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NEWSLETTER

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MVDCO ADVISORY SERVICES

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INCOME TAX & INTERNATIONAL TAX

Fino Fintech Foundation – Mumbai Tribunal

Re: TDS under Section 194J and Section 194C distinguished under Fees for Technical Services.

The assessee Company was engaged in providing banking services through its network of agents in extreme rural areas by use of a device called **"Point of Transaction" (POT).**

The Company was providing services for opening banking accounts to different banks in rural areas and it was taking help of outside service providers who would mobilize technical manpower for opening bank accounts. The services include **capturing photosandfingerprints by web camera** and scanner required highly technical skill and specialized software and that such process could not be performed by non-technical person. The Company deducted tax under "Payment to Contractors" under section 194C whereas the AO claimed that the payment ought to have been deducted under "Fees for Technical Services" under section 194J.

The Tribunal while dealing with the defined the word fees for technical services. Technical Services consists of services of technical nature when special skills or knowledge relating to technical field are required for their provision. Managerial services are rendered for performing management functions and consultancy services relate to provision of advice by someone having special qualification that allows him to do so. What constitutes technical services cannot be understood in a rigid formulative manner. It will vary from industry to industry. There will have to be a specific line of inquiry for determining what in a particular industry would constitute rendering of technical service.

The services provided by the assessee Company in question were manual in nature and no specific skills were required to provide such services. **Mere use of technology would not make it technical services.** It is necessary that there must either be acquisition or use of technical knowhow **which is provided by a human element**. There were no acquisition of technical expertise or knowhow by the assessee and the service providers were contractors merely executing contracts for the projects undertaken and hence provision of section 194C would apply.

Page Industries Ltd. - Bangalore Tribunal

Re: Applicability of Transfer Pricing Regulations

The Indian Company (ICO) was engaged in the business of manufacture and sale of ready-made garments. The ICO was a Licensee of the brand name owned by a USA Company – the Licensor.

The ICO used the brand name for manufacturing and marketing of the garments under the brand named licensed by the USA Company. The ICO was required to pay royalty @ 5% of its sale value to the USA Company for use of its brand name. The ICO owned the entire manufacturing facility, capital investments, employees and all other resources. There was no participation in capital and management of the ICO by the USA Company. The ICO argued that the Transfer Pricing Regulations were not applicable as there is no 'Associated Enterprise' (AE) relationship between the ICO and the USA Company

The Assessing Officer (AO) however referred the matter to the Transfer Pricing Officer (TPO) to determine the Arms' Length Price (ALP) of the transaction. The TPO concluded that the transaction was not at ALP and proposed an adjustment in the income of the ICO.

The Banglore Tribunal made following observations:

Section 92A(1) defines AE based on the parameters of management, control or capital. Section 92A(2) is a deeming provision and it enumerates circumstances in which the enterprise can be deemed to be an AE.

Thus the conditions of both the Sections 92A(1) and 92A(2) are to be satisfied in order to constitute an AE relationship.

The contra view that, satisfaction of only Section 92A(2) is sufficient to create an AE relationship would render Section 92A(1) redundant. While interpreting a statute, the construction should preserve the purpose of the provision. If more than one interpretation is possible, that which preserves the workability and efficacy is to be preferred to the one which renders a part of it redundant.

Thus even though the conditions of section 92A(2)(g) are satisfied, in absence of any right of the USA Company to control and manage ICO, the ICO and USA Company cannot be considered as AEs, and consequently TP regulations wil not apply to transactions undertaken between them.

GOODS & SERVICE TAX (GST)

GST Information Series : No. 1

One of the most innovative reforms of Government of India (GOI), namely “Goods and Service Tax” (GST), is on fast track mode. GST is essentially indirect tax reform. GST is going to radically change the cost & pricing structure of every industry, trade and service industry.

Therefore, we propose to provide information about various aspects of GST at regular interval.

As mentioned earlier, GST will impact every industry, trade & service renderer and hence GST will impact cost and pricing, value chain and distribution chain, mode and manner of doing business, tax cost and compliance procedure, entire IT infrastructure, accounting software i.e. all aspects of business.

