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INTERNATIONAL TAXATION

BEPS IMPACT - OECD REVISED TP GUIDELINES 30.6.2016

Contributed by CA Suresh Babu S

On 23 May 2016, the OECD Council approved the amendments to the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("Transfer Pricing Guidelines"), as set out in the 2015 BEPS Report on Actions 8-10 "Aligning Transfer Pricing Outcomes with Value Creation" and the 2015 BEPS Report on Action 13 "Transfer Pricing Documentation and Country-by-Country Reporting". These amendments provide further clarity and legal certainty about the status of the BEPS changes to the Transfer Pricing Guidelines, which were endorsed by the Council on 1 October 2015, by the G20 Finance Ministers on 8 October 2015, and by the G20 Leaders on 15-16 November 2015.

The amendments approved by the Council translate these BEPS transfer pricing measures into the Transfer Pricing Guidelines, as well as into the Recommendation of the Council on the Determination of Transfer Pricing Between Associated Enterprises, which now contains a reference in the Preamble to these BEPS Reports. Given the way in which the Transfer Pricing Guidelines are integrated into the domestic law of certain countries, including by direct reference to the Guidelines themselves, this update process further clarifies the status of the BEPS changes to the Transfer Pricing Guidelines.

Actions 8-10 – Transfer pricing aspects:

The OECD has included its updated transfer pricing guidance in one report under Actions 8-10, covering: amended guidance on applying the arm's length principle (revisions to section D of chapter I of the OECD Transfer Pricing Guidelines), notably providing guidance on the identification of the actual transaction undertaken, on what is meant by control of a risk, and on the circumstances in which the actual transaction undertaken may be disregarded for transfer pricing purposes.

Guidance on comparability factors in transfer pricing, including location savings, assembled workforce, and MNE group synergies (additions to chapter I of the OECD Transfer Pricing Guidelines). This guidance remains unchanged from the guidance issued as part of the 2014 report on transfer pricing for intangibles.

New guidance on transfer pricing for commodity transactions (additions to chapter II of the OECD Transfer Pricing Guidelines). A new version of chapter VI of the OECD Transfer Pricing Guidelines addressing intangibles, including new guidance on the return to funding activities and on hard-to -value intangibles. New guidance on low-value adding intragroup services (revisions to chapter VII of the OECD Transfer Pricing Guidelines).

An entirely new version of chapter VIII of the OECD Transfer Pricing Guidelines, covering cost contribution arrangements In addition, the Actions 8-10 package describes additional work to be conducted by the OECD to produce new guidance on the application of the transactional profit split method.

The specific changes introduced in the OECD Transfer Pricing Guidelines by these Reports are as follows:

- The current provisions of Chapter I, Section D of the Transfer Pricing Guidelines are deleted in their entirety and replaced by new guidance.
- Paragraphs are added to Chapter II of the Transfer Pricing Guidelines, immediately following paragraph 2.16.
- A new paragraph is inserted following paragraph 2.9.
- The current provisions of Chapter V (Documentation) of the Transfer Pricing Guidelines are deleted in their entirety and replaced by new guidance and annexes.
- The current provisions of Chapter VI (Intangible Property) of the Transfer Pricing Guidelines and the annex to this Chapter are deleted in their entirety and replaced by new guidance and annex.
- The current provisions of Chapter VII (special considerations for Intra group services) of the Transfer Pricing Guidelines are deleted in their entirety and replaced by new guidance.
- The current provisions of Chapter VIII (Cost contribution arrangements) of the Transfer Pricing Guidelines are deleted in their entirety and replaced by new guidance.

Although the countries participating in the OECD/G20 BEPS Project had already agreed to the final reports under BEPS Actions 8-10 and 13, the OECD Council Transfer Pricing Recommendation formally adopts the amendments to the TPG as of 23 May 2016. As noted, these changes could have implications for both the OECD member countries and non-member countries.

Individual countries take different approaches with respect to whether and how they incorporate the TPG into their domestic tax systems. For example, in some countries, the domestic rules explicitly refer to the approved OECD TPG. Other countries may not have such an explicit reference. In addition, some countries require some form of administrative or other action to incorporate a new version of the TPG into the domestic law. Some countries may take the view that the amendments to the TPG merely clarify pre-existing transfer pricing principles, and in practice, consequently could have retroactive effect.

Multinational enterprises (MNEs) should understand and analyse the implications of this development for each jurisdiction in which they operate. For example, MNEs should review the amendments to the TPG with respect to their global operations and their current transfer pricing policies and approaches. There will likely be increased scrutiny by tax authorities from OECD member countries and non-OECD member countries applying the concepts of the amendments to cross-border intercompany transactions.

Further work is being undertaken to make conforming amendments to the remainder of the Transfer Pricing Guidelines, in particular to Chapter IX "Transfer Pricing Aspects of Business Restructurings." This work is well advanced and it is expected that Committee on Fiscal Affairs will soon invite interested parties to review the conforming changes to Chapter IX to establish that real or perceived inconsistencies with the revised parts of the Guidelines have been appropriately addressed, and duplication appropriately removed.

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FEMA

FDI INFLOWS - INDIA'S TRAJECTORY

Contributed by CA Murali Krishna G

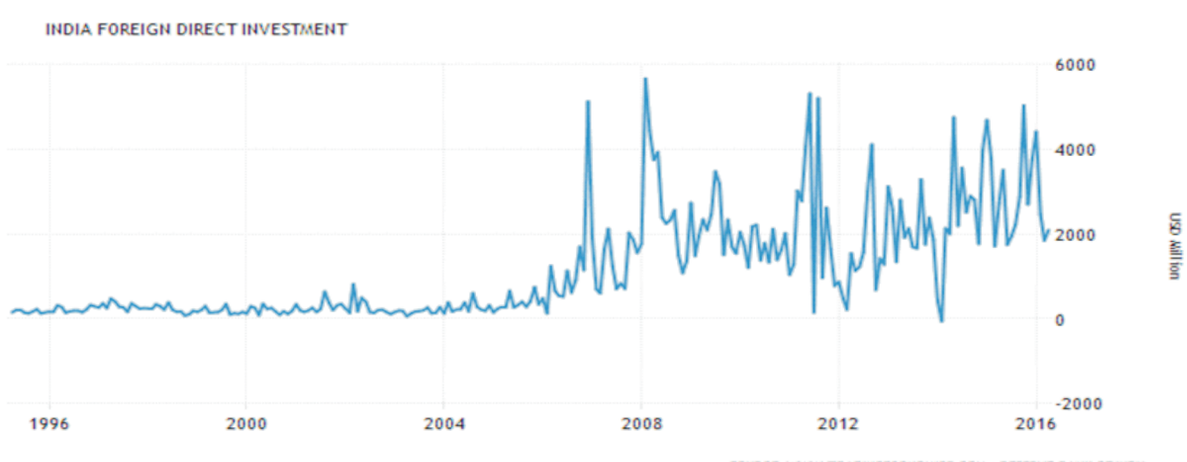
Today majority of the Indians are reaping the benefit of Industrial Liberalization and Globalization of the Indian economy. The then Prime Minister Mr. P V Narasimha Rao with the guidance and support of the then Finance Minister Mr. Manmohan Singh, has made paradigm shift in Industrial Licensing policy, Public Sector Policy, Foreign Investment & Foreign Technology agreement Regulations and Competition Laws (erstwhile MRTP Act) vide new Industrial Policy which was made effective from July 25, 1991.

The author, in commemoration of Silver Jubilee Anniversary of Industrial Liberalization in 1991, has made an attempt to bring the fine details of FDI Inflows and its impact in India post announcement of New Industrial Policy, 1991 (NIP) and also the details of recent FDI regime liberalization.

