receipts, while the formulae for limitation under Article 25(2) of the India-Singapore tax treaty remains broadly the same as it is provided that the credit shall not exceed tax 'which is attributable to the income which may be taxed in Singapore' but the first variable i.e. income taxed in both the countries would change. The tax credit in respect of Singaporean receipts is thus clearly admissible.

(viii) There is no contrary arguments from the tax department so far as the similarity of facts as well as the issues involved in the two Assessment Years, i.e. AY 2010-11 and AY 2009-10 are concerned. The tax department is very fair in not raising any objection since the AO has to frame all the relevant consequential computation. The Tribunal thus adopted judicial consistency in the impugned AY in the absence of any distinction in facts or law involved *vis-à-vis* the preceding AY. The assessee's appeal is therefore partly accepted

Note 1

The reader may also refer to the following decisions in the matter of grant of FTC:

- *CIT vs. Tata Sons Ltd [2011] 43 SOT 27 (Mum.)*

Note 2

The Central Board of Direct Taxes (CBDT) vide Notification No. 54/2016, dated 27th June 2016 introduced Rule 128 in the Income-tax Rules, 1962 (the Rules) with respect to FTC to provide clarity on the subject. These rules clarify the nature and conditions for the availability of FTC to the assessees and provide guidance to claim FTC in India. However, the amendments to Rule 128 do not deal with the situation in the present case.

3. India-USA DTAA – Whether Reimbursement of lease line charges having no income element taxable in India – Held: Yes, in favour of the assessee

T3 Energy Services India Pvt. Ltd. vs. JCIT 2018-TII-66-ITAT-PUNE-INTL Assessment Year: 2010-11

Facts

(i) The assessee is engaged in the manufacturing of industrial valves and valve components which were mainly used in oil field service industry. The U.S. parent company of the assessee had entered into an agreement with service provider i.e., Qwest Communications Inc for providing of bandwidth services against stated consideration. The said agreement is a contract for providing bandwidth services between the parent company and Qwest Communications Inc and the parent company in turn, provided bandwidth services to its subsidiaries against reimbursement of lease line charges.

(ii) The assessee had paid lease line charges to its AE without deduction tax at source. The assessee claimed that the said expenditure was reimbursement of expenditure, having no profit element embedded in it and hence tax was not deductible on the same. The assessee also pointed out that lease line/bandwidth charges were not royalty for the use of process and it should not be considered so. Hence, TDS provisions under Section 195 of the Act was not applicable.

(iii) The Assessing Officer (AO) held that lease line charges were not reimbursement of expenditure to the AE for any services provided by them to the assessee. It was the payment made to the third party, i.e., Qwest Communication Inc, through AE of the assessee. The said payment was for providing lease lines for communication purposes. Thus, the amount remitted to the third party was income in its hands for the services provided. Hence, it was hit by provisions of Section 195 of the Act. The AO made reference to the amendment in the definition of 'royalty' under Section 9 of the Act with retrospective effect, to point out that the intention of Legislature in this regard was clear and explicit. It was pointed out by the AO that reason behind the amendment of the definition of 'royalty' was in the wake of various conflicting decisions on the issue of deduction of tax under Section 194J/195 of the Act on payment of lease line charges. The AO held that the provisions of Section 40(a)(i) of the Act would apply to all payments made during the year, irrespective of the year in which such tax was deductible.

(iv) The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Tribunal's decision

On Appeal, the Tribunal held in favour of the assessee as under:

A) Withholding of tax

(i) The basic principle is that where reimbursement of expenditure does not include any income element, then the same is not subject to tax in India. In the present case, Qwest Communications Inc had raised charges on US parent company, and the portion allocable to the assessee was charged on the cost-to-cost basis. Hence, it cannot be said that there was any income element which has arisen in the case and consequently, it has been held that where the assessee had reimbursed the expenditure having no income element, there is no requirement to deduct tax out of such payments.

(ii) The Tribunal has already decided this issue and held that under the provisions of a tax treaty, the term 'royalty' is defined and it does not cover any such services availed and payment made. In any case, the privity of contract is between Quest Communications Inc, the service provider and US parent company who in turn had received bandwidth and passed on the services to various entities of the group on the cost-to-cost basis.

(iii) The assessee as the recipient of services had reimbursed the same, and in the absence of profit/income element, there is no liability to deduct tax at source. Hence, the assessee cannot be held to be in default. It has been held that there is no merit in invoking the provisions of Section 40(a)(i) of the Act.

B) Taxability of royalty by virtue of amendment in the Act

(i) The Delhi High Court in the case of *DIT vs. New Skies Satellite BV [2016] 382 ITR 114 (Del.)* has elaborated on the general principles relating to international transactions of the tax treaty *vis-à-vis* royalty and also the amendment in the Act widening the scope of royalty. The High Court held that amendments in the domestic law cannot be read into tax treaty provisions without amending the tax treaty itself. It was held that mere amendment to Section 9(1)(vi) of the Act could not result in a change and it was imperative that such amendment was brought about in the tax treaty as well and hence, the amendments were not applicable to the tax treaty.

(ii) In view of the ratio laid down by the Delhi High Court in the case of New Skies Satellite BV and *Delhi Tribunal Shin Satellite Public Co. Ltd. vs. DDIT [2011] 12 taxmann.com 6 (Del.)*, the Tribunal in the instant case are not going into the aspect of the amendment to Section 9(1)(vi) of the Act, under which Explanations 4, 5 and 6 of the Act have been added, which *inter alia*, amended the definition of 'royalty' with retrospective effect. It has been held that the same need not be gone into since the issue otherwise stands decided in favour of the assessee.

(iii) Unilateral amendment by the Indian Government to the term 'royalty' by way of amendment to Section 9(1)(vi) of the Act cannot be extended to the meaning of the term under a tax treaty. Applying the principle laid down by the Delhi High Court in the case of New Skies Satellite BV, the Tribunal held that where the provisions of tax treaty override the provisions of the Act and the definition of 'royalty' not having undergone any amendment in the tax treaty, the assessee was not liable to deduct tax on the lease line charges paid by it. The amended provisions of Section 9(1)(vi) of the Act brought into force by the Finance Act, 2012 are applicable to domestic laws and the said amended definition cannot be extended to the tax treaty, where the term has been defined originally and not amended.

(iv) In the present case also, though the definition of 'royalty' under the Act had been amended, the term 'royalty' under the India-U.S. tax treaty has not been amended. In the absence of the same, the Tribunal held that in view of the definition of 'royalty' under the tax treaty, the assessee is not liable to deduct tax on the payments made to its AE on account of lease line charges.

Note:

The issue with respect to taxability of reimbursement of expenditure has been a matter of debate before the Courts/Tribunal.

In the following cases, the Tribunal held that reimbursement of expenditure is not taxable since there is no profit element.

- *Convergys Customer Management Group Inc. vs. ADIT [2014] 159 TTJ 42 (Del.),*

- *Dampskibsselskabet vs. ADIT [2011] 130 ITD 59 (Mum.),*
- *CIT vs. Expeditors International (India) (P.) Ltd. [2012] 209 Taxman 18 (Del.),*
- *Bureau Veritas-Indian Division vs. ADIT [2015] 54 com 139 (Mum.),*
- *Gemological Institute International Inc vs. DCIT [2017] 166 ITD 8 (Mum.)*

On the other hand, in the following cases, Courts/Tribunal have treated the reimbursement of expenditure as income of recipient liable to tax in India.

- *SPX India (P.) Ltd. vs. CIT [2014] 147 ITD 120 (Del.),*
- *CSC Technology Singapore Pte. Ltd. vs. ADIT [2012] 50 SOT 399 (Del.), Ashok Leyland Ltd. vs. DCIT [2008] 119 TTJ 716 (Chen.),*
- *Inspections (I) (P.) Ltd. vs. DCIT [2013] 156 TTJ 690 (Mum.).*

Further, reimbursements under the cost allocation agreement have been held to be taxable in the following cases:

- *Danfoss Industries (P.) Ltd., In re [2004] 268 ITR 1 (AAR)*
- *A' Systems, The Netherlands, In re [2012] 345 ITR 479 (AAR).*

However, in the following cases, courts have treated that such payment as service fees instead of reimbursement of expenditure.

- *Van Oord ACZ Marine Contractors BV vs. ADIT [2012] 149 TTJ 124 (Chen.),*
- *Danfoss Industries (P.) Ltd., In re [2004] 268 ITR 1 (AAR)*

It is pertinent to note that the Supreme Court in the decision of *A.P. Moller Maersk A S ([2016] 392 ITR 186 (SC)* has observed that no profit element was embedded in the payment made by Indian agents to the foreign company. The payments were in the nature of reimbursement of cost whereby the agents paid their proportionate share of expenditure incurred on the said systems and for maintaining those systems. Accordingly, such payment was not taxable as FTS.

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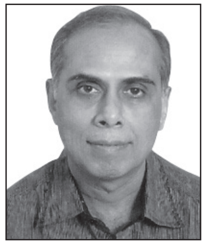

CA Rajkamal Shah & CA Bharat Vasani

INDIRECT TAXES
GST – Legal Update

NOTIFICATIONS

Waiver of late fees for FORM GSTR 3B (CGST Notification No. 22/2018 dt. 14-05-2018)
Late fees for delay in furnishing of FORM GSTR 3B waived for the months October to April, 2018 for registered persons who had submitted but not filed FORM TRAN as on 27-12-2017 provided such FORM TRAN 1 is filed on or before 10-05-2018 and GSTR 3B for each of such months on or before 31-05-2018.

Extension of due date for filing of GSTR 3B of April, 2018 (CGST Notification No. 23/2018 dt. 18-05-2018)
Due date for filing of GSTR 3B for April'2018 extended upto 22-05-2018.

Authority for GST Practitioner under Rule 83(3) (CGST Notification No. 24/2018 dt.28-05-2018)
National Academy of Customs, Indirect Taxes and Narcotics, (NACIN) Department of Revenue, Ministry of Finance, Government of India is notified as an authority to conduct the examination for enrollment as GST Practitioner under Rule 83(3).

Extension of due date for filing of GSTR 6 for Input Service Distributors (CGST Notification No.25/2018 dt.31-05-2018).
The last date for filling of GSTR 6 by Input Service Distributors for the period of July 2017 to June 2018 extended till 31-07-2018.

RCM on Priority Sector Lending Certificate (PSLC) [CGST (Rate) Notification No. 11/2018 and IGST (Rate) Notification No. 12/2018 dt. 28-05-2018]
Supply of PSLC by any registered person to any registered person brought under RCM w.e.f. 28-05-2018.

Union Territory Goods & Services Tax (UTGST)

Notification No. 7, 8, 9/2018 dated 18-05-2018 and 10, 11/2018 dt. 21-05-2018
Notf No.7, 8, 9, 10 & 11 seeks to make E way bill mandatory wef 25.05.2018 in UT Chandigarh, Dadra and Nagar Haveli, Daman and Diu, Andaman &Nikobar Island and Lakshadweep by rescinding earlier Notf. No.316(E), 317(E), 318(E), 315(E) & 319(E) dt 31.03.2018.

CIRCULARS

Clarification on taxability of tenancy rights (CGST Circular No. 44/18/2018 dt. 02-05-2018)
The activity of transfer of tenancy rights is taxable *per-se* as per para 2 of Schedule II of

CGST Act. Transfer of tenancy rights to a new tenant against consideration in the form of tenancy premium is taxable. However, grant of tenancy rights in a residential dwelling for use as residence dwelling against tenancy premium or periodic rent both is exempt owing to Sl. No. 12 of Notification No. 12/2017 Central Tax (Rate).

As regards to services provided by outgoing tenant by way of surrendering the tenancy rights against consideration in the form of portion of tenancy premium is liable to GST.

Clarification on refund related issues (CGST Circular No. 45/19/2018 dt.30-05-2018)

Board has clarified the issues related to refund as below.

A) ***Claim for refund filed by ISD, Composition taxpayer or non-resident taxable person –*** In case of persons referred above claim for refund of balance in electronic cash ledger can be made by filing of FORM GSTR-4 for composition taxpayers, Form GSTR-6 for ISD and Form GSTR-5 for non-resident. But filing of GSTR-1 and GSTR-3B is not mandatory.

B) ***Application for refund of IGST paid on export of services and supplies made to a SEZ developer or a SEZ unit –***

Period starting from 01.07.2017 to 31.03.2018, refund application in FORM GST RFD-01A shall be allowed to file on the common portal subject to the condition that the amount of refund of IGST/cess claimed shall not be more than the aggregate amount of IGST/cess mentioned in the Table under columns 3.1(a), 3.1(b) and 3.1(c) of FORM GSTR-3B filed for the corresponding tax period.

C) ***Refund of unutilised ITC of compensation cess availed on inputs in cases where final product is not subject to the levy of compensation cess:***

It is clarified that a person making zero rated supply of aluminum products under bond or LUT may claim refund of unutilised credit including that of compensation cess paid on coal. Such registered persons may also make zero-rated supply of aluminum products on payment of IGST but they cannot utilise the credit of the compensation cess paid on coal for payment of IGST in view of the proviso to section 11(2) of the Cess Act, which allows the utilisation of the ITC of cess, only for the payment of cess on the outward supplies. Hence refund cannot be claimed of compensation cess in case of zero-rated supply on payment of integrated tax.

D) ***Requirement of bond or LUT in the case of zero rated supply of exempted or non-GST goods and whether refund can be claimed***

It is clarified that in respect of refund claims on account of export of non-GST and exempted goods without payment of IGST; LUT/bond is not required. Exporter exporting non-GST goods shall comply with the requirements prescribed under the existing law i.e., Central Excise Act, 1944 or the VAT law of the respective State or under the Customs Act, 1962. Further, the exporter would be eligible for refund of unutilised ITC of GST.

E) ***Scope of restriction imposed by Rule 96(10) of the CGST Rules, regarding non-availment of the benefit of notification -*** The said rule restricts exporters to export the goods under payment of IGSTwho receiving goods from suppliers who are availing the benefit under NN. 48/2017-CT dated the 18th October, 2017, NN 40/2017-CT (Rate) dated the 23rd October, 2017, or NN 41/2017-IGST (Rate) dated the 23rd October, 2017 or NN 78/2017-Customs dated the 13th October, 2017 or NN 79/2017-Customs dated the 13th October, 2017.

However, restriction shall not be applicable to

1. Exporter who has procured goods from suppliers who have not availed the benefits of the above notifications for making their outward supplies,

2. Exporter who has procured goods from suppliers who have, in turn, received goods from registered persons availing the benefits of these notifications.

3. A manufacturer imported capital goods by availing the benefit of NN. 78/2017– Customs or 79/2017-Customs. Thereafter, goods manufactured from such capital goods may be supplied to an exporter.

Clarification on applicability of IGST on goods deposited in a customs bonded warehouse *(IGST Circular No. 3/1/2018 dt. 25-05-2018)*
It is clarified that IGST on import of goods which are deposited in a customs bonded warehouse shall be levied and collected at the time of final clearance for home consumption i.e., at the time of filing ex-bond bill of entry and the value addition accruing at each stage of supply shall form part of the value on which the integrated tax would be payable at the time of clearance of the warehoused goods for home consumption. In other words, the supply of goods before their clearance from the warehouse would not be subject to the levy of IGST.

Sanction of pending IGST refund claims (Customs Circular No. 12/2018 dt. 29-05-2018)

Procedure is prescribed to overcome the problem of refund blockage of IGST paid on exports where the records have not been transmitted from the GSTN to DG Systems.

A] Cases where there is no short payment
Customs policy wing to prepare a list of exporters whose cumulative IGST paid for Jul-March, 2018 as per GSTR 3B is greater than or equal to cumulative IGST as per GSTR 1 and send the same to GSTN. GSTN to send confirmatory e-mail to all exporters.

B] Cases where there is short payment:
Customs policy wing to prepare a list of exporters whose cumulative IGST paid for Jul-March, 2018 as per GSTR 3B is less than cumulative IGST as per GSTR 1 and send the same to GSTN. GSTN to send e-mails to all exporters so as to inform about the short payment and the procedure to be observed for the same.

Exporter to pay the balance IGST and submit proof of payment (self-certified copy of Challans) with the Customs Officer. Additionally, CA Certificate to be submitted where the aggregate IGST refund amount exceeds ₹ 10,00,000/-.

In both the above cases "A" and "B", for refund processed, the exporter will have to submit CA Certificate before 31-10-2018 to the Customs office to the effect that there is no discrepancy between the IGST amount refunded and actual amount paid failing which refund of further exports will be affected. A copy of the certificate shall also be submitted to the jurisdictional GST office (Central/State).

The exporter would be subjected to post-refund audit under the GST Law.

PRESS RELEASES

GST Council 27th Meeting decision – Return Simplification dt. 04-05-2018
The key elements of the new return design are as under:

1. **One monthly return** for all taxpayers with few exceptions like composition dealer. The due dates to be staggered on the basis of turnover.

2. **Unidirectional flow of invoices** which will be uploaded by the supplier anytime during the month and the same buyer will be able to see continuously. B2B transactions will require reporting of HSN.

3. **Simple return design and easy IT interface** to calculate liability and ITC both automatically on the basis of invoices uploaded by supplier.

4. **No automatic reversal of ITC** for non-payment of tax by the seller.

5. **Recovery of tax and reversal of ITC** shall be through a due online process of issuing notice and order.

6. **Supplier side control** for uploading invoices by the supplier who has defaulted in payment of tax by way of blocking such supplier to control misuse of ITC facility.

7. **Transition of return filing system** – Current system of filing GSTR 1 and GSTR 3B to continue for maximum 6 months. Thereafter, new return will have facility for uploading of invoices and claim of ITC on self-declaration basis. During this phase, the dealer will be constantly fed with information about gap in ITC between provisional credit claimed and as uploaded by the supplier. After 6 months, the facility of provisional credit will be withdrawn and ITC will be allowed only on the basis of invoices uploaded by supplier.

GST Council 27th Meeting decision – Changes in GST Rate dt. 04-05-2018

1. ***Incentive to promote Digital Transactions*** A concession of 2% i.e., 1% each under CGST and SGST (where GST rate is 3% or more) on B2C supplies is proposed for which payment is made through digital mode, subject to maximum of ₹ 100 per transaction.

2. ***Imposition of Sugar Cess over and above 5% GST and reduction in GST Rate on ethanol is proposed***

Roll out of E-way bill system for intra-state supplies dt.14-05-2018& 24-05-2018

State	Effective date of roll out of e-way bill system
Assam	16-05-2018
Rajasthan	20-05-2018
Maharashtra	25-05-2018
Manipur	
Andaman & Nicobar Islands	
Chandigarh	
Dadra & Nagar Haveli	
Daman & Diu	
Lakshadweep	

Clarification on misleading reports appearing in certain section of press with regard to taxation on renting or leasing of land by farmers dt.28-05-2018

It is clarified that there has been no change in GST law and taxation relating to farmers since July, 2017. Accordingly, the reports in the press that from 01-06-2018 farmers would be required to take registrations and pay tax @ 18% is factually incorrect and misleading.

Renting or leasing of land by farmers for agriculture, forestry, fishing or animal husbandry on *batai* (share cropping) or otherwise is exempt from GST. Further, agriculturists are exempted from taking GST registration.

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CA Naresh Sheth & CA Piyush Jain

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Decisions in respect of Writ, Special Leave Petition and other grievances

1. Shree Raipur Cement Plant vs. State of Chhattisgarh and 4 Others (2018-TIOL-37-HC-CHHATTISGARH-GST)

Facts, Issue involved and Contention of Petitioner

The Petitioner is engaged in mining of limestone. It manufactures cement for which High Speed Diesel (HSD) is used. C Form is not being issued for the inter-state purchases of HSD by showing error message that "ED9: Invoice date should be less than 1st July, 2017".

The Company has filed a writ challenging that they are registered under Central Sales Tax Act, 1956 and are entitled to be issued C-Form in respect of HSD purchased by it in the course of inter-State trade and used by it in the course of manufacturing of cement, after the promulgation of the Central Goods and Services Tax Act, 2017 with effect from 1-7-2017.

