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Financial services insight: Tax and regulatory updates

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Preface

With travel, transportation, hospitality, retail, IT, etc. being severely impacted, the banking and financial services sector is going to witness credit squeeze, possibly higher non-performing assets, lack of demand off-take and fear of lending by the bankers to sectors of the economy, such as, micro small and medium enterprises

After a decisive mandate for the second time in 2019, Government of India had set a target of making the country a five-trillion dollar economy in the next five years.

However, coronavirus disease pandemic has left countries battling with uncertain times. As strict lockdown was enforced to prevent the spread of the disease, India implemented one of its longest nationwide lockdown. The impact of which was felt on the financial services sector. With travel, transportation, hospitality, retail, IT, etc. being severely impacted, the sector is going to witness credit squeeze, possibly higher non-performing assets, lack of demand off-take and fear of lending by the bankers to sectors of the economy, such as, micro small and medium enterprises (MSMEs).

While the Reserve Bank of India (RBI) has been pro-active and taken some liquidity measures for the bankers, non-banking finance companies (NBFC) as a sector is in a spot due to its liquidity crisis. Going forward, all eyes will be keenly on the financial services sector to observe if they can facilitate in lifting the economy of the country.

The services sector in India has been a great stimulus to the Indian economy accounting for 54.17% of gross value added, where the financial services segment has been the biggest contributor. Government of India along with the regulators has helped in developing the sector by introducing reforms to liberalise, regulate and enhance.

The finance minister's (FM) second full-term Budget in 2020 also proposed several measures to boost the sector. Some of them included setting up an International Bullion Exchange in International Financial Service Centre, making available specified categories of government securities to non-residents investments, increasing the limit in corporate bonds for foreign portfolio investors and amend the Banking Regulation Act to strengthen the co-operative banks.

The asset management industry in India has grown in the recent years. In November 2019, assets managed by mutual funds reached INR 26.94 trillion (USD 391.11 billion). Private Equity/Venture Capital investments in India have reached USD 37.5 billion in 2018 and touched USD 36.96 billion in 2019. Also, alternative investment funds have received capital investment worth INR 1.17 billion (USD 17 billion) in 2018-19.

In the last few years, the government has taken many reformative steps to make financial sector robust. One such reform has been the introduction of Insolvency and Bankruptcy Code (IBC), 2016, which equipped banks to recover bad loans from defaulting borrowers expeditiously. The IBC has directly/indirectly addressed stressed assets worth INR 3 lakh crore in the last two years. In order to streamline the banking sector, FM announced merger of six public sector banks with four better performing anchor banks. The primary objective of this merger was to make the banks akin to global banks.

The government has also swiftly stepped in to ease the pressure on the beleaguered NBFCs, which have been reeling under liquidity stress since almost a year. Acknowledging the role of NBFCs in sustaining consumption demand as well as capital formation in SMEs, the government has provided a one-time six months' partial credit guarantee to public sector banks to buy high-rated pooled assets worth INR 1 lakh crore from NBFCs. This will provide the much-needed liquidity to NBFCs as they can thus liquidate their portfolio and meet their liabilities in a timely manner.

The relaxation of foreign investment rules in the insurance sector, as announced in Budget 2020, has also received a positive response with many companies announcing plans to increase their stake in joint ventures with Indian companies. On the direct tax front, the government has reduced corporate tax rate to 22% from 30% for domestic companies and to 15% for new domestic manufacturing units. On the regulatory front, key reforms such as liberalising external commercial borrowing, proposing to set up a common authority for IFSC, overhauling the FPI regulations, introducing voluntary retention route for FPI etc. will have a far-reaching impact on the economy.

This publication summarises key tax and regulatory changes related to the financial services sector, between October 2019 and March 2020.

Direct tax updates

Key highlights of Union Budget 2020

The finance minister (FM) on 1 February 2020 presented the Finance Bill 2020 (Bill) proposing amendments in Indian tax laws. However, in the wake of representations received from various stakeholders[1], the FM introduced certain amendments to the Bill while moving it before the Lok Sabha for approval. The Bill and the subsequent amendments received president's assent on 27 March 2020 and was enacted as law under the Finance Act 2020.

The key amendments under the Finance Act 2020 are as follows:

Taxability of dividend income

- Dividend distribution tax (DDT) has been abolished, and dividends are now taxed directly in the hands of shareholders/unitholders at applicable rates. Companies/ mutual funds are, however, required to withhold taxes at prescribed rates in certain cases.
- Removal of cascading in case of inter-corporate dividend by providing deduction in respect of dividends received from domestic companies, foreign companies and business trust.

  Dividends received by the business trust from an special purpose vehicle (SPV) exempt, if the SPV has not exercised the concessional tax regime (i.e. 22% tax rate plus applicable surcharge and cess, as prescribed under section 115BAA of the Income-tax Act, 1961 (Act)).

Residency rule

Citizenship-based deemed residency introduced whereby Indian citizens or a person of Indian origin visit/stay in India exceeding 120 days (as against 182 days) and is not liable to tax in any other country by virtue of residency, domicile and having total income (other than income from foreign sources) exceeding INR 15 lakh shall be considered as not ordinarily resident (NOR).

Amendment in compliances

The scope of exemption of non-filing of tax returns by non-resident has been expanded to income received from royalty and fees for technical services (FTS), in addition to dividend and interest income, provided taxes are deducted on such income at the rates mentioned in the Act.

- The due date for filing the return of income for companies and other tax payers liable to tax audit (other than taxpayers who are required to file a transfer pricing audit report) extended to 31 October 2020 (instead of 30 September). However, the due date for furnishing tax audit and other audit reports continues to be 30 September 2020.
- Threshold for tax audit increased to INR 5 crore from INR 1 crore, provided cash transactions (both receipts and payment side) are less than 5% in value.
- Due date of furnishing the transfer pricing audit report changed to 31 October (instead of 30 November).

New tax regime introduced for individuals and HUFs

A new optional tax regime introduced for individuals and Hindu Undivided Family (HUFs). Based on satisfying certain conditions, such taxpayers shall have an option to pay taxes at reduced slab rates (without claiming certain exemptions and deductions specified). In cases, where the individuals and HUFs are engaged in business and profession, the option to choose the new tax regime is one-time and not year-to-year.

Tax withholding and collection

- Concessional withholding tax rate of 5% on interest income of a non-resident by an Indian company now extended to borrowings made up to 30 June 2023 (instead of 30 June 2020)
- Concessional withholding tax rate of 5% to interest payments made to foreign portfolio investors (FPIs) extended up to 30 June 2023 (instead of 30 June 2020), with respect to rupee denominated bonds and government securities. These benefits also extended to interest payments in municipal debt securities.
- Concessional withholding tax rate of 4% on interest payments made to non-residents by an Indian company on issue of long-term bonds or RDBs on or after 1 April 2020 but up to 30 June 2023 listed on a recognised stock exchange in the IFSC.
- Tax collection at source (TCS) provision introduced on foreign remittance though Liberalised Remittance Scheme (LRS) exceeding INR 0.7 million, including overseas tour related expenses, on tour operators for providing overseas foreign tour and on seller for sale of any goods

1. The Finance Bill, 2020 received the assent of the President of India on 27 March 2020

Exemption to sovereign wealth fund

100% tax exemption is provided to specified sovereign wealth funds, foreign pension funds (meeting specified conditions) and wholly owned subsidiary of Abu Dhabi Investment Authority on interest and long-term capital gains earned from investments in certain specified entities (carrying on specified infrastructure facility business) on or before 31 March 2024.

Taxation of digital transaction

The scope of domestic source rule taxation has been expanded by introducing equalisation levy (EL) on e-commerce transactions through non-resident e-commerce operator at the rate of 2% on amount of consideration received/receivable by "e-commerce operator" from "e-commerce supply or services" from specified payers with effect from 1 April 2020. The term "e-commerce operator", "e-commerce supply or services", "specified payers" and exclusions from EL are defined under the Act.

Others tax amendments

- Definition of business trust under the Act has been amended and it no longer requires a business trust to be listed to enjoy the pass-through benefit under the Act (in accordance with the relaxations issued by the Securities and Exchange Board of India (SEBI)
- Exemption from indirect transfer provisions only provided to Category I FPIs under the SEBI (FPI) Regulations, 2019. However, investment made in Category I and Category II FPIs under the erstwhile SEBI (FPI) Regulations, 2014 grandfathered, provided such investments were made before 23 September 2019.
- While computing business profits of insurance companies (other than life insurance companies), a deduction of certain type of expenditure[2], irrespective of the year in which the liability to pay such expenses was incurred, to be allowed on a payment basis.
- Certain conditions, such as computing aggregate participation or investment in a fund and computing monthly average of the corpus of a fund, are relaxed to enable qualification of eligible investment fund under the special tax regime prescribed under section 9A of the Act.
- Scope of e-proceedings extended to include best judgment assessment made under Section 144, proceedings before the Commissioner of Income-tax (Appeals) [CIT(A)] and penalty proceedings in certain cases.
- Sections 90 and 90A of the Act amended to deny treaty benefits to all arrangements created for the purpose of tax evasion and avoidance.
- Benefit of carry forward of accumulated losses and unabsorbed depreciation in case of amalgamation is now extended to amalgamation of public sector banks and public sector general insurance companies.
- Commodity Transaction Tax (CTT) was introduced on sale of options in goods and on sale of commodity derivatives based on prices or indices.
- The provisions of thin capitalisation restricting deduction of expenditure by way of interest or similar payments to not apply to interest paid in respect of a debt issued by a lender which is a PE of a non-resident engaged in the business of banking in India.

Our view

Introduction of a new tax regime for individuals and HUFs, abolition of DDT in the hands of the Indian companies, exemption of sovereign and pension funds on certain streams of income, reduced rate of WHT on interest income on specified bonds listed in IFSC in addition to enhancing the applicability of lower WHT period to non-resident taxpayers are welcome steps that will help in boosting the economy by attracting more offshore investment and improve liquidity. Modification of tax residency rules, enhancing the scope of EL and introducing e-commerce transactions under the ambit of EL will facilitate government in increasing its tax revenue.

Taxation of dividend income in the hands of shareholders will allow foreign investors to claim credit of such taxes in their home jurisdiction as well as may enable them to avail lower tax rate under the tax treaties subject to fulfilling certain conditions. Overall, the Union Budget was properly balanced as it provided various tax reliefs/compliances ease to taxpayers and simultaneously monitored/controlled fiscal deficit by widening the tax bracket to cover transactions such as e-commerce, remittance outside India, etc.

2. such as bonus, leave encashment, etc

Central Board of Direct Taxes (CBDT) communicates its view on accumulated Minimum Alternate Tax (MAT) credit and unabsorbed additional depreciation under the newly introduced lower tax rate regime for domestic companies[3]

The Taxation Laws (Amendment) Act, 2019, introduced section 115BAA of the Act allowing domestic companies an option to opt for an alternative income-tax regime from FY 2019-20. The key features of the alternative income tax regime are as follows:

- Reduced income tax rate of 22% (plus surcharge and cess) and 15% (plus surcharge and cess) for domestic manufacturing company, respectively, will be applicable
- Certain exemptions, deductions, allowances (including additional depreciation) will not be available
- MAT will not apply

  There is no time limit for companies to opt for the new tax regime. However, once adopted, it cannot be withdrawn. With regard to the representations received from various stakeholders, CBDT vide a circular has clarified the following:

- Companies opting for the new tax regime will not be allowed to claim set-off of any brought forward loss on account of additional depreciation for any year.
- Since MAT provisions would not apply to companies opting for the reduced tax rate, brought forward MAT credit shall not be available to such company.
- Those companies having brought forward loss on account of additional depreciation or brought forward MAT credit may have the option to avail the new tax regime post utilising its unabsorbed additional depreciation or MAT credit under the existing tax regime.

