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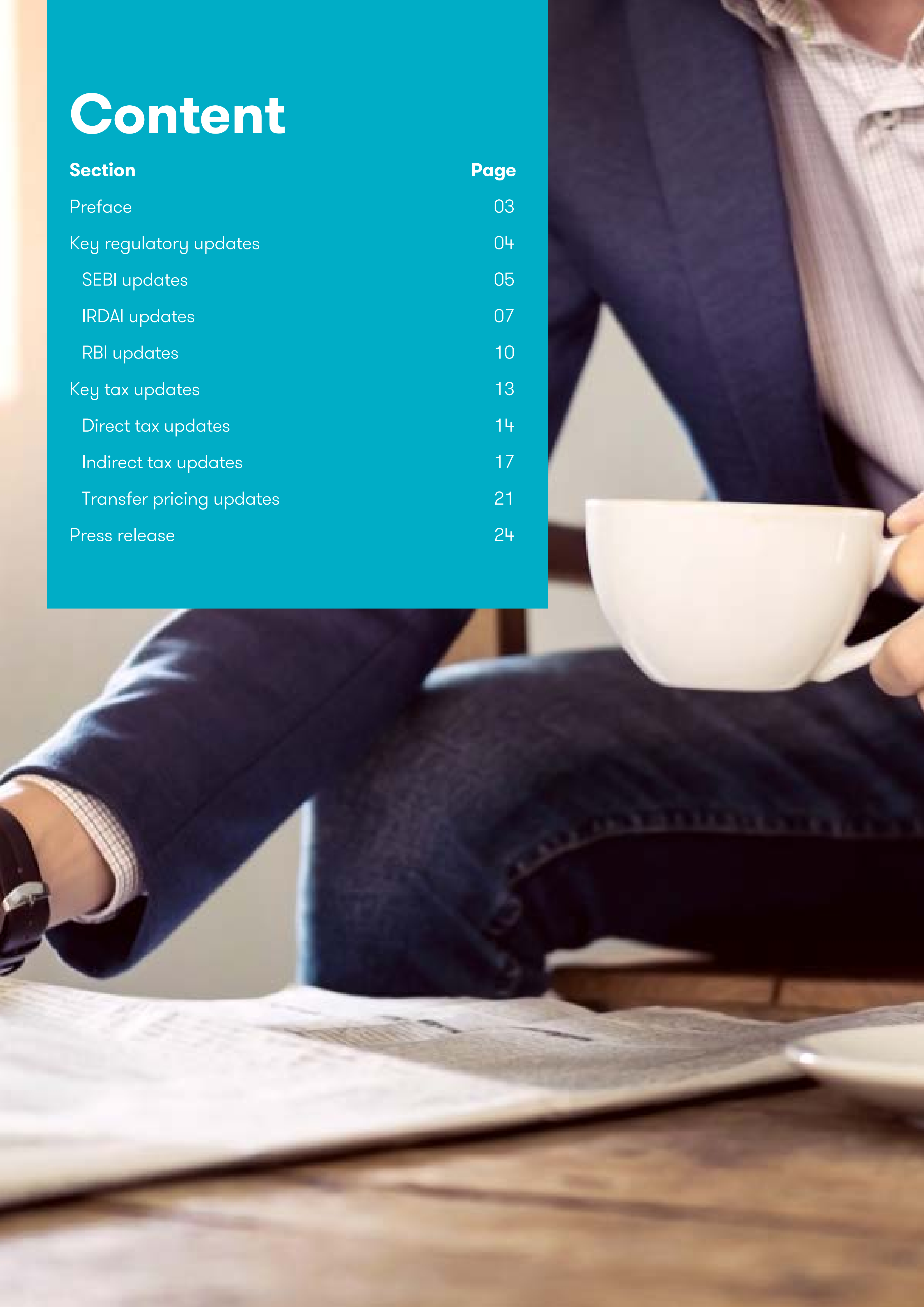

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Preface

The financial services sector is one of the strongest pillars of the Indian growth story. It is expanding rapidly, and is backed by formalisation of economy, improved standard of living and spending habits, digitisation of various financial service products and the extensive focus of government on India's upliftment.

Within the financial sector, banking is the biggest and one of the most important aspects for economic growth. In India, in the last few years, this sector has faced lot of non-performing assets (NPA) issues. However, the introduction of Insolvency and Bankruptcy Code (IBC), 2016 has equipped banks to recover bad loans from defaulting borrowers expeditiously. IBC has directly/indirectly addressed stressed assets worth INR 3 lakh crore in the last two years.

Due to the said NPA issues, especially within the public sector banks, the Reserve Bank of India (RBI) had put 11 public sector undertaking (PSU) banks under the Prompt Corrective Action (PCA) framework to prevent further deterioration in their asset quality. This led the government to initiate the consolidation of weaker public sector banks with stronger public sector banks. These measures would lead to higher capital with banks for increased lending activity and kick-start the credit cycle.

One of the key initiatives of the government in the last few years is digitisation of financial products like the Pradhan Mantri Jan Dhan Yojana (PMJDY), and Aadhaar-enabled e-KYC. The government has also developed a robust payment infrastructure like the Unified Payments Interface (UPI), and the web-based application called Unified Mobile Application for New-age Governance (UMANG). Penetration of the banking/non-banking financial company (NBFC) sector in rural and remote areas of the country has also increased.

Due to the presence of large NPAs in the banking sector and innovative products offered with the use of technology, NBFCs have been able to service urban customers as well as unbanked/underbanked retail, and micro, small and medium enterprises (MSME) customers. This is evident from the exponential growth of over 18.7% in the credit growth of NBFCs during FY 2018-19.

In the last few years, the focus of the government to build a digital payment ecosystem has led to channelising retail investments into financial products offered by mutual funds, insurance companies, etc., which have caused these sectors to grow exponentially, and have helped Indian capital markets insulate themselves from any external shocks.

Considering the importance of the financial services sector in the Indian economy, the government has, from time to time, endeavoured to address tax and regulatory issues faced by the industry to make India a more competitive economy and provide easy access to foreign capital into the Indian markets. Taking the process further, various steps have been undertaken by the Indian government in the last few months, including liberalising External Commercial Borrowing (ECB) norms, issuing operating guidelines for Alternative Investment Funds (AIFs) in International Financial Service Centres (IFSC), setting-up a common authority for IFSC, issuing clarification on clubbing of Foreign Portfolio Investment (FPI) investment limits, proposing Voluntary Retention Route (VRR) for FPI investment, etc.

This publication seeks to keep various stakeholders in the industry abreast of key developments on the tax and regulatory aspects in the financial services sector.

We hope you enjoy reading the second edition and look forward to your valuable feedback.

Key regulatory updates

SEBI updates

a. SEBI issues clarification on clubbing of FPI investment limits

Earlier, FPIs were treated as part of the same investor group and the investment limits of such entities were clubbed for deriving the investment limit as applicable to a single FPI[1] , i.e. 10% of the total issued capital of the company, in case the same set of ultimate beneficial owners are investing through multiple entities.

However, SEBI vide its recent circular[2] has now specified that the clubbing of the investment limits for FPIs henceforth will be on the basis of common ownership of more than 50% or based on common control subject to certain exceptions.

If FPI breaches the conditions, then the said investments will be treated as foreign direct investments (FDIs) from the date of breach of the relevant condition.

Our comments: The circular is a welcome move as it provides the much-needed clarity on the clubbing of investment limit, and is broadly as expected by the market participants. As per the definition of control, where it is determined that the investment manager is controlling more than one fund, the provisions relating to clubbing of investments shall apply. However, one would need to examine it on a case-to-case basis.

b. SEBI issues operating guidelines for AIFs in IFSC

SEBI, in consultation with all the stakeholders, based on the deliberations of the Alternative Investment Policy Advisory Committee (AIPAC), issued operating guidelines for AIFs operating in IFSC.

