K C Mehta & Co LLP

Chartered Accountants

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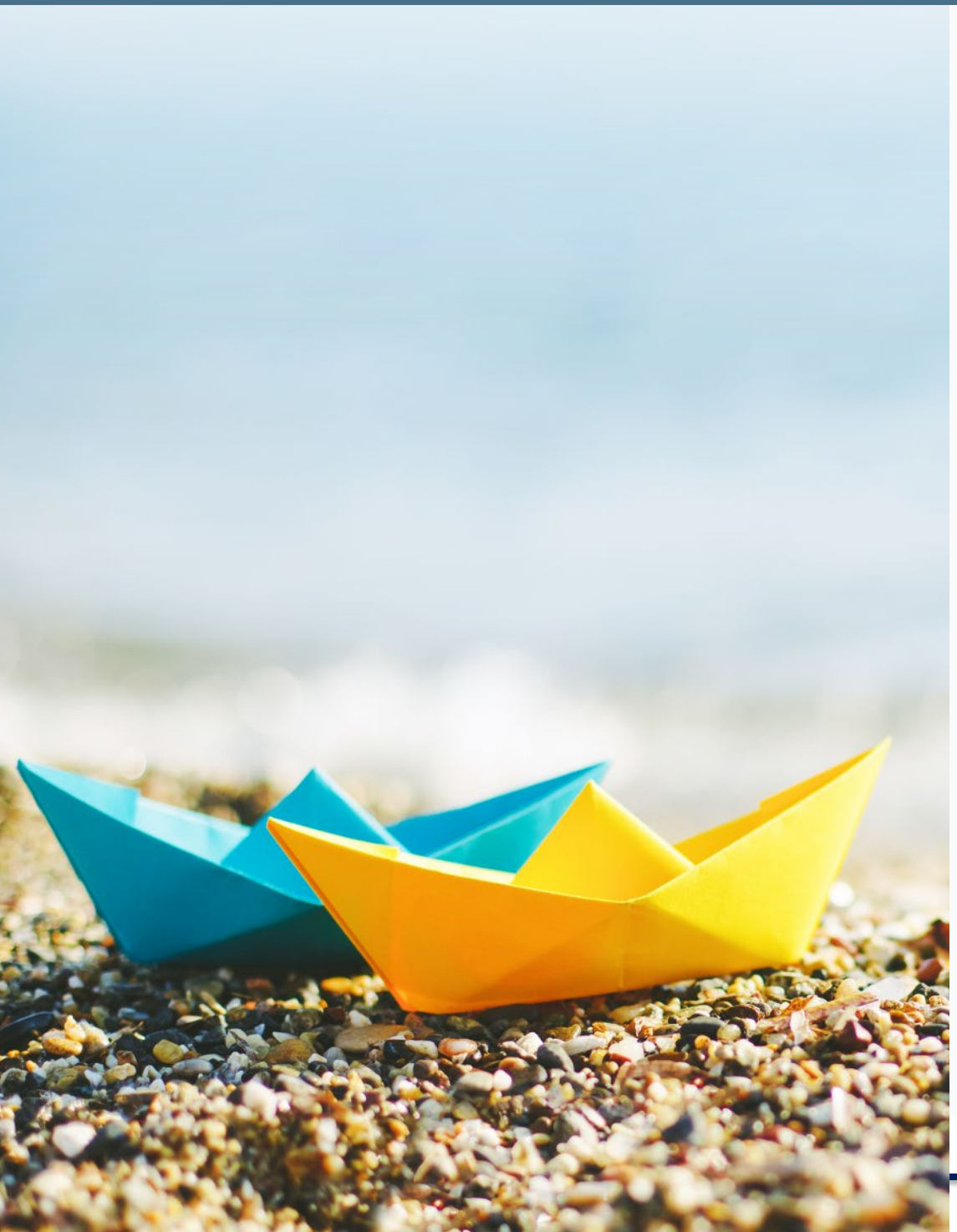

Dear Reader,

We are happy to present **kcmInsight**, comprising of important legislative changes in direct & indirect tax laws, corporate & other regulatory laws, as well as recent important decisions on direct & indirect taxes.

We hope that we are able to provide you an insight on various updates and that you will find the same informative and useful.

Coverage

Detailed Analysis

Abbreviations

For detailed understanding or more information, send your queries to kcminsight@kcmehta.com

Coverage | Detailed Analysis

Mergers & Acquisitions

Valuing the Valuers

Valuing the Valuers - Asset Managers

Corporate Tax

Important Rulings

Education institution created 'solely' for imparting education is eligible for approval u/s 10(23C) – Rule of Strict Interpretation

Amended scheme of reassessment is not applicable if the original notice u/s 148 was issued as per the pre-amended law

Section 14A not applicable merely because foreign tax sparing credit allowable

Recovery of bad debt of amalgamating company is taxable in the hands of amalgamated company

Corporate Tax

Important Notifications

CBDT extends time available to furnish modified return u/s 170A to March 31, 2023, where order of business organization was issued between April 2022- September 2022

CBDT provides rules and form for withdrawal of claim of deduction relating to cess and surcharge

International Tax

Important Rulings

Fiscally transparent LLP entitled to India-UK DTAA benefit, even prior to amending Protocol

Indian Company real employer of seconded employees; no TDS on reimbursement of Salary

Payment made for sale of advertisement space not Royalty; draws corollary from Equalization Levy

Marketing support services do not fulfil the test of make available and cannot be taxed as FTS

International Tax

Important Rulings

MFN clause is an integral part of treaty and has automatic application without a separate notification

Important Updates

Foreign

Proposal from Committee of experts - Inclusion of computer software in the definition of royalties

Transfer Pricing

Important Updates

Interest on outstanding receivables subsumed by TNMM / working capital adjustment

Notional Interest on excess share application money refunded by AE for Preference Share allotment deleted

Coverage | Detailed Analysis

Indirect Tax

Important Rulings

- SCN issued without any allegations or details of tax demand held to be invalid and liable to be set aside by Bombay High Court
- Amount received towards "Liquidated Damages" not to be treated as "Supply"
- Date of electronic submission of refund claim on GST portal to be considered as date of filing refund

Corporate Laws

Important Notifications

RBI

- Reserve Bank of India (Unhedged Foreign Currency Exposure) Directions, 2022
- Multiple NBFCs in a Group – Classification in Middle Layer
- Concept Note on Central Bank Digital Currency
- Operationalization of Central Bank Digital Currency – Wholesale (eRupee-W) Pilot

Corporate Laws

Important Notifications

SEBI

- Participation of Foreign Portfolio Investors (FPIs) in Exchange Traded Commodity Derivatives (ETCDs) in India
- Two-Factor Authentication for transactions in units of Mutual Funds
- Governing Council for Social Stock Exchange ("SSE")

Valuing the Valuers

Coverage

Valuing the Valuers - Asset Managers

Background

Assets under management (AUM) of Indian Mutual Fund industry has grown from Rs 7.20 trillion as on September 30, 2012, to Rs 38.42 trillion as on September 30, 2022, indicating more than 5 fold growth in a span of 10 years. India's asset management industry, which is still at a nascent stage, has seen multi fold rise owing to increase in investor awareness, education amongst domestic investors and growth potential of investee companies. Variety of investment products are being offered by these asset management companies (AMCs). The Government and SEBI have contributed significantly to making investment products easier to understand for public at large. India being the most populated democracy has a huge untapped investment market yet to be penetrated. This in turn has given impetus to professionally managed AMCs and has also led to many strategic transactions in this space over the last few years.

