Financial Services Sector - Tax and Regulatory updates

October 2021

*covering developments during July to September 2021

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01 Regulatory updates

I. Amendment to SEBI AIF Regulations, 2012

SEBI has approved the following amendments to the AIF Regulations:

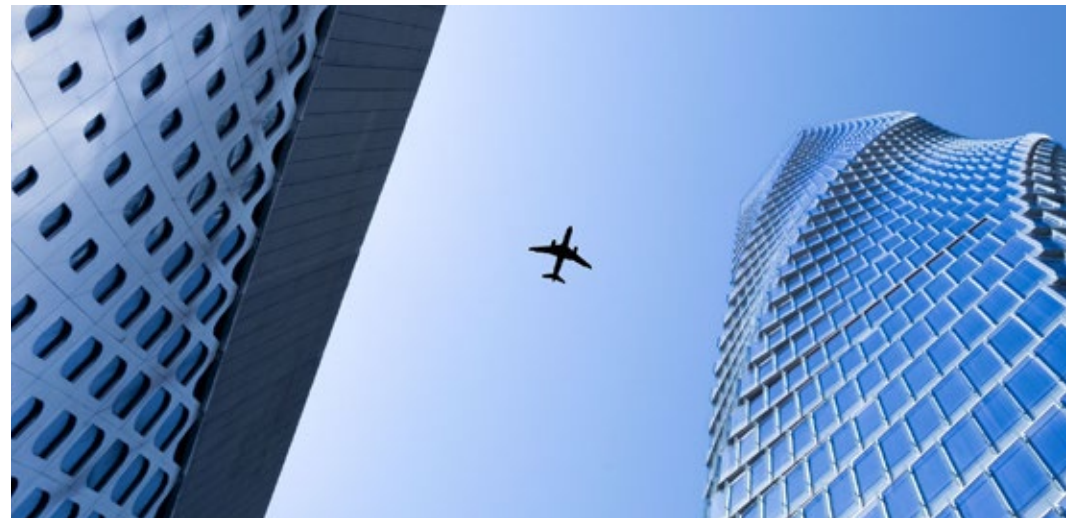
- Definition of 'start-up' included and the list of 'restricted activities or sectors from the definition of 'Venture Capital Undertaking' removed
- AIFs permitted to simultaneously invest in units of other AIFs and directly in securities of investee companies
- AIF manager to ensure compliances with investment conditions, fund documents and applicable laws under all circumstances.
- Code of conduct prescribed for key management personnel of AIF and its manager, including the members of the investment committee
- Framework for Accredited Investors of AIFs basis financial parameters; AIFs with only Accredited Investors are exempt from minimum investment criteria; diversification requirements relaxed; allowed to extend the tenure of the fund beyond 2 years;
- AIFs allowed to issue partly paid-up units to investors
- AIFs to file PPM with SEBI through registered merchant bankers.
- Category III AIFs to calculate concentration norms based on Net Asset Value of the fund instead of investable funds for investment in listed equities of investee companies.

II. Permitting Resident Indian fund managers to be constituents of FPIs

SEBI (Foreign Portfolio Investors) Regulations, 2019 amended to permit eligible Resident Indian Fund Managers (other than individuals) to be constituents of FPIs. Such FPIs shall be investment funds approved by CBDT under Section 9A of the Act. These amendments shall bring the SEBI (FPI) Regulations, 2019 in line with the recent amendments in Section 9A of the Act, thereby facilitating Indian fund managers in managing investment funds incorporated/established/ registered outside India.

III. Change in the minimum amount requirement for AMCs in MF

SEBI (Mutual Funds) Regulations, 1996 amended to provide for the investment of a minimum amount as skin in the game for AMCs in the MF schemes based on the risk associated with the scheme, instead of the current requirement of 1% of the amount raised in new Fund offer or an amount of INR 50 Lakh, whichever is less.



IV. Preferential issue of units only to institutional investors and body corporates on private placement basis of listed InvITs

SEBI vide letter[1] dated June 29, 2021, provided informal guidance on a query raised by an InvIT on whether a privately placed listed InvIT is permitted to issue and allot units to natural person (in this case the Existing Shareholders) under the Preferential Issue Guidelines in exchange for receipt of securities of the target SPV.

SEBI has clarified that although the preferential issue guidelines are silent on aspect of issuance units to InvIT on private placement basis to individuals, in terms of Regulation 14(2) of the InvIT Regulation, an InvIT may raise funds on private placement basis from institutional investors and body corporate only. Therefore, an offer and allotment by InvIT on private placement basis, whether initial or further, can be made only to institutional investors and body corporate.