The operating guidelines provide the requirements related to registration of such AIFs, compliances, and eligible sponsors/ managers, custodians, etc. The said SEBI circular also clarified that AIF regulations, guidelines, and circulars issued thereunder would apply to AIFs setting-up/operating in IFSC (hereinafter referred as AIF(s)–IFSC).

Salient features of the circular

Particulars	Guidelines
Registration	Any fund established/incorporated in IFSC (in the form of company, trust, LLP or body corporate) can seek registration under SEBI Regulations[3]
Minimum corpus	$3 million per scheme of an AIF – IFSC
Eligible investors in AIFs–IFSC	• A person resident outside India • A non-resident Indian • Institutional investor resident in India[4] • A person resident in India[5]
Eligible securities for investment by AIFs-IFSC	AIFs–IFSC are permitted to invest in: • Securities listed in an IFSC • Securities issued by companies incorporated in IFSC or in India • Securities issued by companies belonging to foreign countries • Units of other AIFs set up in IFSC or India, subject to AIF regulations
Investment routes for AIFs–IFSC for investing in India	• FPI • Foreign Venture Capital Investment (FVCI) • FDI
Eligible sponsors and managers of an AIF–IFSC	• In case of the sponsor/manager of an existing AIF in India, they may act as a sponsor/manager of an AIF-IFSC either: – by setting up a branch in the IFSC, or – by incorporating a company or LLP in the IFSC • In other cases, a sponsor/manager would be required to incorporate a company or LLP in the IFSC

All the provisions of the AIF regulations, guidelines and circular issued, thereunder, would apply to AIFs–IFSC, their investors, sponsors and managers and other intermediaries as applicable. However, the regulations[6] governing overseas investments by AIFs shall not be applicable to AIFs–IFSC. Further, AIFs–IFSC would be required to report their activities[7] and the said reporting should be denominated in US dollars.

[1] Regulation 21(7) of SEBI (FPI) Regulations, 2014
[2] Circular No. SEBI/HO/IMD/FPIC/CIR/P/2018/150 dated 13 December 2018
[3] SEBI (Alternative Investment Funds) Regulations, 2012
[4] Subject to the outward investment limits permitted under the Foreign Exchange Management Act (FEMA)
[5] Should have net worth of at least $1 million during the preceding FY and is eligible under FEMA to invest funds offshore to the extent allowed in Liberalised Remittance Scheme (LRS).
[6] Para 2(B) of the SEBI Circular No. CIR/IMD/DF/7/2015 dated 1 October 2015
[7] Para 3.2 of SEBI Circular No. CIR/IMD/DF/10/2013 dated 29 July 2013

Our comments: The operating guidelines issued by SEBI are a welcome move as they were being eagerly awaited by the fund industry and are largely in line with the expectations of the stakeholders. IFSCs' competitive tax regime along with the low cost of operations compared to any other global financial centres should attract institutions to set up fund activities in the IFSCs. Thus, they have the potential to become the preferred destination for launching offshore funds for investment in India.

c. Investment by FPI through primary market issuances

(CIR/IMD/FPIC/CIR/P/2018/114 dated 13 July 2018)

As per the SEBI (FPIs) Regulations, 2014 (the FPI regulations), a single portfolio investor or an investor group cannot hold equity shares of an Indian company more than 10% of the total issued capital of the said Indian company. Further, the said regulation also provides that where the ultimate beneficial owner(s) invest through multiple entities, such entities will be treated as part of the same investor group and the investment limits of all the entities will be clubbed, and the investment limits would apply to it, as if it were a single portfolio investor.

Thus, in order to track and ensure the compliance of the above, at the time of allotment during primary market issuances, SEBI directed Registrar and Transfer Agents (RTAs) for the following:

a. To use PAN issued by the Income Tax Department of India for checking compliance for a single portfolio investor; and

b. To obtain validation from the depositories for foreign portfolio investors who have invested in the particular primary market issuance to ensure that there is no breach of the investment limit

Further, the circular also mandates for the depositories to put in place the necessary systems for sharing information with RTAs within the timelines for issue procedure, as prescribed by the SEBI.

Our comments: In order to restrict the FPI investment below 10% and to ensure that the investment by FPIs is below 10% at the time of allotment, this circular directs RTAs to use PAN and to obtain validation from depositories for the FPIs that have invested in a particular primary market issuance. This will help strengthen the tracking mechanism for compliance of the investment limit for SEBI.

d. SEBI releases revised KYC norms and eligibility conditions for FPIs

(CIR/IMD/FPIC/CIR/P/2018/131 and CIR/IMD/FPIC/CIR/P/2018/132 dated 21 September 2018)

SEBI vide its recent circulars[8] issued revised norms for the purpose of KYC and determining the eligibility conditions of FPI. With regard to the eligibility conditions for FPI, the circular broadly permits NRIs to invest through the FPI route but is subject to certain terms and restrictions. Further, the circular provides that the existing and new FPIs will be given a time period of two years from the date of coming into force of the amended regulations or from the date of registration, whichever is later, to comply with restrictions related to NRIs' investments in India through the FPI route.

With regard to the revised KYC norms, among others, the circular provides for the following:

- FPIs are required to maintain a list of Beneficial Owners (BO) and/or Senior Management Official (SMO) and should provide the details in the prescribed format
- Methodology to identify the BOs for different entity structures
- KYC review (including change in BOs/their holdings) should be done based on risk categorisation of FPIs
- Existing category II and III FPIs should provide the list of BOs and applicable KYC documentation within six months from the date of this circular i.e. by 20 March 2019. Failing so, FPI will face consequences and in extreme cases could lead to deregistration.

Our comments: The revision of BO requirements is a welcome step as it has brought relief to the industry participants by categorically clarifying that the BO declaration will not impact the eligibility conditions of FPIs. It has also provided the much-needed clarity with respect to the applicability of BO requirements. It has excluded category I FPIs from identification and verification of BOs, which we believe is an informed step as all the category I FPIs are either government/government-related entities and are perceived to be low-risk entities. Thus, most of the concerns of stakeholders of FPIs have been addressed.

[8]Vide Circular No. 2018 CIR/IMD/FPIC/CIR/P/2018/131 dated 21 September 2018 - Know Your Client requirements for FPIs and CIR/IMD/FPIC/CIR/P/2018/132 dated 21 September 2018 – Eligibility conditions for FPIs CIR/IMD/FPIC/CIR/P/ 2018/64 dated 10 April 2018

IRDAI updates

a. IRDAI issues final re-insurance regulations

The Insurance Regulatory and Development Authority of India (IRDAI) had, in January 2018, issued the draft re-insurance regulations inviting stakeholder representations on the same. The IRDAI has now issued the final re-insurance regulations IRDAI (Re-insurance) Regulations, 2018 issued vide F. No. IRDAI/Reg/4/151/2018 dated 30 November 2018, which are applicable to insurers, IFSCs, insurance offices (IIOs) and exempted insurers. The regulations shall come into effect from 1 January 2019.

The regulations repeal the IRDAI (General Insurance – Re-insurance) Regulations, 2016, and the IRDAI (Life Insurance – Re-insurance) Regulations, 2013. However, the regulations bring out certain amendments to the IRDAI (Registration and Operations of Branch Offices of Foreign Re-Insurers Other Than Lloyd's) Regulations, 2015 (the branch regulations), and the IRDAI (Lloyd's India) Regulations, 2016 (Lloyd's India regulations).

The key amendments to the branch regulations and Lloyd's India regulations include:

- The requisition for registration application shall now be made for re-insurance business wherein the branch office of a foreign re-insurer or Lloyd's India Syndicate shall maintain a minimum retention of 50% of the Indian re-insurance business. This replaces the existing regulations (Regulation 4 of the branch regulations, and Regulation 8 of Lloyd's India regulations) which provide for category I (with 50% retention) and category II (with 30% retention) types of re-insurance business registration application. Corresponding changes have been made in both the regulations by either deleting or substituting the relevant regulation wherever it dealt with categories of re-insurance business.
- The re-insurance business shall now be subjected to the regulations which substitute the existing regulations (Regulation 28(8) of the branch regulations, and Regulation 50(7) of Lloyd's India regulations) relating to re-insurance and retrocession.