How are AMCs valued?

All AMCs are similar in certain ways because their source of revenue is largely based on development fees, management fees, profit sharing, commissions and transaction fees. However, in order to recognize an asset management firm's worth in the market, one must look at its unique qualities.

The key performing indicators for valuing an AMC are:

- Size of AUM
- Monthly & Annual SIP flows
- Revenue sources
- SIP AUM as a percentage of equity AUM
- Weighted average management fees
- Distribution channels
- Product mix (Debt/Equity/Hybrid)
- Company specific risks

The 3 broadly used valuation approaches for an AMC are:

1. **Income Approach:** Under the income approach, discounted cash flow (DCF) or price-earning capitalization method (PECV) is used for valuation.
2. **Market Approach:** Under the market approach, valuation multiples like EV as a % of AUM, EV/EBITDA are most relevant in evaluating an AMC's business. AMCs with higher asset balances, higher fees' structure and profit margins typically attract higher AUM multiples in the marketplace.
3. **Statistical Approach:** There are a few statistical approaches like Huberman and Berk/Green, which are also used to value asset managers. These approaches use the dividend discount model and simple cross-sectional model, respectively. These methods can be used to validate output under the income/market approach.

Valuing the Valuers

Coverage

Recent valuation trend of AMCs listed in India

Listed AMC	HDFC AMC	Nippon Life	ABSL AMC	UTI AMC
Price/Sales	20.36	12.83	9.64	8.8
Price/Book	8.14	5.03	5.68	2.78
EV/EBITDA	22.56	15.17	12.75	15.8
Net Margin	64.78%	50.53%	47.95%	41.38%
Market Cap/AUM	10.42%	5.82%	4.35%	4.63%

Source: Morningstar.in; AMC websites

AMCs in India enjoy a higher valuation multiple as compared to the developed markets like US and Europe. Net profit margin for Indian AMCs is upward of 30% versus 10-18% for its counterparts in the US. Western economies follow a thumb rule for valuing such investment companies wherein the Market Cap/AUM of AMCs range from 1-2%. Indian AMCs on the contrary command a premium as they are still in high growth stage. As there are only a handful of AMCs listed on the Indian Stock exchanges, one can see that Indian listed AMCs have a net margin in excess of 40% and average Market Cap/AUM in the range of 4-5% (excluding HDFC AMC, the market leader commanding higher premium).

Recent deals in the AMC space in India

Bandhan - IDFC AMC

Bandhan Financial Holding-led consortium acquired IDFC Asset Management Company and IDFC AMC Trustee Company for Rs 4,500 crore. This deal was announced in April 2022 and received regulatory approval in August 2022. The consortium led by Bandhan also included private equity firm Chrys Capital and Singapore's sovereign fund GIC.

The deal allowed Bandhan Group to enter India's growing mutual fund business and provides a scaled-up asset management platform, along with a management team and pan India distribution network. The decision to divest further demonstrates IDFC Board's commitment to consummate the merger of IDFC Limited and IDFC Financial Holding Company with IDFC First Bank. IDFC announced the sale of its MF business after the company faced shareholders' ire on delay in divestments and mergers.

Bank of India - AXA Investment Managers

In 2021, Bank of India purchased the entire shareholding of AXA Investment Managers Asia Holdings in BOI AXA Investment Managers. This acquisition enabled Bank of India to have complete control of the investment management firm and potential to grow the asset management business by leveraging on the BOI brand and distribution strength. AUM of BOI AXA Mutual Fund was over Rs 2,730 crore as on 30 November 2021. It had come under spotlight after one of its debt funds wrote off its entire exposure to IL&FS, which defaulted on payments to institutional investors.

Valuing the Valuers

HSBC - L&T Investment Management

Recently, L&T Investment Management got acquired by HSBC at an EV/Sales multiple of 9.18x. HSBC Asset Management (India) Private Ltd, an indirect wholly owned subsidiary of HSBC Holdings Plc, has received the approval of SEBI to acquire L&T Investment Management Ltd, for Rs 3,191 crore.

Post completion of the acquisition, HSBC will merge the operations of L&T Investment Management with its existing asset management business, which has average AUM of Rs 13,620 crore as of September 2022. With average AUM of Rs 71,703 crore and over 22 lakh active folios as of September 2022, L&T Investment Management is currently the 14th largest mutual fund management company in India. "Strengthening HSBC's asset management business in India will add to its ability to serve the wealth needs of its customers in India as well as those of its growing non-resident Indian customer base across the world," HSBC stated in a press release.

White Oak - Yes Bank AMC

Yes Bank sold its investment and asset management arm to GPL Finance & Investment owned by White Oak Investment Management. The acquisition includes GPL acquiring a 100% stake in Yes AMC and YES Trustee. Registered with RBI, GPL is a non-deposit taking and non-systemically important Non-Banking Financial Company. It is classified as an investment company and is primarily engaged in the business of making investments in mutual funds and providing referral and support services to White Oak Capital.

Sundaram - Principal AMC

Sundaram Asset Management Company Limited purchased the asset management business of Principal Asset Management Pvt Ltd In January 2021. Post deal closure, a wider range of equity schemes were made available to more than two million combined investor base and to the strengthened distribution franchise across the country-wide network of 88 branches.

Consolidation in the AMC space

All things considered, the M&A market for asset management is become more and more appealing as consolidation takes place in the sector. Rising AUM, strong and well diversified top-line growth, excellent profitability, and generally favorable macrotrends such as high growth and savings rate, increased investor awareness and predicted inflation trajectory, all help to draw new investors into the formal financial investment sphere in India. Existing players will position themselves for success in such a market by increasing scale and distinguishing their services. In the coming days, strategic acquirers will seek to build and expand on existing asset management platforms, making M&A activity particularly competitive in this space.

Sources of Information: AMFI, VCCEdge, AMC websites

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For detailed understanding or more information, send your queries to ***kcminsight@kcmehta.com***

Important Rulings

Education institution created 'solely' for imparting education is eligible for approval u/s 10(23C) – Rule of Strict Interpretation

New Noble Educational Society, Civil Appeal Number 3795 of 2014

The Taxpayer is an educational society, and it is running various colleges and institutions at Andhra Pradesh. As per the memorandum of association / constitution deed, the primary object of the society is to run for education purpose whereas the incidental and other charitable objectives also included other related activities such as publication of journals and magazines for promotion of education. Total income of the taxpayer therefore included the income from running educational institutions and income from other charitable activities like publication of journals and magazines for promotion of education.

