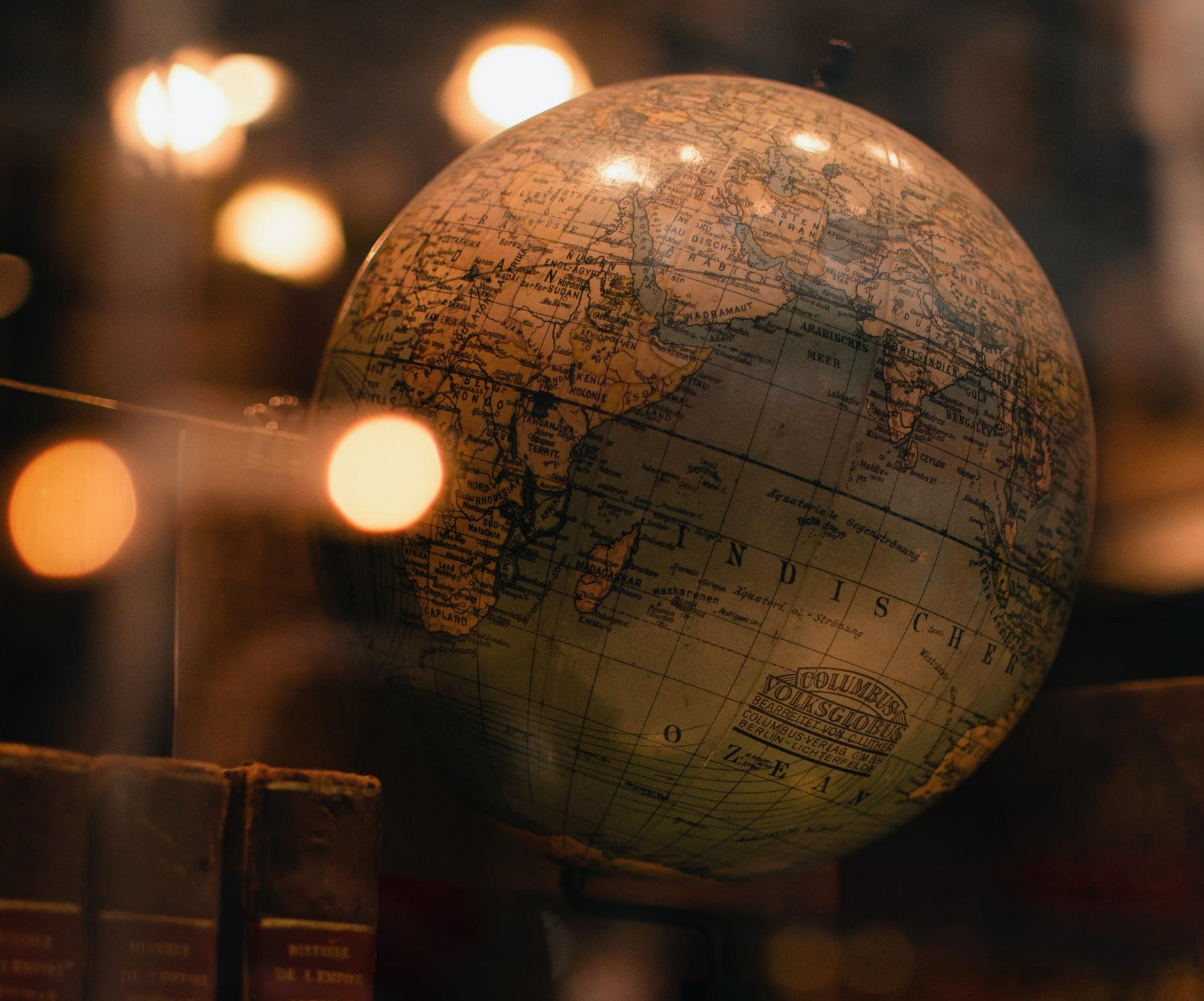

INFODIVE

FEMA | International Tax | Transaction Advisory

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Quarterly Newsletter | June 2021

GBCA & Associates LLP Chartered Accountants

TABLE OF CONTENTS

1	Is One Person Company Suitable for NRIs?	3
2	FEMA FAQs for NRIs	5
3	ESOP – Employee Incentive Tool for Covid Times	8
4	MFN - Tool for Lowering Withholding Tax	10
5	Case Laws and Recent Updates	11

Is One Person Company suitable for NRIs?

