India Tax Konnect

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Contents

Tax article	2
International tax	5
Corporate tax	8
Transfer pricing	10
Indirect tax	12
Personal tax	15

Editorial

According to the International Monetary Fund (IMF) the adoption of Goods and Service Tax (GST) could help to raise India's medium-term Gross Domestic Product (GDP) growth to over eight per cent and create a single national market for enhancing the efficiency of the movement of goods and services. As per IMF, larger than expected gains from GST and further structural reforms could lead to significantly stronger growth, while a sustained period of continued low global energy prices would also be beneficial to India.

Moving a step closer towards implementing the GST from 1 July 2017, the GST council on 4 March approved two crucial supporting legislations for this tax reform. The GST council, in its eleventh meeting, approved drafts of the central GST law (CGST) and the integrated GST law (IGST). The council will again meet on 16 March to clear the state GST law (SGST) and the union territory GST law (UTGST).

Recently, the Finance Ministry launched a mobile app for GST so as to provide updates to taxpayers on the new tax regime. With the app, the taxpayers can readily access a host of GST information such as migration to GST, approach and guidelines for migration, draft law (Model GST Law), IGST Law, GST Compensation Law, draft rules related to registration, returns, payment, refund and invoice. The app is also expected to publish Frequently Asked Questions (FAQs) on GST.

Recently, the Organisation for Economic Co-operation and Development (OECD) has released Economic Survey of India. As per report, economic growth of around 7.5 per cent makes India the fastest-growing G20 economy. The acceleration of structural reforms, the move towards a rule-based policy framework and low commodity prices have provided a strong growth impetus. Recent deregulation measures and efforts to improve the ease of doing business have boosted foreign investment. The report identifies priority areas for future action, including continuing plans to maintain macroeconomic stability and further reduce poverty, additional comprehensive tax reforms and new efforts to boost productivity and reduce disparities between India's various regions.

The Delhi Tribunal in the case of Geo Connect Ltd. held that the payment in respect of international private leased circuit charges and connectivity charges paid to the US entities are not taxable as royalty since the payment was made for transmission of call data and did not involve the use or right to use any industrial commercial or scientific equipment. The service in substance was for providing connectivity facility to the taxpayer to generate and cater to outbound public switch telephone network calls within the USA, hence the same did not amount to 'royalty' under the Income-tax Act, 1961 (the Act) or under the India-USA tax treaty. The Tribunal held that the aforesaid payment is not taxable as Fees for Technical Service (FTS) in the absence of human intervention in the services involved. The 'make available' test under Article 13 of the tax treaty is not satisfied and therefore, it is not taxable as FTS under the tax treaty.

We at KPMG in India would like to keep you informed of the developments on the tax and regulatory front and its implications on the way you do business in India. We would be delighted to receive your suggestions on ways to make this Konnect more relevant.

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Tax article

CBDT issues Foreign Tax Credit Rules

Background

Under the provisions[1] of the Income-tax Act, 1961 (the Act), any income earned by a tax resident is liable to be taxed in India, although the same income may have been taxed in the state of source (the state/country where income is earned).

Generally, the worldwide income of a resident of a country is taxed in that country (resident state), regardless of where it is earned, based on the residence rule. Simultaneously, the state of the source may ask for a fair share out of the tax on that income based on the source rule. Such overlapping of taxing rights gives rise to double taxation. When the same income is taxed in the hands of the same person in more than one jurisdiction, the issue of 'jurisdictional' double taxation arises. Therefore, countries enter into a double tax avoidance agreement (the tax treaty), inter alia, to prevent such double taxation. Alternatively, when the same income is taxed in the hands of more than one person (e.g., dividend), 'economic' double taxation takes place, which is typically not addressed in the Indian tax treaties.

A tax credit is a relief in the total amount of tax that the taxpayer owes to a state, by virtue of the mechanism as provided in the respective tax treaties or the domestic tax laws. Foreign tax credit (FTC) is a credit given by a state for the taxes paid in another state.

Bilateral relief under the tax treaty

The government may enter into a tax treaty with a foreign country, for the granting of relief; inter alia, in respect of income on which income tax has been paid both in India and the foreign country, or income tax chargeable in India and the foreign country[2]. Typically, Article 23 of the tax treaties provide for the bilateral relief from double taxation. If a tax treaty applies to a foreign tax resident, the provisions of this Act shall apply to the extent they are more beneficial to such resident. The relief from double taxation, as provided in the Indian tax treaties under Article 23 is either by way of exemption or by way of credit.

The exemption method

Under the exemption method, the state where the taxpayer is a resident i.e. state of residence, does not tax the income, which according to the tax treaty may be taxed in the state where the income is earned i.e. state of source.

The tax credit method

Under the tax credit method, the income earned in the state of source is also included in the taxable income in the state of residence. However, the state of residence gives credit for the taxes paid in the state of source. Typically, the Indian tax treaties provide that the credit of taxes paid in the state of source is limited to the tax liability on the doubly taxed income in India, and this is known as the 'ordinary credit method'. Under this method, the excess of the foreign tax paid over the Indian tax liability on the same income is neither refunded to the taxpayer nor adjusted against the taxpayer's tax liability on other income. Normally, the Indian tax treaties do not grant the tax credit under the 'full credit method' i.e. tax credit allowed without any restriction or cap.

The tax sparing method

This tax sparing method consists of granting a tax credit to a taxpayer in the state of residence for the tax that would have been payable in the state of source had there been no reduction or exemption under the tax regime of the state of source. Generally, such deductions/exemptions are granted by the state of the source to promote its economic development. Some of the countries with whom India has this beneficial clause in the tax treaties are Cyprus, Mauritius, Singapore, etc. In the case of some countries, this beneficial clause relates to them only as a state of Residence for e.g. Australia, UK, Canada, etc.

Unilateral relief under the Act where a tax treaty does not exist

As per Section 91 of the Act, an Indian tax resident's income, which accrued or arose during a financial year outside India, and the resident has paid income-tax in any country with which there is no tax treaty; he shall be entitled to FTC. Such FTC shall be equal to the deduction from the Indian income tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is lower. Thus, Section 91 of the Act provides for a unilateral relief under the Indian domestic law.

