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News Letter

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Income Tax Act

Century Metal Recycling – Delhi Tribunal

Re: Levy of penalty u/s. 271(1)(c) only on furnishing of inaccurate particulars and concealment of income.

The Assessing Officer while passing order under section 143 denied the claim of the assessee to carry forward the losses since such losses according to Section 79 of The IT Act cannot be allowed to be carried forward since there was change in the majority shareholding in the Company during the year.

The CIT(A) confirmed the action of the AO and the assessee Company did not pursue the matter further. In the meanwhile the AO levied penalty u/s. 271(1)(c) of Rs. 805,000/- for concealment of income.

The Tribunal observed that the losses of the earlier years were duly accepted by the officer as per the returns filed by the assessee Company in those years. It was also not mentioned in the assessment order that the assessee had furnished any inaccurate particulars of income or had made any wrong claim of carry forward of loss. **The disallowance of loss was on account of technical ground and not on account of any concealment of any particulars of income.** The Section 271(1)(c) postulates imposition of penalty for furnishing inaccurate particulars and concealment of income. It was observed that the conduct of the assessee cannot be said to be contumacious so as to warrant penalty. The Tribunal held that the penalty was not justified and therefore set aside the orders of the AO and deleted the penalty.

Antrax Technologies – Bangalore Tribunal

Re: Import of Operations and Service Manuals relating to purchase of equipment – whether Royalty or FTS.

The assessee Company imported certain equipment. It also separately imported software containing operations and servicing instructions for use of the equipments. The AO, following the decisions of Karnataka High Court in the cases of Samsung Electronics and Sonata Software, concluded that the payments for purchase of software were to be treated as Royalty and were subject to withholding tax provisions u/s. 195 of The IT Ac. Since no tax was withhold, the AO disallowed the payment under section 40a(i) of The IT Act.

The Bangalore Tribunal observed that **service manuals were nothing but books containing guidance and instructions for operation**, use and after-sale service of equipment and therefore were very much integral part of the equipment imported by the tax payer.

In case of Samsung Electronics, the court dealt with import of software which required license to use the copyright and hence the court had held that the payment was in the nature of royalty. However, service manuals are not products by themselves. They merely provide guidance in using the product. Also, the equipment imported by the assessee is not protected by license or copyright and can be freely used by anyone who purchases them without any restriction on either its transfer or usage. Therefore the payment was not subject to taxation in India and out of the purview of withholding tax u/s. 195 of The IT Act.

Kothari Food and Fragrance:

The Company was exporter of certain products. During the year, the Company exported to the overseas buyer on credit. The Company offered certain discount to the overseas buyer for making payment before the due date of payment of the bill. The buyer was required to provide through its bank a guarantee or stand by letter of credit to the bank of the tax payer for an amount equal to the provisional price and interest. The contract was silent about pre-payment discount. However in the invoice, the tax payer allowed pre-payment discount and asked the buyer to pay the net amount after adjusting discount which the buyer paid so.

The question is whether pre-payment discount is “interest” and whether the tax should have been withheld u/s. 195 for such discount.

The Tribunal held that the pre-payment discount is different from quantity discount since the quantity discount is reduction in sale price. **Pre-payment discount is in consideration for the tax payer receiving money in advance and to compensate the buyer for making the payment in advance.** Mere nomenclature will not change its character. Such discount therefore takes the colour of interest and therefore taxable under the IT Act.

Section 195 required the tax payer to deduct tax at source from such sum of money (interest) paid to non-resident which was chargeable under the IT Act.

Foreign Exchange Management Act (FEMA):

Borrowing and Lending in Indian Rupees by NRIs:

Borrowing by Non Resident Indian (NRI):

Q 1: Can an NRI borrow money from an Indian bank?

A 1: An NRI is permitted to borrow money from an Indian bank against security of:

- Shares or other securities;
- Immovable property (other than agricultural or plantation property).

Q 2: What are the conditions for such borrowing?

A 2: Such borrowing is subject to the following conditions:

- The funds should not be utilised for “prohibitory sectors”;
- The funds should be utilised for NRI’s personal requirement or his own business purposes;
- The funds should get credited to his NRO account in India;
- The loan amount shall not be remitted outside India;

Q 3: How can repayment of this loan be made?

A 3: The repayment of this loan may be made by sale of shares or securities or immovable property against which the borrowing was made.

The repayment may be made from NRO or NRE or FCNR account in India or remittance from out of India through normal banking channel.

Q 4: Can an NRI borrow money for acquiring a house property in India?

A 4: Yes, an NRI can borrow money from any bank or housing financial institution in India for the purpose of acquiring or renovating a house property in India.

Q 5: Can NRI borrow money from his friends and relatives?

A 5: An NRI cannot borrow money from his friends.

However, an NRI can borrow money from his “close relatives”. (Close relative as defined under the Companies’ Act.) Such borrowing shall be subject to following conditions:

- The loan should be interest free;
- The maturity period of loan should be more than ONE year;
- The loan amount should be within overall limit under the Liberalised Remittance Scheme (LRS) of the resident lender;
- The loan should not be utilised for prohibitory sectors;

- The funds should get credited to his NRO account in India;
- The loan amount shall not be remitted outside India;
- The repayment may be made from NRO or NRE or FCNR account in India or remittance from out of India through normal banking channel.

Borrowing by Indian Resident from NRI:

Corporate Resident:

Q 1: Can an Indian Company borrow from a non resident?

A 1: RBI has prohibited borrowing by any corporate from a non resident. A corporate may however borrow from a NRI or a PIO subject to the following conditions:

- Investment through issue of Non - Convertible Debentures (NCD);
- Issue of NCD should be made by public offer;
- The period of redemption of NCD is more than 3 years;
- The borrowing Company is not carrying on activities which are covered under prohibitory sectors;
- Restriction on the rate of interest;
- The borrowing is on non repatriable basis.

Q 2: Can an Indian Company accept Deposit from a non resident?

A 2: Any Indian proprietorship concern, partnership firm or a Company can accept deposit from an NRI subject to the following conditions:

- The period of maturity of the deposit should be less than 3 years;
- The deposit should be received by way of debit to NRO account only. The amount of deposit should not represent inward remittance or transfer of funds from NRE or FCNR account into the NRO account; (This implies that it should be local funds)
- The deposit amount should not be utilised for undertaking activities covered under prohibitory sectors;
- The amount of deposit accepted should not be allowed to be repatriated outside India.

Resident Individual:

Q 3: Can a Resident Indian borrow money from any NRI?

A 3: A Resident Indian is allowed to borrow from an NRI subject to following conditions:

- The period of loan is less than 3 years;
- Restriction on rate of interest;
- Payment of interest and repayment of loan should be credited only to NRO account;
- The amount borrowed would not be allowed to be repatriated outside India.

In all the cases of borrowing by a Resident, the borrowed funds cannot be utilised for any of the following activities:

- Business of chit fund;
- As Nidhi Company;
- Agricultural or plantation activities;
- Real estate business;
- Trading in TDRs;
- Investments by way of Capital or otherwise, in any Company or Partnership firm or proprietorship concern or any entity;
- Re-lending.

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