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© GBCA & Associates LLP, Chartered Accountants Quarterly Newsletter | September 2021

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Gifting of Assets between Resident and Non-Resident

The concept of exchanging gifts is not new to us. Gift out of natural love and affection, as a mode of transfer, is customary between close relatives and friends. It is essential to realize that when this gift involves exchange between a resident and non-resident, the provisions of Foreign Exchange Management Act, 1999 ("FEMA") and its various rules and regulations thereunder need to be adhered to. In order to assess whether gift of money or assets between a resident and non-resident is permissible or not, and if permissible, what are the applicable terms and conditions applicable to such gift transaction, one needs to understand the nature of such gift transaction.

Under FEMA, gift of money is a current account transaction since on exchange of money, the transaction concludes. However, in order to manage the forex reserves and keep control on unlimited gifts, thresholds are introduced under FEMA. On the other hand, gift of immovable property and shares & securities are capital account transactions since they result in change in cross border assets held by a resident and non-resident.

Since different terms denoting Non-residents are used in different notifications, it is important to understand the following definitions:

- **Non-Resident Indian (NRI)**: NRI is a person resident outside India who is a citizen of India.
- **Overseas Citizen of India (OCI)**: OCI is a person resident outside India who is registered as an Overseas Citizen of India Cardholder under Section 7(A) of the Citizenship Act, 1955.
- **Relative**: Since gifting is largely permitted between relatives, one must note that FEMA uses the definition of relative as per the Companies Act, 2013 and not as per the Income Tax Act, 1961. 'Relative' referred under FEMA means relative as defined in Section 2(77) of Companies Act, 2013 i.e. **father, mother, brother, sister, son, daughter, son's wife and daughter's husband**.
- **Person of Indian Origin (PIO)**[1]: PIO means a person resident outside India who is a citizen of any country other than Bangladesh or Pakistan or such other country as may be specified by the Central Government, satisfying the following conditions:
  a. Who was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955; or
  b. Who belonged to a territory that became part of India after the 15th day of August, 1947; or
  c. Who is a child or a grandchild or a great grandchild of a citizen of India or of a person referred to in above (a) or (b); or
  d. Who is a spouse of foreign origin of a citizen of India or spouse of foreign origin of a person referred to in above (a) or (b) or (c)

GIFT OF SHARES & SECURITIES

GIFT OF SHARES OF AN INDIAN COMPANY

An NRI/OCI has an option to invest in the shares of an Indian Company on repatriation basis or non-repatriation basis. Investment on repatriation basis means an investment, sale or maturity proceeds of which (net of taxes), are eligible to be repatriated out of India. In case of investment on non-repatriation basis, the proceeds cannot be freely repatriated outside India. Investment on non-repatriation basis is treated at par with domestic investment.

[1] *Though PIOs still find a place in certain regulations, vide Government of India's Gazette Notification No. 26011/01/2014-IC.I dated 09.01.2015, all registered PIO cardholders will be deemed to be OCI cardholders w.e.f 09.01.2015. No fresh PIO cards were issued since that date.*

Provisions relating to gift of shares of an Indian Company

Donor	Donee	Permissibility	Reporting* & Sector caps applicable
Non-resident (including NRI/OCI) holding on repatriation basis	Resident	Automatic	Only reporting, Sectoral caps would not apply
	NRI/OCI who will hold on non-repatriation basis	Automatic	Only reporting, Sectoral caps would not apply
	Non-resident (including NRI/OCI) who will hold on repatriation basis	Automatic subject to condition**	Not applicable (Manual changes needed in Entity Master Form)
NRI/OCI holding on non-repatriation basis	Resident	Automatic	Not applicable
	NRI/OCI holding on non-repatriation basis	Automatic	Not applicable
	Non-resident (including NRI/OCI) holding on repatriation basis	Prior RBI Approval subject to conditions***	Both
Resident	NRI/OCI who will hold on non-repatriation basis	Prior RBI Approval subject to conditions***	Not applicable
	Non-resident (including NRI/OCI) holding on repatriation basis	Prior RBI Approval subject to conditions***	Both

* In case reporting is applicable, Form FC-TRS is required to be filed with supporting documents on FIRMS portal. The onus of compliance is on donor or donee who is resident in India.

