Horizons

An FPI Bulletin **February 2015**

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Contents

Relevant changes in the Regulatory Framework

Regulations from the Securities and Exchange Board of India (SEBI) and other regulatory bodies

Changes in the conditions prescribed for FPI investments in government debt securities

(SEBI Circular No.CIR/IMD/FIIC/2/2015 dated 5 February 2015 and RBI Circular No. RBI/2014-15/453 A.P (DIR Series) Circular No.72 dated 5 February 2015)

In accordance with the announcements made by the Reserve Bank of India (RBI) in the sixth bi-monthly monetary policy statement (2014-15), the following has been decided:

- Investments of coupons (viz. interest) in government securities will be enabled even when the existing limits for FPIs are fully utilised

- FPIs shall be permitted to invest in government securities. Further, FPIs shall receive coupons against their investments in government securities. Such investments shall be kept outside the applicable limit (currently US$ 30 billion) for investments by FPIs in government securities

- For the purpose of investment of coupons, the FPIs shall have an investment period of five working days from the date of receipt of the coupon. Government securities that have been purchased by utilising the coupons can be reinvested within five working days. All other existing conditions with regards to investment in government securities market, applicable to FPIs, would remain unchanged for this additional facility of reinvestment of coupons. It is further clarified that the same regulations will be applicable to coupons received on those government securities that are purchased through the investment of coupons

- The coupons invested to purchase government securities shall be listed under a separate investment category, which is over and above the US$ 30 billion government debt limit

Change in investment conditions/ restrictions for FPI investments in corporate debt securities

(SEBI Circular No.CIR/IMD/FIIC/1/2015 dated 3 February 2015 and RBI Circular No.RBI/2014-15/448 A.P (DIR Series) Circular No.71 dated 3 February 2015)

In accordance with the announcements made by the RBI in the sixth bi-monthly monetary policy statement (2014-15), it has been decided that:

- All future investments within the US$ 51 billion corporate debt limit category, including the limits that become available when the current investment by

an FPI runs off either through sale or redemption, have to be made in corporate bonds with a minimum residual maturity of three years

- FPIs shall not be permitted to invest in liquid and money market mutual fund schemes

- There will be no lock-in period and FPIs shall be free to sell the securities (including those that are presently held with less than three years residual maturity) to domestic investors

The RBI has been receiving some queries on the applicability of the aforesaid directions and has, accordingly, provided the following clarifications:

Q: Will the aforesaid directions be applicable to investment in commercial papers (CPs) by FPIs?
A: In terms of the aforesaid directions, any fresh investment shall be permitted in any type of debt instrument in India with a minimum residual maturity of three years. Accordingly, FPIs shall not be allowed to make any further investment in CPs.

Q: What will be the applicability of these guidelines on debt instruments that have a maturity of three years and above, but with optionality clause of less than three years?
A: FPIs shall not be allowed to make any further investments in debt instruments having minimum initial/ residual maturity of three years with optionality clause exercisable within three years.

Q: What will be the applicability of these guidelines on amortised debt instruments having an average maturity of three years and above?
A: FPIs shall be permitted to invest in amortised debt instruments, provided the duration of the instrument is three years and above.

Clarification around foreign direct investment (FDI) in the pharmaceutical industry

(RBI Circular No. RBI/2014-15/441 A.P (DIR Series) Circular No.70 dated 2 February 2015)

On review of the extant FDI policy for the pharmaceutical industry it has been decided that there would be an exception for medical devices. Previously, medical devices followed the same FDI policy as applicable to the pharmaceutical industry.

FDI up to 100% is permitted under the automatic route for greenfield investments and FDI up to 100% is permitted under government approval route for brownfield investments (i.e. investments in existing companies) in the pharmaceutical industry.

Review of the FDI policy: Sector-specific conditions – Construction development sector

(RBI Circular No.RBI/2014-15/420 A.P. (DIR Series) Circular No.60 dated 22 January 2015)

Currently, 100% FDI is permitted under the automatic route in the construction development sector, subject to conditions.

On review of the extant FDI policy for the construction development sector, it has been decided that, effective 3 December 2014, 100% FDI, under the automatic route, shall be permitted in the construction development sector, subject to the conditions specified in the Press Note 10 (2014 Series) dated 3 December 2014.