Government of India has introduced key reforms to the FDI policy, to help attract further investments. To achieve this goal, some measures such as the introduction of the composite cap that does away with the distinction between FDI and Foreign Portfolio Investment (FPI) and liberalizing FDI norms in 15 major sectors have been taken. Higher FDI limits would encourage more investment.

FDI in India has started picking up, which stood at USD16.63 billion in FY2015-16, about 13 per cent higher than 14.69 billion in FY2014-15.

Trends in India's FDI Inflows, 1996 - 2016



Recent key changes of FDI Regulations

I. Press Note No. 5/2016, dated 24th June, 2016

The Union government on 20th June, 2016 has announced radical changes in FDI Regulations and the said changes have been made effective by virtue of Press Note No. 5/2016, by which the following major changes have been made in FDI regulations to give impetus for employment and job creation and also for enhancing the FDI flows into India

1. Permission of 100% FDI under government approval route for trading, including through e-commerce, in respect of food products manufactured or produced in India.
2. Foreign investment beyond 49% has now been permitted through government approval route, in cases resulting in access to modern technology in the country or for other reasons to be recorded. The condition of access to 'state-of-art' technology in the country has been done away with.
3. FDI limit for defence sector has also been made applicable to Manufacturing of Small Arms and Ammunitions covered under Arms Act 1959.
4. 100% FDI under automatic route is permitted for Broadcasting Carriage Services (Mobile TV, DTH, Teleports, Cable Networks and HITS)
5. In case of Pharmaceutical Sector, 74% FDI in Brownfield Projects is made under automatic route. FDI beyond 74% for Brownfield Projects is under government route. The Greenfield Investment is permitted upto 100% under automatic route
6. Civil Aviation Sector is also permitted upto 100% FDI in both Brownfield Projects and the Greenfield projects
7. In case of Private Security Agencies, the FDI is permitted upto 49% under automatic route and under government approval beyond 49% and upto 74%. However Section 6 of the Private Security Agencies (Regulation) Act, 2005 need to be amended to accommodate the above FDI changes.
8. In case of Animal Husbandry, the condition related to "Controlled Conditions" has been done away
9. In case of Single Brand Retail Trading (SBRT), the condition related to 30% local sourcing of goods is relaxed for 3 years of establishment and may relax upto 5 years of establishment with the government approval. FDI into SBRT upto 49% is permitted under automatic route and under government route for FDI beyond 49%

II. Press Note No. 12/2015, dated 24-11-2015

1. The Government has permitted the 100% FDI into Manufacturing Companies (Subject to the sectoral caps and conditions stated for selective list of industries) under automatic route.
2. FDI into LLP is almost made at par with Companies thereby paving the way to use LLP structure of business for most of the business activities.
3. For swapping of shares (i.e., Exchange of Shares of the Indian Company between the Resident Investors and the Foreign Investors with Shares of Foreign Entity), no approval of Government is required, if the transaction otherwise falls under automatic route.
4. Incorporated Foreign entities (viz., Companies, Partnership firms and Trusts) controlled by the NRIs is equated with the NRIs and can avail all the benefits of NRIs.
5. The Limits for approval of FIPB has been enhanced from Rs. 2,000 Crores to Rs. 5,000 Crores, thereby the cases to be referred to Cabinet Committee on Economic Affairs (CCEA) will be reduced.
6. Many plantation activities (coffee, rubber, cardamom, palm oil, olive oil) have been brought under automatic route, over and above the tea plantation activities.
7. Defence production has been opened for FDI upto 49%, subject to the conditions stated therein.
8. In case of Construction and Development Activities, the condition relating to minimum project size and minimum investment size has been done away and necessary changes have been brought in other related conditions.
9. Many changes have been introduced in Single Brand Retail Trading

Conclusion:

Post the above key changes, now very few sectors/industries have been left over for approval from the Government for FDI investments.

The NIP followed with the above key recent changes are further bolstered with the key reforms of the Government viz., "Make in India" and "Ease of doing Business"

Post the Britain Exit Referendum (Brexit) for exit from EU, India is poised to play key role in the World Economy and is becoming silver line in the dark clouds of economic turmoil across the global economies and many countries will select India as a favorable FDI destination.

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AUDIT

REPORTING OF FRAUD UNDER COMPANIES ACT, 2013

Contributed by CA Sandeep Das

The financial and corporate frauds in recent years in India have revitalized the thought on the need for high standards of corporate governance and arduous provision to handle fraud. This prompted to the introduction of stringent provisions in the new Companies Act 2013. The Companies Act 1956 too has provision relating to fraud it provides for punishments for fraud in various sections. There is a lot more in the new Act with respect to tackle the problem of fraud.

What is Fraud –For the purpose of Section 447,**Fraud** has been defined as, "Fraud in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss. **'Wrongful gain'** means the gain by unlawful means of property to which the person gaining is not legally entitled and **'wrongful loss'** means the loss by unlawful means of property to which the person losing is legally entitled." It is the first time that the Act defines fraud and also imposes civil and criminal liability on the fraudster for non-compliance.

The definition of fraud as per SA 240 and the explanation of fraud as per Section 447 of the 2013 Act are similar, except that under Section 447, fraud includes ***'acts with an intent to injure the interests of the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.' However, an auditor may not be able to detect acts that have intent to injure the interests of the company or cause wrongful gain or wrongful loss, unless the financial effects of such acts are reflected in the books of account/financial statements of the company.***

The Companies Act, 2013 had introduced Section 143(12) which requires the statutory auditors of companies to report to the Central Government about fraud/suspected fraud committed against the company by officers or employees of the company. This Section read with corresponding Rule 13 of the Companies (Audit and Auditors) Rules, 2014 require reporting of every fraud to the Central Government irrespective of amount of fraud.

The Companies (Audit and Auditors) Amendment Rules, 2015, issued by the Ministry of Corporate Affairs, on 14th December 2015, substituted Rule 13 of the Companies (Audit and Auditors) Rules, 2014. The new Rule 13 has introduced the thresholds for the purpose of reporting on frauds and differential reporting responsibilities of the statutory auditor with respect to the fraud/s above or below the notified threshold. The reporting requirement under Section 143(12) is for the statutory auditors of the company and also equally applies to the cost accountant in practice, conducting cost audit under Section 148 of the Act; and to the company secretary in practice, conducting secretarial audit under Section 204 of the Act.

The auditors, while carrying out an audit of financial statements, consider the fraud risk factors in terms of the Standard on Auditing (SA) 240, The Auditor's Consideration of Fraud in an Audit of Financial Statements. The SA 240 is also clear as to the types of frauds that are relevant to the auditor in carrying

out an audit of financial statements with the limited objective of expressing an opinion on their true and fair view. However, the auditor's procedures prescribed under the SAs are aimed at meeting this objective only and do not envisage carrying out investigation/ forensic audit like procedures.

Effects of the substituted provision relating to Fraud reporting by Auditors:

The manner and the procedure which the auditor concerned needs to report to the Central Government is detailed in the Companies (Audit and Auditors) Amendment Rules, 2015.The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover, the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number. The report shall be in the form of a statement as specified in Form ADT-4.

As per the new Rule 13, of the Companies (Audit and Auditors) Rules, 2014, as amended from time to time, if an auditor of a company, in the course of performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of **rupees 1 crore** or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government. Auditors are required to report fraud detected in the course of performance of their duties as auditor and the said Auditors must have reason to believe that the fraud or offence involving amounts prescribed in the provisions has been committed or is being committed.

For fraud less than rupees **1 Crore** the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:-

a) Nature of Fraud with description;

b) Approximate amount involved; and

c) Parties involved

The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) of amended Rule 13 during the year shall be disclosed in the Board's Report:-

a) Nature of Fraud with description;

b) Approximate Amount involved;

c) Parties involved, if remedial action not taken; and

d) Remedial action taken.

