FOR MEMBERS / SUBSCRIBERS / VOL. 27 - NO. 8 FEBRUARY 2024

C.V.O.CA'S NEWS & VIEWS

From President's Desk...

Dear Professional Colleagues and Readers,

The first month of 2024 was full of energy and enthusiasm as the two mega events gave the aspirations in India shining and self reliant (Atmanirbhar) vision such as 10th vibrant Gujrat Summit in which our Honourable Prime Minister stated that thinking big is the first step of making a big impact and Ram Mandir in Ayodhya was consecrated by our Honourable Prime Minister Shri Narendra Modi in presence of all several signatories including athletes, movie stars, spiritual leaders and business persons.

As rightly published in one article of global research firm, India has moved from fragile five to first five. The country has come a long way in these 10 years to become a global economic powerhouse. Despite uncertainties caused due to populism break through in the West in 2016, demonetization in 2017, the shadow banking crisis of 2018, a once-in-a-lifetime pandemic in 2020, the highest inflation in 40 years in the West (which still continues), and two wars since early 2022, India managed to sail ahead while building its ship.

CVOCA has launched for the first time ever CVOCA Entrepreneurship and Leadership Awards to celebrate the success of unsung heroes who are our Entrepreneurs, leaders and CVOCA members. The details are available on our website for which I appeal to all our members to motivate everyone to participate in awards with the vision of encouraging to excel in one's entrepreneurial and leadership journey.

Capital Market Committee has also for the first time ever announced INVESTOCRAFT 20-20, an unique capital market conclave held on March 2, 2024 at Taj, Santacruz in which finest of the Equity Market Experts have agreed to grace the event as a speaker. At the same time in January, Value Investing Club had a session on Banking and lending sector by our very own club member CA. Pratik Chheda.

Student Committee has planned a Residential Refresher Course on February 21-22, 2024 at Keshav Shrusti Uttan in which all knowledge filled sessions have been planned. I appeal all our members to encourage student members to take part in RRC specially structured for students to enable them to up skill themselves.

50 Years committee has also planned a financial literacy program jointly with Pune KVO on February 24, 2024.

Also a grand members get together as a part of closure of Golden Jubliee Celebrations has been announced by launch of Dholida- a spectacular Raas Garba evening preceded by Annual General Meeting on June 8, 2024. I Request everyone to block your date and be present to make this Golden Jubliee year a memorable one.

We are also encouraging our members to participate in Residential Refresher Course organised by Vapi Branch of ICAI and hosted by Dadar East CPE Study Circle on February 8-9-10 at Avadh-Utopia, Vapi.

I am also looking forward to Budget to be presented by our Honourable Finance Minister Ms. Nirmala Sitharaman on 1st February 2024. I hope that the Budget would continue to provide impetus to women empowerment, youth and infrastructure.

There are lot many upcoming events so we at CVOCA are looking forward for everyone's active participation so stay connected and stay tuned. Wishing everyone a very happy learning, upskilling and networking.

Thank you all..... Always in Gratitude

Jeenal

CA Jeenal Savla

February 1, 2024

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CROSS - BORDER TRANSACTIONS

MINERAL WATER : PURE OR UNSAFE

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FROM THE DESK OF CHAIRMAN

Over the years, we have been made to believe that a bottled water (popularly known as mineral water) is a safer alternative to the tap water. Infact some of the brand has become synonymous to pure and safe drinking water. When we are on the go, when we are in some social function, or many time at corporate meetings, we grab mineral water and take sip out of it.

However, the latest study reveals it is the other way we think. It may not be as safe and pure as it is considered. Water in plastic bottle, contains nearly a quarter million invisible pieces of ever-so-tiny nano-plastics that were detected and categorised for the first time by a microscope using dual lasers.

Nanoplastics are particles that are less than a micron in size. There are 25,400 microns — also called micrometres because it is a millionth of a metre — in an inch. A human hair is about 83 microns wide.

When a plastic water bottle comes in contact with heat, it releases micro plastics in the water, which further make their way into our body once we drink that water. In hot country like India, the bottles are very often exposed directly in sun especially during transportation in open carriers, storage facilities at local vendors etc.

According to a study by a Columbia physical chemist, much of the plastic seems, come from the bottle itself.

The dangers of nanoplastics to health

Drinking water from plastic bottles can have many detrimental impacts on your health and the environment

From the polar ice caps to mountain peaks, microplastics has rippled through the ecosystems and have found their way into drinking water and food. They are so tiny that they can easily pass through the digestive system and lungs, entering the bloodstream directly, and from there to organs, including the brain and heart.

The world is drowning under the weight of plastic pollution, with more than 430 million tonnes of plastic produced annually. Microplastics are found in the world's oceans, food, and drinking water, with some of them coming from clothing and cigarette filter.

Some early lab studies have linked nano-plastics to toxic effects, including reproductive abnormalities and gastric issues. These nanoplastics with all kinds of chemical additives, can be internalised into cells, and can cause cell stress, DNA damage, and change metabolism or cell function.

A un-published work has found more than 100 "known cancer-causing chemicals in these plastics."

According to a study "in participants who consume water from polycarbonate bottles, the urinary concentrations of the chemical bisphenol A (BPA) (used to produce polycarbonate plastics)are significantly higher. The study further noted that hot liquids would cause this effect to be even bigger

And everyone knows the impact of plastic bottles on the environment.

Wayforward:

To minimize potential risks, consider the following:

- Choose bottles labeled as BPA-free.
- As much as possible, store bottles away from the heat and direct sunlight.
- Avoid reusing single-use bottles, as repeated use can increase the risk of chemical leaching.
- Consider using reusable water bottles made from materials like stainless steel or glass.
- If possible, drink water from a safe and reliable source, such as filtered tap water.

Thank you all..... Always in Gratitude

CA Ameet Chheda

CROSS BORDER TRANSACTIONS – DECODING PRACTICAL ISSUES IN OVERSEAS DIRECT INVESTMENTS UNDER FEMA

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Introduction:

A cross border transaction is basically any transfer of property, goods or services between individuals or business entities who reside in various jurisdictions. The transaction may be either of buying or selling or goods or receipt of provision of services or even making investments or entering into joint ventures. Under FEMA transactions are classified under two categories i.e. Capital Account Transactions and Current Account Transactions. In both cases the transactions happen between persons resident of India and persons resident of other countries.

In this article we will deal with practical issues involved in transaction of Overseas Direct Investment (ODI). ODI is a capital account transaction. Let's understand briefly what a Capital Account Transaction means? As per Section 2(e) of FEMA 1999, Capital Account transaction *means a transaction which alters assets or liabilities including contingent liabilities, outside India of person resident in India or assets and liabilities in India of persons resident outside India and includes transactions referred to in sub-section (3) of Section 6.*

Thus, when assets or liabilities outside India for a person resident in India get altered then the transaction is a capital account transaction. Say for example when a resident person acquires equity shares of a foreign entity in that case his assets outside India get altered and hence the same is considered to be a capital account transaction. Therefore, in case of ODI either a resident person incorporates an entity outside India or acquires stake in entity outside India. Since ODI happens between persons of two jurisdictions i.e. India and countries outside India it is a type of cross border transaction.

Practical Issues in ODI

Central Government vide notification dated 22nd August 2022 notified new Foreign Exchange Management (Overseas Investment) Rules 2022 ("OI Rules") which superseded the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004. Any ODI made by a person resident in India is guided by provisions of OI Rules 2022.

ODI in terms of Rule 2(q) of OI Rules means –

With the new provisions in place let us understand few practical issues being faced in ODI:

A. Whether ODI can be made in LLC or LLP outside India?

Under erstwhile provisions direct investment outside India could be made by way of contribution to capital or subscription to MOA of foreign entity or by way of purchase of existing shares of foreign entity. Foreign entity was however not defined anywhere in erstwhile provisions. Therefore, there was no clarity whether ODI could be made in foreign entity having unlimited liability like partnerships or LLCs which is nothing but a hybrid unincorporated business structure that combines characteristics of corporation with those of partnerships and sole proprietorships.

In new provisions of OI Rules, Rule 2(f) defines foreign entity as *entity formed or registered or incorporated outside India including International Financial Service Centres that has Limited Liability*.

This is further explained in Para 1 of Part I of Overseas Investment Directions. As per Para 1 of OI Directions, Limited Liability means a structure such as a limited liability company, limited liability partnerships etc. where liability of the person resident in India is clear and limited. Thus, LLCs or LLPs formed or registered or incorporated outside India are considered to be foreign entities and ODI can be made in such foreign entities. The ambiguity which was prevalent in erstwhile provisions has been clarified in the new provisions.

B. Whether Deferred Consideration and ODI in company having shares with NIL PAR value allowed?

Deferred Consideration:

Deferred Consideration is a term used to refer to the consideration that will or may be payable sometime in the future rather than at time of completion of transaction. Deferred consideration is usually encountered in connection with asset and share sales.

In erstwhile provisions of ODI, deferred consideration was not allowed under automatic route. Further the same was not allowed even after obtaining prior RBI approval. In many countries specially UAE they issue Share Certificates immediately upon incorporation of company whereas the actual remittance for subscription usually goes only after bank account is opened. This resulted in consideration getting deferred resulting in contravention as per erstwhile provisions. RBI considered the same as contraventions and matters were required to be compounded. In genuine scenarios the investor did not have any intention to receive share certificates without sending remittances. But host countries regulations were such that they were left with no choice but to receive the share certificates even if the shares were not subscribed.

Therefore, with intention to provide relief to investors and government decided to relax the provisions and thereby allowed deferred consideration by dispensing away the requirement of prior approval for same. Now as per Regulation 7 of Overseas Investment Regulations 2022 ("OI Regulations") payment for subscribing to equity shares of overseas entity can be deferred for such definite period as agreed from the date of agreement. The person making investment has to enter into agreement at the time of transfer of foreign securities and agree upon a period upto which the consideration will be deferred. Further the consideration has to be determined up front and has to be in compliance with pricing guidelines.

Despite relaxing the provisions, the contravention of deferred consideration are still taking place. This is because as per the new provisions if a person resident of India agrees to make Financial Commitment in an overseas entity then such person has to file Form ODI for such financial commitment immediately irrespective of whether or not remittance is being made. In such cases since remittance is not taking place immediately the same results in deferment of consideration. Regulation 10(2)(a) of OI Regulations clearly specifies that a person who has made ODI or financial commitment shall report the same either at time of financial commitment or at time of making remittance whichever is earlier. In case where remittance is to be sent at later stage then if Form FC is not filed the same is then considered as delay in filing of Form FC resulting in levy of Late Submission Fees ("LSF").

Further, in such cases if share certificates are also received then one more additional contravention of deferment of consideration takes place. AD Banks are suggesting for making necessary compliances for deferred consideration and getting Form FC filed twice, one for financial commitment and one for actual remittance. Therefore, one has to be very careful and ensure that moment they agree for any financial commitment in overseas entity whether or not remittance is being made, Form FC needs to be filed immediately and necessary documents for deferred consideration also need to be submitted in compliance of regulation 7 of OI Regulations.

NIL PAR Value Shares:

In USA it is seen that companies do not have any face value to equity shares. The companies there can have equity shares with NIL Par Value. Now in such cases if a person resident in India subscribes to such equity shares having NIL Par value then at the time of receipt of shares no remittance will be made because the shares do not have any face value resulting in NIL consideration.

Again, in erstwhile provisions this transaction of subscription to shares having NIL Par Value was not allowed under automatic route and even the provisions had no reference for the same. Hence such transactions required prior RBI approval. Now with concept of deferred consideration being allowed in new provisions, once can say that as and when the person agrees to subscribe or purchase the shares having NIL Par Value then one must ensure that he or she complies with provisions of Regulation 7 of OI Regulations. As and when the shares are acquired Form FC can be filed and at that time only the period after which the consideration will be paid for such NIL par value shares will be required to be decided along with pricing which also being determined upfront.

C. Valuation of shares for secondary transfer or fresh allotment by company

As per Rule 16 of OI Rules, issue of transfer of equity capital shall be subject to a price arrived on an arm's length basis as pert valuation obtained as per any internationally accepted pricing methodology. Thus, whether it is issue of equity shares or transfer of equity shares, in either of cases obtaining of valuation certificate is mandatory. However, the provisions do not specify or mention the period of validity of the valuation report so obtained.

AD Banks are taking a view that in case of ODI, valuation report is valid for 6 months. Again, there is ambiguity as to the period of 6 months has to be calculated whether from date of valuation or whether from date of signing of report. Say for e.g. if fair valuation is arrived as on 31st March 2023 and say report is signed on 31stJuly 2023. Now the actual transaction takes place on 31st October 2023. Now the question arises as to from which date 6 months needs to be calculated. If 6 months are calculated from date of valuation which is 31st March 2023 then the report should be valid on till 30th September 2023. In this case transaction being done after 6 months the report would be considered as invalid. However, if the 6 months are calculated from date of signing of report which is 31st July 2023, then still 6 months are time is not over and hence report should be considered as valid.

Different are being taken by different AD Banks. Some consider date of valuation and some consider date of signing as base date for calculation of 6 months period. RBI however needs to provide clarity on the same.

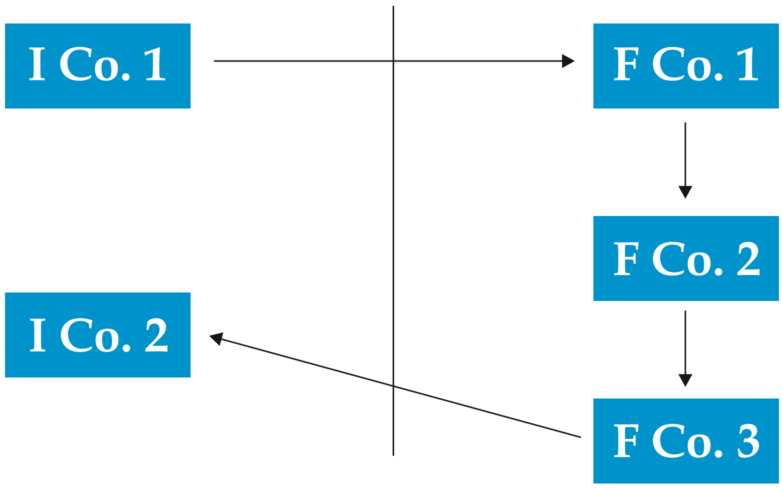
D. Round Tripping

Another important issue on which government has tried to give some clarity. Round Tripping is nothing for bringing Indian funds back to India via investments outside India. FD-ODI structures are nothing but round tripping of funds. In erstwhile provisions round tripping was not allowed. all such type of structures required prior approval.

However, the provisions relating to round tripping are relaxed and now allowed upto two layers of investment in India. As per Rule 19(3) of OI Rules, *no person resident in India shall make financial commitment in a foreign entity that has invested or invests into India, at the time of making such financial commitment or at any time thereafter, either directly or indirectly, resulting in a structure with more than two layers of subsidiaries.*

Now the question arises as to from where the counting of two layers should start. Whether it should start from India or whether it should start from first foreign entity which in turn has step down investment or whether it should start from first step down subsidiary and so on.

Now subsidiary as per 2(y) of OI Rules is defined as subsidiary or step down of a foreign entity means an entity in which the foreign entity has control. So if foreign entity does not have control in any of its step down company it will not be treated as subsidiary. Going by the provisions of Rule 19(3) the counting of number of layers of subsidiaries will start from below the foreign entity.