CBDT notifies FTC rules

There has been long drawn litigation due to uncertainty on various aspects in relation to the claim of FTC since detailed guidelines were not available. In order to resolve such issues, the Central Board of Direct Taxes (CBDT) had set-up a committee to suggest the methodology for the grant of FTC. After due consideration of the issues raised by various stakeholders, the committee submitted its report. Subsequently, CBDT issued draft rules for grant of FTC inviting comments and suggestions on the same.

Recently, CBDT issued a Notification[3] introducing Rule 128 in the Income-tax Rules, 1962 (the Rules) with respect to FTC that shall come into effect from 1 April 2017. Key aspects of the new rule are summarised as follows:

1. Section 5 of the Act
2. Section 90(1) of the Act
3. Notification No. 54/2016, dated 27 June 2016

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- The resident taxpayer shall be allowed FTC of any foreign tax paid in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India.
- In a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, the credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.
- FTC shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.
- FTC shall not be available in respect of any amount of foreign tax or part thereof, which is disputed by the taxpayer. The credit of disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India, if the taxpayer within six months from the end of the month in which the dispute is finally settled, furnishes evidence of settlement of dispute and evidence to the effect that the liability for payment of such foreign tax has been discharged by him/her and furnishes an undertaking that no refund in respect of such amount has directly or indirectly been claimed or shall be claimed.
- FTC shall be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or a specified territory, and given effect to in the following manner:
  - FTC shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income. However, in case the foreign tax paid exceeds the amount of tax payable in accordance with the tax treaty, such excess shall be ignored
  - FTC shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer-buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.
- In the case where any tax is payable under the provisions of Minimum Alternate Tax (MAT) under the Act, the credit of foreign tax shall be allowed against such tax in the same manner as is allowable against any tax payable under the provisions of the Act other than the provisions of the said sections.
- If the amount of FTC available against the tax payable under the provisions of MAT, exceeds the amount of tax credit available against the normal provisions, then while computing the amount of MAT credit in respect of the taxes paid under MAT provisions, as the case may be, such excess shall be ignored.
- As per Rule 128(10), Form No.67 shall also be furnished in a case where the carry backward of loss of the current year results in a refund of foreign tax for which credit has been claimed in any earlier previous year or years.
- FTC shall not be allowed unless the specified documents are furnished by the taxpayer.

Summing up

These rules clarify the nature and conditions for the availability of FTC to the taxpayers and provide guidance to claim FTC in India. However, there are some aspects, which have not been adequately addressed in FTC rules.

The rules are silent on the underlying tax credit on dividend income received by the Indian companies from their overseas subsidiary company. India has such beneficial clause in tax treaties with the USA, the U.K., Cyprus, Australia, Japan, Mauritius, Singapore, etc. subject to certain conditions. Further, the rules are silent on the methodology of allowing tax-sparing credit.

In addition to the taxes covered under the tax treaties, in certain countries, there are additional taxes, which are levied on income in the foreign jurisdiction such as state taxes in the U.S., Branch Profits Tax on repatriation, etc. There is no clarity on the availability of tax credit on such taxes paid in a foreign jurisdiction. However, the Karnataka High Court in the case of Wipro Ltd. [4]held that the income tax in relation to any country includes income tax paid not only to the federal government of that country, but also any income tax charged by any part of that country meaning a state or a local authority, and the taxpayer would be entitled to the relief of double taxation benefit with respect to the latter payment also.

The word tax payable could be the subject matter of different interpretations like tax chargeable, tax paid, etc. This aspect has not been clarified in the Rules. Further, in relation to the disputed FTC, the word 'finally settled' has not been defined/ clarified in the rules. Whether the tax dispute settled by the lower authorities/courts can be treated as finally settled.

Though the claim of FTC in respect of disputed tax subsequently settled has been allowed, further clarity is required on the procedural aspects for claiming such credit, especially when the dispute is settled after the expiry of the time limit for filing revised return of income under the Act.

Para 5(i) of the Rules state that the credit shall be lower of the tax payable under the Act for each source of income arising from a particular country and the foreign tax paid on such income. The tax payable under the Act is computed on the total income after giving effect to items such as brought forward losses and deductions under Chapter VI-A, which may cause practical difficulties in computing as well as availing FTC.

An entity, which is regarded as a separate legal entity in one country, whereas a see through an entity in another country, could lead to a complicated FTC scenario.

Compared to the draft rules, certain relaxation has been made in the documentation requirement, and the self-certification

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4. Wipro Ltd. v. DCIT [2015] 62 taxmann.com 26 (Kar) - The Supreme Court has allowed the Special Leave Petition [CIT v. Wipro Ltd. (2016) 70 taxmann.com 294 (SC)] against this decision.

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supported by proof of payment shall now be accepted as the basis of payment of foreign taxes. While some of the suggestions of the stakeholders have been accepted, the Rules do not deal with certain other expectations. The taxpayer's expectation to provide an option to claim the credit for all overseas tax payment on an aggregate basis has not been accepted. As against that, CBDT has adopted the source-by-source approach, which may increase the compliance burden as well as results into the lesser availability of credit. FTC rules are silent on the methodology of allowing credit due to the difference in the characterisation of income between India and another country. It would also be interesting to see whether the restriction on MAT/AMT credit will come in conflict with the provisions of the Act/tax treaty.

India has entered into a limited tax treaty with a few countries like Pakistan, Afghanistan, Ethiopia, Iran, etc. which deal with income from international air traffic. These tax treaties do not have any provision for taking credit for taxes on any other kind of income. Therefore, the credit of tax paid on any other income (say salary income) in such countries cannot be claimed under Section 90 of the Act. Further, Section 91 of the Act applies where taxes are paid in any country with which there is no tax treaty under Section 90 of the Act. Since India has a limited tax treaty with such countries under Section 90 (although not covering salary income), a literal interpretation of Section 91 of the Act could result in denial of FTC under Section 90 as well. The Rules do not provide for any clarity on this aspect.

The rules limit the availability of credit only in cases where the foreign tax is not disputed in any manner. Any substantive provision should be brought by making a suitable amendment under the provisions of the Act, and should not be impressed upon through the Rules.