One Person Company (OPC), as the name suggests, is a type of company having only one individual as its member and the same individual can also be the Director of the Company. This has been in highlight since Union Budget 2021 as Non Resident Indians (NRIs) are also eligible to incorporate an OPC making it easier for a fresh class of foreign investors to invest in India. This concept has been prevalent globally in countries like USA, UK, Singapore, etc. One of the biggest advantages of an OPC is that it can be incorporated by a single person and does not have any minimum requirement of members as is required in other forms of entities like a Private Limited Company or LLP. An OPC also enjoys a lot of exemptions and relaxations from the stringent compliances under the Companies Act, 2013.

WHO CAN FORM AN OPC?

- Indian Citizen resident in India
- NRI staying at least 120 days in India during the immediately preceding financial year.

Foreign nationals are not eligible to incorporate an OPC.

SALIENT FEATURES

- Separate Legal Entity with perpetual succession
- Member and nominee should be natural individuals
- Limited liability as compared to Sole Proprietorship
- One Member, Minimum One Director
- Can be converted into Private or Public Limited Company any time without any threshold limits for compulsory conversion
- Relaxation from certain compliances under Companies Act, 2013

RESTRICTIONS

- One individual can incorporate only one OPC or become nominee in only one OPC
- No Minor can become a member or nominee in OPC nor can they hold beneficial interest in the shares of OPC
- OPC cannot carry out Non-Banking Financial Investment activities including investment in securities of any body corporate

FEMA PROVISIONS

- NRIs can invest on non-repatriation basis as well as repatriation basis in OPC.
- **Investment on Non-Repatriation basis** is treated at par with domestic investment. Therefore, FEMA pricing guidelines and reporting compliances are not applicable at the time of investment. The share sale proceeds have to be credited to NRO Account only and can be remitted abroad presently under One Million Dollar Scheme after reporting formalities. Certain prohibited sector under this mode includes agricultural, plantation activities, specified real estate business etc.
- **Investment on Repatriation basis** will require compliance with sectoral caps and conditions, FEMA pricing guidelines and reporting compliance. Prohibited sectors include lottery, gambling, specified real estate business etc.