The salient features of other amendments are as follows:

1. Re-insurance programme

The re-insurance programme of every Indian insurer shall be guided by objectives such as maximising retention within the country, developing adequate technical capability and financial capacity, securing the best possible re-insurance coverage at a reasonable cost and simplifying the administration of business. The said programme, inter alia, covers aspects like retention policy, re-insurance arrangements, catastrophic risk protection and maintenance of records.

2. Placement of re-insurance business with CBR

An Indian insurer can place its re-insurance business with any cross-border re-insurer (CBR), provided it satisfies the following eligibility criteria:

i. The CBR is an insurance or re-insurance entity in its home country, duly authorised by its home country regulator to transact re-insurance business during the immediate past three continuous years.

ii. The CBR has a credit rating of at least BBB from Standard & Poor's (S&P) or equivalent rating from an international rating agency during the immediate past three continuous years.

iii. The home country of the CBR has signed a Double Taxation Avoidance Agreement (DTAA) with India.

iv. The CBR has the minimum solvency margin or capital adequacy, as specified by the home country regulator during the immediate past three continuous years.

v. The past claims settlement experience of the CBR is found to be satisfactory.

vi. Any other requirements as stipulated by the authority from time to time.

Reinsurance placements with a CBR not fulfilling the above stated eligibility criteria shall require a prior approval of the IRDAI.

3. Procedure for re-insurance business

New amendments to the clauses for obtaining best terms for cessions and offer for participation are introduced to supersede and replace the existing regulations (Regulation 28(9) of the branch regulations) on order of preference for cessions by Indian insurers.

Further, the amendments also cover that no Indian insurer transacting life insurance business shall have re-insurance arrangements without prior IRDAI approval with its promoter company or its associate/group companies except on terms which are commercially competitive on an arm's length basis

4. Cessation limit

Re-insurance placements with CBRs by the cedants transacting other than life insurance business shall be subject to the following overall cession limits during a FY.

Rating of the CBR as per S&P or equivalent	Maximum overall cession limits allowed per CBR
Greater than A+	20%
Greater than BBB+ and up to and including A+	15%
BBB & BBB+	10%

5. Domestic Insurance Pool (DIP)

Either the Indian insurer can submit the proposal, or wherever necessary, the IRDAI may suo-moto direct Indian insurers to create and participate in DIPs. The IRDAI, after examining certain specified factors, may permit the formation of a DIP.

6. Alternate Risk Transfer (ART)

On being satisfied with the type of ART solution to be adopted by an Indian insurer, the IRDAI may allow their ART proposal on a case-by-case basis.

7. Inward re-insurance business

For writing inward re-insurance business, every Indian insurer shall file with the IRDAI its inward re-insurance underwriting policy (stating the insurance segments, geographical scope, underwriting limits and performance objectives) duly approved by its board along with the re-insurance programme within the specified timeline. Indian insurers shall also submit with the IRDAI any changes to the said policy, within 15 days of board approval to such change.

Our comments: After a long wait of almost a year, the final regulations released by the IRDAI come as a breather for the industry players who were seeking to address various concerns - the key issue being the order of preference for placement of re-insurance business. The final regulations bring out several key amendments to draft regulations.

b. IRDAI frames guidelines for IIO in IFSCs

The IRDAI has recently issued the IFSC Insurance Intermediaries Offices Guidelines (the guidelines). The said guidelines are meant to permit insurance intermediaries which are registered with IRDAI, to undertake operations from a branch office authorised by the IRDAI as IFSC IIO.

The key features of the guidelines are explained below:

1. Applicability

- The guidelines are applicable from the date of their issuance, i.e. 16 January 2019, and shall replace the existing guidelines on the subject.
- Any person or entity desirous of rendering services as an insurance intermediary from an IFSC shall have to obtain prior permission of IRDAI for the same.
- The applicant may apply for any of the specified categories of the intermediary, for which it has been registered with the IRDAI.

2. Eligibility norms

The applicants have to meet the following criterion:

- Applicants should hold a valid certificate of registration issued by IRDAI.
- Applicants should be eligible to apply for authorisation in the category for which it has been granted certificate of registration by IRDAI.
- Applicants should meet any other requirement as stipulated by IRDAI from time to time.

3. Application for grant of authorisation to undertake operations as IIO

- Every application for grant of authorisation shall be accompanied with the documents prescribed under the regulation
- The IRDAI shall then evaluate the application to ensure that it meets the specified requirements
- IRDAI may accept the application upon being satisfied that the applicant is capable of carrying on all functions in respect of insurance intermediary services

[9]IRDAI (IFSC Insurance Intermediaries Offices), Guidelines 2019 dated 16 January 2019
[10]IRDAI (IFSC) guidelines, 2015 dated 06 April 2015 along with all forms and circulars issued thereunder, and circular no. IRDA/NL/CIR/MISC/019/01/2016 dated 28 January 2016

- IRDAI may authorise the applicant to act as an IIO upon being satisfied that:
  - The applicant is likely to meet effectively its obligations as an insurance intermediary
  - The financial condition and the character of the management are sound
  - Interest of the insurance sector will be served
- The authorisation granted by the IRDAI for the first time shall be valid till the expiry of the certificate of registration issued
- The authorisation granted by the IRDAI will be subject to the applicable conditions, rules, regulations, circulars, guidelines and any other instructions issued from time to time
- Applicant shall commence insurance intermediary business within three months of the date of authorisation

4. Renewal and voluntary surrender of authorisation

- Renewal of authorisation shall be co-terminus with the period of certificate of registration of the Insurance intermediary
- Prior permission of IRDAI shall be required for closure of IIO

5. Operations of IIOs

- IIOs shall ensure compliance to the following minimum requirements:

i. Scope of operations

- IIO shall be a branch office of the applicant.
- IIO authorised to undertake insurance intermediary business to the extent permitted under SEZ Act and ruled framed thereunder.
- No IIO shall undertake business which is not permitted to the applicant by IRDAI.

ii. Capital

- IIO is not required to bring in additional capital

iii. Appointment of In-charge of IIO

- The applicant shall inform IRDAI about the person in-charge of IIO within the stipulated timeline

iv. Accounting

- IIO shall maintain separate financial returns including statement of accounts

v. Duties, functions and obligations

- IIO is responsible for the discharge of duties, functions and obligations as applicable under the regulations, circulars and guidelines issued by the IRDAI

vi. Reporting requirements

- IIO shall submit half-yearly returns as stipulated by the IRDAI

vii. Foreign exchange requirements

- IIO shall comply with Foreign Exchange Management (IFSC) Regulations, 2015 or any other circular, guidelines issued by RBI in the matter of currency transactions in IFSC and any other laws as applicable to SEZ

viii. Further powers of authority

- IRDAI shall have a right to call, inspect or investigate any document, record or communication from IIO

Our comments: The guidelines are a welcome move for the overall growth of the insurance sector. The guidelines seek to cover all IRDAI-registered intermediaries who are allowed to undertake operations in IFSC, as compared to the prevailing guidelines which covered only insurance brokers. Also, the guidelines lay down a detailed operational framework for IIOs as compared to the prevailing guidelines and would also enable the intermediaries having cross-border transactions to set up an IIO.

As the guidelines issued by IRDAI specifically cover operations of IIOs (i.e., intermediaries) and do not cover operations of IIOs set up by insurers and reinsurers, it is desirable that IRDAI issues a clarification on the extent to which the guidelines supersede the IRDAI (IFSC) Guidelines, 2015 dated 06 April 2015, which primarily dealt with IIOs engaged in insurance and reinsurance business.