Held

The petitioner is a registered dealer under the provisions of the CST Act, 1956 and his registration certificate under the CST Act, 1956 read with CST Rules of 1957 continues to be valid for the purpose of inter-State sale and purchase of high speed diesel despite the petitioner having been migrated to the GST regime with effect from 1-7-2017.

The definition of goods as defined in Section 2(d) of the CST Act, 1956 has been amended prior to coming into force of the CGST Act, 2017 from 1-7-2017 which includes high speed diesel. Further, under Section 9(2) of the CGST Act, 2017, the GST Council has not made any recommendation for bringing high speed diesel within the ambit of the CGST Act, 2017 and therefore the Central Government has not notified high speed diesel to be within the ambit and sweep of the CGST Act, 2017. Thus, the petitioner's registration certificate under the CST Act, 1956 is still valid for the goods defined in Section 2(d) of the CST Act, 1956, including high speed diesel, and the petitioner is entitled for issuance of C-Form for inter-State purchase / sale of high speed diesel against the said C-Form. Accordingly, the respondents shall be liable and are directed to issue C-Form to the petitioner in respect of high speed diesel to be purchased by the petitioner and used in the course of manufacture of cement and for that, it is further directed to rectify and remove the error on their official website and entertain the petitioner's application submitted on-line on the official website seeking issuance of C Form to the petitioner for said goods.

2. M/s. Maneesh Singh vs. State of UP and 3 Others (2018-TIOL-44-HC-ALL-GST)

Facts, Issue involved and Contention of Petitioner

The petitioner was served a tender notice from the Municipal Corporation of Uttar Pradesh raising a duty demand for advertisement tax. The same is challenged by the petitioner by filing a writ.

Held

Extract of Section 173 of the U.P. Goods and Service Tax Act, 2017 is reproduced below:

'Save as otherwise provided in this Act, on and from the date of commencement of this Act, (i) In the Uttar Pradesh Municipal Corporation Act 1959 clause (b) of sub section (2) of section 172 and section 192, 193 shall be omitted.'

Therefore sections 172(2)(b), 192 and 193 of the U.P. Municipal Corporation Act, 1959 which govern advertisement tax charged by Municipal Corporation are omitted and, thus, the respondent-Municipal Corporation, is vested with no power to levy advertisement tax and it is only GST, which shall be applicable. It is further submitted that since now the Municipal Corporation is left with no authority to levy any advertisement tax, the impugned tender notice dated 24-3-2018 issued for realizing advertisement tax is bad in law and is liable to be quashed.

B. Rulings by Authority of Advance Ruling

3. Reliance Infrastructure Limited – AAR Maharashtra (2018-TIOL-22-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is engaged in the business of generation, transmission and distribution of electricity. The applicant (licensee) has the licence to lay down or place electric supply lines and carry out the following works:

- To open and break up the soil and pavement of any street, railway or tramway;
- To open and break up any sewer, drain or tunnel in or under any street, railway or tramway;
- To lay down and place electric lines, electric plant and other works;
- To repair, alter or remove the same;
- To do all other acts necessary for supply of electricity

In order to carry out aforesaid works, applicant is required to obtain permission from the appropriate government, local authority as the case may be. Further, it is liable to pay compensation to the parties affected by such works. The Government of Maharashtra has also formulated the Maharashtra Electricity Work of Licensee Rules, 2012 for setting out the procedure to be followed by the licensee for carrying out the aforesaid works. The Municipal authority (MCGM) has issued the Policy Guidelines No. AMC/ES/7725/II for granting permissions and collecting following charges:

- **Reinstatement Charges:** For reinstatement of trenches arising out of excavation work done by the licensee
- **Access Charges:** For giving right of way to the licensee to carry out excavation work for laying underground electric supply lines.

Applicant has sought clarification whether GST is applicable on such reinstatement charges and access charges paid to MCGM?

Discussions by and observations of AAR

It is contended by the applicant that the service falls under Entry 4 of Notification No. 12/2017 dated 28-6-2017 – Services by Central Government, State Government, Union Territory, local authority or Governmental authority by way of any activity in relation to a function entrusted to a municipality under Article 243W of the Constitution.

Article 243W has a reference to Twelfth Schedule of Constitution. Matters listed in Twelfth Schedule are as follows:

1. Urban planning including town planning
2. ………
3. ………..
4. Roads and bridges
5. …………..

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12……………………

The function as entrusted by the Constitution in relation to 'Roads' is the construction of roads for the use by general public. These are the sovereign functions carried out by MCGM. The MCGM grants permission to the applicant for digging up trenches for laying power lines. These permissions come with charges for restoring the street which has been dug up. Therefore it does not amount to construction of roads as such. The function in relation to 'Roads' as entrusted by Constitution does not entitle MCGM to receive any charges from anyone for doing the said work. In the present case, the applicant requests the MCGM to be allowed to dig up trenches for their business activities. This restoration work does not result in performing of sovereign function. Charges for restoration work cannot be equated with construction work or maintenance work undertaken *suo-motu* by MCGM.

In respect of access charges, it is contended by the applicant that it falls under composite supply, the principal supply being services of restoration of road by MCGM which is exempt under Notification No. 12/2017. However, the AAR has held that information available is insufficient and therefore the question whether access charges falls under composite supply is not answered.

Ruling of AAR

Reinstatement charges and access charges paid by the applicant to MCGM is liable to GST.

4. M/s. Gogte Infrastructure Development Corporation Ltd. – AAR Karnataka (2018-TIOL-29-AAR-GST)

Facts, Issue involved and Query of Applicant

The applicant is engaged in hotel business, having hotel "Fairfield Marriott" and provides hotel accommodation & restaurant services. It provides services to the employees and guests of some of the units in SEZ area and charging SGST & CGST at the applicable rates. The applicant wants to clarify the following issue:

– Whether the Hotel Accommodation & Restaurant services provided within the premises of the Hotel to the employees and guests of SEZ units, be treated as supply of goods & services to SEZ units in Karnataka or not?

Discussions by and observations of AAR

Supply of goods or services or both to a Special Economic Zone developer or a Special Economic Zone unit are treated as 'Zero Rated Supply' in terms of Section 16(1)(b) of IGST Act, 2017. Further Rule 46 of CGST Rules 2017 stipulates that the invoice shall carry an endorsement "Supply meant for export / Supply to SEZ unit or SEZ Developer for authorised operations on payment of Integrated Tax" or "Supply meant for Export / Supply to SEZ unit or SEZ Developer for authorised operations under Bond or Letter of Undertaking without payment of Integrated Tax" as the case may be.

Therefore on reading Section 16(1)(b) of IGST Act 2017 & Rule 46 of CGST Rules 2017 together it is clearly evident that the supplies of goods or services or both towards the authorised operations only shall be treated as Supplies to SEZ Developer / SEZ Unit.

The place of supply of the services by way of lodging accommodation by a hotel, shall be the location at which the immovable property (hotel) is located or intended to be located, as per Section 12(3)(b) of the IGST Act 2017. Also the place of supply of restaurant and catering services shall be the location where the services are actually performed as per Section 12(4) of the IGST Act 2017. In the instant case, the applicant is located outside the SEZ. Therefore the services rendered by the applicant are neither the part of authorised operations nor consumed inside the SEZ.

Since place of provision of services is location of the Hotel, the rendition of services of restaurant and short term accommodation cannot be said to have been 'imported or procured' into SEZ Unit/Developer. Hence, the supply is intra state supply.

Ruling of AAR

The Hotel Accommodation & Restaurant services being provided by the applicant to the employees and guests of SEZ units cannot be treated as supply of goods & services to SEZ units & hence it is an intra-state supply and taxable accordingly.

Author's comment

It seems that applicant has not drawn attention of AAR to the provisions of section 7(5)(b) of IGST Act, 2017 which provides that any supply of goods or service or both to SEZ unit shall be treated to be supply of goods or service or both in course of inter-state trade or commerce.

5. Shri Sanjeev Sharma – AAR Delhi (2018-TIOL-24-AAR-GST)

Facts, Issue involved and Query of Applicant:

Applicant plans to engage itself in development and sale of residential flats. It intends to acquire land by either purchasing land or entering into collaboration agreements with land owners for a specified share. Following agreements would be entered by the applicant:

– One for sale of undivided and impartible share in land; and

– Another agreement for sale of superstructure

The questions which the applicant seeks to clarify are as follows:

– Whether GST is applicable on agreement to sell the land and

– Whether GST is applicable on sale of superstructure (under construction), if yes then on what value and rate?

Discussions by and Observations of AAR

Sec 7(2)(a) read with entry 5 of Schedule III of CGST Act, 2017 specifically covers sale of land. Thus sale of land is not covered under the scope of supply and no GST is payable on the same. However, sec 7(1)(d) read with Entry 5(b) of Schedule II to CGST Act, 2017 specifically provides that construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration has been received after issuance of completion certificate, where required, by the competent authority or after its first occupation, whichever is earlier is a supply of service. It is observed that during the construction, land and its super structure becomes inseparable. Hence separate sale of land and its super structure does not appear to be permissible. During the hearings, the applicant was asked to submit a sample copy of such separate registered agreements. However, the applicant could not produce the same.

The supply in this case is a composite supply of land, goods used in construction and services undertaken by the applicant for doing the construction. Though GST cannot be levied on value of land, a deemed value of land needs to be ascertained for exclusion from the value of services. The abatement of 75%/ 70% as provided in the Service tax regime by a notification resulted in failure of statutory mechanism (held in *Suresh Kumar Bansal vs. UOI)* to ascertain the value of services involved in a composite contract. This was done away with in GST. Paragraph 2 of Notification No. 11/2017 – CT (Rate) dated 28-6-2017 issued under section 15(5) of CGST Act, 2017 specifically provides for one third of the total amount charged as the value of land. Rule 30 of CGST Rules, 2017 cannot be applied for valuation of land as there are express provisions for valuation of land.

Ruling of AAR

GST would be payable on two-third of the total amount including the amount charged for transfer of land or undivided share of land. Even if agreement is entered after part of construction is already completed, whole of the consideration would be added for payment of GST. The applicable rate of GST on two third of total amount is 9% (CGST) and 9% (SGST) under Notification No. 11/2017-CT (Rate) dated 28-6-2017 and parallel SGST notification.

6. GKB Lens Pvt. Ltd. – AAR West Bengal (2018-TIOL-42-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is a Re-seller and importer of Sun Glasses, Frames, Lenses, Contact Lenses, etc. having Head Office in West Bengal. Goods, namely, Optical Lenses and Frames for Spectacles and accessories are transferred from the Head Office in West Bengal to its branches in other States. Advance Ruling has been sought on whether such goods supplied to the branches in states other than West Bengal can be valued in terms of the Cost Price under the Second Proviso to Rule 28 of CGST Rules, 2017, instead of 90% of MRP as required under the First Proviso of the same Rule. Clarification is also sought by the applicant regarding the phrase "eligible for full input tax credit" as used in the second proviso of Rule 28.

Discussions by and Observations of AAR

Rule 28 deals with valuation of a supply when it is made between distinct or related persons. Supplies to these branches, therefore, qualify as supplies made between the distinct persons, and provisions of Rule 28 will be applicable for valuation of such supplies. Rule 28 provides that the value of a supply to a distinct person shall be the open market value, if available, of such supply. The First Proviso states that "Provided that where the goods are intended for further supply as such by the recipients, the value shall, at the option of the supplier, be an amount equivalent to 90% of the price charged for the supply of goods of like kind and quality by the recipient to his customer, not being a related person".

The Second Proviso to Rule 28 states "Provided further, that where the recipient is eligible for full input tax credit, the value declared in the Invoice shall be deemed to be the open market value of the goods or services.

The First Proviso to Rule 28, thus, is clear that where goods are supplied to a recipient for further supply as such, the valuation of these goods, at the option of the supplier, may be determined at 90% of the price that will be charged by the recipient to its customer, not being a related person. Whether or not the Supplier avails of this option is solely the discretion of the Supplier.

The Second Proviso to Rule 28 does not mention, unlike the First Proviso, "where goods are supplied to a recipient for further supply as such", nor is the Proviso barred to such goods when further supplied as such. In other words, the Second Proviso is applicable for both, goods further supplied to non-related customers and to goods used in and for the course of business. It is stated that the value declared in the invoices shall be deemed to be the open market value of the goods.

As input tax credit is not available unless there is an invoice or document of like nature [Section 16(2)(a)], the above proviso has to be interpreted with reference to specific invoices. Hence all Invoices or documents of like nature under Section 16 of GST Act, of goods for further retail sale or for use in the business (non-trading stock such as stationery and office equipment) transferred to branches are valid documents eligible for Input Tax Credit.

As per Section 17(1) where the goods (or services, or both) are used by the registered person partly for the purpose of any business and partly for other purposes, the amount of credit shall be restricted to so much of the input tax as is attributable to the purposes of his business.

In other words, the expression "where the recipient is eligible for full input tax credit", is to be considered in the light of Section 17(1) of GST Act, to mean that the recipient will be eligible to take full input tax credit of the amount of tax paid by the suppler as mentioned in the respective invoice or any other document valid under Section 16(2)(a) of GST Act.

Ruling of AAR

The applicant is eligible to value the goods by applying the terms of the Second Proviso to Rule 28 of GST Act.

The expression "where the recipient is eligible for full input tax credit" means that the recipient will be eligible to take full input tax credit as mentioned in the respective invoice or any other document valid under Section 16(2)(a) of GST Act.

7. Tathagat Health Care Centre LLP – AAR Karnataka ([2018] 93 taxmann.com 419)

Facts, Issue involved and Query of Applicant

The applicant is a cardiology specialised hospital running on a premises taken on lease. They are providing cardiology related lifesaving health care services to the patients and the said output services are exempt from GST. They have taken premises of one floor on rental basis from existing building of Mallige Hospital for heart care services only.

The applicant has sought advance ruling on the issue that 'whether GST is leviable on the rent payable by a Hospital, catering, lifesaving services?'

Discussions by and Observations of AAR

Renting in relation to immovable property is defined at Para 2(zz) of the Notification No. 12/2017- Central Tax (Rate) dated 28-6-2017 as "renting in relation to immovable property" means allowing, permitting or granting access, entry, occupation, use or any such facility, wholly or partly, in an immovable property, with or without the transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property.

The applicant has taken the premises on lease and running exclusive heart care centre providing health care services on commercial basis. The impugned service of rental or leasing services involving own or leased non-residential property is classified under the heading (SAC) 997212 and is taxable under GST. Further no specific exemption is available under any notification for the time being in force for the said service. Also there is no provision available in the Act which allows exemption on an input service if the output service provided by the taxable person is exempt.

Ruling of AAR

GST is leviable on the rent paid/payable for premises, taken on lease by the applicant.

8. M/s. Bahl Paper Mills Ltd– AAR Uttarakhand

Facts, Issue involved and Query of Applicant

A) The applicant wants clarification on whether under Reverse Charge Mechanism, IGST should be paid by the Importer on ocean freight in case of CIF basis contract, when service provider and service recipient both are outside the territory of India.

B) What supporting documents are required for importer under RCM to take credit of IGST paid on ocean freight under CIF basis contract?

C) Whether credit will be available in GST of office fixtures & furniture, AC plant & sanitary fittings on newly constructed building on its own account for furtherance of business and accounting entry is capitalized in books of account.

Observations and Rulings of AAR

A) As per Notification no. 8/2017- Integrated Tax (Rate) dated 28-6-2017 and notification no. 10/2017- Integrated Tax (Rate) dated 28-6-2017 an importer is required to pay IGST on the ocean freight. Therefore, even if the importer has already paid IGST on CIF value imported goods, he is still required to pay IGST on ocean fright.

B) Credit of IGST can be taken on the basis of invoice/challan issued.

C) As per *explanation* to Section 17 of CGST Act, 2017 credit is not available in respect of land, building or any other civil structure. Therefore, in view of the aforesaid provisions of law, ITC of GST paid in relation to building or any other civil structure is not available and since sanitary fittings are integral part of building or any other civil structure, ITC of GST paid on such sanitary fittings is not available. However, credit of GST is available on office fixtures & furniture, AC plant. CBIC Board Circular No. 943/04/2011-CX dated 29th April 2011 also clarified that goods such as furniture and stationery used in an office within the factory are goods used in the factory and are used in relation to the manufacturing business and hence credit of the same is allowed. Further the Hon'ble CESTAT, Principal Bench, New Delhi in the case of *M/s. Balkrishna Industries Ltd. vs. CCE, Jaipur-I vide* its final order no. A/53217-53218/2015 dated 9-10-2015 reported in 2016 (335) ELT 559 (Tri.-Del.) has held that the credit on duty paid on air-conditioners installed in the office of factory is admissible. Therefore the credit of input tax charged on the supply of fixtures & furniture and AC plant is admissible under CGST/SGST Act. 2017, provided that the registered person has not claimed depreciation on the tax component of capital goods and plant and machinery under the provisions of the Income-Tax Act, 1961.

9. M/s. Sonka Publications (India) Pvt. Ltd. – AAR New Delhi (2018-TIOL-30-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is in the business of publication of books for children (Hindi Books). The books printed by the publication house helps to educate children about the basics of Hindi language which includes teaching the students idioms, word formations, improving the vocabulary etc. The books are aimed with the objective to inculcate ethos and values in the minds of growing children. Apart from the textual matter, the book also includes various exercises for children like joining dots, drawing straight and curved lines. These books have a copyright of the content in it and are designed by authors unlike normal exercise books. The applicant has sought a ruling on:

– Whether its products – Sulekh Sarita Part-A, Sulekh Sarita Part-B and Sulekh

Sarita Parts 1 to 5 qualify to be 'printed books' or 'picture books' falling under HSN 4901 and 4903 respectively (exempted under Notification No. 2/2017 – CT (Rate) or 'exercise books' falling under HSN 4820 taxable at 12%.

– Whether a person is required to obtain registration u/s. 24 when it is engaged exclusively in the business of supplying goods which are not liable to tax or wholly exempt from tax falling u/s 23(1) but is also availing services from service providers where reverse charge is applicable as per Notification No. 13/2017 – Central Tax (Rate).

Discussions by and Observations of AAR

CBEC had clarified the issue *vide* Circular No. 1057/6/2017- CX dated 7-7-2017. From the Circular it was observed that the Headings 4901, 4903 and 4820 generally cover the following:-

1. Heading 4901 – This heading generally covers textual reading/books including textbooks, catalogues, prayer books etc. The heading 4901 specifically covers educational workbooks or writing books.
2. Heading 4903 – This heading generally covers children's picture, drawing or colouring books wherein pictures form the principal interest in the books.
3. Heading 4820 – This Heading generally covers stationery books. However, exercise books are specifically covered in this heading. Such books may contain simple sheets with printed lines or may even have printed examples of handwriting for copying by the students.

In the case of certain goods of Heading 4901 e.g. workbooks, there may be space for writing in addition to the printed text but printing is of primary use and space for writing is incidental. On the contrary, in case of certain goods of Heading 4820 e.g. diaries, exercise books, there may be considerable amount of printed matter but the printing is incidental to their primary use of writing by hand.

It is observed that the main feature which differentiates 'Work Book' of heading 4901 from the 'Exercise Books' of heading 4820 is that the 'Work Books' of heading 4901 contain questions or exercise with space for writing the answers whereas, the 'Exercise Books' of Heading 4820 contain printed texts with space for copying manually. With the abovementioned difference between the Headings 4901 and 4820, the samples submitted by the applicant have been examined and it is observed that in most of the pages, there is a printed text which the child is to copy, once or several times in the space provided. Only in very few pages, any printed exercise or questions are given. Further, since none of the pages have children's pictures, drawing or colouring matter, classification under 4903 is not possible.

Regarding Sec 22, 23 and 24 of CGST Act, 2017 dealing with registration, it is observed that the Sec 24 deals with compulsorily registration in certain cases. Sec 24 requires that if a person is required to pay tax under reverse charge, then he is compulsorily required to get registered irrespective of exemption provided in sec. 23 because without registration payment of tax under reverse mechanism would not be possible. Sections 22, 23 and 24 have to be read together and from the combined reading of the same it is held that the applicant is required to take registration if it has GST liability under reverse charge mechanism.