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International tax

Decisions

The limitation of relief clause under the India-Singapore tax treaty is not applicable to income which is offered to tax on an accrual basis in Singapore

The taxpayer is a non-resident company incorporated under the laws of Singapore and is also a tax-resident of Singapore. It is engaged in the business of operation of ships in international waters, mainly transportation of cargo and container ships all across the globe. The business operations as well as the management team are based in Singapore. The taxpayer also accepts cargo for carriage internationally to and from India. In India, the taxpayer has a shipping agent in the form of a wholly owned subsidiary, APL India Pvt. Ltd. Being a tax-resident of Singapore in terms of Article 4(1) of the India-Singapore tax treaty, it sought the benefit of Article 8 for its gross freight earnings collected from India in respect of 136 ships. Accordingly, the return of income was filed at NIL income on the ground that the gross earnings are not taxable in India in view of Article 8(1) of the tax treaty.

The Assessing Officer (AO) called for the details of the ships. The taxpayer could not produce the details of eight ships. Accordingly, the AO applied the provisions of Section 44B of the Act and taxed the said receipt at the rate of 7.5 per cent. The Commissioner of Income-tax (Appeal) [CIT(A)] enhanced taxable income to INR1106.89 crore holding that entire freight would be liable to be taxed in India pursuant to limitation clause of Article 24 of the tax treaty.

The Mumbai Tribunal observed that on reading of Article 24 (Limitation of relief) of the India-Singapore tax treaty, it is quite apparent that two conditions have been envisaged that needs to be fulfilled; firstly, income earned from the source state (here in this case, India) is exempt from tax or is taxed at a reduced rate in the source state (India) as per the tax treaty; and secondly, under the laws in force of the resident state (Singapore), such income is subject to tax by reference to the amount thereof which is remitted to or received in the resident state and not by reference to the full amount thereof. In this case, the income of the taxpayer from shipping operations is not taxable on remittance basis under the laws of Singapore, albeit is liable to be taxed in-principle on accrual basis by virtue of the fact that this income under the income tax laws of Singapore is regarded as 'accruing in or derived from Singapore'.

From the plain reading of Section 10(1) of the Singapore Income Tax Act it can be inferred that the tax is on income accruing in or derived from Singapore and it is completely irrelevant whether the income is received in Singapore or not. Further the entire income is disclosed in the return of income filed in Singapore and the statement is issued that the Comptroller of Income-tax is satisfied that a company has correctly reported its income accrued in or derived from Singapore.

Additionally, it was observed that an enterprise which is a tax-resident of Singapore is liable for taxation on its shipping income only in Singapore and not in India. When India does not have any taxation right on a shipping income of a non-resident entity, which is the exclusive domain of the resident state, there is no question of any kind of exemption or reduced rate of taxation in the source state. Hence, it cannot be reckoned that shipping income earned from India is to be treated as exempt from tax or taxed at reduced rate, which is a condition precedent for applicability of Article 24. Thus, the condition of Article 24 is not satisfied in the present case from this angle either.

On the taxation of income from eight ships, the Tribunal observed that even if the entire leg of the journey was undertaken by a shipping company through and through charter arrangement or joint service arrangement, the benefit of Article 8 of the tax treaty could not be denied, because it would still fall within the ambit and scope of 'operation of ships' under Article 8 of the tax treaty.

APL Co. Pte. Ltd. v. ADIT (ITA No. 4435/Mum/2013) – Taxsutra.com

Payment for international private leased circuit and connectivity charges for use of private bandwidth in underwater sea cable are not taxable as royalty or FTS

The taxpayer was operating an outbound call centre and was engaged in telemarketing services on behalf of its clients based in the USA. The call centre executive sitting in the premises of the taxpayer makes an outbound call to the USA on telephone numbers of potential buyers of clients in real-time. In the process of calling by the executive to the person located at the USA, the voice data is converted into electronic data and is carried over by multiple entities. From Delhi to Mumbai the call is carried over a line provided by the Videsh Sanchar Nigam Ltd. (VSNL) and Mumbai onwards this call is carried over via an underwater sea cable maintained by VSNL and AT&T, USA up to the shores of USA. From another end of underwater see cables at USA, the call is connected to a basic telephone service provider of the USA by IGTL Solutions (USA) Inc (IGTL Solutions). This underwater sea cable is jointly maintained by VSNL and AT&T, USA. For running the call centre, the taxpayer acquired a dedicated private bandwidth in the underwater sea cable from VSNL and AT&T, USA. In terms of the agreement, the taxpayer paid the international private leased circuit (IPLC) charges to VSNL and to Kick Communication for the use of dedicated private bandwidth in underwater sea cable. The taxpayer deducted tax on payments made to VSNL. However, no tax was deducted on payments made to Kick Communication.

The AO held that the right to use the bandwidth and technical services is in the nature of maintenance and it falls within the definition of royalty. The AO held that income deemed to accrue or arise in India within the meaning of Section 9 of the Act and the India-USA tax

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treaty and hence tax was to be deducted on this amount before making payments. Accordingly, the AO disallowed the payment in terms of Section 40(a)(i) of the Act for non-deduction of tax. The CIT(A) concurred with the finding of the AO that payments made to the two parties were in the nature of royalty.

The Delhi Tribunal held that payment in respect of IPLC charges and connectivity charges paid to the U.S. entity are not taxable as royalty since the payment was made for transmission of call data and did not involve use or right to use any industrial commercial or scientific equipment. The control of equipment (i.e. the undersea cable, etc.) was with the non-resident and was not leased to the taxpayer. The service in substance was for providing connectivity facility to the taxpayer to generate and cater to outbound public switch telephone network (PSTN) calls within the USA, hence the same did not amount to 'royalty' under the Act or under the India-USA tax treaty.

The Tribunal held that the aforesaid payment is not taxable as FTS in the absence of human intervention in the services involved. The 'make available' test under Article 13 of the tax treaty is not satisfied and therefore, it is not taxable as FTS under the tax treaty. Accordingly, deduction of tax under Section 195 of the Act is not applicable.

