Volume I | Issue 1 | Taxes & Policies

June 05, 2015 | ECA PARTNERS | Monthly

Law2Law

Capability for Excellence

From the Editor

Dear Professional Colleague,

This Financial year began with a lot of hope. Hope for the economy, hope for India shining and hope we all do even better. And it is this hope which is sustaining us and keeps us running, for it is too early to expect tangible results. We are at a phase when hope makes us perform collectively.

We are happy to share with you the latest updates and things going around us in the fields of Finance & Economy through this news letter **"Law2Law"** and we hope the same will help you in updating your professional skills and knowledge further.

Your feedback and suggestions are very important for us and Team **"ECA"** would be waiting for your valuable feedback and inputs and we shall try to embed the same in our next issue.

Best Regards,

ECA Partners

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DIRECT TAX

Origin of Tax

In India, this tax was introduced for the first time in 1860, by Sir James Wilson in order to meet the losses sustained by the Government on account of the Military Mutiny of 1857.Thereafter; several amendments were made in it from time to time. At lastIn 1886, a separate Income tax act was passed. This act remained in force up to, with various amendments from time to time. In 1918, a new income tax was passed and again it was replaced by another new act which was passed in 1922.This Act remained in force up to the assessment year 1961-62 with numerous amendments

The Income Tax Act of 1922 had become very complicated on account of innumerable amendments. The Government of India therefore referred it to the law commission in1956 with a view to simplify and prevent the evasion of tax.. The law commission submitted its report-in September 1958, but in the meantime the Government of India had appointed the Direct Taxes Administration Enquiry Committee submitted its report in 1956.In consultation with the Ministry of Law finally the Income Tax Act, 1961 was passed.

Finance Bill, 2015 Enacted

During consideration of the Finance Bill, 2015 by the Parliament (Lok Sabha), as presented by the Union Finance Minister on 28th February, 2015, few amendments were made to the proposals as originally made. The amended Finance Bill has now received the assent of the President of India on 14th May, 2015.

Some important changes in Income Tax w.e.f. June 01, 2015:

- Bank/ Post Office to deduct TDS on RD also if interest more than 10000/- Per Annum.
- Every transaction in real estate be made by cheque if 20000/- or more.
- Purchase of fridge, TV, Car, can be made in cash or cheque but if more than Rs. 1 Lakh then PAN will be compulsory.
- Payment to transporters exceeding 30000/- Per annum, TDS to be deducted if the transporter is having more than 10 vehicles.
- U/s 200A IT Dept can impose fee for late filing of TDS Return @ 200/- Per Day.

Current Issue

MAT issue that FIIs are lamenting about

Brief introduction of MAT

In 1987, Prime Minister Rajiv Gandhi, in charge of the Finance portfolio, introduced what he called a "Minimum Alternate Tax" to target corporate including Reliance, which was then an undivided group that made profits and paid dividends to shareholders, but paid very little or, in some cases, zero taxes. Many companies could do so because the law then allowed several deductions and exemptions which could be utilized to significantly lower or escape tax liability. Rajiv Gandhi in his budget sought to ensure that a local, widely held company had to pay a tax of at least 15% of its book profit.

This Rs 40,000 crore demands is a tax pertaining to years before Finance Minister Mr. ArunJaitley announced scrapping of MAT. Therefore, the tax demand is legitimate although it is likely to hurt investment sentiments.

Credit Lyonnais Securities Asia (CLSA), in its report dated April 19, 2015 said, "Clearly, India is not completely out of the 'tax claims pertaining to prior years' syndrome yet."

CLSA said, "Government officials are largely going by the precedent of the case of Castleton Investments, wherein the Authority for Advance Ruling (AAR) gave a verdict in August 2012, that Castleton is liable to pay MAT when it transferred shares from a Mauritius entity to a Singapore entity. The case is currently with the Apex Court. If the Apex Court upholds the AAR ruling then the case of the income tax authorities will become very strong. If the Supreme Court strikes down the AAR ruling, then the cases will weaken considerably.