Ruling of AAR

– The products supplied by the applicant - Sulekh Sarita Part-A, Sulekh Sarita Part-B and Sulekh Sarita Parts 1 to 5 are to be classified under HSN 4820 and not under HSN 4901 or 4903.

– The applicant is liable for registration if it has GST liability under reverse charge mechanism irrespective of the situation that it has no liability to pay GST as supplier of goods and/or services.


CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES
Service Tax – Case Law Update

Citation: 2018-VIL-364-CESTAT-CHE-ST

Case: Commissioner of Service Tax, Chennai vs. Skylift Cargo (P) Limited

Background facts of the case

The respondents are engaged in the business of rendering Custom House Agent Service, Cargo Handling Service, Business Auxiliary Service and Goods Transport Agency Service. The SCN was issued to the respondents on various points, one of which being demand of service tax on terminal handling charges received from the customers. The respondents had filed an appeal before the Commissioner (Appeal) and the demand was dropped partly on merits & partly on the grounds of limitation. Further, the Commissioner (Appeals) has held that such charges are nothing but expenses recovered by the respondent and therefore not liable to levy of service tax under the category of Business Auxiliary Service. Being aggrieved by the Order of Commissioner (Appeals), the revenue has filed an appeal before the Hon'ble CESTAT.

Arguments put forth

The appellants submitted as under:

a) The respondents had not paid service tax on the terminal charges collected from their clients. The respondents had added their own margin and there is a difference between the amount charged by airport authorities and the amount collected by the service provider (respondent) from their clients.

b) Though the provider of custom house agent service is eligible for exclusion of expenses incurred by them, while providing taxable service, it is subject to the condition that the custom house agent recovers only such amount as has been paid by him as third party to procure such services that are received and used by their clients. Hence the respondents having collected additional service charges do not qualify within the scope of 'pure agent' and are liable to pay service tax on the terminal charges collected from the clients.

The Respondent submitted as under:

a) The show cause notice itself did not have much clarity as to what is the margin that is sought to be taxed under terminal handling charges.

b) The handling charges, service charges etc. are nothing but reimbursable expenses.

These are brought out from the ledger figures. The reimbursable expenses whether subject to levy of service tax was also under litigation and was finally settled by the Hon'ble Supreme Court in the case of *Union of India vs. Intercontinental Consultants and Technocrats Pvt. Ltd. – 2018 (10) GSTL 401 (SC) - 2018-VIL-11-SC-ST.*

Decision

a) The respondents have stated in the reply that the terminal handling charges sought to be taxed as per the SCN is rent paid to airport authorities for storing the cargo before loading the export consignment in flights. When immediate flights are not available the export cargo are stored temporarily at the premises of airport authorities and the rent paid to airport authorities is recovered from the exporters. The demand on these charges has been raised for the period 2006-07 and 2007-08 and the said activity is not service rendered to customers and airport authorities provides storage space and the charges are paid for the same.

b) The handling charges, service charges etc. are nothing but reimbursable expenses. These are brought out from the ledger figures. The issue whether the incentives / discounts received for booking of cargo space is subject to levy of service tax was under litigation and in the respondent's own case *vide* the final order cited supra held in favour of the respondent. Similarly, the reimbursable expenses whether subject to levy of service tax was also under litigation and was finally settled by the Hon'ble Supreme Court in the case of *Union of India vs. Intercontinental Consultants and Technocrats Pvt. Ltd. – 2018 (10) GSTL 401 (SC) - 2018-VIL-11-SC-ST.*

c) Al these issues were under litigation and therefore the contention of respondent that they were under *bona fide* belief that these amounts are not subject to levy of service tax and had not paid the service tax has been accepted by the Commissioner (Appeals) to set aside the part demand on the ground of limitation.

d) Further, no clarity is coming out either from the show cause notice or from the adjudication order and accordingly the Order passed by the Commissioner (Appeal) is confirmed.

Citation: 2018-VIL-366-CESTAT-DEL-ST

Case: Yash Motors vs. CCE, Jaipur II

Background facts of the case

The appellants are a dealer and selling vehicles to various customers. Along with selling the vehicles, they are also getting such vehicles registered with the local RTO on behalf of customers. The appellants are collecting some amounts from the customers, for getting the vehicle registered with the RTO and to cover other minor expenditures relating to such activity. The amount charged for such facilitation is in lump-sum manner and no headwise expenditure is being shown by them.

The Department is of the view that the amount as retained by the appellant on account of RTO handling charges is liable to service tax under Business Auxiliary Service. The Commissioner (Appeals) has confirmed the demand of service tax along with interest and equal amount of the penalty under Section 78 of Finance Act, 1994 has also been imposed

Arguments put forth

The appellants submitted as under:

a) Definition of Business Auxiliary Services does not cover recovery of above stated charges, as appellant is not providing promotion or marketing of service to the client or any customer care service on behalf of the client.

b) Appellant is helping their customer who purchases the vehicles with registration as per Motor Vehicle Act. Such registration is mandatory requirement for buying & driving any vehicle.

c) The decision of Hon'ble Tribunal the case of *Wonder Cars Pvt. Ltd. vs. Commissioner of Central Excise, Pune-I 2016 (42) S.T.R. 1055 (Tri.-Mum.),* has held that amount collected as extra charges for RTO registration is not covered under "support services of business and commerce".

The respondent submitted as under:

a) The respondents on the other hand submit that the Service Tax liability on the amount of RTO fees is the amount which is collected over and above the actual charges paid to RTO authorities. Since the amounts collected in excess of the amounts incurred, the same should be taxable.

Decision

a) The matter is no more *res-integra* as in the case of *M/s. Arpanna Automotive Pvt. Ltd. vs. CC & CE - 2016 (43) S.T.R. 397 (Tri. – Mumbai)* has held that helping the purchaser of vehicle with the registration with the RTO cannot be considered as an activity under Business Auxiliary Service. Since the facts of the case at hand are similar to that of *M/s. Arpanna Automotive Pvt. Ltd. vs. CC & CE,* following the above decision of the Tribunal, it was held that the charges received and retained by the applicant from the customers for facilitating RTO registration is not chargeable to service tax under business auxiliary service.

Citation: 2018-VIL-351-CESTAT-DEL-ST

Case: Cummins Technology India Limited Vs CCE & ST, Meerut II

Background facts of the case

The appellants are engaged in the manufacture of Turbo Chargers, parts, components and assemblies. The appellant was registered as a unit in SEZ by Government of India. As a unit under the SEZ scheme, the appellant was allowed to procure the goods and services without payment of any duty and service tax as per the provisions of Rule 27 of the SEZ Rules, 2006. The Government of India had issued Notification No. 9/2009-ST dated 3-3-2009, under which an exemption is granted to services provided to unit or developer under SEZ. Such exemption is administered by way of refund claim. In this case, the appellant had filed the refund claim of service tax paid on the input services. Out of such refund amount, major portion of the refund claim was rejected on the ground of non-compliance of certain conditions provided in Notification No. 9/2009-ST dated 3-3-2009.

Arguments put forth

The appellants submitted as under:

a) Appellant is exempted from payment of service tax on the services received by its SEZ unit in view of exemption provided under Section 27(1)(e) of the SEZ Act, 2005. He further submitted that the Notification No. 9/2009 as amended cannot prescribe additional conditions, which are not provided in Section 27 of the SEZ Act.

b) It was further submitted that the phrase "prescribed manner" mentioned in Section 26(2) of the Act has been provided under Rule 31 of the SEZ Rules, 2006, whereby it is stated that exemption from payment of service tax shall be to any service provider for use in the authorised operation in SEZ.

The Revenue Respondent submitted as under:

a) It was submitted that since the conditions have not been complied, the refund has been rightly rejected.

Decision

a) On perusal of the provisions of the SEZ Act and Rules contained in Section 26(2) of the Act read with Rule 31, it reveals that such statutory provisions have not prescribed any conditions/stipulations for grant of refund of service tax paid on the taxable services for providing SEZ activities. However, the Central Government has issued Notification No. 9/2009-ST dated 3-3-2009 and the amending Notification No. 15/2009-ST dated 20-5-2009, by providing certain conditions for claim of refund by the SEZ unit/developer. Since the SEZ Act and the rules have not provided any conditions for granting exemption from payment of service tax, the Central Government cannot issue the notification under a different statute i.e., Finance Act, 1994 by providing the conditions for grant of refund of service tax paid on the taxable services used for the authorised operations in the SEZ.

b) Further, by virtue of Section 51 of the SEZ Act, the provisions of the said Act and the Rules made there under are mandated to have overriding effect over the provisions contained in any other statute. Therefore, all the activities relating to SEZ shall be guided and governed by the provisions contained in SEZ Act and the SEZ Rules.

c) In context with the amending Notification No.9/2009 dated 3-3-2009 and 15/2009 dated 20-5-2009, this Tribunal in the case of Reliance Ports & Terminals Ltd. 2015 (40) STR 200 (Tri.) has held that the same notification has been issued only to operationalise the exemption/immunity available to SEZ unit under Section 26(1) (e) of the SEZ Act, 2005.

d) Accordingly, the Order of Commissioner (Appeals) is set aside and the appeal is allowed in favour of the appellant.

Citation: 2018-VIL-355-CESTAT-DEL-ST

Case: M/s. Oil and Natural Gas Corporation Ltd. vs. CCE & St, Meerut-I

Background Facts of the case:

The appellants are registered service tax assessees for payment of service tax under the category of Maintenance or Repair Service, Scientific and Technical Consultancy Services, Erection, Commissioning and installation Services, Consultancy services etc. During the period from October, 2007 to December, 2012, the appellants availed total CENVAT credit of ₹ 4.48 crores for one of Division set up in Dehradun i.e. Keshav Dev Malviya Institute of Petroleum Exploration (KDMIPE). The total value of taxable services provided during the said period was about ₹ 19.74 crore, and the service tax liability of about ₹ 2.09 crore was discharged by the appellants out of CENVAT credit.

Service Tax audit was conducted and it was observed by the audit team that major portion of the input service was being used for their own organisation and only a very small portion in providing of output taxable service to other service recipients . The department issued show cause notice to recover excess CENVAT credit amounting to ₹ 4.42 crore availed by the appellants by adopting a ratio of their output taxable service divided by total expenditure incurred during the year and proceeded to restrict the CENVAT credit availed alleged on the basis of the said formula. Extended period of limitation was also invoked on the allegation of suppression of facts. Present appeal is filed for setting aside the Order upholding disallowance of CENVAT credit and waiver of penalties.

Arguments put forth

The appellants submitted as under:

a) The KDMIPE is a unit of ONGC which caters to the requirement of all other units of ONGC and also renders service to outside parties. In respect of activities carried out by the Institute for other ONGC Divisions, no consideration is charged or received but each Division of ONGC was a separate cost centre only for purposes of internal accounting.

b) Since no consideration was separately charged, there was no question of paying service tax. Such activities were included as 'exempted service' only with effect from 1-4-2016 u/r 6 of CENVAT Credit Rules, 2004, which is not applicable for the impugned period.

c) The Revenue is not justified in disallowing the CENVAT credit covered within the definition of input services, by taking recourse to a formula which does not have any statutory backing.

d) Further, ONGC as well as Institute is a Public Sector Undertaking whose activities are in the public domain and the Revenue cannot allege any suppression with intent to evade payment of Service Tax on the part of such a Public Sector Undertaking.

The Revenue Respondent submitted as under:

a) There is no co-relation between the input service availed with the output service rendered. The other Divisions of ONGC having separate registration and as service rendered to other ONGC units are to be considered as exempt service and hence he justified the reversal of CENVAT credit.

Decision

a) The CENVAT credit accumulated was disproportionately high in relation to total service tax liability payable for the output service. The Department worked out the ratio of the value of total output service in relation to the total amount of expenditure incurred during the year and proceeded to restrict the CENVAT credit allowable in the same ratio. There is no basis in the statute for adopting such a formula for restricting the entitlement of the CENVAT credit on input services.

b) In the absence of any ground by the Department that the credit availed is in respect of ineligible input services, appellants cannot be denied CENVAT credit availed by them.

c) Once the CENVAT credit has been availed in respect of input services falling under Rule 2(l) the same cannot be disallowed by taking recourse to any thumb Rule or formula, when the provisions for reversal of CENVAT credit being specifically spelt out in CCR, 2004

d) The service, if any, rendered by KDMIPE to other ONGC Divisions is in the form of service to self and levy of Service Tax is not justified. Explanation (3) to Rule 6 of CCR, 2004 was amended only w.e.f. 1st April, 2016 to cover such transactions within the ambit of "exempted services" and cannot be applied to the period covered in the present appeal. The impugned order is set aside.

Citation: 2018-VIL-357-CESTAT-ALH-ST

Case: M/s. Arun Enterprises vs. CCE, Ghaziabad

Background Facts of the case

The appellants are engaged in the manufacture of Meter Pillar Boxes filing. On being pointed out by the audit party on scrutiny of records, the appellants discharged service tax amounting to ₹ 15,31,000/- on the amount shown as "other income" under the head of "Business Auxiliary Services (BAS)".

Subsequently, appellants realised that the said "other income" was on account of differential cartage & transportation charges and the service tax thereon should have been payable under the category of "Goods Transport Agency Services (GTA)". Nevertheless, since the GTA Services availed by them were for inward as well as outward transportation, which were eligible Cenvatable input services, the appellants avail the credit of the above service tax paid by them.

The Department contested that appellants have paid service tax under the category of "BAS" & not in respect of GTA services, which cannot be held to be input service. The appellant is not entitled to avail the *suo motu* credit. Hence, the present appeal is assailed on merits as well as limitation.

Arguments

The Appellants & Respondents reiterated their above submissions:

Decision

a) The dispute essentially relates to the fact that as to whether the 'other income' shown by the appellant was taxable under the category of "BAS" or "GTA". Revenue has not shown any detailed evidences to reflect upon the fact that the said 'other income' was taxable under the category of "BAS", also there is nothing on record to show that the appellant has provided the services under the said category.

b) Merely because appellants have discharged service tax under BAS, would not reflect the fact that appellants have provided services under the said category. More importantly, when the appellants contend that said 'other income' was on account of the differential cartage and would fall under the category of "GTA service". Further, since it is Cenvatable input services, tax paid by them is eligible for cenvat credit.

c) As regards the issue of limitation, the credit was availed by reflecting the same in the CENVAT credit account, in which case it cannot be said that there was any *mala-fide* suppression on the part of the appellant. Further, the audit party has also found out the said fact from the scrutiny of the records maintained by the appellant. The demand raised by invoking the longer period of limitation is not sustainable and is liable to be set aside.

d) The reliance placed by the Respondents on the Larger Bench decision in the case of *BDH Industries Ltd. (2008 (229) E.L.T. 364 (Tri. – LB- MUM)* cannot be taken shelter in the instant case, as the Hon'ble Bench observed that appellant was not entitled to take *suo motu* refund without the sanction and permission of the authorities. However, the present case is not a case of refund but a case of availment of credit of Service Tax paid by the appellant on GTA Services, which is admittedly, a Cenvatable input service.

e) The impugned order confirming the demand and imposing penalties is set aside.

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Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Company Law Update

Case Law # 1

[2018] 208 Comp Cas 360 (SC)

[In the Supreme Court of India]

Bengal Chemists and Druggists Association vs. Kalyan Chowdhury

Where there is a special provision contained in section 421(3) of the Companies Act, 2013, which is a peremptory provision providing 45 days period for making appeal to Appellate Tribunal and also provides for additional period not exceeding 45 days for filing appeal subject to condonation of delay in such cases, provisions of section 5 of the Limitation Act cannot apply.

Brief

This appeal has been filed by the Bengal Chemists and Drug Association ("Appellant") against the judgment and order of the National Company Law Appellate Tribunal, New Delhi ("NCLAT")

The appellant had lost petition filed by one of its member for oppression and mismanagement related to holding AGM under section 397 of the Companies Act, 1956 ("CA56") before the NCLT, Kolkata Bench.

Aggrieved by the said order of NCLT, it has appealed against the said judgment before the NCLAT as provided under section 421(3) of the Companies Act, 2013("CA13"). However, the Appellant had delayed in filing the appeal and had also applied for the condonation of delay before the NCLAT. The NCLAT has rejected the said application for condonation by citing the provisions of section 421(3) of CA13 and period given in the said section.

Against the order of NCLAT, the appellant has approached the Supreme Court.

The Supreme Court has reviewed the provisions of the CA13 and made the following observations.

1. Provisions of section 421(3) of the CA13 provides that the appeal under section 421(1) allows any person, aggrieved by an order of the Tribunal to make an appeal against it before the Appellate Tribunal.
2. It also states that the order of the Tribunal against the order of the Tribunal must be filed within 45 days from the date of copy of Tribunal order made available to such person.
3. The Appellate Tribunal may entertain the appeal beyond 45 days with a valid reason.
4. Section 433 of CA13 provides that the provisions of the Limitation Act, 1936 ("LA") shall, as far as may be, apply to proceedings or appeals before the Tribunal or the Appellate Tribunal.
5. Section 421(3) clarifies that it provides a period of limitation which is different from the period as provided under the provisions of LA.

6. Section 433 of CA13 which provides that the applicability of LA to any appeal etc., can not come to aid because the LA provisions only apply "as far as may be".
7. Where there is a special provision contained in section 421(3) of CA13, section 5 of the LA cannot apply.
8. This is peremptory provision, as the 45 days is a period of limitation and the additional period of not exceeding 45 days provided, is only if the sufficient cause for delayed filings in appeal has been justified.
9. The judgment of this Court in *Chhattisgarh State Electricity Board vs. Central Electricity Regulatory Commission [2010] 5 SCC 23* has been referred.
10. In the above Judgment, the similar situation was identified in relation to provisions of section 125 of the Electricity Act, 2003 which is similar to the language of section 421(3) of CA13 which can be considered against the provision of Section 5 of LA.
11. In the said Judgment, this Court has upheld that section 5 of LA cannot apply when section 125 of Electricity Act, 2003 has specific provision in relation to the other periods or timelines for filing/submission.
12. The above judgment was reiterated in *ONGC vs. Gujarat Energy Transmission Corporation Ltd. [2017] 5 SCC 42.*

The Court has also reviewed the reliance placed by the Appellant in the following judgments:

1. In case of *Guda Vijayalakshmi vs. Guda Ramachandra Sekhara Sastry [1981] 2 SCC 646* filed under section 25 of the Code of Civil Procedure, 1908, the preliminary objection was related to section 21 and 21A of the Hindu Marriage Act 1955. The Court has turned down the appeal stating that such provisions would not apply to substantive provisions of the Code.
2. In case of *Dr. Partap Singh vs. Director of Enforcement [1985] 3 SCC 72,* section 37 of the Foreign Exchange Regulation Act, 1973 ("FERA") was referred. Section 37(2) of the FERA provides that the provisions of the Code relating to searches shall, "so far as may be", apply to the searches directed under section 37(1) of the FERA. It was held in said case too that "so far as may be", in 37(2) should be interpreted with a meaning that broadly the procedure relating to search as enacted in section 165 of the FERA shall be followed".

The Court has observed that both the above judgments are misfit while referring to the facts of present case. It is observed that the expression "so far as may be" only means to the extent possible.

The third judgment as relied by the appellant was related to the case of *Mangu Ram vs. Municipal Corporation of Delhi [1976] 1 SCC 392.* In the said judgment, section 417(4) of the Code of Criminal Procedure, 1989 provides that special leave to appeal from an order of acquittal should be filed within 60 days from the date of the order. The court has applied section 29(2) of the LA and said that section 5 of LA would not be impliedly excluded in such cases despite the mandatory and peremptory language of section 417(4). The Court has viewed that the above case applies only to a period of limitation as to whether delay may be condoned beyond such a period.

