



The Chamber of Tax Consultants

Mumbai | Delhi

Registered Office

3, Rewa Chambers, Gr. Floor, 31, New Marine Lines, Mumbai – 400 020.

Tel.: +91-22-2200 1787, 2209 0423, 2200 2455 | E-mail: office@ctconline.org | Website: www.ctconline.org

WhatsApp: 9004945579 | FB Page: <https://www.facebook.com/ctcconnect/>



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FEMA STUDY CIRCLE MEETING

Tuesday, 4th June, 2019

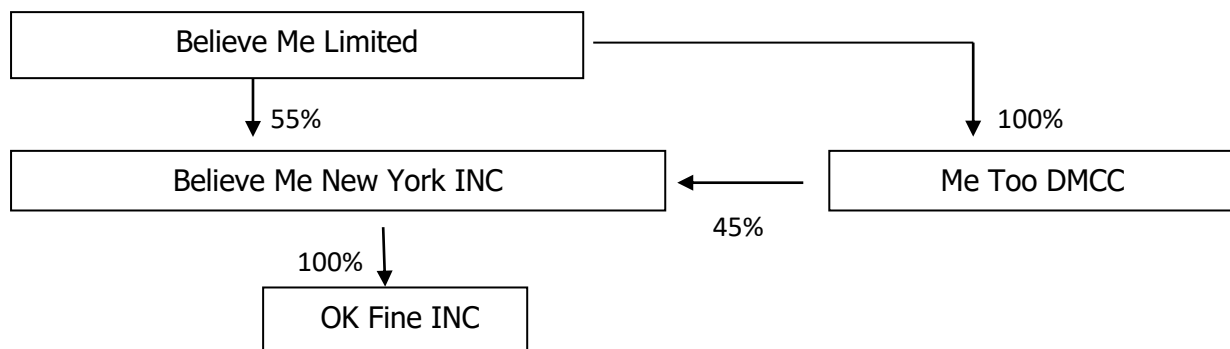
Surat RRC Panel Case Studies discussion

By CA Harshal Bhuta, Group Leader
CA Naresh Ajwani, Chairman

❖ CASE STUDY 1

- Believe Me Limited is a public listed company incorporated under the laws of India.
- Me Too DMCC is a wholly owned foreign subsidiary of Believe Me Limited, incorporated in Dubai.
- Believe Me New York INC is a US based foreign company owned by Believe Me Limited and Me Too DMCC and having shareholding of 55% and 45% respectively.
- OK Fine Inc. is a company incorporated in USA and is a wholly owned subsidiary of Believe Me New York.
- OK Holding is a company proposed to be incorporated under the laws of US, wherein Believe Me Limited and Me Too DMCC will hold 55% and 45% of the shareholding, respectively.

Current Structure:



Proposed Transaction:

The Querist intends to transfer the entire shareholding of OK Fine Inc from Believe Me New York to OK Holding, such that OK Fine Inc becomes the direct subsidiary of OK Holding.

For the purpose of achieving the above, the Querist proposes to enter into an arrangement, whereby Believe Me New York will gift shares of OK Fine to OK Holding, being a company in which both Believe Me Limited and Me Too DMCC hold shareholding in the ratio of 55:45. This mode of

transfer of shares from Believe Me New York to OK Holding will be without any monetary consideration.

The Querist further proposes to make Believe Me New York a wholly owned subsidiary of OK Holding by swap of the shares of Believe Me New York with additional shares of OK Holding without any monetary consideration.

Assume that the above arrangement is permissible under the extant laws of USA.

QUERIES :

a) With respect to the Proposed Transaction, is Believe Me Limited required to obtain any permission from the RBI for gift of shares by Believe Me New York to OK Holding?

b) With respect to the Proposed transaction, if Believe Me Limited swaps its shares in Believe Me New York for additional shares of OK Holding, is Believe Me Limited required to obtain any permission from the RBI?

❖ **CASE STUDY 2**

X Pvt Ltd. (X India, for short) is an Indian Company. It has two WOS – X Singapore and X Belgium. There is one step down subsidiary X US which is subsidiary of X Singapore.

X India has made an investment of Euro 1000 in X Belgium as in 2016.

X India has given a loan to X Belgium in 2017 onwards and has also extended loan in 2018-19.

There is Unpaid interest as on 31-3-2018. This amount forms part of the outstanding as on 31 March 2019.

Further there are transactions with regards to services rendered for which invoices are raised on X Belgium (from 01.01.2017 onwards). There is outstanding as on 31 Mar 2019 towards the same.