The government is simply asking funds to pay up the tax that is due to India. Finance Minister ArunJaitley has said that total tax collection from this revenue could be in the range of Rs 40,000 crore and he could fund India's irrigation projects for farmers with that money.

Moreover, the new government had clearly said that no new retrospective taxation cases will be opened but the ones currently underway will have to reach their logical conclusions.

Since this tax demand is of a period prior to abolishing MAT, the demand isn't unjust. Jaitley has reiterated that India is not a tax haven in his budget speech in parliament.

Budget 2015

- FII income from securities transactions and interest and royalties and fees from technical service exempt from MAT.
- No retrospectively relief.
- Rules for application of MAT for real estate investment trusts eased.
- Exemption will apply only in those cases where the normal tax rate is below 18.5%

FIIs in India

Foreign Institutional Investors (FIIs) ownership in Indian equities was at an all time high of 20.7% as on December 31, 2014.

The investment jumped 40% from FY14 to FY15.

The US (32%) and Mauritius (22%) together account for 50% of the total foreign investments in India followed by Singapore and Luxembourg at 9% each.

➢ Income from letting of properties is assessable as 'business profits' and not 'income from house property'

Assessee, M/s Chennai properties and Investment Ltd is a company incorporated in India with a primary objective of acquiring and letting out property in the city of Madras (now known as Chennai). The rent received from letting out of property was offered to tax by the taxpayer as business Income. However, as the income was received from letting out of property, A.O. considered the same as rental income and offered to tax under the head 'Income from House Property'. It was held by CIT(A) that the above income is required to offered to tax as Business Income. The appeal to ITAT by the department was dismissed however, Madras HC held to offer the above income to tax under the head 'Income from House property'. On appeal to Supreme Court by assessee explaining the law on whether income from letting of property is assessable as business profits or Income from house property, it was held as under:

- An object clause showing a particular object will not be determinative factor in determining whether the income is Income under the head Business and Profession or Income from House Property and it would be depended on the circumstances of each case.
- A commercial asset is an asset used only for business purpose. Business can be carried with all things. Therefore, it is not possible to classify a particular activity as business because it is concerned with an asset with which trade is commonly carried on.
- The letting out of the property for the purpose of exploitation of owner's property is to be considered as Income from House property but not if letting or sub-letting of property is a part of trading operation.
- In case of the assessee having its professed objects and the manner of its activities and nature of its dealings with property, it can be stated that the nature of its letting income is business profits.

Source: Chennai Properties & Investments Ltd vs. CIT (Supreme Court)

➢ Deduction for bad debts

Under the provision of section 36(1)(vii), the deduction for bad debts was allowed on the condition that such debt is written off as irrecoverable in the accounts of the assessee for the said year.

It is now provided that if an amount has been included as income on the basis of Income Computation and Disclosure Standards, which however is not provided in the Books of Accounts, and such amount has become irrecoverable, then deduction shall be allowed for bad debt even though the same is not recorded in the books of accounts.

➢ Interest paid for acquisition of capital assets not allowed as deduction

As per the provisions of section 36(1)(iii), any interest paid for extension of existing business or profession was not allowed as revenue expenditure for the period beginning from the date on which the capital was borrowed for acquisition of capital asset till the date on which such asset was first put to use.

It is proposed in finance act to delete the reference to ‘interest paid for extension of existing business or profession’. Accordingly, interest paid shall not be allowed as revenue expenditure if the capital is borrowed for acquisition of capital asset, whether for ‘extension’ of existing business or profession or otherwise.

➢ Place of Effective Management (“POEM”) in the case of a company

The Finance Bill, 2015 proposed to substitute the criteria for considering a company as ‘resident in India’. As per the proposal as initially made, a foreign company could become resident in India, if it had ‘place of effective management’ in India ‘at any time’ during the year.

Based on concerns expressed and in order to avoid disputes and unnecessary litigation, it is now proposed to omit theterm ‘at any time’ from the amendment as proposed by the Finance Bill, 2015.

