For Private Circulation Only

NEWSLETTER

February 2016

DAMANIA & VARAIYA

Chartered Accountants

CONTENTS

Income Tax	2
Taxation of Expatriates	4
Trade Receivables Discounting System or TReDS	8

INCOME TAX

Re: Hasmukh Gala – Mumbai Tribunal

Sub: Conditions of Section 54 stands complied when the assessee makes advance payment to builder for booking of flat.

The assessee earned Long Term Capital Gain on sale of his residential house. He made advance payment to a builder for booking of another flat under construction and claimed exemption under section 54. The AO observed that even after 2 years from the date of transfer of old house, the new house was not completed. He therefore denied the claim made by the assessee u/s. 54.The CIT(A) upheld the order of the AO. The Tribunal held that:

The new property was still under construction and the legal title had not passed on to the assessee. However, the allotment letter by the builder does mention the flat number and other specific details of the property purchased by the assessee. It opined that when substantial payment was made in the new property, it should be deemed that sufficient steps had been taken and it would satisfy the requirement of section 54 of the Act. The appeal was allowed.

Re: Jagjit Singh Sayal – Mumbai Tribunal

Sub: Section 40(a)(ia) – Retrospective amendment

The assessing officer disallowed interest paid by the assessee to various parties u/s. 40(a)(ia) on the ground that the assessee failed to deduct TDS TDS on the said interest payments. The CIT(A) deleted the disallowance after observing that the recipients had included the interest income in their Return and paid tax on the same. The Tribunal relying on the decision of Delhi High Court held that the second

proviso to Section 40(a)(ia) was retrospective in nature. The Officer was directed to verify if the recipients had included the interest income in their returns and paid taxes thereon. If this was found to be correct, the disallowance was to be deleted.

Circular No. 22/2015

Re: Employers' contribution to funds – allowability u/s. 43B

The Central Board of Direct Taxes (CBDT) issued above circular stating that the contribution to funds made by an employer towards welfare of employees (including contribution to Provident Funds) in terms of Section 43B(b) shall be allowed as deduction if the contribution is made before the 'due date' of filing of Return as specified under section 139(1) of the IT Act.

Notification 95

C.B.D.T. has come up with notification for the nature of following transactions where from 1st April 2016, PAN must be quoted:

Sr. No.	Description	Amount exceeding
1.	Sale or Purchase of Motor vehicle (excluding two wheelers)	All transactions
2.	Opening of bank account	All transactions
3.	Application for Debit or Credit card	All transactions
4.	Opening of Demat account	All transactions
5.	Payment of hotel or restaurant bill at any single time	Rs. 50,000/-
6.	Payment in connection with any foreign travel or foreign exchange	Rs. 50,000/-
7.	Purchase of Mutual Fund units	Rs. 50,000/-
8.	Acquiring Debenture or Bond of any Company	Rs. 50,000/-
9.	Acquiring Bond from RBI	Rs. 50,000/-
10.	Cash deposit in bank or purchase of demand draft	Rs. 50,000/-
11.	Cash withdrawal from bank or demand draft	Rs. 50,000/-
12.	Fixed Deposit with Bank, Post Office, NBFC	Rs. 50,000/- per deposit OR Rs. 500,000/- in a financial year
13.	Payment for any pre-paid payment instrument	Rs. 50,000/-
14.	Life Insurance Premium	Rs. 50,000/-
15.	Sale or Purchase of any security	Rs. 100,000/-
16.	Sale or Purchase of any Share	Rs. 100,000/-
17.	Sale or Purchase of any immovable property	Rs. 10,00,000/-
18.	Any other sale or purchase of any goods or services	Rs. 200,000/-