Routing those funds to India that have been raised abroad

(RBI Circular No.RBI/2014-15/316 A.P. (DIR Series) Circular No.41 dated 25 November, 2014)

On review of the regulatory framework under the Foreign Exchange Management Act (FEMA), 1999 related to the External Commercial Borrowings (ECBs), issuance of guarantees, and overseas direct investment from India, the following clarifications has been provided:

i. Indian companies or their AD category – 1 banks are not allowed to issue any direct or indirect guarantee, create any contingent liability, or offer security in any form for such borrowings for their overseas holding/ associate/ subsidiary/ group companies, except for the purposes explicitly permitted in the relevant regulations

ii. Funds that are raised abroad by overseas holding/ associate/ subsidiary/ group companies with support of the Indian company or their AD category – 1 banks, as mentioned in point (i) above, cannot be used in India, unless it conforms to the general or specific permission granted under the relevant regulations

iii. Indian companies or their AD category - 1 banks that have established structures, which contravene the above, shall be liable to penal actions as prescribed under FEMA, 1999

Income tax updates

Recent amendments:

The Central Board of Direct Taxes (CBDT) signs the first bilateral Advance Pricing Agreement (APA)

(Press release dated 19 December 2014)

The CBDT has signed a bilateral APA with a Japanese company. This is India's first bilateral APA. The APA is for a period of five years.

The APA scheme was introduced in India to bring about certainty and uniformity in transfer pricing matters of multi-national companies and to reduce litigation. With respect to the growing economic ties between Japan and India, especially after the Hon'ble Indian Prime Minister's visit to Japan, this APA is expected to generate positive sentiments among Japanese investors to invest in India.

Interest chargeable on self-assessment tax paid before due date of filing of return of income under Section 234A

(Draft circular no. 2/2015 [F.No.385/03/2015-IT(B)] dated 10 February 2015)

Interest that is chargeable under Section 234A of the Income-tax Act, 1961 ('the Act') is charged in case there is default in furnishing the return of income within due date. The interest is charged at the specified rate on the amount of tax payable on the total income, as reduced by the amount of advance tax, tax deducted/ collected at source, any relief of tax allowed under Section 90 and Section 90A, any deduction allowed under Section 91 and any tax credit allowed in accordance with the provisions of Section 115JAA and Section 115JD of the Act. Presently, interest is being charged on the amount of self-assessment tax paid even before the due date of filing the return.

It has been held by the Supreme Court in the case of *CIT* v. *Prannoy Roy*, 309 ITR 231 (2009) that the interest chargeable under Section 234A of the Act, in case of default in furnishing return of income, shall be payable only on the amount of tax that has not been deposited before the due date of filing the income-tax return for the relevant assessment year. Accordingly, the present practice of charging interest under Section 234A of the Act on self-assessment tax paid before the due date of filing the return was reviewed by the CBDT.

The CBDT has now decided that no interest will be chargeable on the amount of self-assessment tax paid before the due date of filing the return of income, under Section 234A of the Act.

Clarification on amounts not deductible under Section 40(a)(i)

Circular No. 3/2015 [F.NO.225/201/2015-ITA.II], Dated 12 February 2015

Section 40(a)(*i*) of the Act stipulates that in computing the income chargeable under the head 'profits or gains of business or profession', any interest, royalty, fees for technical services or other sum chargeable under this Act, payable either in India to a non-resident (not being a company)/ a foreign company or payable outside India, shall not be allowed as a deduction, if there has been a failure in deduction or in payment of tax deducted in respect of such amounts under Chapter XVII-B of the Act.

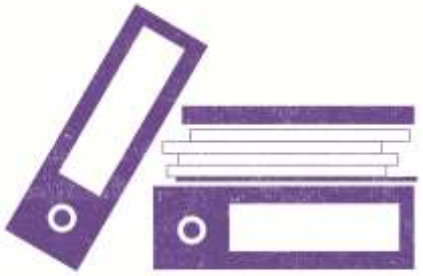
Disallowance regarding 'other sum chargeable' under Section 40(a)(*i*) is triggered when the deductor fails to withhold tax as per the provisions of Section 195 of the Act. Doubts have been raised about the interpretation of the term 'other sum chargeable' i.e. whether this term refers to the whole sum being remitted or only to the portion representing the sum chargeable to income-tax under the relevant provisions of the Act.