The Court also considered the difference between the expression used in the Arbitration Act as construed in *Union of India vs. Pupular Construction Co. [2001] 8 SCC 460* and its absence in the proviso in section 421(3) of CA13. The Court has also analyzed in the same ratio and as reason given in Mangu Ram case as aforesaid, this would also make no difference in interpreting the language of section 421(3) of CA2013 which contains the mandatory or peremptory negative language and states that second period not exceeding 45 days, means the expression "not thereafter" used in section 34(3) of the Arbitration Act, 1996.

Judgment

On the above grounds, the Court has dismissed the appeal.

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Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Recent Developments

The Companies (Amendment) Act, 2017 – PART I
Major Amendments – Impact & Analysis

The enactment of the Companies Act, 2013 ("Act") which overhauled the erstwhile Companies Act, 1956 has much stringent compliance requirements from all the stakeholders. While the Act was a step in the right direction as it introduced significant changes in areas of disclosures, investor protection, corporate governance, etc., there were multiple issues on interpretation and compliances. To address the stakeholder concern, Government has amended the Act from time-to-time. The Companies Amendment Act, 2017 was notified on 3rd January, 2018.

The summary of some important amendments as set out in the Companies Amendment Act, 2017 are given as below:

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
1.	2(6)	Associate Company	The definition has been amended with alteration and clarification. In place of the existing explanation, the new expression has been substituted as follows: a. The first alteration is that for determining the clause "significant influence" in the definition of associate company - instead of the words "total share capital" (which means equity and preference shares), NOW it is replaced with "Total voting power". This is beneficial to various investors, who have majority holding by way of optionally or fully convertible securities. Further due to use of the language as "total share capital", such investors were considered as holding company wherein they had to get their accounts consolidated due to investee company being considered as "associate company".

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			b. It has also clarified as to what the term "Joint venture" means, it has provided that Joint venture means a joint arrangement whereby the parties having joint control of the arrangement have rights to the net assets of the arrangement. The above changes are also relevant for consolidation of accounts and RPT and other disclosure purposes as required under the Act.
2.	2(46)	Holding Company	Prior to the amendment, the holding company means a "company of which such companies are subsidiary companies" which means a company as incorporated under the Act or previous Companies Act. This has led to ambiguity with regards to subsidiary of foreign companies, which are not a company but consider as "Body corporate". With this amendment, an Explanation has been provided to define the term "company" in the definition of holding company wherein company will NOW include body corporate as well. One has to cross verify the implication of the above definition with the following: a. As body corporate also includes an LLP, can LLP be considered as a holding company? b. Nature of holding company whether private or public company - as compliances of the Act related to consolidation of accounts, RPT inter-corporate loans depends on the constitution of the holding company.
3.	2(57)	Net worth	The definition before this amendment did not have debit and credit balance in profit and loss account as part of "net worth" which created a practical issue for a company for e.g. a company may not have securities premium amount but has a good amount of accumulated net profits in their accounts. In such situation by virtue of the earlier definition, the company had to exclude the amount of accumulated profits while calculating net worth. This lead to sometime lower net worth than what actually it should have been. NOW, the amendment has provided that while calculating net worth debit and credit balance in the profit and loss account shall be considered. This is also in align to the definition of "free reserves" as defined in section 2(43). Also, due to the said amendment a clarity is sought on the terms used in other sections of the Act viz., CSR, Board power restrictions under section 180, acceptance of public deposits or requirement of cost audit.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
4.	2(76)	Related Party	Earlier the sub clause (vii) used the word "company"which means the relation with the holding or subsidiary or associate company shall be applicable to a company incorporated in India only. In other words, a company incorporated outside India which could be a holding subsidiary or associate company of a company incorporated in India may not be considered for related party transactions. In order to clarify the overall intention of compliance for various RPT, the existing sub-clause (vii)(A) & (B) has been replaced with new sub clause (vii) (A), (B) & (C). NOW, the applicability of transactions is to be considered with a "body corporate" and not with a "company" as used earlier. Thus a company incorporated outside India and which is a) a holding, subsidiary or an associate company of an Indian company or b) a subsidiary of a holding company to which it is also a subsidiary will be considered as related party. Further a new sub clause (C) now provides"an investing company or a venturer"which is a body corporate will also be considered as a related party in relation to any transaction with the Indian company. The explanation says that "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate. The above brings clarity on the relationship of an Indian company and its holding / subsidiary, associate, investing company or a venture company incorporated outside India to be considered as "related party" for any transaction with the company.
5.	2(87)	Subsidiary Company	This change is more in line with what is proposed for "associate company definition" the criteria to have holding-subsidiary relationship is changed from "total share capital" (which means equity and preference shares) to "Total Voting Power"; thus, only equity share capital shall be considered for voting power. However, while considering total voting power, one has to verify the relationship for each year taking into account, any voting power granted to the preference shareholders under section 47 of the Act for non-payment of dividend for two years.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			The said amendment may provide relief to many investment companies having investment in the nature of OCP /CCP of more than 50% of total share capital but not "total voting power". These companies are NOW not required to consider the investee company as their subsidiary.
6.	92(4) & 92(5)	Annual Return	The amendments are as follows: Section 92(1)(c) stands deleted in reference to the term "indebtedness". Section 92(1)(j) - the details of Foreign Institutional Investors like, names, address, country of incorporation is no more required to be given. New proviso added after existing proviso to section 92(1) wherein the Central Government may prescribe an abridge annual return for OPC/ Small company or other class or classes of companies as may be prescribed. Existing Section 92(3) which requires that every company to attach the extract of annual return in form MGT–9 with Board report is NOW substituted with a new sub-section (3) which NOW requires that the company having a website, if any, has to place on its website the annual return and the web link of such annual return needs to be disclosed in the board's report. In sections 92(4) and 92(5), the reference to section 403 for additional time of 270 days as granted earlier for filing annual return is deleted. Thus, company must file the return within prescribed time or else the company has to pay additional fees / other consequences. Please refer the amendments to section 403 below for consequences of late filings etc.
7.	100	Calling of extraordinary general meeting	The new proviso added to section 100(1) whereby Extra-ordinary General Meeting ("EGM") of the company shall be held at any place in India provided, EGM of a wholly owned subsidiary of a company incorporated outside India may be held outside India. Earlier, this formed part of explanation to Rule 18 of the Companies (Management and Administrations) Rules, 2014. However, it has now increased its scope for WOS of a company incorporated outside India to hold EGM outside India also.
8.	110	Postal Ballot	At present, Rule 22 (16) of the Companies (Management and Administration) Rules, 2014 provides that all companies except OPC and other companies having up to 200 members are not required to comply with postal ballot requirements.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			At present, there are around 10 matters which need to be approved by the shareholders by way of postal ballot. These matters are such as alteration of object clause, change in place of registered office to outside local limit or city, change in objects of IPO, issue of shares with differential rights, buy-back of shares, sale of substantial undertaking etc. Further, the amended section 108 read with Rule 20 of the Companies (Management and Administration) Rules, states that a listed company and every company with a member not less than 1000, must provide voting by electronic mode facility. The main purpose of postal ballot is to have participation of majority shareholders, which can now be achieved through electronic mode too. Thus, the proposed proviso to section 101(1) provides that in case of a company, which has to provide electronic facilities for voting, may transact the business in a general meeting and hence is not required to conduct it through postal ballot. As many a times, company has called for AGM/EGM for certain matters, but one of the matters may require a postal ballot and hence a separate and a parallel process had to be carried out for approving such matters through postal ballot besides holding AGM/EGM. This may save time as well as cost for the companies.
9.	123	Declaration of dividend	In sub-section clause (b) has been replaced with a new clause (b) wherein the amendment has NOW clarified that for computing profits for dividend payout – any amount representing unrealised gains, notional gains or revaluation of assets and any changes in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded. Sub-section 3 is replaced with a new sub-section 3 which NOW allowed the Board of a company to declare interim dividend for any financial year or at any time during the period from closure of the financial year till holding of the annual general meeting. Further, the amendment also allows the company to consider profit of the financial year till the quarter immediately preceding date of declaration for declaration of interim dividend. Thus, this will allow more ease for the companies to calculate the actual profits till year end or end of the quarter preceding the date of interim dividend. This will also reduce the compliances and shorten the process of declaration of dividend

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			as interim dividend is to be declared by the Board and not the shareholders and thus company is not required to wait for the shareholders approval for final dividend till the date of AGM.
10.	129	Financial Statements	Now, with replacement of sub-section (3) of section 129 with new sub-section (3), it has provided for preparation of consolidated of accounts which includes "associate company and also joint-venture".
11.	134 Not yet notified	Financial Statement, Board report, etc.	Earlier, under sub-section 1 of section 134, the Managing Director was one of the requirements to sign the financial statements ("FS'), which had a practical issue when a company did not have a Managing Director or was not required to appoint a Managing Director. Further, the CEO is also required to sign only if, he is a director on the Board. However, a CFO and CS had to sign the FS irrespective of being a director on the board. The sub-section 1 has been replaced whereby, the managing director has to sign the FS, if any person is appointed so, however, CEO who is also a KMP has to sign the FS, irrespective of whether he is a director or not along with the CFO and CS of the company, if any.. Sub-section (3) related to disclosing certain information in Board's Report is also amended as follows: a. No more requirement of attaching the extract of annual return in Form MGT9 with Board report. Instead, board report has to provide the web address, if any where annual return as per section 92(3) has been placed. b. Also, it has been clarified that where disclosure referred to in this section have been included in the financial statements viz. Disclosures on loans u/s. 185 or investments u/s 186, related party contracts u/s. 188, managerial remuneration etc., then reference to such disclosure has to be provided in the Board report, thereby avoiding repetition of such information. c. For polices referred under clauses (e) and (o) related to company's polices under section 178 on director's appointment and remuneration and other matters as mentioned therein as well as on CSR, then instead of giving details, salient features of such polices provided in Board report and web address where complete policies can be available.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			A new sub-section (3A) is inserted giving powers to the Central Government to prescribe an abridged Board's report, for the purpose of compliance with this section by a One Person Company or Small Company.
12.	139	Appointment of Auditors	The existing proviso to sub-section (1) in relation to ratifying the Auditors' appointment at each AGM has been deleted. Prior to this change, there was ambiguity that whether the non-ratification of the Auditors' appointment at each AGM by the Shareholders shall tantamount as "Removal" since it cannot be considered as "Resignation". Further, the Companies (Audit and Auditors) Rules 2014 *vide* proviso to Rule 3 (7) has provided an explanation that the Board can appoint new auditor after following the procedure laid down in the Act. As per section 140(1), the removal of auditor before expiry of his term can be done only through special resolution. This inconsistency has NOW been removed. Thus, there is no need to place the agenda about the ratification of auditor's appointment before the shareholders at AGM every year.
13.	140	Removal, resignation of auditor and giving of special notice.	Under current scenario if the auditor resigns or has been removed, he is required to file Form ADT-3 with the RoC within 30 days from the date of resignation with a reason for intimating his resignation. The penalty for non-filing of such form with the RoC is INR 50,000/-. NOW, the amendment has been made in relation to the penalty for non-compliance under this section which is INR. 50,000/- or the remuneration of the auditor whichever is less.
14.	141	Eligibility, qualifications and disqualifications of auditors.	The amendment to the existing sub-section (3)(i) which has been replaced with new clause (i) NOW clarifies that a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company shall not be appointed as a statutory auditor. Further, the term "directly or indirectly" shall have the meaning assigned to it in the Explanation to section 144.
15.	143	Powers and duties of auditors and auditing standards.	The proviso to sub-section (1) has been altered. Prior to this alteration, the auditor of the holding company had a right to access to books of its subsidiaries for the purpose of consolidation of accounts. While the consolidation under section 129(3) does includes Associate companies, however for the sake of clarity, it is NOW provided that the auditor of the Holding company has a right to access the records of associate companies as well for the consolidated purposes.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			The alteration to clause (i) of sub-section 3 clarifies that with reference to the term "adequacy of internal financial control system", it is NOW specifically linked and referred to the financial statements.
16.	149	Company to have Board of Directors	The amendments are as follows: 1. Sub-section (3) has been substituted and it is now required to consider a person for residential directorship, he or she having stayed in India for a minimum period of 182 days in a financial year, instead of previous calendar year. Hence **NOW** the company must consider the current financial year instead of previous calendar year for considering the status of being a resident for a director in India. 2. Further a proviso has also been added for newly incorporated companies,wherein the requirement of 182 days for the resident directors shall apply proportionately at the end of financial year in which the company is incorporated. 3. Clause (c) and clause (d) of sub-section 6 has been substituted in definition of Independent director wherein the term "pecuniary relationship" has been replaced by elaborating what should be consider as "pecuniary relationship" which are as below: (a) withdrawing remuneration in the capacity of Independent director or having transaction not exceeding ten per cent of his total income or such amount as may be prescribed either in the company, its holding or subsidiary or associate company. (b) With regards to interest of proposed Independent director's relatives, the earlier requirement has **NOW** been made more stringent by with broader coverage on detailed transactions as follow: (i) none of whose relatives has transactions or interest with its holding, subsidiary or associate company holding security of face value exceeding INR 50 lakh or two per cent of the paid-up capital for such higher sum as may be prescribed; during the two immediately preceding financial years or during the current financial year: (ii) is indebted or their promoters, or directors, in excess of such amount as may be prescribed during the two immediately preceding financial years or during the current financial year;

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person associate company or their promoters, or directors of such holding company, for such amount as may be prescribed during the two immediately preceding financial years or during the current financial year; or (iv)has any other pecuniary transaction or relationship amounting to two per cent. or more of its gross turnover or total income singly or in combination with the transactions referred to in sub-clauses (i), (ii) or (iii); 4. The amendment of clause (e)(i) of sub-section 6 has NOW added a proviso and clarified that with regards to holding of KMP position by Independent director himself or his relatives in the company or its holding, subsidiary or associate company in any of previous three financial years, any relative, who is only an employee for above period shall not be consider. Thus, the above amendments help to seek more clarity in determining the materiality test for any Independent directors with regards to his or her "pecuniary relationship".
17.	164	Disqualif-ications for appointment of director	Earlier, if a person has been appointed as a director of a company, who has already defaulted for continuous 3 financial years in filing of the financial statements or Annual Returns or repayment of deposit and dividend etc., as per sub-clause (2), then such director was also immediately considered as a disqualified director and may be considered as "vacated the office immediately" due to provision of section 167 (1)(a). Thus to clarify such situation in cases wherein new directors are appointed in already defaulted companies, the proviso has been **NOW** added to sub-clause 2, whereby such newly appointed director shall not incur the disqualification for a period of six months from the date of his appointment. The above amendment should also be read with now amended section 167(1)(a), whereby the above disqualified directors are deemed to have vacated office as a director in all other companies except in the company in which they have defaulted. The proviso has also been added to sub-section (3), whereby it is **NOW** clarified that person having disqualified as per clauses (d), (e), and (g) of sub-section (1), then his or her disqualification shall continue, even if, an appeal or petition has been filed petition against such disqualification or conviction.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
18.	173	Meetings of Board	The sub-section 2, allows the board meetings to be conducted even through video conferencing and directors can participate and can be counted for quorum too. However, by Rule 4 of the Companies (Meetings of Board and Its powers) Rules, 2014, certain matters like approval of annual financial statements, board report etc. are not allowed to be transacted in such meetings. This allows the directors who are either not available at meeting place or foreign directors who otherwise are not able to attend to participate and provide their important contributions but may be held liable as "officers in default" by virtue of provision of clause (vi) of section 2(60). Further, this also restricts wider participation by board in such important matters. The amendment has added a new proviso after the existing proviso to sub-section 2 and allows the participation by any director through video conferences for such matters which by Rule 4 as above and are allowed to be conducted only in a board meeting, where directors forming quorum are physically present. However, proviso has also been provided that such participation is allowed only, if the quorum in a said board meeting through physical presence of directors, which is in line with Rule 4 requirements. This is a good corporate governance move as the directors are now able to participate and provide their views on the company financials and other important matters. Further this may shelter the directors from any non-compliances because earlier he was not allowed to participate through video-conference but happens to receive the minutes of such meeting and could be considered as his consent and approval for the proceedings of the minutes and decision taken thereof. The Directors can now participate in the proceedings of the meeting and vouch for the correctness of the minutes including noting of his reservation or comments on any matter.
19.	185	Loan to directors, etc.	The entire section 185 has been replaced with new section 185. As the section prohibits loans to related persons which even included the private companies which were otherwise exempted under section 295 of the Companies Act, 1956. This has also created issue as to giving loan or guarantee to subsidiary company. Even, when, there is a genuine proposal, there was no provision to get permission of shareholders or Central Government. While there were many exemptions given, however, overall the provisions were more complicated. The revised section has simplified and clarified the process-as to how to give loan and whom to give loan.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			The sub-section (1) prohibits giving loan or provide guarantee etc. to any director, director of a holding company, firm where he or his relatives are partners. Sub-section (2) has provided for the process of giving loan. It now provides that with a special resolution passed by the shareholders with all detailed explanation, a loan may be provided, guarantee or security may be given in case of other entities where the director is interested (but not the entities as per sub-section 1) the main condition is that such loans shall be utilised by the borrowing company for its principal business activities. The entities to whom the loan can be given are: (i) Any private company to which he is a director or member; (ii) Any body corporate where he is alone or with other directors exercise or control total voting power of not less than 25 per cent; (iii) Any body corporate whose directors, managing director is accustomed to act as per instruction of director or board of the lending company; Further the loan can be given to any managing/WTD or any employee as part their service conditions or scheme approved by members. It also allows giving loan, guarantee or security to WOS. In case of other subsidiaries apart from WOS, then the lender can provide guarantee or security. The above simplification made easy to give loan, however earlier for certain private companies who does not have any body corporate as a shareholder or borrowings with the banks of less than ₹ 50 crores or twice of its paid up share capital whichever is less and not defaulted in repayment of such borrowings then this section was not applicable. Due to above exemption, such private companies were able to give loan to its directors or the firm in which they are interested. NOW in the new amended section this may not be possible unless exemptions granted earlier are restored

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
20.	186	Loan and investment by company	The earlier provisions of sub-section 2 has used the words "any person" for the purpose of giving loan or guarantee which included even the employees of the company. As a common practice, companies are providing loans or facilities to its employees including for ESOP etc., the provisions implied that it also covers under the overall limit of loan as well as attracts minimum levy of interest as provided in sub-section 7. The amendment made to sub-section (2) where by an explanation has been added so as to clarify that the term "persons" for the purpose of section 186(2) excludes employees who is in the employment of the company. With this change, any loan given as a part of the condition of service or pursuant to a scheme approved by all employees of the company, is not covered in this section. The sub-section (3) has been substituted with new sub-section. The new sub-section provides relaxation from the requirement of passing special resolution, where loan/guarantee/security is provided by a company to its WOS or a joint venture company or acquisition by subscription or otherwise shares company by the holding of its WOS provided the same shall be disclosed in financials in accordance with section 186(4). The explanation (a) after sub-section 13 has been amended and clarified that for investment company, 50% or more of its assets consist of investment in shares and securities and also income from such investment up to 50% of its income. This explanation is on the same line as in what does RBI consider for NBFC registration.
21.	403	Fee for filing, etc.	The amendments to this section read with The Companies (Registration Offices and Fees) Second Amendment Rules, 2014 dated 7th May, 2018 has NOW made stricter provisions and has imposed an increase in the fees and penalties with respect to the compliances related to all the statutory filings of forms / returns / documents to be filed under the Act. It has replaced the first and second proviso to sub-section (1) with new provisions. The existing amendments are as follows: a. First, it has removed the additional period of 270 days allowed for filing various forms beyond the 30 days limits as specified in the respective sections in the Act. b. It is NOW implied that, once the statutory period of filings ends, which is generally a 30 days period or 60 days in case of annual returns, then the levy of additional fees starts.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			c. For late filing of forms like AOC4/AOC4XBRL/MGTC as to audited accounts and annual returns, the additional fees is ₹ 100/- for each day default. d. For balance sheet and annual returns to be filed under the erstwhile Companies Act, 1956, up to June 30, 2018, 12 times of normal fees. From 1st July, 2018, in addition to 12 times of normal fees, per day ₹ 100/-. e. If there is default on two or more occasions, in filing of forms or returns, then payment will be double the additional fees as applicable. This provisions may lead to an issue as from which date, one has to check that whether there was delay in filing of forms for more than two occasions. Further, whether two times default is of any forms or particular forms. In general, most of the companies might have this non-compliance in the past. Does that mean, from NOW onwards, each form filing will attract payment of double fees. f. All the above default is without prejudice to any other legal actions or liability under this Act.
22.	446A New Section inserted	Factors for determining level of punishment	This is new provision and provides for parameters to be considered by the court or a special court while deciding the amount of fine or imprisonment. The parameters are as follows: a. Size of the company; b. Nature of business; c. Injury to public interest; d. Nature of default; and e. Repetition of the defaults.