Also there is payables to X Belgium towards import of services as on 31 Mar 2019 (from 01.01.2015 onwards).

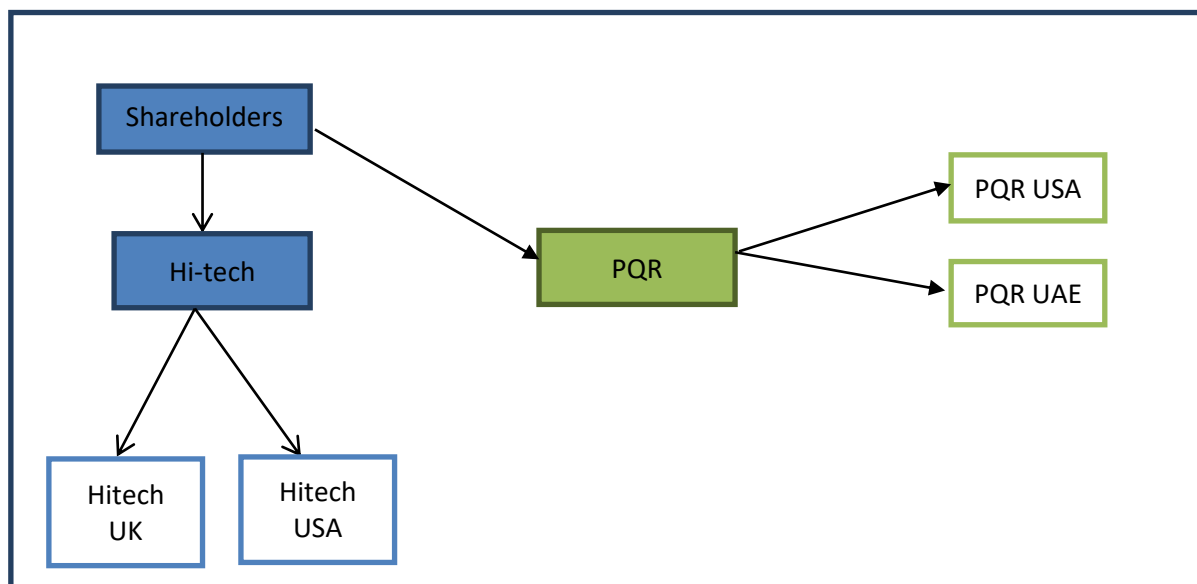
X Belgium is incurring losses from its first year FY 15-16 and is not in a position to repay either the loan or the Bills raised by X India.

Queries:

1. Can X India write off entire loan outstanding (Principal + Interest) in its books?
2. Can X India write off receivables due from X Belgium? Is there any limit to which the receivables can be written off?
3. Is X India required to set off receivables against payables before writing off the receivables?
4. For both loan outstanding as well as receivables, is it advisable to write off the amount outstanding as on 31/03/18 or is it advisable to write off entire amount outstanding till date?
5. Who is competent to approve the above write-offs?
6. What is the process involved in getting the approval?