** Prior Government approval is needed if the company is engaged in a sector which requires Government approval

*** Following are the conditions:

- Donee is eligible to acquire such shares under the Rules

- The gift does not exceed 5% of the paid up capital of the Indian company or each series of debentures or each mutual fund scheme on cumulative basis by a single person to another single person
- The applicable sectoral cap in the Indian company is not breached by such gift
- The donor and the done should be relatives as described above
- The value to be transferred by the donor together with any shares transferred to any person residing outside India as gift during the financial year does not exceed INR equivalent of 50,000 US Dollars
- Such other conditions as considered necessary in public interest by the Central Government.

GIFT OF FOREIGN SECURITIES

A resident is permitted to accept gift of foreign securities from a Non-resident.

A resident individual is permitted to purchase shares of listed as well as unlisted companies, units of Mutual Funds, debt securities etc. under LRS for portfolio investment. Securities acquired under LRS can be gifted to a non-resident.

GIFT OF MONEY

Currently, a resident individual is permitted to remit USD 250,000 abroad per financial year for permissible capital and current account transactions. Gift of money under LRS is a permissible current account transaction. The amount of gift has to be within the upper limit of USD 250,000 when considered along with the other remittances done or to be done in the said year for the other permitted capital account or current account transactions. For example, in FY 2021-22, if Mr. A, a resident, has utilized USD 25,000 for business travel in May 2021 and USD 50,000 for purchase of shares of Apple Inc. in June 2021. In such a case, Mr. A has utilized USD 75,000 and balance LRS limit of USD 1,75,000 is available for gift and other permissible transactions for remaining FY 2021-22.

Provisions for Gift of Money between Resident and Non-Resident

Donor	Currency	Donee	Permissibility
Resident	Foreign Currency	Non-Resident	Allowed upto LRS limit of USD 250,000 per financial year
	Indian Rupee	Non-Resident	Allowed only to **NRI/PIO relatives** of the donor as per Companies Act, 2013 by credit **in the NRO account of such relative** upto LRS limit of USD 250,000 per financial year
	Foreign Currency	Resident	**Not a permitted transaction**
Non-Resident	Foreign Currency	Resident	Allowed without limit, but the **amount should be repatriated to Resident's bank account in India**
	Indian Rupee	Resident	Allowed without limit
	Indian Rupee	Non-Resident	Not regarded as a permissible credit to NRO Account

Note: Remittances under LRS for gifts have to be out of own funds and not borrowed funds. Money received as gift by a Resident may be gifted to a non-resident under LRS later, but this should not lead to flouting of the limits directly or indirectly.

GIFT OF IMMOVABLE PROPERTY

The term immovable property is not defined explicitly under FEMA. It includes all type of immovable properties – agricultural land, commercial/residential properties, plantations etc.

GIFT OF IMMOVABLE PROPERTY SITUATED IN INDIA

Provisions for gift of immovable property in India as per Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

Provisions for gift of immovable property situated in India

Donor	Donee	Permissible Type of Property
Person resident in India	NRI/OCI relative as defined above	Immovable property other than agricultural land / farm house / plantation property
NRI/OCI	NRI/OCI relative as defined above	Immovable property other than agricultural land / farm house / plantation property
NRI/OCI	Person Resident in India	Any immovable Property

Note: No person being a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Hong Kong or Macau or Democratic People's Republic of Korea can acquire or transfer immovable property in India without prior approval of RBI. This prohibition is not applicable to an OCI Cardholder.

GIFT OF IMMOVABLE PROPERTY OUTSIDE INDIA

The provisions relating to gift of immovable property outside India are covered under Foreign Exchange Management (Acquisition and transfer of immovable property outside India) Regulations, 2015 which are summarized as under:

Gift to a Resident

1. A resident individual can acquire immovable property outside India by way of gift from:
   - Another resident individual who acquired a property outside India while he was a Non-resident.
   - Another resident individual who had acquired such property in accordance with the foreign exchange provisions in force at the time of such acquisition.
   - A resident individual who had acquired such property on or before 08.07.1947 and continued to be held by him with the permission of the RBI.
2. There is no explicit permission to receive gift of immovable property outside India from a Non-resident by a resident individual. Resident receiving such property as gift would need to sell and bring the funds back to India.

Gift to a Non-resident

A resident individual is permitted to acquire an immovable property outside India under LRS. Once a property is acquired under LRS, the same can be gifted to a non-resident.