The Taxpayer filed an application for registration U/s. 10(23C) (vi) of the ITA. The application filed by the taxpayer was rejected by the prescribed Authority on two grounds. Firstly, the taxpayer was not registered under the Andhra Pradesh Charitable and Hindu Religious Institutions and Endowments Act, 1987 ("the A.P. Charities Act") and secondly, the taxpayer was not existing /created 'solely' for the purpose of education.

Before the tax authorities, the Taxpayer has contested that for the purpose of granting registration u/s 10(23C) (vi) of the ITA, it is only required to demonstrate that the primary and main object of the trust / institution is to run educational activity and there is no profit motive. There is no such requirement like mandatory registration under the AP Charities Act. The taxpayer placed reliance on the division bench decision of the Hon'ble SC in the cases of American Hotel and Lodging Association (Civil Appeal No 3468 of 2008) and Queen's Education Society (Civil Appeal No 5167 & 5168 OF 2008) wherein the Hon'ble SC has interpreted the terms "solely" in light of the principle of "predominant object test" after relying upon the constitutional bench decision of the Surat Art Silk Cloth Manufactures Association (Tax Reference No. 1A of 1979 and 10-14 of 1975). The Taxpayer has accordingly argued that the approval u/s 10(23C) ought to have been granted to it since it satisfied the test of "predominant object test".

The prescribed authorities were of the view that as per the provision of section 10(23C) (vi) of the ITA as amended from time to time, the legislature has clearly provided that the approval shall be granted to only those institutions/ trust which existed "solely" for education purpose and therefore, once the trust is established for any other unrelated activities then it is not entitled to claim the exemption under the ITA. The prescribed authorities have argued that the decisions of American Hotel (supra) and Queen's Education (supra) relied by the taxpayer are distinguishable on facts and section 10(23C) is not based on the "predominant object test" but rather the statutes expressly stipulate that institution must exist "solely" for the purpose of education. Reliance has been placed on the decision of the Hon'ble SC in the case of TMA Pai Foundation (civil Petition no 317 of 1993) and PA Inamdar (Civil Appeal no 5041 of 2005).

Important Rulings

The HC also confirmed the action of the tax authorities and accordingly, the matter is before the Hon'ble SC.

The Hon'ble SC considered the provision of section 10(23C) vis a vis the legislative intent behind enacting the amendment and held that in terms of section 10(23C), the educational institution which are 'solely' engaged in education activities alone are entitled to get approval u/s 10(23C) (vi) of the ITA. The Hon'ble SC has made categorical distinction between the term "solely" and "primarily" or "main". The SC has held that the terms "solely" used in the context of section 10(23C) connotes exclusion of others and therefore, if it is established that the trust is also carrying out other activities not related to education, or the objective of the institutions appears to be profit oriented then it is not eligible to get approval u/s 10(23C). The SC accordingly overruled its division bench decisions in the case of American Hotel (supra) and Queen's Education (supra). The SC also categorically held that at the stage of approval the prescribed authorities need to examine the objects of the institution, genuineness of the institution and manner of its functioning.

It is also to be noted that the Apex Court recently in the case of **Ahmedabad Urban Development Authority & others** C.A. No. 8193/2012 and others have given a detailed decision running into 150 pages and laid down a law on charitable institution dealing with various types of charitable institutions including Cricket Associations whereby strict interpretation has been adopted by the Apex Court. The Apex Court has also interpreted the meaning of term "advancement of any other general public utility" under section 2(15) of ITA and not in favor to adopt predominant object test while looking to the activities of institutions to qualify them as charitable activities under ITA. Our next KCM Insight will cover such decision.

The aforesaid decisions of Apex Court reflects that while interpreting the provision of section 2(15) broad interpretation shall not be adopted and basis of recovering of expenses, fees etc. would be utmost important. It is therefore necessary for each charitable institution to revalidate its claim of exemption in the light of the above decisions to take suitable action to avoid any litigation on exemption claimed.

Amended scheme of reassessment is not applicable if the original notice u/s 148 was issued as per the pre-amended law

Nagesh Trading Co., Write Petition No. 13781 of 2022, High Court of Delhi

The FA 2021 has revamped the procedure of conducting reassessment proceedings with effect from April 1, 2021, whereby under the new scheme of reassessment, the AO shall be required to issue show cause notice before formally initiating the reassessment. The SC in the case of Ashish Agrawal (civil petition no 3005 to 3017 of 2021) had an occasion to deal with the issue as to whether the notices u/s 148 of the ITA issued by the tax department across the country during the period April 1, 2021 to June 30, 2021, period covered by TOLA [Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020] was valid notice or not. The SC has exercised the extraordinary jurisdiction as per Article 142 of the Constitution and held that such notice should be deemed to have been issued under substituted section 148A.

Important Rulings

In the given case, the Taxpayer was a partnership firm and notice u/s 148 of the ITA has been issued on March 31, 2021, as per the provision of section 148 as it stood prior to the amendment made by the FA 2021. In pursuant to that the Taxpayer has filed the ITR and also responded to the notice issued by the AO. In pursuant to the decision of the Hon'ble SC in the case of Ashish Agrawal (supra), the AO issued fresh notice for reassessment u/s 148A on 02.06.2022. In response to that notice, the Taxpayer primarily challenged the validity of the notice and consequential action u/s 148A on the ground that the period of limitation for completion of the reassessment proceeding had expired and therefore, the subsequent notice issued u/s 148A of the ITA was not valid.

The AO has rejected the contentions of the Taxpayer and passed an order u/s 148A(d). The AO has stated that the notice u/s 148A of the ITA has been issued in accordance with the mandate of Hon'ble SC and secondly the proceeding so initiated u/s 148 has been quashed by the HC.

The Taxpayer has therefore challenged the validity of the order passed u/s 148A(d) before the HC on the ground that the notice issued u/s 148A of the ITA on 02.06.2022 is invalid and barred by limitation.

The HC after considering the facts of the case, decision of the Hon'ble SC in the case of Ashish Agrawal(supra) vis a vis the assessment records set aside the order of AO u/s 148A of the ITA and categorically held that the directions given by the SC in the decision of Ashish Agrawal (supra) are applicable only in those cases where the notices u/s 148 of the ITA are issued during April 1, 2021 to June 30, 2021. The notices issued prior to this period are governed by the old scheme of section 148. The HC further held that the contentions of the department that the original proceeding has been quashed by this court is also devoid of the facts since it was never quashed.

Section 14A not applicable merely because foreign tax sparing credit allowable

PCIT v. IFFCO Ltd, ITA no. 390/2022, High Court of Delhi

In the facts of the case, Taxpayer earned dividend income from OMIFCO-OMAN, an overseas company in Oman. The said dividend income is taxable as income under the ITA but tax sparing credit is available under Article 25 of the treaty between India and Oman and accordingly, no tax is effectively payable by the taxpayer either in the source country or in India.

The question under consideration is whether expenditure incurred for earning said dividend income is disallowable under section 14A of the ITA since said dividend income is not taxable in India on account of tax sparing credit as allowed under India Oman treaty.