Please note that our info on GST will be brief and in general and business specific issues will have to be dealt with separately.

GOODS & SERVICE TAX (GST)*(cont.)*

Journey of Legal Frame work:

1. Constitutional amendment bill (passed)
2. President's assent (received)
3. Constitution of Goods and Service Tax Council (GST Council) (constituted)
4. GST Council to recommend various aspects of GST law (going on)
5. Enactment of laws in Parliament and each state assembly(to be in winter session)
6. Notification of various rules
7. Implementation of GST network (Unified nation based IT platform)
8. Notification of Appointed day for implementing GST law

(Steps 4 to 8 expected to be completed phase wise by 31st March, 2017)

We will endeavour to impart information as regards effect and impacts of GST on business, cost processes, procedures and so on, based on which you can restructure wherever required.

CORPORATE LAW, ACCOUNTING STANDARD & Ind AS

Permanent Residency Status to Foreign Investor:

With a view to promote 'Make in India' programme, The Union Cabinet has approved the scheme for grant of Permanent Residency Status (PRS) to foreign investors with the objective of encouraging foreign investment in India. This scheme will be subject to fulfilment of specified conditions in the Foreign Direct Investment (FDI) Policy, as notified by the Government of India from time to time.

The important highlights of this scheme is as follows:

Eligibility:

- ✓ The foreign investor will have to invest in India a minimum of **INR 100 Million within 18 months**, or minimum of **INR 250 million within 36 months;**
- ✓ Foreign investment should result in generating **employment to at least 20 resident Indians** every financial year

Validity:

- ✓ PRS will be granted to foreign investors for a period of **10 years with multiple entry facility;**
- ✓ PRS **can be further renewed for 10 years**, if nothing adverse has come to notice of the relevant authorities
- ✓ Procedure to apply for PRS Provisions to obtain PRS will be notified in the Visa Manual

Benefits of PRS:

- ✓ Long term validity of 10 years with renewal facility for another 10 years. Currently, the investors (other than specified nationals) are generally granted business visa up to a maximum period of 5 years;
- ✓ PRS will serve as a multiple entry visa **without any stipulation with respect to maximum continuous stay in India**
- ✓ PRS holders will be **exempted from the requirements to register with the Foreigners Regional Registration Office(FRRO);**
- ✓ PRS holders will be **allowed to purchase one residential property** for dwelling purpose;
- ✓ **Spouse/dependents** of the PRS holder will be allowed to take up employment in private sector (in relaxation to minimum salary stipulations for Employment Visa) and undertake studies in India.

Disclosure of Income from Operation: (Ref: NSE/BSE Circular dated 20.09.2016)

Listed Entities:

SEBI had issued a circular dated November 30, 2015, wherein, it was prescribed that 'revenue from operations' may be disclosed net of excise duty.

As per Schedule III of the Companies Act, 2013, which was notified on April 6, 2016, revenue from sale of products should be disclosed inclusive of excise duty.

SEBI issued a circular dated July 5, 2016, wherein as per clause 2.9 it was clarified that in case of any technical difficulty in the interpretation of any specific item in the formats or implementation of this circular while publishing the financial results, the listed entities shall be guided by the relevant provisions of the Ind-AS Rules / AS Rules and Schedule III to the Companies Act, 2013 and may make suitable modifications, as applicable.

However, it has been observed that some companies have been disclosing 'revenue from operations' including excise duty and some companies have been disclosing 'revenue from operations' excluding excise duty in their financial results for the quarter ended June 30, 2016.

It is desirable that companies follow a uniform approach with regard to disclosure of 'revenue from operations'. In the view of the same, the following clarification has been issued by SEBI dated 20th September 2016:

'Income from Operations', as mentioned in the formats for publishing financial results prescribed in the circular dated November 30, 2015, may be disclosed inclusive of excise duty, instead of net of excise duty, as specified in the Companies Act, 2013.

Listed Companies are required to take note of the said clarification and comply accordingly.

Remuneration Payable in case of inadequate profit (Notification dated 12th September 2016)

Section II of Part II of Schedule V of the Companies Act, 2013 has been substituted by this amendment. This section relates to remuneration payable by companies having no profit or inadequate profit without Central Government approval.