Introduction of the 'range concept' for determining the arm's length price (ALP) and allowing the use of multiple year data for comparability analysis

On 21 May 2015, the Central Board of Direct Taxes (CBDT) has released long awaited draft rules of the proposed application of range concept and use of multiple year data for computation of ALP. The draft rules are made open for public comments now.

Currently, the Income Tax Act, 1961, provides that when more than one price is determined using the most appropriate method, the arm's length price will be the arithmetic mean of such prices and the variation, if any, should not exceed 1% for wholesale traders and 3% in other cases. Further, current rules require that the data to be used for determining an arm's length price compulsorily must pertain to the year in which the international transaction has been entered into, unless the taxpayer can provide evidences that the data for the prior two years has a bearing on the determination of transfer price. The above mechanism created significant issues for taxpayer, because some industries may be cyclical, prices are generally set based on the past year's data, and current-year data may not be available at the time preparing documentation.

The proposed mechanism and conditions released by the CBDT, under which 'multiple year data' and 'range computation' would be used for determination of ALP, shall be as under:

Multiple Year data

1. The multiple year data would be used only in cases where the method used for determination of ALP is Transaction Net Margin Method (TNMM), Resale Price Method (RPM) or Cost Plus Method (CPM); and
2. The multiple year data should comprise three years including the current year i.e. (year in which transaction has been undertaken) and its use for above mentioned methods shall be mandatory;
3. In case of non-availability of data for 3 years for any of the following reasons: -

- Data of the current year of the comparable may not be available on the databases at the time of filing of returns of income by taxpayers;
- A comparable may fail to clear a quantitative filter in any one out of the three years; and
- A comparable may have commenced operations only in the last two years or may have closed down operations during the current year.

Range Concept

1. The ‘’range? Concept shall be used only in cases where the method used for determination of ALP is TNMM, RPM or CPM;
2. A minimum of 9 entities are required to be selected as comparable entities for the tested party, based on the similarity of their functions, assets and risks (FAR) with that of the tested party;
3. 3-year data of these 9 entities (or more) would be considered and the weighted average of such 3-year data of each company would be used to construct the data set. In certain circumstances, data of 2 out of 3 years could also be used.

Thus, the data set or series would have a minimum of 9 data points;

- For calculating the weighted average, the numerator and denominator of the chosen Profit Level Indicator (PLI) would be aggregated for all the years for every comparable entity and the margin would be computed thereafter; and
- The data points lying within the 40th to 60th percentile of the data set of series would constitute the range.
- In case the transfer price of the tested party falls outside the range arrived at, the median of the range would be considered as the ALP.
- There would not be a separate tolerance band once the range is allowed.

In cases where ‘range’ concept does not apply, the arithmetic mean concept would continue to apply in the same manner as it applied before the amendment to the income tax law along with benefit of tolerance range, which should not exceed 1% for wholesale traders and 3% in other cases.

It is worthwhile to note that use of range application and multiple year data for determination of ALP is a prevalent mechanism internationally. The OECD guidelines 2010 advocates the use of multiple year data in paragraph 3.77 as under:

"Multiple year data will be useful in providing information about the relevant business and product life cycles of the comparables. Differences in business or product life cycles may have a material effect on transfer pricing conditions that needs to be assessed in determining comparability. The data from earlier years may show whether the independent enterprise engaged in a comparable transaction was affected by comparable economic conditions in a comparable manner, or whether different conditions in an earlier year materially affected its price or profit so that it should not be used as a comparable."

Similarly, the OECD guidelines 2010 also advocates the use of range concept in paragraph 3.57 as under:

“It may also be the case that, while every effort has been made to exclude points that have a lesser degree of comparability, what is arrived at is a range of figures for which it is considered, given the process used for selecting comparables and limitations in information available on comparables, that some comparability defects remain that cannot be identified and/or quantified, and are therefore not adjusted. In such cases, if the range includes a sizeable number of observations, statistical tools that take account of central tendency to narrow the range (e.g. the inter quartile range or other percentiles) might help to enhance the reliability of the analysis.’’