Our view

Clarification from CBDT is a welcome move and will help in reducing ambiguities. In case where brought forward loss or MAT credit are not substantial in amount depending on the overall business operations, it would be essential for such companies to carry out cost-benefit analysis between the two tax regimes to evaluate the more efficient one.

Insertion of new section i.e. section 269SU in the Act to prescribe electronic modes[4]

The CBDT has notified the prescribed electronic modes of payment under Rule 119AA for the purpose of section 269SU of the Act:

- Debit card powered by RuPay
- Unified payments interface (UPI) (BHIM - UPI)
- Unified payments interface quick response code (UPI QR code) (BHIM - UPI QR code)

The above shall be applicable from 1 January 2020 for every person carrying on business if his total sales, turnover or gross receipts in business exceeds INR 50 crore during the immediately preceding financial year.

Such persons to whom this section is applicable shall mandatorily provide facilities for accepting payments through the above-mentioned electronic modes.

The circular issued further clarifies that any person to whom provisions of section 269SUof the Act are applicable but fails to comply with is liable for penalty of INR 5,000 per day. However, such penalty is leviable from 1 February 2020.

Our view

This measure adopted by Government of India is in line with its drive against black money and promotion of the digital economy.

3. Circular No. 29/2020 dated 02 October 2019
4. Circular 32 of 2019 and Notification No. 105 of 2019 dated 30 December 2019

CBDT lays down procedures for allotment of Permanent Account Number (PAN) to FPI's through Common Application Form (CAF)[5]

CBDT has laid down the procedure for allotment of PAN to the New FPIs through CAF for simplifying the registration process for FPIs.

CAF was notified by the SEBI on 27 January 2020 for the purpose of registration, opening of bank and DEMAT a/c and application for PAN to FPIs in India.

The applicants seeking FPI registration and PAN allotment shall duly fill CAF and provide supporting documents and applicable fees.

The introduction of the CAF would significantly reduce the processing timelines for allotment of PAN.

Our view

The move by CBDT shall simplify the process of FPI registration and PAN allotment for FPIs. FPIs would now enjoy seamless access to Indian capital markets as CAF would eventually enhance their operational flexibility.

Government notifies the Direct Tax Vivad se Vishwas Act, 2020 and its Rules[6]

The Direct Tax Vivad se Vishwas Scheme, proposed in the Union Budget 2020, has received the president's assent.

The scheme provides amnesty for all direct tax disputes (subject to certain exceptions) pending as on 31 January 2020, before various appellate forums i.e., Supreme Court (SC), High Court (HC), Income-Tax Appellate Tribunal (ITAT), Dispute Resolution Panel (DRP), CIT(A) and revision application before the commissioner. In addition, disputes for which time limit for filing an appeal has not expired are also eligible for the scheme.

In addition to the scheme, CBDT has as also issued a circular in the form of FAQs clarifying various aspects and eligibility related concerns of the scheme vide press release dated 5 March 2020.

Salient features of the scheme are:

- Complete waiver of interest and penalty in cases other than search cases, if the disputed tax amount is paid by 30 June 2020
- For search and seizure cases, waiver of interest and penalty, if 125% of the disputed tax amount is paid by 30 June 2020
- In disputes relating to interest, penalty or fee, 25% of the disputed amount is to be paid to settle the dispute
- The rules notified for the scheme prescribe the manner of computing disputed taxes, the forms to be filed by the taxpayers, manner of furnishing such forms

Our view

The scheme is in line with the government's stated objective to cut down litigation and build trust and confidence among taxpayers. The success of the scheme will garner revenues for the government and also benefit taxpayers. Further, immunity is provided to the taxpayer from any future prosecution and litigation on the issues that are considered under the scheme for the respective years.

CBDT notifies five more securities eligible for exemption under Section 47 (viiab) of the Act[7]

As per the existing provisions, the transfer of below mentioned securities listed on a recognised stock exchange located in an IFSC were covered under the ambit of the exemption under section 47(viiab) of the Act, provided the consideration is paid or payable in foreign currency:

i. Bonds/Global Depository Receipts (GDRs),

ii. Rupee denominated bond of an Indian company and

iii. Derivatives

The central government on 5 March 2020 notified the following five additional securities listed on recognised stock exchange located in an IFSC, to be eligible for the exemption under section 47(viiab) of the Act:

- Foreign currency denominated bond
- Unit of a mutual fund
- Unit of a business trust (REITS/InvITS)
- Foreign currency denominated equity share of a company and
- Unit of alternative investment fund

This notification came into force with effect from 1 April 2020.

5. Notification No. 11 of 2020 dated 07 February 2020
6. Circular 7 of 2020 dated 04 March 2020 and Notification No. 18 dated 18 March 2020
7. Notification No. 16 of 2020 dated 05 March 2020

Our view

By notifying the aforesaid securities within the purview of Section 47(viiab) of the Act, it will attract foreign investments into IFSC thereby promoting investments into such securities listed on recognised stock exchanges located in an IFSC.

CBDT notifies Eligible Foreign Investor for making investments in International Financial Service Centre (IFSC) to be deemed FPIs for the purpose of section 115AD of the Act[8]

CBDT vide its notification has specified that non-residents being an Eligible Foreign Investor (EFI), operating in accordance with the SEBI circular shall be deemed as Foreign Institutional Investor (FII) for the purpose of transactions in securities made on a recognised stock exchange located in any IFSC, where the consideration for such transaction is paid or payable in foreign currency.

Thus, provisions of Section 115AD of the Act providing a special tax regime for FIIs shall also be applicable to the EPIs operating in IFSC.

This notification came into force with effect from 1 April 2020.

Our view

According to the provisions of the Act, any security held by an FII in accordance with the SEBI regulations is deemed to be a capital asset. Thus, the income derived on transfer of such securities is regarded as capital gains. With the issuance of this notification, it is now clarified that income earned by EFIs from transfer of investments shall be construed as capital gains and not business income.

8. Notification No. 17 of 2020 dated 13 March 2020

Due to COVID-19, the Ministry of Law and Justice (Legislative department) has decided to provide relief with respect to adherence of compliances and other norms under various laws, which are due during the period 20 March 2020 to 29 June 2020

The Ministry of Law and Justice (Legislative department) on 31 March 2020 has issued an Ordinance named as Taxation and Other Laws (Relaxation of Certain Provisions) Ordinance, 2020 (the Ordinance) to provide relief under various Laws due to COVID-19 outbreak in India. Some of the tax related relief measures are summarised as follows:

under the Act

Compliance related

- Last date for filing belated income-tax return for Financial Year 2018-19 has been extended from 31 March 2020 to 30 June 2020.
- The last date for linking Aadhaar-PAN has been extended to 30 June 2020.
- The date for completion of any proceedings, passing of order or issuance of notice, notification, sanction or approval and filing of appeal, documents, reply or application under the Specified Act (as defined in the Ordinance) has been extended to 30 June 2020.

Investment/Payment linked tax deduction

- The last date for making investment/payment under Chapter-VIA under the heading 'B. – Deductions in respect of certain payments' which inter alia includes the following:
  - Section 80C such as life insurance premium, Public Provident Fund, National Savings Certificate, etc.
  - Section 80D for Mediclaim
  - Section 80G for donations

  It has been extended to 30 June 2020. Thus, payment made up to 30 June 2020 shall be eligible for deduction in FY 2019-20.

  Donations made to Prime Minister's Citizen Assistance & Relief in Emergency Situations Fund (PM CARES Fund)

- Amendment is made in section 80G of the Act, whereby any donation made to PM CARES Fund by 30 June 2020 shall be eligible for 100% deduction under section 80G under the Act.
- Further, the press release clarified that corporates opting for concessional tax regime in FY 2020-21 can also donate by 30 June 2020 without losing their eligibility to opt for the concessional tax regime.

Capital gain tax exemption

Extension has been provided for claiming capital gains exemption under section 54 to 54GB of the Act. Thus, any investment or construction or purchase of property/ assets which was made or proposed to be made for claiming capital gains exemption under section 54 to 54GB of the Act, the due date has been extended to 30 June 2020 for FY 2019-20.

Commencement of operation by Special Economic Zone (SEZ) units

The due date for commencement of operation for the SEZ units (which have received necessary approval by 31 March 2020) for the purpose of claiming tax deduction under section 10AA of the Income-tax Act, 1961 has also extended to 30 June 2020.

Reduction in rate of interest for delayed payment of tax

- Relief in the rate of interest is provided for any delay in payment of any amount of tax or levy which is due and falls during the period 20 March 2020 to 29 June 2020, then in such instances, interest at 9% (i.e., 0.75% for every month or part of the month) shall be payable for the delay (i.e. paid after the due date prescribed) provided, such tax or levy is paid on or before 30 June 2020 or post 30 June 2020 as notified by Central Government.
- Further, it has been clarified that no-penalty/prosecution shall be initiated for such delay in payment of tax or levy.

Our view

Various relief measures have been announced considering the hardship faced by taxpayers in meeting compliance requirements. It would certainly help to address some of the issues faced by taxpayers.

CBDT extends validity of lower/nil deduction certificates until 30 June 2020

To mitigate hardship caused to taxpayers due to the coronavirus pandemic, CBDT has issued following clarifications and guidelines:

- **Where application for FY 2020-21 is filed**: TDS/TCS certificate for FY2019-20 shall remain valid till 30 June 2020 or disposal of application by the tax officer whichever is earlier.
- **Where application for FY 2020-21 is not filed**: TDS/TCS certificate for FY2019-20 shall remain valid till 30 June 2020. However, taxpayer would need to make application at the earliest, as per modified procedure by 30 June 2020 or when normalcy is restored, whichever is earlier.
- **Fresh Application where no certificates were issued for FY 2019-20:**
  - Taxpayer would need to follow the modified procedure for application and consequent handling by the tax officer.
  - Tax shall be deducted at 10% (including surcharge and cess) on any payments, made upto 30 June 2020, to a non-resident having a permanent establishment (PE) in India.

Our view

Extending the validity of the tax certificate will help in reducing the hardship faced by taxpayers. However, clarity is required on applications made under Section 195(3) of the Act, threshold/ transaction limits prescribed in the certificates, etc.

Key tax jurisprudence

Direct Tax

JP Morgan Chase Bank N.A.[9]

The ruling was pronounced in the context of taxability of interest income in the hands of the head office (HO) and whether the amendment introduced in section 9(1)(v) of the Act is retrospective in nature. We have produced the facts and held part of the case below.

Facts

- The taxpayer is the Indian branch of a non-resident banking company, JP Morgan Chase Bank N.A. incorporated in the United States of America (USA). The taxpayer carries on its banking activities in India through its branch located in Mumbai.
- During Assessment Year (AY) 2011-12 and 2012-13, the taxpayer paid interest to its head office and overseas branches on the sum borrowed. In the income tax returns filed by the taxpayer, the taxpayer had appended notes detailing the reasons for which the interest paid to the head office and overseas branches are not taxable in the hands of the taxpayer in India.
- The tax officer made specific enquiries with regard to the said interest income and had duly passed the assessment order for the above-mentioned years accepting the taxpayer's claims.
- However, the Commissioner of Income Tax (CIT) invoked the powers conferred under section 263 of the Act i.e., revision of orders and concluded that the interest income earned by the head office and overseas branches from the Indian branch AY 2011-12 and 2012-13, is taxable in India. Accordingly, the assessment orders passed for the impugned AYs were considerederroneous and prejudicial to the interests of revenue, and the CIT cancelled them with a direction to the tax officer to make fresh assessment keeping in view the observations made by him.
- Aggrieved by the order of the CIT, the taxpayer filed an appeal before the Income Tax Appellate Tribunal (ITAT).
- The taxpayer relied upon the judgements in the cases of Sumitomo Mitsui Banking Corporation and BNP Paribas S.A., where it was held that interest paid by the Indian branch to head office/overseas branches is not taxable in India as it is considered a payment made to self, hence, governed under the principle of mutuality. Further, it also stated that the amendments made by the Finance Act, 2015, would apply prospectively from 1 April 2016 and not retrospectively. Also, the taxpayer stated that reference to the CBDT circular no.740, dated 17 April 1996, shall be overlooked since it cannot override the statutory provisions of the Act.