Now in above example, I Co. 1 has made ODI in F Co. 1 which is main foreign entity. F Co. 1 has two step down subsidiaries viz. F Co. 2 and F Co. 3 and it has control in both. And F Co. 3 in turn has made investment back into India. So, the calculation of two layers of subsidiaries will start from subsidiaries below F Co. 1 because F Co. 1 is main foreign entity in which I Co. 1 has made ODI. First layer subsidiary is F Co. 2 and second layer is F Co. 3. After F Co. 3 there is no other layer of subsidiary outside India. F Co. 3 has made investment in I Co. 2. Thus, the above structure is a permissible one as per Rule 19 of OI Rules where F Co. 1 does not have more than two layers of subsidiaries for making of investment back into India.

E. Requirement of Audited Accounts for filing of Annual Performance Report("APR")

This is another important issue which is faced at the time of filing of APR. As per Regulation 10(4) of OI Regulations, APR is required to be filed every year before 31st December based on audited financial statement of overseas entity if person resident in India has control in foreign entity. Thus, if a person has control in foreign entity then even if host country laws do not mandate for audit of overseas entity still for purpose of filing of APR one will require to get the accounts audited.

This mandatory requirement of audit for entities in jurisdictions where audit is not mandatory is posing lot of challenges to investors because they are not getting audited financials for doing APR compliance. In erstwhile provisions it was mentioned that if laws of host country did not mandate for audit then APR can be submitted basis certification from statutory auditor of Indian entity. However, in new provisions this can be done in case when person resident in India does have control in foreign entity and if laws of host country do not provide for mandatory auditing of books only then APR may be submitted basis unaudited financial statements certified as such by statutory auditor of Indian entity or by a chartered accountant.

Now in case where audit is to be done only for purpose of APR, the question arises whether it needs to be compulsorily done by CPA from host country or whether it can be done by an Indian Chartered Accountant. AD Banks in many cases are allowing the companies to get the audit done from Indian Chartered Accountants based on request of customer. There is no specific format of audit report prescribed by ICAI for specific purpose audits. Since the audit of foreign entity will be done specifically for limited purpose of submission of APR once can refer to Illustration 5 for format of audit report on financial statements prepared in accordance with general purpose compliance Framework in SA 700 (Revised) – Forming an opinion and reporting on Financial Statements.

F. Issue of Employee Stock Option Plans (ESOP)

As per para 3 of Schedule III of OI Rules, a resident individual who is an employee or a director of an office in India or branch of an overseas entity or a subsidiary in India of any overseas entity or of an Indian entity in which the overseas entity has direct or indirect holding, is allowed to acquire shares under ESOP scheme offered by such entity globally on an uniform basis. Acquisition of shares under ESOP scheme of less than 10 percent of foreign entity shall be treated as Overseas Portfolio Investment ("OPI") for resident individual.

AD Banks allow remittances to be made towards acquisition of shares acquired under in overseas entity under the scheme. There is no limit on the amount of remittance made towards acquisition of shares / interest under ESOP scheme, such remittances shall be reckoned towards LRS limit of individual. In case investment is of less than 10% it will be OPI and necessary reporting in Form OPI shall be done by the employer concerned in accordance with Regulation 10(3) of OI Regulations. Form OPI is to be filed within 60 days from end of half year. If such investment qualifies as ODI then Form FC is to be filed by concerned resident individual.

When remittance for acquisition of shares under ESOP is made by resident individual himself the same will be done under LRS Limit of USD 2,50,000 and Tax Collected at Source ("TCS") @ 20% will be collected by bank making the remittance. If however, Indian company makes payment for acquisition of shares under ESOP on behalf of employee to foreign entity then same will be considered as reimbursement of expenses for Indian company and there will be no TCS at time of remittance. Further the amount paid by Indian company will be considered to be as perquisite for employee and TDS will be deducted by Indian company on such perquisite.

ESOP will be taxed in two stages. Firstly when an employee exercises his option at the exercise price and thereafter, when shares are sold. In first stage, difference between the exercise price and the fair value of shares will be taxable as perquisite in the hands of employee and employer deducts TDS on such perquisite. When shares are disposed off they will attract capital gains tax which can be either short term or long term depending upon period of holding.

Conclusion

Even though Central Government has provided many relaxations under new provisions, some of practical issues pose challenges before the investors thereby resulting in unnecessary delays in compliances. Sometimes AD Banks take so much of time for processing of transactions that the transaction becomes commercially unviable for investors. May be with passage of time these practical issues will also get settled resulting in ease of doing transactions and quick disposal of applications at AD Bankers end.

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CROSS-BORDER M&A – OVERVIEW OF INCOME-TAX PROVISIONS (PART-1)

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1. Background:

In this era of globalization and revolutionary business ideas, it is not uncommon for established businesses as well as budding startups, to expand their presence overseas from India or vice versa. The spread of business operations over multiple jurisdictions may create the need for cross border structuring and arrangements.

Cross border mergers and acquisitions are a means of achieving commercial and/or geographical consolidation or segregation, winding up of presence in a particular jurisdiction and inward or outward fund remittance in a tax efficient and regulatory compliant manner. Cross-border mergers are complex than domestic mergers as they involve compliance of legal and regulatory rules of multiple jurisdictions.

The past decade has witnessed an exceptionally large volume of cross border transactions, some of them were incredible examples, such as:

- Walmart acquired second biggest ecommerce retailer in India i.e., Flipkart. Walmart is registered in the US and Flipkart has operations in India and registered in Singapore, (2018);
- Reliance Retail (an Indian company), as part of its global expansion strategy acquired Hamleys (a UK-based company) to enter the toy retail market, (2019);
- The merger of Vodafone (British Company) and Idea (Indian Company) in order to survive the competitive markets together, (2020);
- Adani Green Energy acquired 100% interest in SB Energy India from Soft Bank Group Corp (80%) and Bharti Group (20%), (2021), etc.

With and intent of enabling the ease of doing business and maneuvering operations from one jurisdiction to another, India has over a period of time eased the procedural and legal barriers with regard to cross border structuring, over a period of time.

The Indian tax and regulatory framework allows for carrying out of cross border M&A transactions within the scope of the **following regulations**:

- Companies Act, 2013 and Companies Rules;
- FEMA Cross Border Regulations, 2018;
- Income-tax Act, 1961 ("IT Act")

The current articles seeks to focus on the Indian income-tax aspects[2], added up by the key nuances/issues, structuring options and income-tax implications surrounding the same.

2. Key income-tax provisions[3] applicable to cross border M&A transactions:

2.1 Merger:

As per section 2(IB) of the IT Act, merger qualifies as an 'amalgamation' based on satisfaction of the following conditions:

- All properties and liabilities of the transferor company[4] / amalgamating company to become all the properties and liabilities of the transferee[5] company / amalgamated company; and
- Shareholders holding **75% or more (in value)** of the shares in the transferor company **become shareholders** of the transferee company by virtue of the amalgamation*(Shares in the transferor company* ***already held by the transferee company or its nominee or subsidiary*** *are* ***not*** *considered in calculating the aforesaid limit of 75% in value).*

Subject to fulfillment of certain additional conditions, such an amalgamation may be regarded as **'tax-neutral' and exempt from capital gains tax** as discussed in the ensuing paragraph below.

A. In the context of an amalgamation, Section 47 of the ITAct specifically **exempts** the following transfers from capital gains tax:

[2]The structuring scenarios, and issues provided herewith are strictly from an income-tax perspective, and do not cover any implications with respect to other Indian legal and regulatory aspects (such as Corporate laws or FEMA, etc.) or with respect to overseas laws

[3]In this article, wherever implications in the hands of Foreign Company are mentioned, we have not commented on the implications as per the IT Act and not as per the DTAA/treaty*. One can evaluate the treaty implications or the treaty benefits available to foreign company, on a case to case basis.*

[4]the terms 'transferor company' and 'amalgamating company' have been used interchangeably

[5]the terms 'transferee company' and 'amalgamated company' have been used interchangeably

	Tax neutrality (Pursuant to a scheme of amalgamation)		Key conditions/ aspects for availing such capital gains exemption
	In the hands of:	**For:**	
(i)	Transferor Company [section 47(vi)]	Transfer of capital assets to the transferee company	Such transferee company is an '***Indian Company***'
(ii)	Shareholders of the transferor company [section 47(vii)]	Transfer of shares held in transferor company	• Such transfer is made against the consideration of transferee company's shares i.e., shares have been allotted by the transferee company **(except where the shareholder itself is the amalgamated company)**; and • transferee company is an '***Indian Company***'
(iii)	Amalgamating ***foreign company*** [section 47(via)]	Transfer of '**shares held in an Indian company**', to the amalgamated foreign company	• **At least 25% of the shareholders** of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company. • Such transfer does **not** attract capital gains tax in the amalgamating company's country of incorporation.
(iv)	Amalgamating ***foreign company*** [section 47(viab)]	Transfer of '**shares held in a foreign company deriving substantial value from India**', to the	[same conditions as per point (iii) above]

B. Additional considerations for the shareholders:

(i) The Honorable Supreme Court of India has held[6] that a transfer of shares of the amalgamating company constitutes an "extinguishment of rights" in capital asset and hence falls within the definition of 'transfer' under Section 2(47) of the IT Act; but has been **specifically exempted** from capital gains tax in the hands of the shareholders by virtue of section 47(vii).Consequently, if conditions w.r.t. tax neutrality provided under Section 47(vii) [as per point (ii) in paragraph A above] are not met, one would have to evaluate based on first principles.

(ii) Pursuant to the exemption for the shareholders u/s 47(vii) of the IT Act:

- The **cost of acquisition**[7] and the **period of holding**[8] of the shares of the transferor company– travels to the shareholders with respect to the new shares received from the transferee company;

- Receipt of the shares of the transferee company - **exempt** from section 56(2)(x)[9]

(iii) Unlike a case of an amalgamation where the transferee company is an Indian Company and exemption to the shareholders is available u/s 47(vii) of the IT Act; **there is no exemption for the shareholders of the amalgamating *foreign company*, in case of amalgamation with another *foreign company*.** Hence, even though tax neutrality is accorded to the transferor foreign company under sections 47(via) and 47(viab); one will have to evaluate (based on first principles)whether such merger could attract capital gains tax for the 'shareholders of the amalgamating foreign company'.

2.2 Demerger:

Upon satisfaction of certain prescribed conditions, a demerger should qualify as a 'Demerger' within the meaning of **section 2(19AA)**for income-tax purposes. One of the key conditions with respect to issuance of shares is as under:

- In consideration of the demerger, the resulting company must issue its shares to the shareholders of the demerged company on a proportionate basis (except where the resulting company itself isa shareholder of the demerged company);

- Shareholders holding **at least 75%(in value)** of shares in the demerged company **become shareholders** of the resulting company by virtue of the demerger. *(Shares in the demerged company **already held by the resulting company or its nominee or subsidiary** are not considered in calculating the aforesaid limit of75% in value).*

Subject to fulfilment of certain additional conditions, such a demerger may be regarded as **'tax-neutral' and exempt from capital gains tax** as discussed in the ensuing paragraph below.

[6]In the case of Grace Collis, CIT v. Grace Collis [2001] 248 ITR 323 (SC).
[7]As persection 49(2) of the IT Act
[8]As per Explanation 1(c) to section 2(42A) of the IT Act
[9]As per the provio (IX) to section 56(2)(x) of the IT Act

A. In the context of a demerger, section 47 of the IT Act specifically **exempts** the following transfers from capital gains tax:

#	**Tax neutrality (pursuant to a scheme of demerger)**		**Key conditions/ aspects for availing such capital gains exemption**
	In the hands of:	**For:**	
(i)	Demerged company [section 47(vib)]	Transfer of capital assets to the Resulting company	Such Resulting company is an '***Indian Company***'
(ii)	Demerged ***foreign company*** [section 47(vic)]	Transfer of 'shares held in an Indian company', to the resulting ***foreign company***	• Shareholders holding **at least 75% in value of the shares** of the demerged foreign company continue to remain shareholders of the resulting ***foreign company***; and • Such transfer does not attract capital gains tax in the country of incorporation of the demerged foreign Company
(ii)	Demerged ***foreign company*** [section 47(vicc)]	Transfer of 'shares held in a foreign company deriving substantial value from the shares in India', to the resulting ***foreign company***	[same conditions as per point (iii) above]

B. Additional considerations for the shareholders:

(i) **Section 47(vid)** of the IT Act provides that – "*any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking*".

Basis the language of the above provision, one may realize that (unlike amalgamation), there is **no specific exemption accorded to the shareholders of the demerged company**. Hence, one will have to analyze(based on first principles)whether there is any actual 'transfer' in the hands of such shareholders, sincesuch shareholders continue to remain the shareholders of the demerged company as well.

(ii) Despite of the above, the following is provided for the shareholders of the demerged company:

- The **period of holding** of the shares of the resulting company – inclusive of the period for which shares of the demerged company had been held[10];
- The formula for the **cost of acquisition of the shares in the resulting company** -

  cost of acquisition of demerged company's shares * net book value of the assets transferred in a demerger / net worth of the demerged company immediately before such demerger[11].
- The **cost of acquisition of the original shares held by the shareholder in the demerged company**- deemed to have been reduced by the amount so arrived above[12].

2.3 Other Modes of cross-border restructuring typically involve:-

A. Overseas Acquisition by an Indian Company, by way of:

(i) Primary or secondary acquisition of shares of a Foreign Company; or

(ii) acquisition or expansion of business in an overseas jurisdiction;

B. Foreign Investment into India, by way of:

(i) Primary or secondary acquisition of shares of an Indian Company; or

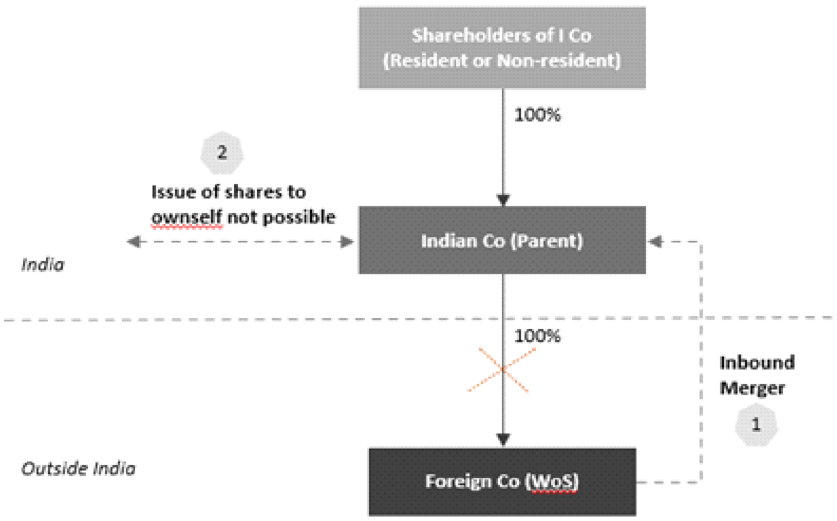
(ii) Acquisition or expansion of business in India

3. Basics structures of cross border M&A along with their income-tax implications:

Note: We have not commented or evaluated on the feasibility of such structures from a legal, regulatory and corporate laws standpoint.

3.1 Inbound merger of a Foreign wholly-owned subsidiary ('WoS') into an Indian Parent Company

Such types of mergers are usually done to transfer the control of the foreign business in India, under the Indian Holding/Parent Company.



Key Construct:

(i) Foreign Co (transferor company or 'F Co') to merge into Indian Co (transferee company or 'I Co');

(ii) As a consideration for such merger, issuance of shares by the transferee company(I Co) to the shareholders of the transferor company (i.e., I Co itself) - I Co thus cannot issue shares to own self.