RBI updates

a. RBI introduced new ECB framework

The RBI has rationalised the framework for ECB and rupee denominated bonds (RDB). The new ECB framework, which came into force with effect from 16 January 2019, comprises two options:

i. Foreign currency denominated ECB, and

ii. Rupee denominated ECB

The key changes under the new framework are as follows:

a. Merging of tracks

The existing ECB categories comprising Track-I (medium term ECB of 3 to 5 years) and Track-II (long-term ECB of up to 10 years) are now merged into one category as foreign currency denominated ECB (FCY ECB). The ECB under Track-III (i.e. ECB in INR) and RDB framework are combined as rupee denominated ECB (INR ECB).

b. Eligible borrowers

The list of eligible borrowers has been expanded to include all entities eligible to receive FDI. Entities like Limited Liability Partnerships (LLPs), port trusts, units in Special Economic Zones (SEZs), SIDBI, Exim Bank and registered entities engaged in microfinance activities will also be covered in the list of eligible borrowers.

c. Recognised lender

Lender should be a resident of a Financial Action Task Force (FATF) or International Organisation of Securities Commissions (IOSCO) compliant country. However:

- Multilateral and regional financial institutions are eligible, if India is a member country
- Individuals are eligible, if they are equity holders
- Foreign branches/subsidiaries of an Indian bank are eligible for FCY ECB (except ECCBs and FCEBs) only

d. Minimum average maturity period (MAMP)

MAMP for all ECBs will be three years except in cases of ECBs raised:

- From foreign equity holder and utilised for working capital, general corporate purposes or repayment of rupee loans, where MAMP will be five years, and
- ECB raised by manufacturing companies of up to $50 million per FY, where MAMP will be one year

e. All-in-cost ceiling per annum

- All-in-cost ceiling is now prescribed as a benchmark rate plus 450 bps spread
- Benchmark rate in case of:
  – FCY ECB: A 6-month LIBOR rate or any other six-month interbank interest rate applicable on the currency of borrowing
  – INR ECB: Prevailing yield of the Indian government securities of corresponding maturity

f. End use prescription: Negative list

ECB proceeds cannot be utilised for the following:

- Real estate activities
- Investment in capital market
- Equity investment
- Working capital purposed except from foreign equity holder
- General corporate purposes except from foreign equity holder
- Repayment of rupee loans except from foreign equity holder, and
- On-lending to entities for the above activities

g. Relaxation of borrowing limit across sectors

- All eligible borrowers can now raise ECBs up to $750 million or equivalent per FY under the automatic route replacing the existing sector-wise limits.
- In case of FCY ECB raised from direct foreign equity holder, the ECB to equity ratio under the automatic route cannot exceed 7:1, except where the outstanding amount of the ECBs is up to $5 million or equivalent.

h. Guidelines for untraceable entities introduced

- There are certain conditions such as non-filing of ECB returns, non-availability at the registered office, etc. which, if triggered, would render the borrower to be categorised as an untraceable entity. Apart from other consequences, the major drawback for these untraceable entities is that they will not be able to receive any foreign exchange in any form.

i. Late submission fee (LSF)

- LSF has been introduced for regularising delays in reporting drawdown of ECB proceeds before obtaining Loan Registration Number (LRN) or delay in submission of ECB 2 returns.

Our comments: Rationalisation of the ECB framework is a welcome step from the central bank which is expected to act as a catalyst for capital inflows. Expansion of eligible borrower's category would present a unique proposition for the corporates to re-look at financing options, especially for their subsidiaries in India. Restriction on repayment of existing rupee loans through ECB proceeds from a foreign equity holder may have a bearing on companies in the infrastructure or other sectors requiring long-term financing, and which use the ECB route to repay existing rupee loans.

b. RBI reduces hedging provision for external commercial borrowings to 70%

(RBI/2018-19/79 A.P. (DIR Series) Circular No.15 dated 26 November 2018)

Earlier, the eligible borrowers raising foreign currency denominated ECBs under Track I, having an average maturity between three and five years, are mandatorily required to hedge their ECB exposure fully. However, RBI has relaxed these norms by reducing the mandatory hedging provision for ECBs to 70% from the current provision of 100%.

The relaxed norms will apply to the ECBs with a maturity period between three and five years, as per notification.

Further, the RBI also clarified that the ECBs raised prior to the date of this circular will be required to mandatorily roll over their existing hedge provision only to the extent of 70% of outstanding ECB exposure from 100%.

c. RBI proposes VRR for FPI investment

The RBI, in its earlier circular, revised[11] norms for investment in debt securities with certain additional restrictions which had negatively impacted the investment in the Indian debt market.

In view of the above, the RBI in consultation with the Indian government and SEBI has proposed a draft discussion paper for inputs from various stakeholders. As per the said note, the RBI intends to introduce a separate VRR channel for attracting long-term and stable FPI investments by enabling operational flexibility to the FPIs for making investment in the Indian debt market through bidding process.

Among others, the circular lays down the bidding process, eligible securities for VRR, retention period etc.

Our comments: The proposed special channel aims to encourage FPI investments into the Indian government and corporate bonds. The proposed investment route should address most of the concerns of the FPIs that are looking to make debt investments in India, which is why it is a move in the right direction. This should result in deepening the corporate debt market and attracting long-term investment in India.

[11] Vide Circulars - RBI/2017-18/168 A.P. (DIR Series) Circular No. 24 dt 27 April 2018 and RBI/2017-18/170 A.P. (DIR Series) Circular No. 26 dated 01 May 2018; superseded by RBI/2017-18/199 A.P. (DIR Series) Circular No. 31 dated 15 June 2018

d. RBI amends FEMA Regulation pertaining to transfer or issue of security by person resident outside India

(Notification No. FEMA. 20 (R)(3)/2018-RB dated August 30, 2018)

RBI has recently issued a notification amending certain aspects of the FEMA Regulation[12]. Amendments made by the circular to current FEMA Regulation are as follows:

- **No requirement to file advance remittance form to the regional office**

Earlier, an Indian company that received the consideration on the issue of capital instruments[13] had to report to the regional office about the receipt in Advance Remittance Form (ARF) within 30 days from the date of the receipt. However, such reporting requirement has been omitted now. As a result, an Indian company is under no requirement to report the same in ARF to the regional office while receiving the consideration on the issue of capital instruments.

- **Indian LLP and investment vehicle [14] are now required to file Form DI**

Earlier, an Indian company making a downstream investment in another Indian company, which is considered as an indirect foreign investment for an investee company, had to notify the Secretariat for Industrial Assistance, DIPP and file Form DI within 30 days of such investment. However, now the circular provides for filing of Form DI with RBI within 30 days from the date of allotment of capital instruments.

- **Additional compliance on Investment vehicle to file Form InVi**

This circular provides additional compliance on Investment vehicle to file Form InVi with the RBI within 30 days from the date of issue of units in the case where investment vehicle issues its units to a person resident outside India. Earlier, there was no such requirement on Investment vehicle.

These amendments shall come into force with effect from the 1st day of September 2018.

Our comments: RBI has now done away with the requirement of filing ARF, thus providing relaxation in compliance to Indian companies. However, on the other hand, RBI has extended a requirement to file Form DI to Indian LLPs and investment vehicles. Apart from this, it has also introduced a new form, i.e. Form InVi, which is required to be filed by an investment vehicle when it issues its units to a person resident outside India.

[12] Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Second Amendment) Regulations, 2018

[13] Issue of capital instruments shall be considered as FDI

[14] 'Investment vehicle' means an entity registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose. It shall include Real Estate Investment Trusts (REITs) governed by the Securities and Exchange Board of India (REITs) Regulations, 2014, Infrastructure Investment Trusts (InvIts) governed by the Securities and Exchange Board of India (InvIts) Regulations, 2014 and AIFs governed by the Securities and Exchange Board of India (AIFs) Regulations, 2012

Key tax updates

Direct tax updates

a. Key highlights of the Interim Budget 2019

On 1 February 2019, the Finance Minister of India put forth the Interim Budget for FY 2019 before the Parliament. The Budget seemed to be directed towards the objective of providing a fine balance between larger socio-economic requirements and fiscal prudence. The government adopted a pro-active approach by focusing on the key themes comprehensively covering all aspects of the economy to take India to the next level of development with social equity.