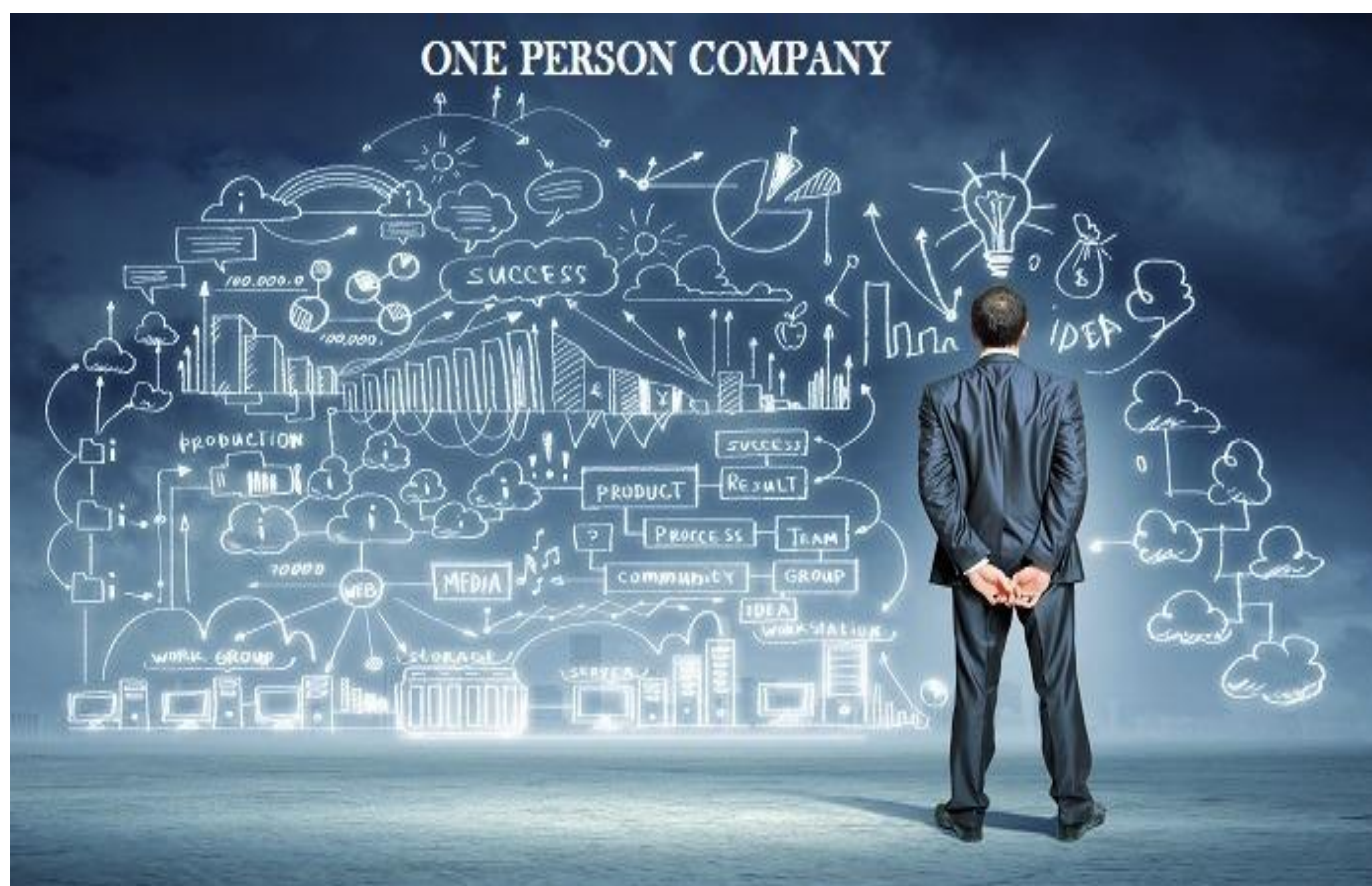
TAXATION

The tax structure for OPC is the same as in case of Private Limited Company. As against the slab rates applicable to individual which goes as high as 42.74%, the corporate tax rates range from 17.16% to 34.94% depending upon various conditions.

Dividend from OPC shall be taxable in India for the shareholder. NRI shareholder can avail treaty benefits on dividend income.

OUR COMMENTS

With certain key advantages of OPC namely limited liability, perpetual succession, concessional corporate tax rates in India, NRIs looking to invest in India now need to evaluate OPC along with other modes of entities such as LLP to decide the most optimum structure on a case to case basis.



FEMA FAQs for NRIs

Many Indians move abroad to foreign nations for various purposes such as education, employment, etc. and also settle there. When a person moves abroad, his residential status may change from Resident to Non-Resident under FEMA depending upon the number of days he resides outside India as well as intention of such person to stay outside India for uncertain period. When the residential status changes, along with the provisions of Income Tax Act, 1961, he also has to adhere to the provisions of FEMA which regulates various types of investments in India by the NRIs. The terms Persons resident outside India, NRI and PIOs are defined specifically under the FEMA regulations. This article is primarily focused on Indians who have left the country to reside abroad.

Following are the frequently asked questions for NRIs:

1. **When a Resident becomes an NRI, whether he has to change his bank account?**
   Yes, such a person has to close his regular saving account and open Non-Resident Ordinary Rupee Account (NRO) / Non-Resident External Rupee Account (NRE).