[10] *As per Explanation 1(g) to section 2(42A) of the IT Act*
[11] *As per section 49(2C) of the IT Act*
[12] *As per section 49(2D) of the IT Act*

Income-tax implications on the above:

In the hands	Income-tax implications
Transferor (F Co)	The said merger qualifies as an 'amalgamation' for income-tax purposes since the transferee is an Indian Company - exemption u/s 47(vi) available.
Shareholders of F Co (i.e., I Co itself)	Exemption u/s 47(vii) available, as:- • the condition of issuance of shares by transferee company in consideration to the shareholders, **need not be fulfilled** where such shareholders and transferee company is the same; and • transferee Co is an Indian Company
Transferee (I Co)	In a **domestic merger** (where both transferor and transferee are Indian companies), brought forward losses or WDV or unabsorbed depreciation ('UAD') or accumulated profits – **typically travel** to the transferee company. However, it would be interesting to evaluate whether such **losses or WDV or UAD or accumulated profits of the *foreign transferor company*** should be allowed for carry-forward to the ***Indian transferee company***. Some points for consideration are: • The brought-forwardlosses or WDV or UAD or accumulated profits of the foreign company may have not been '**assessed to tax' in India**; and • Moreover, the mode of computation of such losses or WDV or UAD may not be as per the Indian tax laws. **Hence, one will have to analyze that had the said amalgamation not taken place, then whether such accumulated loss or UAD would have been allowed[13] to the foreign company**

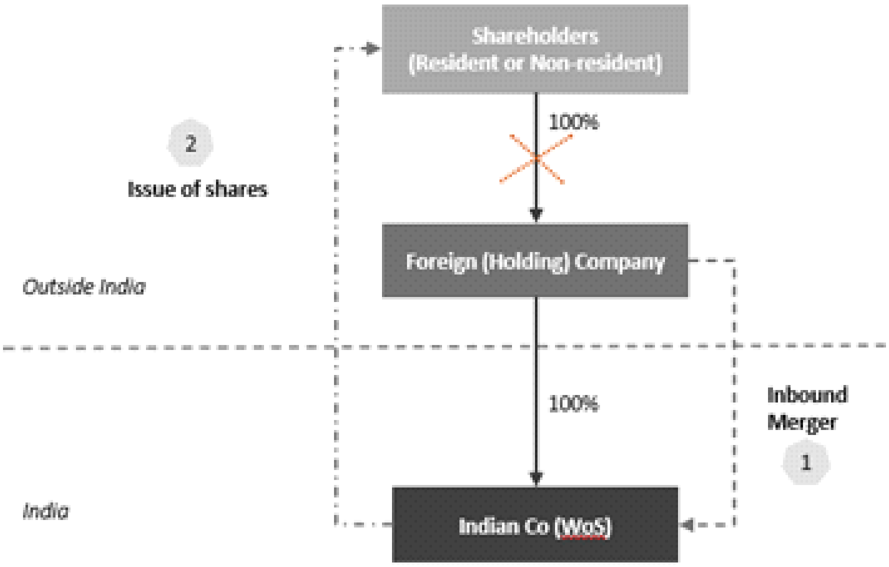
3.2 Inbound merger of a Foreign Holding Company into an Indian WoS

Such mergers are usually done to eliminate the intermediary Holding Company overseas, such that the shareholders directly hold shares in India and control the Indian Company's business.

[13]***For the purposes of section 72A of the IT Act, an extract of the definitions of the meaning provided for'accumulated loss' and 'unabsorbed depreciation' is as under****:*

(a) "accumulated loss" means so much of the loss of the amalgamating company under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating company would have been ***entitled to carry forward and set off*** *under the provisions of section 72* ***if the amalgamation had not taken place****;*

(b) "unabsorbed depreciation" means so much of the allowance for depreciation of the amalgamating company, which ***remains to be allowed and which would have been allowed*** *to the amalgamating company under the provisions of this Act,* ***if the amalgamation had not taken place***



Key Construct:

(i) Foreign Holding Co (transferor company or 'FHC') to merge into Indian subsidiary (transferee company or 'I Co');

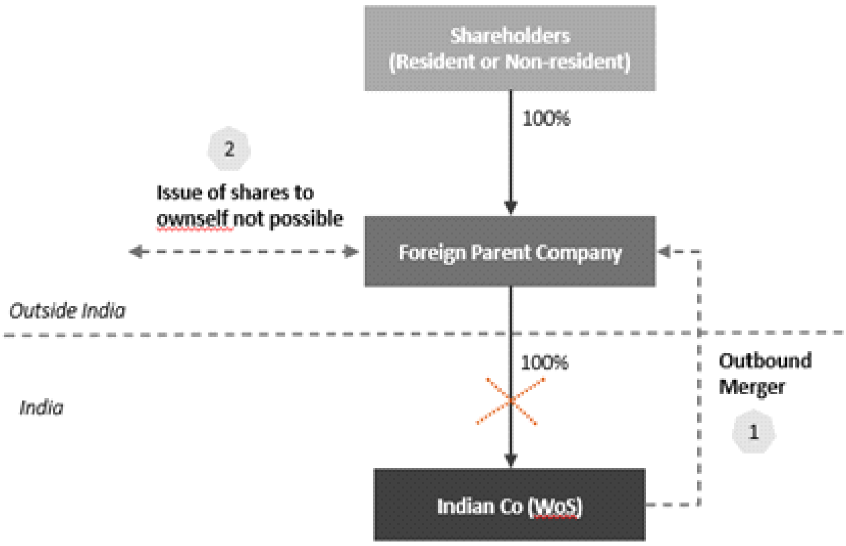
(ii) As a consideration for such merger, issuance of shares by the I Co to the shareholders of FHC.

Income-tax implications on the above:

In the hands of:	Income-tax implications
Transferor (FHC), Transferee (I Co)	(same as 3.1 above)
Shareholders of FHC	Exemption as per section 47(vii) may be available, as:- • The condition of issuance of shares by transferee company in consideration of the merger, stands fulfilled; and • Transferee Co is an Indian Company

3.3 Outbound merger of an Indian wholly-owned subsidiary ('WoS') into Foreign Parent Company

Such types of mergers are usually done to shift the Indian operations overseas and to transfer the control of the Indian business under the Foreign Parent Company/Share holders level.



Key Construct:

(i) Indian WoS (transferor company or 'I Co') to merge into its Foreign Parent (transferee company or 'F Co');

(ii) As a consideration for such merger, issuance of shares by the transferee company (F Co) to the shareholders of the transferor company (i.e., F Co itself) - **F Co thus cannot issue shares to ownself**.

Income-tax implications on the above:

In the hands of:	Income-tax implications
Transferor (I Co)	**No tax neutrality has been provided u/s 47(vi), since the transferee Co is not an *Indian Company*.** Hence, one may have to evaluate (based on **first principles**) that whether the capital gains arising on the transfer of assets pursuant to the merger, may be taxable in the hands of I Co; based on the following arguments: • Whether any 'consideration 'has been actually received by I Co? Typically, in a merger; it is the shareholders who receive 'consideration' in the form of 'shares of transferee Company'. **The Transferor Company ceases to be in existence and receives no consideration on the assets transferred by it.** • Accordingly, one may explore the view that, **in the absence of 'any consideration' received by I Co, a 'charge' u/s 45 may not be created**. • Hence, one may further explore the argument that; where a case is **outside the ambit of the charging section 45**, then section 50CA or any other provision of the 'capital gains' chapter, may also not be held as applicable.
F Co (asShareholders of I Co)	**No tax neutrality has been provided u/s 47(vii), since the transferee Co is not an *Indian Company*.** Hence, one may have to evaluate (based on **first principles**) that whether the capital gains arising on the transfer of 'shares held in I Co', may be taxable in the hands of the shareholders of I Co., based on the following: • One would need to analyze that there has been **'mere cancellation of I Co' shares, without any 'receipt' of fresh shares by F Co**. • Hence, **without any 'consideration', it may be argued that there is no charge u/s 45**(similar argument as above). • However, it may be possible that the tax authorities allege that consideration for F Co. is actually present in the form of 'business received by it from I Co.'Interestingly, one may also defend the said allegation based on the following arguments: - The 'business' received by F Co, is nothing but the 'vesting of such business due to amalgamation' i.e., **it is only due to the amalgamation, that such business has been vested onto F Co**. Hence, one may argue that the 'acquisition of business by discharging a consideration' is **different** than 'vesting of such business only pursuant to an amalgamation'.

In the hands of:	Income-tax implications
F Co (asShareholders of I Co)	- Further, it cannot be denied that in the present facts; F Co is playing a dual role of 'transferee company' as well as the 'shareholder of transferor company'. **Accordingly, when F Co is under the shoes of the shareholder, it seems that the only consideration could have been in the form of 'fresh shares received from the transferee company'.** Consequently, **from a shareholder's perspective, such consideration may be said to be 'absent' for F Co.** • Accordingly, one may further proceed on the argument that - in the **absence of 'consideration'** where a case is **outside the ambit of the charging section 45**, then section 50CA or any other provision of the 'capital gains' chapter, may also not be held as applicable.

The above positions in case of taxability (i.e., the absence of tax neutrality) in an outbound merger scenario, has been untested and hence the ambiguity prevails in various aspects.

◆◆◆

CROSS-BORDER M&A – STRUCTURING AND KEY INCOME-TAX ISSUES (PART-II)

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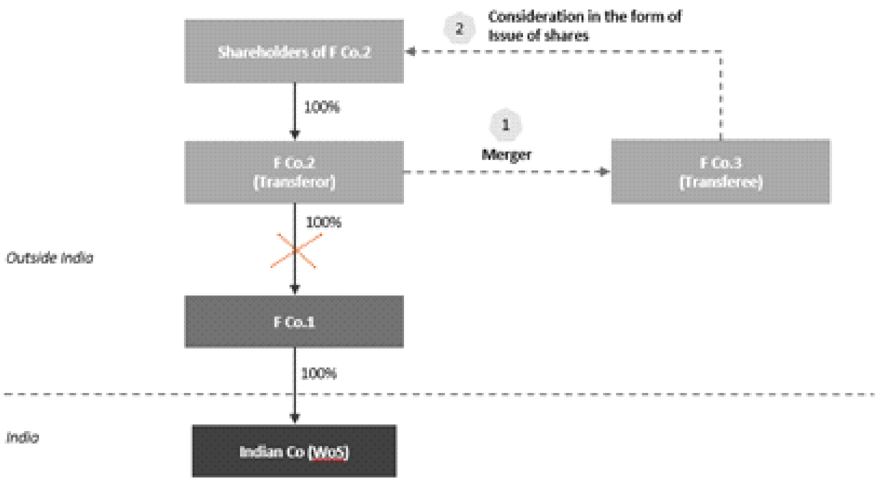
1. Background:

After having discussed the basic overview of key income-tax provisions relating to cross-border M&A in Part I, this article discusses key issues and some structuring options surrounding cross-border M&A.

2. Key Issues in cross border M&A:

Since the cross-border M&A sphere is in a maturity phase, the tax and regulatory framework is also equally evolving. Based on the host of provisions provided in the IT Act, we have deliberated the income-tax implications for certain cross border M&A examples in Part I of the article. **However, there are certain open-ended issues prevailing in the industry, and the ambiguity pertaining to the same has not been settled yet in the courts or is untested as of now**. We have briefly discussed some of these issues from an Indian income-tax perspective, as under:

2.1 Merger of F Co into F Co – No exemption to the shareholders:



Key Construct:

i. F Co.2 to merge into F Co.3 (unrelated party), such that consideration is in the form of shares issued to the shareholders of F Co.2

ii. By virtue of such merger, F Co.2's holding in the shares of F Co.1 shall stand transferred to F Co.3

A. Income-tax implications in the hands of F Co 2 (transferor company):

If the said merger qualifies as an 'amalgamation' within the meaning of section 2(1B) for income-tax purposes; then **the transfer of shares held in a foreign company deriving substantial value from India**(i.e., the shares held in F Co.1 deriving value from the shares of Indian Co) by the foreign transferor company (F Co.2) to foreign transferee company (F Co.3) - may be exempt in the hands of such transferor (i.e., F Co.2) u/s 47(viab) provided the prescribed conditions are fulfilled.

B. Income-tax implications in the hands of the shareholders of F Co.2

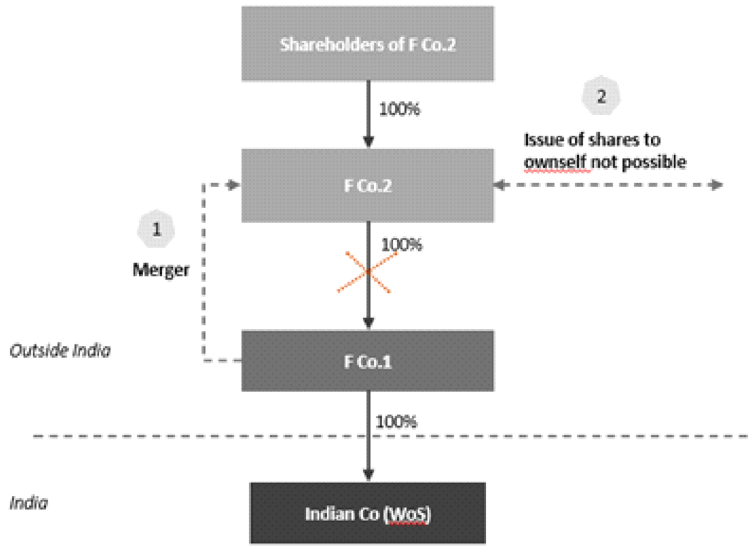
The provisions of the IT Act do not provide for any exemption to the shareholders of the transferor company, in a case of a merger of two foreign companies.

Hence, capital gains accruing on the transfer of shares held in F Co.2, may be taxable in India under the provisions of the IT Act, wherein such shares **derive substantial value from India (i.e., in an indirect transfer scenario)**, except as covered within the small shareholders' exemption[2].

One may also have to explore whether **benefit under the treaty**could be claimed in respect of such indirect transfer, depending upon aspects such as:

- the wordings of the respective treaties;
- the eligibility to claim treaty benefits; and
- the surrounding jurisprudence on the said aspect.

2.2 Merger of F Co (WoS) into F Co (Parent):



Key Construct:

(i) F Co.1 (WoS) to merge into its Parent (F Co.2).

(ii) As a consideration for such merger, transferee company (F Co.2) should issue shares to the shareholders of the transferor company (i.e., F Co.2 itself). In the present facts, F Co.2 cannot issue shares to own self.

A. Income-tax implications in the hands of F Co 1 (transferor company):

If the aforesaid merger qualifies as an 'amalgamation' within the meaning of section 2(1B) for tax purposes; then one will have to analyze whether such an **amalgamation of two foreign companies** [where there is a **transfer of shares held in an Indian Company (i.e., the shares held in I Co),** by the foreign transferor company (F Co.1), to the foreign transferee company (F Co.2)] - qualifies for **exemption u/s 47(via)** of the IT Act ?

One of the key pre-requisitefor such exemption is that:

- *25%* of the shareholders of F Co.1 should continue to remain as shareholders of F Co.2

In the definition of 'amalgamation' u/s 2(1B) and in the exemption provided u/s 47(vii) in case of mergers where the transferee company is an Indian Company - **an exception has been provided for a situation where the transferee company itself is the share holder. A similar exception is absent in the language of section 47(via) where the merger is of two foreign companies**.