Held

- Relying on the decision of the special bench in the case of Sumitomo Mitsui Banking Corporation (supra). The ITAT held that since the interest paid by Indian branch to foreignhead office/overseas branches is in the nature of payment made to self, it will be governed by the principle of mutuality, hence, would not be taxable under the provisions of the Act.
- With reference to the CBDT circular no.740[10], the Branch of a foreign company in India is a separate entity for the purpose of taxation under the Act, the ITAT held if the interest income is not chargeable to tax under the provisions of domestic law, it cannot be brought to tax by way of a board circular. The ITAT also observed, since the provisions of the Act are more beneficial to the taxpayer, it will prevail over the provisions of the Tax Treaty.
- The ITAT further confirmed that the introduction of explanation (a) to section 9(1)(v)(c) of the Act by Finance Act, 2015 [which states that interest paid by Indian branch of a non-resident bank is taxable in India] would apply prospectively from 1 April 2016 and not prior to that.
- Hence, the ITAT held that the interest income is not taxable in the hands of the taxpayer (the Indian branch) based on the principle of mutuality.
- Further, it also held that the assessment orders passed by the tax officer are not erroneous and prejudicial to the interest of the revenue and the orders passed by the CIT under section 263 of the Act are unsustainable and therefore, quashed. The assessment orders passed by the tax officer were restored and the case was held in the favour of the taxpayer.

Our view

The decision passed by the ITAT is in line with the ruling of the high court in the case of ABN AMRO Bank N.V. vs CIT[11] and Sumitomo Mitsui Banking Corporation vs DCIT[12]. The decision provides clarity on the applicability of explanation (a) to section 9(1)(v)(c) of the Act. It is a settled principle that any statutory construction is prospective in nature unless it is stated to have retrospective operations. Thus, interest paid by an Indian branch of a non-resident banking company to the head office for any AY prior to AY 2016-17 should not be deemed to accrue or arise in India under section 9(1)(v)(c) of the Act.

9. IT APPEAL NOS. 3747 (MUM.) OF 2018 & 363 (MUM.) OF 2019
10. dated 17 April 1996
11. [2012] 343 ITR 81 (Cal)
12. [2013] 26 Taxmann.com 111 (Mum-Tri)

The Oriental Insurance Co. Ltd.[13]

Applicability of Section 14A in case of an insurance company governed by the provisions of section 44 of the Act. The broad facts and held part are produced below:

Facts

- The taxpayer is engaged in the business of general insurance. During AY 2011-12, the taxpayer has computed its total income as per the provision of Section 44 read with Rule 5 of the first schedule to the Act.
- The tax officer invoked the provisions of Section 14A and made additions to the total income of the taxpayer.
- Both the CIT (A) and the ITAT held the case in favour of the taxpayer. The case held that income of the taxpayer will be computed as per the special provisions of the Act and Section 14A had no applicability to profits and gains of an insurance business. Further, it was held that since the special provisions begin with a non-obstante clause, the tax officer could not travel beyond these provisions.
- The ITAT, when passing the order in this regard, relied on its earlier rulings in taxpayer's own case for AY 2000-01, 2001-02 and 2005-06 that involved similar issue.
- Aggrieved by the order of the ITAT, the tax department filed an appeal with the Delhi HC.

Held

- Section 44 begins with a non-obstante clause and accordingly, overrides other provisions of the Act relating to computation of income. Section 14A begins with "for the purposes of computing the total income under this chapter, no deduction shall be allowed in respect of expenditure incurred." The section cannot be applied independently unless when Chapter IV is invoked. Thus, it is held that the exclusion in special provision would include Section 14A as well making it inapplicable in the cases of insurance companies.
- The HC also observed that the ITAT has taken the same view as taken in earlier years thereby invoking rule of consistency. Thus, the HC held that the tax officer could not have travelled beyond the special provisions to make disallowance under the Section 14A.
- As regards tax department's second argument, the ITAT should have remanded the matter back to the tax officer, the HC held that the tax department had confined its challenges only in respect of applicability of Section 14A before the ITAT. It cannot now argue that the ITAT should have remanded the matter back to the tax officer.
- In absence of any substantial question of law arising from the ITAT order, the HC dismissed the tax department's appeal.

Our view

The issue of applicability of Section 14A of the Act to insurance companies has long been a subject matter of debate. The HC decision brings a sigh of relief to the insurance industry. While the decision rendered is in the case of a non-life insurance company, the observations of the HC are relevant for the insurance companies in general i.e., including life insurance companies and foreign reinsurance branches.

13. TS-148-HC-2020(DEL)

Acciona Wind Energy (P.) Ltd[14]

Denies capital gains exemption u/s. 47(iv) on share buy-back from 99.99% Spanish parent. The broad facts and held part are produced below:

Facts

- The taxpayer is an Indian subsidiary of M/s. AccionaEnergia International S.A, Spain, with 99.99% stakes in the company. The remaining stake of 0.01% is held by M/s. AccionaEnergia SA, Spain.
- During the AY 2014-15, the taxpayer bought back its shares and contended that the transaction was covered by Section 47(iv) of the Act and therefore considered exempt from tax.
- The CIT(A) held that in order to get covered under Section 47(iv), the taxpayer's parent company should hold entire share capital of the subsidiary. Also, it was concluded that Section 47 of the Act is limited in its application to Section 45 and does not apply to buy-back of shares to which provisions of Section 46A of the Act also applies. In other words, the conditions stipulated in Section 47(iv) of the Act for exempting capital gains arising from transfer of shares (or buy back) to/by parent company from its subsidiary company are restricted to taxability under Section 45 of the Act and has no relevance with provisions of Section 46A of the Act.
- Aggrieved by the order passed by CIT(A), the taxpayer filed an appeal before the ITAT.
- The taxpayer argued that as per the Companies Act, 2013, there is a requirement of at least two shareholders to form a company. Hence, entire share capital of a company cannot be held in the name of a single company i.e., there can be no 100% folding by a single company in the other company. Thus, Section 47(iv) of the Act cannot apply. Reliance was placed on the judgment of Bombay High Court in the case of Papilion Investments (P.) Ltd, in this regard.

Held

- Section 47(iv) of the Act requires that whole of the shares of the subsidiary company should be held by the parent company or its nominees. However, M/s. AccionaEnergia SA, Spain, holding 0.01% stake is not the nominee of M/s. AccionaEnergia International S.A, Spain (parent company).
- The ITAT held that the judgment relied by the taxpayer is not applicable.This is because the two shares out of all the share capital in that casewere also held by the parent company not single but jointly with a director.
- The ITAT further stated that Section 46A is applicable to the taxpayer since the shareholders received a consideration from the company for purchase of its own shares though there is no transfer of shares.
- The difference between the cost of acquisition and value of consideration received by the shareholders shall deem to be the capital gains arising to such shareholder.
- Accordingly, the ITAT concluded that the provisions of Section 47(iv) shall not be applicable and Section 46A is applicable to taxpayer. In view of above, the ITAT dismissed the appeal.

Our view

The ITAT has reiterated the importance of adherence to the conditions prescribed under Section 47(iv) of the Act. However, it has been observed that the ruling is silent on the provisions of India-Spain Double Taxation Avoidance Agreement (DTAA) while evaluating the facts of the case despite the shareholder of the taxpayer being from Spain.

14. ITA No 1783/Bang/2018

Merrill Lynch Capital Market Espana SA SV[15]

No taxable capital gains on sale of Indian real estate companies shares under the Treaty. The broad facts and held part are produced below:

Facts

- The taxpayer provides financial, security brokerage and investment services.
- During the AY 2013-14 the taxpayer earned capital gains from sale of shares held by it in six Indian real estate development companies (classified under the BSE Realty Index). The investee companies were dealing in development of immovable properties.
- The issue relates to the taxation of such income under the capital gains provisions i.e., Article 14(4), of the India-Spain DTAA. This provision provides that gains from alienation of shares of a company, the property of which consists directly or indirectly, principally of immovable property situated in a jurisdiction may be taxable in that jurisdiction.
- The CIT(A) decided the matter in favour of the taxpayer. It observed that the value of shares is based not just on the extent of the immovable property held as stock-in-trade, but on several other factors such as capital adequacy, projects in the pipeline, current profits and future prospects. With the view that the taxpayer's shareholding in these companies was well under 7%, and with such miniscule holdings, the taxpayer cannot be treatedwith rights in the immovable property of the companies.
- Aggrieved by the order of the CIT(A), the tax department challenged the matter before the ITAT.

Our view

This ruling brings out a distinction in the business model focused on gains from real estate development vis-à-vis gains from holding immovable properties as investments. For the purpose of taxing capital gains on sale of shares in India, consideration should be given to the following points:

- the non-resident should have substantial interest in the Indian company making real estate investments in India; and
- the real estate company in addition to the principally deriving value from the property in India should be deriving income from the real estate held as investments and not from real estate development activities.

This decision would also be useful in interpreting tax treaties having similar provisions such as the Spain, Korea, Luxembourg, Ireland tax treaties.

Held

- The capital gains Article 14 in the DTAA provide taxing right to source jurisdiction (as an exception to general rule of providing taxing rights to residence jurisdiction) in two cases, namely:
  - Capital gains on sale of immovable property; and
  - Gain on sale of shares of a company, property of which principally consists of immovable properties. Such holding may be direct or indirect.
- The second exception is a result of first exception. At times, companies are floated mainly to hold immovable propertiesbecause transfer of ownership of company is easier than that of an immovable property.
- Article 14(4) is only an extension of Article 14(1). Hence, if the immovable property is held by a taxpayer on their own or throughcorporate structures, the gains on account of value appreciation of such immovable property must be taxed in source jurisdiction as well.
- The wordings of the United Nations (UN) and Organisation for Economic Co-operation and Development (OECD)model convention differ from the tax treaty under consideration, however, the intent and purpose for which Article 14(4) was introduced is not different.
- The threshold to trigger taxation on alienation of shares of a company where underlying asset constitutes immovable property is of 51% or more of the aggregate value of assets.
- The expression 'principally' is not specifically defined in the tax treaty under consideration; however, the threshold test can be applied at 51% of total assets.
- The scope of Article 14(4) of the tax treaty must remain confined to the shares which, taken on a standalone basis or as a cumulative effect of the related transactions, lead to the control of the company; or, in any other way, give right to enjoy or occupy the underlying immovable property owned by the company in question and such property must be what the company in question principally holds. Alienation of shares directly or indirectly results in the control and enjoyment, of the underlying property, which includes changing ownership.

15. ITA No. 6108/Mum/2018

Direct Media Distribution Ventures Pvt. Ltd[16]

Corporate gift of shares under internal restructuring exercise, not a colourable device. The broad facts and held part are produced below:

Facts

- The taxpayer is engaged in media distribution business of all type, form and manner.
- During AY 2014-15, the taxpayer transferred equity shares of Dish TV India Limited to one of its related parties, Direct Media Solution P. Ltd. at NIL consideration to consolidate the group's onshore media assets (including shares of the listed company). These shares had been acquired by the taxpayer during AY 2012-13 from its related parties, Essel Corporate Resource P. Ltd. and Prajatma Trading Co P. Ltd. at NIL consideration.
- The tax officer completed the assessment, inter alia, accepting the transfer of shares at NIL consideration.
- The CIT, however, by exercising his revisionary powers under Section 263 of the Act, opened the case by holding the tax officer's order to be prejudicial in the interest of revenue. The CIT opined no enquiry was made by the tax officer during the assessment proceedings regarding the transfer of shares at NIL consideration.
- The re-opening of the assessment by the CIT was challenged by the taxpayer before the ITAT.

