Deloitte.
デロイト トーマツ

Global Tax Update

India

Deloitte Tohmatsu Tax Co.

April 2019

1. Voluntary Retention Route (VRR) for foreign portfolio investments (FPI) in debt securities

The Reserve Bank of India (RBI) has notified the VRR guidelines vide its circular dated 1 March 2019[1]. The investment limits prescribed under VRR are in addition to the existing limits prescribed for FPI investments in debt securities. Further, the investments made under VRR will not be subject to the regulatory restrictions currently applicable to FPI investments in debt securities like residual maturity conditions, concentration limits or single / group investor-wise limits.

Some of the key features of the VRR framework are tabulated below:

Eligible Investors	■ All FPIs registered with Securities Exchange Board of India (SEBI)
Eligible Instruments	■ Debt securities permitted for FPI like central government securities, treasury bills, bonds, etc. ■ FPIs can also undertake repo and reverse repo transactions provided the amount borrowed or lent under repo transactions does not exceed 10% of investment under VRR.
Minimum retention period	■ 3 years from the date of allotment, or such other period as decided by RBI for each allotment. ■ FPI can sell off its investment to another FPI within the retention period, subject to terms and conditions.
Investment limit and mode of investment	■ Capped at INR 400 billion for government securities ■ Capped at INR 350 billion for corporate debt securities ■ RBI has prescribed certain mechanism for investments in VRR like allocation of investment through an auction mechanism, timelines for making the investment after allocation investment to a FPI, hedging of interest rate or currency risk, etc.
Operational aspects	■ Separate bank account for making investment in VRR, appropriate documentation by custodian to ensure FPIs adhere to VRR conditions, conditions on repatriation, etc.

2. Review of investment by FPI in debt securities

SEBI and RBI vide their respective circulars dated, 15 June 2018[2] had mandated that no FPI shall have an exposure of more than 20% of its corporate bond portfolio to a single corporate (including the related parties[3] of that corporate).

1 RBI/ 2018-19/ 135 A.P. (DIR Series) Circular No. 21 dated 1 March 2019

2 SEBI Circular No. CIR/IMD/CIR/P/2018/101 and RBI Circular A.P. (DIR Series) Circular No. 31 both dated 15 June 2018.

3 Related parties as prescribed under the relevant provisions of Companies Act, 2013.

However, in order to encourage a wider spectrum of investors to access the Indian corporate debt market, RBI vide its circular dated 15 February 2019[4] had withdrawn with immediate effect the above-mention restriction on FPI investments. SEBI vide its circular dated 12 March 2019[5] has clarified that its circular dated 15 June 2018 stands withdrawn with immediate effect.

In view of the above circulars, a FPI can now have an exposure of more than 20% of its corporate bond portfolio to a single corporate.

3. Royalty – Industry average rate as CUP[6]

Income Tax Appellate Tribunal[7] (the Tribunal) recently pronounced a ruling[8] on royalty payment pertaining. The Tribunal held that since the rate of royalty paid by the taxpayer is lower than the industry average rate of royalty, the transaction was concluded to be at arm's length (ALP) and accordingly deleted the entire adjustment on royalty.

It is pertinent to note that so far most of the earlier judicial decisions on Royalty payment were focused on one among the following principles:

- Accepting the aggregation approach under TNMM[9] when the operating margins of the Appellant after making Royalty payment is higher than the comparables;
- Adopting Royalty rates specified by RBI i.e., 5 percent and 8 percent as the ALP;
- Considering the approval provided by FEMA[10] Guidelines for making Royalty payment.

Whereas this is an important ruling on a different premise wherein average rate prevailing in the automotive sector based on a study of 35 licenses conducted by an independent body has been considered as the ALP for the purpose of benchmarking the Royalty transaction.

Considering the reluctance on part of the Indian tax authorities to accept separate Royalty benchmarking conducted using foreign databases viz., RoyaltyStat, adopting publicly available industry average rates as CUP for benchmarking Royalty is a welcome approach by the Tribunal. This can act as a precedent for other automobile companies who are facing similar issues on Royalty payment.

4. False verification of return and false statement on oath in relation to foreign assets can lead to prosecution charges being framed

An individual taxpayer had filed income tax return without declaring any foreign income / investments. As per the documents received by revenue authorities from the competent authorities of British Virgin Island (BVI) and Singapore under 'Exchange of Information', the taxpayer was a director and shareholder in a BVI company and an authorised representative as well as beneficial owner of a bank account in Singapore.

The revenue authorities alleged that the taxpayer has committed two offences which should be subject to prosecution.

- firstly, he has made wilful attempt to evade tax1[11]; and
- secondly, he has made false verification in income tax return and a false statement on oath[12].