[2]***Indirect transfer tax shall not be applicable*** *for small-scale investors who either individually or with their related parties (at any time within 12 months preceding the date of transfer):*

*a. do not hold more than **5%** of the total voting power or share capital or interest in the foreign entity that holds Indian asset; and*

b. do not hold any right of management or control in the foreign entity that holds an Indian asset;

In the present facts, no shares have been issued as consideration, as the transferee company itself is the shareholder. **Consequently, an ambiguity arises that in absence of exception clause in section 47(via), whether the condition of "*continuity of 25% of the shareholders*" stands fulfilled in the current scenario.**

One will have to thus evaluate basis first principles as under:

- Even though the law prescribes the requirement of "*continuity of 25% of the shareholders*", **such conditionality could not be fulfilled in the present facts because of "impossibility of performance" at F Co.2's level**;

One may argue that it is "impossible" for F Co.2 to issue shares to own self, i.e**., impossible to perform the issuance of shares and satisfy the conditionality provided u/s 47(via)**.

B. Income-tax implications in the hands of the F Co.2 (as "shareholders of F Co.1"):

As mentioned earlier, there has been no exemption u/s 47 for the shareholders, in the scenario of a merger of two foreign companies. Hence, evaluation based on first principles would be needed for the capital gains accruing in the hands of F Co.2, on the **transfer of F Co.1's shares which derive substantial value in India**–refer to the probable **arguments as provided for the shareholders** under paragraph 3.3of Part I of the article.

2.3 Permanent Establishment ('PE') exposure risk in an outbound merger:

Practically, after the merger is completed, the Indian operations of the transferor company could be carried out by the ***surviving foreign entity***, either directly or through a branch in India. Consequently, there is a significant risk that the tax authorities may characterize the **India presence of the surviving foreign entity as constituting a PE in India**.

For example, where an Indian amalgamating company is engaged in an asset intensive business viz a manufacturing plant in India; then post the outbound merger with foreign amalgamated company, the Indian manufacturing plant shall be regarded as a 'branch office' of a foreign company in India and thereby regarded as a PE in India for tax purposes.

Consequently, the aforesaid PE risk may result in '**business profits**' earned by the surviving foreign entity (from its operations in India being taxed in India) at a **higher rate of 40%** (exclusive of the applicable surcharge and cess). Hence, one will have to explore the structuring of the Indian (post-merger) operations in a manner that lowers the risk of PE exposure.

2.4 Dividend re-characterization risk in an inbound merger of foreign WoS into Indian parent:

In a scenario where a ***foreign subsidiary*** (transferor company) having surplus reserves, has amalgamated into its ***Indian parent*** company (transferee company); the tax authorities may possibly allege that the transfer of assets by the transferor company is **nothing but the distribution of such free reserves by the company to its shareholder.**

Accordingly, there is a possibility that **the tax authorities may characterize such distribution as in the nature of 'dividend'** and thus proceed to tax the same in the hands of the recipient shareholder.

On this matter, one may explore the argument provided under the CBDT Circular dated 09-10-1967 – an extract of such circular states as under:

"….The Board, are, therefore, of the view that the provisions of sub-clause (a) or (c) of section 2(22) are not attracted in a case where a company merges with another company in a scheme of amalgamation"

Based on the ratio laid down by the aforesaid circular, one may possibly contend that any transfer of assets including the transfer of accumulated profits embedded in such assets; ought **not attract the taxability as 'dividend'** provided within the meaning of section 2(22)(a) or section 2(22(c) of the IT Act.

3. Internalization:

Due to favorability of India in the world economy and with the increasing appeal of the Gujrat's GIFT City in India, many overseas companies are now making a 'strategic move' towards India. This brings in the concept of 'internalization of businesses into India'.

This trend of internalization is being largely adopted by **Indian start-ups (who had originally relocated their holding company to overseas jurisdictions by way of 'flipping')– are** now opting to **"reverse flip back into India"** i.e., move their bases back into India, due to several factors such as:

- favorable economic policies/ government incentives and the easing of regulations in India;
- significant untapped pool of domestic retail investors eager to invest;
- burgeoning domestic market;
- growing investor confidence in the country's start-up ecosystem; and
- Eyeing for a public listing in Indian markets, etc.

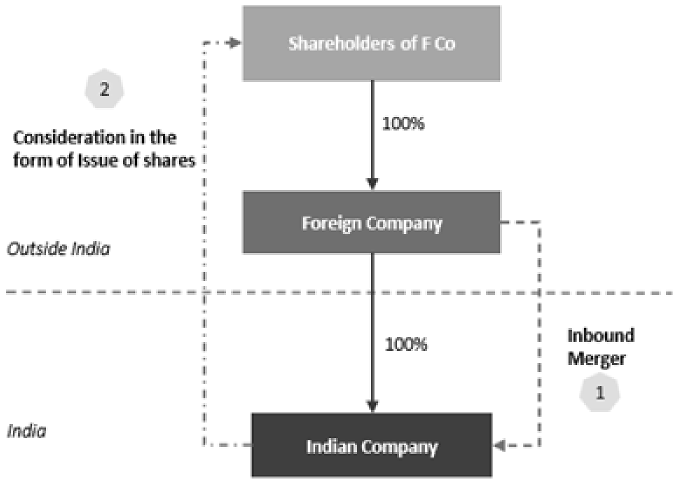
Hence, various **restructuring exercises (such as share swaps or mergers, etc.)** are being adopted by start-up companies, in order to tweak their corporate structure and thus enable the relocation of their holding company and intellectual properties, back into India.

Headlines for various start-ups which have done or contemplating their "flip back" or locally known as *"Ghar Vapsi"* into India, are in the news. In light of the above background, we have briefly touched upon **some of the structuring routes by which internalization could be ideated** as well as **the key income-tax issues surrounding such structures:**

3.1 Inbound merger of a Foreign Company into an Indian Company:

Inbound merger is the most basic type of an Internalization structure, wherein the overseas shareholders get control in the Indian Company and the Indian Company receives the business directly from the Foreign Company. Such structure is best suited where legal and the regulatory framework of the overseas jurisdiction (where the Foreign Company is situated) **permits**[3] such outbound mergers.

[3] *Based on desktop research, some of such jurisdictions (permissible ones) are – Mauritius, Luxembourg*



Key Construct:

(i) Merger of F Co (transferor company) into I Co (transferee company);

(ii) Issuance of shares as a consideration for such merger, to the shareholders of F Co.

Key income-tax considerations:

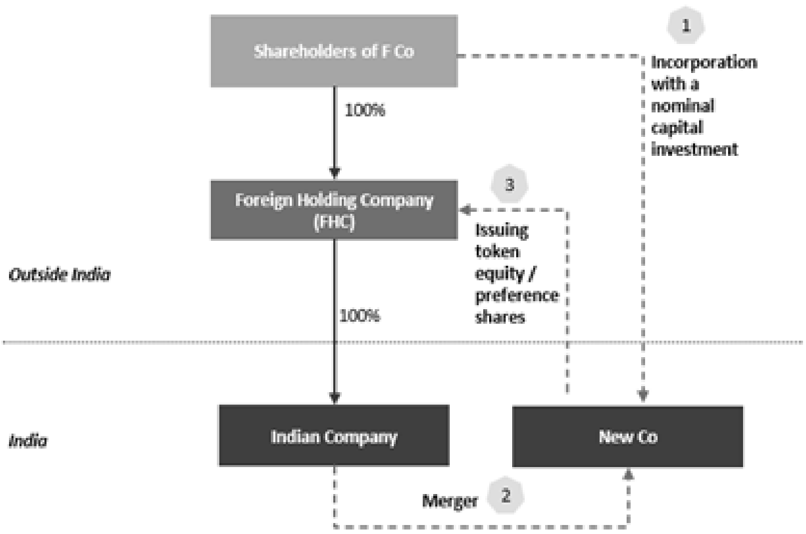
1) If the said merger qualifies as an 'amalgamation' for income-tax purposes and since the transferee is an Indian Company; exemption u/s 47(vi) and 47(vii)may be provided to F Co and the shareholders of F Co, respectively.

2) One should note that the aforesaid structuring by way of 'inbound merger' is the simplest option for carrying out internalization. However, as mentioned**; if the overseas jurisdictions do not permit[4] outbound merger for F Co**, then **other options for ideating internalization** have been discussed below in the ensuing paragraphs.

3.2 Merger into mirror entity:

Mirroring the overseas shareholding pattern at Indian level, is also one of the types of Internalization structures, wherein the Indian Company's business gets transferred to a New Company which is then directly controlled by the overseas shareholders.

Proposed Structuring:



Key Construct:

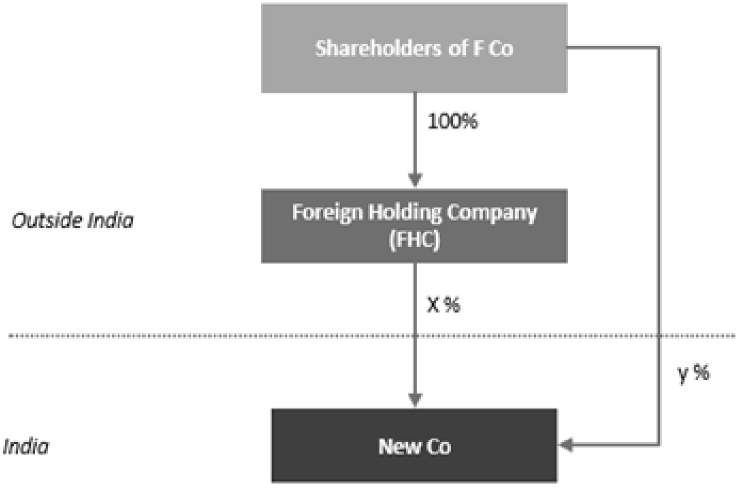
(i) Shareholders of FHC will form a New Co. in India, with **mirror (identical) shareholding pattern** of FHC;

(ii) Merger of India Co. (transferor company) into New Co. (transferee company).

(iii) As a consideration of such merger, **issuance of nominal equity shares** to FHC (shareholders of transferor company), by New Co.

[4] *Based on desktop research, some of such jurisdictions (non-permissible ones) are - UAE, Japan, Australia, Canada, Singapore, Hong Kong*

Resultant Structure: Construct achieved:



(i) FHC obtain the Indian business by way of ownership in New Co and the shareholders of F Co also achieve control in New Co.in India.

(ii) Shareholders of F Co have obtained a direct control in the Indian business, without carrying out any cross-border merger[5]

Key income-tax issues/considerations:

1) Whether the transaction of merger shall qualify as an 'amalgamation' within the meaning of section 2(1B) for tax purposes; given that **nominal shares are issued as a consideration for the amalgamation**

2) Whether the issuance of nominal shares, trigger the **applicability of section 56(2)(viib)[6],** in the hands of New Co. (i.e., transferee company issuing shares upon merger)

3) Considerations around the **cost of acquisition and the period of Holding** of the shares acquired in New Co., by way of:
- Subscription (by the shareholders of FHC); and
- Pursuant to amalgamation (by FHC)

4) Potential risk of GAAR exposure, for which strong commercial rationales may be built to substantiate to the tax authorities.

5) Considerations surrounding the **migration of ESOPs** from FHC to I Co.

6) Realignment of business operations/business model, between FHC and I Co.

3.3 In addition to the aforesaid option of "merger with mirror entity" under paragraph 3.2 above, one may also explore **other options for internalization** such as:

- merger into mirror entity, after the slump sale;
- Swap of shares;
- Liquidation of FHC; and
- In-specie distribution of the shares of I Co., by FHC; etc.

[5] *The shareholders of F Co would have obtained a direct control in India Co, if FHC would have merged into India Co (i.e., inbound merger for India, and outbound merger for FHC).* ***However, if outbound merger is non-permissible for FHC, then the structuring for internalization could be explored in the above manner i.e., by merging of two Indian companies and subsequently obtaining control in the transferee company.***

[6] *where an closely held company receives any consideration from any person for the* ***issue of shares in excess of the fair market value [FMV as determined under Rule 11UA(2)];*** *such excess amount of 'premium' shall be chargeable to tax under the head 'Income from Other Sources' in the hands of such issuer company*

4. Externalization:

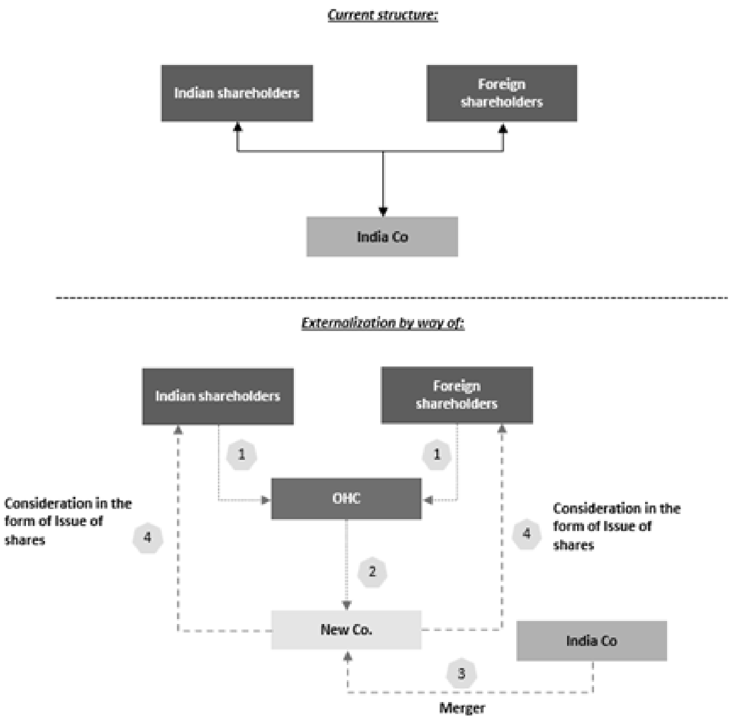
With the intent of globalization, businesses are now expanding beyond their jurisdiction, and India is no exception. The last decade has witnessed an upsurge of Indian companies expanding globally and tapping their potential in the foreign markets. This brings in the concept of 'Externalization' wherein Indian companies are "flipping their businesses outside India" with flexibility to list shares overseas.

Externalization involves:

- migration and mirroring of cap table from existing Indian company to the Overseas Holding Company ('OHC'); and
- subsequent realignment / consolidation of India business under the OHC structure.

In light of the above background, we have briefly touched upon **some of the structuring routes[7] by which externalization could be ideated** as well as **the key income-tax issues surrounding such structures:**

4.1 Merger:



Mechanics:

(i) An overseas holding company ('OHC') to be incorporated by Indian shareholders and the foreign shareholders – thinly capitalized. Shareholding in OHC to be in ratio similar to India Co., i.e., **mirror shareholding.**

(ii) OHC to incorporate New Co. in India as a 100% WoS.