Our view

Taxability of corporate gifts, including gift of shares during corporate restructuring, has often been litigated. This ruling reiterates some of the important principles, however, keeping in mind the type of restructuring, Section 56(2)(x) and Section 50CA of the Act would also need to be factored in now. Also, care is required to ensure that the transaction should be able to clear the General Anti-Avoidance Rule (GAAR) test.

Held

- The ITAT observed that when the subject shares were acquired by the taxpayer for NIL consideration, the tax department had accepted the transaction. In such circumstances, the subsequent transfer of shares to a related party at NIL consideration (pursuant to consolidation of onshore media assets) cannot be doubted.
- Based on material on record, the ITAT observed that the tax officer had examined the entire transaction during the course of assessment proceedings. In the present case, the CIT is trying to substitute his opinion in place of tax officer's opinion, observed the ITAT. Relying on a Bombay HC ruling in the case of Gabriel India Ltd., the ITAT held that substitution of opinion is outside the purview of the CIT's powers.
- The ITAT noted that the purpose of the transaction was internal group restructuring. Thus, relying on the decision of the Chennai tribunal in case of Redington (India) Ltd., the ITAT heldthat a transaction without consideration when claimed as a gift is always a gift.
- The ITAT rejected tax department's argument that the transaction was a colourable device and was entered into only for avoiding capital gain tax.
- The ITAT relied on its earlier decision in case of one of the taxpayer's group companies, JayneerInfrapower&Multiventures (P) Ltd. and held that:
  - Fair market value of shares cannot be taken as full value of consideration;
  - Gift need not be by way of a gift deed;
  - A company should however, be authorised by its memorandum of association to gift shares.
- Further, the ITAT observed that the tax officer had made sufficient enquiries while completing the assessment. Thus, it held that the tax officer's order cannot be said to be erroneous or prejudicial to the interest of the revenue and quashed the revision order passed by the CIT.

16. ITA No. 2211/Mum/2019

ING BewaarMaatschappij I BV[17]

Constituents' residential status relevant while determining Treaty eligibility of fiscally transparent entity. The broad facts and held part are produced below:

Facts

- The taxpayer is a trustee of ING Emerging Markets Equity Based Funds (INGEMEF) established in the Netherlands and registered with SEBI as a sub account of ING Assets Management BV (INGAMBV), a SEBI registered Foreign Institutional Investor (FII).
- INGEMEF is a fiscally transparent entity and hence, constituents of INGEMEF are taxable for their respective share of earning. The funds held by INGEMEF were invested in India through the custodian i.e., the taxpayer [who was the legal owner of the investments on behalf of the investors], which was made on the advice of the fund manager i.e., INGAMBV.
- During AY 2007-08, the taxpayer earned short-term capital gains and long-term capital gains from sale of shares held by it.
- There was no dispute on the non-taxability of the long-term capital gains in accordance with Section 10(38) of the Act. However, the short-term capital gains were claimed to be treaty protected from taxation in India, under Article 13 of the India-Netherlands DTAA.
- However, the tax officer rejected the claim of the taxpayer and denied the benefit of Article 13 of India-Netherlands DTAA, taxing the short-term capital gains as per the provisions of the Act.
- Aggrieved by the order of the tax officer, the taxpayer carried appealed before the CIT(A). However, the CIT(A) also confirmed the stand of the tax officer.
- Aggrieved by the decision of the CIT(A), the taxpayer filed an appeal before the ITAT.

Our view

The issue of a fiscally transparent entity being eligible to the benefits of a tax treaty has been a matter of judicial debate in India for years. While Article 4 of the tax treaty covers any person who, under the domestic tax laws of the Netherlands, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of similar nature, the ITAT ruling appears to imply where the income per se is taxed in the Netherlands (irrespective of the manner in which it is taxed), the benefit under the tax treaty should be allowed on such income.

Held

- The ITAT observed that the taxpayer is a trustee of INGEMEF by way of a contractual arrangement between the investors, fund manager and its custodian. Given that INGEMEF is not a legal entity, it is to be ignored for the purpose of taxability of the income under consideration and thus, the question that needs to be addressed is who the actual beneficiary is, in whose representative capacity the taxpayer is to be assessed to taxed.
- As a result of the investments by INGEMEF, income accrues directly to the three participants, who are undisputedly tax residents of the Netherlands and hence, the treaty protection cannot be denied.
- The ITAT referred to the co-ordinate bench ruling in the case of Linklaters LLP, where it was held that to decide eligibility of benefits under the tax treaty, the fact of income being covered within the tax net of the treaty partner country is relevant and not the manner of taxation.
- The ITAT held that principally, where a taxpayer is the representative assessee of a tax transparent entity, the status of the beneficiaries/constituents of such tax transparent entity is relevant to determine the eligibility of benefits under the tax treaty.
- The ITAT heavily relied on the legal position stated in the ruling of Linklaters (supra) and held that as long as the income is liable to tax in the Netherlands, whether in the hands of the taxpayer or in the hands of constituents of INGEMEF, the benefit under the tax treaty cannot be denied.
- In case of the taxpayer, income has actually been accrued to the investors, which are taxable entities in the Netherlands, and hence, the benefit under the Tax Treaty has to be allowed on the income taxed in the hands of the taxpayer, in its representative capacity. Thus, in accordance with Article 13(5) of the tax treaty, the short-term capital gain shall not be taxable in India.

17. ITA No. 7119/Mum/2014

Transfer pricing updates

OECD's transfer pricing guidance on financial transactions

The OECD issued final guidance on transfer pricing (TP) for financial transactions on 11 February 2020. The guidance provides useful tools to the taxpayers as well as tax authorities in arm's length analysis of financial transactions. Few key points from the guidance are summarised below:

- **Loan transactions:** The guidance puts focus on accurate delineation of transactions and provides that both interest rate on loan and loan amount should be tested for arm's length purposes. In this context, analysis of contractual terms, functional and risk analysis, characteristics of the financial instruments, economic circumstances and business strategies should all be considered in making an accurate delineation of the transaction.
- **Credit assessment:** The guidance discusses the role of credit assessments along with an analysis of the purpose of loan, structure of transaction and source of repayment. It discusses credit ratings and use of publicly available financial tools or methodologies to approximate credit ratings and suggests considering the impact of "implicit support" by the parent company on a subsidiary's credit rating.
- **Treasury functions:** Apart from noting that treasury functions may be in the nature of support services, the guidance also recognises that more complex functions may be performed by the treasury centers like performing a centralised financing function. Hence, the consideration for treasury centers activities depends on analysis of the functions and risks related to its operations.
- **Cash pooling:** The guidance covers the benefits of cash pooling arrangements and stresses on the need for accurate delineation of cash pooling transactions. It recognises practical difficulties in determining how long a balance should be treated as part of the cash pool. The guidance further suggests an allocation of the benefits from the pool to the participants however challenging the data and analysis required for such allocations. Particular attention should be given to the remuneration for the cash pool leader. As such, a careful evaluation of its functions and risks should be undertaken.
- **Hedging:** The guidance discusses the distinction between transactions where the centralised treasury function (Group entity) arranges a hedging contract that an operating entity enters into versus other situations in which the treasury (Group entity) enters into a hedging contract. In the former case, the activity can be viewed as service. In the latter the positions are not matched within the same entity even though the group position might be protected.
- **Financial guarantee:** The guidance recognises financial guarantees as compensable as long as they provide a measurable benefit such as reductions in the borrower's interest rate. To the extent that a guarantee results not only in a more favorable interest rate but also increased borrowing capacity, an accurate delineation analysis should be performed to determine whether the increased borrowing capacity should be considered a loan from the lender to the guarantor followed by a capital contribution to the borrower.
- **Captive insurance:** Captive insurances may be subject to regulation in the same way as other insurance and reinsurance companies under the guidance. Analyses covering sufficient diversification of pooling of risk, improvement in the capital position of entities, whether the risk would be insurable outside the group, and what entity exercises control of risk are among those that should be addressed for a proper arm's length analyses. Where the characterisation of an insurance company is retained after functional and risk analysis, the guidance covers the approach towards arm's length pricing of insurance premium, profitability of claims and return on capital.
- **Risk free and risk adjusted rate of return:** The guidance provides how to determine the risk-free rate of return and a risk-adjusted rate of return when an associated enterprise is entitled to those returns. While recognising that there is no investment with zero risk, the guidance points to the use of certain government issued securities as a reference rate for a risk-free return. To eliminate currency risk, the security should be in the same currency as the investor's cash flows, and the reference security should be issued at the time of the controlled transaction to achieve temporal proximity. In addition to government securities, interbank rates, interest rate swap rates, or repurchase agreements may be alternatives. In determining a risk-adjusted rate, it is important to address the financial risk assumed by the funder in its financing activity. The risk-adjusted rate of return can be based upon the return of a realistically available alternative investment with the same risk profile. Another approach would be to add a risk premium to the risk-free return.

Our view

In July 2018, the OECD had issued a non-consensus discussion draft on financial transactions in July 2018. The final guidance in this regard has been rolled out in February 2020. It elaborates the delineation principle in relation to financial transactions and role of functional and risk analysis. Taxpayers should now be more focused and come to terms with the need for a detailed and robust analysis of financial transactions and not merely rely on exchange control limits and other high level reference points.

PE attribution covered under APA and Safe Harbours

The Finance Act 2020 has widened the scope of Section 92CC (Advance Pricing Agreements or APA) and Section 92CB (Safe Harbours) by including the determination of attribution of income of a non-resident to the Permanent Establishment (PE) in India.

Our view

The determination of PE and attribution of profits thereto have always been a subject of litigation. Once, a PE is determined to exist in India, the question of how to apportion profits to such PE looms large. While approach based on FAR (Function, Assets and Risks) analysis is an option, the same is often disputed by Indian revenue authorities. The CBDT had introduced a draft report on amendments to PE attribution rules where it advocated use of fractional apportionment methodology. Since, this is a complex matter where different approaches adopted by revenue authorities in the past have been prone to litigation, inclusion of PE attribution within the scope of APA and Safe Harbour[18] would provide certainty to taxpayers. Especially, a bilateral APA that would avoid double taxation as well.

Limitation on interest deduction

Section 94B of the Income Tax Act, 1961 (Act) provides that deductible interest exceeding INR 1 crore of an Indian company, or a PE of a foreign company, paid to the Associated Enterprise (AE) shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortisation (EBITDA) or interest paid/payable to AE whichever is less and balance interest can be carried forward for subsequent eight AYs for claiming deduction. Under the current provisions, the interest paid/payable by a taxpayer to a branch of a foreign company was getting covered where the loan amount was 51% or more of the book value of the taxpayers' total assets. Since, this is essentially a bank loan received by taxpayer, loans advanced by branches of foreign companies were excluded from the purview of Section 94B by virtue of Finance Act, 2020.

Our view

The amendment provides much-needed relief to taxpayers who have borrowed from PE of a foreign bank. It should be noted that the exclusion is only for loan taken from PE of a foreign bank and not for the foreign bank itself.

Due date of filing of Accountant's Report (Form 3CEB)

The due date of filing the Accountant's Report in Form 3CEB has been amended from 30 November to 31 October. This amendment will be effective from 1 April 2020 i.e., FY 20 relevant to the AY 2020-21 and subsequent years.

Our view

The taxpayers should be prepared to meet the revised timeline of 31 October 2020[19] and maintain contemporaneous TP documentation before filing of Form 3CEB.