The Form ADT – 4 contains details including:

- Date of Annual General Meeting when the auditor was appointed or reappointed.
- Address of office or location where the suspected offence is believed to have been or is being committed.
- Full details of the suspected offence involving fraud.
- Particulars of officers or employees who are suspected to be involved in the commission of the offence.
- Basis on which fraud is suspected.
- Period during which the suspected fraud has occurred.
- Gist of replies received
- Estimated amount involved in the suspected fraud.
- Details of steps, if any, taken by the company in this regard.
- Any other relevant information.

Reporting timeline by the auditor

- The auditor shall report to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five days;
- On receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;
- in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

Reporting on Suspected Offence Involving Frauds noted in the course of providing such other attest or non-attest services

Section 143 deals with auditor's duties and responsibilities under the Act with respect to financial statements prepared under the Act, the auditors perform other attest services in their capacity as auditors of the company. **Should the auditor report under Section 143(12) on frauds noted in the course of providing such other attest or non-attest services?**

If an offence of fraud in the company by its officers or employees that is identified/noted by the auditor in the course of providing such attest or non-attest services as referred above, is of such amount/s as specified in Rule 13 of the Companies (Audit and Auditors) Rules, 2014 {as amended by the Companies (Audit and Auditors) Amendment Rules, 2015} which the auditor uses or intends to use the information that is obtained in the course of performing such attest or non-attest services when performing the audit under the 2013 Act, then in such cases, the matter may become reportable under Section 143(12), read with the Rules thereunder, as specified in the Guidance Note on Internal Financial Controls issued by ICAI.

Can the Auditor apply the Concept of Materiality for Reporting on Fraud?

The auditor should continue to apply the concept of materiality in performing the audit in accordance with SA 320 "Materiality in Planning and Performing an Audit". Section 143(9) requires the auditor to comply with the SAs, which, inter alia, includes consideration of materiality, applying materiality in evaluating misstatements and disposition of the same. The concept of materiality is fundamental for setting up an appropriate system of internal control, preparation of financial statements and its audit.

Should the Auditor Report under Section 143(12) in case of Corruption, Bribery, Money Laundering and Non-compliance with other Laws and Regulations?

The auditor should comply with the relevant SAs with regard to illegal acts (e.g. SA 240 and SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements") when performing the audit.

If the auditor, in the course of performance of his/her duties as the auditor, comes across instances of corruption, bribery and money laundering and other intentional non-compliances with laws and regulations, the auditor would need to evaluate the impact of the same in accordance with SA 250 to determine whether the same would have a material effect on the financial statements.

Whether the cases of fraud is only restricted to provisions as mentioned in the new Act?

There are around 17 provisions spread all across the new Act wherein the punishment provided is as in Section 447. But that doesn't mean that only those cases would be considered as "fraud" and punished as "fraud"Undoubtedly those would be punished as fraud but other cases which fall within the meaning of the definition of fraud under section 447 will also attract punishment as provided in Section 447.

The following table includes sections which attracts liability U/s 447. Person accused of any such offence under these sections shall not be released on bail or bond, unless subject to the exceptions provided u/s 212(6) of the act.

Section	Fraud pertain to the following	Who will be penalized for Fraud
7 (5)	Registration of a Company – submission of false or incorrect information at the time of filing documents for incorporation.	Person furnishing false information or suppressing any material information of which they are aware.
7(6)	If proved at a later stage that the company was got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action.	the promoters, the persons named as the first directors of the company, and the persons making the declarations other than the first directors i.e., an advocate, or a chartered accountant, or acost accountant or a company secretary in practice, who is engaged in the formation of the company.
8(11)	Section – 8 Company. If proved that the affairs of the company were conducted fraudulently.	Every Officer of the Company who is in default [Sec. 2 (60)], shall be liable for fraud.
34	Mistatement in prospectus	every person who authorises the issue of such prospectus shall be liable.
36	Fraudulently Inducing person to invest	Any person making such statement, promise, forecast shall be liable.
38(1)	Personation for acquisition, etc., of securities:	Any person making such application or abetting to make such applications shall be liable.
46 (5)	issue of a duplicate certificate of shares, by a Company with an intent to defraud	Company liable with fine which shall not be less than 5 times the face value of the shares involved in the issue of the duplicate certificate but which may extend to 10 times the face value of such shares or Rs. 10 Crores whichever is higher Every Officer of the Company who is in default [Sec. 2 (60)], shall be liable for fraud.
56 (7)	**Transfer and Transmission of Shares:** where any depository or depository participant, with an intention to defraud a person, has transferred shares.	Such Depository or Depository Participant shall be liable for fraud

Section	Fraud pertain to the following	Who will be penalized for Fraud
66(10) – Section not yet notified	**Reduction of Share Capital:** Knowingly concealing the name of a Creditor, knowingly misrepresents the nature or amount of creditor or abets or is pricy for any such concealment or misrepresentation.	Every officer [Section 2(59)] of the Company shall be liable
75(1)	Failure to repay the deposits or part thereof or any interest thereon, and if proved that acceptance of deposit was with a intent to defraud depositors or for any fraudulent purpose	Every officer of the company who accepted the deposit.
140 (5)	Auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, and the NCLT has passed an order against them.	In addition to the penalty that they shall not be eligible to be appointed as an auditor of any company for a period of 5 years from the date of passing of the order, the auditor shall also be liable for action under section 447.
206(4)	Conducting business of a company for a fraudulent or unlawful purpose	Every Officer of the Company who is in default [Sec. 2 (60)], shall be liable.
213	Investigation in to Company's affairs, and if after investigation, it is proved that: (i) Business of a Company being conducted with the intent to defraud its creditors (ii) Fraud, misfeasance or other misconduct of the company or any of its members (iii) Company withholding information from members with respect to its affairs, which they may reasonably expect.	Every Officer of the Company who is in default [Sec. 2 (60)], and the person or persons concerned in the formation of the company or the management of its affairs shall be punishable.
229	Furnishing false statement, false entry in any document, or destruction of document during the course of inspection, inquiry or investigation	Any person, an officer or an employee of the Company or other Body corporate which is also under investigation are liable

Section	Fraud pertain to the following	Who will be penalized for Fraud
251 (1)- Section not yet Notified.	Fraudulent Application for removal of name from register with the object of evading liabilities / intent to deceive	The persons in-charge of the management of the company shall be liable under Section 447, in addition to being jointly and severally liable to any person or persons who had incurred loss or damage as a result of the company being notified as dissolved
266(1)- Section not yet Notified	Power of Tribunal to Assess Damages Against Delinquent Directors, officers and employees in the course of the scrutiny or implementation of any scheme or proposal of rehabilitation	In addition to the penalty or direction to repay the amount, any director, manager, officer or employee of the sick company who are or have been in employment of such company, responsible for mis-appropriation or guilty of any misfeasance shall be liable for Fraud.
339(3)- Section not yet Notified.	Conducting business of company with intent to defraud its creditors, any other persons or for any fraudulent purpose	Every person who was knowingly a party to carrying on of the business in such fraudulent manner, shall be liable under Section 447. Further, the Tribunal, on the application of the Official Liquidator, or the Company Liquidator or any creditor or contributory of the company, may, if it thinks it proper so to do, declare that any person, who is or has been a director, manager, or officer of the company or any persons who were knowingly parties to the carrying on of the business in the manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company.
448	Making a false statement or omits any material fact knowing it to be material, in any return, report, certificate, financial statement, prospectus, statement or other document required by or for the purpose of any of the provisions of this act or the rules made thereunder	Every person who has made the false statement or omits any material fact shall be liable under Section 447.