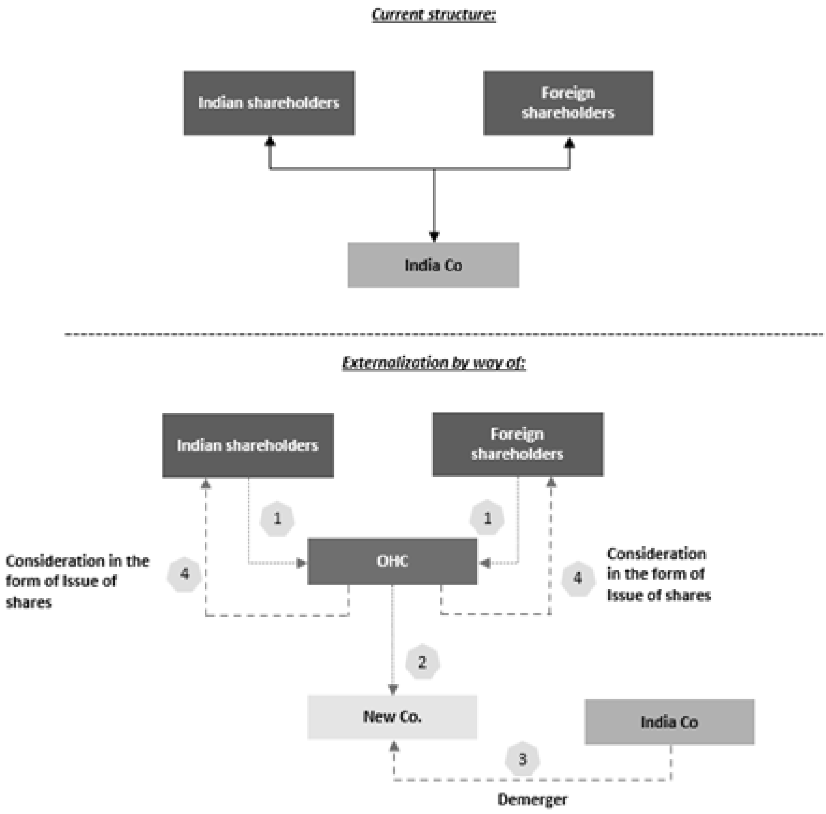
(iii) India Co to merge with New Co.

(iv) In consideration of such merger, New Co to issue **nominal equity shares**, to the Indian and foreign shareholders (being the 'the shareholders of the transferor company').

Key income-tax issues / considerations: similar to as discussed under paragraph 3.2 above.

[7] *The existing article/ paragraphs do not discuss the recent proposals/ amendments under FEMA and Company law, involving direct listing of Indian companies on international stock exchanges in IFSC*

4.2 Demerger:



Mechanics:

(i) OHC to be incorporated by Indian shareholders and the foreign shareholders – thinly capitalized. Shareholding in OHC to be in ratio similar to India Co., i.e., mirror shareholding

(ii) OHC to incorporate New Co. in India as its WoS.

(iii) Substantially the entire business of India Co ('Demerged Company') to be demerged into the New Co.

(iv) In consideration of such Demerger, OHC (the wholly-owned shareholder of New Co) to issues its own shares to the Indian and foreign shareholders (being the 'shareholders of Demerged Company').

1) **Who shall qualify as a 'resulting company'** within the definition of section 2(41A) of the IT Act:

- OHC (the company who has issued the shares upon demerger); or
- New Co. (the company to whom the business of the demerged undertaking has been vested upon, pursuant to the demerger)

2) **Due to the involvement of two such resulting companies, the impact on the tax neutrality of such demerger u/s 47(vib).**

5. Concluding remarks:

Striking a cross-border deal requires profound fore thought to facilitate smooth and seamless implementation of such transaction across two jurisdictions, across two businesses and also in line with the sentiments, cultures of the people working in the organizations involved. The transaction structure needs to be tax-efficient and compliant with a host of regulations (local and overseas); and at the same time also meet the commercial desires of the parties involved. Regulatory and corporate laws play a key role in ensuring that a cross-border transaction is consummated in a conducive manner; whereas taxation plays a key role in striking the equilibrium between cost v/s benefit and thereby gauge the various outflows and adverse consequences involved (if any). However, as we have discussed in this article; taxation remains a vexed issue and hence various income-tax aspects are still open, ambiguous and eyeing clarity from law.

1. *Views expressed in this article are personal views of the author and do not represent views of any organization. Further, the entire content in this article is only for academic purpose and should not be construed as a professional opinion or advice. The authors assume no responsibility of anyone relying upon this article for the purpose of drawing any inference or advice.*

CROSS BORDER TRANSACTIONS - ISSUES UNDER GST LAW

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The phrase "*Vasudhaiva Kutumbakam*", which translates to "One Earth, One Family, One Future," gained its popularity during the Group of Twenty (G20) summit which was hosted in India in 2023. Under the Indian Presidency, the G20 in 2023 focused on the theme, 'One Earth, One Family, One Future'.The Foreign direct investments (FDI)& Climate change being few of the core topics of discussion of the summit, The G20 also helped to promote liberalisation by entering into Trade facilitation agreements.

As the world comes closure, there arises a need to assess its effects across various cross border segments. One such very crucial segment being indirect taxes of any economy for ease of global trade.

With the above backdrop, Let's discuss some of the key impacts from indirect tax perspective on cross border transactions:

Global trading of goods

A. Importation of goods

Typically, Importation of goods are leviable to duties of customs upon clearance of goods in India by filing of bills of entries. As per proviso to section 5(1) stipulated under IGST Act, 2017, the importer of goods is required to discharge Basic Customs duty, applicable cess & Integrated Goods & Service Tax (IGST) as per applicable rate on the assessable value arrived in accordance with prevailing rules & provisions of Customs Law. IGST so paid on importation of goods can be claimed as input tax credit in GST returns by the importers subject to section 16 & Section 17 of CGST Act, 2017.

The rates of duties on imports of goods are subjected to exemption Notifications (conditional /non-conditional). Certain provisions of Foreign Trade Policies& other Foreign Trade Agreements also play pivotal role to determine the effective rate of duties on goods imported.

Additionally, in cases where the transaction involved procurement of goods from related parties located outside India, Special Valuation Branch (SVB) intervenes to assess the valuation and verify if the prices have been influenced due to the relationships. The given process of SVB is governed as per No 05/2016 dated 9th February 2016. Whilst there is a possibility of facing practical nitty-gritties in entire SVB investigation, however, the value is determined as per the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.As the term related parties has been defined in a different manner in various Indian Laws such as Income Tax, Companies Act, GST, Customs, SEBI etc., it becomes imperative to analyse the impact of all the laws including SVB applicability.

It is observed that in some cases, the foreign counterpart enters into an agreement with Indian entities for the exploitation of intellectual property rights such as licensed trademark, technical knowhow, patent &brand at the global level. If the consideration agreed is said to be linked to quantity of goods imported from foreign suppliers& if the consideration is a pre-requisite for importation of goods, then as per Rule 10(1)(c)of Customs Valuation (Determination of Value of Imported Goods) Rules,2007, such consideration being a condition of sale would be an addition to assessable value & would attract customs implications. As against that, wherever one can establish the payments are not pre-requisites & are linked with the event after importation of goods, it would be considered as an import of service (not part of import of goods)upon fulfilment of the condition stipulated in the definition of imports of services under GST Law and would attract implication of GST under reverse charge mechanism. Thus, there is an inter-play between Customs & GST Laws.

B. High Seas Sales, Warehoused Goods & Out & Out sales:

In normal parlance, the term High Seas Sales (HSS) can be said to be defined as the sales of goods to the customers during the period when goods have been sailed from load port but have not reached the destination port i.e., sales in the transit.

In HSS, the goods are being sold before in transit i.e., before crossing the customs frontiers of India on a journey from foreign nation. The ownership & title is transferred high seas. Accordingly, the ultimate Indian customer undertakes entire customs clearance process.

In Central Sales Tax regime, as per section 5(2) of Central Sales Tax Act, 1956, HSS were neither treated as intra nor inter State sales, thereby not made exigible to tax under the State and CST Acts. However, upon implementation of GST, the question of applicability of GST remained unanswered.To clear the air around this, GST council initially issued circular in 2017 with respect to GST treatment on high seas sales. However, after a lot of hue & cry, at a later point in time, GST council made a retrospective amendment in GST Law by insertion of Entry 8(b) in Schedule III of GST Act, 2017 for HSS GST treatment. The extract of the schedule is captured below for reference.

Schedule III - ACTIVITIES OR TRANSACTIONS WHICH SHALL BE TREATED NEITHER AS A SUPPLY OF GOODS NOR A SUPPLY OF SERVICES

7. Supply of goods from a place in the non-taxable territory to another place in the non-taxable territory without such goods entering into India.

8. (a) Supply of warehoused goods to any person before clearance for home consumption.

(b) Supply of goods by the consignee to any other person, by endorsement of documents of title to the goods, after the goods have been dispatched from the port of origin located outside India but before clearance for home consumption.

Explanation 2.—For the purposes of paragraph 8, the expression "warehoused goods" shall have the same meaning as assigned to it in the Customs Act, 1962 (52 of 1962).

As of today, HSS, warehoused goods and out & out sales are kept outside the purview of GST through afore stated entries of schedule III of CGST Act, 2017, it is given retrospective impact effective from 1st July 2017 with no requirement of Input tax credit reversals. It is worthwhile to know that historically HSS always mandates the companies to maintain robust documentation such as HSS agreement, Bills of Lading, Invoices etc. to substantiate the sales in transit to avoid any indirect tax implications in India.

C. Exports of goods

The goods moved out of India are considered as an export of goods, resultantly, the exporters are entitled for the benefit of zero-rated supplies of goods by not attracting GST. The exports are also benefitted by refund of GST paid on input & input services used in exports of goods.

Export & Import of services

A. Intermediary services:

The specific provision of place of supply of 'intermediary services' under section 13 of the IGST Act gets invoked only when either the location of supplier of intermediary services or location of the recipient of intermediary services is outside India. The circular has been issued in 2021 clarifying certain key aspects of intermediary provisions under GST. It emphasises on some pre-requisites for determination of intermediary services, which has to considered as guidelines for determination of intermediary in line with the definition of intermediary covered in Section 2(13) of IGST Act, 2017.

Whilst the circular reduces considerable uncertainty of GST implications of intermediary services, however, the hot favourite "intermediary services" continues to remain in a grey area for many service providers.

B. Transportation services:

Logistics is the lifeblood of international trade, as it serves as the invisible force that ensures the effective movement of goods. The below tabulation can be referred for ease of understanding:

i. Indian Recipients of services:

ii.

Particulars	Import shipment	Export Shipment	Out & out shipment
Indian Shipping Lines	Taxable under forward charge @5% (subject to ITC on inputs disallowed)	Exempt till 30th September 2022. However, w.e.f. 1st October 2022, taxable under forward charge @5% (subject to ITC on inputs disallowed)	Taxable under forward charge @5% (subject to ITC on inputs disallowed)
Foreign Shipping Lines	Taxable under Reverse charge mechanism@5%	Taxable under Reverse charge mechanism @5% (Due to omission of section 13(9), place of supply is as per 13(2))	Taxable under Reverse charge mechanism @5% (Due to omission of section 13(9), place of supply is as per 13(2))

iii. Foreign Recipients of services:

Particulars	Import shipment	Export Shipment	Out & out shipment
Indian Shipping Lines	Qualify for exports of services and considered as zero-rated supplies. (Due to omission of section 13(9), place of supply is as per 13(2))	Qualify for exports of services and considered as zero-rated supplies.	Qualify for exports of services and considered as zero-rated supplies.
Foreign Shipping Lines	Not taxable The Apex Court judgment in case of Mohit Mineral Pvt Ltd. has deliberated on Non-levy of GST in case of CIF arrangements where transport services are procured from foreign shipping lines by foreign consignor.	Not taxable	Not taxable

(*) For Supplies to customers of Nepal & Bhutan, the applicability undergoes a change.

The above tabular explanation can be referred only for transportation services. There are many other services such as handling, loading, unloading etc., linked to transportation services. However, the GST treatment of such services depends upon the terms agreed by the supplier & purchaser of goods.

Indian establishment & Head quarter cross charges:

Analysis of Indian establishment & Head quarter cross charges:

In case of supply of service by one branch or agency or any representation office of a foreign company to any establish of the said foreign company out of India would not qualify for exports of services since the supply would be treated as supply between establishments of distinct persons. This would be a violation of one of the conditions as provided in the definition of exports of services.

However, import of services between branches without consideration would be taxed based as per entry no.4 of Schedule I, which is read as *"import of services by a person from a related person or from any of his other establishments outside India, in the course or furtherance of business"*.

The explanation 1 to section 8 of IGST Act, 2017 envisages the methodology to determine whether the branches / offices can be termed as establishments of distinct person. Whist, as per literal interpretation, the definition of import of services only covers judicial persons within its ambit, however, the deeming provision creates a charge to attract GST on the transactions between branches not being a separate person. On this aspect, as per news prevailing, the foreign Airline companies&foreign Shipping Line companies are under the radar from GST intelligence investigation wing. The outcome of which may turn out to be next iconic litigation in GST.

Any transactions between subsidiary &holding companies or related sister concerns would not directly get qualify as an export of services, the other conditions stipulated in the definition of exports of service need to be analysed. Any services & cost recharge by the Indian subsidiaries to outside holding companies / sister concerns would require to have a microscopic look of the definition of exports of services& relevant rules to determine GST applicability.

Secondment of Employees:

Last year, The Supreme Court provided an important ruling in the case of CCE & ST vs. Northern Operating Systems Pvt. Ltd ("NOS judgment") which unsettled the position of law relating to applicability of indirect taxes to secondments. This mandated all the organisation to relook at their established service tax positions. Due to this judgement, DGGI & other officials started issuing numerous notices & summons to validate the issue of who would be the employer in a secondment arrangement through the judgement and its implications on GST on salary costs. In maximum cases, it is observed that the salaries are being paid to foreign expats from Indian companies, but certain social security cesses continued to be paid by foreign counter parts. It is said typically that deputed employees can be termed to be employees for entire group, however, various Show cause notice were issued challenging Non-levy of GST. Recently in some of the High courts, such SCNs have been stayed. CBIC has also issued instructions to the tax authorities to analyse the aspect of secondment on cases to case basis without following straight jacket formula by issuance of Notice u/s 74 of CGST Act. For future, the companies need to undertake a thread-bare analysis of these secondment contracts from overall perspective.

Corporate Guarantees:

The term corporate guarantee was also much in news in last year from GST perspective. Considering latest amendment, in a scenario where the guarantee is given by the parent entity located outside India for a borrowing by its subsidiary in India, the transaction will qualify as 'import of services' under GST and would attract GST in the hands of subsidiary in India. However, the reverse scenario, where the Indian parent company would be providing such guarantees for foreign subsidiaries, it may not automatically qualify for exports of services due to absence of consideration flowing from foreign subsidiaries. There is still a space for GST council for further clarification.

Co-location services:

The co-location services have gained its momentum currently due to the growth of Indian data centre market. In line with recent circular, co-location services (some of the services listed in the circular dated 27th October 2023) would be governed by default rule i.e.,recipient based rule. Thus, any Indian data centre service provider providing the co-location services can explore the benefit of zero rating of exports of services.

Online Information DataBase Access and Retrieval(OIDAR) Services:

With the rapid growth of current digital age and boom of social media platforms, the Government had to bring in the taxability on online services. OIDAR is a category of services provided through the medium of internet and received by the recipient online without having any physical interface with the supplier of such services. The definition of OIDAR as per IGST Act is an illustrative, however, it is indicative & not exhaustive. To determine if services are OIDAR, the two-fold test needs to be undertaken viz,

(I) Whether Provision of service mediated by information technology over the internet or an electronic network,

(ii) Whether it is impossible to ensure in the absence of information technology.

Particulars	Suppliers	
	Supplier located in taxable territory	Supplier located in a non-taxable territory
Taxable recipient	Taxable under forward charge	Taxable under reverse charge
Non-taxable online recipient (including for personal use)	Taxable under forward charge	Taxable under forward charge (through intermediary as per Section 14 of IGST Act, 2017)

The Finance Act 2023 removed the terms "minimal human intervention" and "essentially automated" from the definition of OIDAR services. Resultantly, this had widened the scope of OIDAR services. Further, the definition of Non-taxable online recipient has been amended to include recipient who are using the OIDAR service for personal usage, which was previously exempt.

With the above in-depth discussion on various points, we can surely conclude that the cross-border transactions would continue to evolve as the world grows whether in terms of acceptance of digital currencies for payments, evolution of tech-based platforms, steps towards carbon footprints of industries or any other manner. The change would undoubtedly entail all of us to be aware about the indirect taxability around the same.