V. Minimum number of unitholders for unlisted InvIT

SEBI (Infrastructure Investment Trusts) Regulations, 2014 amended for introduction of minimum unit holder's requirement for unlisted InvITs. The minimum number of unit holders, other than sponsor, its related parties and its associates shall be 5 holding not less than 25% of the total unit capital of the InvIT.

VI. Revision in minimum subscription and trading lot for publicly issued REITs and InvITs

SEBI (Infrastructure Investment Trusts) Regulations, 2014 and SEBI (Real Estate Investment Trusts) Regulations, 2014 amendments for revision in minimum subscription and trading lot for publicly issued REITs and InvITs. The revised minimum application value shall be within the range of INR 10,000-15,000 and the revised trading lot shall be of one unit.

[1] SEBI/HO/DDHS/OW/P/13826/2021

VII. Introduction of Framework for Accredited Investors in securities market

SEBI introduced a framework for 'Accredited Investors' in the Indian securities market, a class of investors who are well informed or well advised about investment products.

The salient features of the proposed framework include:

- Eligibility criteria for Accredited Investors who may be Individuals, HUFs, Family Trusts, Sole Proprietorships, Partnership Firms, Trusts and Body Corporates based on financial parameters and information as may be specified by SEBI.
- Eligible subsidiaries of depositories and specified stock exchanges, and any other specified institutions to be recognized as Accreditation Agencies.
- Accreditation Agencies to grant accreditation status and issue Accreditation Certificate to Accredited Investor.
- Modalities of accreditation and procedure to avail benefits linked to accreditation.

The benefits linked to accreditation include:

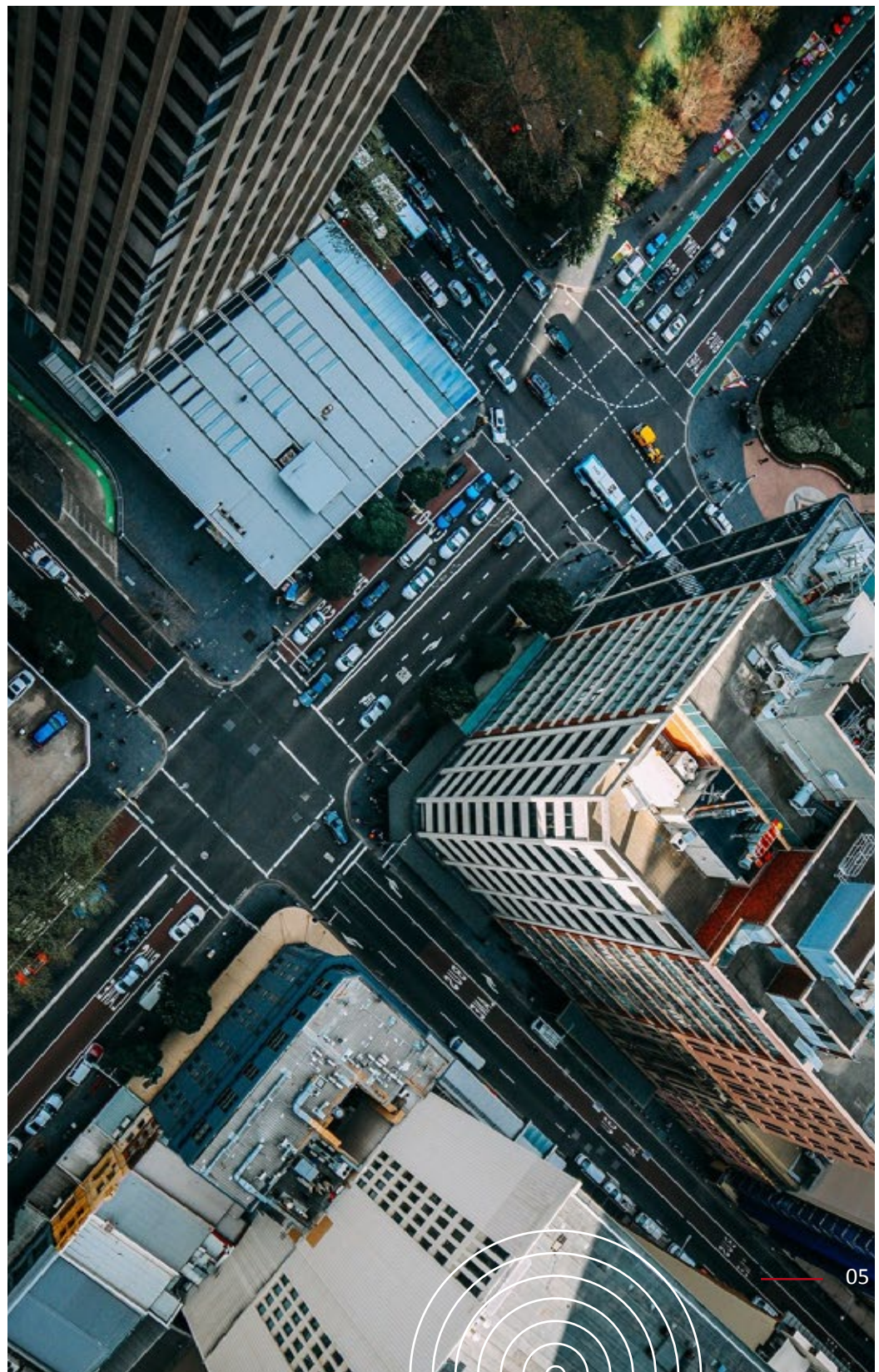
- Accredited Investors shall have flexibility to participate in investment products with an investment amount lesser than the minimum amount mandated in the AIF Regulations and PMS Regulations.
- AIF for Accredited Investors where each investor invests minimum investment amount of INR 70 Crores may avail relaxation from regulatory requirements such as portfolio diversification norms, conditions for launch of schemes and extension of tenure of the AIF.
- Accredited Investors with minimum investment of INR 10 Crores with registered PMS provider, may avail relaxation from regulatory requirement with respect to investment in unlisted securities and can enter into bilaterally negotiated agreements with the PMS provider.
- Accredited Investors who are clients of Investment Advisers will have the flexibility to determine the limits and modes of fees payable to the Investment Adviser through bilaterally negotiated contractual terms.