2. **What is the meaning of Investment on Repatriation and Non-Repatriation basis?**
   - Investment on Repatriation basis means that the sale proceeds, profits and dividends/interest (net of taxes) arising from such investment made by the NRI, are eligible to be freely remitted outside India.
   - Investment on Non-Repatriation basis means that the investment made by the NRI cannot be freely remitted outside India. The investment proceeds have to be accumulated in the NRO Account. Only the current income in the form of dividend or interest, net of taxes, can be remitted out of India.

3. **What is the scheme available for making remittances out of non-repatriable investments in India to a foreign country?**
   - RBI has introduced the USD One Million scheme under which proceeds of non-repatriable investment can be remitted outside India upto USD One Million per financial year.

   Note: The scheme is governed under certain terms and conditions and is also subject to reporting compliance.

4. **Can NRIs invest in shares and mutual funds on Indian stock exchange?**
   Yes. NRIs can purchase shares, mutual funds, Exchange Traded Funds on Indian stock exchange on repatriation basis under the Portfolio Investment Scheme (PIS) subject to reporting compliance. The DEMAT account should be linked with the NRE Account.

   They can also invest in Initial Public Offer (IPO) of listed companies under PIS. NRIs can also invest in shares and mutual funds on non-repatriation basis without any reporting compliance.

5. **Can NRI make direct investment in shares of a private/public Indian company?**
   Yes, an NRI can make direct investment in shares of listed as well as unlisted company subject to certain conditions and reporting obligations. The investment can either be on repatriation basis or non-repatriation basis. Please seek advice before making investments to comply with regulations.

6. **Can NRI borrow money from his resident relatives?**
   - Yes. He can borrow money in rupees from his resident relatives (as defined under Companies Act, 2013) within the limit of USD 250,000 per resident relative per financial year.
   - Such borrowed funds have to be deposited into the NRO account of such NRI and can be used only for his personal purposes and own permitted business and not for relending nor investments.

- Further, the proceeds of the said loan cannot be remitted outside India.

  Note: The term 'relative' is very narrowly defined under section 2(77) of Companies Act, 2013. 'Relative' includes Father (Including Step-Father), Mother (Including Step-Mother), Sons (Including Step-Son), Son's Wife, Daughters, Daughter's Husband, Brothers (Including Step-Brother), Sisters (Including Step-Sister) and members of HUF.

7. Can NRI receive any gifts from his resident relatives in Indian Rupees or even foreign currency after he becomes person resident outside India?

- Yes. A resident individual can gift his NRI relatives in Indian rupees as well as foreign currency under Liberalized Remittance Scheme (LRS) within the limit of USD 250,000 per resident relative per financial year.
- Gift received in Indian rupee can be deposited only in NRO Account. It can be remitted outside India under the USD One Million scheme (Q.4).

  Note: For the purpose of Gifts, definition of the term relative under Companies Act, 2013 as mentioned above in Q.7 is to be applied. Also, one has to keep in mind the gift tax laws of the foreign country in which such NRI resides.

8. Can NRI continue his investment in PPF account and National Savings Certificate (NSC) after he becomes a person Resident outside India?

- An NRI cannot open a new PPF Account. However, if a resident who had a PPF Account subsequently becomes a non-resident then he can continue to subscribe to the fund till its maturity on a Non-repatriation Basis.
- Similarly, NRIs cannot invest in NSCs. However, if a Resident had purchased NSC, and subsequently becomes a non-resident, he can hold it till the period of maturity of the Certificate.

9. Can NRI continue his LIC, medical Insurance and other insurance policies after he becomes a person resident outside India?