References

1. Highlights of the Companies (Amendment) Bill, 2017 by ICSI
2. Report of the Companies Law Committee - February 2016
3. Standing Committee on Finance (2016-17) on the Companies (Amendment) Bill, 2016 dated December 2016.

The author acknowledges the contribution made by Ms. Hetal Pandya and Ms. Emriel Pereira, Company secretary.

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CA Mayur Nayak, CA Natwar Thakrar & CA Pankaj Bhuta

OTHER LAWS
FEMA Update and Analysis

In this article, we have discussed recent amendments to FEMA through Circulars & recent FAQs issued by RBI & updation of Master Directions.

A. Amendments to FEMA through AP Dir. Circular issued by RBI

1. Monitoring of foreign investment limits in listed Indian companies

In terms of the **Foreign Exchange Management (Transfer or Issue of Security by a person Resident outside India) Regulations, 2017** notified *vide* **Notification No. FEMA 20(R)/2017-RB dated November 7, 2017** and as amended from time-to-time, the onus of compliance with the sectoral/statutory caps on foreign investment lies with the Indian investee company.

Currently, Reserve Bank of India receives data on investment made by Foreign Portfolio Investors (FPI) and Non-Resident Indians (NRI) on stock exchanges from the custodian banks and Authorised Dealer Banks for their respective clients, based on which restrictions beyond a threshold limit is imposed on FPI/NRI investment in listed Indian companies.

In order to enable listed Indian companies to ensure compliance with the various foreign investment limits, RBI in consultation with SEBI, has decided to put in place a new system for monitoring foreign investment limits, for which the necessary infrastructure and systems for operationalising the monitoring mechanism, shall be made available by the depositories. The same has been notified by SEBI *vide* Circular-IMD/FPIC/CIR/P/2018/61 dated April 5, 2018 read with Circular- IMD/FPIC/CIR/P/2018/74 dated April 27, 2018. In terms of para 6 of Annexure A of the circular dated April 05, 2018, all listed Indian companies are required to provide the specified data/information on foreign investment to the depositories. The requisite information may be provided before May 15, 2018. The listed Indian companies, in non-compliance with the above instructions will not be able to receive foreign investment and will be non-compliant with Foreign Exchange Management Act, 1999 (FEMA) and regulations made thereunder.

[A.P. (DIR Series) Circular No. 27 dated May 3, 2018]

(Comments: This is a welcome move to improve monitoring various statutory caps for foreign investments)

2. Data Sharing with Directorate of Revenue Intelligence

RBI has advised AD Category I to follow provisions contained in Sections 108 A and 108 B of the Customs Act, 1962 and the Rules notified thereunder *vide* GSR 1512 (E) Notification No. 114/2017-Customs (N.T.) dated December 14, 2017.

All AD Category I banks are advised to ensure compliance with the same with immediate effect.

[A.P. (DIR Series) Circular No. 28 dated 3rd May, 2018]

B. Updated through FAQs

a) FAQs – External Commercial Borrowings & Trade Credits

RBI Update on FAQs on External Commercial Borrowings & Trade Credits as on May 3, 2018 contains the following changes:

Questions 63 and 64 have been newly inserted as under:

Q.63 Does discontinuance of LoU/ LoC mean that Trade Credit has been discontinued as a means of trade finance?

Ans. No, Trade Credits, including Buyers' Credit, can be availed as a form of clean credit apart from availing Bank Guarantee for Trade Credits, subject to extant Trade Credit guidelines and compliance with provisions contained in Department of Banking Regulation Master Circular No.DBR No. Dir. BC.11/13.03.00/2015-16 dated July 1, 2015 on "Guarantees and Co-acceptances", as amended from time-to-time. Letters of Credit/ Bank Guarantee arrangements continue as a form of trade finance, as hitherto.

Q.64 Do LoUs/ LoCs, which have been issued prior to issuance of A.P. (DIR Series) Circular No.20 dated March 13, 2018, but whose tenor is not over need to be cancelled?

Ans. No, LoUs/ LoCs issued and accepted prior to the issuance of the said circular may continue till theiroriginal validity. However, no roll-over is permitted.

Earlier FAQ was updated as on 16-6-2017.

RBI Update on FAQs on External Commercial Borrowings & Trade Credits as on May 11, 2018 contains the following changes:

1. Questions 28 and 42 have been newly inserted.

2. Questions 25, 31, 38, 39, 40 and 44 of FAQ on ECB dated 3-5-2018 have been deleted and Questions 21 and 37 have been amended.

Newly Inserted

Q.28 Should the proposed ECB be added to all outstanding ECBs for arriving at the individual limit for raising of ECBs?

Ans. The individual limit for raising ECB under the automatic route will take into account all outstanding ECBs including the proposed one. However, refinancing of ECB amount will not be considered for arriving at individual limit per financial year.

Q.42 Can refinancing/ partial refinancing be undertaken under auto route even for ECBs raised under approval route, subject to compliance with guidelines?

Ans. Yes.

Amended

Q.21 Whether ECB liability: equity ratio of 7:1 is applicable for raising ECB from both direct and indirect equity holders under automatic route?

Ans. No, it is only applicable to direct equity holders.

Q.37 Can ECB be availed for making equity investment domestically or buying goodwill?

Ans. No. Equity investment either directly or indirectly (through purchase of goodwill) is not permitted.

Earlier FAQ was updated as on 3-5-2018.

RBI Reference Link:https://www.rbi.org.in/scripts/FS_FAQs.aspx?Id=120&fn=5

A. FAQs-Foreign Investment in India

RBI Update on FAQs as May 7, 2018 now contains new lines (marked in bold) in the introduction paragraph. Questions 37, 38, 39, 40, 41, 42 and 43, have been newly inserted as under:

Introduction Paragraph

These FAQs attempt to put in place the common queries that users have on the subject in an easy to understand language. However, for conducting a transaction, the Foreign Exchange Management Act, 1999 (FEMA) and the Regulations made or directions issued thereunder may be referred to. The relevant principal regulations are the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, **2017 dated November 7, 2017 as amended from time-to-time (hereinafter referred to as FEMA 20 (R)). The modalities as to how the foreign exchange business has to be conducted by the Authorised Persons with their customers/ constituents with a view to implementing the regulations framed is laid down in Master Direction on Foreign investment in India.**

Q.37 Who is an FVCI?

Ans. Foreign Venture Capital Investor' (FVCI) means an investor incorporated and established outside India and registered with Securities and Exchange Board of India under Securities and Exchange Board of India (Foreign Venture Capital Investors) Regulations, 2000.

Q.38 Where can a Foreign Venture Capital Investor (FVCI) invest?

Ans. A SEBI registered Foreign Venture Capital Investor may make investment in terms of Schedule 7 of FEMA 20(R) as per the conditions prescribed therein.

Q.39 How can the FVCI make payment for the investment?

Ans. The amount of consideration for all investment by an FVCI has to be received/ made through inward remittance from abroad through banking channels or out of funds held in a foreign currency account and/ or a Special Non-Resident Rupee (SNRR) account maintained by the FVCI with an AD bank in India. The foreign currency account and SNRR account shall be used only and exclusively for transactions under the relevant Schedule.

Q.40 How can the sale/ maturity proceeds be taken out by the FVCI?

Ans. The sale/ maturity proceeds (net of taxes) of the securities may be remitted outside India or credited to the foreign currency account or Special Non-resident Rupee Account of the FVCI.

Q.41 What is an investment vehicle?

Ans. Investment Vehicle is an entity registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose. For the purpose of Schedule 8 of FEMA 20(R), an Investment Vehicle is a Real Estate Investment Trust (REIT) governed by the SEBI (REITs) Regulations, 2014, an Infrastructure Investment Trust (InvIt) governed by the SEBI (InvIts) Regulations, 2014 and an Alternative Investment Fund (AIF) governed by the SEBI (AIFs) Regulations, 2012. It does not include a Venture Capital Fund registered under the erstwhile SEBI (Venture Capital Funds) Regulations, 1996.

Q.42 What are the provisions with regard to Downstream investment for an investment vehicle?

Ans. Investment made by an Investment Vehicle into an Indian company or an LLP will be indirect foreign investment for the investee company or the LLP, as the case may be, if either the Sponsor or the Manager or the Investment Manager (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India.

Q.43 What are the restrictions on the investments made by an AIF?

Ans. An Alternative Investment Fund (Category III) with foreign investment can make portfolio investment in only those securities or instruments in which an FPI is allowed to invest under the Act, rules or regulations made thereunder.

Earlier updated as on 13.02.2017

RBI Reference Link:https://www.rbi.org.in/scripts/FS_FAQs.aspx?Id=26&fn=5

B. FAQs – Purchase of Immovable Property

RBI Update on FAQs on Purchase of Immovable Property as on May 7, 2018 contains the following changes in Part II of the FAQs-

1. Questions 5 and 6 have been newly inserted
2. Questions 1, 2, 4 and 8 have been amended

Q.1 How can a non-resident Indian (NRI) and an Overseas Citizen of India (OCI) acquire immovable property in India?

Particulars	NRI/ OCI (regulation of FEMA 20(R))
Purchase (other than agricultural land/ farmhouse/ plantation etc.) from	Resident/ NRI/ OCI [3(a)]
Acquire as gift (other than agricultural land/ farmhouse/ plantation etc) from	Resident/ NRI/ OCI [3(b)] who is a relative
Acquire (any IP) as inheritance from	a. Any person who has acquired it under laws in force [3(c)] b. Resident [3(c)]
Sell (other than agricultural land/ farmhouse/ plantation etc.) to	Resident/ NRI/ OCI [3(e)]
Sell (agricultural land) to	Resident [3(d)]
Gift (other than agricultural land) to	Resident/ NRI/ OCI [3(e)]
Gift (agricultural land) to	Resident [3(d)]
Gift residential/ commercial property	Resident/ NRI/ OCI [3(e)]

Q.2 What are the accepted modes of payment for property acquired in India?

Ans. Payment for immovable property has to be received in India through banking channels and is subject to payment of all taxes and other duties/levies in India. The payment can also be made out of funds held in NRE/FCNR(B)/NRO accounts of the NRIs/ OCIs. Payments should not be made through travellers' chequeand foreign currency notes.

Q.4 Can foreign nationals acquire property in India?

Ans. a. Citizens of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Macau, Hong Kong or Democratic People's Republic of Korea (DPRK), irrespective of their residential status, cannot, without prior permission of the Reserve Bank, acquire or transfer immovable property in India, other than on lease, not exceeding five years. This prohibition shall not be applicable to an OCI.

b. Foreign nationals of non-Indian origin resident in India (except 11 countries listed at (a) above) can acquire immovable property in India.

c. Foreign nationals of non-Indian origin resident outside India can acquire/ transfer immovable property in India, on lease not exceeding five years and can acquire movable property in India by way of inheritance from a resident.

Q.5 How can a Long Term Visa (LTV) holder acquire property in India?

Ans. Citizens of Pakistan, Bangladesh or Afghanistan belonging to minority community (Hindu, Christian, Sikh, Parsi, Buddhist, Jain) in that country and residing in India who has been granted an LTV by the Central Government can purchase only one residential immovable property in India as dwelling unit for self-occupation and only one immovable property for carrying out self-employment. However, such acquisition is subject to the conditions as specified under Regulation 7 of Notification No. FEMA 21 (R)/2018-RB dated March 26, 2018.

Q.6 Can a spouse of an NRI/ OCI who is not a NRI/ OCI acquire property in India?

Ans. A person resident outside India, not being a Non-Resident Indian or an Overseas Citizen of India, who is a spouse of a Non-Resident Indian or an Overseas Citizen of India may acquire one immovable property (other than agricultural land/ farm house/ plantation property), jointly with his/ her NRI/ OCI spouse subject to the conditions laid down in regulation 6 of FEMA 21(R).

Q.8 What is the meaning of transfer?

Ans. As per section 2(ze) of FEMA transfer means, sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien.

The Principal Regulations

1. Notification No. FEMA 7(R)/2015-RB dated January 21, 2016

2. Notification No. FEMA 21(R)/2018-RB dated March 26, 2018

Earlier Updated as on 2-9-2016

RBI Reference Link: https://www.rbi.org.in/scripts/FS_FAQs.aspx?Id=117&fn=5

C. Master Direction No.5/2015-16 dated 1-1-2016 - External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers was updated as on May 09, 2018

The Master Direction has been updated as follows –

a) The following has been inserted in Para 2.4.2 Eligible Borrowers:

In case of eligible borrowers Housing Finance Companies, regulated by the National Housing Bank, Port Trusts constituted under the Major Port Trusts Act, 1963 or Indian Ports Act, 1908 have been included in Track I and companies engaged in maintenance, repair and overhaul and freight forwarding have been included in Track III of entities eligible to raise ECB.

b) The following has been inserted in Para 2.4.4 relating to All-In-Cost

1. The all-in-cost ceiling is prescribed through a spread over the benchmark, i.e., 450 basis points per annum over 6 month LIBOR or applicable benchmark for the respective currency in case of Track I entities

2. he maximum spread over the benchmark of 6 month LIBOR or applicable benchmark for the respective currency will be 450 basis points per annum in case of Track II entities.

3. The maximum spread will be 450 basis points per annum over the prevailing yield of the Government of India securities of corresponding maturity in case of Track III entities

c) The following has been inserted in Para 2.4.5 End-use prescriptions:

The negative list for all Tracks would include the following:

a. Investment in real estate or purchase of land except when used for affordable housing as defined in Harmonised Master List of Infrastructure Sub-sectors notified by Government of India, construction and development of SEZ and industrial parks/integrated townships.

b. Investment in capital market.

c. Equity investment.

Additionally for Tracks I and III, the following negative end uses will also apply except when raised from Direct and Indirect equity holders or from a Group company, and provided the loan is for a minimum average maturity of five years:

d. Working capital purposes.

e. General corporate purposes.

f. Repayment of Rupee loans.

Finally, for all Tracks, the following negative end use will also apply:

g. On-lending to entities for the above activities from (a) to (f).

d) The following has been inserted in Para 2.4.6 Individual Limits

In case the ECB is raised from direct equity holder, aforesaid individual ECB limits will also subject to ECB liability: equity ratio requirement. The ECB liability of the borrower (including all outstanding ECBs and the proposed one) towards the foreign equity holder should not be more than seven times of the equity contributed by the latter. This ratio will not be applicable if total of all ECBs raised by an entity is up to USD 5 million or equivalent.

We have discussed below few recent compounding orders issued by RBI

A. External Commercial Borrowings:

1. C.A.No.4631/2018 in the matter of M/s. Surbana International Consultants (India) Private Limited (SICPL) (Amount imposed under the compounding orders dated 25-4-2018 – ₹ 24,55,213/-)

Facts of the Case

The applicant was engaged in the business of providing architectural design, master planning and project consultancy services to various clients in India. It regularly sought expert assistance in the areas of business development and technical consultancy from its overseas group entities viz. Surbana Jurong Consultants Pte Ltd., Singapore (Surbana Singapore) and SIPM Consultants Pte Ltd., Singapore (SIPM Singapore). During the course of rendering the services, the overseas group entities incurred expenditure amounting to SGD 64,27,869 (₹ 31,96,08,020/-) primarily on account of travel expenses, hotel expenses, consultancy services, etc. on behalf of SICPL which were cross charged to SICPL on cost-to-cost basis. SICPL could not pay the above dues to the overseas group companies due to financial hardships and liquidity concerns and as a result, the dues remained outstanding for a period exceeding three years.

Selected Contravention

The contravention sought to be compounded related to the following:

- Deemed ECB as result of the dues remaining outstanding for a period exceeding three years

(Comments:

- ***We have dealt with one of the several contraventions committed by the company in this case. It may be noted that although the guidelines governing ECB have been modified time and again, the FEMA Notification No. FEMA.3/2000-RB dated May 03, 2000 has not been amended simultaneously from time-to-time.***
- ***It is important to bear in mind that any dues which remain outstanding for a period beyond 3 years may be treated as deemed ECB by RBI and may give rise to consequential contraventions as a result of the outstanding dues being treated as deemed ECB.)***

B. Foreign Currency Account Outside India

2. C.A. No.4624/2018& 4623/2018 in the matter of Arvind Singh Mewar (Amount imposed under the compounding orders dated 25-4-2018 & 6-4-2018 – ₹ 3,32,777/-& ₹ 1,54,289/- respectively)

Facts of the Case

The applicant, Arvind Singh Mewar, is a resident individual. The applicant, during his visit to UK, opened accounts with HSBC, UK on July 09, 2008 (parent account) by depositing an amount of GBP 5000 (₹ 4,25,100/-) by cash and saving account by transfer of funds from the parent account. Another account was opened by the applicant with HSBC, UK on August 03, 2011 by transfer of funds from the parent account. The applicant remitted an amount of GBP 154,500 (₹ 1,33,91,218.85) to these foreign currency accounts held with HSBC, UK during the period from November 2008 to October 2014 under the Liberalised Remittance Scheme (LRS) from the bank accounts held in India. The applicant continued to maintain the foreign currency account after his return to India.

In addition to the above remittances, a total amount of USD 800,000 (₹ 4,62,75,732/-) was deposited in the applicant's foreign currency accounts by the JCB group directly during the period 2010-2018 towards fee for appointment as a senior advisor on the JCB Indian Advisory Council. Out of this amount, USD 200,000 (₹ 1,31,48,730.40/-) was repatriated by the applicant in January 2018. This amounted to non-repatriation of the balance amount of USD 600,000 (₹ 3,31,27,001.60) to India.

Apart from the above, the applicant, as director of the company, extended loan amounting to GBP 156,563.80 (₹ 1,48,98,472,72/-) to a non-resident company registered in UK viz The Lake Palace Hotels & Motels UK Limited. A part of the loan was given by way of incurring expenditure on behalf of the company amounting to GBP 76,563.80 (₹ 72,49,355.72) during the period from May 29, 2013 to June 30, 2017 and the balance amount of GBP 80,000 (₹ 76,49,117) by transfer of funds from the parent account during the period from November 28, 2015 to February 09, 2017. A total amount of GBP 70,000 (₹ 63,53,324) was received towards part repayment of the loan by the applicant during the year 2016-17. The repayment towards balance amount of loan amounting to GBP 86,563.80 was received by the applicant on January 18, 2018.

Contravention

The contravention sought to be compounded related to the following:

- Maintenance of foreign currency accounts with a bank outside India after return to India for purpose other than LRS: Regulation 7(6) of Notification No. FEMA10/2000-RB dated May 03, 2000, states that, 'A person resident in India who has gone abroad for studies or who is on a visit to a foreign country may open, hold and maintain a Foreign Currency Account with a bank outside India during his stay outside India, provided that on his return to India, the balance in the account is repatriated to India.'

- Non-repatriation to India of the balance amount of USD 600,000 (₹ 3,31,27,001.60/) out of a total amount of USD 800,000 (₹ 4,62,75,732/-) deposited in the applicant's foreign currency accounts: Regulation 3 of Notification No. FEMA 9/2000-RB dated May 3, 2000 states that, 'A person resident in India to whom any amount of foreign exchange is due or has accrued shall, save as otherwise provided under the provisions of the Act, or the rules and regulations made thereunder, or with the general or special permission of the Reserve Bank, take all reasonable steps to realise and repatriate to India such foreign exchange…'

- Lending in foreign exchange by a resident individual to a non-resident entity from the bank accounts held outside India: Regulation 5(1) of Notification No.FEMA.3/2000-RB dated May 3, 2000 as amended from time-to-time states that 'An Indian entity may lend in foreign exchange to its wholly owned subsidiary or joint venture abroad constituted in accordance with the provisions of Foreign Exchange Management (Transfer or issue of Foreign Security) Regulations, 2004. 'Whereas the applicant extended loan to the non-resident entity otherwise than in accordance.