OVERVIEW OF INCENTIVES UNDER FTP AND CUSTOMS LAWS


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Every Country intends to grow their economy and footprint in foreign trade and India is not an exception. Considering the broad vision of Indian Government, new foreign trade policy is introduced to expand foreign trade exponentially through focused areas such as digital economy, towns of export excellence, district export hubs, etc. While World is edging towards Global recession, India is moving towards its goal to achieve Atmanirbhar Bharat, Vocal for Local and Make in India. The author intends to shed light on various incentive avenues available to exporters.

Overview of Duty Exemption and Remission Schemes

Advance Authorization Scheme (AA)

If an exporter is importing goods which are ultimately used in goods exported then this is one of the most popular schemes of India since 1976. It is a duty exemption scheme wherein the exporter shave to incorporate such inputs physically in export goods subject to a minimum value addition of 15% generally. Exemption is available not only from Basic Customs Duty, Additional Duty, Safeguard Duty, Anti-dumping Duty but also from IGST and Compensation Cess[1] generally. Authorisation is issued for physical exports as well as for deemed exports. AA is subject to actual user condition. AA is not available for specific export or import of goods such as bio-technology related goods, fruits, vitamins etc. Domestic Sourcing of inputs is also allowed under AA through prescribed procedure.

There is a room for wastage and the benefit is extended to packing material, fuel, oil, catalyst consumed in production process[2]. One of the interesting conditions of AA is imports of raw materials shall be done on the basis of SION i.e. Standard Input Output Norms. SION are fixed by Norms Committee on DGFT on the basis of technical and other data received by DGFT for various categories of products. If SION doesn't exist then AA is issued on self-certification basis. AA has a validity period of 12 months from the date of issue of authorisation and export obligation has to be fulfilled in 18 months from the date of issue of authorisation. AA are non-transferable.

In case any additional input is to be used, the same can be imported under self ratification scheme[3]. Further, advance authorisation is also available for annual requirement for goods notified in SION except a few. Sector Specific schemes or conditions are provided for spices, apparel and clothing accessories, gems and jewellery.

[1] *Notification No. 18/2015-Cus. Dated 01.04.2015*
[2] *Chapter 4 of Foreign Trade Policy 2023 (FTP 2023)*
[3] *Para 4.06 of FTP 2023*

Duty Free Import Authorization (DFIA)

DFIA is issued for duty free import of inputs with minimum value addition requirement of 20%[4]. DFIA is exempted only from payment of Basic Customs Duty. DFIA is issued on post export basis for products for which SION is notified. DFIA is transferable. DFIA are issued with validity period of 12 months from the date of issue. Exports shall be completed in 12 months from the date of filing online application. DFIA is not available for gems and jewellery sector. From the date of export or 6 months from the date of realisation of export proceeds, whichever is later, application shall be made for issuance of transferrable DFIA.

Advance Authorization Scheme vs. Duty Free Import Authorization Scheme

Advance Authorization Scheme (AA)	Duty Free Import Authorization Scheme (DFIA)
Authorisation with actual user condition	Post import authorisation
Minimum Value addition – 15% generally	Minimum Value addition – 20% generally
Eligible for both SION/Non-SION goods	Only for SION products
Imports are exempted from payment of BCD, Additional Customs Duty, Anti-dumping, countervailing and safeguard duty, GST and Compensation Cess	DFIA is exempted only from payment of Basic Customs Duty (BCD)
Non-transferrable authorisation	Freely transferrable authorisation

Though DFIA is freely transferrable, AA is much more popular considering vast benefit of saving not only BCD but various other additional Customs Duties, Safeguard Duties etc. at the stage of import itself.

Export Promotion Capital Goods Scheme (EPCG):

One of the important schemes of FTP is EPCG Scheme where major cash outflow i.e. Customs Duties on Capital Goods can be saved[5]. For manufacturer exporters, this popular benefit continues to be part of new FTP 2023.It may be noted that this Scheme is not only available to exporters of goods but also to specific exporters of services. EPCG allows import of capital goods for pre-production, production and post-production.There is no post export EPCG Scheme in New FTP 2023. Exemption is available from basic customs duty and additional customs duty. In case of physical exports, exemption is extended to IGST and Compensation Cess.

Validity period of EPCG authorisation is of 24 months from the date of issue of such authorisation. With a view to promote make-in-India concept, capital goods can also be sourced indigenously and domestic manufacturer of capital goods would then be eligible for deemed export benefit.

[4] *Para 4.24 of FTP 2023*
[5] *Chapter 5 of FTP 2023 read with Notification No. 16/2015-Customs dated 01.04.2015*

Under the new FTP 2023, import of capital goods under EPCG Scheme is subject to fulfilment of specific export obligation of 6 times the duties and taxes saved which shall be fulfilled in 6 years from the date of issue of authorisation. While calculating duties and taxes saved, IGST and Compensation Cess shall be excluded if the importer has paid such taxes and cesses in cash and Input Tax Credit thereof is not claimed. In other words, if ITC of IGST or Compensation Cess is claimed, the same is also considered to be duties and taxes saved for calculation of export obligation. Imported capital goods are subject to actual user condition until export obligation is fulfilled. In case capital goods are procured indigenously, specific export obligation to be fulfilled shall be 75%. Specific export obligation to be fulfilled as under for block of years:

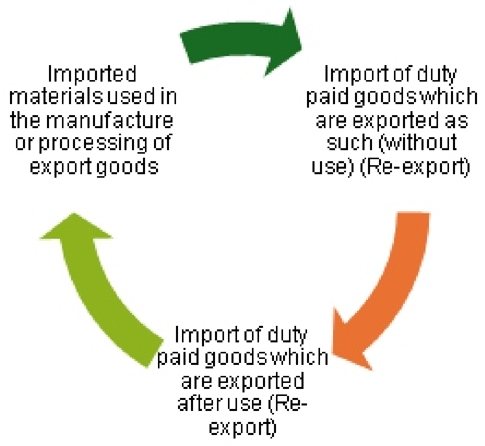
Period from the date of issue of authorisation	Proportion of total export obligation to be fulfilled
1^{st} to 4^{th} year	Atleast 50%
5^{th} and 6^{th} year	Balance 50%

In view of possible gradual growth, balance 50% export obligation can be fulfilled in last 2 years from the date of authorisation.

Export obligation under the scheme shall be, over and above, the average level of exports achieved by authorisation holder in the preceding 3 licensing years for same or similar products within the overall Export obligation period except few categories of goods. The Average Export Obligation (AEO) shall be fulfilled every financial year until export obligation is completed on overall basis. Exports over and above AEO shall only be considered for fulfillment of Export Obligation under EPCG authorisation. Therefore, there is direct measurement of duty saved on import of capital goods viz-a-viz incremental exports done. For few sectors such as handicrafts, agriculture, etc., AEO is not required to be fulfilled.

Duty Drawback Scheme (DBK) Scheme

'Drawback' scheme is a scheme to claim benefit of Customs Duties and Central Excise, borne by either imported goods re-exported or by the inputs and input services used in manufacture of exported goods. Following types of duty drawbacks are available:



Duty drawback in cases of re-export[6]:

In case of re-export of goods, duty drawback is available for all customs duties paid along with IGST and Compensation Cess provided goods are re-exported within 2 years from the date of payment of duty or extended time period, as is allowed by CBIC.

For unused goods, 98% of import duty is available as duty drawback. For used goods, depending upon the period of use, duty drawback rates are notified from 95% to 60% except motor car or goods imported for personal and private use. If the goods are re-exported after 18 months, no duty drawback is available.

In case of re-export of used wearing apparels, tea-chests, exposed cinematograph films passed by the Board of Film Censors in India and Unexposed photographic films, paper and plates, and X-ray films, duty drawback is not available.

[6] *Section 74 of Customs Act 1962*

Duty drawback in cases of manufacture of goods[7]:

In case of manufacture of goods, duty drawback is available to Customs Duty other than IGST and GST Compensation Cess. Rate of drawback in this case is as a percentage of the free on board value or the rate per unit quantity of the export goods.

- Drawback is allowed as per All Industry Rate (AIR) notified by Drawback Directorate
- Exporter may also apply for Brand Rate if AIR is not determined
- Exporter may also apply for Special Brand Rate if duty drawback as per AIR is less than 80% of import duty

Duty drawback is not available if there is negative value addition or if the value addition in % terms is not achieved as notified by Central Government.

Remission of Duties and Taxes on Exported Products (RoDTEP Scheme)

In view of long drawn dispute at WTO, India has introduced this Scheme only from 1 January 2021 replacing one of the most popular Foreign Trade Scheme i.e. MEIS (Merchandise Exports from India Scheme). RoDTEP Scheme provides remission of taxes, duties, and levies at the Central, State, and Local levels, which are not refunded through any other existing mechanisms such as VAT, mandi tax, taxes on fuel, etc. Rebate is allowed as per notified percentage of FOB (free on board) value of exports. This scheme is based on the globally accepted principle that *"exports should be of goods and services and not of duties and taxes"*. In this case, rebate is issued as a transferable electronic scrip which can be used to pay Basic Customs Duty.

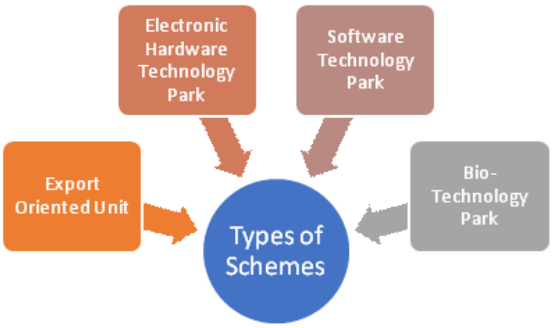
Product wise schedule is provided wherein rebate is available in the range of 0.3% to 4.3% on FOB value of exports[8]. Though the benefit is peanuts when compared with earlier MEIS Scheme, RoDTEP benefit is available to numerous sectors and is extended to both manufacturer exporters and merchant exporters. One of the pertinent conditions is that the goods should be of Indian Origin to claim the benefit of RoDTEP.

If the Organisation has a typical structure focusing on exports, major benefits are available through following routes:

Export Oriented Units (EOU) Scheme

There are various types of Schemes provided hereunder:

Units undertaking to export their entire production may be set up under this scheme for import without payment of duties. This Scheme is available for Units engaged in manufacture of goods including repair, re-making, reconditioning, re-engineering, rendering of services, development of software, agriculture, biotechnology, horticulture etc. One may note that trading units cannot get status of EOU.



Projects with minimum investment of Rs. 1 Crore in plant and machinery shall be considered for establishment as EOU except units engaged in IT services, agriculture, handicraft etc.100% FDI investment is permitted through automatics route similar to SEZ Units.

[7] *Section 75 of Customs Act 1962*
[8] *Appendix 4R of Handbook of Procedures 2023 (HBP 2023)*

Exemption is available from Basic Customs Duty as well as Additional Customs Duty[9]. Further, inputs and capital goods imported are subject to actual user condition which have to be used for export production. Export proceeds shall be realised in 9 months from the date of export.

One of the pertinent conditions for EOUs is achievement of positive Net Foreign Exchange (NFE). Calculation of NFE is done cumulatively for the block of 5 years starting from commencement of production with extension upto 1 year as is approved by Board of Approvals. NFE is calculated as under:

Positive NFE =A-B>0

A = FOB value of export by EOU/EHTP/STP/BTP Unit

B = CIF (Cost Insurance Freight) value of all imported inputs and capital goods + value of payments made in foreign currency such as commission, royalty etc. + High sea purchases even if in INR

Though this Scheme is fit for Units with 100% exports, the Unit can very well sell goods in Domestic Tariff Area. Therefore, if manufactured goods are removed to DTA, alongside GST liability on removal of goods to DTA, basic customs duty, GST and other customs duties would also have to be paid on imported goods used in manufacture of such goods.

It is extremely important to note that this is an old school scheme which requires heavy investment with strict compliances and therefore, the Organisation needs to be diligent for entry in and exit from this Scheme.

Special Economic Zone (SEZ)

SEZ is a specifically allocated duty-free enclave and shall be deemed to be foreign territory for the purposes of trade operations, duties and tariffs[10]. Customs authorities do not carry out routine examination of export or import cargo, however, SEZ being a separate geographical area does include various procedures for taking goods into or out from SEZ. This is one of the popular Scheme amongst service exporters. In the manufacturing sector, barring a few segments, 100% FDI is allowed. SEZ also needs to achieve positive NFE.

Goods and services coming to SEZ units from domestic tariff area (DTA) are treated as exports from India and goods and services rendered from SEZ to DTA are treated as import into India. Import of goods and services for SEZ units and developers are duty free when meant for their authorized operations. Further, goods imported for setting up SEZ Units are also granted exemption from payment of Duties and Taxes. All supplies by DTA to SEZ are treated as exports and are considered as zero rated supplies under GST Law.

Free Trade Warehousing Zones

These are special Category of SEZs with a focus on warehousing and trading in free currencies with the object of making India a global trading hub like Dubai and Singapore. FTWZ units are allowed to hold inventory on behalf of foreign suppliers or domestic buyers. If an Organisation doesn't intend to carry out any processing but is engaged in trading i.e. import and export or import and DTA sale of goods with packing, re-packing, re-sale, assembly of CKD (Complete Knockdown)/SKD (Semi-Knockdown) goods etc., FTWZ could be a game changer to save working capital. It is interesting to note that Organisation need not have its own warehouse i.e. imported goods can avail warehousing services of any FTWZ Unit..FTWZ is one of the Scheme in India which allows deferment of customs duty without incurring interest or penalty.

[9] Notification No. 52/2003-Cus. Dated 31.03.2003
[10] Special Economic Zones Act, 2005

Manufacturing and other operations in Warehouse under bond (MOOWR)

This is one of the recent Schemes which allows importer manufacturer to defer payment of Customs Duties until removal thereof for home consumption. All Customs Duties are deferred on import of inputs and capital goods since it is a customs bonded warehouse registered under Section 65 of Customs Act 1962 wherein the owner of the warehoused goods can carry on any manufacturing process or other operations in the warehouse with prior permission of Principal Commissioner of Customs or Commissioner of Customs in the Units registered under Manufacturing and Other Operations in Warehouse (no. 2) Regulation 2019, popularly known as MOOWR scheme.

From a date to be notified yet[11], deferment of such Customs Duties is restricted to duties other than IGST and Compensation Cess and therefore, from a notified date goods can be deposited in such warehouse only after payment of IGST and Compensation Cess. IGST and Compensation Cess paidon impots shall be available as input tax credit (ITC) subject to conditions as mentioned in Customs Laws and GST Laws.

Once the goods are manufactured, Customs Duties on imported goods shall be paid if finished goods are removed to domestic markets. In case finished goods are exported, there is no need to pay any Customs Duties thereon.

Hitherto, this Scheme was quiet attractive in view of working capital benefit, no requirement of export commitment and lesser compliances as compared to EOUs and SEZs. However, this Scheme faced small turbulence with recent amendment which removed deferment of IGST and Compensation Cess.

Preferential Trade Agreements(PTAs)/Free Trade Agreements (FTAs)

If the Orgainsation doesn't export but is engaged in import from particular Country/Countries especially Asian Countries, one of the major benefits could be availed through Preferential Trade Agreements and/or Free Trade Agreements. Few examples of PTAs / FTAs are:

- India-Sri Lanka Free Trade Agreement (FTA);
- Agreement with South Asian Free Trade Area (SAFTA);
- Agreement with Association of Southeast Asian Nations (ASEAN);
- India-South Korea Comprehensive Economic Partnership Agreement (CEPA);
- India-Japan CEPA etc.