A. Remuneration in case of any managerial personnel (Clause A):

Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may, without Central Government approval, pay remuneration to the managerial person not exceeding the limits given in clause (A) –

Where the effective capital is	***Limit of yearly remuneration payable shall not exceed (Rs.)***
Negative or less than Rs. 5 crore	60 lakhs
5 crore and above but less than Rs. 100 crore	84 lakhs
100 crore and above but less than Rs. 250 crore	120 lakhs
Rs. 250 crore and above	120 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores.

Above limits shall be doubled if the resolution passed by the shareholders is a special resolution. [Proviso to clause (A)]

B. Managerial Person in professional capacity (Clause B):

A managerial person functioning in a professional capacity may get any amount of remuneration without Central Government approval on satisfaction of following conditions that such managerial person –

- is not having any interest in the capital of the company or its holding company or any of its subsidiaries directly or indirectly or through any other statutory structures [**Independent from company**]and;
- not having any direct or indirect interest or related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during the last two years before or on or after the date of appointment [**Independent from promoters and directors**] and;
- possesses graduate level qualification with expertise and specialized knowledge in the field in which the company operates [**Professional expertise and knowledge**].

Interest in the company defined as follows:

Any employee of a company holding shares of the company not exceeding 0.5% of its paid up share capital under any scheme formulated for allotment of shares to such employees including Employees Stock Option Plan or by way of qualification shall be deemed to be a person not having any interest in the capital of the company. [Proviso to section (b) of section II of part II of Schedule V]

As discussed earlier here, according to sub–section (4) of section 197 of the Companies Act, 2013 read with its proviso, the remuneration payable to directors shall be inclusive of all remuneration payable to him for services rendered by him in any other capacity except services rendered are of professional in nature and in opinion of Nomination and Remuneration Committee or of Board of Directors as the case may be, director has requisite qualification for practice of profession.

However, Clause (B) does not talk about professional income of any director of the company but income of a professional director of the company.

General conditions for managerial remuneration

In relation to both clauses (A) and (B), following conditions shall apply –

- payment of remuneration is **approved by a resolution passed by the Board** and, in the case of a **company covered under sub-section (1) of section 178 also by the Nomination and Remuneration Committee** [approval by Board and NRC, if required];
- the company has **not committed any default in repayment of any of its debts** (including public depositscontinuous period of thirty days in the preceding financial year before the date of appointment of such managerial person and in) or debentures or interest payable thereon for a case of a default, the company obtains prior approval from secured creditors for the proposed remuneration and the fact of such prior approval having been obtained is mentioned in the explanatory statement to the notice convening the general meeting [in case of default, prior approval by secured creditor];
- an ordinary resolution or a special resolution, as the case may be, has been passed for payment of remuneration as per the limits laid down in item (A) or a special resolution has been passed for payment of remuneration as per item (B), at the general meeting of the company for a period not exceeding three years [Approval in GM]
- **a statement along with a notice calling the general meeting** referred to in clause (iii) is given to the shareholders containing the information mentioned in the Schedule V.

Implementation guide on Auditor's Reports under Indian Accounting Standards for Transition Phase

The ICAI has issued 'Implementation guide on Auditor's Reports under Indian Accounting Standards for Transition Phase' (Implementation guide). This implementation guide provides guidance on reporting responsibilities of the auditors for the audit of:

- Ind AS financial statements prepared for the first year in which Ind AS are applicable to the company;
- Ind AS financial results prepared by a listed entity under SEBI Listing Regulations during the first year of adoption of Ind AS;
- Special purpose financial statements for the corresponding period and opening balance sheet as per Ind AS which will be presented by the company as part of its first Ind AS financial statements.