Moreover, the concept of inter-quartile range is generally practiced in countries such as Australia, Denmark, France, Germany, Italy, Korea, Netherlands, Spain, Sweden, the United Kingdom, the USA ,etc. However, there are certain divergences between the rules proposed by CBDT and the practices in other developed and developing countries, which are as under:

1. There is no such specification in the OECD guidelines or in other country regulations for the use of multiple year data and range concepts, while applying specific benchmarking methods – TNMM, RPM or CPM. In the proposed rules, the range benefit is not made applicable to the genuine cases where sufficient comparable transactions are available and related party transactions are benchmarked using Comparable Uncontrolled Price (CUP) method.
2. There is no such guideline which restricts the use of range concept on the basis of number of comparables to be selected as comparable entities of the tested party.

Service Tax

The penalty provisions contained under section 76 and section 78 were proposed to be substituted by the Finance Bill, 2015. It was proposed that:

a) Where service tax and interest is paid within 30 days of the date of service of notice under section 73(1), no penalty shall be payable under section 76.
b) Similarly, where service tax and interest is paid within 30 days of the date of service of notice under the proviso to section 73(1), penalty under section 78 shall be 15% of such service tax.

It has now been provided that:

a) In case payment is made as per (a) above pursuant to notice under section 73(1), the proceedings in respect of such service tax and interest shall be deemed to have been concluded.
b) In case payment is made as per (b) above pursuant to notice under the proviso to section 73(1), the proceedings in respect of such service tax, interest and penalty shall be deemed to have been concluded.

New Service Tax Rates of 14 % applicable from June 1st, 2015.

Service tax levied in India on all services , except few as listed in the negative list of services, will be applicable at the rate of 14 % , instead of 12% with effect from June 1, 2015.However, both the Education Cesses , i.e. Education Cess and Secondary & Higher education cess , have been abolished , from such date in respect of all services.

FOREIGN EXCHANGE MANAGEMENT ACT(FEMA)

- **Export of Goods and Services – Project Exports**

As per the extant provisions under Foreign Exchange Management Act, 1999 (“FEMA”) relating to Project Exports of Goods and Services, Authorised Dealer Banks (“AD Banks”)/Exim Bank (“EB”) were permitted to grant post-award approvals without any monetary limit and permit subsequent changes in the terms of post award approval in accordance with the relevant FEMA guidelines / regulations.

Further, in terms of the revised Memorandum of instructions on Project and Service exports, E B in participation with commercial banks in India is eligible to extend Buyer’s credit upto the limit of USD 20 million to foreign buyers in connection with export of goods on deferred payment terms and turn key projects from India.

With a view to further liberalizing the procedure and considering that the Working Group structure has been dismantled, it has been decided to withdraw the abovementioned limit of USD 20 million for Buyer’s credit extended to foreign buyers in connection with export of goods on deferred payment terms and turn key projects from India. The Memorandum of Instructions on Project and Service Exports (PEM) has been revised accordingly.

[Source: A.P. (DIR Series) Circular No. 93 dated April 1, 2015]

- **Foreign Direct Investment (“FDI”) – Insurance Sector**

Under the erstwhile provisions of the Foreign Direct Investment (“FDI”) Policy, FDI upto 26% was permitted under theautomatic route in the Insurance Sector, subject to specific conditions.

Recently, the Government of India (“GoI”) has introduced certain changes in the FDI policy for insurance sector, vide Press Note No. 3 (2015 Series) dated March 2, 2015, issued by the Department of Industrial Policy and Promotion (’DIPP’), Ministry of Commerce & Industry (“MoC&I”), GOI.