The key tax announcements in the Interim Budget are as follows:

a. Enhancement in threshold of TDS applicability

- The threshold for applicability of TDS on interest from banks, post office and co-operative society has been increased from the current level of INR 10,000 to INR 40,000 per annum.
- The threshold for applicability of TDS on rent has been increased from INR 180,000 to INR 240,000 per annum.

b. Stamp duty on issue and transfer of securities to be centralised

- Earlier, the stamp duty in such cases was collected by the respective state governments (through collector of stamps).
- With a view to rationalise the levy and collection of stamp duty on securities, it is now proposed that stock exchange/ depository/clearing corporation be vested with the responsibility of collecting stamp duty on such instruments and disbursing the same to the respective states.
- The levy is proposed to apply on issue and transfer of securities covering shares, debentures, derivatives, government securities and corporate bonds.

c. Transfer of dematerialised securities now under the ambit of stamp duty

- Earlier, transfer of securities in dematerialised form was exempt from levy of stamp duty.
- It is now proposed to remove the above exemption and levy the same rate on transfer of shares even in the dematerialised form.

Our comments: In this Interim Budget 2019, to align with the government's focus towards social equity, the thrust is to provide the tax reliefs to the middle-class and salaried taxpayers. The increase in the TDS threshold on interest and rent amount is expected to ease cash flow and provide relief to small taxpayers from filing tax returns.

The rationalisation and standardisation of levy and collection of stamp duty across securities is a welcome move that generally reduces cost of transactions as well as simplifies compliance for investors/stakeholders.

b. CBDT issues final notification on conversion of foreign bank's Indian branch into subsidiary

(Notification no. 86/2018 and Notification No.85/2018)

Under the provisions[15] of the Income-tax Act, 1961 (the Act), exemption from capital gains taxation has been granted on conversion of a foreign bank's Indian branch into an Indian subsidiary in accordance with the scheme[16] framed by RBI. As per the said provisions, unabsorbed depreciation, set-off or carry forward and set-off of losses, tax credits, etc. would apply to the subsidiary, subject to certain modifications as may be prescribed. In this regard, the Central Board of Direct Taxes (CBDT), the apex income-tax authority in India, in November 2017, issued a draft notification[17] specifying the prescribed conditions.

The CBDT has now issued the final notification[18] specifying the conditions to be satisfied in order to avail the said capital gain exemption. Broadly, the conditions are:

- Amalgamation shall be approved by the shareholders of both the foreign company and the subsidiary, and sanctioned by RBI under the relevant framework.
- Assets and liabilities of the Indian branch immediately before conversion shall become the assets and liabilities of the subsidiary.
- Foreign bank or its nominee should hold the whole of the share capital of the subsidiary during the period from the date of conversion till the last day of the previous year in which the conversion took place and shall continue to hold the subsidiary's shares carrying at least 51% of the voting power for the period of five years immediately succeeding the said previous year in which the conversion took place.
- No consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the subsidiary shall be received by the foreign bank.

Further, the notification also provides the modifications and exceptions while applying certain provisions of the Act which are in relation to depreciation allowance, accumulated loss and unabsorbed depreciation, actual cost of block of the assets or other capital assets, tax credit, applicability of tax provision, period of holding, provision of doubtful debts, etc.

Our comments: The CBDT's notification is a welcome move as the same was eagerly awaited by foreign banks operating in India and intending to convert their branch into a subsidiary. The notification is also largely in line with the stakeholder expectations. However, there are certain other aspects which require further clarity such as deduction of the expenses related to the conversion, deduction of certain expenses incurred by the branch which are allowed on payment basis, rollover of the advance pricing agreements obtained by the branch, etc.

[15] Section 115JG of the Act
[16] 'Scheme for Setting up of Wholly Owned Subsidiaries (WOS) by foreign banks in India' dated 06 November 2013
[17] F. No. 370133/34/2017-TPL dated 17th November, 2017
[18] Notification No. 86/2018 and Notification No. 85/2018
[19] Framework for setting up of wholly owned subsidiaries by foreign banks in India issued by RBI vide Press Release 2013-14/936 dated 06 November 2013

c. CBDT notifies the timeline for PAN application by specified persons

Finance Act, 2018 has amended the provisions[20] of the Act to provide for mandatory allotment of PAN in case of the following categories of persons:

- Every resident (other than individual) who enters into a financial transaction of an amount aggregating to INR 250,000 or more in an FY, and
- Managing director, partner, trustee, principal officer or office-bearer or any person competent to act on behalf of the aforementioned resident

The CBDT has now notified the timelines within which such persons shall apply for a PAN. As per the amended rules, the application for allotment of PAN shall be filed on or before 31 May immediately following such FY in which the financial transaction was entered into by the above category of persons.

The amendment also includes an option to provide mother's name in the PAN application form in case of an individual applicant whose mother is a single parent.

d. CBDT issues instructions making e-assessment mandatory

(Instruction No 03/2018 dated 20 August 2018)

The CBDT, partially modifying its earlier instruction[21] , has now issued an instruction[22] directing that all the assessments required to be framed under section 143(3) of the Act in FY 2018-19 be conducted electronically through the e-proceeding facility. However, the CBDT has specified the following seven situations where e-proceedings shall not be mandatory:

- Where the assessment[23] is to be framed for search and seizure, income escaping assessment/re-assessment and best judgement cases
- In case of assessments which have been set aside
- Where the assessments are being framed in non-PAN cases
- Where return was filed through the paper mode and the taxpayer does not have an e-filing account
- In all cases at specified stations[24]
- Cases where substantial hearing has already taken place prior to the issuance of CBDT's earlier instruction[25] and the tax officers obtains necessary approval
- In exceptional cases, such as complex cases or due to administrative difficulties, after obtaining necessary approvals

However, personal hearing may take place in the following circumstances during the course of e-proceeding where:

- Books of accounts need examination
- Tax officer invokes the provisions of section 131 of the Act
- Examination of the witness is required
- Show cause notice contemplating any adverse view is issued and the taxpayer requests a personal hearing through the e-filing account

Under the above situations, details would have to be subsequently uploaded on the tax portal.

Our comments: The above instruction for e-assessment seeks the elimination of person-to-person contact, leading to greater efficiency and transparency. However, having followed the manual proceeding process for decades, some teething problems can be expected in terms of adaptability to the new system for both the taxpayer and the tax department.

[20]Section 139A of the Act
[21]Instruction No. 1 of 2018 dated 12 February, 2018
[22]Instruction No. 03 of 2018 dated 20 August, 2018
[23]Under sections 153A, 153C, 147 and 144 of the Act
[24]Stations connected through VSAT or with limited bandwidth, which are to be specified by Pr. DGIT (Systems)
[25]Instruction No 01/2018 dated 12 February 2018

Indirect tax updates

a. Amendments to the provisions of the CGST Act effective from 1 February 2019:

The Central Board of Indirect Taxes and Customs (CBIC) has notified 01 February 2019 as the effective date from when various amendments to the GST statutes have come in to force.