Penalties for "Fraud" – Section 447 & 451

Section	Related to	Nature of Penalty	Applicability	
Sec 447	Every Person involving in fraud	Fine	Min: 100%	Max: 300%
		Imprisonment	Min: 6 Months	Max: 10 years
Sec 451	Company	Fine	200% of Fine	
	Every officer in default	Fine	200% of Fine	
		Imprisonment	As per respective section	

Conclusion:

The introduction of new stringent provisions under the new Companies Act will be tested if any corporate fraud and scams are disclosed now in corporate India. Again, as with the reporting on Internal Financial Controls, the requirement to report frauds to Central Government, has given rise to many a issues in the minds of both the auditors as well as companies which need to be addressed so that the auditors can properly understand and implement the requirements of section 143(12) of the Companies Act, 2013

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INTERNATIONAL TAXATION

DTAA - FEW ISSUES

Contributed by CA Ramprasad

Legal History:

Section 90 of the Income Tax Act, 1961(Act) empowers the Central Government to enter into agreement (Tax Treaties-aka DTAA) with Government of any country outside India or specified territory outside India for

I. *granting relief in respect of doubly taxed income or* ***income tax chargeable*** *under this Act and under the corresponding law in force in that country or specified territory,* ***to promote mutual economic relations, trade and investment*** *or*

II. *for avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory or*

III. *for exchange of information for prevention of evasion or avoidance of income tax chargeable under this Act or under the corresponding law in force in that country or specified territory or*

IV. *for recovery of income tax under this Act and under the corresponding law in force in that country or specified territory as the case may be*

There are two modes of granting relief under DTAA. They are:

(i) Exemption Method and
(ii) Tax Credit Method.

Exemption Method:

Under exemption method, a particular income is taxed in one of the two countries.

Tax Credit Method:

Under tax credit method, an income is taxable in both the countries in accordance with their respective tax laws read with the DTAA. However, the country of residence of the taxpayer allows him credit for the tax charged thereon in the country of source against the tax charged on such income in the country of residence.

Agreement vs DTAA:

In case of difference between the provisions of the Act and of the agreement, the provisions of the agreement prevail over the provisions of the Act and can be enforced by the appellate authorities and the court.

Issue 1:

Whether income be exempted from tax in India if tax was paid outside India at a higher rate?

This issue was answered in case of ***ITO vs BESCO Engineering & Services (P) Ltd - ITAT KOLKATA.***

Facts:

The Assessee is an Indian Company made equity investment in a Brazilian Company (Foreign Company). The Indian Company received dividend from the Foreign Company. Assessing Officer taxed the dividend on the contention that dividend received from foreign company is not exempt under section 10(34) of the Act.

Assessee has contended that the foreign company has already paid tax @34% on its profits which is in excess of the rate prescribed in paragraph 2 of Article 10 of DTAA with Brazil (i.e.,15%). However, Assessing Officer has taxed the dividend without referring to provisions of DTAA.

Assessee filed an appeal against the order of Assessing Officer before CIT(A). Order of the Assessing Officer was set aside by CIT (A). Revenue filed an appeal against the order of CIT(A).

Ruling by ITAT:

As per paragraph 3 of Article 23 of DTAA between India and *Brazil where a company which is resident of a contracting state derives dividend in accordance with the provisions of paragraph 2*[1] *of Article 10 may be taxed in other contracting state, the first mentioned State shall exempt such dividends from tax.*

Withholding tax rates for dividends is 0% as per Brazilian Tax Law and also as per DTAA if dividend is paid to non-residents. Hence the appeal of the revenue dismissed.

Issue 2:

Is Tax credit available in respect of deemed tax foregone?

This issue was answered in ***KrishakBharati Cooperative Ltd vs Asst. CIT - ITAT DELHI***

Facts:

The Assessee held 25% shares in a foreign company registered in Oman. Assessee has received dividend income from the foreign company which was exempt from tax in Oman by virtue of Article 8(bis) of Omanian Tax Laws. The said dividend income was brought to tax in India as per the Act. The Assessing Officer allowed tax credit with respect to dividend income.

[1]such dividends may also be taxed in the contracting state of which the company paying dividends is a resident according to the laws of that state but if the recipient is a company which is the beneficial owner of dividend the tax so charged shall not exceed 15% of the gross amount of dividend.

Subsequently Principal CIT revised the order of the Assessing Officer and disallowed the tax credit so claimed by the assessee. The CIT was of the view that as the assessee did not pay any tax in Oman owning to exemption, no foreign tax credit was available to it.

The aggrieved assessee filed an appeal against the order of the CIT passed u/s 263.

Ruling by ITAT:

Article 25(4) of DTAA between India and Oman lays down that tax payable shall deemed to include the tax which would have been payable but for tax incentive granted under the tax laws of the contracting state and which are designed to promote economic developments.

The exemption for dividend income was granted in accordance with the article 8(bis) and such exemption was granted with the objective of promoting economic developments within Oman by attracting investments.

The Order of CIT quashed and appeal of the assessee allowed.

Note: Such credit was allowed by the Assessing Officer in the past also. When there is no change in facts and the relevant provisions of the law the principle of consistency of approach should be followed.

Take away

One just has to read DTAA with different countries separately. Each DTAA has similarities and dissimilarities. We have to go through each DTAA and analyze the issue before drawing conclusions.

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INDIRECT TAX

NEW LEVY UNDER SERVICE TAX -THE AGE OLD CANON AND THE PARADOX

Contributed by CA Manindar K & CA Harsha Vardhan K

Introduction:

Section 66B provides for levy of service tax on services provided or agreed to be provided. On the other hand, we have Rule 5 of the Point of Taxation Rules, 2011(POT Rules) which can extend its arms to tax even those services which are provided prior to effective date of levy but the amount is received afterwards. Swacch Bharat Cess (SBC) and Krishi Kalyan Cess(KKC) are two levies that are newly introduced in recent past. A lot of confusion is prevailing in the trade whether Rule 5 can extend its arms to tax services already provided. Recently a notification is issued to exempt KKC for all services provided and invoices issued on or before 31st May, 2016.Is it required to really exempt these services by Notification? What is the rationale in extending this exemption only for KKC and not so when SBC is introduced? In this backdrop, an attempt is made to really under the nature of levy under section 66B and validity of Rule 5 in light the said section.

Rule 5 of the POT Rules and its ramifications on literal interpretation:

Rule 5 of the POT Rules is reproduced as under;

"Where a service is taxed for the first time, then,-

(a) no tax shall be payable to the extent the invoice has been issued and the payment received against such invoice before such service became taxable;

(b) no tax shall be payable if the payment has been received before the service becomes taxable and invoice has been issued within fourteen days of the date when the service is taxed for the first time.

Explanation 1.- This rule shall apply mutatis mutandis in case of new levy on services.

Explanation 2.- New levy or tax shall be payable on all the cases other than specified above (inserted recently with effect from 01.03.2016)"

In terms of the above rule read with newly inserted explanation 2, new levy is applicable except in the two circumstances stated therein i.e.

i. invoice issued and payment received before the effective date of new levy and

ii. Payment is received before the effective date of new levy and invoice is issued within 15 days after the levy became effective.

Let us consider the impact of this rule assuming a new levy is effective from 01st June, 2016 with the following examples;

i. The service is completed by May 15th, 2016 and invoice is issued on June 01st 2016. Payment for the service is received on June 20th, 2016. In terms of Rule 5,new levy is applicable as payment and invoice are after the effective date of new levy.

ii. Advance received in the month of May 15th and invoice raised immediately on the same date. But service provision is started on 15th of June, 2016 and completed by 30th of June 2016. As first condition is satisfied, new levy is not applicable though the service is provided after the levy coming into force.

iii. Service is provided in December 2015 and invoice is raised in the same month. Payment is received on 16th June 2016. The service is provided and invoice issued at the time when the levy of service tax is never contemplated. On plain reading of Rule 5, as payment is not yet received, it can be interpreted that new levy is applicable on all outstanding debtors as on 31st May, 2016 which gets realized on or after 01.06.2016.