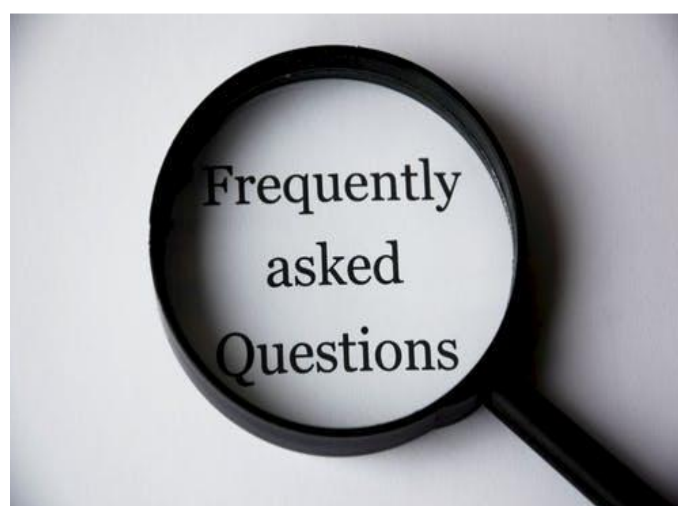
Yes. Indian person becoming Non Resident can continue paying the premium on the LIC and other existing policies for insurance etc.

10. Can NRI continue loans given to residents while such NRI was a resident?

Yes. NRI can continue loans given to residents given in their capacity as residents. Any new loan/new instalment will have to be given as per extant FEMA regulations only and all the applicable terms and conditions pertaining to end use, maturity period, rate of interest etc. are to be followed.

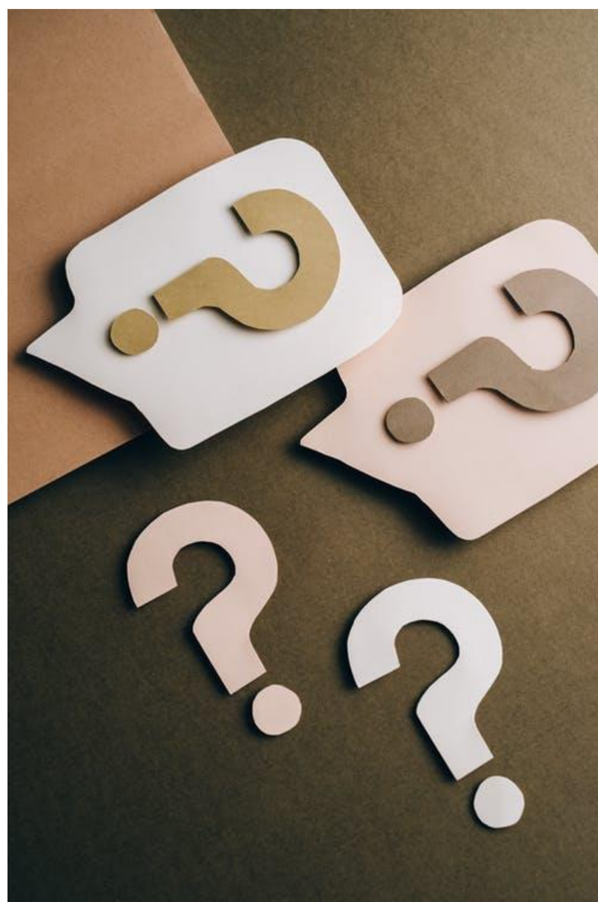
11. Can NRI continue as a partner in the Indian partnership firm and LLP?

- Yes. He can continue to be a partner in the Partnership Firm/LLP subject to applicable terms and conditions, provided the partnership firm/LLP is not engaged in prohibited sectors for investment by NRIs in partnership firms/LLPs.
- Fresh investment by NRI in Indian Partnership Firm/LLP can be made only on non-repatriation basis.



12. Can NRI acquire immovable property in India?

Yes, an NRI can purchase immovable property in India other than a plantation, farmhouse and agricultural property. He can also acquire property in India by way of gift from Residents or from another NRI who are relatives as per Companies Act, 2013 (mentioned in Q. 7).



13. After NRI returns to India, can he still continue to hold his bank account, investments and property in the foreign country?

Yes. Under FEMA, any person who was once a Non-Resident, can continue to hold his foreign bank accounts, investments and properties abroad even after he becomes a person resident in India.

14. What are the penal consequences for non-compliance of any provisions under FEMA?

Any person contravening FEMA provisions may be liable to a penalty as under:

- Penalty upto thrice the sum involved in such contravention where such amount is quantifiable
- Penalty up to INR 200,000 where the amount is not quantifiable.
- If such contravention is a continuing one, further penalty upto INR 5,000 per day during which the contravention continues can also be levied.