Amendments to the provisions of the CGST Act effective from 1 February 2019:

The key tax announcements in the Interim Budget are as follows:

a. Definition of services amended (by way of inserting explanation) to clarify that arranging / facilitation the transaction in securities is a services:

- Explanation to the definition of services inserted to provided that services shall include facilitating or arranging transactions in securities
- For example, some service charges or service fees or documentation fees or broking charges or charges which are charged in relation to transactions in securities

b. Amendment to Section 7 of the CGST Act: To clarify the scope of supply

- A new sub-section (1a) in section 7 inserted and clause (d) of sub-section (1) omitted
- Accordingly, an activity has to be a supply as per Section 7(1) and only then will it be tested as per Schedule II

c. Provisions in relation to Reverse Charge Mechanism (RCM) liability on procurement of goods/services from an unregistered person are omitted and the provisions are amended as follows:

- Section 9 of the CGST Act empowering the Central Government to notify classes of registered persons to pay the tax on reverse charge basis in respect of receipt of supplies of certain specified categories of goods or services or both from unregistered suppliers.

d. Composition scheme

- The threshold limit for the composite suppliers has been increased from INR 1 crore to INR 1.5 crore.
- Also, the supplier of services can also opt for the composition scheme. A person opting for such scheme may supply services (other than restaurant services) of value not exceeding 10% of the turnover in a state/union territory in the preceding FY or INR 5 lakh, whichever is higher.

e. Deemed receipt of goods or services for availment of input tax credit (ITC)

It shall be deemed that the registered person has received the goods or services where:

- The goods are delivered by the supplier to a recipient or any other person on the direction of such registered person
- Where the services are provided by the supplier to any person on the direction of and on account of such registered person

f. Amendment in relation to ITC under the CGST Act

No ITC reversal

- Section 17 (3) of the CGST Act - No reversal will be required in cases falling under Schedule III

Allowed ITC in respect of the following transactions

- Availment of ITC allowed on activities or transactions specified in Schedule III (other than sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building) by excluding it from the ambit of exempt supply on which ITC is blocked
- ITC allowed in respect of food and beverages or both where the provision of such goods or services or both is obligatory for an employer to provide to its employees under any law for the time being in force
- ITC restricted for motor vehicles for transportation of persons having seating capacity of not more than 13 persons except when they are used for making further supply of motor vehicles, transportation of passengers or imparting training on driving such motor vehicles
- ITC for services of general insurance, servicing, repair and maintenance relating to motor vehicles, vessels or aircrafts shall be available only where the motor vehicles, vessels and aircrafts are used for above mentioned purpose or received by a taxable person engaged in the manufacture of such motor vehicles, vessels or aircrafts or in the supply of general insurance services in respect of such motor vehicles, vessels or aircraft

g. Amendment in relation to registration provisions under the CGST Act

- Increase in threshold limit for registration from INR 10 lakh to INR 20 lakh in the states of Assam, Arunachal Pradesh, Himachal Pradesh, Meghalaya, Sikkim and Uttarakhand.
- The term 'multiple business verticals' has been removed from the provisions of registration and has been substituted by the term 'multiple places of business' and separate registration for each such place of business within the state or union territory shall be granted subject to fulfillment of conditions specified therein.

- Separate registration shall be required by a person having an SEZ unit or being an SEZ developer from his/her other units located outside the SEZ in the same state or union territory.

h. One credit note can be issued for multiple invoice

- A registered person can issue a consolidated credit note/debit note in respect of multiple invoices issued in a financial year.

i. Cross-utilisation of ITC rationalised

- The credit of state tax/union territory tax can be utilised for payment of integrated tax only when the balance of input tax credit on account of central tax is not available for payment of integrated tax.
- A Section 49A has been inserted to provide that the input tax credit on account of central tax, state tax/union territory tax can be utilised towards the payment of integrated tax, central tax, state tax/union territory tax only after the input tax credit available on account of integrated tax has been first utilised fully towards such payment.
- A Section 49B has been inserted to allow the government, on the recommendation of the GST Council, to provide a specific order in which a registered person can utilise ITC viz. integrated tax, central tax, state tax or union territory for the settlement of the tax liability.

j. Amendment to the refund provisions of the CGST Act

- A service can be said to be exported even if the consideration is received in Indian rupees wherever permitted by RBI subject to the fulfillment of other conditions prescribed therein.
- There are certain payments received in Indian rupees through Nostro/Vostro accounts for goods/services supplied abroad. The payment for such transactions would be considered for the purpose of refund even though such amounts are received in Indian rupees.

k. Clarifications in respect of the transition provisions

- The provision has been retrospectively amended to include CENVAT credit of eligible duties and further clarifies that the expression 'eligible duties and taxes' excludes any cess specified therein.

l. Amendment to Schedule III (Items which are neither goods or services) of the CGST Act

- Supply of goods from a place in the non-taxable territory to another place in the non-taxable territory without such goods entering into India
- Supply of warehoused goods to any person before clearance for home consumption
- Supply of goods in case of high sea sale

Our comments: The government has made continuous efforts to assist taxpayers and ease the compliances by making suitable amendments to the GST law from time to time. The amendment relating to increasing the threshold limit for registrations and composition scheme is a welcome move for small taxpayers and will ease compliances. An important development which may require detailed analysis/interpretation is the newly inserted Section 49A under CGST Act, which provides that ITC on account of central tax and state tax/union territory tax can be utilised towards the payment of integrated tax, central tax and state tax/union territory tax only after the ITC available on account of integrated tax has first been utilised fully towards such payment.

A. TDS and TCS provisions are made effective from 1 October 2018

a. TDS provision

Any supply of goods or services made to:

- An authority or a board or any other body (set up by an act of parliament or a state legislature or established by any government) with 51% or more participation by way of equity or control, to carry out any function or
- Society established by the Central Government or the state government or a local authority under the Societies Registration Act, 1860 (21 of 1860) or public sector undertakings

These would be subject to TDS at the rate of 2% from the payment made or credited to the supplier of taxable goods or services or both, where the total value of such supply, under a contract, exceeds INR 2 lakh and INR 50,000.

b. TCS provisions

Every e-commerce operator shall collect an amount calculated at 1% on the net value of taxable supplies made through it by other suppliers where the consideration with respect to such supplies is to be collected by the operator.

Our comments: The applicability of the TDS and TCS provisions was deferred twice before its implementation from 1 October 2018. The government has extended the due date for filing TDS return till 28 February 2019 to ease the compliance burden.

B. Other key amendments:

c. Waiver of late fees leviable on account of delayed filing of Form GSTR-3B and GSTR-1 for the period July 2017 to September 2018 in specified cases

- Late fee shall be completely waived for all taxpayers in case Form GSTR-1, Form GSTR-3B and Form GSTR-4 for the months/quarters July 2017 to September 2018, are furnished after 22 December 2018 but on or before 31 March 2019.

d. Exemption for certain services

- Services supplied by an establishment of a person in India to any establishment of that person outside India, which are treated as establishments of distinct persons in accordance with Explanation 1 in section 8 of the Integrated Goods and Services Tax Act, 2017 (IGST Act, 2017) shall be exempt from levy of GST (w.e.f. 27 July 2018).
- Services provided by a banking company to basic saving bank deposit (BSBD) account holders under PMJDY (w.e.f. 1 January 2019).
- Services supplied by the Central Government, state government, union territory to their undertakings or PSUs by way of guaranteeing the loans taken by such undertakings or PSUs from the banking companies financial institutions.
- Services provided by International Finance Corporation (IFC) and Asian Development Bank (ADB) are exempt from GST in terms of provisions of the IFC Act, 1958 and ADB Act, 1966. The exemption will be available only to the services provided by IFC and ADB and not to any entity appointed by or working on behalf of IFC or ADB.

e. No penalty under Section 73(11) of the CGST Act, 2017 on delayed filing of GSTR-3B

- It has been clarified that penalty under Section 73 (11) of the CGST Act, 2017 on delayed filing of GSTR-3B will be invoked because tax along with applicable interest has already been paid at the time of filing of GSTR-3B. However, since the tax has been paid late in contravention of the provisions of the CGST Act, a general penalty under section 125 of the CGST Act may be imposed after following the due process of law.

f. Applicability of rate of tax on debit or credit note issued under CGST Act, 2017 for a supply made in the pre-GST regime

- It has been clarified that in case of revision of prices, after the appointed date i.e. 1 July 2017, of any goods or services supplied before the appointed date thereby requiring issuance of any supplementary invoice, debit note or credit note, the rate as per the provisions of the GST Acts (both CGST and SGST or IGST) would be applicable.