Scope of dispute resolution widened (Section 144C)

Under Section 144C, a taxpayer can file objections before the Dispute Resolution Panel (DRP) if it is aggrieved by the variations to its income or loss returned by the assessing officer. There were instances where the assessing officer (transfer pricing officer or TPO) modified the facts of the assessee or disagreed on principal issues with no modification to the returned income or loss due to transfer prices falling within the benchmark ranges. Such matters include determination of tested party, selection of comparables, economic characterisation etc. The Finance Act 2020 has also allowed the assessee to approach DRP on matters that do not lead to change in returned income or losses.

The Finance Act 2020 has also expanded the scope of eligible assessee who can file objections before the DRP by adding a non-resident non-corporate taxpayer as an eligible assessee.

Our view

There are several instances of disagreement on principle issues between the TPO and the taxpayer. The disagreement can be on matters, such as selection of tested party, economic characterisation, application of filters etc. This can have implications from a business perspective and can materially impact TP outcomes in future years. Allowing taxpayers to file objections on such matters is a welcome move.

18. Safe harbour rules for FY 2019-20 and subsequent are to be notified as on the date of this update
19. Considering the Covid-19 situations, the due date of filing has been extended to 30 November 2020 for FY 2019-20

Key tax jurisprudence

There is wide ranging jurisprudence available in Indian TP landscape for a range of financial transactions. Here are a few key transfer rulings published during the past two quarters encompassing financial transactions such as compulsory convertible debentures (CCDs), letter of comfort (LOC), advances towards share allotment etc.

S.No.	Citation	Summary
1	Hyderabad Infratech Private Ltd vs. ACIT (ITA No.1891/ Hyd/2018)	The TPO treated CCDs as loans and levied interest @ LIBOR plus 200 BPS. Upon appeal by the assessee, the ITAT relied on the decision of the Supreme Court in case of Sahara Real Estate Corporation Ltd and Sahara Housing Investment Corp. Ltd in civil appeal no.9813/2011 wherein CCD has been held a hybrid instrument in the nature of equity and cannot be thus considered as a loan. Thus the ITAT deleted the TP adjustment made treating the CCDs as loan and upheld the coupon rate at which assessee had issued CCDs.
2	Gurgaon Investment Ltd vs. DCIT (ITA No.6821/Mum/2017, ITA No.1499/ Mum/2014, ITA No.7359/Mum/2016)	The assessee in this case is a non-resident investment holding company in Mauritius. The assessee had waived off interest for a certain period on the CCDs of its Indian AE. The TPO imputed notional interest for such period and made TP adjustments that were upheld by the CIT-Appeals. Upon appeal by the assessee, the Mumbai ITAT held that under Article 11(1) of the India-Mauritius Tax Treaty, interest income can be brought to tax only on fulfillment of twin conditions of accrual as well as actual receipt. Since, the condition of actual receipt of interest was not satisfied in this case, the ITAT deleted the TP adjustment for the period interest was waived-off.
3	ACIT vs. M/s. CAE Flight Training (India) Pvt. Ltd (IT(TP)A No. 2060/Bang/2016)	In this case, the TPO had disallowed the interest payment on CCDs treating the same as equity. The Bangalore ITAT deleted the TP adjustment by rejecting the TPO's thin capitalisation principle. The ITAT noted that the CCD holder did not have voting rights nor could it receive any dividend before the CCD's conversion and till the date of conversion for allowing interest, the CCDs are to be considered as debt and interest thereon has to be allowed.
4	Tata International Ltd vs. ACIT (ITA No.4376/ Mum/2010) ACIT vs. Tata International Ltd (ITA No.4451/Mum/2010)	The assessee had issued LOC to the bankers of its AEs. The TPO concluded that the LOC provided benevolent advantage to the AEs in obtaining credit facility from bankers. The TPO treated issuance of LOC similar to issuance of guarantee in favour of AE and made a TP adjustment by imputing a guarantee commission. On an appeal the CIT(A) concluded that assessee did not incur any cost in giving a LOC. The CIT(A) also concluded that there is a fundamental difference between guarantee and LOC. Guarantee is legally enforceable and LOC is not. The LOC is an assurance that the AE would comply with the terms of the contract but it is not a guarantee for performance (Karnataka High Court in United Braveries Holding Ltd. Karnataka State Industrial Investment and Development Corporation Ltd. [M.F.A. No. 4234 of 2007 SFC]. The Mumbai ITAT upheld the order of CIT(A) in this regard and deleted the TP adjustment.
5	M/s. Wockhardt Ltd. vs. ACIT (ITA No.4866/Mum/2013)	In this case, the Mumbai ITAT concluded that because there is delay in allotment of shared by the AE, share application money pending allotment cannot be treated as loan for the purposes of making TP adjustment.
6	ACIT vs. Shilpa Medicare Ltd. (ITA Nos.1373 & 1374/ Bang/2015) Shilpa Medicare Ltd vs. ACIT (ITA Nos.1351 & 1352/Bang/2015)	In this case, the assessee had invested in equity shares of its subsidiary and also gave interest free advances to the subsidiary. The TPO imputed interest at LIBOR plus 1% mark-up and made TP adjustment on the advances. The assessee filed an appeal before the CIT(A) submitting that advances made to the subsidiary was used as an equity infusion into the step-down subsidiary company that is a wholly-owned subsidiary. Also, the advances were converted into equity shares. The CIT(A) accepted the contention of the assessee and held that the disallowance made by the AO/TPO were unwarranted and unjustified and accordingly directed to delete the addition. On appeal by the revenue, the ITAT relied on the case of Instrumentarium Corporation Ltd vs. ADIT (IT) in ITA No. 1548 and 1549/2009 and held that interest-free loans are subject to provisions of Section 92 of the Act and arm's length price (ALP) has to be determined. The ITAT remanded the case back to the TPO for determination of ALP.
7	Bialkhia Holdings Pvt Ltd [TS-118-ITAT-2020(SUR)-TP]	In this case, the Surat ITAT deleted TP-adjustment in respect of interest-free loan advanced to its Singapore-AE for the purpose of redeeming preference shares held by assessee treating the same as quasi equity in nature. The Singapore-AE was a special Purpose Vehicle (SPV) formed to hold investment with no purpose to engage in any other activity. Also, the assessee wound up the AE and all the capital was remitted and gains on disposal of investments had been completely brought back to India and taxes were paid on such gains. The ITAT inferred, "transaction in the case of assessee therefore, be considered as a quasi-equity in substance, as against the transactions considered and characterised by the TPO as pure loan simplicitor as given by a financial institution". It relied on the Ahmedabad ITAT ruling in Cadila Healthcare, and noted that substantive reward for assessee's loan was not interest but an opportunity to redeem its preference share capital and bring back the same into India and accordingly, held "..the loan transaction as quasi-capital". The ITAT also deleted the TP adjustment on account of guarantee fee, noting that guarantee was given to the bank to facilitate loan to the AE for bringing back funds into the country by way of redemption of preference shares, and that assessee earned more income in form of dividends than expenditure incurred on account of providing guarantee.

It is evident that there is no standard approach applicable to ALP analysis of financial transactions. Both taxpayers and tax authorities have taken different approaches in different situations. In this background, the guidance provided by the OECD on financial transactions is helpful. An emerging thought post issuance of OECD's guidance is that an ALP analysis of financial transactions should cover delineation analysis, analysis of functions and risks, economic characteristics, credit analysis, purpose of loan etc., apart from interest rate benchmarking.

Indirect tax updates

Relaxation in filing of annual returns for FY 19

A registered person whose aggregate turnover during a FY does not exceed INR 5 crore shall have the option to furnish the annual return for FY 19 (Rule 80 of CGST Rules, 2017 was amended vide Notification no.16/2020 Central Tax dated 23 March 2020).

Our view

This will provide relief to small taxpayers from growing compliance burden

Extension of due date in filing of annual returns for FY 19

The Central Board of Indirect Taxes and Customs (CBIC) has extended the due date for furnishing GST annual return and GST audit report for FY 19 to 30 September 2020 (vide Notification No. 41/2020 – Central Tax dated 5 May 2020).

Extension of GST due dates with waiver of late fees and waiver/concessional interest

The Central Board of Indirect Taxes and Customs (CBIC) has extended the due date for furnishing GST annual return and GST audit report for FY 19 to 30 September 2020 (vide Notification No. 41/2020 – Central Tax dated 5 May 2020).

Forms	Turnover	Extension of dates
GSTR-3B [February 2020 to April 2020 (notification no. 31/2020-CT and 32/2020-CT dated 3 April 2020)]	More than INR 5 crore	24 June 2020; interest at 9% per annum to be levied after 15 days of due date
	More than INR 1.5 crore but less than INR 5 crore	For February-March: 29 June 2020 For April: 30 June without any late fee or penalty/interest
	Less than INR 1.5 crore	February 2020 – 30 June 2020 March 2020 – 3 July 2020 April 2020 – 6 July 2020
GSTR-3B [May 2020 (notification no. 36/2020-CT dated 3 April 2020)]	More than INR 5 crore	27 June 2020
	Less than INR 5 crore	22 June 2020: 12 July 2020 24 June 2020 - 14 July 2020
GSTR-1 [March 2020 to May 2020 (notification no. 30/2020-CT dated 3 April 2020)]	N.A.	For March-May 2020 upto 30 June 2020 without any late fees

- **Extension of due dates for issue of notices under customs and GST laws**

Due date for issue of notice, notification, approval order, sanction order, filing of appeal, furnishing applications, reports, any other documents etc., time limit for any compliance under the Customs Act, GST laws and other allied laws where the time limit falls between 20 March 2020 to 29 June 2020 shall be extended to 30 June 2020.

Our view

The extension will help taxpayers in due compliance.

Relevant circulars:

Circular No. 129/47/2019-GST dated 24 December 2019

Issuance of a notice in FORM GSTR-3A to a registered person who fails to furnish return under Section 39 or Section 44 or Section 45 (hereinafter referred to as the defaulter) requiring him to furnish such return within 15 days. Further Section 62 provides for assessment of non-filers of return of registered persons who fails to furnish return under Section 39 or Section 45 even after service of notice under Section 46. (Section 46 of the CGST Act read with rule 68 of the CGST Rules, 2017.

Circular No. 135/05/2020-GST dated 31 March 2020

- **Bunching of refund claims across financial years**

  Earlier, the CBIC had clarified that exporters cannot club tax periods across different financial years while filing refund claim. [Circular 124/44/2019-GST dated 18 November 2019]

  The Delhi High Court[20] had stayed para 8 of the said circular and observed that

  - Circular can supplant but not supplement the law
  - Circulars might mitigate rigors of law by granting administrative relief beyond relevant provisions of the statute, however, central government is not empowered to withdraw benefits or impose stricter conditions than postulated by the law.

  Further, on perusal of Section 16(3) of the IGST Act and Section 54(3) of the CGST Act, there appears to be no bar in claiming refund by clubbing tax periods across successive financial years

  Thus, the circular clarified that restriction on clubbing of tax periods across FYs has been removed and is not applicable.

- **Change in manner of refund of tax paid on supplies other than zero rated supplies**

  Refund of tax paid on supplies (other than zero rated supplies) will now be admissible proportionately in the respective original mode of payment i.e., where tax is paid by debiting both electronic cash and credit ledgers (other than the refund of tax paid on zero-rated supplies or deemed export).

  - Refund to be paid in cash and credit shall be calculated in the same proportion in which the cash and credit ledger has been debited for discharging the total tax liability in the period in which refund application has been filed.
  - Such amount shall accordingly be paid by issuance of order in

    1. Form GST RFD-06 for amount refundable in cash and
    2. Form GST PMT-03 to credit the amount in the electronic credit ledger

- **Refund of accumulated ITC because of reduction in GST rate:** It has been clarified that the refund of accumulated input tax credit (ITC) because of inverted duty structure would not be applicable in cases where the input and the output supplies are same.