Further, this implementation guide also provides illustrative formats of Independent Auditor's Report on the following:

- Audit Report on the First Standalone Ind AS Financial Statements of a Company under the Companies Act, 2013 and the Rules thereunder;
- Audit Report on the Comparative Ind AS Financial Information which will be presented by a Company as Part of its First Ind AS Standalone Financial Statements;
- Audit Report on Quarterly Financial Results (Companies other than Banks and Insurance Companies) (Phase 1) – Unmodified Opinion (only for quarterly results in the first year of Ind AS implementation);
- Limited Review Report on Quarterly Financial Results for Companies (other than banks and insurance companies) (Phase 1) - Unmodified Opinion (only for quarterly results in the first year of Ind AS implementation).

For details, please refer implementation Guideline with the link as referred below:

http://resource.cdn.icai.org/43184aasb32904.pdf

ALLIED LAWS

Amendment in Payment of Bonus Act

On 31 December 2015 the President gave his assent to certain amendments to the Payment of Bonus Act, 1965. The amendments have increased the wage threshold for determining applicability of the Act from INR 10,000 to INR 21,000 per month. Additionally, the wage ceiling for calculation of bonus has been increased from INR 3500 to INR 7000 per month.

Certain key **Amendments** are as follows:

a) **Revision of wage threshold for eligibility**: The wage threshold for determining eligibility of employees has been revised from INR 10,000 to INR 21,000 per month, covering a larger pool of employees.

b) **Change in the wage ceiling used for calculation of bonus**: Previously the maximum bonus payable was 20% of INR 3500 per month. The minimum bonus payment was also capped at 8.33% of INR 3500 per month or INR 100, whichever is higher. The calculation ceiling of INR 3500 has now been doubled to INR 7000 per month "*or the minimum wage for the scheduled employment, as fixed by the appropriate Government*" (whichever is higher). Therefore, the cost associated with bonus payments could double (or be greater still, depending on applicable minimum wages), based on the organization's performance.

c) **Retrospective Effect**: The amendment has been brought into effect from 1 April 2014.

The Bonus Act applies to **every factory and every establishment that employs 20 or more persons**, and unlike other performance linked incentives offered by companies, the bonus payable under this law is not linked to the performance of the employee. All employees earning up to the wage threshold (increased to INR 21,000 by the Amendments), and who have worked in the establishment for not less than 30 working days in the year are eligible to receive this statutory bonus. Therefore, the Amendments could have a significant financial bearing for establishments, especially those in the medium and small scale sectors. We have analyzed the Amendments in some more detail below.

Impact of the Amendments and potential challenges:

Reference to minimum wages under the Minimum Wages Act (MW Act):

The insertion of a reference to the minimum wage under the MW Act to calculate bonus payments has created an additional challenge for companies. The appropriate Governments (i.e. State Governments) fix different minimum wages for various scheduled employments. Further, even within a particular scheduled employment, different minimum wages are notified for different categories of employees. Thus, employers would have to carry out an assessment of the applicable wage rates for different categories of employees in order to calculate the statutory bonus payable.

This issue would be even more significant for employers having offices in multiple States since the minimum wages for the same scheduled employment also vary from one State to another, and the variation can sometimes be quite significant.

Complexities in paying the bonus retrospectively:

Under the Bonus Act, an employer is required to pay bonus within 8 months from the close of the accounting year. Employers in India usually follow a financial year from 1 April to 31 March and close their books of accounts accordingly. Therefore, most companies would have already determined the allocable surplus for the financial year 2014 - 15 (i.e. 1 April 2014 to 31 March 2015) and distributed bonus to eligible employees. Since the Amendments are retrospective, it would impact the distribution of bonus in relation to the financial year 2014 - 15 as well. The allocable surplus would need to be re-assessed to account for the increased pool of covered employees and the bonus eligibility re-determined based on the revised calculation ceilings and available surplus.

Therefore, there would be an increase in the financial burden and greater accounting complexities for employers, and in some cases, there may also be issues around recovery of amounts from employees.

It is therefore critical that the government issues clarifications, further amendments or exemptions to ease the operational complexities with the retrospective amendments. The requirement to consider the minimum wages under the MW Act while calculating bonus will create uncertainty and disparity around bonus payments, which was best avoided at this stage. However, at present, the obligation to pay statutory bonus in accordance with the amended eligibility threshold and wage ceiling in relation to financial year 2014 - 15 continues to exist.