The salient features of the revised regulatory regime for the insurance sector inter alia include:

- Foreign investment in Indian insurance company shall be limited up to forty -nine percent of the paid up equity capital, which shall include the foreign investment by Foreign Portfolio Investors (“ FPI”), Foreign Institutional Investors (“FII”), Qualified Foreign Investors (“QFI”), Foreign Venture Capital Investors (“FVCI”), Non-Resident Indians (“NRI”) and Depository Receipts (“DR”);
- FDI up to 26 percent shall be under automatic route and beyond 26 percent and up to 49 percent shall be underGovernment approval route;
- Foreign investment in the Insurance Sector is subject to compliance of the provisions of the Insurance Act, 1938 and the condition that companies bringing in FDI shall obtain necessary license from the Insurance Regulatory & Development Authority of India for undertaking insurance activities.
- An Indian insurance company shall ensure that its ownership and control remains at all times in the hands of resident Indian entities;
- Any increase of foreign investment of an Indian insurance company shall be in accordance with the pricing guidelines specified by RBI under the FEMA.

FDI in Pension Sector

The GoI has allowed foreign investment in the pension sector upto 49%, subject to specific conditions. While FDI up to 26%is covered under the automatic route, FDI beyond 26% and upto 49% shall require Foreign Investment Promotion Board(FIPB) approval.

In terms of the above, the specific conditions inter alia include the following:

- FDI in the Pension Funds is allowed as per the Pension Fund Regulatory and Development Authority Act, 2013 (“PFRDA Act”).
- Foreign entities bringing in foreign equity investment are required to obtain necessary registration from the Pension Fund Regulatory and Development Authority and comply with other requirements as per the PFRDA Act and Rules and Regulations framed there under for so participating in Pension Fund Management activities in India.
- The said FDI limit of 49% includes foreign investment by FPI, FII, QFI, FVCI, NRI and DR.

- **Parliament approves the Companies (Amendment) Bill, 2014**

The Union Cabinet approved the introduction of Companies (Amendment) Bill, 2014, in the Parliament on December 2nd 2014, to make certain amendments in the Companies Act, 2013 ("The Act") and the same was passed by Lok Sabha on 17th December, 2014. Again on 29th April, 2015, the Union Cabinet gave its approval for moving some more amendments in the Act, which was passed by Lok Sabha on 07th May, 2015 and approved by Rajya Sabha on May 13th 2015, as the Companies (Amendment) Bill, 2014.

The major amendments made to the Companies Act, 2013 by the above bill are as follows:-

- Removal of Minimum Paid Share Capital **(for ease of doing business)**
- Doing away with the requirement of filling a declaration by a Company before commencementof business orexercising its borrowing powers. **(for ease of doing business)**
- Making Common Seal optional, & consequential changes for authorization for executions of documents **(for ease of doing business)**
- Specific punishment for deposits accepted under the new Act is proposed to be prescribed. This was left out in theAct inadvertently. **(To remove an omission)**
- Public inspection of Board Resolutions filled with Registrar of Companies is proposed to be prohibited. **(to meet corporate demand)**
- Including provision for writing off past losses/depreciation before declaring dividend for the year. **(This was missed in the Act but included in the Rules.)**
- Rectifying the requirement of transferring equity shares for which unclaimed/unpaid dividend has been transferred to the IEPF even though subsequent dividend(s) has been claimed. **(To meet corporate demand)**
- It is proposed to provide for prescribing the thresholds beyond which fraud shall be reported to the Central Government below the threshold, it will be reported to the Audit Committee. Disclosure for the latter category also to be made in the Board Report. **(Demand of auditors)**
- Exemption u/s 185 (Loans to Directors) provided for loans to wholly owned subsidiaries and guarantees/securities on loans taken from banks by subsidiaries. **(This was provided under the Rules but being included in the Act as a matter of abundant caution).**
- Empowering Audit Committee to give omnibus approvals for related party transactions on annual basis. **(Align with SEBI policy and increase ease of doing business)**
- Replacing special resolution with ordinary resolution for approval of related party transactions by non-related shareholders. **(Meet problems faced by large stakeholders who are related parties)**
- Exempt related party transactions between holding companies and wholly owned subsidiaries from the requirement of approval of non-related shareholders. **(Corporate demand)**
- Bail restrictions to apply only for offence relating to fraud u/s 447.
- Winding Up cases to be heard by 2 member Bench instead of a 3 member Bench. **(Removal of an inadvertent error)**
- Special Courts to try only offences carrying imprisonment of two years or more. **(To let magistrate try minor violations)**
- Rationalizing the procedure for laying draft notifications granting exemptions to various classes of companies.