It is because of this reason, notification 35/2016-ST dated 23.06.2016 is issued to exempt from KKC all the services which are provided on or before 31.05.2016 and invoice is issued to that extent. But the whole issue raises the following questions;

1. What would be the position for cases, where invoices are not yet issued but services are provided before 31.05.2016?

2. Is it really required to exempt KKC by a notification on services provided upto 31.05.2016 i.e. services provided before the effective date of levy?

3. How logical/prudent it is in not demanding anytax on services provided after the effective date of levy just because payment is received in advance before the effective date of levy?

4. What would be the position in case of SBC which is introduced with effect from 15.11.2015?

In order to find solutions to the above posers, it is pertinent to understand the moot question i.e. what is the taxable event under Finance Act, 1994 to attract service tax?

Understanding Taxable Event under Finance Act, 1994:

Every taxing statute contains a section which provides for event upon satisfaction of which the respective tax becomes payable by authority of law. This is popularly called charging section and the event is said to be taxable event. The taxable event for excise duty is manufacture of goods and for VAT, it is sale of goods.

Thus in a case where taxable event is not satisfied or the charging section (Law) is not in force at the time when the taxable event occurred, then no tax is leviable as per the said taxing statute. In this regard, let us now examine the charging section under Finance Act, 1994. Under erstwhile positive based taxation, the charging section is section 65(105) of the Finance Act, 1994 and under the present negative list based taxation regime, it is section 66B. The same are reproduced as under;

Section 66B effective from 01.07.2012	Section 65(105) upto 30.06.2012
There shall be levied a tax (hereinafter referred to as the service tax) at the rate of fourteen per cent on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed	"taxable service" means any service provided or to be provided….

On plain reading of the above two charging sections under Finance Act, 1994, both the sections are using more or less similar phrase 'provided or agreed to be provided' and 'provided or to be provided'. Even upon strict interpretation of provisions, there is no difference between the two. Thus the judicial precedents on new levy of service tax under erstwhile regime can also be considered for determining the chargeable event under the current regime.

Coming to interpretation of charging section, there are two phrases in the charging section. One is 'provided' and the other one is 'to be provided' or 'agreed to be provided'. The first phrase 'service is provided' which means that provision of service is completed. The second phrase 'to be provided' is added in levy section after the words 'provided' during the Finance Budget, 2005. It has been then clarified that the objective of the amendment is to collect service tax on the advances received for the services to be provided in future.

Though the charging section is amended to tax the advances received immediately without waiting for the services to be completed, it is just a conditional collection of tax amount and in case where service provider failed to provide the service, the same is required to be returned. Without the service being provided, question of collection of service tax do not arise. This legislative intent is clearly evident from provisions of Rule 6(3) of the Service Tax Rules, 2004 as reproduced below;

"Where an assessee has issued an invoice, or received any payment, against a service to ***be provided which is not so provided by him either wholly or partially for any reason,*** *or where the amount of invoice is renegotiated due to deficient provision of service, or any terms contained in a contract, the assessee may take the credit of such excess service tax paid by him, if the assessee.-*

(a) has refunded the payment or part thereof, so received for the service provided to the person from whom it was received; or

(b) has issued a credit note for the value of the service not so provided to the person to whom such an invoice had been issued"

In view of the above rule, assesse is entitled to take credit of service tax amount paid on advances received if the service is not provided either wholly or partly. In case where it is not practicable for him to take credit of service tax and adjust against future liabilities, he can claim refund also. The principle that when no service is provided eventually, Government is not entitled to retain service tax paid on advance receipts has been upheld by Mumbai tribunal in the case of Datamatics Software P Ltd vs. CST, 2014-35-CESTAT-Mum.

Thus upon plain reading of charging section and other provisions of Finance Act, 1994 and the rules made thereunder, it is very clear that the taxable event is the provision of service. Though service tax is collected by Government immediately upon receipt of advance, it is only a conditional collection. Only upon completion of service, the levy gets crystalised thereby Government gets the right to unconditionally retain such service tax. The question of taxable event and the issue relating to liability to pay service tax in case of new levy are considered in various judicial forums. Some of them are reproduced hereunder;

a. In the case of Association of Leasing & Financial Service Companies vs. UOI, 2010(20)S.T.R417(SC) wherein it was held by Supreme Court that the taxable event for service tax is the rendition of service.

b. In the case of CCE vs. Krishna Coaching Institute, 2009(014)STR0018(Tri-Del) wherein payments were received in advance for the services yet to be rendered. Service tax levy was in force at the time when service is rendered. it was held *"The respondent has no vested right to collect in advance the fees for conducting the training programme to be conducted after 1-7-2003. The main obligation to pay tax arises out of Finance Act, 2003 and the service has been brought into tax nets by Notification No. 7/2003-S.T. dated 20-6-03 with effect from 1-7-03. This main obligation cannot be altered by subsidiary obligation like taking registration as an assessee, issuing invoices, filing returns etc. Even if the amount is collected in advance, it is not impracticable to raise an invoice indicating the service charges (noting that the amount already stands paid) and indicating service tax payable."*

c. In the case of British Airways PLC vs. CST, 2013(29)STR177(Tri-Del) wherein the appellant contended that as levy was not in force at the time when tickets are sold, service tax payment do not arise though services are provided after the levy i.e. 01.05.2016. It was held that—*"the levy of Service Tax has no connection with the receipt of payment and the service tax is required to be paid when the service is provided. Since all tickets though sold prior to 1-5-2006 journey was undertaken on and after 1-5-2006 and at the time of journey undertaken the levy of service tax on the amount of taxable service was in force and, therefore, the appellant is liable to pay the service tax on the air tickets sold by them prior to 1-5-2006 also."*

In view of the above analysis, in the opinion of paper writer the taxable event under Section 66B or Section 65(105) is the rendition of service. At the time when service is provided, if the levy is in force, service tax gets attracted. It is not relevant whether or not money is received before or after the levy is in force. The said principle is in complete contrast to Rule 5 of POT Rules which provides that levy is applicable and tax is payable in all cases except in cases where amounts for the services are received prior to the effective date of levy. No importance is given to rendition of service.

Is Rule 5 a case of excess utilisation of delegation power?

Point of Taxation Rules, 2011 is introduced with effect from 01.04.2011 with two fold purpose i.e. to determine the time when service tax is required to be paid as provided under Rule 6(1) of the Service Tax Rules, 1994 and also to provide for the rate at which such service tax is to be paid as provided under sub-section 2 of section 67A of Finance Act, 1994.

Thus the power extended to Central Government to frame the rules is to achieve the above stated objectives and not to make the levy applicable to services provided much before the charging section is introduced or to exempt services for which payment is made before levy but services are provided after the levy. Further no such express power is conferred in terms of section 94 of Finance Act, 1994 which provides the rule making power to Central Government. Thus in the opinion of paper writer Rule 5 of the POT Rules is clearly traversing the charging section and is excess utilisation of its delegated power under the guising prescribing the time when service tax is to be paid.