OTHER ASSETS

FEMA regulations are silent on gifting of assets other than those already listed above. A view would have to be taken on a case-to-case basis in such instances.

TAX IMPLICATIONS ON GIFT

Gifts within specified limits are not taxable. Similarly, gifts received from relatives are not taxable. 'Relative' as per Income Tax Act, 1961 ("Act") means

In case of an individual

- spouse of the individual;
- brother or sister of the individual;
- brother or sister of the spouse of the individual;
- brother or sister of either of the parents of the individual;
- any lineal ascendant or descendant of the individual;
- any lineal ascendant or descendant of the spouse of the individual;
- spouse of the persons referred above

In case of a Hindu undivided family

- any member thereof

Provisions for Taxability of Gifts

Class of Asset	Threshold	Taxable Income
Sum of Money	Aggregate amount ≥ INR 50,000	**Entire** sum of money if aggregate value during a particular financial year if it exceeds the threshold limit
Immovable property	Stamp Duty Value (SDV) of Property ≥ INR 50,000	**Entire** Stamp duty value
Movable property*	Fair Market Value (FMV) ≥ INR 50,000	**Entire** Aggregate FMV

**It covers specified property viz. shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or bullion.*

CONCLUSION

Keeping in view the relevant laws applicable to gift transactions in India, it becomes important to understand and analyse the possible implications that could arise from all the angles since what could be permissible from a FEMA perspective could result in substantial tax liability and transactions which are exempt from tax perspective may not be permitted from FEMA perspective. One should also be mindful of taxability of such gifts in India as well as in foreign country. If one feels there is an ambiguity in interpreting the law in a particular case, one can surely seek RBI's approval before entering into the transaction since non-compliance would result into compounding of offences and penal proceedings under FEMA as well as Income Tax Act.

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END OF LIABILITY… TRIGGERS TAX?

During COVID times, where global economy is facing challenges, the waiver of liabilities under commercial arrangement is very widely seen phenomenon. When such waiver (and resultant write backs) are supposed to give financial relief to the business, one needs to be mindful of the corresponding tax implications arising from benefit obtained on account of such waiver. In this note, we have covered tax implications on benefit obtained from waiver/write back of various liabilities.

WHAT ARE TAXATION PROVISIONS?

For tax implications on write backs/waivers, following provisions of the Income Tax Act, 1961 ("the Act") are relevant:

- As per **section 28(iv)**, the value of any benefit/ perquisite, whether convertible into money or not, arising from business/profession shall be taxable under the head "Profits and gains of business or profession".

- As per **section 41(1)**, where an allowance/ deduction has been made in any year in respect of a trading liability incurred by the person and subsequently such person has obtained some benefit in respect of such trading liability by way of remission or cessation thereof, then the value of such benefit shall be taxable under the head "Profits and gains of business or profession"

- As per **section 56(2)(x)** where any person receives, from any person/s any sum of money, without consideration, the aggregate value of which exceeds INR 50,000, the whole of the aggregate value of such sum shall be taxable under the head "Income from other sources"

Considering the above provisions, let us discuss the taxability of various write backs.

WRITE BACK OF PAYABLES U/S 28(iv) & 41(1)

WRITE BACK OF ACCOUNT PAYABLES

If the write back of account payables relate to purchase/services availed by the person for his business and were claimed as expense in any year, then such write back amount shall be taxable as business income u/s 41(1).

WRITE BACK OF LOAN

As per principles laid down by the Apex Court in the case of Mahindra And Mahindra Ltd[2], the term 'loan' refers to borrowing something, especially a sum of cash that is to be paid back along with the interest decided mutually by the parties. The lender may exercise his 'Right of Waiver' to absolve the borrower from his liability to repay. After such exercise, the borrower is deemed to be absolved from the liability of repayment of loan subject to the conditions of waiver. The waiver may be a part waiver i.e., waiver of part of the principal or interest repayable, or a complete waiver of both the loan as well as interest amounts. Hence, waiver of loan by the lender results in the borrower having extra cash in his hand. It is receipt in the hands of the debtor/assessee.

(I) Loan for acquiring capital asset

As per decision of aforementioned Apex Court in the case of Mahindra And Mahindra Ltd[3] , the waiver of loan is in nature of receipt of money/cash. Therefore, the very first condition of section 28(iv) which says any benefit /perquisite arising from the business shall be in the form of benefit/perquisite other than in the shape of money, is not satisfied in case of waiver of loan.