RELEVANT DATES

STATUTORY DATES FOR THE MONTH OF JUNE' 2015

05-06-2015	**Service Tax** - Service Tax Payment by Companies for May **Central Excise** - Payment of Excise Duty for all Assesses (other than SSI Units) for May.(if Excise Duty / Service Tax paid electronically through internet banking, the date is to be reckoned as 6th instead of 5th.)
07-06-2015	**Income Tax** - TDS Payment for May
10-06-2015	**Central Excise** - Monthly Return in Form ER-1 (Ann-12) for other than units availing SSI exemption for May – Monthly Return in Form ER-2 (Ann-13) by 100% EOUs for May – Monthly information relating to principal units in Form ER-6 (Ann – 13AC) for specified assesses for July – Exports – Procurement of specified goods from EOU for use in manufacture of Export goods in Form Ann-17B for DTA units, procuring specified goods from EOU for manufacture of export goods – Proof of Exports in form Ann.-19, once in a month for all exporters, exporting goods under Bond – Export detains in Form Ann.-20, for Manufacturing following simplified export procedure. – Removal of excisable goods for specified use at concessional rate of duty in terms of Rules described in Col. 4.
15-06-2015	**Provident Fund** - PF Payment for May **Income Tax** - Advance Income Tax – Companies.
21-06-2015	**ESIC** - ESIC Payment for May.

PROVIDENT FUND

<u>TDS on premature withdrawal (Section 192A & 197A)</u>

Trustees of RPFs shall, at the time of payment of the accumulated balance due to the employee, deduct tax at source at the rate of 10%, where the aggregate withdrawal is Rs. 30,000/- or more. However, Form No. 15G/15H is available for non-deduction of TDS. Further, in case PAN is not provided by the assessee, TDS will be deducted at the Maximum Marginal Rate i.e. 34.608%.

INSPIRATION

Fred Smith | Federal Express

Fred Smith was an undergraduate at Yale University in 1965. As part of the coursework, he wrote an economics paper exploring the process of transportation of goods in the United States. He found that the shippers relied on transporting large packages across the United States by means of truck or passenger airplanes. Smith thought of a more efficient transportation idea. He wrote a last minute paper on how a company carrying small, essential items by plane could be a much better business. He, however, did not go into details about how to actually run such a company. His paper was graded "C". But Smith did not give up on the idea and launched the company in 1971.

But within three years of the founding of the company, Federal Express was on the verge of bankruptcy. It was losing over $1 million a month, due to the rising fuel costs. At its zenith, the company had just $5000 to its name. Smith made a final pitch to General Dynamics for more funding. The request was turned down.

Most ordinary people would have quit at this point and shut down the company. Not Fred Smith. What he did next is easily the boldest move by the founder of a company. Smith flew to Las Vegas and played Black Jack that weekend with the remaining company funds. Yes, all of the $5000. On Monday, the management of the company had a pleasant surprise lined up. FedEx had $32,000 in its bank account, which was just enough to cover the fuel for their planes and to continue operating a few days more.

Soon after, the company was able to raise significant amounts in funding. Today FedEx is a global giant with operations in more than 220 countries and territories and annual revenue of US $45 billion.

About ECA Partners:

ECA is a professionally managed company. The team consists of distinguished chartered accountants, corporate financial advisors and tax consultants. The firm represents a combination of specialized skills, which are geared to offers sound financial advice and personalized proactive services. Those associated with the firm have regular interaction with industry and other professionals which enables the company to keep pace with contemporary developments and to meet the needs of its clients.

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Success is how high you bounce when you hit bottom
~ Michael Jordan

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