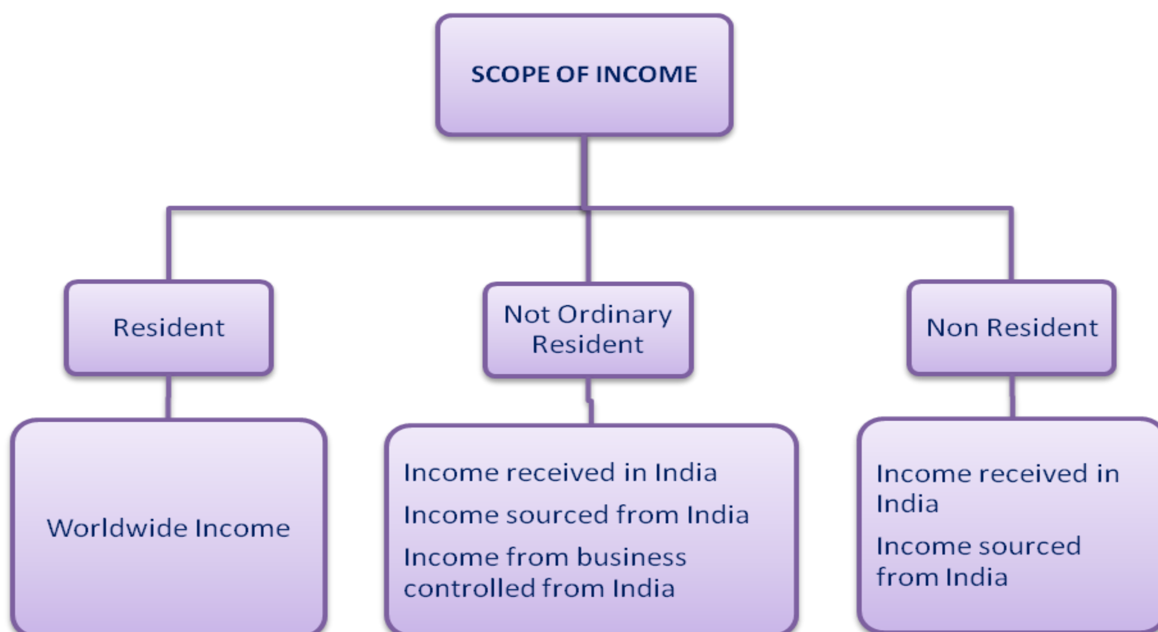
Compiled by: CA Malay Damania, Partner

Taxation of Expatriates

With the increased Globalisation, India opening up its economy and Make in India Campion, many foreign Companies choose India as their destination to expand their business operations. They may either set up a Liaison office or a Branch office or a subsidiary Company or a Joint Venture Company in India. In any case in order to supervise and overview Indian business, they prefer to deploy their foreign employee in India, specially for the initial period of their business set up in India.

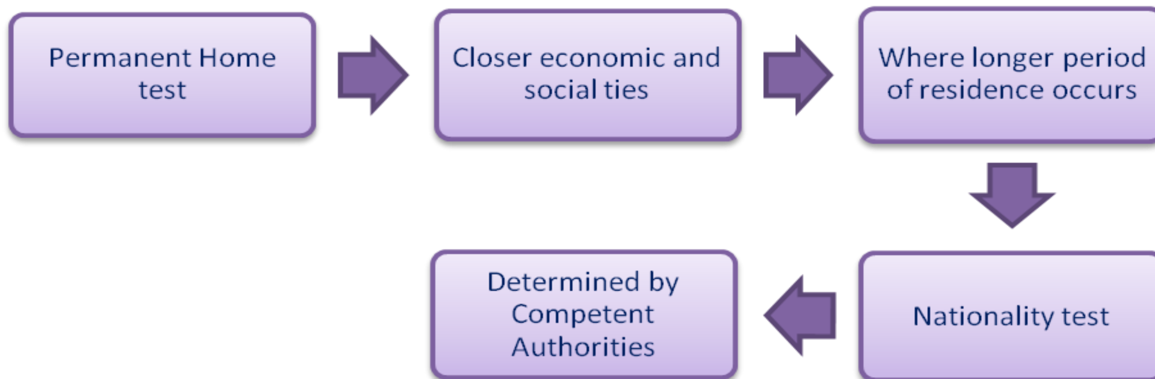
Though such Inbound employee referred to as “Expatriate” is not defined under the Income Tax Act (ITA), it generally refers to an Employee working abroad who comes to work in India for a short period of 6 months to 5 years.

The Scope of taxability of income of such Expatriate primarily depends up on his Residential Status in India as explained in below chart:



Residential Status of an individual is determined based on the physical presence in India and is determined as per Section 6 of the ITA. It is equally important to determine the Residential Status of the expat under the Double Tax Avoidance Agreement (Treaty) with that country. At times, an expat employee may be a resident of both the countries under the taxation laws of respective countries. Under such situation, ‘Tie Breaker Rule’ as mentioned in the Treaty has to be applied to determine his residential status. Tie breaker rule broadly follows following pattern:

INCOME TAX *(cont.)*



The basic rule of taxation of Salary income is that Salary is taxable in the country where the employee is physically present while rendering Services. However both the ITA and Treaty provide exemption to this basic rule if following specified conditions are satisfied.