ESOP – Employee Incentive Tool for Covid Times

ESOP (Employee Stock Option Plan) is an effective way to align the interest of employees with the interest of the Company, to retain key employees and to reward them in spite of cash flow crunch especially during Covid pandemic.

WHAT IS ESOP?

Under an ESOP, a company grants option (right without any obligation) to acquire a certain number of shares in the company or its holding / subsidiary company generally at a predetermined price (exercise price) within a pre-determined period (exercise period) to its employees. The option to acquire shares can be exercised once the vesting conditions are fulfilled. Such vesting conditions may include continued employment for a defined time or performance based or both. Upon vesting, the employee gets a right to 'exercise' the vested options by payment of the exercise price. On exercise, the shares are allotted to the employees who may sell them subject to lock-in period, if any, specified under the ESOP.

COMPANY LAW PROVISIONS

Important Company Law provisions are as under:

- Issue of ESOP shall be approved by Special Resolution of the Equity Shareholders.
- ESOP can be given to employees of the Company[1] which includes:
  - Permanent employee working in India or outside India;
  - Director (other than Independent Director)
- However ESOP can NOT be given to[2]:
  - Promoter or any person in Promoter Group
  - Director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than 10% equity shares
- Listed company shall comply with SEBI Employee Stock Option Scheme Guidelines.

FEMA PROVISIONS

ESOPs of Indian Company to a Non-Resident Employee including Directors:

- Can be given to employee of the Company, Holding Company, Joint Venture and Subsidiary
- ESOP shall be in compliance with Companies Act and SEBI Guidelines (if listed)
- Sectoral Caps apply
- Government approval if:
  - FDI in the company is under approval route or
  - Employee is a citizen of Bangladesh/Pakistan
- Non-resident employee exercising ESOP which was issued when he was resident shall hold such shares on a non-repatriation basis.
- Reporting to RBI within 30 days from the date of issue of ESOP as well as exercise of ESOP.

ESOPs of Foreign Company to a Resident Employee:

- Can be issued by the Foreign Company to employees (including director) of its Indian office or its branch or of its Indian subsidiary or of an Indian company with atleast 51% foreign equity holding.
- Can be issued by a Joint Venture or Wholly Owned Subsidiary outside India of the Indian Promoter Co. (in the field of Software) to employees (including director) of the Indian promoter company, subject to specified[3] threshold.
- Annual Return has to be filed by the Indian Company with AD Bank giving details of remittances, beneficiaries etc.

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[1] Including its subsidiary and holding company

[2] This restriction shall not apply to eligible startups up to 10 years from the date of its registration.

[3] The Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004

TAXATION

The benefit received under an ESOP by an **employee is taxed as Salary Income** as under:

- Point of Taxation: At the time of **allotment**[4] of Equity Shares to such employee. However in case of eligible startups, the point of taxation is:
  - On expiry of 5 Financial Years from the end of Financial year in which shares are allotted; or
  - Date of sale of Equity Shares received on exercise of ESOP; or
  - Date of termination of employment

  whichever is earlier

- Taxable income = Fair Market Value ('FMV') of equity shares (as given below) less Exercise Price paid by the employee.

- Fair Market Value :
  - Listed Shares : Average of Opening and Closing market price as on date of exercise of ESOP
  - Unlisted Shares : Value as determined by Category I Merchant Banker on specified date

The corresponding expense deduction for tax purpose to the Company (i.e. Employer) is as under[5]:

- The discount under ESOP is in the nature of employees cost and hence **deductible business expense** during the vesting period proportionally w.r.t. the FMV of shares at the time of grant of options to the employees.
- The amount of discount claimed as deduction during the vesting period is required to be reversed in relation to the lapsed options.
- However, an adjustment to the discount is required at the time of exercise of option by the amount of difference in FMV at the time of grant of option and the FMV at the time of exercise of option.