Conclusion:

Before parting, it is very clear from the fact of issuance of notification to exempt KKC that the rule is having a direct conflict with the charging section. Otherwise there is no reason to exempt them from KKC. Similar exemption is not provided with SBC is introduced. It seems that Government has identified the flaw but wanted to give just a temporary solution to the problem without thinking of amending or withdrawing the Rule 5. Further certain assesses who receives advances before the levy is introduced but services are provided subsequently would get unjust advantage as they need not have to pay service tax by virtue of Rule 5. Thus arbitrary and indifferent treatment prevails amongst the service providers and continues every time when a new levy is introduced. Let us hope that sooner or later the age-old canon(taxable event is rendition of service) is endured clearing the paradox on applicability of service tax in case of new levy.

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COMPANIES ACT, 2013

COMPANIES AMENDMENT BILL 2016-PART 2

Contributed by CS DVK Phanindar

Sl. No.	Section(s) under the CA, 2013, amended	Clause No. in the Amendment Bill	Proposed amendment relating to	Remarks/Comments/Penalty
30.	Section 123 Declaration of Dividend	31	Substitution of sub-section (3)of Section 123 to allow declaration and payment of interim dividend, during the period from closure of financial year till date of Annual General Meeting for a financial year, and out of the profits of the said year; or from the surplus in the profit and loss account; or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend. In addition to the above, the substitution also prescribes the rate at which the interim dividend can be declared, in case of loss is incurred during the financial year.	**Welcome amendment, as it allows a new criteria for declaration of Interim Dividend, and clarity on the rate of dividend in the absence of profits.**
31.	Section 129 -Financial Statements	32	Substitution of sub-section (3) of section 129, in connection with preparation of Consolidated Financial Statements in the same form and manner as that of its own in accordance with applicable accounting standards, for associate companies also in addition to subsidiary.	**Amendment/inclusion to remove ambiguity.**

Sl. No.	Section(s) under the CA, 2013, amended	Clause No. in the Amendment Bill	Proposed amendment relating to	Remarks/Comments/Penalty
32.	Section – 130 – Re-opening of Accounts on Court's or Tribunal's Orders **(Section notified with effect from 01.06.2016)**	33	Amendment to sub-section (1) of Section 130, so as to provide that in addition to authorities already specified in the section, any other person concerned shall be given notice before passing an order for re-opening of accounts. Insertion of a new sub-section (3) to provide that no order shall be made for re-opening of books of account relating to a period earlier than eight financial years immediately preceding the current financial year, unless there is a specific direction under section 128(5) [i.e., maintenance of books of accounts] from the Central Government for longer period.	**Welcome amendment, as there is a increased scope of authorities, to whom notice as to re-opening of accounts is to be given by the Tribunal; and also giving the periods for which order can be given by Tribunal, for re-opening of accounts.**
33.	Section 132- Constitution of National Financial Reporting Authority (NFRA). (**Section yet to be notified)**	34	Amendment (reduction) of the minimum penalty that can be levied by way of an order by NFRA on CA Firms, if professional or other misconduct is proved from Rs. 10 Lakhs to Rs.5 Lakhs.	**Welcome amendment.**
34.	Section 134 – Financial statements & Board Report	35	Substitution of sub- section (1)of section 134, with a new section, thereby removing the requirement that the CEO signing the financials shall be a Director, and accordingly, a CEO shall now sign financial statements irrespective of whether he is a director or not. Amendments to sub-section (3) of section 134 seeks to modify the disclosure requirements with respect to **(a)** removal of the requirement of attaching the extract of annual return to the Board report, and just mentioning the web-address, if any, where the extract of annual return is placed is to be mentioned	**Welcome amendment as the proposed amendments reduce the reporting requirements in the Board Report.**

Sl. No.	Section(s) under the CA, 2013, amended	Clause No. in the Amendment Bill	Proposed amendment relating to	Remarks/Comments/Penalty
			(b)amendment to clause (p) of the sub-section relating to statement on annual performance of the Board, its committees and independent directors by the companies to which the provision is applicable**(c)**mentioning only the salient features of the Remuneration and nomination policy (Section 178) and CSR policy(Section 135) in the Board Report, and providing the web-address where the complete policy is available. Insertion of a new section **3A**, which empowers the Central Government to prescribeabridged Board's report for small company and one person company.	
35.	Section - 135 – Corporate Social Responsibility.	36	Amendment to sub-section (1) of section 135,with regard to the period for which the criteria for applicability of CSR to a Company (i.e., Turnover, Net worth & Net Profit) are to be seen from **"any financialyear"** to "**immediately preceding financial year".** Insertion of a proviso to sub-section (1) regarding composition of CSRcommittee with two or more directors, by a company which is not required to appointindependent director under section 149. Amendment of Clause (a) in sub-section (3) with regard to areas in which CSR activity can be undertaken **"as specified in Schedule VII",** the words and figures **"in areas or subject, specified in Schedule VII",** thereby providing more scope in the CSR activities.	**Amendment to remove ambiguity and ease of operations.**

Sl. No.	Section(s) under the CA, 2013, amended	Clause No. in the Amendment Bill	Proposed amendment relating to	Remarks/Comments/Penalty
			Amendment to the explanation given in sub-section (5) earlier with regard to **"Average Net profit",** now changed to **"Net profit",** and further to empower the CentralGovernment to prescribe sums which shall not be included for calculating **'net profit'** of a Company for the purpose of section 135.	
36.	Section - 136 – Right of member to copies of audited financial statement.	37	Amendment to sub-section (1) of section 136 by inserting a new proviso to provide that copies of audited financial statements and other documents can be sent at shorter notice if 95 % of members entitled to vote at the meeting agree for the same; and accordingly aligning the existing provisos, after the insertion. Substituting the existing 4th proviso to Sub-section (1) with new proviso, to rationalise the requirements with respect to financial statements of foreign subsidiaries of a listed company subject to conditions. Insertion of a proviso to Sub-section (2) thereby companies having subsidiaries to provide financials of the subsidiary for inspection by the member who asks for it.	**Welcome amendment.**
37.	Section – 137 – Copy offinancialstatement tobe filed with Registrar.	38	Insertion of a new proviso after the existing 4th proviso to sub-section (1) so as to enable filing of unaudited financial statements by listed companies, of their foreign subsidiaries which is not required to get its accounts audited, under the laws of the country of incorporation. The filing of unaudited financial statements are to be accompanied by a declaration by the listed company, to the above effect.	**Welcome amendment.**

Sl. No.	Section(s) under the CA, 2013, amended	Clause No. in the Amendment Bill	Proposed amendment relating to	Remarks/Comments/Penalty
38.	Section – 139 – Appointment of Auditors	39	Omission of the first proviso to sub-section (1), i.e., ratification of the appointment of auditors by the members at every AGM.	**Welcome amendment.**
39.	Section – 140 - Removal,resignation of auditor and giving of Specialnotice	40	Amendment to sub-section (3) of section 140 to reduce the penalty/penalty criteria, withrespect to failure to file resignation form (ADT-3) by auditor to the Registrar concerned and also to the Comptroller and Auditor General (CAG) for the applicable companies, from the existing **"Rs.50,000/-" to "Rs.50,000/-or the remuneration of auditors whichever is less".**	
40.	Section – 141 - Eligibility, Qualifications and disqualifications of auditors.	41	Insertion of an explanation to clause (d) of sub-section (3) of section 141, to clarify the meaning of relative with reference to eligibility for appointment of auditors. Substitution of the existing clause (i) of sub-section (3) along with explanation, for harmonisation with section 144 in respect of providing of certain non-audit services to holding or subsidiary company of a company.	**Amendment to remove ambiguity.**
41.	Section 143 - Powers and duties of auditors and auditing standards.	42	Amendment to sub-section (1) of section 143 of the Act to include associate companies in addition to subsidiary companies with respect to right of auditors to have access to accounts and records for the purpose of consolidation. Amendment to clause (i) of sub-section (3) to provide that auditors shall report on internal financial control systems relating to financial statements. Amendment to sub-section (14) to replace the term "cost accountant in practice" with "cost accountant".	**Amendment to remove ambiguity.**