(Comments:

- ***Though Foreign Exchange Management (Realisation, repatriation and surrender of foreign exchange) Regulations have been replaced by revised regulations; Regulation 3 of extant FEMA 9(R)/2015-RB dated 29th December 2015 corresponds to Regulation 3 of erstwhile FEMA 9 /2000-RB dated 3rd May 2000.***

- ***Though Foreign Exchange Management (Foreign currency accounts by a person resident in India)Regulations have been replaced by revised regulations; Regulation 5(F)(6) of extant FEMA 10(R)/2015-RB dated 21st January 2016 corresponds to Regulation 7(6) of erstwhile FEMA 9 /2000-RB dated 3rd May 2000.***

- ***Travellers who open foreign currency account while on their visit to a foreign country need to ensure that account is closed upon return to India with complete repatriation of funds deposited therein.***

❍❑❍

> The mainspring of the strength of every race lies in its spirituality and the death of that race begins the day that spirituality wanes and materialism gains ground.
>
> — *Swami Vivekananda*

CA Yagnesh Mohanlal Desai & CA R. Venkata Subramani

In Focus – Accounting and Auditing

IND-AS 109- Derivatives and Hedging

Introduction

The global market for financial instruments has expanded rapidly over the last years, not only in the sheer volume of such instruments but also in their complexity. Entities have moved from using "traditional" instruments (e.g., cash, trade receivables, long-term debt and investments) to highly sophisticated risk management strategies based around derivatives and complex instruments.

The traditional cost-based concepts are not adequate to deal with the recognition and measurement of financial assets and liabilities. Traditional accounting bases recognition on the transfer of risks and rewards. It does not deal with transactions that divide up the risks and rewards associated with a particular asset (or liability) and allocate them to different parties. Some financial instruments have little or no initial cost (e.g., options) and are not adequately accounted for (if at all) under traditional historical cost-based accounting systems. If a transaction has initial no cost, for example derivatives, they are not accounted for, in other words not recognised. Further, the historical cost of financial assets and liabilities has little relevance to risk management activities. Thus, many derivatives remain off-the balance sheet.

Accounting literature for derivatives and hedge accounting under Indian GAAP

The Institute of Chartered Accountants of India (ICAI) has withdrawn the Accounting Standards related to financial instruments, viz., AS 30, Financial Instruments: Recognition and Measurement (AS 30); AS 31, Financial Instruments: Presentation (AS 31); AS 32, Financial Instruments: Disclosures (AS 32). Thus, at present The Guidance Note on Accounting for Derivative Contracts, issued in June 2015, which is effective from accounting periods beginning on or after 1st April 2016 is the only accounting literature for accounting for derivatives and hedge accounting.

Accounting literature for derivatives/ hedge accounting under Indian Accounting Standards (Ind AS)

The whole gamut of financial instruments Viz., recognition, measurement, presentation and disclosures are dealt with by Ind AS 32 Financial Instruments Presentation (Ind AS 32); Ind AS 109 Financial Instruments (Ind AS 109) and Ind AS 107 Financial Instruments Disclosure (Ind AS 107).

Present Practices

In the absence of specific guidance about derivatives and hedge accounting, the accounting practices followed by Indian entities varies a lot. Generally following practices are followed by Indian entities:

a) Many entities do hedging, but they don't follow hedge accounting, as the hedge accounting is not mandatory.

b) Loss on derivatives are recognised but not the gain.

c) Gain/loss on derivative contracts is offset against the loss/gain on the underlying hedged item, and only net loss, if any, is recognised, ignoring gain, if any.

d) AS 30 Financial Instruments: Recognitions and Measurement is being followed without fully complying with the requirements of AS 30 relating to establishing hedge effectiveness and documentations. AS 30 / AS 31 and AS 32 are neither mandatory nor recommendatory.

Derivatives

A derivative is a financial instrument or other contract within the scope of Ind AS 109 with all of the following ingredients.

A derivative is a financial instrument or other contract with all three of the following characteristics:

a) its value changes in response to the change in a 'underlying';

b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts; and

c) it is settled at a future date.

A derivative usually has a notional amount, such as an amount of currency, number of shares, number of shares or units of weight or volume, but does not require the holder or writer to invest or receive the notional amount at the inception.

It is clear from the definition that a derivative will always have at least one underlying variable. Following table gives examples of derivatives and underlying.

Type of contract	Underlying variable
Interest rate derivative (Swaps / Caps / Floors)	Interest rates
Currency swap (foreign exchange swap)	Currency rates
Commodity swap	Commodity Prices
Credit Default Swap	Credit rating, credit index, or credit price
Total return swap	Total fair value of the reference asset
Bond option (call or put)	Interest rates
Currency option (call or put)	Currency rates
Commodity option (call or put)	Commodity Prices
Stock option (call or put) / Index options	Equity / Index
Interest rate futures / Forwards	Interest rates
Currency futures / Forwards	Currency rates
Commodity futures /Forwards	Commodity Prices

Key features

One of the characteristic of a derivative is that it has no initial or net investment, or one that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. An option contract meets the definition because the premium is less than the investment that would be required to obtain the underlying financial instrument to which the option is linked. Settlement at a future date is also one of the characteristics of derivatives.

Common examples of derivatives include:

a) Forward Contracts: Agreement to buy or sell an asset at a fixed price at a future date.

b) Future Contracts: Similar to forward contract except that contracts are standardised and traded on an exchange.

c) Options: Rights (but not obligations) for the option holders to exercise at a pre-determined price, the option writer loses out if the option is exercised.

d) Swaps: Agreement to swap one set of cash flows for another (normally interest rate or currency swaps).

The nature of derivatives often gives rise to particular problems. The value of derivative (and the amount at which it is eventually settled) depends on the movements in an underlying item (such as an exchange rate). This means the settlement of a derivative can lead to very different result from the one originally envisaged. An entity which has derivatives is exposed to uncertainty and risk (potential for gain or loss) and this can have a very material effect on its financial performance, financial position and cash flows.

Since a derivative contract normally has little or no initial cost, under traditional accounting it may not be recognised in financial statements at all. Alternatively, it may be recognised at an amount which bears no relation to its current value. This is clearly misleading and leaves users of the financial statements unaware of the level of risk that the entity faces.

Futures & Options:

Characteristics	Futures	Options
Underlying	√	√
Notional amount	√	√
Expiry date	√	√
Investment - small portion	√	√
Risk reward	Symmetric	Asymmetric
Is it hedging instrument?	No	Yes – if bought
Maximum profit - if bought	Directional call - risk reward is symmetric	Call: Unlimited Put: Strike price
Maximum loss - if bought		Premium paid
Maximum profit - if sold		Premium received
Maximum loss - if sold		Call: Unlimited Put: Strike price

Accounting treatment for derivatives under Ind AS

Derivative assets and liabilities are initially and subsequently measured at fair value, except for those derivatives which qualify as hedging instruments. Derivatives are presented as financial assets or liabilities in balance sheet.

Example of Derivative

For instance, a call option on a share is settled on the future date on which the holder may exercise the call option to purchase the share for a fixed price. Under Ind AS 109 Financial Instruments, the expiration of an option is also considered to be a form of settlement.

Example Assume Entity A enters into a call option contract on January 1, 2018, that gives it a right, but not an obligation, to purchase 1,000 shares issued by Entity B on April 15, 2018, at an exercise price (i.e., strike price) of ₹ 100 per share. The cost Entity A pays for each option is ₹ 3. Entity has not designated this transaction as hedge.

Therefore, Entity A makes this journal entry on January 1,2018.

Dr Derivative Asset	3,000
Cr Cash	3,000

(To record the purchase of 1,000 call options for ₹ 3.00 per option)

On March 31, 2018 the market value of each option is ₹ 4. Therefore, on March 31, 2018, Entity A makes these journal entries to recognise the increase in fair value:

Dr Derivative asset	1,000
Cr Derivative gain	1,000

(To record the increase in fair value of ₹ 1.00 per option)

On April 15, 2018, the fair value of each option is ₹ 10. The share price on this date is ₹ 110. Since the share price is higher than the exercise price, Entity A decides to exercise the option by buying 1,000 shares for ₹ 100 per share.

Under Ind AS 109, financial assets are initially recognised at fair value, so the shares are recognised at their fair value of ₹ 110 per share rather than the option exercise price of ₹ 100 per share.

In addition, the option asset is derecognised. Entity A makes these journal entries:

On April 15, 2018

Dr Derivative asset	6,000
Cr Derivative gain	6,000

(To record the increase in fair value of ₹ 6.00 per option)

On April 15, 2018

Dr Investment in shares of Entity B	110,000
Cr Cash	100,000
Cr Derivative asset	10,000

(To record exercise and derecognition of call options and recognition of shares)

Embedded Derivatives

An embedded derivative is a component of a hybrid contract that also includes a non-derivative host—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative (combined).

An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

If an embedded derivative is separated, the host contract shall be accounted for in accordance with the appropriate Standards. Ind AS 109 Financial Instrument does not address whether an embedded derivative shall be presented separately in the statement of financial position.

A first-time adopter shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required as per Ind AS 109. Ind AS 109 does not permit embedded derivatives to be separated from host contracts that *are* ***financial assets***.

A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument. An example is a bond with a detachable warrant where the owner of the bond-warrant package can exercise warrant and buy shares for cash but keep the bond, unlike the convertible bonds where the owner has to give up the bond in order to exercise the option.

Examples of host contracts:

a) A lease

b) A debt or equity instruments

c) An insurance contract

d) Executory contracts such as purchase and sales contracts:

Accounting for embedded derivatives

Circumstances where the separation of embedded derivatives is prohibited

Under Ind AS 109 the concept of embedded derivatives is applied to only financial liabilities and non-financial items. Embedded derivatives are not separated from ***financial assets*** within the scope of Ind AS 109 and the requirements of Ind AS 109 are applied to the hybrid contract as a whole. Where the host contract is a **financial asset** within the scope of Ind AS 109 the embedded derivatives are not separated.

Circumstances where the separation of embedded derivatives is required

In case of all other contracts, i.e., where the host contract is other than the financial assets within the scope of Ind AS 109, whether and when the embedded derivatives are required to be separately accounted or not depends on whether the embedded derivatives are closely related to the host contract.

If the embedded derivatives are closely related to the host contract, embedded derivatives would be separated and accounted accordingly. If the embedded derivatives are ***not closely*** related to host contract, embedded derivatives would not be separated.

For example, in case of an operating lease if the lease rentals are based on sales, the embedded derivatives would be treated as closely related. In such a situation, the embedded derivatives would not be separated, and the entire lease contract would be accounted for as per Ind AS 17 Leases.

However, if the lease rentals are based on, say, profit after tax, the embedded derivatives would be treated as **not** related to host contract. In such a situation, the embedded derivatives would be separated and accounted under Ind AS 109 Financial Instruments

If the embedded derivatives are separated (from host contract), they are to be separately accounted for like any other derivatives. Thus, they are measured at fair value, with changes in fair value are recognised immediately in profit or loss, unless such derivatives qualify as hedge.

If a hybrid contract contains a host that is not an asset within the scope of this Standard, an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if all of the following conditions are met.

a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host;

b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

c) the hybrid contract is not measured at fair value with changes in fair value recognised in profit or loss (i.e., a derivative that is embedded in a financial liability at fair value through profit or loss is not separated).

If any of these conditions are not met, the embedded derivatives ***should not*** be accounted for separately.

If an entity is required by this Standard to separate an embedded derivative from its host but is unable to measure the embedded derivative separately either at acquisition or at the end of a subsequent financial reporting period, it shall designate the entire hybrid contract as at fair value through profit or loss.

Hedge Accounting

Hedging instrument - Futures

a) Futures cannot be a hedging instrument; it merely locks the unrealized profit [Stock futures No; Index futures Yes can be a hedging instrument]

b) Risk reward ratio of a futures position is symmetric

Hedging instrument - Options

- Bought Options minimizes the risk and offers scope for unlimited profits
- Ideal instrument for hedging
- Risk reward ratio of a options position is asymmetric
- Written options cannot be designated as hedging instrument – limited profit but unlimited potential for loss
- Bought caps and floors can be designated as hedging instrument – unlimited profit with mere cost of caps/floor as potential loss
- Interest Rate Swap (IRS) also has a symmetric risk reward; can still be a hedging instrument as IRS helps achieve the risk management objective of the enterprise

What is the issue? – Profit and Loss distortion

IRS entered into to hedge the fair value of a fixed rate issuance (bond). Bond (being amortised cost liability) is recognized at amortized cost in the balance sheet. Swap being a derivative fair value changes are recognized in the Profit or Loss.

Date	Action	Accounting basis for Bond (Liability)	Bond	Swap	P&L Impact (Incremental) Profit / (loss)	Balance Sheet Asset /(Liability)	
			Fair Value	Fair Value		Bond	Swap
16-Mar-15	Issued Bond + Swap trade	Amortized Cost	(100,000)	0		(100,000)	
31-Mar-15	Valuation	Amortized Cost	(110,000)	9,000	**9,000**	(100,000)	9,000
30-Apr-15	Valuation	Amortized Cost	(106,000)	5,500	**(3,500)**	(100,000)	5,500
31-May-15	Valuation	Amortized Cost	(96,000)	(5,000)	**(10,500)**	(100,000)	(5,000)
30-Jun-15	Valuation	Amortized Cost	(115,000)	16,600	**21,600**	(100,000)	16,600
31-Jul-15	Swap terminated	Amortized Cost	(110,000)	11,000	**(5,600)**	(100,000)	11,000
31-Aug-15	Valuation	Amortized Cost	(115,000)	0	0	(100,000)	0
30-Sep-15	Valuation	Amortized Cost	(97,000)	0	0	(100,000)	0
31-Oct-15	Valuation	Amortized Cost	(120,000)	0	0	(100,000)	0

PL shows wide fluctuations due to the FV changes of the Swap. Swap is not a speculative instrument but only a hedging instrument to hedge the fair value of Bond.

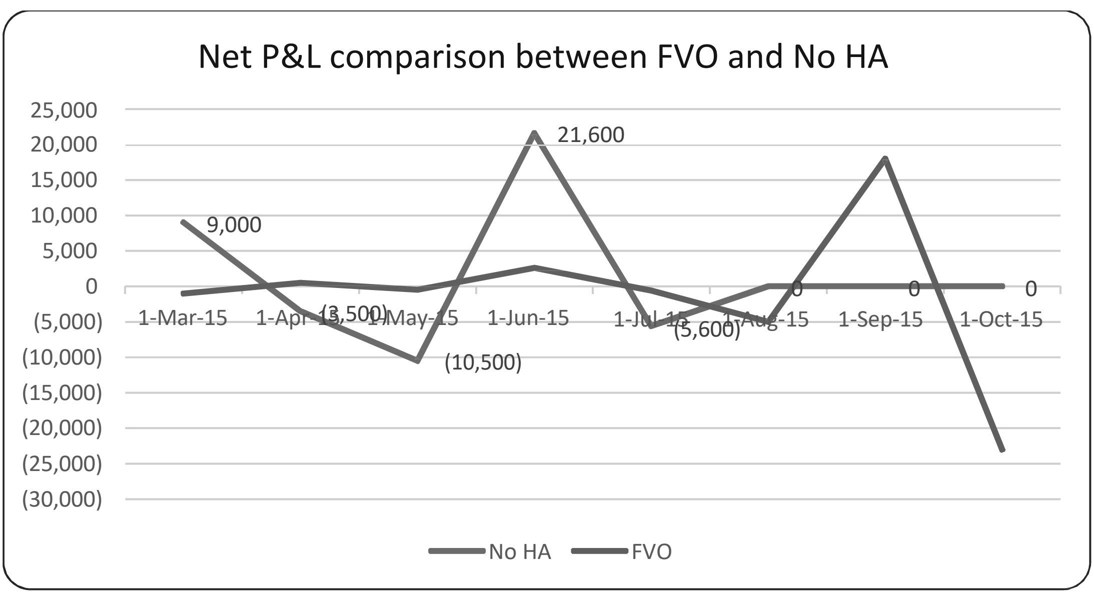
Can the issue be resolved with Fair Value Option?

To resolve the issue the entity exercises FVO for Bond. Bond is then recognized at fair value in the balance sheet & FV changes are recognised in the P&L. Due to extraneous circumstances the IRS is terminated after some months. Does this resolve the issue?

Date	Action	Accounting basis for Bond	Bond	Swap	P&L Impact (Incremental) Profit / (loss)			Balance Sheet Asset /(Liability)	
			Fair Value	Fair Value	Bond	Swap	Net	Bond	Swap
16-Mar-15	Bought Bond & Swap	Amortized Cost	(100,000)	0				(100,000)	
31-Mar-15	Valuation	Fair Value	(110,000)	9,000	(10,000)	9,000	**(1,000)**	(110,000)	9,000
30-Apr-15	Valuation	Fair Value	(106,000)	5,500	4,000	(3,500)	**500**	(106,000)	5,500
31-May-15	Valuation	Fair Value	(96,000)	(5,000)	10,000	(10,500)	**(500)**	(96,000)	(5,000)
30-Jun-15	Valuation	Fair Value	(115,000)	16,600	(19,000)	21,600	**2,600**	(115,000)	16,600
31-Jul-15	Swap terminated	Fair Value	(110,000)	11,000	5,000	(5,600)	**(600)**	(110,000)	11,000
31-Aug-15	Valuation	Amortized Cost	(115,000)	0	(5,000)	0	**(5,000)**	(115,000)	0
30-Sep-15	Valuation	Amortized Cost	(97,000)	0	18,000	0	**18,000**	(97,000)	0
31-Oct-15	Valuation	Amortized Cost	(120,000)	0	(23,000)	0	**(23,000)**	(120,000)	0

After the IRS is terminated, no FV changes on IRS. However, since FVO is irrevocable P&L is impacted by FV changes of the Bond after IRS is terminated. Here the remedy is worse than the disease!

Net P&L impact without FVO and with FVO



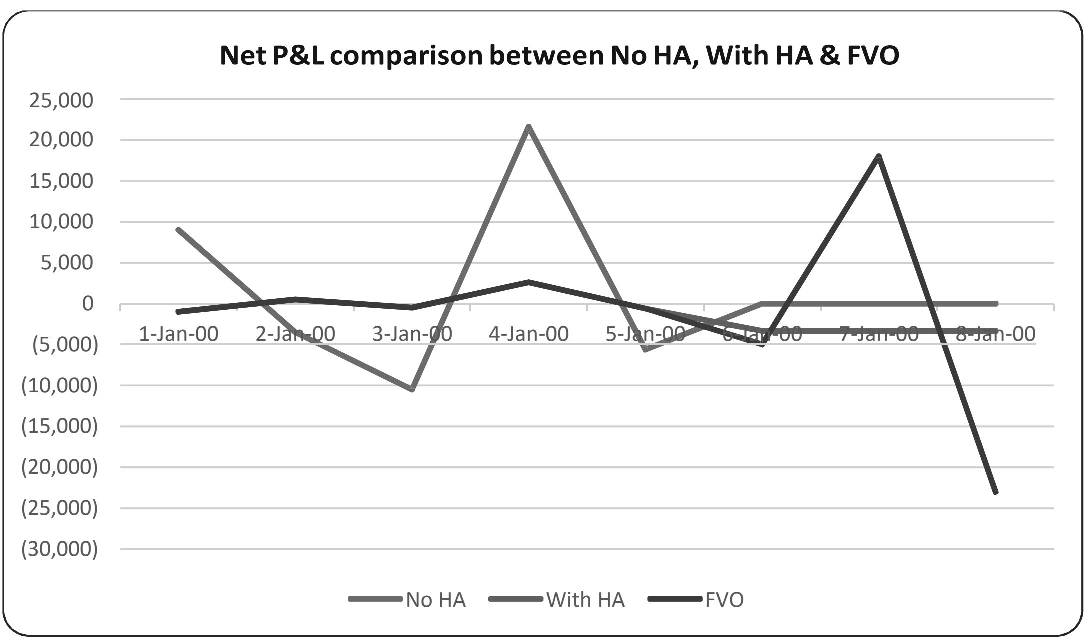
Without FVO P&L shows wide fluctuations with a hedging IRS. With FVO, P&L shows wide fluctuations without a hedging IRS. So 'hedge accounting' is the remedy.