Revenue argued that even though such foreign divided income is taxable under ITA, no tax is actually paid by the Taxpayer in view of notional tax credit available to it in view of Article 25(4) of the tax treaty.

Hon'ble High Court opined that as per section 14A (1), no deduction is to be allowed in respect of expenditure incurred by the Taxpayer in relation to income which does not form part of the total income under the ITA. As per section 2(45) of the ITA, "total income" means the total amount of income referred to in section 5, computed in the manner laid down in the ITA.

The dividend received by the Taxpayer from OMIFCO, Oman is chargeable to tax in India

under the head "Income from other sources" and forms part of the total income in computation of income. Further such income is also taxable in India as per tax treaty. However, rebate of tax has been allowed to the Taxpayer from total taxes in terms of section 90(2) of the ITA read with Article 25 of Indo Oman DTAA. Thus, as per the High Court, dividend earned can be said to be in nature of excluded income and therefore, provisions of section 14A would not be attracted in this case.

The Court relied on its earlier decision in case of CIT v. M/s Kribhco IT Appeal NO. 444 OF 2011, wherein it was held that provisions of section 14A are not applicable as far as deductions, which are permissible and allowed under Chapter VI-A are concerned since deductions allowable under Chapter VI-A form part of total income but are allowed as deduction and reduced from total income.

In this case it can also be arguable that since such foreign divided income is taxable in India both under the ITA as well as under the tax treaty, provision of section 14A shall not be invoked since there is no exemption of such income. The manner of providing foreign tax credit shall not make the dividend as exempt from tax.

Recovery of bad debt of amalgamating company is taxable in the hands of amalgamated company

M/s. Sundaram Finance Ltd. v. The Joint Commissioner of Income Tax, TCA Nos. 272 & 275 of 2022, High Court of Madras

The Taxpayer had filed its return of income, wherein the taxpayer had not offered income from recovery of bad debts, written off by the amalgamating company in the income tax return. The Assessing officer made an addition to the returned income of the Taxpayer as per the provisions of section 41(4) of the ITA, on the ground that recovery of bad debts written off by the amalgamating company shall be taxed in the hands of the amalgamated company, viz., the Taxpayer. CIT(A) & ITAT upheld the order of the AO. Aggrieved by the order of ITAT, the taxpayer filed an appeal before Madras HC.

The Taxpayer contended that in view of decision of the Apex Court in case of Saraswathi Industrial Syndicate Ltd v. CIT, wherein, it was held that since no corresponding amendment had been made to the provisions of section 41(4) in line with the amendment made u/s. 41(1) w.e.f. 01.04.1993, bad debts recovered by the taxpayer, which had been written off by the amalgamating company cannot be taxed in the hands of the taxpayer.

It was held by the Madras High Court that the provisions of section 41(1) cannot be read in isolation with 41(4) and therefore, the amendment made to section 41(1) w.e.f. 01.04.1993 shall be squarely applicable for section 41(4). Further, it was held that, recovery of debt is a right transferred along with other rights in the course of such amalgamation and thus, upheld the decision of ITAT in taxing such recovery of bad debts in the hands of the taxpayer.

Important Notifications

CBDT extends time available to furnish modified return u/s 170A to March 31, 2023, where order of business organization was issued between April 2022- September 2022

Order F No. 370142/41/2022-TPL, dated September 26, 2022

Section 170A was inserted w.e.f. April 1, 2022, to provide that entities going through business reorganization may furnish modified return of income for any assessment year, to which business reorganization is applicable, within period of 6 months from end of month in which such order was issued by competent authority.

In pursuance thereof, form ITR A has been notified by CBDT vide Notification G.S.R. 709(E) dated September 19, 2022, which will come into effect from November 1, 2022. Since time available for furnishing modified return for successor companies, where order for business reorganization was issued between April 1, 2022, to September 30, 2022, has reduced, CBDT extended time to furnish modified return u/s 170A to March 31, 2023, for such cases.

CBDT provides rule and form for withdrawal of claim of deduction relating to cess and surcharge

Notification G.S.R. 733(E) [No. 111/2022/F.No.370142/32/2022-TPL], dated September 28, 2022

The Finance Act, 2022 has made retrospective amendments w.e.f. April 1, 2005 in section 40(a)(ii) wherein it has been clarified that no deduction shall be allowable in respect of surcharge and cess. Further it has been provided in section 155(18) of ITA that such claim shall be regarded as underreporting of income unless the same has been withdrawn by way of re-computation of income as per proviso to such section.

In line with the above provision, CBDT has now inserted Rule 132 for filing an application for re-computation of income, without claiming deduction of surcharge or cess. Such application shall be filed in Form No. 69 on or before March 31, 2023. The Assessing officer shall recompute the total income and issue a notice of demand u/s 156 specifying the time within which tax payable shall be paid. The taxpayer shall furnish the details of such tax payment to the AO in Form No. 70 within 30 days from the date of making the payment.

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For detailed understanding or more information, send your queries to ***kcminsight@kcmehta.com***

Important Rulings

Fiscally transparent LLP entitled to India-UK DTAA benefit, even prior to amending Protocol

Herbert Smith Freehills LLP - ITA No.5760/Del./2016 and ITA No.3993/Del./2017 – Delhi ITAT

The taxpayer, a UK based law firm, contended that fees for legal services provided by it did not fall within the definition of FTS under the provisions of Article 13 of India-UK DTAA as it did not make available technical knowledge, experience, skill, know-how or process. Further, in absence of PE in India, taxpayer filed return of income in India offering to tax only that portion of income which was attributable to partners which were residents of countries other than UK. Income attributable to UK resident partners was not considered as chargeable to tax in India in light of the beneficial provisions of India-UK DTAA.

Revenue authorities took a contrary view and sought to tax the entire fees and denied benefit of India-UK DTAA on the ground that the taxpayer was considered as fiscally transparent in the UK and prior to the 2012, a fiscally transparent partnership could not be considered as a person resident of a country for tax treaty purposes as it is not liable to tax as such and was therefore not entitled to claim benefits under India-UK DTAA. The amended protocol to India-UK DTAA for providing treaty benefits to fiscally transparent entities came into effect from 27 December 2013.

Taxpayer contended that LLPs were required to file return of income and were covered by the taxation laws of UK. The firm was liable to tax on its profits in the UK and the recovery of tax was done through its partners. It relied on the decision of ITAT in the case of Linklaters LLP [2010] 40 SOT 51 (Mum.), wherein it was held that as long as the entity's income was taxed in the concerned jurisdiction, either in the hands of partners or the partnership firm, the relevant tax treaty benefits should be available to the partnership firm.

Quoting the decisions of Linklaters (supra) and Azadi Bachao Andolan [2003] 263 ITR 706 (SC), Taxpayer contended that 'liable to taxation' was not same as 'payer of tax' and that in order to determine the eligibility of claiming the tax treaty benefits, what was relevant was that the entity should be taxed in its resident jurisdiction (i.e., fact of taxability) and not necessarily that the tax liability should actually be imposed and discharged by the same entity (i.e., mode of taxability).