g. Extension of due dates and last date for availing ITC

- ITC in relation to invoices issued by the supplier during FY 2017-18 may be availed by the recipient till the due date for furnishing of Form GSTR-3B for the month of March 2019, subject to specified conditions.
- The due date for furnishing the annual returns in Form GSTR-9, Form GSTR-9A and reconciliation statement in Form GSTR-9C for FY 2017 – 2018 is further extended till 30 June 2019.

h. Certain services brought under the Reverse Charge Mechanism (RCM)

In case of the following services, the tax needs to be discharged by the recipient of services under RCM:

- Services supplied by individual direct selling agent other than a body corporate, partnership or a limited liability partnership firm to bank or non-banking financial company located in a taxable territory (NBFCs), w.e.f. 27 July 2018
- Services provided by a business facilitator (BF) to a banking company located in a taxable territory, w.e.f. 1 January 2019.
- Services provided by an agent of business correspondent to business correspondent located in a taxable territory, w.e.f. 1 January 2019.
- Security services provided by any person other than a body corporate to a registered person located in a taxable territory, w.e.f. 1 January 2019.

i. Export of services would also include outsourced services

- In case an exporter of services outsources a portion of the services contract to another person located outside India, it is clarified that the supplier of service would be liable to pay IGST on reverse charge basis on the import of services on that portion of services which has been provided by the supplier located outside India to the recipient of services located outside India.
- Furthermore, the said supplier of services located in India would be eligible for taking ITC of the IGST so paid.
- Thus, even though full consideration for the services as per the contract value is not received in convertible foreign exchange in India due to the fact that the recipient of services located outside India has directly paid to the supplier of services located outside India (for outsourced part of services), that portion of the consideration shall also be treated as receipt of consideration for export of services in terms of Section 2(6)(iv) of the IGST Act, 2017 provided:
  - Supplier of service located in India has paid the IGST on the outsourced portion of services as mentioned above
  - RBI by general instruction or by specific approval has allowed that a part of the consideration for such exports

can be retained outside India

j. Clarification of values of services of BF or business correspondent (BC) to a banking company

- It has been clarified that banking company is the service provider in the business facilitator model or the business correspondent model operated by a banking company as per RBI guidelines. The banking company is liable to pay GST on the entire value of service charge or fee charged to customers whether or not received via a BF or business correspondent.

k. Clarification on the scope of services by a BF or BC to a banking company with respect to accounts in rural areas

- Services by a BF or BC to a banking company with respect to accounts in a rural area branch are exempt from the GST leviable on the same.
- It has been clarified that for the purpose of availing exemption under GST, the conditions to be satisfied are that the services provided by a BF/BC to a banking company in their respective individual capacities should fall under the Heading 9971 and that such services should be with respect to accounts in a branch located in the rural area of the banking company.
- The procedure for classification of a branch of a bank as located in a rural area and the services which can be provided by a BF/BC is governed by the RBI guidelines. Therefore, the classification adopted by the bank in terms of RBI guidelines in this regard should be accepted.

l. Clarification on refund-related issues

- The requirement of physical submission of all documents/ undertaking/statements along with the refund claim in Form GST RFD-01A post application reference number (ARN) generation has been done away with and the same can be submitted online. The copies of only those invoices need to be submitted the details of which are not found in Form GSTR-2A.
- Further, the GST authorities have been directed to issue the final sanction order in Form GST RFD-06 within 45 days of date of generation of ARN so that disbursement of refund is completed within 60 days.

m. There were various amendments made to the Central Goods and Services Tax Rule, 2017 (CGST rules). We have outlined key amendments under the GST Act herein below:

- Revised Formats of GSTR – 9 (Annual Return for regular tax payers), GSTR – 9A (Annual return for registered person under composition scheme) and GSTR – 9C (GST Audit form) are notified.
- Amendment in the definition of the 'adjusted total turnover' of Rule 89 of the CGST Rules to bring the same in line with the service tax provisions.

Our comments: The amendments related to waiver of late fees and extension of return filing timelines have been welcomed by the business concerns. Further, the extension of time limit for filing the annual return and GST audit report till 30 June 2019 will provide sufficient time to taxpayers for preparation, reconciliations and review of the returns. Doing away with the physical submission of documents for the purpose of refund is a welcome move and will save time in collation and documentation.

Transfer pricing updates

a. Draft discussion paper BEPS on financial transactions

The Organisation for Economic Co-operation and Development (OECD) released the Base Erosion and Profit Shifting (BEPS) discussion draft on the transfer pricing aspects of financial transactions. The draft report provides guidance and addresses specific issues related to pricing of financial transactions such as treasury functions, intra-group loans, cash pooling, guarantees, etc.

The discussion paper broadly discusses the following:

- **Identifying commercial or financial relations**

This section broadly covers the following:

- Broad understanding of the industry sector in which the MNE group operates
- Factors affecting the performance of any business operating in that sector
- Accurate delineation of actual transaction - a multi-factor analysis to ensure economically relevant conditions are identified
- Analyse commercial perspective of parties to the transaction
- **Economically relevant characteristics of financial transactions**

The broad economically relevant characteristics of actual financial transactions are:

- **Contractual terms** - Generally, the terms and conditions of a financial transaction between independent enterprises are usually explicitly stated in a written agreement. But in case of associated enterprise, the actual conduct of the relevant parties to the contract play a vital role.
- **Functional analysis** - In accurately delineating the actual financial transaction, a functional analysis is necessary. The perspectives of lender and borrower are clearly demarcated and accordingly the pricing and other aspects are looked into.
- **Characteristics of financial products or services -** There is a wide variety of financial products and services in the open market that present very different features and attributes, which may affect the pricing of those products or services. Consequently, when pricing related party products and services, it is important to document the transactions' features and attributes.
- **Economic circumstances -** There are several economic factors that can have an impact on the pricing like currency difference, growth rate, inflation rate, foreign exchange restrictions, etc.
- **Business strategies -** Business strategies must also be examined in accurately delineating the actual financial transaction and in determining comparability for transfer pricing purposes since different business strategies can have a significant effect on the terms and conditions which would be agreed between independent enterprises.

The discussion paper further discusses the key issues which cover some specific financial transactions or financial instruments. Below is a snapshot of the same:

Treasury instrument	Factors
Intra-group loans	• Lender and borrower perspective • Credit ratings • Effect of group membership • Covenants • Loan fees and charges • Pricing approaches
Cash pooling	• Structure of pooling arrangement • Savings and efficiencies • Practical aspects • Pricing approaches
Hedging	• Risks assumed • Pricing approaches

Further, there are various cases and situations discussed wherein the pricing methodology of various financial transactions is discussed. This discussion draft is kept open to comments and then accordingly the final paper will be issued considering the inputs from the public.

Our comments: The initiative of OECD in discussing the transfer pricing aspect of financial transactions in order to provide more clarity to taxpayers and consistency in the application is appreciable and very helpful. The OECD discussion draft on financial transaction provides transfer pricing guidance on several types of financial transactions with various illustrations. The discussion draft addresses the economically relevant characteristics that should be considered when analysing the terms and conditions of financial transactions, including contractual terms, functional analysis, characteristics of financial transactions, economic circumstances and business strategies. Although not a consensus document, it still provides highly relevant guidance for taxpayers engaged in financial transactions with related taxpayers.

b. CBDT prescribes due date for filing CbCR by inbound constituent entities in certain cases

On 26 March 2018, India's Ministry of Finance released a clarification on country-by-country (CbC) reporting requirements under section 286(4) of the Act (see BEPS Action 13). Section 286 of the Act was inserted vide Finance Act, 2016, providing rules for parent or constituent entities to submit a CbC report with respect to an international group.