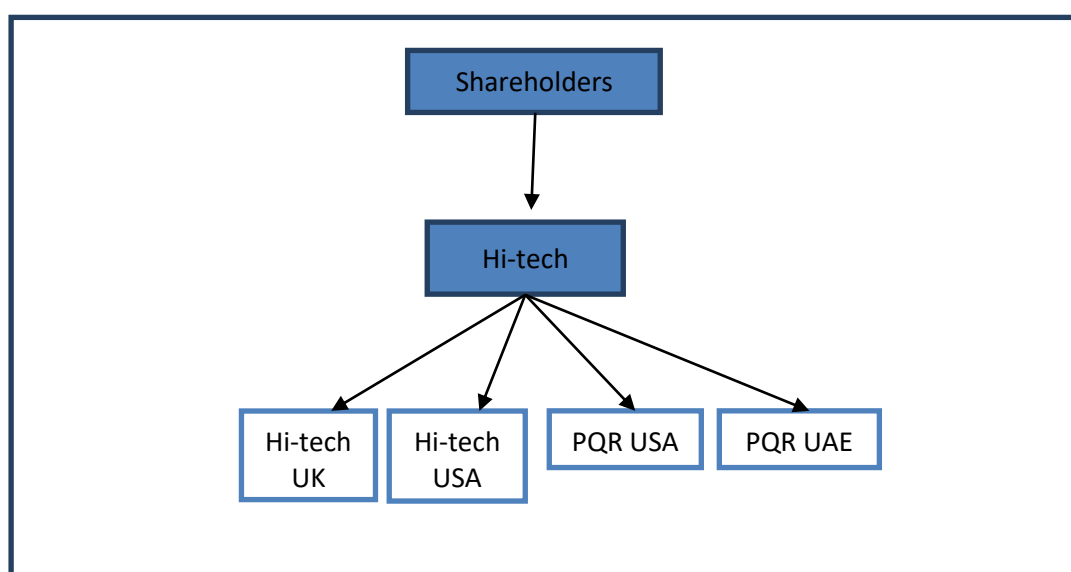
❖ **CASE STUDY 3**

- The Hi-Tech Group is engaged in the business of providing IT enabled market research and analytics solutions to global clients.
- The Hi-tech group comprises of the following entities:
 - Hi-tech Pvt. Ltd, PQR Pvt. Ltd;
 - Branches – in USA, UK and UAE.
- The current structure of the group is as follows:



Transaction:

- Hi-tech and PQR have filed a Scheme of Arrangement with the NCLT whereby it is proposed that PQR will be merged into Hi-tech with effect from 01 April 2017.
- Thus, the resulting structure post approval of the Scheme of Arrangement by the NCLT will be as follows:



QUERIES :

- Whether the existing branches would be deemed to be transferred to Hi-tech pursuant to the Scheme of Arrangement or would the branches have to be closed and set up again under Hi-tech?
- If the branches would be deemed to be transferred pursuant to the Scheme of Arrangement, Hi-tech would have 2 branches in USA with effect from 01 April, 2017 (please note that this is a retroactive date merger). Whether it is permissible under automatic route or would it require approval from RBI?
- Please let us know the procedure to be followed and filings to be done with RBI by Hi-tech and PQR.

❖ **CASE STUDY 4**

Mr. KK and his wife MK are Hindu, Indian citizens and residents. They have two children RK and VK. RK, his son, is a resident Indian citizen. VK, his daughter, is a Canadian citizen, while her husband is an Indian citizen. She and her husband have H1B visa and live in USA. KK has been transferring money under Liberalized Remittance Scheme limits to VK on a monthly basis. Currently there is only one grand-daughter who is an Indian citizen and resident.

OBJECTIVES :

- 1) Mr. KK wishes to settle a trust for funding education for all his grandchildren, whether existing now or not. He is planning to set up the trust in Singapore where he and his wife are the primary beneficiaries and barring exceptional circumstances, the income of the Trust shall be accumulated. Each grandchild that is born shall be, on applying to the Trustees, eligible to receive from the corpus of the Trust the cost of their education for which the Settlor will set a maximum limit. On each child reaching 25 years, the difference between this maximum limit and the actual amount withdrawn shall be paid out to such child. The balance corpus, if any, shall be paid to the other family trusts which KK will settle in the future.
- 2) Given the presence of US persons in the family, from a US tax perspective, we have discussed the objectives of this trust with a US counsel. He has advised that the preference would be for a Singapore revocable Grantor Trust.
- 3) It is planned that the Trust be preferably be set up as a discretionary trust, whether revocable or irrevocable. The Settlor will leave a letter of wishes with the Trustees to appoint a specified maximum corpus in favor of each of the Grandchildren. The Protector of the Trust would be RK, KK's son, with negative powers of vetoing trustees' decision in specified circumstances.

QUERIES :

1. Can an Indian person settle a trust outside India for the benefit of himself, wife and grandchildren?
2. If the trust is settled as a revocable trust or irrevocable trust, what would be the implications under FEMA, 1999?

❖ CASE STUDY 5

1. Company, ABC Pvt. Ltd (India) is a 100% subsidiary of ABC GmbH & Co. KG, Germany.
2. Principal business activities of the Indian company comprise of marketing services in respect of Textile Machineries, providing erection & commissioning, field services etc. to 3rd party Indian customers as well as to other customers of our parent company, trading of spares and assembly of control panels. The company has a team of about 35 engineers who provide above mentioned services.
3. The parent company (Germany) has a customer by the name PQR in Turkey.
4. 2 of our engineers were deputed to carry out technical services to PQR for & on behalf of our parent company. The said 2 engineers were required to sign a fixed term employment contract with PQR.
5. In addition to the employment contract, our said two engineers were asked to open bank account in Turkey. This was with the view that out of the monthly deposits made by PQR in the engineer's account (salary), certain amount would be withdrawn by PQR towards discharge of legal social security / other statutory obligations.