Geo Connect Ltd. v. DCIT (ITA Nos. 1927/Del/2008 & 127/Del/2011) – Taxsutra.com

Income from rendering consultancy services to India-based clients is not FTS

During AY 2011-12, the taxpayer offered to tax a sum of INR3.42 crore as income attributable to work performed in India by the Permanent Establishment (PE) of the taxpayer in India which was created on account of its personnel (employees and other executives) staying in India for more than 90 days. However, the AO was of the opinion that entire receipts were in the nature of FTS within the meaning of Explanation 2 to Section 9(1)(vii) of the Act as the services were legitimately utilised in India. It was also held by the AO that the taxpayer was not eligible for the benefit of the India-U.K. tax treaty on the ground that the taxpayer was a fiscally transparent entity not liable to tax in the U.K. in its own right. In addition to that it was also held by the AO that aforesaid amount of income were in the nature of FTS as defined in Article 13(4) of the tax treaty and were chargeable to tax under Article 13 thereof. Also, AO held that in any case, these amounts were also taxable under Article 15 of the tax treaty relating to Independent Personal Services.

The Mumbai Tribunal followed its earlier order and held that the taxpayer is eligible for the benefits of the India-U.K. tax treaty.

With respect to the tax department's contention of treating the fee received by the taxpayer for the services provided as FTS, the Tribunal referred to the FTS definition under Article 13(4) of the tax treaty which provides for 'make-available' condition. The Tribunal rejected the tax department's contention that the taxpayer parted with its knowledge, skill and experience with its clients while rendering consultancy services and thus it can be said that the taxpayer 'made available' the same to its clients. The Tribunal observed that the expression 'make available' does not mean that when the recipient uses the services, then that itself amounts to making available of technical knowledge, experience, skill, know-how or processes, etc. to the recipient. There is a clear distinction between 'user' of the services and making available of technical knowledge, experience, skill, know-how or processes, etc. by the service provider. On proper analysis of the background and the context in which this term has been used in the tax treaty, 'make available' postulates that the recipient gets equipped to perform similar activity in the future without recourse to the service provider. Accordingly, the Tribunal held that the services provided by the taxpayer were not taxable as FTS under the India-U.K. tax treaty.

The Tribunal rejected the applicability of Article 15 of the India-U.K. tax treaty as it is applicable only to individuals and not to partnership firms. Further noting that the taxpayer has a service PE in India on account of its personnel staying in India for more than 90 days, the Tribunal remitted matter back to the AO for detailed examination with respect to taxability as business income.

Linklaters LLP v. DCIT (ITA No. 1690/Mum/2015) – Taxsutra.com

Notifications/Circulars/Press Releases

CBDT issues guiding principles for determination of the Place of Effective Management of a company

The provisions of Section 6(3) of the Act were amended with effect from 1 April 2016 to provide that a company is said to be resident in India in any previous year, if (i) it is an Indian company; or (ii) its place of effective management (POEM) in that year is in India. These provision have come into effect from 1 April 2017 and it applies from Assessment Year 2017-18 onwards.

On 23 December 2015, the CBDT[2] issued draft guiding principles for the determination of POEM of a company. Comments/suggestions on this draft guidance were invited from the stakeholders as well as the general public.

On 23 January 2017, CBDT issued the guiding principles to be followed for determination of POEM. Key features of the guiding principles are as follows:

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1. The dedicated 'private bandwidth' means certain portion of total data carrying capacity of the cable would be available to the taxpayer.
2. F. No. 142/11/2015-TPL

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- The final guidelines provide guidance on ‘income’, ‘value of assets’, ‘number of employees’ and ‘payroll’ in context of determining ‘active business outside India’ which were not present in the draft.
- The guidelines are primarily based on the fact as to whether or not the company is engaged in ‘active business outside India’. For determination of ‘active business outside India’ factors such as passive income, total asset base, the number of employees, payroll expenses in India and outside, etc. are considered.
- The guidelines state that the concept of POEM is one of substance over form.
- It also deals with the impact of modern technology in POEM determination.
- These guidelines are not intended to cover foreign companies or to tax their global income, merely on the ground of presence of a PE, a foreign company completely owned by an Indian company, some of the directors are resident in India, etc.
- An exception has been provided for ‘interest’ income earned by banking companies/Public Financial Institutions (PFIs). Any income by way of interest earned by banks/PFIs shall not be considered as passive income. The guidelines provide certain illustrations to provide clarity on various aspects.
- The guidelines provide that the AO would require to seek prior approval of the Principal Commissioner or the Commissioner before initiating any proceedings. The AO shall also obtain approval from Collegium of Principal Commissioners of Income-tax before holding that POEM of a non-resident company is in India.
- It has been clarified that the principles for determining the POEM are for guidance only and a ‘snapshot’ approach is not to be adopted.

CBDT Circular No. 06/2017, dated 24 January 2017

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Corporate tax

Decisions

Mere cash seizure is not an offence under Indian Penal Code and hence declaration is to be allowed under the Pradhan Mantri Garib Kalyan Yojana 2016

The taxpayer carrying cash amount of INR30 lakh (carrying new currency notes of denomination of INR2000) was stopped by the police officials. The police officials took him to the police station and the income tax officials were called. Subsequently, the cash was seized by the income tax official. The said cash was on account of sale proceeds of old jewellery belonging to him, his wife and mother. The tax officer treated the cash as undisclosed income. Chapter IX-A has been inserted in the Finance Act, 2016 to provide 'Taxation and Investment regime for Pradhan Mantri Garib Kalyan Yojana, 2016' (the Scheme). On 16 December 2016, the Department of Economic Affairs, Ministry of Finance, notified the Scheme that same is said to be in force from 17 December 2016 till 31 March 2017. The taxpayer filed a writ petition before the High Court contending that in view of the amendment in the Act, notification and circular, the petitioner is eligible to avail the remedy under the Scheme and also contend unconditional release of amount seized by the tax officer. However, the tax officials did not allow the same.