Sl. No.	Section(s) under the CA, 2013, amended	Clause No. in the Amendment Bill	Proposed amendment relating to	Remarks/Comments/Penalty
43	Section 148 - Central Government to specify audit of items of cost in respect of certain companies.	44	Amendment to substitute the words 'cost accountant in practice' with the words 'cost accountant' in sub-section (3) & (5) of Section 148 and also to substitute the words 'Institute of Cost and Works Accountants of India' with the words 'Institute of Cost Accountants of India',in the explanation to Sub-section (3) of Section 148.	**Amendment to remove ambiguity.**
44	Section 149 -	45	Amendment to Sub-section (3) of Section 149, relating to the requirement of resident director, the amendment proposed requires that **"every company shall have at least one director <u>who stays in India</u> for a total period of not less than 182 days <u>during the financial year"</u>**instead of the existing requirement of **"shall have at least one director <u>who has stayed in India</u> for a total period of not less than 182 days <u>in the previous calendar year."</u>** Further the amendment proposes that in case of a newly incorporated company the requirement under this sub-section shall apply proportionately at the end of the financial year in which it is incorporated. Amendment to clauses in sub-section (6) of Section 149, to specify limits with respect to pecuniary relationship of a director with respect to eligibility of a director to be appointed as an independent director. It also seeks to specify the scope of restriction on pecuniary relationship entered into by a relative.	**Welcome Amendment to remove ambiguity and ease of operations.**

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LABOUR LAWS

WAGES UNDER EMPLOYEES' PROVIDENT FUNDS AND MISCELLANEOUS PROVISIONS ACT, 1952

Contributed by S V Ramachadra Rao

In the recent past there has been constant conflict between the employers and the Employees Provident Fund Organisation (EPFO)enforcement authorities on the issue of 'basic wages' on which contributions are required to be made. In this paper an attempt is made to collate the information on the subject based on the various judgements of the High Courts and Supreme Court to create a perspective on the subject for future guidance and to initiate corrective measures to avoid possible litigation with the EPFO.

Para 29 of the Employees' Provident Funds Scheme, 1952 deals with the contributions payable by the employer. In accordance with the said para, the employer shall contribute twelve per cent of the basic wages, dearness allowance (including the cash value of any food concession) and retaining allowance (if any)payable to each employee to whom the Scheme applies.

The EPF&MP Act has defined 'Basic Wages' as all emoluments which are earned by an employee while on duty or on leave or on holiday with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, ***but does not include –***

(i) The cash value of any food concession;
(ii) Any dearness allowance (that is to say, all cash payment by whatever name called paid to an employee on account of a rise in the cost of living), house rent allowance, overtime allowance, bonus, commission or any other similar allowance payable to the employee in respect of his employment or of work done in such employment;
(iii) Any presents made by the employer.

Most of the new economy establishments are devising a salary structure with Basic Salary, HRA and other allowances without the component of Dearness Allowance and contributions towards provident fund are being paid on the basic salary only on the assumption that all other allowances fall under the exclusion category as per the above definition.

There has been conflict between the employers and EPF Organisation and hence these matters reached various Hon'ble High Courts in the country and some of the matters are pending before the Apex Court for its final verdict. Review of some important judgements are mentioned hereunder to understand the views of the judiciary in the matter.

The Hon'ble Madhya Pradesh High Court Division Bench in the matter of Montage Enterprises Pvt Ltd Vs EPFO, Indore [2011 LLR 867] held that the conveyance allowance and Special Allowance will fall within the definition of 'Basic Wages'. The rationale taken by the Hon'ble bench is that the Conveyance Allowance and Special Allowance is paid to all non-executive category of employees and it is not a case that some of the employees are not getting the same. ***It is a settled law that if such wages are paid universally, necessarily and ordinarily to all across the board, the same will fall under the definition of basic wages.***

In the year 2005,the Hon'ble Calcutta High Court Division Bench in the matter of RPFC (II), WB Vs. Vivekanadnda Vidya Mandir [2005 LLR 339] held that ***contributions are payable on Special Allowance when it is revised from time to time and the company has not adopted the system of payment of Dearness Allowance.*** The detailed view of the court in the matter is as under:

In order to exclude any allowance from the purview of Section 6 which provides for liability to pay contribution based on basic wages, such allowance should fall under Clause (i), (ii) and (iii) of Section 2 (b) which enumerate allowances which are not included in the definition of 'basic wages'. In the instant case the special allowance paid by the employer was not a retaining allowance, neither cash payment for food concession, nor over time allowance, house rent, bonus, commission, nor a present by employer and it did not satisfy any of the ingredients of Clauses (i) to (iii). Considering that the said allowance was paid in terms of contract of employment and was upwardly revised every 2 years and there is no system of payment of dearness allowance, it was held to be dearness allowance though described differently (Special Allowance) and therefore has to be treated as a part of pay and hence order passed by PF Authority that special allowance was subject to liability of contributions under section 6 of the Act is upheld.

In the year 2004, the Hon'ble High Court of Gujarat in the matter of Gujarat Cypromet Ltd Vs APFC [2004 III CLR 485] also held that the contribution to Provident Fund made on basic wages includes all emoluments earned by the employee and allowances like lunch allowance, medical allowance, conveyance allowance etc., except those which are specifically excluded by the legislature, such as house rent allowance which is clearly excluded from the definition of basic wages by virtue of Section 2(b).

It could be seen from the above the judiciary has interpreted the term 'basic wages' to include all allowances which are not specifically excluded. This interpretation has major cost implications to industry.

The establishments have been engaging employees through contractors and agencies to meet the non-core activities of the industry such as Security, House Keeping etc., In addition to this, during the last one decade, the establishments started engaging manpower through outsourcing agencies to meet the work requirements without having long term liability. The number of such employees have increased substantially in the recent past. Most of these employees are paid applicable minimum wages. The outsourcing agencies in general bifurcate the minimum wages as basic wages, house rent allowance and conveyance allowance etc.,

The E P F authorities have come to the view that the employers are bifurcating the minimum wages with a view to avoid payment of provident fund contributions and this led to litigation across India. The Hon'ble High Court of Andhra Pradesh issued a stay order on the circular issued by the PF Department on this issue. ***The Division Bench of Punjab & Haryana held that the definition of wages under Minimum Wages Act is inapplicable to that of basic wages under EPF Act.***

The decisions of the Hon'ble High Courts, which are discussed above and similar other matters are pending before the Hon'ble Supreme Court of India for disposal. We have to await the decision of the Apex Court on these matters.

The courts have also held that certain category of payments ***does not fall under the ambit of basic wages*** and does not attract provident fund contributions. They are:-

The Supreme Court held that the ***Production Bonus / Incentive*** when paid in a sliding scale with due regard to the production made by each workman then no contribution is payable. Similarly if the production bonus is paid on an average to all workmen on the basis of extra production made by them, then also, no contribution need be paid. [Daily Pratap Vs RPFC 1999 I LLJ 1]

The Madras, Delhi and Gujarat High Courts held in various matters that the ***ad-hoc allowance*** and ad-hoc payments made to employees does not form part of 'basic wages' and hence no contributions are payable.

The Hon'ble High Court of Bombay held that payment made ***in lieu of notice for terminating the contract of employment*** of a permanent employee does not constitute 'basic wages' and hence no contributions are payable. The Gujarat High Court in the matter of Swastik Textile Engineers Vs V M Rathod [2008 II LLJ 533] held that the ***back wages*** awarded by Court cannot be regarded as 'basic wages' payable to the employee and it is in the form of damages or compensation and hence provident fund contributions are not required to be paid.