QUERY :

1. Is the above arrangement valid / legal, considering that the engineers were made to open bank account only with the primary objective of discharge of social security obligation by PQR?

❖ CASE STUDY 6

IMF Trust is a discretionary trust settled by M.

Beneficiaries of the trust are Mrs. M, Ms. I (Daughter of M) and daughters of Ms. I.

Mrs. M is resident Indian and other beneficiaries are UK Resident.

M has settled cash and some shares of listed co. Out of cash settled in Trust and dividend received from listed co, investment is made in Mutual Funds etc.

Trust has income from Capital Gain on its Investment, Dividend from Listco and Mutual Funds and Interest income.

QUERY :

If Trust makes distribution out of its income in favour of beneficiaries who are UK Resident, then:

- a) Can they deposit distribution in their NRO account?
- b) Can they remit money outside India? If yes, how much?
- c) Can Trust directly make distribution in favour of beneficiaries, who are UK Resident?

❖ CASE STUDY 7

Case Study 6

Background of A Group:

'A', an Indian company and part of the 'A' Group, is engaged in the business of making investment in shares of group companies and earning income therefrom as well as providing management / advisory services.

B (UK) Limited, a wholly owned subsidiary of A, is a holding cum operating entity of the 'A' group engaged in the hospitality sector. B UK also has operating assets in Amsterdam and Germany which it had acquired from third parties. Additionally, B UK also provides consulting services to the group companies *inter alia* asset management services, back office accounting support etc.

Background of D 3 Group:

D 3 Investments S.a.r.l (Luxembourg) is the ultimate holding company in the group and the group is involved in running operations of C Hotels. Group entities are C Hotels BV (Netherlands), C GP1 Limited (UK), C Hotels Property LP (UK Partnership Firm), C Hotels Limited (UK).

D 3 Investments S.a.r.l. (Luxembourg) has obtained a debt from third party banks which has further been pushed down in group companies. Additionally, D 3 Investments charges interest from various group entities and the same is utilized to discharge the interest which is due to banks (known as cash pooling services). Currently, D 3 Investments is not charging any fee from the group entities for rendering such cash pooling services, however, post-acquisition a fee is proposed to be charged from the group entities in compliance with transfer pricing regulations.

Group company C Hotels BV (Netherlands) does not have any standalone operations / income. Additionally, C Hotels BV (Netherlands) along with C GP1 Limited (UK) holds 100% shareholding of C Hotels Property LP (UK Partnership Firm) which in turns owns the UK real estate hotel. C Hotels Property LP has leased out the hotel asset to C Hotels Limited (UK) which is managing the hotel operations and pays lease rentals to C Hotels Property LP UK.

Proposed Transaction:

Management discussions indicated that B UK along with a JV partner is contemplating to acquire the entire business operations of C Hotels from the current owners by acquiring 100% stake in D 3 Investments S.a.r.l (Luxembourg). Further, there is no intention of the Purchasers to lease any hotel asset of the group to third parties and / or sell out any asset individually without the business operations.

Queries:

- A. Given that the intent of B UK is to acquire the business operations of C Hotels, whether the proposed acquisition in the existing structure on as is basis is permissible under automatic route from ODI perspective?
- B. D 3 group has group entities which are pure holding companies (SPV) as well as operating companies earning lease rentals; managing the business operations of other entities. Whether this overall structure is fine from ODI perspective or that each entity in the structure would need to comply with the extant ODI guidelines?
- C. The Hotel is owned by a UK Limited Partnership (LP). Is there any issue in indirectly holding capital of an LP under FEMA Notification 120?

- D. The Investments by B Limited shall be governed by the Master Direction – Direct Investment by residents in Joint Venture (JV)/ Wholly Owned Subsidiary (WOS) abroad” (“**master direction ODI**”). As per master direction ODI, it is possible to make the investments by “**A**” SPV (i.e. a non-operating holding company) where the Target is an SPV. In view thereof, can there be more than one SPV in the group structure from ODI standpoint (horizontally)?
- E. In light of the fact that D 3 Investments is earning interest income on loans given to group entities and would also be earning fee from group entities, whether D 3 Investments could be said to be engaged in financing activity from ODI standpoint?
- F. Whether single ODI form reporting is to be made for all the entities acquired under the structure?