High Court's ruling

In the instant case the possession of undisclosed income in cash is not as per any of the offences under Indian Penal Code and therefore, the seizure of same cannot be said to be by the police officials. Not disclosing the correct income is undisputed and an offence under the Act. The income tax authorities are within their domain but the police officials cannot exercise such power under the Act. On a perusal of the provisions of the Scheme, it indicates that a person can avail the remedy of declaration. Thus, the taxpayer is not trying to falsify to project undisclosed income as duly accounted for availing the remedy. Since the taxpayer is not amongst the persons mentioned in the circular, being not eligible for availing the Scheme, therefore, the income tax officer cannot deny the taxpayer from availing the benefit of the Scheme. The High Court directed that the tax department shall not take any coercive action against the taxpayer and he may be granted a permission to take the assistance of a lawyer to be present at visible but not audible distance during his interrogation and recording of statement in connection with said seizure in the instant case or any proceedings consequential thereto. However, prayer of the taxpayer for directing unconditional return of the seized amount is rejected.

Vishal Jain v. State of Punjab and others (CWP No.1072 of 2017) – Taxsutra.com

Intimation issued under Section 143(1) though not an order can be considered for revision under Section 264 of the Act

The taxpayer is a society registered under the Travancore Cochin Literary Scientific and Charitable Societies Registration Act, 1955. During AY 2013-14, the taxpayer filed income-tax return disclosing taxable income. Subsequently, the taxpayer received a notice under Section 143(1) of the Act disallowing the claim of expenditure contending that it did not have a registration under Section 12A of the Act and assessed to a liability of INR2.85 lakh. The taxpayer subsequently filed a revised return. This was followed by a reminder letter for non-payment of tax dues. The taxpayer clarified that the receipt of INR7.63 lakh consisted of voluntary contribution which was received towards specific projects or activities and interest thereon which was claimed as an application towards charitable purpose. The taxpayer thereafter filed a revision petition under Section 264 which was declined by the Pr. CIT. Aggrieved, the taxpayer filed a writ petition before Kerala High Court.

The High Court observed that there had been some changes in the statutory format over a period of time and Section 143 of the Act had undergone certain changes with effect from 1 June 1999. The statute used the words intimation and not an order. The AO was empowered to pass an order under Section 143(3) of the Act after conducting an enquiry in terms of Section 143(2) of the Act. In light of change in the statutory provision one has to consider the scope and effect of the revisional powers under Section 264 of the Act. The High Court referred to Section 156 of the Act and observed that a mere intimation could not amount to an order which could be revised under Section 264 of the Act. However, the High Court observed that the revisional powers of CIT under Section 264 of the Act are very wide. Accordingly, pursuant to intimation under Section 143(1) of the Act, when the taxpayer has filed a revised return and has sought for interference by the Commissioner, the CIT has to consider the claim in accordance with law. The High Court directed the CIT to reconsider the matter in accordance with law.

Agarwal Yuva Mandal (Kerala) v. UOI (WP(C). No. 26779 of 2016) – Taxsutra.com

Since the securities are held as stock-in-trade, no disallowance of expenditure is to be made under Section 14A of the Act

The taxpayer filed a return declaring an income of about INR670 crore which was selected for scrutiny. The return showed dividend income exempt under Section 10(34) and (35) and net interest income exempt under Section 10(15)(iv)(h) of the Act. The taxpayer while claiming the exemption contended that the investment in shares, bonds, etc. constituted its stock-in-trade. The investment was not made with the intention of earning tax-free income. The tax-free income was only incidental to the taxpayer's main business of sale and purchase of securities and, therefore, no expenditure had been incurred for earning such exempt income. The AO restricted the disallowance to the amount which was claimed as exempt income and added the

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same to the taxpayer's income by applying Section 14A of the Act. The CIT(A) held that the AO had wrongly restricted the disallowance to the extent of exempt income claimed by the taxpayer and that the entire sum of INR40.72 crore of expenditure should have been disallowed by the AO as there was no legal provision either in Section 14A or Rule 8D to limit the disallowance to the amount of dividend received. The Tribunal set aside the order of the AO and of the CIT(A) and held that if shares are held as stock-in-trade and not as investment, even the disallowance under Rule 8D would be nil as Rule 8D(2)(i) would be confined to direct expenses for earning the tax exempt income.

High Court ruling

The CBDT Circular No. 18, dated 2 November 2015 carves out a distinction between stock-in-trade and investment and provides that if the motive behind purchase and sale of shares is to earn profit then the same would be treated as trading profit and if the object is to derive income by way of dividend then the profit would be said to have accrued from the investment. The investments made by the taxpayer are part of its banking business and the income arising from trading in the securities is attributable to the business of the bank/taxpayer falling under the head 'profits and gains of business'. Further, the securities dealt with in the course of such trading constitutes the taxpayer's stock-in-trade. What is to be disallowed under Section 14A of the Act is expenditure incurred to 'earn' exempt income. The securities in question constituted the taxpayer's stock-in-trade and the income that arises on account of the purchase and sale of the securities is its business income and is brought to tax as such.

The entire expenditure including administrative costs was incurred for the purchase and sale of the stock-in-trade and, therefore, towards earning the business income from the trading activity of purchasing and selling the securities. Irrespective of whether the securities yielded any income arising therefrom, such as, dividend or interest, no expenditure was incurred in relation to the same. Once it is found that no expenditure was incurred in earning this income, there would be no further expenditure in relation thereto that falls within the ambit of Section 14A of the Act. Accordingly, the High Court held that since the securities are held as stock-in-trade, no disallowance of expenditure is to be made under Section 14A of the Act.

Pr. CIT v. State Bank of Patiala (ITA No.244 of 2016) (P&H) – Taxsutra.com

Lower withholding as per certificate issued by the AO is 'person specific'

During the AY 2008-09, the taxpayer paid interest to MKJ Enterprises Ltd. and Amrit Sales Promotion Pvt. Ltd. The taxpayer was liable to deduct tax under Section 194A of the Act on these interest payments. Further, both parties had obtained a certificate from their respective AO under Section 197 of the Act authorising the taxpayer to deduct tax at source at a lower rate. However, the amount mentioned in such certificate was lesser than the actual amount of interest paid and the taxpayer had deducted tax at source at a lesser rate on the entire payment. The AO held that the deduction of tax at a lower rate was valid only in respect of the amount specified in the certificate and on the balance amount, the taxpayer ought to have deducted tax at source at the normal applicable rate. Therefore, for the shortfall, the AO held the taxpayer is under default and levied interest under Section 201(1A) of the Act. The CIT(A) confirmed the AO's order.