ITAT observed that the case of the taxpayer was squarely covered by the decision of Linklaters LLP and held that the taxpayer was entitled to claim benefits of India-UK DTAA even in respect of earlier years.

The important aspect of this decision is that notwithstanding the fact that Protocol of India-UK DTAA was effective from 2013, the benefit of India-UK DTAA has been provided to the taxpayer considering the principle that once there was a liability to tax (either by the partnership or its partner), treaty benefit is available. The position of allowing treaty benefits with respect to UK firms is no more res integra under India-UK DTAA as well as CBDT Circular No 2 of 2016, which allows treaty benefits if incomes of partnership are taxed in hands of the firm or its partners. However, only few Indian DTAAs, for example DTAAs with UK, USA and Canada have explicitly clarified this position for fiscally transparent entities.

Important Rulings

The decision, therefore, is welcome and would be very relevant in context of DTAAs which do not explicitly provide for tax treatment of fiscally transparent entities. In fact, AAR has held different view in the case of Schellenberg Wittmer (AAR No. 1029 of 2010), wherein, AAR concluded that the partnership could not be termed as a person for the purposes of the India-Switzerland DTAA and hence would not be eligible to its benefits. However, the Revenue authorities did not draw the attention of the Tribunal to the said case. It may be possible to take a view that the AAR ruling is not binding and the decision of Mumbai ITAT in the case of Linklaters and the present decision of Delhi ITAT are likely to have more persuasive value.

Indian Company real employer of seconded employees; no TDS on reimbursement of Salary

M/S Boeing India Pvt. Ltd. - ITA No. 71/2022 - Delhi High Court

Employees from group companies had been seconded to India. As per the agreement, the expatriate employees were to receive salary in home country. The taxpayer had made reimbursement of salaries paid by the group company to expatriate employees. Revenue authorities relied on the decision of Centrica India Offshore (P). Ltd [2014] 364 ITR 336 (Delhi) and contended that reimbursement of salary is essentially FTS / FIS and invoked disallowance under section 40(a)(i) of the Act, which was upheld by DRP.

Before the ITAT, the taxpayer contended that the employees were under the control of the company without any relation / connection with the group company. Further, salary was paid by the taxpayer on which the appropriate taxes were duly deducted and deposited under section 192 of the Act. The taxpayer distinguished the decision of Centrica India and highlighted that in that case, employees were making available experience and skill for newly formed entity, however in case of taxpayer, the role of expatriate employees was in such division that any knowledge could not be made available. The ITAT analyzed salary reimbursement agreements which essentially provided that secondees had expressed their willingness for secondment and that they would be under supervision, control and management of the taxpayer. Accordingly, relying on the decision in case of AT & T Communication Services India Pvt Ltd. [2019] 101 taxmann.com 105 (Delhi - Trib.), is the ITAT held that provisions of Section 195 of the Act do not apply and accordingly disallowance cannot be invoked under section 40(a)(i) of the Act.

On appeal to High Court, considering the decision of Hon'ble the Supreme Court in case of A.P.Moller Maersk A S [Civil Appeal No.8040/2015] and Division Bench of High Court in case of Karl Storz Endoscopy India (P) Ltd. [ITA No.13/2008], the High Court observed that Centrica India judgement was not applicable. Also, High Court did not interfere with the finding of ITAT treating taxpayer as real employer, as the same was not a "question of law".

The issue discussed in the judgement is a vexed issue with plethora of favorable as well as unfavorable judgments. Recently, Karnataka High Court in case of Flipkart Internet (P.) Ltd. [2022] 139 taxmann.com 595 (Karnataka), also had similar finding that services rendered by seconded employees, though technical in nature but as it did not satisfy requirement of

make available and hence could not be treated as FIS / FTS. Here, important aspect on which courts have decided the issue is to determine the conduct of the employee as well as the Company. Essentially, the Company has to justify on the basis of corroborative documents that the seconded employees were working under the control, direction and supervision of the Indian Company. Also, Indian Company is duty bound to undertake all employer related responsibilities for the seconded employees. The aspect of "lien on employment" has not been considered in this ruling which was one major aspect considered by Supreme Court in the case of Northern Operating Systems Pvt. Ltd. in the context of Service Tax.

Payment made for sale of advertisement space not Royalty; draws corollary from Equalization Levy

Google India Private Limited - ITA No. 1513 of 2013 - Banglore ITAT

The taxpayer, Google India, acted as a distributor of advertisement space in India and made necessary payment to Google Ireland for such advertisement space without deduction of any tax as the taxpayer was of the view that the said transaction was taxable as Business Profits under Article 7 of India-Ireland DTAA and in absence of any PE of Google Ireland in India, the said transaction was not liable to tax in India. However, the Revenue contended that the transaction should be taxed as Royalty as payment was in the nature of advertisement fees and the taxpayer had been granted the right to use confidential data and customer data which constitutes the right to use Intellectual Property.

The Tribunal observed that the taxpayer was engaged in the business of sale of online advertisement space to advertisers in India. The Bench found that none of the rights as defined under the Copyright Act, 1957 have been transferred by Google Ireland to the taxpayer. The bench while reiterating the case of Engineering Analysis Centre of Excellence (P) Ltd [2021] 125 taxmann.com 42 (SC) stated that mere use of or right to use a computer program without any transfer of underlying copyright will not be satisfying the definition of Royalty under the DTAA.

It was observed by the Bench that the trademark and other brand features of Google Ireland were not used by the taxpayer independently, but they were incidental or ancillary for the purpose of carrying out the marketing and distribution of advertisement space. Placing reliance on the Delhi HC judgement in the case of DIT v. Sheraton International Inc. [2009] 313 ITR 267 (Delhi), it held that use of Google Brand Features and its related IP are incidental to the main service of distribution of advertisement space and further there is no separate consideration payable for such use of brand features and hence, the consideration cannot be characterized as Royalty.

It is to be noted here that the Bench also drew corollary from the concept of Equalization Levy 1.0 which was specifically introduced to bring in the tax bracket the sale of advertisement space by non-residents in India. The Bench took the view that if online advertisement was already covered under the definition of royalty, then bringing it as a part of Equalization Levy scheme would not arise.

Marketing support services do not fulfil the test of make available and cannot be taxed as FTS

Anand NVH Products Inc. – ITA No. 1951 of 2021 - Delhi ITAT

Important Rulings

The taxpayer was a non-resident corporate entity incorporated in USA and a wholly owned subsidiary of the Indian entity named Anand NVH Products Private Limited. The taxpayer was engaged in providing marketing support services to its parent company in India. The scope of marketing support inter-alia included providing support in various areas including market research, providing updates on regulatory developments, collection of information, providing expert advice on marketing strategies, etc.

Taxpayer had claimed that amount received from parent company in India towards rendering of marketing support services was business profit and could not be taxed in India in absence of PE in India while Revenue authorities challenged the same and considered the same as taxable.