Circular No. 133/03/2020-GST dated 23 March 2020

The CBIC has clarified various issues pertaining to apportionment of ITC in cases of business re-organisation. A few important clarification have been summarised below:

1. In case of demerger whether value of asset for new unit shall be considered at state level or all India level?

   The value of asset for new unit to be taken at state level.

2. Is transferor required to file ITC-02 in all states?

   No, transferor required to file ITC-02 only in those state where both transferor and transferee are registered.

3. Whether ratio of value of asset shall be applied for each of heads of ITC (CGST/SGST/IGST)?

   No, the ratio of value of asset shall be applied to the total amount of unutilised ITC.

Extension of validity of registration cum membership certificate:

The Directorate General of foreign trade vide Trade Notice No 60/2019 dated 31 March 2020 has extended the validity of registration cum membership certificate (in cases where same has not been expired before 31 March 2020) till 30 September 2020.

Extension of Foreign Trade Policy 2015-2020:

In view of COVID-19 crisis, the government vide Notification No 57/2015-20-DGFT dated 31 March 2020 has extended the existing Foreign Trade Policy 2015-20 upto 31 March 2021. Further, various other changes have also been made in the FTP and procedures to ease the compliance burden of the business concerns.

Extension of last date of payment under Sabka Vishwas scheme:

The government vide Notification No 01/2020-Central Excise (NT) dated 14 May 2020 has extended the last date of payment under the Sabka Vishwas (Legacy Dispute Resolution Scheme), 2019 till 30 June 2020.

20. Pirambara books private limited [2020-VIL-45-DEL]

Extension of period of limitation under all central and state Acts:

The SC has taken suo motu cognisance of the challenges faced by litigants due to the COVID-19 pandemic across the country in filing their petitions/applications/suits/appeals/all other proceedings within the period of limitation prescribed under the general law of limitation or under special laws (both central and/or state). To obviate such difficulties and to ensure that lawyers/litigants do not have to come physically to file such proceedings in respective courts/tribunals across the country including the SC, the apex court has ordered that the period of limitation in all proceedings shall stand extended, with effect from 15 March 2020, till further orders, irrespective of the limitation prescribed under any law. The court has also stated that this order shall be binding on all courts/tribunals and authorities. [Writ Petition (Civil) No. 03/2020 dated 23 March 2020].

Key tax jurisprudence

M/s Jotun India Private Limited (GST-ARA-19/2019-20/B-108)

The company is a leading manufacturer, supplier and exporter of paints and powder coatings that are specially designed for unique conditions.

The company has introduced a parental insurance scheme for employees' parents, which is an optional scheme provided to the employees and entered into an agreement with the insurance company to receive services in lieu of coverage of parental health of its employees.

As per this scheme, the company initially pays the entire premium along with the taxes to the insurance company and recovers 50% of the premium from the respective employees who opt for the scheme.

The company contends that providing parental medical insurance service and recovery of 50% of the premium amount is not in the course or furtherance of business and cannot be considered as supply of service.

The Authority ruled that the activity undertaken by the company like providing of mediclaim policy for the employees' parents through insurance company neither satisfies conditions of Section 7 to be held as supply of service nor is it covered under the term business of Section 2(17) of CGST ACT 2017. Hence, the company is not rendering any services of health insurance to their employees' parents and hence there is no supply of services in the instant case of transaction between the employer and the employee.

Mr. Anil Kumar Agarwal [Advance Ruling Order No KAR ADRG 30/2020, dated 4 May 2020]

The applicant filed an application before advance ruling on which of the following incomes should be included for the purpose of computing aggregate turnover for obtaining registration under the GST law.

- **Salary received as a director of a private limited company** – should not be included in aggregate turnover, if the director is an employee (i.e. executive director). It shall not be included if he is a non-executive director.
- **Rental income** – from commercial property and residential property should be included in aggregate turnover.
- **Interest income** – from deposits, loans, advances is an exempted service. The actual amount of deposits, loans, advances become value of services, should be included in aggregate turnover.
- **Maturity proceeds of life insurance policies** – once received, there would not be any service involved between the policy-holder and insurance company. Hence, this income should not be included.
- **Dividend on shares and capital gain/loss on shares** – income from shares should not be included as the same is outside the purview of GST.

The present ruling is in sharp contrast to the recent ruling pronounced by the Rajasthan AAR on Clay Craft India Private Limited where the AAR held that the directors cannot be regarded as employees of the company. Accordingly, the salary/remuneration paid to the directors shall be liable to GST under RCM.

M/S. Clay Craft India Private Limited (RAJ/AAR/2019-20/33)

The Directors of a company work as employees at different levels in the management and handle day-to-day affairs. Such Directors are compensated by way of regular salary and other allowances. The salary is taxable and PF laws apply to the services.

Thus, the company contends that the Directors are the employees of the company as such besides being Directors of the company.

Apart from salary, the company also pays commission to such Directors on which the company has discharged GST under reverse charge mechanism. The company also contends that as per Clause (1) Schedule III of the CGST Act, any amount paid by the employer to the employee under the contract of employment shall not be covered under the purview of GST.

However, the department contended that consideration paid to the directors is against supply of services that is specifically covered under the RCM Notification No 13/2017 Central tax (Rate) dated 28 June 2017.

Basis the above notification, the department views that directors are not the employees of the company and any consideration paid to the directors under any head is liable to GST under RCM.

The authority ruled that consideration paid to the directors in any head by the applicant will attract GST under RCM as it is covered under Notification No. 13/2017 Central Tax (Rate) dated 28.06.2017 issued under Section 9(3) of the CGST Act, 2017.

Further, the situation will remain same as above and will attract GST under reverse charge mechanism even if the director is a part-time director in another company.

RBI updates

RBI issues Foreign Exchange Management (Non-debt Instruments) Rules, 2019 [NDI Rules] and Foreign Exchange Management (Debt Instruments) Regulations, 2019 [Debt Regulations] (Notification No. FEMA 396/2019-RB and Notification No. S.O. 3732(E). Dated 17 October 2019)

The NDI Rules and Debt Regulations issued by the Reserve Bank of India (RBI) shall supersede the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 [FEMA TISPRO Regulations 2017] and Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018 [FEMA Immovable Property Regulations].

The RBI has also issued the Foreign Exchange Management (Mode of Payment and Reporting of Non – Debt Instruments) Regulations, 2019 pertaining to the mode of payment and reporting requirements for investments in India by person resident outside India by way of issuance of non-debt instruments.

The above amended NDI Rules and Debt Regulations are in accordance with the erstwhile regulations except certain key changes in the NDI Rules explained below:

- **Key changes in the definition:**
  - Equity instrument: This replaces the term capital instrument and comprises equity shares, convertible debentures, preference shares and share warrants issued by an Indian company.
  - Hybrid security: This has been defined to mean optionally or partially convertible instruments.
  - Non-debt instruments: This shall now inter-alia include investments in units of mutual funds or ETFs that invest more than 50% in equity.
- **Investments by foreign portfolio investors (FPIs):**
  - The aggregate limit for investments to be made by the FPIs in an Indian company has been amended up to the sectoral cap/statutory ceiling applicable for the Indian company (instead of the erstwhile 24%) with effect from 1 April 2020
  - An Indian company by means of a resolution of the board of directors and a special resolution of the members may increase or decrease the aggregate investment limit by FPIs (24%, 49% or 74% as the case may be), prior to 31 March 2020
- **Foreign Venture Capital Investor (FVCI):**

  FVCIs can invest in equity or equity-linked instrument or debt instrument issued by start-ups irrespective of the sector in which the start-up is engaged, subject to sectorial caps and conditions under the NDI Rules.

Our view

The classification of debt and non-debt instruments is intended to specify the rules for different types of investment, ensure efficient reporting and transparency, and improve the environment for investors. The NDI Rules has shifted the power to form the policy in relation to issue and transfer of non-debt instruments by a person resident outside India and acquisition or transfer of immovable property, from the RBI to the central government. Such bifurcation of power and roles concerning foreign exchange transactions between the central government and the RBI will bring efficiency and avoid any conflict with respect to foreign exchange transactions.

RBI amends the IBU Regulations with regard to Permissible activities (DOR.IBD.BC.26/23.13.004/2019-20 dated 23 December 2019)

The RBI has issued guidelines for setting up IFSC Banking unit (IBUs) that prescribes various operational conditions for IBUs. These operational conditions inter-alia include conditions related to the source of funds, permitted banking activities, capital adequacy requirements, prudential norms etc. The RBI in accordance with its announcement in its 5th Bi-monthly Monetary Policy Statement 2019-20 dated 5 December 2019, has made the following key amendments:

- The IBUs are allowed to raise liabilities, including borrowings foreign currency without any restrictions on the maturity period that was erstwhile for a maturity period of more than a year.
- The IBUs permitted to open foreign currency current account (FCC), including escrow accounts, of their corporate borrower's subject to the provisions of FEMA and the regulations issued thereunder. Earlier the IBUs were only permitted to open accounts units operating in IFSC and non-resident institutional investors to facilitate their investment transactions.
- The IBUs permitted to accept fixed deposits in foreign currency of tenure less than one year from non-bank entities and repay prematurely without any time restrictions. Earlier the IBUs were not allowed to repay premature fixed deposits within the first year, except in certain conditions.
- In addition to the know your customer, combating the financing of terrorism and anti money laundering provisions, the IBUs are now also required to comply with the reporting requirements, as maybe prescribed by the RBI/ other agencies in India from time-to-time. `

Our view

These amendments shall enable the IBUs to carry out their operations smoothly.

RBI introduces rupee derivatives in IFSC

(A.P. (DIR Series) Circular No.17 dated 20 January 2020) and (DOR.IBD.BC.No.28/23.13.004/2019-20 dated 21 January 2020)

The RBI, in its statement on Development and Regulatory Policies dated 4 October 2019, announced to permit rupee derivatives (with settlement in foreign currency) being traded in IFSC.

In this regard, the RBI issued directions to implement the same and salient features of these directions are given below:

- Currency derivatives in any currency pair involving the rupee or otherwise are permitted on recognised stock exchanges set up in IFSCs
- Contracts in the rupee shall be settled in a currency other than the Indian rupee
- Any person residing outside India may undertake these derivative contracts Consequent amendments have also been made in the permissible activities of IBUs under the operational guidelines issued by the RBI whereby the IBUs now permitted to participate in exchange traded currency derivatives (ETCD) on rupee (with settlement in foreign currency) listed on stock exchanges set up at IFSC.

Our view

The introduction of Indian rupee derivative in the IFSC is a welcome step to attract various foreign investors that otherwise trade in Indian rupee derivatives through other international finance centers such as London, Dubai and Singapore. The implementation of the rupee derivatives in IFSC would not only bring large volumes and price discovery to onshore market but also address certain issues including restriction on non-residents in participation in domestic markets limited time of operations of domestic exchanges, etc.

Relaxations in Voluntary Retention Route (VRR) for FPIs investment in debt and review of investments by FPIs in Debt

(A.P. (DIR Series) Circular No. 18 and 19 dated 23 January 2020)

Relaxations to FPI investments through VRR:

- Investment cap increased to INR 1,50,000 crore from INR 75,000 crore
- Transfer investments under general investment limit to VRR (if allotted investments under VRR)
- Invest in exchange traded funds (ETFs) investing only in debt instruments

Changes to FPI investments in debt:

- Short-term investment limit (i.e. investments having minimum maturity upto one year) increased to 30% from 20% of its total investment either in central government securities (G-secs) (including Treasury Bills) or state development loans (SDLs) and corporate bond.

In addition to the security receipts, the following securities shall also be not included for computing the short-term investment limit:

- Debt instruments issued by asset reconstruction companies
- Debt instruments issued by an entity under the Corporate Insolvency Resolution Process as per the resolution plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016

Our view

The amendments will increase the operational flexibility of the existing scheme and make VRR more attractive for FPIs investing in the debt market. Additionally, the enhancing of investment limits shall encourage the flow of capital into Indian debt markets.