CBDT has already issued Instruction No. 02/2014, dated 26 February 2014 (F.No. 500/33/2013-FTD-I) regarding the deduction of tax at source under sub-section (1) of Section 195, read with Section 201 of the Act, relating to payments made to non-residents, in cases where no application is filed by the deductor for determining the sum so chargeable under sub-section (2) of Section 195 of the Act.

Vide this Instruction, the CBDT has clarified that in cases where tax is not deducted at source under Section 195 of the Act, the Assessing Officer (AO) shall determine the appropriate portion of the sum chargeable to tax, as mentioned in sub-section (1) of Section 195, to ascertain the tax liability on which the deductor shall be deemed to be an assessee in default, under Section 201 of the Act. It has been further clarified that such appropriate portion of the said sum will depend on the facts and circumstances of each case, taking into account the nature of remittances, income component therein or any other fact relevant to determine such appropriate proportion.

As disallowance of amount under Section 40(a)(*i*) of the Act in case of a deductor is interlinked with the sum chargeable under the Act, as mentioned in Section 195 of the Act, for tax deduction at source, the CBDT, exercising the powers conferred on it under Section 119 of the Act, hereby clarifies that for the purpose of making disallowance of 'other sum chargeable' under Section 40(a)(*i*) of the Act, the appropriate portion of the sum, which is chargeable to tax under the Act, shall form the basis of such disallowance and shall be the same as determined by the AO having jurisdiction for the purpose of sub-section (1) of Section 195 of the Act, as per CBDT's Instruction No. 2/2014, dated 26-2-2014.

Further, where determination of 'other sum chargeable' has been made under sub-section (2), (3) or (7) of Section 195 of the Act, such a determination will form the basis for disallowance, if any, under Section 40(a)(*i*) of the Act.



Relevant jurisprudence

Recent rulings

Dharamshila Cancer Foundation and Research Centre vs. CIT [TS-773-HC-2014(DEL)]

The Delhi High Court (HC) has directed expeditious disposal of application for issuance of certificate for lower/ nil withholding of tax under Section 197 of the Act. The HC observed that the issuance of certificate under Section 197 of the Act has become an issue of annual dispute and has held that if the petitioner moves the application in the first week of the financial year, the same ought to be disposed-off within a reasonable period of time. The applicable time, in case of withholding tax certificates under Section 197 of the Act, should not exceed six weeks.

NEO Path Ltd vs. DIT [TS-783-HC-2014(BOM)]

The Mauritian company had approached the Authority for Advance Rulings (AAR) on the issue of capital gains tax applicability arising on the sale of the shares of the Indian company from Mauritius to Singapore, resulting in a long-term gain of over US$ 75 million. The Revenue authorities argued that 'control and management' was in India and Indian residents were the ultimate beneficiaries. Correspondingly, the AAR declined to entertain the application, and held that transaction was designed prima facie for tax avoidance. The HC has set aside the AAR ruling wherein the AAR had declined to consider the application filed by a Mauritian company seeking advance ruling under Section 254Q of the Act. The HC held that the AAR ruling has been passed in breach of the natural justice principles.

The HC has relied on the Supreme Court ruling in the case of Shukla Brothers and Kranti Associates (P) Ltd., and held that "recording of reasons is an essential feature of providing justice and, in fact, is the soul of orders". The HC concluded that the AAR order "suffers from the vice of being an order without reasons" and restored the matter back to the AAR for fresh disposal in accordance with the law.

DDIT vs. H & R Johnson (Overseas) Ltd. [TS-799-ITAT-2014(Mum)]

The Tribunal upholding the order of CIT(A), ruled that in respect of shares, including bonus shares issued prior to 1 April 1981, capital gains must be calculated after giving benefit of the fair market value as on 1 April 1981, in view of Section 55(2)(b)(i) of the Act. The Tribunal held that in case of bonus shares acquired prior to 1 April 1981, the assessee is entitled to consider the fair market value as on 1 April 1981 as the acquisition cost. However, in case of bonus shares acquired after 1 April 1981, the acquisition cost would be nil.

CIT(A) vs. Sarosh Nowrojee Burjorjee[TS-802-HC-2014(KAR)]

The HC allows deduction for loss on sale of securities. The HC held that Section 94(7), in relation to dividend stripping, was not applicable, since the assesse sold securities after three months from its 'purchase' date.