ITAT held that first, considering peculiar nature of services performed by taxpayer, it could be termed as technical or consultancy services. Further, even if it was assumed that it involved a bit of consultancy element, it could not be classified as FIS in absence of satisfaction of 'make available' test. ITAT relied on various judicial precedents to explain the term 'make available' and held that even if services by taxpayer provided enduring benefit to the service recipient, the same could nott fall within the ambit of FIS in absence of transfer of technology, knowledge, experience, etc. The ITAT held that since there was no transfer of any knowledge, experience, skills, etc., make available test was not satisfied in the present case and hence, amount received by taxpayer did not fall within the definition of FIS under India-USA DTAA and could not be brought to tax in India.

This is important ruling provided by ITAT which would be helpful to Indian MNCs, who take marketing and allied support from its group companies situated outside India. Interestingly, ITAT had not discussed much on exclusion provided under section 9(1)(vii) of the Act which provides that if payment is made for earning income from a source outside India, then payment made should not be considered as FTS under the Act.

MFN clause is an integral part of treaty and has automatic application without a separate notification

Converteam Group - IT Appeal No. 8112 of 2019 - Delhi ITAT

The taxpayer was a Company and tax resident of France. The taxpayer provided management support services (which inter-alia included corporate and public relation support, accounting & auditing support, health & safety support, environmental and regulatory affair support, legal support etc.) to Indian companies and had received service fee for the same. Taxpayer had claimed that management support charges received from Indian companies were not taxable in view of Article 13 of India-France DTAA read with protocol which provides for MFN Clause, which restricts the scope of FTS. Pursuant to said MFN clause, taxpayer had invoked and applied restrictive definition of FTS as per India-UK DTAA whereas Revenue authorities took a contrary view.

ITAT held that issue under consideration was already settled in the decision of Hon'ble Delhi High Court in case of Steria (India) Limited

Important Rulings

[2016] 386 ITR 390 (Delhi), wherein it was held that protocol to a tax treaty is indispensable part of the treaty, and the tax treaty will have to be read along with the protocol. Also, unless otherwise specified in the treaty, protocol will have automatic application without there being need of separate notification to be issued by government of any contracting state. Hence, taxpayer is eligible to invoke and apply restrictive definition of FTS provided under India-UK DTAA as per MFN clause provided in protocol to India-France DTAA.

Whether benefit of protocol and MFN could be invoked or not has now become the latest topic of discussion, especially post issuance of CBDT Circular No. 03 of 2022 on 03 February 2022, wherein it has been inter-alia provided that benefit of MFN clause cannot be taken in absence of any separate notification issued in that effect, though validity of the said circular has already been challenged and the matter is pending before the Hon'ble Supreme Court. MNCs are awaiting the final decision of Hon'ble Supreme Court as it would undoubtedly have a larger impact and bearing on ongoing and pending litigations as well as taxability of cross border transactions.

Important Updates

Foreign

Proposal from Committee of experts - Inclusion of computer software in the definition of royalties under treaty

Proposal from Committee of Experts on International Cooperation in Tax Matters

Discussion was initiated on long awaited proposal regarding inclusion of 'computer software' within the meaning of royalties provided under Article 12 of UN Model Convention, in the twenty fifth session of Committee of Experts on International Cooperation in Tax Matters, held at Geneva.

During this discussion, committee was asked to decide whether:

- The sub-committee should work on developing an expanded definition of royalties that refer to the computer software, including relevant commentary that what would or would not be covered by such expanded definition; or
- The sub-committee should instead make changes to the existing commentaries on Article 12

Characterization of payment for acquiring right to use the computer software has always been a complex and debatable issue and various judicial authorities including foreign Courts have held that payment for acquiring right to use the computer software cannot be termed as royalty as per treaty definitions and interpretations of Copyright Laws.

Recently UN had also approved inclusion of Article 12B for taxing automated digital services transactions. Now, computer software is also proposed to be included within the meaning of royalties. These are imminent changes at an international tax front and would have larger impact on cross border transaction between MNEs and one would also have to carefully analyze the tax and transfer pricing impact of the same.

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Important Rulings

Interest on outstanding receivables subsumed by TNMM / working capital adjustment

Devi Sea Foods Limited [TS-618-ITAT-2022(VIZ)-TP]

The assessee was engaged in the business of export of processed and frozen shrimp, shrimp feed and windmill power. The assessee entered various international transactions with its Associated Enterprises (AE) and benchmarked those international transactions by adopting the Transaction Net Margin Method (TNMM) as the Most Appropriate Method (MAM). The case was referred to the Transfer Pricing Officer (TPO) for determining Arm's Length Price (ALP) u/s 92CA(3) of the Income-tax Act (the Act), pursuant to which the TPO made an upward adjustment on the outstanding balance of "Trade Receivable" and "Corporate Guarantee" provided by the assessee to its AE. The assessee filed objections before the Dispute Resolution Panel (DRP), which ruled in favour of the TPO. Aggrieved by this, the assessee filed an appeal before the Income Tax Appellate Tribunal (ITAT).

The ITAT observed that the assessee sold goods to AEs as well as non-AEs, where major receivables pertained to the AE. The ITAT considered the arguments of the assessee in respect of the working capital adjustment submitted by the assessee. The ITAT also observed that the assessee's margin (4.17%) was substantially higher than the operating margin of comparable companies (1.28%) when export incentives were considered as a non-operating item of income. When export incentives were considered as an operating item of income, the operating margin of comparables companies was 8.08% vis-à-vis the assessee's margin of 12.15%.

The ITAT further observed, *"there may be a delay in collection of receivables even beyond the agreed time limits due to a variety of factors which has to be decided on a case-to-case basis. When TNMM is considered as MAM, which was also not disputed by Revenue, the net margin thereunder would take care of such notional interest cost."* ITAT considered the assessee's submission that the impact of delay in the collection of receivables would have a bearing on its working capital investment accordingly, an adjustment on account of working capital be considered before deciding on the matter.

The ITAT ruled in favour of the assessee and held that *"these working capital adjustments on the ALP has been already factored in its pricing/profitability vis-à-vis that of its comparables"* and directed the Assessing Officer (AO) to delete the TP adjustment holding that any further adjustment to assessee's margin on outstanding receivables cannot be justified.

With regard to corporate guarantee, the ITAT finds merit in the assessee's argument that the rate of corporate guarantee should be restricted to the amount utilized by AE and should not be applied to the gross corporate guarantee. The ITAT upheld the adjustment made on the guaranteed commission by placing reliance on the ruling delivered by Bombay HC in the case of "Everest Kanto Cylinders" and fixed commission at 0.50% on the amount utilized by AE.

Notional Interest on excess share application money refunded by AE for Preference Share allotment deleted

Reliance Industries Ltd [TS-702-ITAT-2022(Mum)-TP]

Important Rulings

The brief facts of the case pertaining to this issue are: The assessee is engaged in a diverse set of businesses such as petroleum etc. During the relevant previous year, the assessee was allotted certain shares of its AE and share application money was remitted for the same. The shares were allotted in due course.