Other tax aspects relating to ESOP are as under:

- TDS: Employer is required to withhold TDS on point of taxation for employee (as defined above). In practical scenario, employer may agree to bear the tax liability of the employee arising on ESOP. Such benefit (i.e. bearing of tax liability) shall be exempt for the employee but the employer will not get any tax deduction for such tax paid on behalf of employee.

- Subsequent sale of shares received on ESOP by Employee: Gains arising on subsequent sale of shares shall be taxable as 'capital gains' - long term or short term, depending upon the period of holding of such shares computed from the date of its allotment. Cost of Acquisition shall be the FMV considered for determining the taxable salary.

- ESOPs issued by Holding Co. to the employees of Subsidiary Co.: Based on judicial decisions[6] it shall be taxable in the hands of employee as 'salary' (including ESOPs issued by foreign holding company).

OUR COMMENTS

Though ESOP is widely used by Start Ups and MNCs, in present times, all the companies can evaluate ESOP as part of compensation policy.

Various judicial decisions have provided for tax deduction for ESOP to the Company (i.e. employer) as salary cost, however, an explicit statutory provision in this regard will further strengthen the tax neutrality of ESOPs and eliminate litigation risk.

[4] Section 17(2)(vi) and decision of ITAT Hyderabad in case of Bharat Financial Inclusion Ltd - [2018] 96 taxmann.com 540

[5] Based on the provisions of the IT Act and the judgment of the Karnataka High Court in case of Biocon Ltd . CIT v. Biocon Ltd [2020] 121 taxmann.com 351 (Karnataka)

[6] Microsoft Corporation USA - [1999] 235 ITR 565 (AAR)

MFN - Tool for Lowering Withholding Tax

INTRODUCTION

The Most Favoured Nation (MFN) clause under a Tax Treaty/ Double Taxation Avoidance Agreement ('DTAA' or 'tax treaty') allows a more beneficial treatment over and above the terms of the DTAA. Under the MFN clause, a contracting state agrees to accord to other contracting state a beneficial treatment, in line with the similar beneficial treatment which it has accorded to the other third states.

The objective of MFN clause is to promote free trade and non-discrimination i.e. the state who has signed any DTAA with other state is not at a disadvantage when more liberal terms are agreed with any third state. The intention of MFN clause in tax treaties includes granting of lower rate on specified income, restricting the scope of income, allowance of expenses in case of business income.

PRESENT CONTROVERSY

In practice, application of MFN clause per se has not been controversial. However, an interesting question is whether beneficial provisions of third country treaty can be restored under MFN clause of the primary treaty, if that third country was not an Organization for Economic Co-operation and Development (OECD) member at the time of signing of treaty or protocol between India and that third country.

Several tax treaties explicitly provide that the third country should be an OECD member on the date of signing of treaty or protocol. In absence of explicit wordings in few tax treaties, an interpretation may be possible that there is no prerequisite that the third country needs to be a member of OECD at the time of signing of treaty or protocol with India.

RECENT JUDICIAL DECISION

The Delhi High Court in one of the first such decision on this controversy in the case of Concentrix Services Netherland B.V. vs. Income Tax Officer (TDS)[7] has held that protocol of a tax-treaty forms an integral part of the tax treaty. It dismissed the contention raised by the Tax Department and held that it is not necessary for the other treaty partner to be member of OECD when the tax treaty is executed. It also emphasized on the principle of 'Common Interpretation' of tax-treaties.

Thus, the Hon'ble High Court held that the beneficial withholding tax rate of 5% (instead of 10%) on dividend income in India-Slovenia DTAA will be available under India-Netherlands DTAA by invoking MFN clause.

OUR COMMENTS

This is the first landmark decision in interpretation of MFN clause under tax treaties. The court has adopted liberal interpretation of the relevant provisions. This decision provides timely and beneficial guidance on the potential of lowering withholding rates pursuant to the MFN clause as India has recently adopted classical system of dividend taxation in the hands of shareholders. Entities from other jurisdictions such as France, Switzerland, Spain, Sweden, etc. may evaluate the impact of this favourable judgment for lowering their withholding taxes in case of specified income such as interest, royalties, fees for technical services and dividend. However, the language may be different for every MFN clause and should be analysed on case-to-case basis. It may be worthwhile to see how future litigation takes shape in this matter.