Under The Act:

1) The Foreign Company is not engaged in any trade or business in India;
2) The employees' stay in India does not exceed 90 days in the previous year AND
3) Such salary is not deductible from the income of the employer chargeable to tax in India.

Under the Treaty:

1) The expat is present in India for not more than 183 days;
2) The salary is paid by an employer who is not a resident in India AND
3) The salary is not borne by a permanent establishment in India of the foreign Enterprise.

The conditions would vary depending up on the actual conditions mentioned in the specific treaty with the home country of the expat.

In a case where the Indian Company bears only a portion of Salary of the expat employee, proportionate salary to the extent paid in India will be subject to tax in India.

Per Diem Allowance or Daily Allowance:

Often foreign Companies deputing their employees on Indian assignments whereby over and above the salary that they pay in their home country, pay Per Diem or Daily Allowance to the employees to compensate for ordinary living charges they have to incur on account of absence from normal place of duty. The question arises whether such allowances are taxable in India or not.

According to Section 10(14)(i) of The ITA read with Rule 2BB(1)(b), any ordinary daily allowance paid, while on tour, is exempt from Income Tax to the extent actually incurred for the purpose of daily living expenditure. The term "daily allowance" is not defined under the Act but is normally understood to mean boarding, lodging and local conveyance expense incurred in India in this case.

These Allowances are not taxable in India provided the following broad conditions are satisfied:

- Such allowance was paid to enable the employee to meet daily ordinary cost of living in India on account of him/her away from the normal place of duty;
- These allowances are wholly, exclusively and necessarily to meet their personal expenses **while on deputation** for specific duty;
- A Statement showing detailed daily expenses incurred by them is prepared;
- The employee produces the **proof of expenditure spent** in India towards such expenses AND
- The allowances are **"reasonable"** having regards to the total Salary and nature of duties performed in India.

Contribution towards Social Security and Funds:

Any foreign national holding foreign passport – International Worker (IW) - comes to India to work for an Indian company to which the Employees Provident Fund Act applies, has to contribute to the provident fund in India. However such IW coming from a country with which India has a Social Security Agreement (SSA) and he is contributing to the social security of the home country and enjoys the status of detached worker is excluded from making such contribution provided he produces a Certificate of Coverage (COC) from the home country.

Employers' Contribution:

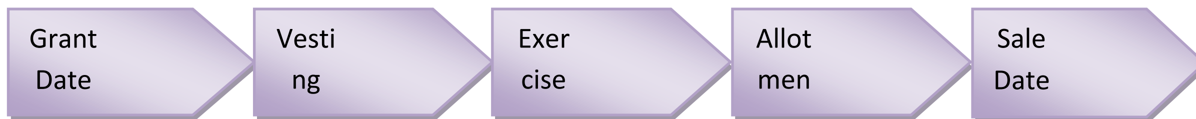
Question arises whether the Employers' contribution to overseas social security is taxable in India. Generally when the employer makes such contributions, the payments from the scheme are contingent on certain events like Retirement or termination of employment etc. Where such payments are contingent in nature and where the employee has no right to claim such amount till the contingency occurs, the amount does not confer any immediate right/benefit to the employee over such contribution and therefore the same should not be treated as part of taxable salary at that stage.

Employees' Contribution:

Question also arises whether Employees contribution to overseas social security should be allowed as deduction from taxable Salary in India. According to Section 16 of The ITA, only the specified contributions to funds in India are allowable as deductions from Salary income. It is important to examine whether the contribution by the expat employee to social security scheme in the home country is mandatory or is in the nature of saving scheme. In case such contribution is mandatory and is retained by the employer and paid directly into the scheme, the employee has no right to receive it. It would be regarded as "diversion of income by overriding title" and therefore possible to contend that it is only the amount of salary after deducting employees' contribution to such fund that is chargeable to tax in India.

Employee Stock Option Plan (ESOP):

Many multinational Companies offer ESOP to their key employees as incentive to retain the talent in the Company. The ESOP has various stages spread over multiple years, generally 2 to 3 years, as stated below but are taxable at the time of allotment of shares by the Company.