The TPO considered the entire amount of share application money pending allotment as well as value of preference shares already issued to the assessee as loan and computed imputed interest by adopting LIBOR plus spread. The CIT(A) too upheld the levy in respect of part application money which was returned by the AE without issuance of preference shares by treating the same as loan. The assessee being aggrieved, appealed before the ITAT. The assessee has remitted the share application money to AE in UAE placing reliance Master Direction No. 15/2015-16 dated 01/01/2016, issued by Reserve Bank of India on 'Direct Investment by Residents in Joint Venture/Wholly-Owned Subsidiary abroad'. From the perusal of aforesaid Master Direction issued by RBI, it was evident that direct investments by residents in joint venture and wholly owned subsidiary abroad are being allowed in terms of section 6(3)(a) of Foreign Exchange Management Act, 1999 read with Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004.

Concluding the same, the ITAT ruled that transaction of subscribing to preference shares was itself not found to be bogus or sham. Hence, no merits were found of learned CIT(A) in upholding levy of interest on excess share application money refunded, by treating the same as loan and the adjustment was directed to be deleted.

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Important Rulings

SCN issued without any allegations or details of tax demand held to be invalid and liable to be set aside by Bombay High Court

Archana Textile Corporation V/s State of Maharashtra

[TS-569- HC(Bom)-2022-GST]

Bombay High Court set aside Show Cause Notice (SCN) and assessment order for lapse of not providing all the details along with SCN. The SCN was issued without any allegation or details of any sale or claim of deduction which the Petitioner had claimed or recorded in an incorrect manner. Hon. High Court stated that the procedure adopted is totally incorrect. It also directed the respondents (i.e., State of Maharashtra) to issue a fresh SCN containing every detail in which it feels tax is sought to be evaded by not recording or recording in an incorrect manner or taxpayer has claimed or deducted incorrectly.

Amount received towards "Liquidated Damages" not to be treated as "Supply"

Achampet Solar Private Limited

[TS-564-AAAR (TEL)- 2022 – GST]

Telangana Appellate Authority for Advance Ruling ("AAAR") set aside the order of Authority for Advance Ruling and ruled that amount recoverable in the form of liquidated damages does not qualify as "Supply". It treated liquidated damages as ancillary supply to principal supply of electricity production and distribution. Further, in alignment with Circular No. 178/10/2022-GST dated August 03, 2022 relating to GST applicability on liquidated damages, AAAR clarified that such payments do not constitute consideration for a supply and are not taxable by holding that where the amount paid as 'liquidated damages' is an amount paid only to compensate for injury, loss or damage suffered by the aggrieved party due to breach of the contract, in such cases liquidated damages are mere a flow of money from the party who causes breach of the contract to the party who suffers loss or damage due to such breach.

Date of electronic submission of refund claim on GST portal to be considered as date of filing refund

M/s Chromotolab and Biotech Solutions Vs Union of India

[2022-VIL-714-Guj HC in case of SCA 16308 of 2020]

Gujarat High Court held that date of filing application by the petitioner on common portal would be liable to be treated as date of filing claim of refund to the satisfaction of requirement of Section 54 of the CGST Act and Rule 89 of the CGST Rules. The procedure evolved in Circular dated 15.11.2017 cannot operate as delimiting condition on the applicability of statutory provisions - The respondents are directed to re-credit the amount in the electronic credit ledger of the petitioner with interest at the rate of 9% p.a. from the date of order of rejection of the claim till realization.

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Important Notifications

RBI

Reserve Bank of India (Unhedged Foreign Currency Exposure) Directions, 2022

Notification No. RBI /2022-23/131 vide circular DOR.MRG.REC. No. 76/00-00-007/2022-2023 dated October 11, 2022

With effect from January 01, 2023, Reserve Bank of India (Unhedged Foreign Currency Exposure) Directions, 2022 shall be applicable for assessing the hedged / unhedged foreign currency exposures of entities which have borrowings from Banks. These guidelines for assessments of exposures shall apply to all commercial banks but exclude the payment banks and regional rural banks.

The Directions provide elaborate and detailed guidelines for computation of Unhedged Foreign Currency Exposure on annual basis, provisioning and capital requirements, assessment of risks and necessary control requirements, consortium lending, capital treatment & disclosure requirements, guidelines for overseas branches/ subsidiaries, and exemption or relaxation as applicable to the entities as well as the data requirements from the entities to whom the said Directions are applicable.

Multiple NBFCs in a Group – Classification in Middle Layer

Notification No. RBI /2022-23/129 vide circular DOR.CRE.REC. No. 78/03.10.001/2022-2023 dated October 11, 2022

With reference to para 16 of Master Directions – Non-Banking Financial Company-Systematically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions 2016, Multiple NBFCs in a common Group or floated under common set of promoters are not to be viewed on standalone basis. In line with the said policy of consolidation, the total assets of the group companies categorized as NBFCs shall also be consolidated for the purpose of classification into the Middle Layer.

On the basis of such consolidation, if the consolidated asset size of the Group is INR 1000 Crore or more, then each such individual NBFC-ICC, NBFC-MFI and NBFC-MGC shall be classified in the Middle Layer and all the regulations applicable to Middle layer shall apply to the NBFCs on an individual basis.

Concept Note on Central Bank Digital Currency

October 7, 2022

Reserve Bank of India in its "Concept Note" released in October 2022 has in great detail explained the objectives, choices, benefits and risks of issuing a Central Bank Digital Currency (CBDC) in India, referred to as e₹ (digital Rupee). The e₹ will provide an additional option to the currently available forms of money and though it is not substantially different from banknotes, being digital it shall be easier, faster, and cheaper to issue and maintain.

CBDC is a digital form of currency notes issued by a central bank. Central banks across the globe are exploring the issuance of CBDC though the key motivations for its issuance are specific to each country's unique requirements.

The purpose behind the issue of this Concept Note by RBI has been to bring awareness about CBDCs as a new form of currency as well as the salient features of the digital Rupee. Link to the Concept Note is provided herewith Reserve Bank of India - Reports (rbi.org.in).

Important Notifications

Operationalization of Central Bank Digital Currency – Wholesale (eRupee-W) Pilot

Notification No. RBI/2022-23/1118 dated October 31, 2022

In line with the release of the Concept Note on Digital Currency, with effect from November 01, 2022, RBI has commenced a pilot launch (with 9 participating banks) for settlement of secondary market in government securities using Digital Rupee – Wholesale segment (eRupee-W), which shall reduce transaction cost considerably. Other wholesale transactions, cross border payments and retail segment shall also be covered in subsequent pilot launches aiding trade significantly.

SEBI

Participation of Foreign Portfolio Investors (FPIs) in Exchange Traded Commodity Derivatives (ETCDs) in India

SEBI/HO/MRD/MRD-RAC-1/P/CIR/2022/131 dated September 29, 2022

SEBI has allowed Category III Alternate Investment Funds (AIF), Mutual Funds, Portfolio Managers to participate in Indian Exchange Traded Commodity Derivatives (ETCDs) in order to broaden the spectrum of institutional participation in such instruments. Eligible Foreign Entities (EFEs) having actual exposure to Indian commodity markets were permitted in ETCDs since 2018. However, because of non-participation by EFEs, it has been decided that the existing EFE route be discontinued.