VIII. Introduction of T+1 rolling settlement on an optional basis

SEBI introduces an option for the Stock Exchange to choose T+1 settlement cycle on any of the scrips, after giving an advance notice of at least 1 month, regarding change in the settlement cycle, to all stakeholders, including the public at large, and disseminating the same on its website.

The settlement option is available to all types of transactions in the security on that Stock Exchange. After opting for a T+1 settlement cycle for a scrip, the Stock Exchange shall have to mandatorily continue with the same for a minimum period of 6 months. However, in case, the Stock Exchange intends to switch back to the T+2 settlement cycle, it shall do so by giving 1-month advance notice to the market. Any subsequent switch (from T+1 to T+2 or vice versa) shall be subject to a minimum period and notice period as mentioned. Also, no netting between T+1 and T+2 settlements will be allowed.

The new guidelines will come into effect from January 01, 2022.



IX. SEBI issues clarification on alignment of interest of Key Employees of AMCs with the unitholders of the MF Schemes

SEBI vide circular[2] dated September 20, 2021, has issued clarification with respect to circular dated April 28, 2021, on 'Alignment of interest of Key Employees ('Designated Employees') of AMC with the unitholders of the MF Schemes.

- SEBI has clarified the term, 'key employees' in the circular associated with the compensation rules refers to 'designated employees', and the phrase 'paid in the form of units' shall be read as 'mandatorily invested in units' which means a portion of designated employees' remuneration will have to be mandatorily in the form of units of scheme they manage.

- SEBI has mandated that all designated employees of AMCs be paid up to 20% of their monthly compensation in units of the schemes in which they have a role or oversight with effect from October 1, 2021.

- Junior employees below 35 years must invest 10% of their monthly compensation from 1 October 2021 to 30 September 2022, and 15% from 1 October 2022 to 30 September 2023, in the MF schemes they have a role or oversight. This cap will be increased to 20% from 1 October 2023 onwards.

- Designated employees may set off their existing investments in the prescribed schemes as on April 28, 2021, the day new Sebi rules on salaries came into effect, against the required fresh investments. They may set off their units for which the required lock-in period of 3 years is expired. In such cases, AMC shall ensure that such units are locked in for the further period of 3 years or tenure of the scheme, whichever is less.

- Investment of the Designated Employees will be made in 'Growth option' of the mutual fund schemes. For schemes where growth option is not available, the investment shall be made in the 'Reinvestment of Income Distribution cum capital withdrawal option'. For schemes where both the above options are not available, investment shall be made in the 'Payout of Income Distribution cum capital withdrawal option'.

X. Further liberalisation of foreign investment norms in the insurance sector

Ministry of Finance vide notification[3] dated 19August 2021 has amended the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 in line with Press Note No. 2 (2021 series) issued by the DPIIT amending provisions relating to Foreign Direct Investment ('FDI') in the Insurance Sector.