On perusal of Section 197(1) of the Act, the Tribunal observed that the recipient of the payment has to satisfy the AO that his total income justifies deduction of tax at a lower rate. Once the AO issues a certificate for deduction of tax at a lower rate or no deduction, then, the person making the payment will be at liberty to deduct tax at rates specified in the certificate. Section 197(2) of the Act nowhere makes any reference to any income specified in such certificate. Rule 28AA(2) of the Rules indicates that the certificate issued under Section 197 will be valid for the AY specified in the certificate. The deduction of tax at source at lower rate is 'person specific' and could not be extended to the amounts specified by the recipient of the payment while making an application for grant of certificate under Section 197 of the Act. The AO cannot treat the taxpayer as a person who has not deducted tax at source to the extent of the payments made by the taxpayer over and above the sum specified in the certificate under Section 197 of the Act. Thus, the Tribunal held that the taxpayer could not be treated as a person who has not deducted tax at source on the difference between the amounts specified in the certificate issued under Section 197 and the amounts actually paid by the Tribunal. The Tribunal deleted interest levied under Section 201(1A) of the Act.

Twenty First Century Securities Ltd v. ITO (ITA Nos 464 & 465/Kol/2014) – Taxsutra.com

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Transfer pricing

The Finance Minister for the first time presented a combined Fiscal and Railway Budget for the FY 2017-18. The Finance Bill, 2017 proposed the following amendments in the Transfer Pricing (TP) regulations:

Tax neutral related party transaction exempted from domestic TP provisions

The applicability of domestic TP provisions has now been restricted to only those related party transactions where one of the party enjoys any kind profit linked tax-incentives. Transactions between related parties that are tax neutral will not be covered within the ambit of TP provisions from FY 16-17 onwards.

Secondary adjustments

The Finance Bill, 2017 has introduced the concept of secondary adjustment on TP adjustments. A taxpayer is required to make a secondary adjustment, where the primary adjustment to transfer price has been made in the following situations:

- Suo motu by the taxpayer in the return of income;
- By the AO during assessment proceedings, and has been accepted by the taxpayer;
- Adjustment determined by an Advance Pricing Agreement entered into by the taxpayer;
- Adjustment made as per the safe harbour rules; or
- Adjustment arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into for avoidance of double taxation.

'Secondary adjustment' has been explained as an adjustment in the books of accounts of the taxpayer and its associated enterprise (AE) to reflect that the actual allocation of profits between the taxpayer and its AE are consistent with the arm's length price determined.

The additional amount receivable from the AE as a result of the primary adjustment should be repatriated by the taxpayer into India within a prescribed time limit. If the same is not received by the taxpayer within the time-limit, then the primary adjustment will be deemed as an advance extended to the overseas AE and a secondary adjustment in the form of notional interest on the outstanding amount should be offered to tax as an income of the taxpayer.

The above requirements for repatriating the adjustment amount into India and imputing a notional interest are triggered if the TP or primary adjustment exceeds INR1 crore. The manner of computation of interest on the amount deemed as advance made by the taxpayer to the AE would be prescribed. The said provisions will be applicable for FY 2016-17 and subsequent years.

Introduction of Thin Capitalisation Rules

Where an Indian company, or a PE of a foreign company in India, being the borrower, pays interest exceeding INR1 crore in respect of any debt issued/guaranteed (implicitly or explicitly) by a non-resident AE, then the interest shall not be deductible in computing income chargeable under the head 'Profits and gains of business or profession' to the extent, it qualifies as excess interest.

Excess interest shall mean total interest paid/payable by the taxpayer in excess of thirty per cent of cash profits or earnings before interest, taxes, depreciation and amortisation or interest paid or payable to AEs for that previous year, whichever is less. The excess interest shall be allowed to be carried forward for a period of eight years and allowed as deduction in subsequent years.

The above restrictions shall not be applicable to the taxpayer engaged in the business of banking or insurance and will be applicable for FY 2017-18 and subsequent years.

Penalty for furnishing incorrect information

A new provision relating to levy of penalty of INR10,000 per default has been proposed to be levied on accountants, merchant bankers or registered valuers, in cases, where the AO or Commissioner (Appeals) finds that incorrect information has been furnished by them in any reports or certificates issued by them.

Time limit for completion of assessment

It has been proposed that for the AY 2018-19, the time limit for making an assessment order under Sections 143 or 144 of the Act shall be reduced from twenty-one months to eighteen months, and for the AY 2019-20 and onwards, the said time limit shall be twelve months from the end of the AY in which the income was first assessable.

Union Budget 2017 presented on 01 February 2017

Resale Price Method considered as most appropriate method for distributors engaged in buying and reselling of goods without any value addition to such goods

- During the TP assessment, the taxpayer submitted the analysis in respect of the Comparable Uncontrolled Price (CUP) method selected in the TP study for benchmarking the transaction of import of goods under trading activity. The Transfer Pricing Officer (TPO) rejected CUP analysis on the pretext that the data relates to different items.
- The TPO applied Transactional Net Margin Method (TNMM) as the most appropriate method (MAM) and arrived at an adjustment by analysing net margins of foreign independent comparables. Simultaneously, the

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TPO also undertook secondary analysis and arrived at an adjustment by analysing Gross Profit Margin (GPM) of AEs of the taxpayer. The TPO finally computed an adjustment by averaging the above two adjustments arrived at in respect of transaction of import of goods.

- During the CIT(A) proceedings, the taxpayer submitted alternative analysis by applying Resale Price Method (RPM) as the MAM for trading activity. The CIT(A) upheld the application of TNMM as the MAM and also made an adjustment on account of AMP expenses incurred by the taxpayer by applying Bright Line Test.