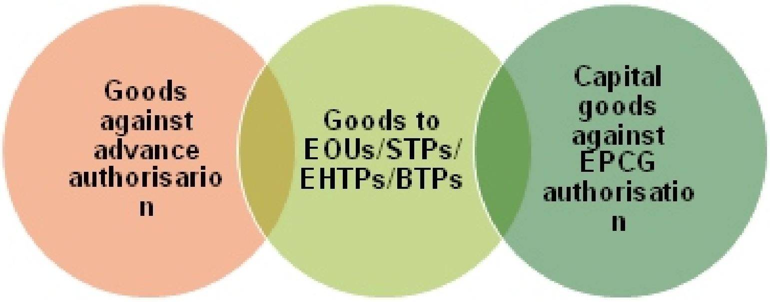
For regular imports, this benefit directly affects the top line of business and can help to beat competition with other manufacturers either using indigenous duty paid goods or using imported goods from other Countries without the benefit of PTAs/FTAs. Saving in Customs Duty may reach to 100% i.e. complete exemption from Customs Duty. Key essential to avail this important benefit is procuring Certificate of Origin. To restrict misuse of this benefit, now, importer is required to carry out due diligence to ensure that goods meet the criteria of rules of origin[12].

[11] *Amendment made through Finance Act 2023, effective date of which is yet to be notified*

[12] *Custom (Administration of Rules of origin under Trade agreements) Rules, 2020*

Deemed Exports

Even if the Organisation is not directly engaged in exports but in penultimate exports, benefit of deemed export can be explored. Therefore, if Indian manufacturer supplies:



then deemed export benefit is available under FTP as well as GST Law.

Further, supply by main or sub-contractor to specific projects such as projects financed by multilateral or bilateral agencies, projects under international competitive bidding (ICB) etc. also enjoy benefit of deemed export under FTP. Under FTP, benefit of advance authorization, Duty Drawback and/or Terminal Excise Duty is available[13] whereas under GST Law, refund can be claimed by either supplier or recipient of deemed exports[14].

Though the Schemes are lucrative, importers and exporters shall be cautious for compliances to be done under FTP, HBP and various other provisions of Customs Laws since heavy penal consequences may arise for failure to adhere to stringent provisions of relevant Laws. Penal consequences under Foreign Trade Policy read with Foreign Trade (Development & Regulation) Act, 1992 could be as high as 5 times the value of goods or services[15].

The author has tried to provide a broad overview above of important incentives available to genuine and serious exporters to save import duties and taxes. Further, there are various other incentives such as Status Holder recognition, Gold Card Scheme, market access initiative scheme, etc. which can be availed by such exporters under FTP .Though there are no sky-high incentives discussed above in new Foreign Trade Policy 2023but steps are taken to promote exports, ease of doing business and reduce transaction costs.

[13] *Chapter 7 of FTP 2023*
[14] *Section 147 of CGST Act 2017 read with NOTIFICATION No. 48/2017–Central Tax dated 18.10.2017*
[15] *Section 11 (2) of Foreign Trade (Development and Regulation) Act, 1992*

SIGNIFICANT ECONOMIC PRESENCE

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1. Background

1.1. The Organization for Economic Co-operation and Development ('OECD'), with a view to curb double non-taxation and evasion of taxes introduced its report titled **'Action Plan on Base Erosion and Profit Shifting'**. The Base Erosion and Profit Shifting ('BEPS') Action Plan, inter-alia, addressed the challenges posed by the spread of the digital economy on international taxation. BEPS Action Plan 1 deals with identifying and addressing various challenges posed by taxation of digital economy.

1.2. Under the BEPS Action Plan, the OECD established the Task Force on the Digital Economy to develop a report identifying issues raised by the digital economy. The Task Force analysed the following options to curb the tax challenges faced in an increasingly digitalised economy:

- new nexus in the form of a Significant Economic Presence ('SEP')
- withholding tax on certain types of digital transactions
- equalisation levy

1.3. The above options / alternatives were not recommended by the Task Force; however, countries could adopt all / any of the above alternatives to address the challenges faced by them. Subsequently, the Central Board of Direct Taxes('CBDT') established a committee on taxation of e-commerce. The committee recommended the introduction of equalisation levy. Further, as a part of 'Other Recommendations', it was also of the view that the concept of 'business connection' may be expanded to include the concept of SEP. The object behind introducing the concept of SEP was to widen the scope of 'business connection' within which business profits could be taxed in order to include digital transactions. In connection with the same, the observations of the committee were as under-

"53. In view of the extensive analysis of these aspects provided in the BEPS Report on Action 1 and the observations made above, ***the Committee is of the view that the physical presence based threshold for taxing income in the economy from where the payments arise, was conceptualized in an era when it reasonably indicated the significant economic presence of an enterprise in the economy of a jurisdiction.*** *The evolution of the definition of permanent establishment, both in terms of its interpretation, as well as in terms of alternate conditions that give rise to it, is an evidence of the adaptation of this rule to the evolving ways in which business conducts itself.* ***It signifies the dynamic evolution of taxable nexus with business modes, and justifies its further evolution to the needs of new business models of digital economy."***

2. Overview of SEP provisions

2.1. Vide Finance Act, 2018, the scope of 'business connection' in India was expanded to include the concept of SEP by insertion of Explanation 2A to Section 9(1)(i) of the Income-tax Act, 1961 ('the Act'). The said provisions were enforceable with effect from 1 April 2019. The Memorandum explaining the provisions to the Finance Bill, 2018 categorically stated that –

- *"..with the advancement in **information and communication technology in the last few decades**, new business models operating remotely through **digital medium** have emerged.."*
- *"..**OECD under its BEPS Action Plan 1** addressed the tax challenges in a **digital economy** wherein it has discussed several options to tackle the direct tax challenges arising in **digital businesses**. **One such option is a new nexus rule based on 'significant economic presence'**.*
- *"As per the Action Plan 1 Report, a non-resident enterprise would create a taxable presence in a country if it has a significance economic presence in that country on the basis of factors that have a purposeful and sustained interaction with the economy by the aid of **technology and other automated tools**. It further recommended that revenue factor may be used in combination with the aforesaid factors to determine 'significance economic presence'."*
- *"..emerging business models such as **digitized businesses**, which do not require physical presence of itself or any agent in India, is not covered within the scope of clause (i) of sub-section (1) of section 9 of the Act.."*

2.2. However, vide Finance Bill 2020, the SEP provisions were deferred to apply from Assessment Year 2022-23. The explanation offered by Memorandum to the Finance Bill, 2020stated as under–

"..since discussion on this issue is still going on in G20-OECD BEPS project, these numbers have not been notified yet. G20-OECD report is expected by the end of December 2020.."

2.3. Also, apart from such deferral of the provisions, certain drafting changes were made to Explanation 2A to Section 9(1)(i) of the Act. Post the changes, SEP, as per Explanation 2A to Section 9(1)(i) of the Act shall mean:

(I) transaction 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, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed **[Transaction based SEP]**; or

(ii) systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India, as may be prescribed **[Activity based SEP]**.

2.4. Further as per the first proviso to Explanation 2A to Section 9(1)(i) of the Act, transactions shall constitute SEP irrespective of:

(i) Whether the agreement for such activities is entered in India or not; or

(ii) Whether the non-resident has a residence or place of business in India or not; or

(iii) Whether non-resident renders services in India or not

This proviso further solidifies the position that Explanation 2A was inserted to bring within the scope of 'business connection' those transactions / activities that would not be covered within the scope of 'general business connection' as per Explanation 1(a). This creates a virtual nexus of the non-resident in India.

Transaction based SEP

2.5. Transaction based SEP seeks to cover transactions ***'in respect of'*** goods / services / property. While interpreting the phrase 'in respect of', reference may be drawn to the judgement of the Hon'ble Supreme Court in the case of *Engineering Analysis Centre of Excellence Private Limited v CIT*(2021) 125 taxmann.com 42 (SC) which held that the phrase 'in respect of' has to be given a wide meaning. It has been used in the sense of *being connected with* something and must be interpreted in the broader sense. Accordingly, it can be inferred that SEP seeks to cover all transactions that *relate to* goods / services / property.

2.6. Further, with the inclusion of 'property' in Explanation 2A, the scope of Transaction based SEP is extended. As per *Black's Law Dictionary (6th edition, 1990)*, 'property' has been given following meanings:

- That which is peculiar or proper to any person; that which belongs exclusively to one. In the strict legal sense, an aggregate of rights which are guaranteed and protected by the Government.

- The word is commonly used to denote everything which is the subject of ownership, corporeal or incorporeal, tangible or intangible, visible or invisible, real or personal; everything that has an exchangeable value or which goes to make wealth or estate.

The above meaning of the term property is wide and thus, it indicates that Explanation 2A seeks to cover transactions relating to any kind of property.

2.7. It is important to note that the presence of physical operations in India is not a prerequisite for the establishment of a business connection and the subsequent attribution of income to India.

2.8. The transaction must be carried out with 'any person in India'. This implies that the counter party with whom the non-resident is transacting must be *in India*, irrespective of whether such person is resident or non-resident. This ensures that the non-resident is virtually economically connected with India for the purpose of creating a business connection.

2.9. Further, the transactions should be 'carried out'. 'carryout' has been defined in **New Shorter Oxford English Dictionary (1993)** as "*perform, conduct to completion and put into practice*".

2.10. Having regard to above, it appears that the clause is wide enough to cover all kinds of transactions of goods / services/ property by non-residents with persons in India provided the payments are above the prescribed monetary threshold. In this connection, Rule 11UD of the Income-tax Rules, 1962 ('the Rules') prescribes the threshold limit of Rs. 2 Crores during the previous year for aggregate amount of payments to trigger Transaction based SEP

Activity based SEP

2.11. To fall within the scope of Activity based SEP, there should either be 'systematic and continuous soliciting of business activities' or 'engaging in interaction with' such number of users in India.

2.12. As per Black's Law Dictionary, 'systematic' is defined to mean a methodical and repeatable procedure. Therefore, for the activity to constitute SEP, it should not be carried out in a haphazard manner and must be done in an orderly and planned manner.

2.13. As per Pramanatha Aiyar's Advanced Law Lexicon, 'continuous' is defined to mean recurring at repeated intervals so as to be of repeated occurrence; without interval or interruption. Therefore, the activity should be of a recurring nature and should not be a one-time act.

2.14. There should be 'soliciting of business activities', therefore, in order to constitute SEP there need not be solicitation of the business as a whole. As per Oxford Learner's Dictionary, 'solicitation' refers to the act of asking somebody for something, such as support, money or information; the act of trying to get something or persuading somebody to do something.

2.15. Therefore, to summarise, the solicitation of business activities should be done in a repeated, recurring and methodical manner in order to constitute SEP.

2.16. Under Activity Based SEP, SEP can also be constituted if the non-resident is engaging in interaction with such number of users in India. As per Pramanatha Aiyar's Advanced Law Lexicon, the term 'engaged' ordinarily, means doing of more than one act or one transaction. In a way, the term 'engaged' also represents continuous activity and not a mere one-off activity.

2.17. Further, 'interaction' with users also constitutes SEP in India. While the scope of what constitutes 'interaction' with users is not specified in the Act, the OECD in its 'Public Consultation Document Addressing the Tax Challenges of the Digitalisation of the Economy' had identified various indicative factors that would constitute a sustained interaction with users via digital means:

- the existence of a user base and the associated data input;
- the volume of digital content derived from the jurisdiction;
- billing and collection in local currency or with a local form of payment;
- the maintenance of a website in a local language;
- responsibility for the final delivery of goods to customers or the provision by the enterprise of other support services such as after-sales service or repairs and maintenance; or
- sustained marketing and sales promotion activities, either online or otherwise, to attract customers.

2.18. The scope of what constitutes 'users' in India is also not defined. Similar to transaction-based SEP, the counter party should be 'in India' irrespective of its residential status. In this connection, Rule 11UD of the Rules prescribes the threshold limit of 3 lakh users for the number of users with whom systematic and continuous business activities are solicited or who are engaged in interaction in order to determine Activity based SEP.

2.19. One of the question which could arise is; does the above threshold include 'free' users or does it only include 'paid' users who pay consideration to the non-resident. In such a situation, it has to be determined whether the users and the e-commerce operator are *interacting* for the purpose of establishing SEP. Will such 'users' be considered in determining SEP threshold? will such solicitation of business activities be considered as 'continuous' and 'systematic'? – clarity is not provided on such key points and differing interpretations can be drawn for the same.

Scope of SEP – Whether also covers non-digital transactions?

2.20. The definition of SEP was amended through Finance Act, 2020, wherein the term 'digital means' was deleted from Clause (b) of Explanation 2A to section 9(1)(i) of the Act. Thus, it can be inferred that SEP provisions cover 'digital' as well as 'non-digital' transactions.

2.21. Therefore, the scope of SEP is quite wide and can potentially cover any transaction carried out by a non-resident irrespective of whether it is through digital means or otherwise.

2.22. Further, vide **Letter No. 370412/11/2018-TPL**, the CBDT had called for suggestions/comments of stakeholders and the general public regarding revenue threshold for transactions in respect of ***physical goods or services.*** Although Rule 11UD as enacted does not prescribe such threshold for physical goods or services, doubt still remains over the scope of SEP provisions.

2.23. However, another possible interpretation is that, although the words "through digital means" were deleted vide Finance Act, 2020, the intent to introduce the concept of SEP remains the same i.e. to levy tax on emerging business models in the era of "digital economy".Such an inference could be drawn since the Committee on taxation of e-commerce formed by the CBDT which recommended the inclusion of SEP within the scope of 'business connection', was specifically formed to provide recommendations to address challenges posed by emerging business models in the "digital economy". Further, BEPS Action Plan 1 on 'Digital Economy' recognises SEP as one of the measures for taxing digital transactions.

2.24. In this connection, it may be noted that vide Finance Act 2020, Explanation 3A to Section 9(1)(i) was inserted which has extended the scope of income attributable to operations in India as per Explanation 1 by including within its purview income from:

(i) Advertisement services targeting Indian customers;

(ii) Sale of data;

(iii) Sale of goods and services using data collected.

The Finance Act also states that the above Explanation shall apply to income attributable to transactions or activities as referred to in Explanation 2A w.e.f. AY 2022-23.

2.25. The above Explanation merely extends the scope of Explanation 1 to include within its ambit the aforementioned income which are attributable to operations carried out in India. Further, it shall also include income attributable to transactions or activities that constitute SEP. The Explanation starts with the phrase '*for the removal of doubts…*' Accordingly, Explanation 3A does not create a nexus / business connection by itself but merely clarifies that such income is included in the scope of Explanation 1 and Explanation 2A.Since Explanation 3A mainly deals with digital economy related specific items which are specifically covered for attribution purposes in Explanation 2A 'also', one may contend that Explanation 2A covers within its purview only such digital transactions or income generated on account of the digital transactions.

2.26. From a practical standpoint, it may be noted that even the Indian tax authorities do not require filing of Form 15CA/ 15CB with respect to payments for import dues. Therefore, such payments do not even require reporting before the tax authorities. If the intent was to levy tax even in respect of traditional imports payments, CBDT could have amended the Rules requiring furnishing of Form 15CA / CB in respect of all transactions where the threshold under SEP rules is met. However, this has not been done yet. Thus, above practical indicator could be relied on to interpret that only the digital transactions should be covered within the purview of SEP.

2.27. However, this is still an untested proposition and only time would tell whether purposive interpretation would succeed over the literal interpretation; and the manner in which jurisprudence develops on this aspect.