[7] 127 taxmann.com 43

Case Laws and Recent Updates

FOREX GAINS ON PERSONAL LOANS NOT TAXABLE

The assessee had extended a personal interest free loan to his cousin in Singapore from his personal bank account under the Liberalised Remittance Scheme (LRS) issued by the RBI. The assessee received more amounts on repayment due to exchange gain fluctuation. During scrutiny proceedings, the assessee claimed that the transaction was of capital receipt and hence should not be taxed. However, the Assessing Officer (AO) brought the foreign exchange gain to tax.

The Mumbai Tribunal held that the amount received on loan repayment was in the nature of capital transaction. Capital receipts are not taxed unless there are specific provisions for it. Since, the foreign exchange gain was in respect of a capital transaction, it was also to be considered as a capital transaction and should not be brought to tax in absence of specific provisions to tax it.

-[2021] 127 taxmann.com 343 (Mumbai - Trib.)

AMOUNT RECEIVED FROM CHARTER HIRE ARRANGEMENT NOT TO BE CONSIDERED AS ROYALTY

The assessee, a Singapore based company, gave its vessel along with its crew to an Indian Company under charter hire arrangement for exploration/ extraction of mineral oils. The assessee did not constitute a Permanent Establishment (PE) in India and hence did not offer the income received from charter hire arrangement to tax in India. The AO called for an explanation as to why shouldn't the receipt be taxed as royalty, to which the assessee submitted that control of the vessel and crew remained with the assessee and was not transferred to the Indian Company.

The Mumbai Tribunal held that there was no transfer of 'use' or 'right to use' the vessel or crew and hence the income received from such arrangement cannot be considered as royalty under the Income Tax Act and the India-Singapore DTAA.

-[2021] 125 taxmann.com 349 (Mumbai - Trib.)

REIMBURSEMENT OF SOCIAL SECURITY, INSURANCE AND OTHER COSTS NOT TAXABLE AS FEES FOR TECHNICAL SERVICES

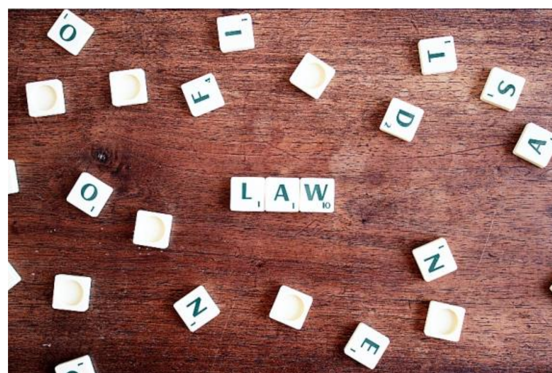
The applicant was a wholly owned Indian subsidiary of Switzerland company. The applicant requested its associate company (KRP) to deploy experienced personnel to India for work. As per the inter-company agreement executed between the applicant and KRP, social security contribution, insurance and relocation expenses of such personnel in their home country was to be disbursed by KRP and subsequently reimbursed by the applicant.

The Authority for Advance Rulings, Mumbai concluded that the entire salary including reimbursed component was offered for tax in India by seconded employees. Payments never accrued to KRP and were specifically related to social security/ insurance/ relocation commitments and were mandatorily paid to respective accounts. KRP only performed a supportive function as no operational or functional control was exercised over the seconded employees. It did not pay any perquisite or performance related payments to the personnel. It was merely paying the statutory payments on behalf of seconded employees in their home countries. Thus, social security, insurance, relocation expenses being committed and obligated payments are in nature of reimbursements and not fee for technical services.

-[2021]126 taxmann.com 32 (AAR – Mumbai)

INCREASED LIMIT OF CBCR

The threshold limit for applicability of Country-by-Country Reporting (CbCR) to a Multinational Group has been increased to INR 6,400 Crores from INR 5,500 Crores w.e.f 1st April, 2021.



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Quarterly Newsletter – June 2021

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