It also cannot be taxed as a remission of liability u/s 41(1) on following grounds:

- For section 41(1) essential condition is that there should be an allowance/deduction claimed by the

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[2] *CIT vs Mahindra and Mahindra [2018] 404 ITR 1 (SC)*
[3] *CIT vs Mahindra and Mahindra [2018] 404 ITR 1 (SC)*

assessee in any year in respect of trading liability incurred by the assesse. Then, subsequently, during any previous year, if the creditor remits/waives any such liability, then the assessee is taxed u/s 41. The objective is to ensure that the assessee does not get away with a double benefit once by way of deduction and another by not being taxed on the benefit received by him in the later year with reference to deduction allowed earlier in case of remission of such liability. Purchase/acquisition of capital asset is not debited to trading account/profit and loss account to claim deduction/allowance. The only deduction claimed will be towards depreciation of such capital asset due reduction in its value over time, due to wear and tear. However the same cannot be equated with claiming of deduction/allowance for principal amount of loan.

- Also, there is difference between 'trading liability' and 'other liability'. Section 41(1) particularly deals with the remission of trading liability. Whereas in the case of loan for capital asset, waiver of loan amounts to cessation of liability other than trading liability.

Pertinent to note that the interest portion of such waiver, if claimed as deduction, may be taxed u/s 41(1).

(II) Loan for working capital

In case of write back of loan taken for working capital purpose, there is lack of clarity in the law and different views taken by various courts are as under:

Against the Assessee

The Delhi High Court in case of Rollatainers Ltd[4] held that if the loan was taken for trading purpose and was treated as such from the very beginning in the books of account, the waiver thereof may result in the income, more so when it was transferred to the profit and loss account.

Similar view was taken by Bombay High Court Solid Containers Ltd.'s case and Madras High Court in case of Aries Advertising (P.) Ltd.

Favourable to the Assessee

The Apex Court in case of Compaq Electric Ltd held that waiver of unsecured loan taken from holding company for the purpose of funding the business operation amount to capital receipt and since no allowance or deduction claimed by the assesse on such loan, it is not liable to tax u/s 41(1).

Our View

In our view the waiver of loan cannot be taxed under section 28(iv) as for the said the section the benefit should be in other form rather than in the shape of money as per the decision of the Apex court in case of Mahindra and Mahindra Ltd. With respect to taxability u/s 41(1), the pre-requisite is that there should be allowance/deduction claimed by the assesse on such loan. The judgments mentioned above, wherein such waiver is considered as taxable have majorly relied upon the judgment of the Apex Court in case of T.V. Sundaram Iyengar & Sons Ltd . The said decision of the Apex Court was in context of section 28(i). In the fact of the case, the assessee had received certain advance from its customers and since they remain unsettled for several years, were unilaterally written back by the assesse and credited to Profit & Loss account. However, assesse claimed that they were capital receipt and hence not chargeable u/s 41 or 28. In the factual background, the Apex Court held the receipt to be revenue in nature and arising from business as they were received from customers in normal course of business only. In our view, loan taken for business purpose cannot be equated to amount received from customers and hence applicability of section 41(1) to such section can be argued. However, it will be highly litigative when such loan is used for payment of business expenses, which were claimed as deduction.

[4] *Rollatainers vs CIT [2011] 15 taxmann.com 111 (Delhi HC)*

WRITE BACK OF DEPOSITS

If deposits are in ordinary course of business, then:

- Considering them in nature of "cash/money receipt" (similar to loan write back), their write back shall not be taxable under section 28(iv).
- Since the deposits/advances are not claimed as allowance/deduction the same shall not be taxable under section 41(1).
- However, it can be taxable as normal business income u/s 28(i) as normal profit/gain from business based on the judgement of the Apex Court in case of T.V. Sundaram Iyengar & Sons Ltd. The Apex court held that if assessee receives certain deposits from customers in course of its business which were originally treated as capital receipt then the said amount changes its character when amount becomes assessee's own money (when written back to profit and loss account) because of limitation or by any other statutory or contractual right and such amount should be treated as business income of assessee under section 28(i).

If the deposit is not in the ordinary course of business, then the same can be treated as loan and taxability as mentioned for loan will apply.