Introduction of a separate route named Fully Accessible Route for investments by non-residents in government securities

(A.P. (DIR Series) Circular No. 25 and Notification No. FMRD.FMSD.No.25/14.01.006/2019-20 dated 30 March 2020)

In accordance with the measures announced in Union Budget 2020 to deepen the bond market and achieve aspirational growth rate through flow of additional capital in the financial system, a route such as Fully Accessible Route (FAR) was introduced to enable non-residents to invest in specified securities issued by Government of India without being subject to any investment limit.

This scheme shall operate along with the two existing routes, viz., the Medium Term Framework (MTF) and VRR. FAR shall come into effect from 1 April 2020. The key features of the scheme are explained below:

- **Eligible investors** - Eligible investors include any 'person resident outside India' as defined under the Foreign Exchange Management Act (FEMA). The eligible investors under FAR shall inter-alia include non-resident investors already registered as FPIs with the SEBI.

- **Specified securities** – The RBI vide its notification dated 30 March 2020 has specified the following government securities eligible for investment under FAR, from the date on which the scheme comes into effect (i.e., 1 April 2020)

Sr. No.	ISIN	Security
1.	IN0020190396	6.18% GS 2024
2.	IN0020180488	7.32% GS 2024
3.	IN0020190362	6.45% GS 2029
4.	IN0020180454	7.26% GS 2029
5.	IN0020190032	7.72% GS 2049

Additionally, all new issuances of government securities of 5 year, 10 year and 30 year tenors from the financial year 2020-21 will be eligible for investment under the FAR.

- **Investment limits** -
  - No quantitative limit on investment in specified securities
  - Investments made under FAR shall not be subject to certain limits specified by the RBI for FPIs (vide its Circular No 31 dated 15 June 2018 read with Circular NO 18 dated 23 January 2020) such as the minimum residual maturity requirement, security-wise limit and concentration limit
  - All existing investments by eligible investors in the specified securities shall be reckoned under the FAR

- **Other features** – The RBI vide its notification dated 30 March 2020 has specified the following government securities eligible for investment under FAR, from the date on which the scheme comes into effect (i.e., 1 April 2020)

Our view

Introduction of FAR by the RBI is a welcome move as it would facilitate the inflow of stable foreign investment in government bonds and ease the access of non-residents to Indian Government Securities Markets.

Guidelines for regulating payment aggregators and payment gateways issued

(Notification No. DPSS.CO.PD.No.1810/02.14.008 /2019-20 dated 17 March 2020)

Until recently, the activities of the payment aggregators (PAs) and payment gateways (PGs) were governed by the RBI directions, which required banks to maintain a nodal account with permissible credits/debits and a prescribed settlement cycle for credit to merchants.

After considering the suggestions on the discussion paper, the RBI issued Guidelines on Regulation of Payment Aggregators and Payment Gateways (Guidelines) to regulate the activities of PAs in entirety and to provide baseline technology-related recommendations to PGs. The Guidelines shall come into force from 1 April 2020 other than for activities for which specific timelines are mentioned.

Key features of the Guidelines are:

PAs are defined as entities that facilitate e-commerce sites and merchants to accept various payment instruments from the customers for completion of their payment obligations without the merchants requiring separate integration system of their own; Entities that facilitate merchants to connect with acquirers and in the process, they receive payments from customers, pool and transfer them on to the merchants.

PGs are defined as entities that provide technology infrastructure to route and facilitate processing of an online payment transaction without any involvement in handling of funds.

- **Applicability of the Guidelines**

  The Guidelines are applicable only to PAs. Domestic leg of import and export related payments facilitated by PAs would also be governed by the Guidelines. However, cash on delivery (CoD) e-commerce model are outside the purview of the Guidelines.

- **Authorisation and net-worth requirements**

Particulars	Authorisation	Net-worth requirement
Bank PAs	No separate authorisation	-
New non-bank PAs	Yes under Payment and Settlement Systems Act, 2007 (PSSA)	• INR 15 crore on the date of application and • INR 25 crore by the end of the third financial year of grant of authorisation
Existing non-bank PAs	Obtain authorisation by 30 June 2021	• INR 15 crore as on the date of application or by 31 March 2021, whichever is earlier and • INR 25 crore by 31 March 2023
Existing e-commerce market places providing PA services	Set-up separate entity and obtain authorisation under PSSA by 30 June 2021	NA

- Net-worth includes paid-up equity capital, compulsorily convertible preference shares (CCPS), free reserves, share premium balances, capital reserves representing surplus arising out of sale proceeds of assets.
- FDI allowed, subject to extant consolidated FDI policy and relevant foreign exchange management regulation on this subject.
- The Guidelines also provide for governance of PAs, safeguards against money laundering, settlement conditions, fund management etc

Our view

With constant evolution of the fin-tech and e-commerce industry in India, it was crucial to have clear guidelines in place to increase transparency and efficiency. With the introduction of these Guidelines, existing PAs will be directly regulated by the RBI.

SEBI updates

SEBI issues Operational Guidelines for FPIs & DDPs (IMD/FPI&C/CIR/P/2019/124 dated 05 November 2019)

The SEBI issued the operational guidelines (Guidelines) for FPIs, Designated Depository Participants (DDPs) and Eligible Foreign Investors (EFIs) in order to implement the revised SEBI (Foreign Portfolio Investor) Regulations, 2019 [SEBI (FPI) Regulations, 2019] notified on 23 September 2019. These Guidelines replaces all existing circulars, FAQs, operating guidelines and other guidelines issued by SEBI on this subject.

The Guidelines are segregated into five sections and the key changes in these Guidelines are outlined as under:

FPI registration-related activities

- Operational guidelines provides for a process of re-categorisation of existing FPIs registered under the erstwhile SEBI (FPI) Regulations, 2014 (erstwhile Regulations), which is as under:

Existing FPI registered under the erstwhile regulations as	Deemed registration in the new regulations
Category I	Category I
Category III	Category II FPI
Category II	Either as Category-I FPI or Category-II FPI depending on the eligibility criteria met by such FPIs

- There will be no deemed re-categorisation of registration for eligible entities from Category-III in the erstwhile regulations to Category-I FPI under the new regulations.
- FPIs having segregated portfolio(s) are required to provide BO declaration for each fund/sub-fund/share class/ equivalent structure that invests in India. These Guidelines also require ring-fencing of assets and liabilities for FPIs that have segregated portfolios by way of sub-funds, separate classes of shares or equivalent

Know your client (KYC) requirements for FPIs

- The Guidelines provide for a list of documents required basis the category under which FPI registration is sought.

Investment conditions/restrictions on FPIs registered under the new Regulations

- The SEBI has consolidated a list of circulars prescribing the list of permissible investments and its limits and certain other clarifications
- The Guidelines provides for investment limits for different categories of FPIs in various derivative products which include stock and interest rate derivative, interest rate future and currency derivatives
- Off-market transfer of securities permitted in certain cases, which inter-alia includes unlisted, illiquid and delisted shares
- In case of breach of the individual and group investment limits prescribed (i.e. investment by an FPI or FPI group to be below 10% of the investee's fully diluted paid-up capital), FPIs are required to divest the excess holdings within five working days. Failing which the investments shall be considered as FDI investment and the FPIs shall not be allowed to make any further portfolio investment in that company

Issuance of offshore derivative instruments (ODIs)

- FPIs not allowed to issue ODIs referencing derivatives. Further, no FPIs shall be allowed to hedge their ODIs with derivative positions on stock exchanges in India, except the conditions specifically provided under the Guidelines.

Particulars	Remarks
Permitted issuers of ODIs	FPIs registered as Category I FPIs
Permitted subscribers to ODIs	Persons eligible to obtain Category I licence under the SEBI (FPI) Regulations

- FPI to segregate its ODI and proprietary derivative investments through separate FPI registrations under the same PAN.
- ODI issuing FPI cannot co-mingle its non-derivative proprietary investments and ODI hedge investments with its proprietary derivative investment or vice versa in the same FPI registration.
- Individual and group FPI investment limits shall be applicable to ODI subscribers as well

Guidelines for participation/functioning of EFIs in the International Financial Service Centre (IFSC)

- These Guidelines provide for an eligibility criteria for EFIs making investment in IFSC

Our view

The Guidelines have simplified registration and KYC requirements and provided more clarity on the KYC documents that need to be collected for each category of FPIs, resulting in ease of access for FPIs in India. The Guidelines remove the broad-based requirement, remove opaque structure restrictions for FPIs, liberalise conditions for hedging ODIs and allow appropriately regulated entities to invest on behalf of their clients. However, some of the industry asks relating to removal of restrictions on majority NRI holdings in FPI funds and less favourable treatment for non-FATF member jurisdictions from the perspective of registering as Category-I FPI continue to remain.

SEBI permits by asset management companies (AMCs) to provide management and advisory services to FPIs

(SEBI/HO/IMD/DF2/CIR/P/2019/155 dt 16 December 2019)

The SEBI has allowed AMCs to provide management and advisory services to FPIs, which includes Banks, Pension funds, and Insurance company.

AMCs can provide such services to government and government-related investors such as Central Banks, sovereign wealth funds, international or multilateral organisations or agencies, including entities controlled or at least 75% directly or indirectly owned by such government and government-related investors, also to the FPIs falling under the category of appropriately regulated entities such as reinsurance entities, banks.

In case of agreements entered into by AMCs up to 16 December 2019, for management and advisory services to FPIs not following in the above criteria, SEBI said that the AMCs may continue to provide the services for the period as mentioned in the agreement or one year from the date of this circular, whichever is earlier.

According to the SEBI, government and government-related investors as well as pension funds, insurance or reinsurance should hold more than 50% of shares or units in appropriately regulated FPIs.

Further, the SEBI has given one-year exit time to AMCs, which are already providing management and advisory services to such FPIs which are not falling under the above categories.

Our view

The permission would enable AMC to provide management advisory services to FPIs such as banks, insurance companies etc. and those FPIs where more than 50% shares or units are held by government and government-related investors.

SEBI introduces Stewardship Code for all mutual funds and all categories of AIFs, in relation to their investment in listed equities

(CIR/CFD/CMD1/ 168 /2019 dated 24 December 2019)

The importance of institutional investors in capital markets across the world is increasing the world over, thus SEBI has decided that all mutual funds and all categories of AIFs shall mandatorily follow the Stewardship Code in relation to their investment in listed equities under the SEBI Act, 1992 read with the provisions of SEBI (Mutual Funds) Regulations, 1996 and SEBI (Alternative Investment Funds) Regulations, 2012.

Stewardship Code is a principles-based framework that assists institutional investors in fulfilling their responsibilities to help them protect and enhance the value of their clients and beneficiaries. The Code was to come into effect from 1 April 2020. However, due to the COVID-19 pandemic, the SEBI extended implementation of the Stewardship Code to 1 July 2020.

The code lays down following six broad principles to be adhered by Mutual Funds and AIFs while dealing with their investee companies:

- Formulate a comprehensive policy on discharge of their stewardship responsibilities, publicly disclose it, review and update it periodically
- Effectuate a clear policy on management of conflict of interest and public disclosure of the same
- Policy on continuous monitoring of investee companies
- Effectuate clear policy on intervention in investee companies along with a policy for collaboration with other institutional investors to preserve investor interest
- Formulate a policy on voting and disclosure of voting activities
- Periodical reporting of stewardship activities to clients

Our view

Stewardship code is a long awaited measure, one that adds a much-needed element of enfranchisement for unit holders in funds and recognises the need to channelise the financial clout wielded by large institutions into a participative corporate ecosystem. Also, adherence to the code by institutional investors also enhances the corporate governance of the investee companies.