With Hedge Accounting

Date	Action	Accounting basis for Bond	Bond	Swap	P&L Impact			Balance Sheet Asset /(Liability)	
			Fair Value	Fair Value	Bond	Swap	Net	Bond	Swap
16-Mar-15	Bought Bond & Swap	Amortized Cost	(100,000)	0				(100,000)	
31-Mar-15	Valuation	Fair Value	(110,000)	9,000	(10,000)	9,000	**(1,000)**	(110,000)	9,000
30-Apr-15	Valuation	Fair Value	(106,000)	5,500	4,000	(3,500)	**500**	(106,000)	5,500
31-May-15	Valuation	Fair Value	(96,000)	(5,000)	10,000	(10,500)	**(500)**	(96,000)	(5,000)
30-Jun-15	Valuation	Fair Value	(115,000)	16,600	(19,000)	21,600	**2,600**	(115,000)	16,600
31-Jul-15	Swap terminated	Fair Value	(110,000)	11,000	5,000	(5,600)	**(600)**	(110,000)	11,000
31-Aug-15	Valuation	Amortized Cost	(115,000)	0	(3,333)	0	**(3,333)**	(100,000)	0
30-Sep-15	Valuation	Amortized Cost	(97,000)	0	(3,333)	0	**(3,333)**	(100,000)	0
31-Oct-15	Valuation	Amortized Cost	(120,000)	0	(3,334)	0	**(3,334)**	(100,000)	0

Here the Bond hedged with a swap till 31-Jul-2015 when the swap is terminated. Fair Value of Bond from 31-Aug-2015 is irrelevant as the Bond will be valued on amortised cost basis from then onwards as there is no hedging relationship. The fair value as on the date on which the hedging relationship is terminated is taken as the amortised cost as on that date. The difference between the maturity value and the FV on the date on which the hedging relationship is terminated would be amortised to the Bond till the maturity date.

Net P&L impact with and without HA



Without hedge accounting PL shows wide fluctuations in profit/loss. The profit and loss impact is evened out when the hedging relationship is effective irrespective of the existence of the hedging instrument.

What is Hedge Accounting and what is the objective of 'hedging transaction'?

Process by which the effects on profit or loss of changes in the fair values of the hedging instrument and hedged item are offset. To reduce the risk exposure, usually to minimize loss or to protect the gains already earned Hedging transactions reduce or neutralize the variability in fair value or cash flows that arise from these risks.

Objective of hedge accounting is to protect the Profit & Loss from unintended fluctuations in profits. Hedge accounting enables the matching of timing in the recognition of gains and losses in profit and loss and to represent in the financial statement, the effect of an entity's risk management activities.

Hedging relationship

- Hedging relationships are of three types:
  - Fair value hedge
  - Cash flow hedge
  - Hedge of a net investment in a foreign operation

Hedged Items

- A hedged item must be an item that could affect profit or loss
- A hedged item can be:
  - a recognized asset or liability
  - an unrecognized firm commitment
  - a highly probable forecast transaction [only through cash flow hedge]
  - a net investment in a foreign operation that could affect profit or loss

Features of Hedging Instruments

1. It should help minimise risk
2. It should protect the profit still unrealized by locking the same
3. It should not have the effect of taking unrealised profit
4. It should not increase the existing risk by taking a changed exposure to risk
5. It should usually have a positive net present value i.e., it should be an asset in the books and should not be a liability at any point of time
6. It usually has a zero cost or a cost that is very low at the inception of the instrument
7. It should normally be a derivative instrument even though there are exceptions for these

Pre-requisites of hedge accounting

- At inception formal designation and documentation of
  - Hedging relationship
  - Entity's risk management objective
  - Strategy for undertaking the hedge
  - Identification of hedging instrument
  - Identification of hedged item
  - Nature of risk being hedged
  - Method of assessing the hedge instrument's effectiveness

Risk management Strategy & Objective

The risk management strategy is established at the highest level at which an entity determines how it manages its risk. The risk management strategy is normally in place for a longer period of time. It may include some flexibility to react to changes in circumstances even while the strategy is in place. The risk management strategy is usually documented at the highest level with guidance on the policies to be pursued for implementing the strategy.

Risk management Objective: The risk management objective is applied for every hedging relationship which dovetails into the risk management strategy of the enterprise. The risk management objective specifies how a particular hedging instrument that has been designated is used to hedge a particular exposure of the corresponding hedged item. A risk management strategy may have multiple hedging relationships whose risk management objectives relate to executing that overall risk management strategy.

Fair value hedge

A hedge of the exposure to changes in fair value of:

a) a recognised asset, liability or an unrecognised firm commitment, or

b) an identified portion of an asset, a liability or a firm commitment that are attributable to a particular risk and could affect profit or loss.

Examples of hedged items in a fair value hedge:

a) fixed-rate debt

b) fixed-rate receivables

c) equity instruments, or inventory

Identify the hedged item

1. A hedged item can be a recognised asset or a liability (financial or non-financial)

2. Or an unrecognised firm commitment to buy or sell a non-financial asset

3. Or a component of the above two

4. Identify the risk that is to be hedged

   i. A forecast transaction cannot be designated as a hedged item in a fair value hedge.

   ii. The firm commitment should be with a party external to the entity.

   iii. Foreign currency risk of an intra group monetary item can be hedged if there is a net exposure after consolidation.

   iv. A component of an item can also be designated as hedged item. A component of an item means changes attributable to a specific risk component.

Identify the hedging Instrument

1. The hedging instrument should be a derivative but not a written option.

2. Non-derivative measured at fair value through profit or loss (FVTPL) can also be a hedging instrument.

3. FX component of a non-derivative financial asset or a non-derivative financial liability can also be a hedging instrument.

Hedging instrument should be designated in its entirety. A portion of the hedging instrument can be designated. A portion of the time period of the hedging instrument cannot be designated.

Hedge effectiveness requirements

1. Economic relationship should exist between the hedged item and the hedging instrument. Implication: 80% to 125% condition is now relaxed. Delta FV changes of hedged and hedging should move in opposite directions.

2. Effect of credit risk should not dominate the hedge. Implication: Credit risk of the cash item and/or counterparty credit risk of the hedging instrument (derivative) should not vitiate the hedging relationship.

3. Hedge ratio for accounting purposes should be the same as actually deployed by the entity. Implication: Hedge ratio means the quantity or notional of hedged item / quantity or notional of the hedging

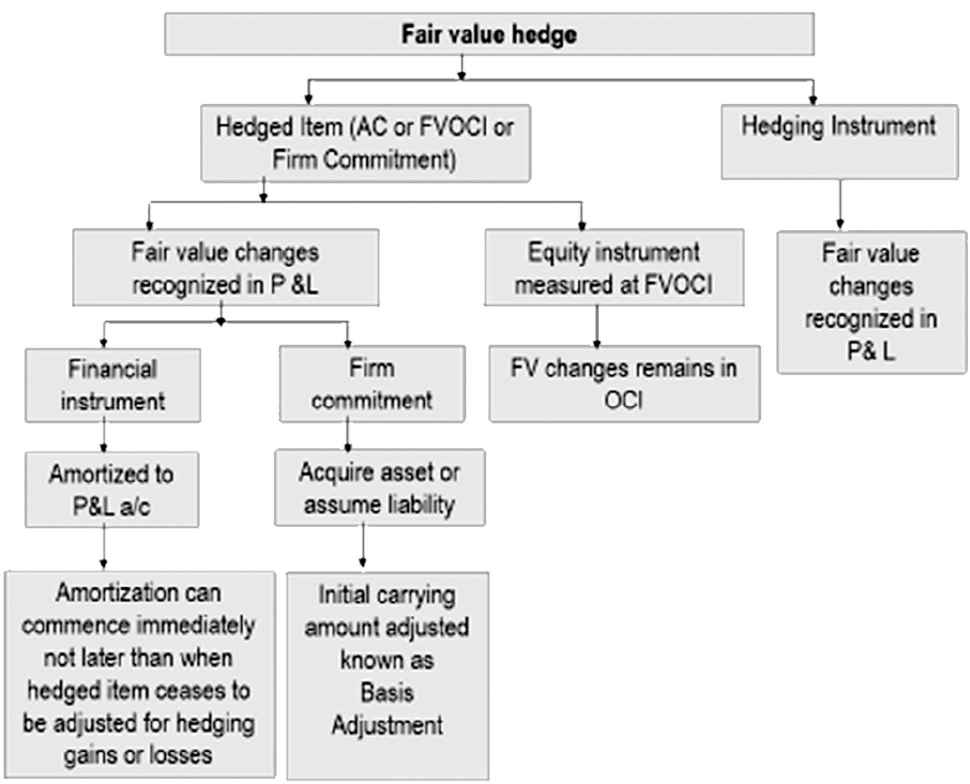
item. The ratio cannot be different to achieve artificial effectiveness and should be the same as the one that is used for risk management purposes.

Accounting for the hedging relationship

1. Qualifying and effectiveness criteria should be met.
2. Fair value changes to the hedging instrument should be recognised in profit and loss.
3. Hedging gain/loss on the hedged item should be recognized in profit and loss and the carrying amount of the hedged item should be adjusted.
4. In other words, the hedged item should be valued at fair value irrespective of the classification of such asset or liability.

Discontinuance of hedge accounting

When the hedging instrument is liquidated or if the hedge is discontinued otherwise the hedged item will be measured at amortised cost. A properly designated hedge cannot be discontinued voluntarily by an entity unless the risk management objectives of undertaking the hedge continues to the same. Rebalancing means adjustments made to the designated quantities of the hedged item or the hedging instrument for the purpose of maintaining a hedge ratio to comply with the hedge effectiveness requirements.



Cash flow hedge

A cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and could affect profit or loss. A cash flow hedge could be a hedge of variable interest payments on a debt instrument or the variability in the future cash outflow on a forecast transaction to purchase inventory in a foreign currency.

Eligible Hedged Item (Cash Flow Hedge)

- A recognized asset or a liability with potential variability in cash flows impacting profit
  - Example: Floating rate Bond purchased, Floating rate Bond issued
- An unrecognised firm commitment to buy or sell a non-financial asset – only FX risk *[This can be accounted either as FVH or CFH]*
  - Example: Buy/sell inventory in foreign currency – delivery in future
- A highly probable forecast transaction impacting profit
  - Example: Sales forecast (expressed in foreign currency)
  - Example: Highly probable forecastfixed rate Issuance
- A component of the above
  - Example: Cash flows of Bond attributable to changes in bench mark rate
  - Example: A portion of the Bond say 60% of the Bond Principal
- Aggregated exposure
  - Example: A combination of a bond and a swap can be a hedged item

Eligible Hedging Instrument

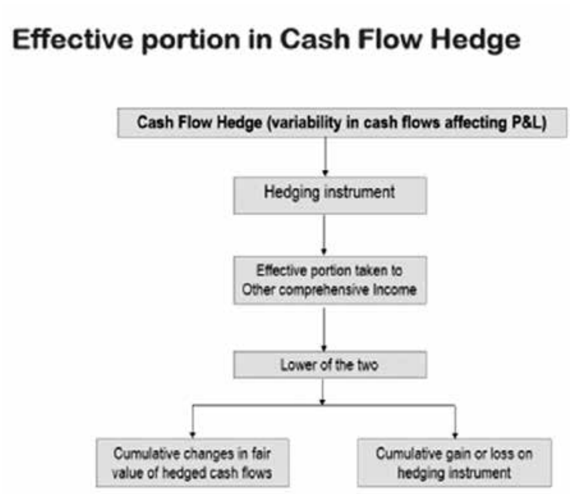
- Should normally be a derivative but not a written option
  - Example: Bought put options, Bought Caps or Floors, IRS allowed
  - Example: Written options, sold caps or floors not allowed
  - Interest Rate Collar / Reverse collar – allowed so as the FV is positive
- FX component of a non-derivative financial asset or a non-derivative financial liability
  - Example: FX component of a Foreign Currency debt
- FV changes should be designated in its entirety
  - Exception 1. Can designate only the changes in intrinsic value of an option
  - Exception 2. Can designate only the changes in the spot element of a FX Forward
- A portion of the hedging instrument can be designated
  - Example: 60% of interest rate swap
- A portion of the time period of hedging instrument not allowed
  - Example: First 3 years of a 5 year swap

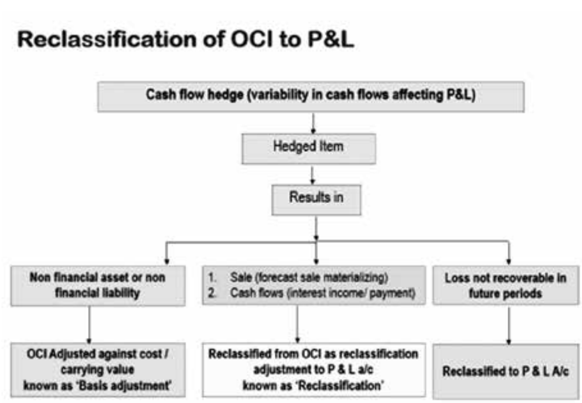
Accounting for Cash Flow Hedge

1. The lower of the absolute value of cumulative FV changes to the hedging instrument and the FV changes to the hedged item viz., the net present value of the expected cash flows is taken to Other Comprehensive Income (OCI).

2. The FV changes to the hedging instrument is recognised in P&L – usual entry as the derivatives are accounted for on FVTPL basis.
3. The ineffective portion of the hedging relationship remains the profit and loss account
4. The effective portion parked in OCI is recycled back to P&L when the hedged item hits the P&L

Note: OCI in a Cash Flow Hedge is also referred to as Cash Flow Hedge Reserve





Discontinuation of Cash Flow Hedge

If the hedged future cash flows are still expected to occur that amount remains in OCI until the future cash flows occur.

1. When the future cash flows occur
   - o Hedged item results in non-financial asset or non-financial liability – OCI adjusted against cost/carrying value – 'Basis Adjustment'
   - o Hedged item is a forecasted sale – OCI adjusted against the actual sales
   - o Hedged item affects the P&L say interest expense/income, OCI adjusted to offset the income/ expense
   - o Hedged item results in loss – OCI immediately recognized in P&L
2. If the hedged future cash flows are no longer expected to occur
   - o that amount is immediately reclassified from OCI to P&L as reclassification adjustment

Examples of treatment of OCI

1. Hedged item results in non-financial asset or non-financial liability – OCI adjusted against cost/carrying value
   - o Example: FX forwards to hedge a forecasted purchase of copper results in a non-financial asset (inventory) in foreign currency
2. Hedged item is a forecasted sale – OCI adjusted against the actual sales
   - o Example: FX Forwards to hedge a forecasted sale in foreign currency
3. Hedged item affects the P&L say interest expense/income, OCI adjusted to offset the income/expense
   - o Example: IRS to hedge variable rate loan
4. Hedged item results in loss – OCI immediately recognised in P&L
   - o Example: FV of hedged item drops resulting in a loss

Adjusted against carrying value

Scenario: FX Forwards (hedging instrument) taken to hedge purchase of copper in Euros (non-financial hedged item) results in a gain of USD 1.5 m which is taken to OCI *[base currency USD].*

FX Forwards gains taken to Other comprehensive Income

↓

When the goods are imported

↓

Particulars	*(In millions USD)*
Cost of inventory	65.00
Less: OCI Balance adjusted	(1.50)
Carrying value of inventory	63.50

Adjusted against cost

Scenario: FX Forwards (hedging instrument) taken to hedge purchase of machinery (depreciated @ 10% SLM) in Euros (non-financial hedged item) results in a gain of USD 1.5 m which is taken to OCI.

FX Forwards gains taken to Other comprehensive Income

↓

When the machinery is imported

↓

Particulars	*(In millions USD)*
OCI balance	1.50
Since machinery is depreciated at 10%, OCI will be released to P&L on the same basis @ 10% SLM	(0.15)

Adjusted against the actual sales

Scenario: FX Forwards (hedging instrument) taken to hedge forecasted sales in Euros (non-financial hedged item) results in a gain of USD 1.5 m which is taken to OCI.

FX Forwards gains taken to Other comprehensive Income

↓

When the actual sales happen

↓

Particulars	*(In millions USD)*
Sales	65.00
Add: OCI balance reclassified	1.50
Adjusted value of sales	66.50

Revision in forecasted cash flows

Scenario: FX Forwards (hedging instrument) taken to hedge forecasted sales in Euros (non-financial hedged item) results in a gain of USD 1.5 m which is taken to OCI.

FX Forwards gains taken to Other comprehensive Income

↓

When the sales forecast is revised

↓

Particulars	*(In millions USD)*
Original Sales forecast	60.00
Revised Sales forecast (60%)	36.00
OCI Balance	1.50
Reclassified to P&L (being speculative) 40%	0.60

Accounting for the cash flow hedging relationship

1. Get the lower of the cumulative fair value changes to the hedging instrument and the fair value of the hedged item viz., the present value of expected cash flows.
2. The amount calculated in step 1 above is taken to 'Cash Flow Hedge Reserve'.
3. The difference between the fair value changes to the hedging instrument and the amount taken to Cash Flow Hedge Reserve is taken to the profit and loss account.

4. Where the hedged item ultimately results in a non-financial asset or a non-financial liability, the balance in the cash flow hedge reserve is adjusted with the carrying value of such item known as 'Basis Adjustment'

5. Where the hedged item ultimately results in actual sales, the balance in the cash flow hedge reserve is reclassified to profit and loss account as 'Reclassification Adjustment' during the same period as the hedged item affects the profit and loss account.

6. Where the hedged item is a financial instrument impacting future cash flows in the form of interest, the balance in the cash flow hedge reserve is reclassified to profit and loss account as 'Reclassification Adjustment' during the same period as the hedged item affects the profit and loss account.

7. If cash flow hedge reserve shows a debit balance and if the loss is not expected to covered in future cash flows, then to that extent it is immediately taken to the profit and loss account.

   i. Qualifying and effectiveness criteria should be met

   ii. If the hedged item is an unrecognised firm commitment the cumulative fair value changes of the hedged item is recognised as an asset or a liability. Subsequently this amount gets adjusted with the carrying amount of the asset or liability that ultimately results

   iii. If the hedged item is an existing asset or a liability, then the carrying amount of the hedged item is adjusted for the fair value changes of that instrument. Subsequently this amount is effectively amortised based on the effective interest rate computed after the hedge accounting is discontinued.

Discontinuance of hedge accounting

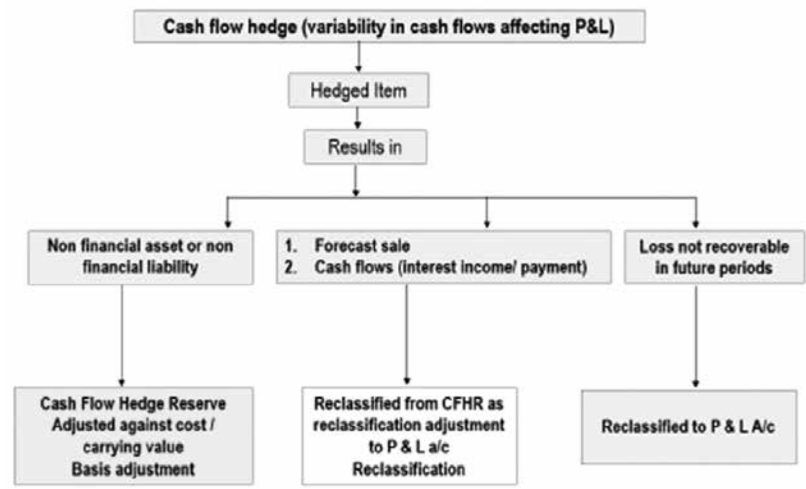
1. If the hedge effectiveness requirements are not met, the entity should adjust the hedge ratio by a process known as 'rebalancing' so long as the hedging relationship continues to meet the risk management objective of the enterprise.