Tribunal's ruling

- **MAM:** The Tribunal rejected CUP as the MAM since the complete data for analysis was not available. The Tribunal held that one needs to focus on the merits of TNMM and RPM for the selection of MAM even though such methods have been rejected by the taxpayer in its TP study.
- The Tribunal rejected the workings of the arm's length price (ALP) determined by the TPO based on the following:
  - The basis of margin computation of comparables selected by the TPO in its order is not provided.
  - Averaging the amount of TP adjustment computed based on net and GPM analysis is not envisaged under the TP regulations.
  - The TPO's action of selecting controlled comparables i.e. AEs of the taxpayer for comparability analysis is out of the ambit of TP regulations.
  - The selection of independent foreign companies by the TPO which are altogether engaged in different line of business distorts the calculation of ALP.
- By relying on Rule 10B(1)(b) of the Rules, 1962, the Tribunal held that RPM is applicable in cases where the property purchased from AEs is resold as such and no value addition is made to the goods imported before resale. In the instant case, the Tribunal held that RPM is the MAM for determining ALP of import of goods since the taxpayer is engaged solely into selling of imported goods, without any alterations/value additions made to the physical conditions of the same.
- The Tribunal referred back the matter to the TPO firstly to apply RPM as the MAM and only consider those comparable companies for which GPM can be computed without allocations/truncations.
- In case this cannot be complied with, only then the TPO shall resort to the application of TNMM subject to the infirmities in earlier approach of TPO for applying TNMM.
- Following the judgement of the Hon'ble Delhi High Court in the case of Sony Ericson, Rayban Sun Optics, Toshiba India and Bose Corporation, the Tribunal restored the matter to the AO/TPO to decide afresh for the existence of AMP transaction.

Swarovski India Private Limited vs ACIT (ITA No. 5621/Del/2014 - Assessment Year 2004-05) and (ITA No. 5622/Del/2014 - Assessment Year 2005-06)

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Indirect tax

Service tax - Decisions

Service-tax applicable on service component in retreading of tyres and not on gross consideration

The issue before the Supreme Court was whether in case of a contract for retreading of tyres, Service tax was payable on the total amount charged including the value of materials/ goods or only on the service component, under the provisions of the erstwhile service tax regime (i.e. prevailing before 1 July 2012).

The Supreme Court held that the taxpayer was only liable to pay service tax on the service component which under the State Value Added Tax (VAT) laws was quantified at 30 per cent, on the basis of the following rationale –

- By virtue of the provisions of the erstwhile service tax regime, the value of goods and materials sold by a service provider to a service recipient in the course of provision of service is exempted from service tax subject to documentary proof; and
- Further, VAT assessment with respect to payment of VAT on 70 per cent of the total value was also not disputed.

M/s. Safety Retreading Company (P) Ltd. & Others v. Commissioner of Central Excise, Salem & Others, 2017-VIL-06-SC-ST

Notifications/Circulars/Press Releases

Withdrawal of service tax exemption on specified services to charitable institutions

The government has withdrawn the service tax exemption on online information and database access or retrieval services (OIDAR services) provided by a person located outside India to charitable institutions registered under income tax laws. Accordingly, such institutions are liable to pay service tax under reverse charge on OIDAR services received from outside India.

Notification No. 5/2017- Service Tax dated 30 January 2017

Extension of time period for payment of service tax for OIDAR services

In case of OIDAR services provided by a person located outside India to an individual, government, governmental authority in India, the time period for service tax payment for the months of December 2016 and January 2017 has been extended to 6 March 2017.

Notification No. 6/2017- Service Tax dated 30 January 2017

No service-tax on transshipment goods transported to Indian customs station from overseas

The Central Board of Excise and Customs (CBEC) has clarified that service tax would not be applicable on transshipment of goods through India (through a vessel) to any country outside India if the same is mentioned in the import manifest/import report and the goods are transshipped in accordance with the procedure prescribed under the customs law.

Circular No. 204/02/2017-Service Tax dated 16 February 2017

Central Excise - Decisions

No requirement for service tax to be deposited by service provider before availment of credit by service recipient

In the present case, the taxpayer, engaged in the manufacture of pistons, piston rings, etc. classifiable under HS Code 8409 claimed CENVAT credit on certain input services procured. During the course of Excise Audit, the audit team raised an objection and issued a Show Cause Notice demanding the CENVAT credit availed since, there was delay in depositing the service tax by the service provider.

Based on the submissions of the parties, the Bangalore Tribunal mentioned that the taxpayer, who has paid the service tax to the service provider is entitled to avail the credit without finding whether such service tax paid by him to the service provider stands further deposited by him to the Exchequer. It is neither possible nor practical for any service recipient to verify the fact of payment of service tax by the service provider. Accordingly, the appeal was allowed.

Federal Mogul TPR (India) Ltd vs Commissioner of Customs and Service Tax (2017-TIOL-163-CESTAT-BANG)

CENVAT credit is eligible on input services of outdoor catering, rent-a-cab, hotel booking expenses and car maintenance services

In the present case, the taxpayer, manufacturer of oil seeds classifiable under HS Code 84 claimed CENVAT credit on various input services. During the course of EA Audit, the audit team noticed that the taxpayer had availed CENVAT credit on outdoor catering services, rent-a-cab, hotel booking services and car maintenance services incorrectly, since, the said services are beyond the purview of definition of input service under Rule 2(l) of CENVAT Credit Rules, 2004 as the same are not used either directly or indirectly in or in relation to manufacture of their final products.

In this regard, the Bangalore Tribunal held that the issues involved in the present case are no longer res integra as it is settled by Karnataka High Court in the case of CCE Bangalore-III vs Stanzen Toyotetsu India (P) Ltd (2011-TIOL-866-HC-KAR-

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ST). Accordingly, in the instant case, the Tribunal allowed the CENVAT credit on outdoor catering and rent-a-cab services. Further, in light of various Tribunal judicial precedents, hotel booking services and car maintenance services have been held as directly related to business hence, the CENVAT credit on the same was also allowed.

SKF Sealing Solutions Pvt Ltd. vs CCE (2017-TIOL-169-CESTAT-BANG)

Notifications/Circulars/Press Releases

Periodicity of CAS-4 certificates

Earlier, Board's Circular No. 692/08/2003-CX had clarified that the cost of production of captively consumed goods needs to be done in accordance with CAS-4. In this regard, it has been clarified that CAS-4 certificate of the FY ending on 31 March shall be issued by 31 December of the next FY. For example, for the FY 2016-17, CAS-4 certificate is required to be issued by 31 December 2017.