3. Equalisation Levy

3.1. As mentioned earlier, Committee on taxation of e-commercerecommended the introduction of equalisation levy. Subsequently, vide Finance Act, 2016, the concept of Equalisation Levy was introduced (India becoming one of the first countries to do so)at the rate of 6% of the amount of consideration for online advertisement services.

3.2. Further, the scope of equalisation levy was expanded by Finance Act, 2020, to include online sale of goods and services in India through digital means at the rate of 2% of the amount of consideration received or receivable by an e-commerce operator.

Interplay between Equalisation Levy and SEP

3.3. In case of co-existenceof Equalisation Levy and SEP provisions, a doubt may arise as to which of the provisions are applicable.

3.4. In this regard, reference may be drawn to section 10(50) of the Act, which stipulates that income chargeable to equalisation levy will be exempt from tax under the provisions of the Act. Accordingly, in case of overlap, the provisions of Equalisation Levy will prevail and income attributable to SEP will not be chargeable to tax.

3.5. Both equalisation levy and SEP provisions are concerned with taxation of digital economy. The concept of SEP is much broader than Equalisation Levy. SEP would result in Business Connection whereas Equalisation Levy will be levied where there is no PE. Further, SEP covers the services which are covered under Equalisation levy regime, giving rise to overlapping of services covered under both the concepts. However, there will be no double taxation on those items which are subjected to equalization levy and accordingly, exempted as per the provisions of section 10(50) of the Act.

3.6. Also, it is interesting to note that given the above interpretation the provisions of equalization levy would prevail, the thresholds provided for the trigger of SEP provisions become academic. This aspect further deepens the controversy regarding relevance of SEP and its applicability to non-digital transactions.

3.7. In other words, such an overlap of SEP and equalization levy could lead to an adverse impact on non-residents if a view is taken that SEP is wide enough to cover even non-digital transactions. For example, if a non-resident enters into a digitalized transaction for online sale of goods or services with a person in India which is subject to both SEP and Equalisation levy provisions, the equalization levy provisions will prevail, accordingly, the non-resident will be liable to such levy at the rate of 2% of the consideration received / receivable (instead of 40% in case SEP provisions were applicable). However, in case of import of physical goods which do not attract equalisation levy, owing to ambiguity regarding the scope of SEP, the non-resident (assuming from a non-treaty country) may be covered within SEP provisions and shall be taxed at the rate of 40% (plus surcharge and cess). Therefore, on account of the provisions of section 10(50) of the Act, the non-resident would be taxed at the rate of 2% for digital transactions and at the rate of 40% for non-digital transactions even though the very purpose of insertion of SEP provisions was to tax digital transactions.

4. Interplay with tax treaties

4.1. The SEP provisions form part of the scheme of the Act, therefore they cannot override the beneficial provisions of the tax treaties that contain the conventional concept of permanent establishment ('PE') for taxing business profits of a non-resident (unless the tax treaties are amended).The Memorandum to Finance Bill 2018also clarified that unless corresponding modifications to PE rules are made in the DTAAs, the cross border business profits will continue to be taxed as per the existing treaty rules.

4.2. Further, even MLI does not contain a separate article for e-commerce taxation. Thus, as long as a non-resident is entitled to the tax treaty benefits, the provisions of such tax treaty would prevail over the SEP provisions and such provisions would become academic.

Impact on non-treaty jurisdictions and non-residents not eligible for treaty benefit

4.3. In case of non-resident located in a non-treaty jurisdiction, the SEP provisions of section 9 of the Act may apply.

4.4. Therefore, where SEP/ business connection of a non-resident is constituted in India, it would be subject to tax at 40% (plus surcharge and education cess) on its net income attributable to its operations in India. Consequently, the payer may be required to withhold tax at such rate from the payments.

4.5. However, Equalisation Levy does not form part of the provisions of the Act but it is an independent chapter in the Finance Act and therefore, remains unaffected whether the tax treaty provisions are applicable or not.

5. Withholding Implications

5.1. In case of non-residents situated in non-treaty jurisdictions who are not able to avail treaty benefits and in case of non-residents to whom treaty benefits have been denied, withholding implications under section 195 of the Act may apply(provided the provisions of equalization levy do not apply) in case it is determined that such non-residents have SEP in India.

5.2. However, in absence of well-defined rules, this may lead to significant compliance burden in the hands of the non-resident to provide information regarding its users, revenue, etc. and at the same time very onerous obligation on the payer given the grave consequences which could result if tax is not withheld at the rate of 40%.

5.3. Thus, from a withholding perspective, it is imperative that the payer always insists for the non-resident recipient to provide adequate documentation which would support its claim for tax treaty benefits to mitigate the tax impact on account of harsh SEP provisions.

6. Profit attribution to SEP

6.1. As per second proviso to Explanation 2A, only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) of Explanation 2A shall be deemed to accrue or arise in India.

6.2. However, there is no specific guidance provided by CBDT for attribution of profits in case of SEP and the aspect of attribution of profits to SEP is ambiguous.

.3. The primary concern that arises in this regard is as to how profit should be attributed based on user activity. Traditionally, profit has been attributed based on sales, manpower / wages and assets (with appropriate weightage to be given to all three factors) i.e. FAR (Functions, Assets and Risk Analysis). However, profit arising out on account of Transaction or Activity based SEP may not fall within the scope of traditional factors of profit attribution.

6.4. However, reference may be drawn to BEPS Action Plan 1 which analyses three alternatives / options for attributing profits to SEP as under:

- Replacing functional analysis with an analysis based on game theory that would allocate profits by analogy with a bargaining process within a joint venture.
- The fractional apportionment method wherein the profits of the whole enterprise relating to the digital presence would be apportioned either on the basis of a predetermined formula or on the basis of variable allocation factors determined on a case-by-case basis. However, this would require –(1) definition of the tax base to be divided, (2) the determination of the allocation keys to divide that tax base, and (3) the weighting of these allocation keys.
- The deemed profit method wherein the SEP for each industry has a deemed net income by applying a ratio of the presumed expenses to the taxpayer's revenue derived in the country. Determining an appropriate ratio would depend on a number of factors, including the industry concerned, the degree of integration of the particular enterprise, and the type of product and service provided.

6.5. Further, the CBDT included a chapter in its draft report on Profit Attribution to Permanent Establishments (CBDT Press Release F 500/33/2017-FTD.I dated 18th April, 2019)also laid out various recommendations for determining the profits attributable to SEP of non-resident in India and the requisite amendments which should be carried out either in Rule 10 or the amendment of the Income-tax Act itself to incorporate a provision for profit attribution to a PE. However, none of these recommendations have still seen the light of the day.

6.6. Therefore, the contention that the entire income attributable to the transactions or activities shall be taxable in India based on second proviso of Explanation 2A, seems to be against the alternatives for profit attribution as laid down in BEPS Action Plan 1 as well as CBDT draft report for profit attribution. Thus, until the Government provides any clarity on attribution of profits to SEP, confusion shall persist over such attribution methodology.

Overlap between Explanation 1 and Explanation 2A of section 9(1)(i)

6.7. As per second proviso to Explanation 2A, only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) of Explanation 2A shall be deemed to accrue or arise in India. At the same time Explanation 1(a) seeks to cover only those business for which the operations are ***'carried out in India'*.**Further, Explanation 1(a) specifically mentions that its scope is restricted to businesses having a business connection in India provided that such business connection is not constituted by means of SEP.

6.8. Therefore, in case of business connection by way of SEP, it is not necessary that the transaction must be 'carried out in India'. Furthermore, the purpose of inclusion of Explanation 2A was to bring within the scope of 'business connection' those transactions that eluded Explanation 1(a) since such transactions were not carried out in India.

6.9. While one may contend that the provisions of SEP overpower those contained in Explanation 1(a) since they seek to cover transactions carried out in India as well as outside India with a counter party in India as long as it meets the Transaction or Activity based SEP thresholds.

6.10. However, if Explanation 2A were to be read with the interpretation that transactions 'carried out in India' were also to be included within its scope, then it would render the very purpose of its insertion redundant. Therefore, if a transaction satisfies the threshold limits prescribed in Rule 11UD but falls within the scope of Explanation 1 (i.e. business connection is formed as a result of business carried out in India), it should not be covered by SEP provisions.

6.11. Thus, it appears that the provisions of Explanation 1(a) and Explanation 2A have been designed to ensure that both remain mutually exclusive and apply in their respective spheres.

7. Applicability of SEP to certain transactions

Import of goods

7.1. In case of import of goods or services, one may need to evaluate SEP provisions (provided that the prescribed thresholds are met). In order to determine the applicability of the provisions, one has to first consider whether the transaction has been 'carried out'. As per the Oxford Learner's Dictionaries, **carry out** means '*to do something that you have said you will do or have been asked to do*'. Further, as mentioned earlier, merely 'entering into' the transaction is not sufficient. The counter party importing the goods (whether resident or non-resident) has to be in India. One may also need to consider the *nature* of the transactions entered into. A view may be taken that considering the legislative intent behind introducing SEP provisions i.e. taxation of digital transactions, non-digital transactions can be considered to be outside the scope of SEP provisions. However, in absence of sufficient clarity / judicial precedents, doubts still remain if the said Explanation 2A could apply in case of non-digitalised transactions, especially where aggregate payments made to non-residents exceed Rs. 2 crores. Thus, it is imperative that the payer shall always insist for the non-resident recipient to provide adequate documentation which would support its claim for tax treaty benefits to mitigate the tax impact on account of harsh SEP provisions

Dividend income earned by non-resident entities

7.2. A question that may arise is whether the receipt of dividend income by non-residents as a result of investment made in Indian companies would constitute SEP. In this regard, it is pertinent to note that SEP covers only those transactions which are chargeable to tax as business income. Further, where there is an express provision for treating an item of income as deemed to accrue or arise in India, then the case may not fall within the general provision of "business connection". As income by way of dividend paid by an Indian company outside India is provided for in section 9(1)(iv) of the Act, this case may not again be brought within the scope of "business connection". Further, in order to qualify as SEP, the 'transaction' must be in respect of any goods / services / property. Since dividend becomes payable on account of the Board of Directors of the Company passing a resolution, the payment of dividend cannot be considered a 'transaction' between the resident and non-resident.

Income from royalty or Fees for technical services (FTS)

7.3. In case of payment towards royalty or FTS, a question which would arise is whether the SEP provisions would be applicable given its wide coverage. In this connection, it is imperative to note that there are specific provisions under the Act (i.e. clause (vi) and (vii) of section 9) to deal with specific case of royalty or FTS. Thus, in view of various precedents such as CIT vs. Copes Vulcan Inc. (1987) (167 ITR 884) (Bom), wherein it is held that specific would prevail over general, such specific provisions dealing with royalty / FTS under the law shall apply and the SEP provisions shall take a back seat.

Tax return filing compliances

7.4. Another issue that has arisen on the introduction of SEP provisions, is the significant compliances that need to be followed. In the income-tax return (ITR-6), non-residents are required to disclose whether they have SEP in India. In case SEP exists, non-residents are also required to disclose quantum of payment made / number of users as per Explanation 2A. In case non-resident is claiming treaty benefits to escape virtual PE created because of SEP, the non-resident is required to disclose details of the same in Schedule Exempt Income (EI). However, one may take a stand that owing to beneficial provisions of DTAA, if no income is chargeable to tax in India, reporting requirement may not arise since the requirements are based on machinery provisions. Thus, each non-resident would have to weigh the pros and cons before deciding the requirement of filing tax return in India.

8. Conclusion

Judicially, the SEP provisions have not been analysed to a large extent, mainly because of beneficial treaty provisions which prevent its application.

Various ambiguities remain over the provisions such as, whether the provisions cover non-digital transactions, rules regarding attribution of profits, the enforcement of thresholds, whether a taxpayer can obtain relief by submitting a declaration for non-applicability of the provisions, etc.

However, these provisions can be of greater significance in the future if tax treaties are amended or MLI provisions are introduced for creating a virtual PE.

In order to resolve ambiguities regarding the scope and applicability of SEP provisions and the related compliances, it is imperative that CBDT provide sufficient clarifications for the same.

BALANCING THE BOOKS AND BUILDING BRIDGES: THE ART OF NETWORKING FOR ACCOUNTING PROFESSIONALS

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In the intricate world of finance, where precision meets strategy, accounting professionals are not just number-crunchers but architects of success. "Balancing the Books and Building Bridges: The Art of Networking for Accounting Professionals" delves into the synergy between financial acumen and the power of professional connections. In the dynamic landscape of today's professional world, networking stands as a powerful catalyst for personal and career growth. This article explores the multifaceted advantages of networking, elucidating its role as a boon to professional development.

Expansive Opportunities

One of the primary merits of networking lies in the expansive opportunities it accords. Whether attending industry conferences, joining professional organizations, or engaging on online platforms, it open doors to a plethora of possibilities. These connections serve as conduits for collaboration, job prospects, and access to valuable resources. In a world where opportunities are often obscured, networking acts as a beacon, guiding professionals towards avenues they might have otherwise overlooked.

Knowledge Exchange

Knowledge exchange is another critical facet of networking. Interacting with diverse individuals within one's industry or related fields fosters a continuous flow of information. Professionals gather knowledge at conferences, seminars, and industry events. They not only share insights but also contribute to the collective wisdom that propels the entire field forward. This exchange not only broadens one's understanding but also keeps them abreast of the latest changes in financial reporting standards, tax regulations and compliance requirements.

Mentorship

Mentorship emerges as a central theme in this exploration. Mentorship creates a harmonious cycle where experience is passed down, enriching the profession with a legacy of expertise. Mentorship is a cornerstone of professional development and is readily facilitated through networking. Establishing connections with seasoned professionals provides a platform for learning from their experiences and gaining invaluable advice. Mentors, often acquired through networking channels, can offer guidance, share wisdom, and provide a roadmap for navigating the complexities of one's career journey.

Supportive Ecosystem

The supportive ecosystem created through networking serves as a safety net during challenging times. In a competitive professional landscape, having a network of individuals who can offer support, encouragement, and constructive feedback is paramount. This network not only bolsters one's confidence but also provides a sounding board for ideas and initiatives. This ecosystem dynamic not only aids in the development of aspiring accountants but also strengthens the overall fabric of the accounting community.

Career Advancement

Accountants who actively engage in networking often find themselves well-positioned for career growth as they can leverage their connections for access to job openings, referrals and strategic alliances. Networking enhances visibility and personal branding. Building a positive reputation within professional circles can open doors to new opportunities and elevate one's professional standing. Whether through social media, industry events, or collaborative projects, networking allows individuals to showcase their skills and expertise to a broader audience.

Vibrant picture of Networking as an Art Form

It's a delicate dance of numbers and relationships, a strategic endeavour that goes beyond spreadsheets. As accountants balance the books with precision, they simultaneously build bridges that span across careers, industries, and the ever-evolving landscape of finance. Networking ensures accountants are not isolated islands but interconnected hubs of information, collectively navigating the currents of change.

In conclusion, networking is the lifeblood of professional development within the accounting domain. Its ability to unlock opportunities, facilitate knowledge exchange, provide mentorship, create a supportive community, and enhance visibility collectively contribute to its transformative power. As accounting professionals navigate the complexities of their careers, actively engaging in networking becomes not just a choice but a strategic imperative for those aiming to thrive in an ever-evolving professional landscape.

Events In Retrospect

Day & Date	Committee	Program Name	Moderator / Speaker	Attendance / Views
Friday,19th January 2024	Capital Market Committees	"Fundamentals & Value Investing - Banking & NBFC Sector"	CA Pratik Chheda Equity Fund Manager with Guardian Capital	70+ participants