Since taxability of Salary largely depends up on the place of rendering of services, question arises is when an employee has rendered part of the services in India during the grant period, whether the benefit derived by employee under ESOP would be taxable in India. Relying on certain Tribunal judgments, OECD report and CBDT circular, in my opinion, the proportionate benefit that pertains to the period of service rendered in India between grant period and vesting period will be subject to tax in India.

Further, there will be many other challenges for the employees of how to get credit for the tax paid in source country against the tax liability in country of residence, overlapping accounting years between the two countries, production of Tax Residency Certificate (TRC) to be able to get advantage of DTAA, filing of his tax return etc.

There will be challenge for the foreign Enterprise whether it establishes a Permanent Establishment (PE) in India by deputing their employee/s in India and tax consequences thereof.

Compiled by: CA Malay Damania, Partner

Trade Receivables Discounting System or TReDS

I. The Reserve Bank of India (RBI) recently granted in-principle nod to three entities namely Axis Bank, Mynd Solutions (Gurgaon, Haryana) and NSE Strategic Investment Corporation and Small Industries Development Bank of India (Mumbai) to setup a Trade Receivables Discounting System (TReDS)

It is a step by RBI to secure finances for micro, small and medium enterprises (MSMEs) as MSMEs find it very difficult to convert their trade receivables into liquid funds.

TReDS has been set up under the regulatory framework set up by RBI under Payment and Settlement Systems Act 2007. RBI has defined TReDS as the institutional mechanism for financing of trade receivables of MSMEs from corporate buyers through two or more financiers

TReDS deals with discounting of both invoices and bills of exchange.

MSMEs sellers, corporate buyers, other buyers including Government Departments and Public Sector Undertakings (PSUs), financiers (both banks and NBFC factors) will be direct participants in this.

The TReDS could deal with both receivables factoring as well as reverse factoring so that higher transaction volumes come into the system and facilitate better pricing.

The bankers who are linked to MSMEs and corporate buyers may be provided with the relevant details of discounted invoices of respective clients, if required.

II. TReDS works in two phases – the first one deals with discounting of factoring units (invoices/bills) by financiers thus ensuring fund-flow to MSME.

The second phase comprises re-discounting of the factoring units by the financiers. Random audits would be introduced to verify authenticity of invoices and genuineness of the transactions.

The bankers of sellers and buyers may be provided access to the system, where necessary, for obtaining information on the portfolio of discounted invoices / bills of respective clients. The TReDS may tie up with necessary technology providers, system integrators and entities providing dematerialisation services for providing its services.

TReDS has a one-time agreement between various participants and TReDS (Master Agreement - broadly having three clauses - obligation to pay on due date, no recourse to disputes regarding quality of end goods and no off-sets.

III. Factoring unit means a standard nomenclature used in the TReDS for an invoice or a bill on the system. Factoring Units may be created either by the MSME seller (in the case of factoring) or by corporate and other buyers, including Government Departments and PSUs, (in case of reverse factoring) as the case may be.
Financier – refers to a bank as well as an NBFC factor participating in the TReDS and who accepts the factoring unit for financing purpose.

Process flow under TReDS

There will be a window period provided for financiers to quote their bids against factoring units. Financiers will be free to determine the time-validity of their bid price. Once accepted by the MSME seller, there will be no option for financiers to revise their bids quoted online.

The MSME seller is free to accept any of the bids and the financier will receive the necessary intimation. Financiers will finance the balance tenor on the factoring unit.

Once a bid is accepted, the factoring unit will get tagged as "financed" and the funds will be credited to the seller's account by the financier on T+2 basis (T being the date of bid acceptance).

On the due date, the financier will have to receive funds from the corporate buyer. The TReDS will send due notifications to corporate buyers and their banks advising them of payments due.

Non-payment by the buyer on the due date to their banker should tantamount to a default by the buyer and attract penal provisions and enable the banker to proceed against the corporate buyer. Any action initiated in this regard, will be strictly non-recourse with respect to the MSME sellers.

Once financed, these instruments will be rated by the TReDS on the basis of an external rating of the buyer corporate, the nature of the underlying instrument (invoice or bill of exchange), previous instances of delays or defaults by the buyer corporate w.r.t. transactions on TReDS etc.

The rated instruments may then be further transacted / discounted amongst the financiers in the secondary segment.

ILLUSTRATION