WRITE BACK OF LOAN U/S 56(2)(X)

The Apex Court in case of Mahindra And Mahindra Ltd, held that waiver of loan is in nature of receipt of cash/Money. Due the said principle laid down by the Apex Court, though in the context of s. 28(iv), the question arises about applicability of section 56(2)(x) on waiver of loan being receipt of money. For applicability of section 56(2)(x) there should be receipt of money and such receipt should be without consideration. Now, the issue to be analysed is whether waiver of loan by the lender for One Time Settlement or similar other commercial arrangement can be considered as without consideration. The similar issue was dealt by the Chandigarh ITAT in case of Jai Pal Gaba wherein it held that:

- If the donor firstly, gives some amount as a loan and then waive of or relinquish the right to recover the said amount, then on the date of such remission or relinquishment, the nature of such loan changes from loan to receipt.
- The loan was advanced by the banker for a consideration of interest and also with the condition that the same is to be repaid. Advancement of loan cannot be said to be without consideration.
- However, due to losses, the loan become NPA. The bank, after considering the remote possibility of recovery of the said loan, thought it prudent to go for one time settlement with the loanee. It is not just a case where the bank had simply waived or remitted the loan amount, rather the bank to secure payment of certain amount, which otherwise the bank was feeling difficult to recover, was the consideration for settlement of the loan account. Hence, the amount received by the assessee as waiver or remission of loan amount cannot be said to be without consideration. Hence, the provisions of section 56(2) could not be applicable.

In our view, the applicability of section 56(2)(x) to waiver of loan is prone to litigation and will depend upon facts of the case and its commercial substance.

OUR COMMENTS

The write back issue is very prevalent in case of takeovers under Insolvency and Bankruptcy Code, wherein the Creditors are paid amounts as provided in the resolution plan in full and final settlement of their claims which results into heavy write backs. One needs to be very careful about the tax treatment, accounting and disclosures about the write backs in order to avoid unexpected tax implications.

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GIFT CITY – HYPE OR GAME CHANGER?

INTRODUCTION

International Financial Services Centre ('IFSC') or more commonly the GIFT City (Gujarat International Finance Tec-City) has often been in news due to its regulatory relaxations and evolvement of financial products. Thus, it would be interesting to briefly acquaint with this emerging global financial and IT services hub. GIFT City, situated at Gandhinagar, Gujarat, is the first operational smart city and IFSC, providing financial services to non-residents and residents primarily in foreign currency. The IFSC regime is trying to emerge as a one-stop shop for both domestic and offshore financial service players. IFSC empowers the banking and financial service sectors to compete with the global players without the need of setting-up an office at global financial centres like Dubai, Singapore or London. To promote IFSC, Government has granted various relaxations, exemptions to the units located in IFSC. This article provides bird eye view of tax and regulatory aspects for units located in IFSC.

BUSINESS OPPORTUNITIES

Following businesses can explore opportunities in IFSC –

- IT/ITeS
- Banks
- Depositories, Clearing Corporations & Stock Brokers
- Foreign Portfolio Investor (FPI)
- Wealth Management Services
- Asset Management Companies
- Indian & Foreign Insurers

EXCHANGE CONTROL REGULATIONS (FEMA)

- From FEMA perspective, a financial institution or branch of a financial institution set-up in the IFSC permitted/recognized by Government or specified regulatory authority shall be treated as a 'Person Resident Outside India'. Thus, all transactions between such unit in the IFSC and a person resident in India shall be subject to FEMA provisions.
- Recently, the RBI has permitted resident individuals to make investment in IFSC securities, other than those issued by entities/companies resident in India (outside IFSC) to deepen the financial markets and provide an opportunity to resident individuals to diversify their portfolio. However such investments by resident individuals will be under Liberalised Remittance Scheme (LRS) and subject to overall LRS limit (USD 250,000 per financial year) and related compliance.

INCENTIVES UNDER INDIAN INCOME TAX

TAX HOLIDAY

SEZ (Special Economic Zone) Unit in the IFSC can avail 100% tax deduction for its business income for 10 consecutive years out of 15 years from the commencement of its operations at its option.

REDUCED CORPORATE TAX

Domestic companies may opt for concessional corporate effective tax rate of 25.17% (inclusive of surcharge and cess) provided certain tax deductions/benefits are not availed. However IFSC units have been given specific exemption whereby it can opt for the reduced corporate tax rate as well as above mentioned tax holiday.