❖ **CASE STUDY 8**

S Ltd. is a foreign company having 6 equal shareholders – A & B, who are NRIs and C, D, E, F, who are resident Indians. All shareholders are also directors of the company, but the control and management is with A & B. S Ltd holds two immovable properties in the UK, using funds borrowed from the shareholders and earns rent from both these properties. S Ltd. has incurred loss in the last two years, resulting in a negative net worth. All the original remittances were made by C, D, E & F under the LRS scheme into their foreign bank accounts and from there into S Ltd without complying with ODI conditions under FEMA 120.

The Board of the company had announced a rights issue to the existing shareholders. The Indian shareholders declined the offer in view of the FEMA regulations. However, the NRI shareholders subscribed to an equity shares worth GBP 1,00,000. To partly reduce the negative networth, E & F have agreed to convert their loan to equity to the extent of GBP 1,00,000.

Due to their old age, A, B, C & D now wish to transfer their shareholdings to E & F at fair value certified by auditors of the company. The fair value of the shares is computed by substituting market value of the immovable properties instead of the book value and the same shall result in capital gains to the transferors. Further, E & F shall infuse additional funds into S Ltd., which shall be used to repay the loans of C & D.

Questions:

- a) Can C & D transfer their shareholding to E & F at the fair value computed by the statutory auditors of S Ltd.?
- b) Would C & D be required to remit the full sales proceeds from transfer of shares to India?
- c) Whether E & F can remit further funds under the LRS scheme to their personal foreign bank accounts and give loan to S Ltd. for repayment of loan of other shareholders?
- d) Are C & D required to remit back to India the loan repaid by S Ltd. into their personal foreign bank accounts?
- e) Can E & F purchase shares from A, B, C & D out of funds lying in their foreign bank account, which were remitted under the LRS scheme from India?

❖ CASE STUDY 9

Definition of “Owned & Controlled by NRI” – Reg. 5(4) r.w. Schedule 4 The term “Owned and Controlled by NRI” is not defined under Reg. 2 (Definitions). Reg. 14 is the only place from where guidance could be drawn to interpret “owned and controlled”. Reg. 14 itself contains a caveat restricting the interpretation of ‘ownership’ and ‘control’ to Reg. 14 only.

Query:

How to interpret this phrase otherwise?

❖ CASE STUDY 10

100% FDI is allowed into an Indian company carrying in Agricultural activity.

Query:

Whether the same will hold good where company is carrying out B2B wholesale trading of agricultural products and not carrying agricultural activities.

❖ CASE STUDY 11

NRI had invested in Partnership Firm on Non-Repatriable basis in the year 2014. Partnership Firm had acquired the plot. It had planned to build row houses and then sell it to various buyers either resident or non-resident. However construction of row houses could not commenced as planned due to some reason or other. Now NRI wants to withdraw from the Partnership firm.

Queries:

- i. Whether Partnership firm can sell the plot and repay the partners in their NRO account? Whether it will be covered under Real Estate Business?
- ii. Whether Partnership firm can build infrastructure like street lights, drainage, electric cables, gardens and then sell the plot to one or more buyers?
- iii. Whether the activity stated in (ii) above will be covered under “City and Regional level Infrastructure”?

❖ CASE STUDY 12

A Private Ltd. is an Indian company having non-resident investors. Presently, the non-resident investors are holding CCDs and equity shares. A Private Ltd. will be merging with B Private Ltd. (another Indian company).

Queries:

- i. Is it necessary that as a consideration for merger only share have to be issued?
- ii. Can CCDs be issued against the existing CCDs instead of shares?

❖ CASE STUDY 13

Regulation 6 of Notification 120 requires that Indian party should not be on the list of Exporter's caution list/ list of defaulters of the banking system/ list of defaulters in CIBIL/ under investigation by enforcement agency or Regulatory body. It is well known that some investigations in India almost never end. Many times, there is no formal order of closure of investigation. Hence technically, even for normal proposals which are otherwise under automatic route, an approval is required.

Questions:

(a) RBI has been considering that if a group company is under investigation, other group companies also require an approval when making ODI. Just because of investigation against the Indian party is carried out by the agencies, are other group companies required to take an approval?

(b) A person may be a director in many companies which are not of same group. If he is under investigation for transactions under one company, why do all companies on which he is a director require an approval? Or if he is under investigation for some personal transactions, why do all companies on which he is a director require an approval?

(c) The matter may be in appeal. It takes years to reach the Supreme court. Does it mean that till the case is decided by Supreme court, approval will be required?

(d) Whether a show cause notice is considered as an investigation?

(e) Whether a normal enquiry is also considered as an investigation i.e. notice from the ED can be considered as an investigation?