Instruction F.No.206/01/2017-CX 6 dated 16 February 2017

VAT - Decisions

Proceedings initiated before the expiry of period of limitation but, not concluded within such period, shall not be considered irrelevant unless the provision provides for period of limitation for conclusion of proceedings

The taxpayer in the present case, received notice from the Revenue to assess the escaped turnover under the Kerala VAT Act, 2003 (KVAT Act) for the Assessment year 2010-11 on 19 March 2016. The notice invoked the extended period of limitation as provided under Section 25 of the KVAT Act. Aggrieved by this, the taxpayer preferred writ petition before Kerala High Court that assessment was not concluded within the extended time period.

In this connection, the taxpayer contended that basis Proviso to the Section 25 of KVAT Act, there is limitation on conclusion of assessment within the extended time. In the present case, only a notice had been issued before limitation period and no enquiry/proceedings have been concluded by the department within the limitation period. Accordingly, the taxpayer argued that, no enquiry can be made or proceedings continued after the limitation period.

On the other hand, Revenue contended that the limitation provided under Section 25 and its proviso pertains to the initiation of proceedings during the stipulated period and not the completion of proceedings during such extended period.

The High Court, on analysis of the provisions of KVAT Act and referring to the various judicial pronouncements, stated that extension provided under proviso does not refer to the time period for completion of assessment.

Further, the High Court stated that the purpose of proviso to the main provision is to refer certain exceptions/qualifications to the main provision but it cannot include what is not considered under the main provision. Further, it stated that the Section 25 specifically refers to the initiation of proceedings to determine escaped assessment to tax within a period of five years from the last date of the year to which the return relates. Thus, the High Court rejected the taxpayer's contention that proviso was inserted for the purpose of conclusion of assessment during such extended period.

Accordingly, the High Court held that the proceedings initiated before the limitation period would not be rendered inapplicable merely on the reason that such proceedings were not concluded during the extended period provided under the proviso.

M/s. Paharpur Cooling Towers Limited v. State of Kerala and Assistant Commissioner (TS-17-HC-2017(KER)]

Notifications/Circulars/Press Releases

Delhi

Delhi VAT department has modified Circular No 06 of 2016-17 dated 17 May 2016 to further ease the procedure for grant of registration under Delhi Value Added Act, 2004 and Central Sales Tax Act, 1956 as follows:-

- The applicant dealer, applying through DVAT MSewa would be granted registration preferably within the period of one day.
- The provision for bank account details for the purpose of registration shall be optional on the part of the applicant dealer. However, the dealer shall need to provide bank account details on or before the filing of the first return.
- The digitally signed registration certificate will be granted within one day to the prospective applicant dealer, applying through MSewa.

Circular No. 20/2016-17 Dated 13 January 2017

Commissioner of the Delhi VAT department has directed all the assessing authorities to complete the Form-9 assessments (reconciliation return) for the FY 2012-13 as time limit for the same shall expire by the end of current FY i.e. FY 2016-17.

Form-9 assessment relates to declaration forms which are required to be filed by all such dealers who had effected interstate sale against any statutory form like Form C,F,H, E-I, E-II, I & J under Section 9(2) of the CST Act, 1956 read with Section 32 of the Delhi VAT Act, 2004.

Circular No. 22/2016-17 Dated 2 February 2017

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Maharashtra

Maharashtra state government has prescribed guidelines for applicants who have paid fees/deposits relating to the registration under the old system, but failed to take registration before up gradation to new SAP based registration system from 19 December 2016.

As per these guidelines, the applicants who have created a login ID and password for registration before 17 December 2016 but did/could not upload application for registration, can use the same details for the new system. Further, an applicant who has paid registration fee and security deposit under the old system but failed to submit registration application on or before 19 December 2016 or has not received registration certificate, will have to pay the registration fee or deposit again to obtain the registration under various Acts administered by Maharashtra Sales Tax Department. Also, states where such applicants may apply for refund of registration fee or deposit paid under the earlier system to the Additional Commissioner or can claim the amount as payment of tax in the returns to be filed for FY 2016-17.

Trade Circular No. 4T of 2017 Dated 2 February 2017

Kerala

For FY 2015-16, the Kerala VAT government has extended the time limit for filing certified Audit Report in Form 13 and Statement in Form No. 13A by the companies, up to 31 March 2017

Circular No. 3/2017 dated 14 February 2017

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Personal tax

Decisions/Notifications/ Circulars/Press Releases

Provident Fund Office directs its field offices to expedite exemption applications under Employees' Deposit-Linked Insurance Scheme, 1976

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPF Act) is an employee welfare legislation aimed at, inter alia, securing welfare of the employees upon termination of their employment. The following schemes have been established under the EPF Act:

- The Employees' Provident Funds Scheme, 1952 (EPFS)
- The Employees' Pension Scheme, 1995 (EPS)
- The Employees' Deposit-Linked Insurance Scheme, 1976 (EDLIS).

The EDLIS facilitates the grant of assurance benefit in the event of death of an employee who was a member of EDLIS.

The EPF Act provides for grant of exemption from the operation of Employees' Deposit-Linked Insurance Scheme, 1976 and allows establishments/employers to opt for a more beneficial insurance scheme in lieu of the statutory EDLI scheme. Many establishments have used this provision in the EPF Act to opt out of the statutory EDLIS. Employers make arrangements with life insurance companies for giving higher benefits than the statutory scheme and apply for exemption from the statutory EDLIS.

A number of establishments preferred such exemption applications to the Employees' Provident Fund Organisation (EPFO), however, have not been granted exemption for certain reasons.

Recently, EPFO issued a circular to its field offices to expedite the disposal of pending EDLI exemption applications.

Highlights of the circular

The circular has given directions to review the proposals pending for exemption or further extension of exemption from EDLI scheme. The circular also highlights that a number of cases which are being recommended pertain to past several years and some of these cases even date back to 20 years.

The field offices have been directed through this circular that all the pending proposals received up to 31 December 2016 should be forwarded to the Head Office by 28 February 2017. It has also been clarified in the circular that, henceforth, no relaxation should be given to an establishment where the exemption application is pending for disposal.

Circular Dated 6 February 2017 - Letter No. EDLI/5(1) Exemption/ Extention/17/29967

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