INTEREST INCOME

Interest income earned by non-resident on long term bond or rupee denominated bond listed on IFSC exchange issued by Indian company or business trust shall be taxable at concessional rate of 4%*.

Interest income on monies lent by non-resident to a unit in the IFSC shall not be taxable.

* *plus applicable surcharge & cess*

CONCESSIONAL MAT/AMT RATES

MAT/AMT shall be applicable at concessional rate of 9%* for units located in the IFSC and deriving its income solely in convertible foreign exchange. MAT-shall not apply to Companies opting for concessional tax regime of effective 25.17% (inclusive of surcharge and cess).

CAPITAL GAINS EXEMPTION - SPECIFIED SECURITIES

Capital gains earned by a non-resident from transfer of following securities transacted in foreign currency on a recognized stock exchange in the IFSC shall not be taxable:

- Bond or Specified Global Depository Receipt
- Rupee denominated bond of an Indian Company
- Derivatives
- Securities as notified by the Central Government (Foreign Currency Bond/Equity Share, Units of Mutual Funds, Business Trust or AIF)

CONCESSIONAL RATE OF TAX ON CAPITAL GAINS

Transactions carried out on IFSC exchange are exempt from Securities Transaction Tax (STT). However, long term/short-term capital gains on sale of equity share, units of equity oriented funds or units of a business trust listed on Recognized Stock Exchange in IFSC shall be taxable at a concessional rate of 10%* or 15%* respectively, where sale consideration is received in foreign exchange even though STT is not applicable.

COMPLIANCE RELAXATIONS

Eligible Foreign investors having only income from specified securities listed on IFSC exchange are not required to obtain PAN and file tax return on fulfilment of specified conditions.

RELAXATIONS UNDER COMPANIES ACT, 2013 TO SPECIFIED IFSC COMPANIES

1. ***Resident Director*** mandatory only after first year of incorporation
2. No requirement to set up ***Audit Committee and Nomination & Remuneration committee***
3. ***Managerial Remuneration*** shall not be subject to any limits for Specified IFSC Public Company
4. ***Internal Audit*** applicable only if provided in Article of Association
5. ***CSR provisions not applicable*** for 5 years from commencement of business
6. ***Extra Ordinary General Meeting (EGM)*** of Specified IFSC Private Company can be conducted at any place within or outside India subject to all shareholder's approval
7. Specified IFSC Company can follow ***same financial year as holding company*** without any approval
8. Conditions prescribed for ***acceptance of deposits from Members*** is not applicable.
9. ***Appointment of Independent Director*** are not applicable to specified IFSC public limited Companies.

OUR COMMENTS

Government has set up IFSC Authority as unified regulator for regulation and development of financial activities for ease of doing business. Also, significant relaxations have been provided to promote IFSC. Despite the commendable efforts from Government, IFSC has not yet achieved the desired popularity. The dependence on political will and absence of self-sufficient ecosystem may deter businesses to consider IFSC as alternative business hub. IFSCs are competing with global financial hubs where there are no or minimal tax and other regulations. Hence, only future would suggest how successful India is to promote IFSC as a global financial hub and attract offshore funds. However, GIFT City is definitely a matter of boardroom discussion and cannot be ignored in the evaluation of future business expansion.

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* *plus applicable surcharge & cess*