Section 94(7) of the Act is an anti-avoidance provision and is also known as dividend stripping. Section 94(7) denies deduction of losses if (a) the assessee acquires any securities within three months prior to the 'record date' for dividend declaration and (b) sells 'such' securities within three months after 'such date'.

The HC denied the interpretation by the Revenue authorities of 'such date' in clause (b) of Section 94(7) as 'record date'. Further, the HC held that if the intention of the legislature was "on such date" used under clause (b), to mean record date, there was no difficulty to use the word 'record date' itself instead of 'such date'. The HC further held that 'record date' is the definite date while 'purchase date' varies from transaction to transaction. The HC has observed that the legislature has intentionally used a vague expression in the form of 'such date'. The HC has concluded that the word 'such date' used under Section 94(7) (b) is 'purchase date' of securities and not the 'record date'.

Investeringsforeningen BankInvest I Afd Indien & Kina vs. DDIT [TS-667-ITAT-2014 (Mum)]

Assessee, a Foreign Institutional Investor (FII), and a resident of Denmark, liable to income-tax deduction in Denmark, made capital gains on the sale of shares of Indian companies. In its income-tax return, the tax residency certificate was produced by the assessee and capital gains earned were claimed as exempt under article 14 of Indo-Denmark Double Taxation Avoidance Agreement (DTAA). The income-tax return was processed accordingly. The AO sought to reopen the assessment, holding that the assessee was not a taxable unit in Denmark and hence he/ she was liable to income-tax deduction in India in respect of capital gain earned in India. However, the AO had not referred to any other information or material that the assessee had falsely claimed benefit under Article 14 of the DTAA.

The Tribunal held that no reassessment should be initiated where reasons recorded for the reopening fell within the realm of surmises to deny capital gains exemption under the India-Denmark DTAA.

Expro Gulf Limited vs. Union of India and others [TS-11-HC-2015 (UTT)]

The CBDT notification specifying Cyprus as a 'non-cooperative jurisdiction' under Section 94A (1) of the Act with regards to the lack of 'effective exchange of information ('EOI')' was challenged before the Uttarakhand HC. Since the term 'effective EOI' has not been defined under the Act, the petitioner argued that 'arbitrary' powers are delegated to the Central Government under Section 94A of the Act. The petitioner also contended that without rescinding or renegotiating the DTAA, no departure can be made from the specific provisions of such DTAA, by enacting the corresponding legislation in any one contracting State.

The Uttarakhand HC dismissed the writ petition which challenged the blacklisting of Cyprus as a non -jurisdictional geographic region under Section 94A of the Act. The HC held that there was no requirement for it to look into whether the information sought by the Indian Authorities were ever declined by the Government of Cyprus or whether the Government of Cyprus is ready and willing to supply the information sought by the Indian Authorities. The HC also stated that there seems to be no valid reason to question the satisfaction levels of the Indian Authorities on this matter.

Glossary

AAR	The Authority for Advance Ruling
AD	Autorised Dealers
AO	Assessing Officer
APA	Advance Pricing Agreement
CBDT	Central Board of Direct Taxes
CIT	Commissioner of Income-tax
CIT(A)	Commissioner of Income-tax (Appeals)
CP	Commercial Paper
DDIT	Deputy Director of Income-tax
DIT	Director of Income-tax
DTAA	Double Taxation Avoidance Agreement
ECB	External Commercial Borrowings
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act, 1999
FII	Foreign Institutional Investor
FPI	Foreign Portfolio Investor
HC	High Court
ITAT	Income Tax Appellate Tribunal
RBI	Reserve Bank of India
SEBI	Securities and Exchange Board of India
SEBI (FPI) Regulations	Securities and Exchange Board of India (Foreign Portfolio Regulations), 2014
The Act	The Income-tax Act, 1961

Our view

About Stock Holding Corporation of India Limited

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In terms of the SEBI (Foreign Portfolio Investors) Regulations, 2014 notified on 7 January 2014, SHCIL, being a custodian of securities registered with SEBI on the date of commencement of the regulations, is permitted to act as a Designated Depository Participant (DDP).

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SHCIL is registered with SEBI as DDP. SHCIL will grant Registration to FPIs on behalf of SEBI and will carry out other allied activities in compliance with the regulations and other guidelines.

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