SEBI issues operating guidelines for investment advisers in IFSC:

(SEBI/HO/IMD/DF1/CIR/P/2020/04 dated 09 January 2020 and SEBI/HO/IMD/DF1/CIR/P/2020/31 dated 28 February 2020)

The SEBI issued detailed guidelines, in 2015, to facilitate and regulate the securities market in India's first International Financial Services Centre (IFSC) set up in Gujarat – Gujarat International Finance Tec-City (GIFT City). These guidelines provided a broad framework for various intermediaries in IFSC (which inter-alia included Investment Advisors (IAs), permissible investors and permissible investments.

The SEBI has now issued operational guidelines for IAs operating in IFSC, which provide clarity on key regulatory issues like applicability of existing regulations, capital adequacy norms, conditions for overseas applicants, form for set-up, qualification and certification requirement, etc. The key features of the operational guidelines are as under:

Applicability of IAs regulations

All the provisions of the SEBI (Investment Advisers) Regulations, 2013, the guidelines and circulars issued thereunder would apply to IAs setting up/operating in IFSC, subject to the provisions of these operating guidelines.

Registration process

An application for grant of certificate shall be made in accordance with the IA regulations subject to the payment of the following fees:

Application fees	USD 750
Registration fees for grant or renewal of certificate	USD 7,500

Eligibility

Any recognised entity or entities desirous of operating in IFSC as an IA may form a company or a limited liability partnership (LLP) to provide investment advisory services.

Client

IAs registered with the SEBI under the IA Regulations read with the Operational Guidelines are permitted to provide advisory services to the persons referred under clause 9(3) of the IFSC Guidelines which inter-alia include the following:

- Non-resident;
- Non-resident Indian;
- Resident financial institution resident in India who is eligible under the FEMA to invest funds offshore, to the extent of outward investment permitted; and
- A person resident in India who is eligible under FEMA, to invest funds offshore, to the extent allowed under the liberalised remittance scheme of RBI, subject to a minimum investment as specified by SEBI from time-to-time.

Net worth requirement

- Minimum net-worth should not be less than USD 0.7 million.
- If IA is set up as a subsidiary, the net worth requirement may either be met by the subsidiary itself or the parent
- These Guidelines also prescribe certain other requirements, which includes professional qualification, requirement of annual audits and certification
- Further, the SEBI issued another circular dated 28 February 2020 clarifying that the existing intermediaries registered with SEBI/foreign securities market regulator can operate in IFSC without forming a separate company/LLP

Our view

This circular sought to provide a framework for IAs intending to operate in IFSC and will encourage the IAs to provide investment advise to global investors from IFSC. In order to address the industry concerns, these operational guidelines were also amended to revise the minimum net worth requirement from USD 1 million to USD 0.7 million to allow small and medium sized IAs to operate in IFSC.

SEBI issues disclosure standards for AIFs

(SEBI/HO/IMD/DF6/CIR/P/2020/24 dt 6 February 2020)

Pursuant to the consultation paper seeking comments, the SEBI issued templates for Private Placement Memorandum (PPM) thereby standardising the PPM, subject to certain exemptions and have introduced minimum benchmark for disclosure of performance of the AIFs. The key features of the circular are:

Templates for PPM:

- Due to absence of standardised PPM, many AIFs have been submitting draft PPMs while applying for registration leading to significant variations in the manner in which various clauses, explanations and illustrations are incorporated in the draft PPMs.
- To ensure a minimum standard disclosure, the SEBI has prescribed templates of PPM for all categories of the AIFs (separate template for Category I/ II and Category III AIFs)
- To ensure compliance with the terms of PPM, the AIFs are required to conduct mandatory annual audit of such compliance, the findings of which are to be communicated to specified persons listed in the Circular

The above requirement are applicable to

- Angel funds [as defined in SEBI (Alternative Investment Funds), Regulations 2012]
- AIFs/schemes in which each investor commits to a minimum capital contribution of INR 70 crore (USD 10 million or equivalent, in case of capital commitment in non-INR currency).

These requirements shall come into force from 1 March 2020.

Performance Benchmarking

- This is required in order to minimise potential of mis-selling of AIF products
- In order to compare the performance of AIF industry against other industry avenues, the SEBI has decided that the AIFs will enter into an agreement with the benchmarking agencies[21] for carrying out a benchmarking process
- Such agreement should cover the mode and manner of data reporting, specific data that needs to be reported, and terms of confidentiality
- Benchmarking will apply to all schemes that have completed at least one year from the date of First Close
- The above is not applicable to angel funds registered under sub-category of venture capital fund under Category I - AIF

Our view

With the rapid growth of the AIF industry in India, the initiatives of introducing minimum performance benchmark and standardisation of PPM would create a more conducive environment for AIF as an asset class. These initiatives would help bring the AIF landscape closer to the global standards while simultaneously ensuring that investors make informed decision relating to AIFs.

SEBI issues portfolio manager regulations and guidelines therein

(No. SEBI/LAD-NRO/GN/2020/03 dated 16 January 2020 and SEBI/HO/IMD/DF1/CIR/P/2020/26 dated 13 February 2020)

The SEBI (Portfolio Managers) Regulations 1993 were amended with a view to improve transparency, to bring changes in the reporting format of the performance disclosures by the Portfolio Managers and to bring in necessary disclosures relating to the distributors

Pursuant to the consultation paper issued by the SEBI to seek comments on recommendations of the Working Group, SEBI (Portfolio Managers) Regulations, 2020 (PMS Regulations) in supersession of the 1993 Regulations came into effect from 20 January 2020.

The key changes in the PMS Regulations are:

- Minimum investment amount for investors to avail PMS services increased to INR 50 lakh from INR 25 lakh
- Minimum net worth increased to INR 5 crore from INR 2 crore. Existing portfolio managers shall comply with this net worth requirement within 36 months from the date of commencement of the 2020 Regulations.

Investment norms

- Discretionary portfolio managers[22] allowed to invest only in listed securities
- Non-discretionary portfolio managers allowed to invest in unlisted securities upto 25% of their AUM in addition to the listed securities
- Portfolio managers to invest in units of mutual funds only through direct plans

21. These benchmarking agencies shall be notified by any association of AIF, which in terms of membership, represent at least 51% of the number of AIFs
22. discretionary portfolio manager" means a portfolio manager who under a contract relating to portfolio management, exercises or may exercise, any degree of discretion as to the investmen of funds or management of the portfolio of securities of the client, as the case may be;

Investment approach

The agreement between the client and the portfolio manager shall include details of the investment approach[23], areas of investment and restrictions, if any, imposed by the client with regard to the investment in a particular company or industry

Execution of off market transfers

Off market transfers from or to clients' accounts are restricted with certain exceptions to facilitate operational convenience

Appointment of custodian

- Appointment of custodian shall be mandatory for all portfolio managers (including portfoilio managers having an AUM less than INR 500 crore, which were exempt in the erstwhile regulations) except in cases where the portfolio managers provide only advisory services
- Qualifying criteria for employees and principal officers have been amended in the new PMS Regulations
- The calculation of the performance standards standardised by replacing the weighted average return with time - weighted rate of return (TWRR) which takes into account the performance of the account over a period of time

Our view

The changes in the PMS Regulations bring in enhanced disclosures and standardisation for the PMS industry. PMS clients will be able to better understand and compare the terms of services offered by various portfolio managers. Although the changes in the regulations are welcome, the growth of the PMS industry may see a slowdown due to the increased investment minimum limit of INR 50 Lakh for PMS clients.

23. An investment approach is a broad outlay of the type of securities and permissible instruments to be invested in by the portfolio manager for the customer, taking into account factors specific to clients and securities

IRDAI updates

Guidelines on repatriation of dividends by insurance intermediaries having majority by foreign investors

(Guidelines no. IRDAI/ INT/ GDL/ MISC/ 004/ 01/2020 dated 3 January 2020)

The guidelines lay down operational framework including quantum of dividend payable in addition to various other procedural matters like timeperiod for disposal of application and powers of the Chairman to issue clarifications. The features of the guidelines are as follows:

Applicability

The guidelines apply to repatriation of dividends by the following insurance intermediaries that has majority shareholding of foreign investors:

- Insurance brokers
- Insurance web aggregators
- Insurance marketing firms
- Corporate agents
- Insurance surveyors and loss assessors
- Third party administrators (Health Services)

Operational framework

An insurance intermediary shall make an application to IRDAI for repatriation of dividend in Form RD -1. Following points should be considered by IRDAI while considering the permission:

- Net-worth of 1.5 times of the statutorily required minimum paid-up capital (as specified for the respective insurance intermediary) after proposed dividend pay-out
- Aggregate payments (other than dividends) made to related parties not to exceed 10% of the total expenses of the insurance intermediary in the financial year
- Proposed dividend is payable out of current year's profit
- No restrictions placed on the insurance intermediary for declaration of dividend
- Compliance with the provisions of Insurance Act, 1938, IRDA Act, 1999, Rules, Regulations, guidelines, circulars, directions issued by IRDAI
- Any other point which the IRDAI may consider relevant

Quantum of dividend payable

- Dividend pay-out ratio shall not exceed 75%
- Ratio shall be calculated as a percentage of dividend payable to profit after tax in a year (excluding dividend tax). For this purpose, the profit after tax shall be excluding extra-ordinary profits/income
- The financial statement of the respective financial year should be free from any qualification by the statutory auditors, which has an adverse bearing on the profit of that year. In case of any such qualification, the net profit should be suitably adjusted while computing dividend payout ratio

Time period for disposal of application

- If application is not cleared/approved without any query raised or clarification sought within 30 days of receipt of the application, it would be deemed as approved.
- If a query is raised or clarification sought, then on receipt of satisfactory reply to the query or satisfactory clarification from the applicant, the application shall be closed within 30 days of receipt, failing which the application shall be deemed to have been approved.

In addition to the above, IRDAI has laid down certain procedural matters in terms of timeperiod for disposal of application and powers of the Chairman to issue clarification.

Our view

Pursuant to allowing 100% FDI in insurance intermediary, the IRDAI will now monitor the outflow of funds from India from such intermediary in the form of dividend to avoid any capital disruption. Further, the restriction on payment to related parties, the criteria of net worth, the dividend pay-out ratio are some of the internal controls enacted by IRDAI to avoid outflow of funds from such intermediary to their foreign shareholders enabling more funds to remain in India for business purpose.

IRDAI has issued a notification for obligatory cession for the FY 21 with GIC

(Notification No. F. No. IRDAI/RI/1/167/2020 dated 3 February 2020)

IRDAI has recently issued a notification laying down the norms for Obligatory cession for FY 21. The salient features are:

Applicability

Applicable to all Indian re-insurers and certain other insurers. However, it requires the entire obligatory cession to be placed with General Insurance Corporation of India ('GIC') only

Percentage of cession

- The minimum percentage of the obligation cession shall be 5% of the sum insured on each general insurance policy during the FY 21.
- However, the percentage of cession with respect to terrorism premium and premium ceded to Nuclear pool would be 'NIL'.

Cession limit and notice of information

There would be no limit on the sum insured for the cessions made during FY 21. In view of this, GIC may require the ceding insurer to give immediate notice of underwriting information on any cession exceeding an amount specified by GIC and the ceding insurer shall inform GIC accordingly.

Commission

The minimum percentage of commission, as specified in the notification, on obligatory cession would range from 5% to 15% depending on the different class of business. Commission over and above these specified percentages can be as agreed between GIC and the ceding insurer.

Profit commission

- GIC shall share the profit commission on 50:50 basis with the ceding insurer
- Sharing of profit commission shall be based on the performance and surplus of total obligatory portfolio of the ceding insurer after considering the specified percentages of incurred loss, management expense, profit, commission and the loss ratio.
- No profit commission is payable where the loss ratio exceeds 78%.
- Also, the profit commission shall not exceed 14%.

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