Effective Date: Immediate (i.e.) from the date of notification.

Two-Factor Authentication for transactions in units of Mutual Funds

SEBI/HO/IMD/IMD-I DOF1/P/CIR/2022/132 dated September 30, 2022

In order to safeguard the interest of unitholders of mutual funds, SEBI has implemented Two-Factor Authentication to authenticate online and Signature Verification for offline transactions for redemption of Mutual Fund units since June 2022.

To further provide safeguards to investors, the Two-Factor Authentication has been extended for subscription transactions in the units of Mutual Funds as well.

As a result of this notification, both the subscription and redemption of units in Mutual Funds shall have the process of Two-Factor Authentication (for online transactions) and signature method (for offline transactions). To bring into effect this authentication, an One Time Password (OTP) shall be sent to registered mail ID and phone number registered with the AMC / RTA.

Effective Date: April 01, 2023.

Governing Council for Social Stock Exchange ("SSE")

SEBI/HO/MRD/MRD-RAC-2/P/CIR/2022/141 dated October 13, 2022

Important Notifications

SEBI vide its circular no. SEBI/HO/CFD/PoD-1/P/CIR/2022/120 dated September 19, 2022, has provided a framework for launching of Social Stock Exchange (SSE), which was preceded by issuance of notification of a broad framework for such SSE in July 2022.

With a view to kickstart the operationalizing of the SSE, SEBI has recommended constituting a Social Stock Exchange Governing Council (SGC) for facilitating the functioning of SSE with regard to registration, fundraising and adequate disclosures by Social Enterprises to be registered on the Exchange.

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Abbreviations

Back

Abbreviation	Meaning
AAR	Authority of Advance Ruling
AAAR	Appellate Authority of Advance Ruling
AAC	Annual Activity Certificate
AD Bank	Authorized Dealer Bank
AE	Associated Enterprise
AGM	Annual General Meeting
AIR	Annual Information Return
ALP	Arm's length price
AMT	Alternate Minimum Tax
AO	Assessing Officer
AOP	Association of Person
APA	Advance Pricing Arrangements
AS	Accounting Standards
ASBA	Applications Supported by Blocked Amount
AY	Assessment Year
BOI	Body of Individuals
BRC/FIRC	Bank Realisation Certificate / Foreign Inward Remittance Certificate
CBDT	Central Board of Direct Tax
CBIC	Central Board of Indirect Taxes and Customs
CCA	Cost Contribution Arrangements
CCR	Cenvat Credit Rules, 2004

Abbreviation	Meaning
CESTAT	Central Excise and Service Tax Appellate Tribunal
CGST Act	The Central Goods and Services Tax
CIT(A)	Commissioner of Income Tax (Appeal)
COO	Certificate of Origin
Companies Act	The Companies Act, 2013
CPSE	Central Public Sector Enterprise
CSR	Corporate Social Responsibility
CTA	Covered Tax Agreement
CUP	Comparable Uncontrolled Price Method
Customs Act	The Customs Act, 1962
DFIA	Duty Free Import Authorization
DFTP	Duty Free Tariff Preference
DGFT	Directorate General of Foreign Trade
DPIIT	Department of Promotion of Investment and Internal Trade
DRI	Directorate of Revenue Intelligence
DTAA	Double Tax Avoidance Agreement
ECB	External Commercial Borrowing
ECL	Electronic Credit Ledger
EGM	Extra-ordinary General Meeting

Abbreviation	Meaning
FEMA	Foreign Exchange Management Act, 1999
FII	Foreign Institutional Investor
FIFP	Foreign Investment Facilitation Portal
FIRMS	Foreign Investment Reporting and Management System
FLAIR	Foreign Liabilities and Assets Information Reporting
FPI	Foreign Portfolio Investor
FOCC	Foreign Owned and Controlled Company
FTC	Foreign Tax Credit
FTP	Foreign Trade Policy 2015-20
FTS	Fees for Technical Service
FY	Financial Year
GAAR	General Anti-Avoidance Rules
GDR	Global Depository Receipts
GOI	Government of India
GST	Goods and Service Tax
GSTN	Goods and Services Tax Network
GVAT Act	Gujarat VAT Act, 2006
HC	High Court
HSN	Harmonized System of Nomenclature
ICAI	Institute of Chartered Accountant of India

Abbreviations

Abbreviation	Meaning
ICDS	Income Computation and Disclosure Standards
ICDR	Issue of Capital and Disclosure Requirements
IEC	Import Export Code
IGST	Integrated Goods and Services Tax
IRDA	Insurance Regulatory and Development Authority
ISD	Input Service Distributor
ITA	Income Tax Act, 1961
ITC	Input Tax Credit
ITR	Income Tax Return
IT Rules	Income Tax Rules, 1962
ITAT	Income Tax Appellate Tribunal
ITR	Income Tax Return
ITSC	Income Tax Settlement Commission
JV	Joint Venture
LEO	Let Export Order
LIBOR	London Inter Bank Offered Rate
LLP	Limited Liability Partnership
LO	Liaison Office
LODR	Listing Obligations and Disclosure Requirements
LTA	Leave Travel Allowance
LTC	Lower TDS Certificate
LTCG	Long term capital gain
MAT	Minimum Alternate Tax
MCA	Ministry of Corporate Affairs
MEIS	Merchandise Exports from India Scheme
MSF	Marginal Standing Facility
MSME	Micro, Small and Medium Enterprises
ODI	Overseas Direct Investment
OECD	The Organization for Economic Co-operation and Development
OM	Other Methods prescribed by CBDT
PAN	Permanent Account Number
PE	Permanent establishment
PPT	Principle Purpose Test
PSM	Profit Split Method
PY	Previous Year
RBI	Reserve Bank of India
RCM	Reverse Charge Mechanism
RMS	Risk Management System
ROR	Resident Ordinary Resident
ROSCTL	Rebate of State & Central Taxes and Levies
RoDTEP	Remission of Duties and Taxes on Exported Products
RPM	Resale Price Method
SC	Supreme Court of India
SCN	Show Cause Notice
SDS	Step Down Subsidiary
SE	Secondary adjustments
SEBI	Securities Exchange Board of India
SEP	Significant economic presence
SEZ	Special Economic Zone
SFT	Specified Financial statement
SION	Standard Input Output Norms
SST	Security Transaction Tax
ST	Securitization Trust
STCG	Short term capital gain
SVLDRS	Sabka Vishwas (Legacy Dispute Resolution Scheme) 2019
TCS	Tax collected at source
TDS	Tax Deducted at Source
TNMM	Transaction Net Margin Method
TP	Transfer pricing
TPO	Transfer Pricing Officer
TPR	Transfer Pricing Report
TRO	Tax Recovery Officer
WHT	Withholding Tax
WOS	Wholly Owned Subsidiary