The Indian Courts discharged the taxpayer from the charges framed for wilful attempt to evade tax[13]. However, based on the materials available on record, the Court held that it cannot be said the allegation regarding the false verification of return and false statement on oath are without any basis. The Court further clarified that argument put forth by the taxpayer regarding mens rea can be judged only after the trial and not

4 A.P. (DIR Series) Circular No. 19 dated 15 February 2019
5 IMD/FPIC/CIR/P/2019/37
6 Comparable Uncontrolled Price
7 Chennai Bench
8 in the case of Hyundai Motor India Limited (HMIL, the taxpayer, the company)
9 Transaction Net Margin method
10 Foreign Exchange Management Act
11 Section 276C of the Income-Tax Act, 1961 (the Act)
12 Section 277 of the Act
13 As the entries in the bank accounts were merely reversal entries and not income

at the stage of framing the charge. Accordingly, the Court directed to set aside the order discharging the taxpayer from the offence of false verification.

Considering the fact that India has signed pacts with various countries for exchange of information, the revenue authorities are in a much better position to receive the information and documents relating to investment made / income earned by a person resident in India. The ruling acts as a caution to taxpayers that prosecution proceedings can be initiated for non-disclosure or incomplete / inaccurate disclosure of foreign income / investments. Taxpayers therefore need to bear in mind that it is imperative to comply with the statutory requirements relating to disclosures in the tax return.

5. Allowances are in nature of pay and need to be considered for PF purposes, rules Supreme Court[14]

As per the Employees' Provident Funds & Miscellaneous Provisions Act, 1952 (the EPF Act) contributions are required to be made by the employer at 12 percent of basic wages, dearness allowance (DA) and retaining allowance with a matching contribution by the employee.

Dearness allowance for this purpose would include cash value of food concessions (collectively being referred to as PF wages). Basic wages includes all emoluments earned by the employee in accordance with the terms of contract paid or payable in cash, but inter alia excludes house-rent allowance (HRA), overtime allowance, bonus, commission or any other similar allowance payable to the employee. While DA was also excluded from the definition of basic wages, since it was included as a separate component, PF has always been payable on DA.

Given that "any other similar allowance" payable to employees is specifically excluded from the definition of basic wages, the industry at large has been grappling with the question of what constitutes wages for the purposes of PF computation, and whether the allowances paid by the companies can be excluded for this purpose. For domestic employees, the PF wages may be limited to statutory wage ceiling, which is currently INR 15,000 pm. However, this wage ceiling is not applicable to foreign nationals, who are required to be categorised as International Workers.

The question framed before the Supreme Court was - Whether allowances in question such as travel allowance, medical allowance, canteen allowance, management allowance, special allowance etc. would fall within the expression 'basic wages' as defined in Section 2(b)(ii) read with Section 6 of the Act for determination of monthly PF contributions?

The SC opined that the wage structure and the components of salary have been examined on facts, by the authorities, who have arrived at a factual conclusion that the allowances in question were essentially a part of the basic wage camouflaged as part of an allowance to avoid PF contributions. The Apex Court's ruling will warrant increased PF contributions by companies for employees whose basic wages are lower than INR 15000 per month. Further, foreign nationals who are required to be treated as International Workers would also have a higher PF contribution since the wage ceiling of INR 15000 per month does not apply to them. Given the Supreme Court decision on what constitutes PF wages, companies would be well advised to review the positions adopted with respect to the above categories of employees and determine the way forward.

14 Supreme Court's decision dated February 28, 2019 in Civil Appeal No. 6221 of 2011 (RPFC II West Bengal Vs. Vivekananda Vidyamandir and Others); 3965-3966 of 2013 (Surya Roshni Ltd. Vs. EPF & Others); 3969-3970 of 2013 (U-Flex Ltd. Vs. EPF & another); 3967-3968 of 2013 (Montage Enterprises Pvt. Ltd. Vs. EPF & another) and Transfer Case No. 19 of 2019 (The Management of Saint-Gobain Glass India Ltd. Vs. RPFC, EPFO).

Newsletter Archives

To see past newsletters, please visit our website.
www.deloitte.com/jp/tax/nl/ao

Contacts

Deloitte Tohmatsu Tax Co.
India Practice
Hiroyuki Hayashi, Partner hiroyuki.hayashi@tohmatsu.co.jp
Pawankumar Kulkarni, Senior Manager pawankumar.kulkarni@tohmatsu.co.jp

Issued by

Deloitte Tohmatsu Tax Co.
Tokyo Office
Marunouchi Nijubashi Building, 3-2-3 Marunouchi, Chiyoda-ku, Tokyo 100-8362, Japan
Tel : +81 3 6213 3800
email : tax.cs@tohmatsu.co.jp
Corporate Info. : www.deloitte.com/jp/en/tax
Tax Services : www.deloitte.com/jp/tax/s/en