The Supreme Court held that ***Leave Encashment*** should not be taken as part of 'basic wages' and hence no provident fund contributions are payable.

The Hon'ble High Court of Madras in the matter of Wipro Ltd Vs PO Employees PFAT [[2007 LLR 624] held that the ***canteen subsidy is not equivalent to cash value of food concession*** and hence provident fund contributions are not payable on canteen subsidy.

With effect from 1.9.2014, employees drawing basic wages, dearness allowance and retaining allowance of Rs. 15,000/- or below are liable to be covered under the provident fund scheme. Once covered employee will continue to get covered even though his wages exceed Rs. 15,000/- per month. The Supreme Court in the matter of Marathwada Gramin Bank Karamchari Sanghatana Vs Management of Bank [2011 LLR 1130] held that employers need not pay provident fund contributions higher than the prescribed limited under the Act and Scheme that is now Rs. 15,000/-.

Most of the new generation organisations are following the concept of cost to the company of the employee and the compensation package is decided on annualised basis. As the organisations are deciding the cost to the company, it has all the freedom to bifurcate the mutually agreed compensation package. Say for example the annual CTC is Rs. 2.90 Lacs, the monthly wages can be defined as Basic: Rs. 15,000/-, HRA 40% of the Basic Salary ie Rs. 6000/- and the employer Provident Fund contribution as Rs. 1800/-. Thus the monthly cost to the company is Rs. 22,800/- and annual cost is Rs. 2, 73, 600/-. In view of the recent amendment to the Payment of Bonus Act, the employee with basic wages of Rs. 15,000/- will also be covered under the Act. Hence the employee will be entitled to at least 8.33% of the basic wages earned in the financial year which translates to one month basic wage of Rs. 15,000/-. Thus the annual cost to the company will be Rs. 2, 88, 600/-.

When the CTC offered to an employee is higher than the Rs. 2.9 lacs per annum, other allowances such as conveyance allowance, medical reimbursement etc., may be introduced.

In case of employees whose monthly wages are minimum wages, it would be advisable to bifurcate the minimum wage as basic wages and house rent allowance only. For example if the minimum wage is Rs. 10,010/- per month the same may be bifurcated as Rs. 7150/- as basic wage and 40 percent of basic wage as HRA ie Rs. 2860/-. The cost to the company per annum would be Rs. 1, 43, 272/- which includes statutory minimum bonus of 8.33%, 12% of PF and 4.75% of ESI contributions.

If the monthly wages are above minimum wage and below Rs. 22,800/- per month, that is the annual cost to the company is between Rs.1.45 lacs and Rs. 2.9 lacs, the applicable minimum may be taken as basic and the balance wage be bifurcated as HRA, Conveyance Allowance, Washing Allowance and Medical Reimbursement etc.,

In the above mentioned cost to the company, the liability that may arise on account of Payment of Gratuity Act is not included.

Of late the highly reputed and law abiding employers are also finding it difficult to convince the provident fund enforcement authorities the method followed by them in finalising the compensation package of the employees during the 7A proceedings and the matters are going against them. This has led to large scale litigation in the Tribunal and also depositing a part of the amount determined in the 7 A proceedings by the Qasi Judicial Authority by the company. The cost of litigation has also become substantial besides monitoring the maters under litigation which may become major liability on the company at a later date.

In view of the above analysis, it is suggested that organisations may consider to restructure the salaries of the employees, as suggested above, to ensure litigation free statutory compliance under Provident Fund Act, Payment of Bonus Act and the Minimum Wages Act.

This article is contributed by S V Ramachadra Rao, an associate of SBS and Company LLP, Chartered Accountants. The author can be reached at svrr@resourceinputs.com

TECHNICAL SESSIONS:

S.No.	Event	Date	Speaker	Venue
1	Income Tax Assessment Procedures	08/07/2016	CA Sai Phani Kumar M	SBS - Hyd
2	Indian Constitution vis-à-vis Indirect Taxes (Part-2)	15/07/2016	CA Manindar K	SBS - Hyd
3	Interpretation of Statues	22/07/2016	CA Harsha Vardhan K	SBS - Hyd
4	An overview of E-Commerce Business	29/07/2016	CA Sandeep Das	SBS - Hyd
5	Companies Amendment Bill 2016 (Part -2)	05/08/2016	CS DVK Phanindar	SBS - Hyd

Note:

The timings for the above events shall be from 17:30 hrs to 19:30 hrs. We request the recipients of "SBS Wiki" who are interested to attend the above events to send confirmation of your participation two days in advance to make appropriate arrangements. The relevant material will be hosted at slideshare shortly after the session. The link to download is *http://www.slideshare.net/Team-SBS*

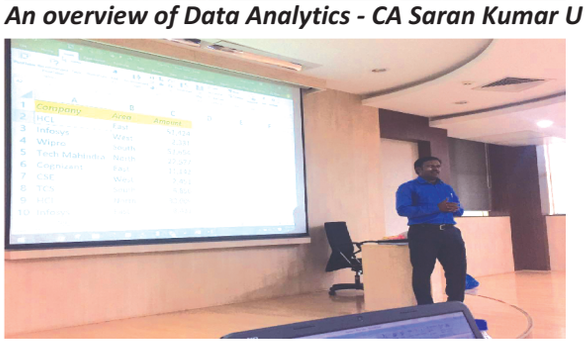
Incisive Analysis of Exemptions under Service Tax-Part III - CA Manindar K

A Peak into MSME Advantages - CA Rajesh D

Types of Deposit Accounts- Residents and Non-Residents- CA Murali Krishna G - ICAI Hyd. Branch

Introduction to Standards of Internal Audit - CA MHS Bhyrav

An overview of Data Analytics - CA Saran Kumar U

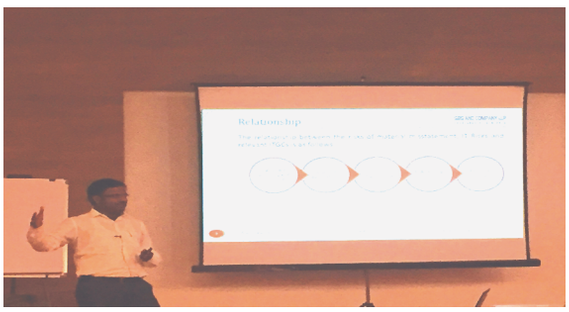


Assurance on Data Analytics - CA Saran Kumar U - COE

SEMINAR ON INTERNAL FINANCIAL CONTROLS - FINANCIAL REPORTING

Introduction of IFC - CA Murali Krishna G

Business Process Controls- Audit & Documentation - CA Sandeep Das



Review of IT General Controls under IFC - CA Saran Kumar U

Hyderabad: 6-3-900/6-9, #103 & 104, Veeru Castle, Durganagar Colony, Panjagutta, Hyderabad, Telangana
Kurnool: No. 302, 3rd Floor, V V Complex, 40/838, R.S. Road, Near SBI Main Branch, Kurnool, Andhra Pradesh
Nellore: 16-6-259, 1st Floor, Near Santi Sweets Opp: SBI ATM, Vijayamahal Centre, SPSR Nellore, Andhra Pradesh
Tada: 8-3-425/2, Flat No. 202, 2nd Floor, Bigsun Avenue, Near SRICITY, TADA, SPSR Nellore Dist, Andhra Pradesh
Visakhapatnam: # 39-20-40/6, Flat No.7, Sai Yasoda Apartments, Madhavadhara,Visakhapatnam (Urban),Vizag, Andhra Pradesh
Bengaluru: B104,RIRCO, Santosh Apartments, Wind Tunnel Road, Murugeshpalya, Old Airport Road, Bangalore – 560017, Karnataka.

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