There are situations wherein the India constituent entities are required to locally file the CbCR. They are as follows:

1. Where the parent entity of India constituent entity is 'not obligated' to file a CbC report in the country in which the ultimate parent entity or alternate reporting entity of the MNE is resident
2. Where India does not have an agreement for the exchange of the CbC Report by the country in which the Ultimate Parent Entity is resident
3. Where there has been a systemic failure of the country to exchange CbC report with a country in which the ultimate parent entity of the MNE is resident and the failure is intimated by the prescribed authority to the India constituent entity of the MNE

A filing requirement in respect of a CbC report (CbCR) arises in India for an inbound constituent entity (i.e., a constituent entity, resident in India, of an international group, the parent entity of which is not resident in India) if any of the circumstances mentioned in section 286(4) of the Act apply to that constituent entity.

The CBDT has now prescribed the due date for filing of CbCR by an inbound CE to which section 286(4) of the Act applies.

Rule 10DB(4) of the Rules has been amended to prescribe the due date to be 12 months from the end of the reporting accounting year (RAY). This rule becomes effective from 18 December 2018.

Further, as per a proviso to the amended rule, if the parent entity of the inbound CE is a resident of a country or territory, where there has been a systemic failure by the country or territory, and the said failure has been intimated to such CE, the due date for submission of CbCR in such cases would be six months from the end of the month in which such systemic failure has been intimated to the inbound CE.

Clarification

Based on representations received, the due date for filing the CbCR under section 286(4) (a) and section 286(4) (aa) of the Act has been extended to 31 March 2019 for reporting accounting years ending up to 28 February 2018. The due date in such cases was originally notified to be 12 months from the end of the relevant reporting accounting year. This extension will provide the much needed additional time for preparing and filing the CbCR to those inbound constituent entities resident in India, covered by the said provisions.

Our comments: CBDT released clarification on CbCR reporting on certain scenarios discussed above. The latest circular from CBDT clarifies that the requirement to furnish CbCR in India applies to all reporting accounting year ending up to 28 February 2018 has been extended to 31 March 2019. The due date in such cases was originally notified to be 12 months from the end of the relevant reporting accounting year. This extension will provide the much needed additional time for preparing and filing the CbCR.

c. CBDT's second annual report on Indian APA programme

(Circular No. 3/2018 dated 11 July 2018)

The CBDT has recently released its second annual report (Report) to highlight the significant achievements of the government's Advance Pricing Agreement (APA) programme till 31 March 2018. The APA programme in India was launched in 2012 and has become a popular option amongst taxpayers for effective dispute avoidance/resolution in transfer pricing matters.

The report provides qualitative and statistical insights into India's APA programme with a view to encourage discussion and debate amongst taxpayers, policy makers, media, economists, etc., on the strengths and weaknesses of the programme

Qualitative aspects of the Indian APA programme

- There was a significant rise in the total number of APA requests — a total of 168 APA applications were filed in FY 2017-18 as compared to 101 filed during FY 2016-17. A total of 985 applications have been filed so far, which include 821 unilateral APAs (UAPAs) and 164 bilateral APAs (BAPAs).
- Due to opening up of the India-USA BAPA route by the US Competent Authority, and the Indian government's willingness to accept BAPA applications even in the absence of Article 9(2)1 in the tax treaties, requests for BAPA more than doubled during FY 2017-18 vis-à-vis FY 2016-17.

- UAPAs are preferred by taxpayers over BAPAs. It is interesting that 35 unilateral applications filed in different years were converted into bilateral applications, whereas 2 BAPAs were converted to UAPAs.
- The rollback provision for dispute redressal has attained a noteworthy response. Out of the 67 agreements signed in 2017-18, 30 had rollback provisions.
- The Indian government has successfully concluded 219 APAs in 5 years vis-à-vis 139 APAs concluded by China in 12 years (between 2005 and 2016).
- The 219 signed APAs have resulted in an additional litigation-free tax revenue of INR 3,000 crore (approximately).

Distribution of agreement: Activity-wise, industry-wise and methods

The APAs signed span across different industries.

Particulars	UAPA	BAPA
Economic activity-wise distribution of agreements signed during FY 2017-18	• Covers various activities including service, manufacturing and trading • 69% of the agreements covered the service sector • Spanned across 18 industries • Information technology, computer hardware and banking/finance constituted almost 40% of agreements	• Covers various activities including service, manufacturing and trading • 78% of the agreements covered the service sector • Six broad industry categories covered, including electronics, banking, finance and insurance, and information technology
Nature of transactions covered by agreements signed during FY 2017-18	• 25 types of transactions covered by 58 UAPAs signed during FY 2017-18 (total 164 transactions covered) • Provision of software development (SWD) services and information technology enabled services (ITeS) predominantly featured in most of the UAPAs • Transactions like incurrence of advertising, marketing and promotion AMP expenses, financial transactions also covered	• 11 types of transactions covered by 9 BAPAs signed during FY 2017-18 (total 18 transactions covered) • Service transactions were the most prevalent amongst the covered transactions (including SWD and ITeS)
Method applied in agreements signed during FY 2017-18	• Transactional net margin method (TNMM) and other method and comparable uncontrolled price (CUP) were the most applied methods (one transaction closed using internal resale price method)	• TNMM was the most applied method
Countries covered in agreements signed during FY 2017-18	• Transactions with associated enterprises (AEs) situated in 134 countries covered • USA and UK the most covered destinations	• Agreements concluded with UK, USA and the Netherlands
Average duration of processing	• Average 31.75 months (38.62 months for agreements concluded during FY 2017-18)	• 42.10 months (45.78 months for agreements concluded during FY 2017-18)

Our comments: FY 2017-18 witnessed an overall rise in the number of fresh APA requests as compared to FY 2016-17. This rise in APA applications despite the fall in the overall transfer pricing litigation in India demonstrates the fact that Indian taxpayers are recognising APA as a viable litigation avoidance tool, resulting in various benefits such as cost savings, certainty and peace of mind. Release of the second annual report shows the government's intent to promote the APA programme amongst the taxpayers and to preserve a non-adversarial tax regime by developing an environment of mutual trust and transparency.

Press release

Establishment of a unified authority for regulating financial services in IFSCs

Considering the dynamic nature of businesses in IFSCs which requires greater level of inter-regulatory synchronisation between RBI, SEBI and IRDAI, the Central Government has now approved the establishment of a unified authority (Authority) for regulating all financial services in IFSCs through International Financial Services Centres Authority Bill, 2019 (the Bill).

Salient features of the Bill

a. Management of the authority

The authority shall consist of the following:

- A chairperson
- One member each to be nominated by RBI, SEBI, IRDAI and Pension Fund Regulatory and Development Authority (PFRDA)
- Two members to be nominated by the Central Government
- Two other whole-time or full-time or part-time members

b. Functions of the authority

- Regulate all financial services, financial products and financial institutions (FIs) present in the IFSC which have already been permitted by the financial sector regulators for IFSCs
- Regulate such other financial products, financial services or FIs as may be notified by the Central Government from time to time.
- Recommend to the central government such other financial products, financial services and financial institutions which may be permitted in the IFSCs.

c. Powers of the Authority

All powers exercisable by the respective financial sector regulators (viz. RBI, SEBI, IRDAI, and PFRDA etc.) under the respective acts shall be solely exercised by the authority in the IFSCs in so far as the regulation of financial products, financial services and FIs that are permitted in the IFSC.

d. Processes and procedures of the authority

The processes and procedures to be followed by the authority shall be governed in accordance with the provisions of the respective Acts of Parliament of India applicable to such financial products, services or institutions, as the case maybe.

e. Transactions in foreign currency

The transactions of financial services in the IFSCs shall be done in the foreign currency as specified by the authority in consultation with the central government.

Our comments: Establishment of a unified financial regulator for IFSCs is a welcome move as it will provide a world-class regulatory environment to market participants from an ease of doing perspective. This move would provide the much-needed impetus to further development of IFSC in India in sync with the global best practices and enable bringing back of financial services and transactions that are currently carried out in offshore financial centres to India.

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