U-TURN ON INDIRECT TRANSFER RETROSPECTIVE AMENDMENT

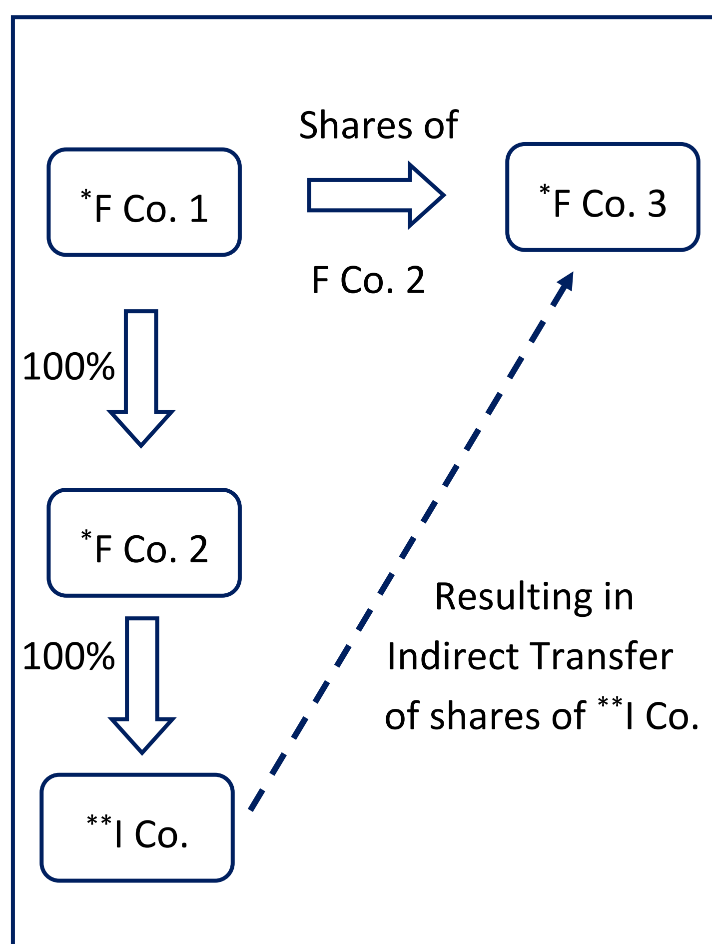
India had attracted severe criticism when it sought to retrospectively tax indirect transfer by Foreign Company in a move to overturn the favourable Apex Court decision in 2012. This move severely impacted India's image as favourable investment destination. Although 'better late than never' and maybe due to the ongoing international arbitration cases against India, almost 9 years later, India has withdrawn this retrospective amendment subject to certain conditions. This article seeks to highlight briefly the legislation, the withdrawal of the retrospective amendment and impact going forward.

WHAT IS INDIRECT TRANSFER?

Currently, global businesses are held through multi-tiered structures with intermediate holding company outside India deriving substantial value from assets/business in India. However, many developing countries including India have concerns with non-residents avoiding capital gains on assets located in the source country (such as India), by transferring those assets indirectly, i.e. transferring interests in entities that owns such assets, rather than the assets themselves.

When shares of foreign company or interest in any entity incorporated or registered outside India is transferred and if such shares or interest derives its substantial value from assets located in India directly or indirectly, then such transfer is commonly referred to as 'Indirect Transfer' *(To read our detailed note on Indirect Transfer, please click here)*.

In case of such indirect transfer, the income shall be deemed to be Indian income and taxable for non - residents.



* F Co. = Foreign Company
** I Co. = Indian Company

RETROSPECTIVE LAW

- The Apex Court had ruled in favour of Vodafone[5] that indirect transfer of Indian assets was not chargeable to tax in India.
- However, Government thereafter amended the provisions of the Income Tax Act, 1961 ("the Act") by the Finance Act, 2012 with retrospective effect from 1st April, 1962 clarifying that gains arising from the sale of shares or interest in foreign entities are taxable in India if such shares/ interest, directly or indirectly, derive their value substantially from the assets/business located in India.

PROPOSED AMENDMENT

The retrospective amendment invited criticism from stakeholders and damaged India's reputation as attractive destination. India has been involved in arbitration cases on account of this amendments. The country today stands at a juncture when quick recovery of the economy after the COVID-19 pandemic is the need of the hour and foreign investment has an important role to play in promoting faster economic growth and employment.

Government has introduced The Taxation Laws (Amendment) Bill, 2021 to give relief to certain eligible entities impacted by the above retrospective amendment. Amongst others, few noteworthy proposals are -

- The Bill proposes to amend the Act to provide that no tax demand shall be raised in future on the basis of the said retrospective amendment for any indirect transfer of Indian assets if the transaction was undertaken before 28th May, 2012.
- Further it proposes that the tax demand raised for indirect transfer of Indian assets made before 28th May, 2012 shall be nullified on fulfilment of specified conditions such as withdrawal or furnishing of undertaking for withdrawal of pending litigation and furnishing of an undertaking to the effect that no claim for cost, damages, interest, etc., shall be filed.
- It is also proposed to refund the amount paid in these cases without any interest thereon.

OUR COMMENTS

This is definitely a welcome move made by the Government. Although this amendment/ relief is relevant only for very few cases, it is important to consider the implications of Indirect Transfer in global restructuring since it continues to apply in all other cases not covered by the proposed amendments. One has to comprehensively analyse and document the taxability of indirect transfer of assets in India under the Act as well as the Treaty to avoid any future adverse consequences.