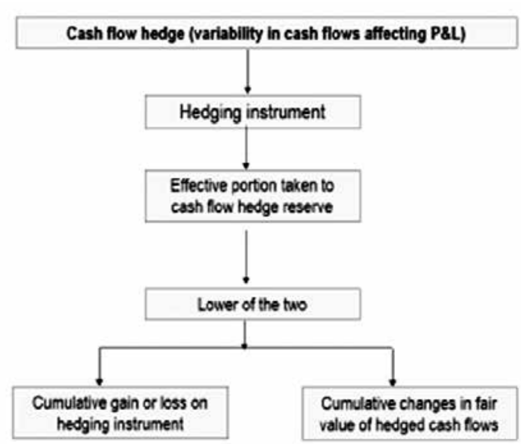
2. When the hedging instrument is liquidated or if the hedge is discontinued otherwise the balance in the cash flow hedge reserve will continue to remain there till the expected cash flows affecting the hedged item affects the profit and loss account.

3. If the hedged expected future cash flows are not expected to occur then to that extent it is immediately recognised in profit and loss account.

   i. A properly designated hedge cannot be discontinued voluntarily by an entity unless the risk management objectives of undertaking the hedge continues to the same.

   ii. Rebalancing means adjustments made to the designated quantities of the hedged item or the hedging instrument for the purpose of maintaining a hedge ratio to comply with the hedge effectiveness requirements.





Treatment on first time adoption of Indian Accounting Standards (Ind AS)

Hedge accounting under Ind AS can be applied prospectively from the date the hedge relationship is fully designated and documented. Thus, if hedge relationship was not designated and documented under Indian GAAP, on the date of transition, hedge relationship can be established only if the relationship is established and documented on the basis of the circumstances and conditions prevailing on the date of transition.

Ind AS First Time Adoption of Indian Accounting Standards (Ind AS 101) prescribes few mandatory exceptions and few voluntary exemptions from the retrospective applications of Ind AS.

Mandatory exceptions

On the date of transition as required by Ind AS 109, an entity shall:

a) measure all derivatives at fair value; and

b) eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP as if they were assets or liabilities.

If any entity has not classified derivatives as hedge this situation does pose any problem on the date of transition. It will measure the derivatives at fair value on the date of transition and going forward will measure derivatives at mark to market and will recognise both gains and losses.

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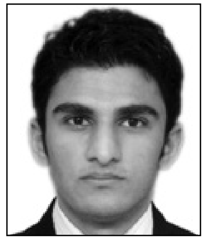

Rahul Sarda, *Advocate*

Best of the Rest

1. Winding up order to be recalled when company in liquidation has settled all claims and dues of creditors

The Respondent Company filed an application for recall of the winding up order on the ground that all the dues of the petitioner were settled by the company under winding up and there were no creditors to whom any accounts were due by the company under winding up. The Bank and the creditors including the petitioning creditors permitted the withdrawal of the company petition as all their dues had been paid. The Official Liquidator did not oppose the revival of the Company under winding up.

Held it was a matter of record that though a learned Single Judge by his order dated 26/06/2009 had ordered the respondent company to be wound up and directed the Registrar to draw the winding up order in terms of Rule 37 of the Companies (Court) Rules, 1959, no such order was drawn by the Registrar. In the factual matrix that there are no dues remaining to be settled, held it is a fit case for recall of the winding up order dated 26/06/2009 and to permit the withdrawal of the petition. Therefore, the order of winding up dated 26/06/2009 was recalled and the petition was allowed to be withdrawn and the Official Liquidator was discharged from the proceedings.

Shekhar Electricals vs. Falcon Retreat (P.) Ltd. [2018]93 taxmann.com344 (Bom.)

2. Mistake apparent from the record by the NCLT – Non-consideration of judgments cited – Not a mistake apparent from the record

The Applicant director of a company, against which a petition for oppression and mismanagement was filed, filed an intervention application challenging maintainability of oppression and mismanagement petition filed against company on ground of limitation, latches, suppression of material facts. The Tribunal, by an order, dismissed said intervention application. It was the case of the Applicant director that while passing the impugned order, the Tribunal had not taken into consideration oral arguments and contentions in written arguments on aspect of delay and latches. It was also the case of the Applicant director that the Tribunal had not taken into consideration relevant decisions applicable to the facts of the case and hence there was a mistake apparent from the record.

Held, the decisions relied upon by the applicant director did not lay down any proposition of law which applied to all fact situations, therefore non-referring of judgments relied upon by applicant was not a mistake apparent from record. Further held that question of limitation was mixed question of fact and law, and, delay aspect had to be considered at final hearing. Therefore, the instant application filed by the Applicant director was nothing but for review of the impugned order of the Tribunal, and hence, could not be considered as there was no mistake apparent from the record.

Ashok Kumar Khosla v. PGH International (P) Ltd. [2018] 93 taxmann.com 332 (NCLT – Ahd.)

3. Contract and Specific Relief – Fraud and misrepresentation – Matters required to be established

Appellant-plaintiff filed suit for partition and separate possession against her uncle and his son. She contended that the suit properties originally belonged to her grand-father and after his death, her father and uncle succeeded. And, after the death of her father, she is entitled to half share in the suit properties. The suit was opposed on the ground that father of appellant-plaintiff had sold his share to the Respondent-uncle. In rejoinder, appellant-plaintiff contended that the sale deed executed by her father was obtained by fraud and misrepresentation. The Trial Court decreed the suit but the first appellate court dismissed the suit which was upheld by the High Court. Held, the Sub-Registrar who registered the sale deed executed by the father of the appellant-plaintiff, deposed that sale deed was executed only after contents were read out to him. Though it was contended that the father of appellant-plaintiff was not keeping well, no medical records were submitted to establish it.0 Also, witnesses of the appellant-plaintiff did not state in the deposition that the father of the appellant-plaintiff was not in a good state of mind at the time of execution of the sale deed. Held, in absence of any proof, it could not be said that the sale deed executed by the father of the appellant-plaintiff was obtained by misrepresentation and fraud. Hence, the High Court was held justified in dismissing the appeal.

Krishna Devi vs. Keshri Nandan (2018) 4 SCC 481

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Kishor Vanjara, *Tax Consultant*

Tax Articles for Your Reference

Articles published in Taxman, The Bombay Chartered Accountant Journal (BCAJ), The Chamber's Journal (CJ), The Chartered Accountant Journal (CAJ), All India Federation of Tax Practitioners Journal (AIFTPJ), Sales Tax Review (STR), Times of India and Economic Times for the period April 2018 To May 2018 has been arranged and indexed topic-wise.

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Interpretation and Practical Application: Ind AS 115 – Revenue from contracts with Customers	Dolphy D'Souza	BCAJ	50-A/Part 1	123
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CA Ketan Vajani & CA Nishtha Pandya *Hon. Jt. Secretaries*

The Chamber News

Important events and happenings that took place between 8th May, 2018 and 8th June 2018 are being reported as under:

I. ADMISSION OF NEW MEMBERS

1) The following new members were admitted in the Managing Council Meeting held on 1st June, 2018.

List of new members admitted in the 10th Managing Council Meeting held on 1st June, 2018 (for the year 2018-19)

Life Membership

1	Mr. Rahul Raman	CA	Mumbai
2	Mr. Devendra Hastimal Jain (Transfer from Ord. to Life)	CA	Mumbai
3	Mr. Sheth Mahul Ramesh (Transfer from Ordinary to Life)	B.Com. FCA	Mumbai
4	Mr. Chintan Jayprakash Vajani	B.Com, FCA, CISA	Jamnagar
5	Mr. Mohnish Tulsidas Wadhwa	CA	Mumbai
6	Mr. Gaurav Santosh Kenkre	CA	Goa
7	Mr. Dharmendra Chandravadan Shah	B.Com, FCA	Mumbai
8	Mr. Ajit Satish Dhamane	CA	Pune
9	Mr. Kunal Agrawal	B.Com.	Indore
10	Mr. Rakesh Sharma	LLB	Mumbai
11	Mrs. Karishma Dhruvin Shah	CA	Mumbai

Ordinary Membership

1	Mr. Chitre Nilesh Raghunath	B.Com	Mumbai
2	Mrs. Kinjal Vishal Bhuta	CA	Mumbai
3	Mr. Rohit Jain	CA	Mumbai
4	Mr. Ronak Balwant Doshi	B.Com. GDCA	Mumbai
5	Mr. Narayan Devappa Bodake	LLB	Kolhapur
6	Mr. Sunil Khupchand Vakharia	CA	Pune
7	Mrs. Manasi Chinmaya Bhave	M.Com. ACA	Mumbai

8	Mr. Mehul Mahavirprasad Mundhra	CA	Mumbai
9	Mr. Avnish Jagmohan Arora	B.Com.	Pune
10	Mr. Moinuddin Rahim Shaikh	B.Com, Inter CA	Mumbai
11	Mr. Paunil Sunil Shah	B.Com.	Mumbai
12	Mr. Girish Arvind Satav	B.Com.	Pune
13	Mr. Darshan Kishorbhai Dagli	CA	Ahmedabad
14	Miss. Ashita Atul Shah	B.Com. CA	Mumbai
15	Mrs. Charmi Atul Shah	B.Com. CA	Mumbai
16	Mr. Sudhakar Shetty	B.Com.	Mumbai
17	Mr. Sridhar Namakkal	CA	Mumbai
18	Mrs. Jagruti Prashant Sheth	CA	Mumbai
19	Mr. Mohit Elesh Shah	CA	Mumbai
20	Mr. Nitin Manilal Gutka	CA	Mumbai
21	Mr. Sandeep Baghirath Chetiwal	CA	Mumbai
22	Mr. Malvik Pankaj Majithia	MBA	Mumbai
23	Mr. Sankit Ashok Porwal	CA	Mumbai
24	Mr. Ganesh Ramesh Jagtap	M.Com.	Pune
25	Mr. Avinash Mallinath Mhetre	M.Com.	Solapur
26	Mr. Ranjeet Sadashiv Natu	B.Com.	Pune
27	Mr. Radha Krishin Rawal	LLB	New Delhi
28	Mr. Vishal Haridas Pawar	M.Com.	Mumbai
29	Mr. Bhavyan Vijay Dalal	CA	Mumbai

Student Membership

1	Mr. Harish Ahuja	IPCC	Mumbai
2	Mr. Naishadam Chandrashekar	ICSI	Seconderabad
3	Mr. Achintya Seshadrinathan	CA-Final	Mumbai
4	Mrs. Sejal Manish Shah	CA	Mumbai
5	Mr. Vipul Vimalchand Jain	CWA	Mumbai
6	Mr. Anirudh Bajpai	LLB	Jabalpur
7	Mr. Varun Kalra	LLB	Noida
8	Ms. Akanksha Ashok Verma	LLB	Mumbai
9	Ms. Meenal Jain	LLB	Jaipur
10	Mr. Manish Agarwal	CA	Jaipur
11	Ms. Krisha Jitesh Sanghvi	CA	Mumbai
12	Mr. Meet Hiren Shah	CA	Mumbai
13	Mr. Sagar Khandelwal	CA Final	Jaipur
14	Ms Rucha Chintamani Limaye	CA	Pune
15	Miss. Jyoti Bharti	LLB	Lucknow
16	Ms. Anushka Sandip Mehta	LLB	Mumbai

17	Mr. Jay Kishan Sharma	LLB	Jodhpur
18	Mr. Umang Gupta	CA	Mumbai
19	Mr. Bijal Tushar Sanghavi	CA	Mumbai
20	Mr. Shiren Panjolia	LLB	Nurpur
21	Mr. Rahul R.	LLB	Erode
22	Mr. Aadarsh Kothari	LLB	Kolkata
23	Mr. Vaibhav Garg	LLB	Ghaziabad
24	Mr. Jayesh Sandha	IPCC	Mumbai
25	Mr. Piyush Senghani	IPCC	Mumbai
26	Mr. Thakkar Parth	IPCC	Mumbai
27	Mr. Sahu Bhagrati	IPCC	Mumbai
28	Mr. Deep Gosar	IPCC	Mumbai
29	Mr. Harsh Desai	IPCC	Mumbai
30	Ms. Sanjana Virkar	IPCC	Mumbai
31	Mr. Niraj Daki	IPCC	Mumbai
32	Mr. Piyush Gada	IPCC	Mumbai
33	Ms. Priyanka Gulekar	IPCC	Mumbai
34	Ms. Madhavi Hemant Rane	IPCC	Mumbai
35	Mr. Shankar Bhise	IPCC	Mumbai
36	Mr. Vinod Habib	IPCC	Mumbai
37	Ms Harsha Jain	IPCC	
38	Ms. Ranjita Phale	IPCC	Mumbai
39	Mr. Rahul Nirmal	IPCC	Mumbai
40	Ms. Sneha Solanki	IPCC	Mumbai
41	Ms. Dolly H. Haria	IPCC	Mumbai
42	Mr. Rashminath R. Sheety	IPCC	Mumbai
43	Ms. Trisha M Kilje	IPCC	Mumbai
44	Ms. Akshata P Choudhary	IPCC	Mumbai
45	Ms. Laxmi C Sahu	IPCC	Mumbai
46	Ms. Diksha Singh	IPCC	Mumbai
47	Mr. Vismi Viswanathan	IPCC	Mumbai
48	Ms. Prachi K Shirdhokar	IPCC	Mumbai
49	Ms. Jaya Mangal	IPCC	Mumbai
50	Ms. Minal Shinde	IPCC	Mumbai
51	Ms. Tanvi Bamne	IPCC	Mumbai

II. PAST PROGRAMMES

1. DELHI CHAPTER

Full day Seminar on Practical Insights on Key GST Issues was held on 26th May, 2018 at New Delhi.

ML-794

2. PUNE STUDY GROUP

Full Day Seminar on International Taxation was organized on 19th May, 2018 jointly with International Taxation Committee at Pune.

3. MEMBERSHIP & PUBLIC RELATIONS COMMITTEE

Full Day programme on "Direct Tax Enclave "was organized on 9th June, 2018 at Nasik.

III. FUTURE PROGRAMMES

1. ALLIED LAWS COMMITTEE

Full day workshop on the subject "Benami Transactions (Prohibition) Act, 2016 is scheduled to be held on 30th June, 2018 at West End Hotel, New Marine Lines, Mumbai.

2. DIRECT TAXES COMMITTEE

Half Day workshop on Return Filing Provisions under the Income-tax Act is scheduled to be held on 15th June, 2018 at A.V.Room, Jaihind College, Churchgate.

3. IT CONNECT COMMITTEE

Half Day Workshop (Practical) on "Skype Meetings and Google Drive" is scheduled to be held on 16th June, 2018 at CTC Conference Room.

4. INTERNATIONAL TAXATION COMMITTEE

12th Residential Conference on International Taxation, 2017 is scheduled to be held from 21st June, 2018 to 24th June, 2018 at The Grand Bhagwati, Indore.

5. NOTICE OF AGM

Notice is hereby given that the Ninety First Annual General Meeting of THE CHAMBER OF TAX CONSULTANTS will be held at Garware Club House, Wankhede Stadium, D Road, Churchgate, Mumbai - 400 020 on Wednesday, 4th July, 2018 at 4.30 p.m.

6. RENEWAL OF MEMBERSHIP FEES 2017-18

The Renewal fees for Annual Membership, Study Group, Study Circle and other Subscription for the financial year 2018-2019 was due for payment on 30th April, 2018. The Renewal notices has been sent separately which contains entire information of members as per CTC Database. In case any change of information of members shown in form, kindly provide updated information along with the form.

Members are requested to visit www.ctconline.org for online payment of the Renewal fees.

(For details of the future programmes, kindly visit www.ctconline.org or refer The CTC News of June, 2018)

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NOTICE OF THE ANNUAL GENERAL MEETING

Notice is hereby given that the Ninety First Annual General Meeting of THE CHAMBER OF TAX CONSULTANTS will be held at Garware Club House, Wankhede Stadium, D Road, Churchgate, Mumbai – 400 020 on Wednesday, 4th July, 2018 at 4.30 p.m. to transact the following business:

1. To read and adopt the minutes of the last annual general meeting.
2. To consider the Annual Report of the Managing Council for the year 2017-18.
3. To consider and adopt the annual audited accounts for the year ended 31st March, 2018.
4. To appoint auditors and fix their honorarium for the year 2018-19.
5. To announce the results of the elections of President and fourteen Members of the Managing Council.
6. To felicitate winners of Dastur Essay Competition 2018
7. To have Book release function

FOR AND ON BEHALF OF THE MANAGING COUNCIL

Sd/-

Ketan L. Vajani / Nishtha Pandya

Hon. Jt Secretaries

Place : Mumbai

Dated : 13th April, 2018

Office :

3, Rewa Chambers,

31, New Marine Lines, Mumbai-400 020.

Notes:

1. As per the decision taken at 86th Annual General Meeting, Annual Report would be circulated in electronic form. It shall also be available on the Chamber's website after 6th June, 2018. Any member desiring physical copy can send written request and get it collected from Chamber's office after 6th June, 2018. Alternatively, can also send written request for sending it by post or courier.
2. If there is no quorum by 4.30 p.m. the meeting will be adjourned for half an hour and the members present at such adjourned meeting shall form the quorum.
3. The members are requested to send their queries, in writing, if any, on the Statements of Accounts and Annual Report for the year 2017-18 to the Hon. Jt. Secretaries at least four days before the day of the Annual General Meeting.

Indirect Taxes Committee

Study Circle Meeting on the subject Recent Landmark Judgments under Service Tax & GST Law held on 4th May, 2018

Shri S. S. Gupta
Chairman of the session

Shri Sachin Chitnis
Advocate

Indirect Tax Study Circle Meeting held on 6th June, 2018 on the subject Procedures on filing Authority for Advance Ruling in GST and Issues under Interest & Penalty in GST

Faculties

Shri Parth Badheka
Advocate

Shri Vinay Jain
Advocate

Study Circle & Study Group Committee

Study Group Meeting held on 9th June, 2018 on the subject Recent Judicial Judgments under Income-tax

Shri Ashwani Taneja, Advocate
addressing the members

Membership & Public Relations Committee

Self-Awareness Series held on Thursday, 10th May, 2018, on the subject - "Be Your Own Doctor !!!" Discover Secrets of Healthy Living & Learn Self-Management of Common Health Problems through Naturopathy

Dr. Urvisha Ashar,
addressing the members

Delhi Chapter

Full Day Seminar on Practical Insights on key GST issues held on 26th May, 2018

Faculties

Ms. Sonakshi Paharia

Ms. Sunisha Chawla

Shri Nikit Popli

Shri Saurabh Agarwal

Shri Sukhpal Singh

Student Committee

Articles Orientation Programme held on 7th, 8th and 9th June, 2018

7th, June, 2018

Faculties

CA Hinesh Doshi, Vice President giving opening remarks

CA Sheel Bhanushali

CA Vinodkumar Jain

Section of Students

8th June, 2018

Faculties

CA Ankit Sanghvi

CA Mehul Sheth

9th June,2018

Faculties

CA Ketan Vajani

CA Vyomesh Pathak

International Taxation Committee

Full Day Seminar on International Taxation held on 19th May, 2018 jointly with Pune Study Group at Pune

Faculties

CA Bhaumik Goda

CA Dinesh Supekar

CA Pramod Achutanan

CA Rajesh P. Shah

Indirect Taxes Committee

Public Lecture Meeting held on 22nd May, 2018 on the Subject of "E-Way Bill"

Faculties

CA Janak Vaghani

CA Jignesh Kansara

CA Manish Gadia

THE CHAMBER'S JOURNAL

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