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[5] *Vodafone International Holdings B.V. v. UOI (2012) 341 ITR 1*

CASE LAWS AND RECENT UPDATES

MONETARY REDEMPTION OF REWARD POINTS IS TAXABLE – US COURT

The assessee purchased Gift Cards using his Credit Cards and in turn used the Gift Cards to purchase Money Orders which were deposited into his Bank Account. This amount deposited in the Bank Account was used to repay for his Credit Cards. The Credit Card Company offered Cash Rewards for eligible purchases from the Credit Cards. On closure of the Credit Cards, the assessee redeemed his Cash Rewards into his Bank Account.

The US Internal Revenue Services (IRS) proposed to tax these Cash Rewards because the assesse did not earn them by purchasing goods / services. The US Court held that rebate provided to Cardholders for purchase of goods / services is not taxable. However, purchasing money order and reloading the cards is a form of Cash Transfer and the Cash Reward earned on that should be taxable.

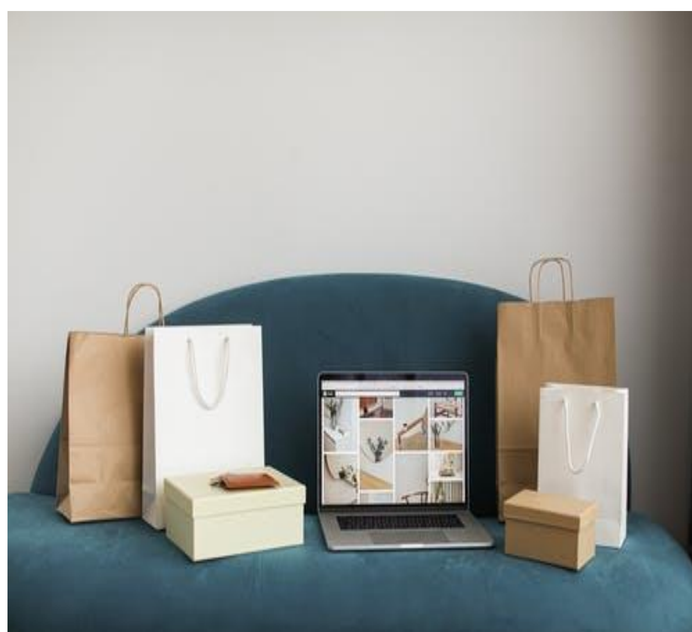
- [2021] 127 taxmann.com 612 (TC- US)

PAYMENTS TO ONLINE PLATFORMS FOR MARKETING / ADVERTISING NOT ROYALTY

The assessee, an Indian Company, availed Advertising / Marketing Services from Foreign Online Platforms such as Facebook, Amazon Web Services (AWS). While making payments, the assessee had not withheld taxes u/s 195 of the Income Tax Act. Revenue raised a demand including interest for not withholding tax.

The Bangalore ITAT observed that there was mere usage of facility without parting copyright. Further, use of IT facilities do not give any license or right to the assessee to use their IT Infrastructure Facilities. Thus, Bangalore ITAT held that the payment made to the Foreign Online Platforms do not fall within the meaning of Royalty under relevant DTAA provisions and hence no withholding is required since such payments cannot be brought to tax in India.

- [TS-773-ITAT-2021(Bang)]



APPLICABILITY OF SEP PROVISIONS

Income from any Business Connection in India is deemed to accrue in India under Indian domestic laws. The scope of Business Connection is widened to include even those businesses that do not have a physical presence in India but have a Significant Economic Presence (SEP). These provisions are applicable from 01st April 2021.

The coverage of SEP is wide to cover goods, services or property whether digital or not as well as systematic and continuous solicitation of business activities or interactions. If Non-Resident fulfils the definition of SEP, it shall be deemed to constitute business connection in India and income attributable to transaction/activities in India will be taxable. Transactions with countries/jurisdictions having DTAA with India may not be impacted by the SEP provisions subject to certain requirements.

The threshold limits for SEP to apply as are as follows:

1. Aggregate of payments arising from transactions in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India during the previous year exceeds INR 20 Million (~ USD 270,000), **OR**
2. Systematic and continuous soliciting of business activities or engaging in interaction with more than 3 Lakh (300,000) users in India

(To read our detailed note on Significant Economic Presence, please click here)

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Quarterly Newsletter – September 2021
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