According to the said notification, the limit for FDI in Indian Insurance Company has now been increased to 74% (earlier 49%) under the automatic route.

However, it would be mandatory for the Indian Insurance Company having foreign investment up to 74% to have majority of its directors, Key Management Persons and at least one amongst the Chairperson of its Board/ Managing Director/ Chief Executive Officer as a Resident Indian Citizens. Also, RBI and IRDA will jointly consider applications for FDI in private banks having insurance Joint Ventures or subsidiaries to ensure compliance with the 74% FDI limit.

XI. Framework for Outsourcing of Payment and Settlement-related activities by Payment System Operators

RBI on 3 August 2021 has notified a new framework for outsourcing of payment and settlement-related activities by Payment System Operators ('PSOs').

The framework will be applicable to non-bank PSOs and shall put in place minimum standards for managing risks in outsourcing of payment and/or settlement-related activities. These standards shall not applicable to activities other than those related to payment and/or settlement services, e.g., internal administration, housekeeping or similar functions will not be covered under the ambit.

[2] SEBI/HO/IMD/IMD-I/DOF5/P/CIR/2021/629
[3] S.O. 3411(E) dated 19 August 2021

XII. Master Directions on Prepaid Payment Instruments ('MD-PPIs')

The Department of Payment and Settlement Systems, RBI has revised the Master Directions on Prepaid Payment Instruments (PPIs) on August 27, 2021. The applicability of these master directions now stands widened to include all PPI Issuers and System Participants. Earlier, the said master directions have been issued to provide a framework for authorisation, regulation and supervision of entities issuing and operating PPIs in the country.

Some of the important provisions under the master directions are as follows:

- Prior approval or authorisation of the RBI is required to set up and operate payment systems for PPIs.
- PPIs have now been classified into two categories viz. Small PPIs and full KYC PPIs where Small PPIs have been defined as "Issued by banks and non-banks after obtaining minimum details of the PPI holder" and Full-KYC PPIs have been defined as "instruments issued by banks and non-banks after completing Know Your Customer (KYC) of the PPI holder
- Minimum positive net-worth of INR 5 crore has been set for all non-bank entities seeking authorisation from RBI at the time of submission of application. Thereafter, by the end of the third financial year from the date of receiving final authorisation, they shall achieve a minimum positive net worth of INR 15 crore which shall be always maintained
- PPI issuer shall have a board-approved policy for PPI interoperability.
- Interoperability shall be mandatory on the acceptance side as well. QR codes in all modes shall be interoperable by March 31, 2022.
- PPI issuer shall put in place a formal, publicly disclosed customer grievance redressal framework, including designating a nodal officer to handle customer complaints or grievances, the escalation matrix, and turn-around-times for complaint resolution.
- In the case of PPIs issued by banks and non-banks, customers shall have recourse to the Banking Ombudsman Scheme and Ombudsman Scheme for Digital Transactions respectively for grievance redressal.

XIII. Phasing out Libor as a Benchmark for arriving at interest payments

RBI vide notification dated 8 September 2021 has issued Foreign Exchange Management (Export of Goods and Services) (Amendment) Regulations, 2021. According to the amendment, RBI may direct any other benchmark rate for computation of rate of Interest payable on the advance payment against export.

02

International Financial Services Centre (IFSC)

I. CBDT notifies rules for computation of exempt income and income taxable at concessional tax rates of a Specified Fund

The Act provides for tax exemption/concession in relation to any income accrued/ arisen/ received by a Cat III AIF located in IFSCA (specified fund), where all the units (except the contribution by the fund's sponsor/ manager) are held by the non-residents from specified sources of income provided in the Act to the extent such income is attributable to the units held by the non-residents.

CBDT vide notification[4] dated August 9, 2021, has prescribed rules for determining exempt income and income subject to tax at concessional rates for a specified fund located in IFSC. The determination of the aforesaid income specifically in relation to transfer of specified securities is based on aggregation of daily asset under management from date of acquisition of a security to date of disposal.

The Specified fund needs to furnish an annual statement of exempt/ concessional income in Form 10IG/Form 10IH electronically on or before the due date [i.e., due date of filing the return of income for the specified fund] in the prescribed format provided.

II. Exemption from various provisions of Companies Act 2013 to Foreign Companies raising funds IFSC

The Ministry of Corporate Affairs vide its notification dated 5 August 2021 has issued the Companies (Specification of definitions details) Third Amendment Rules, 2021 and Companies (Registration of Foreign Companies) Amendment Rules, 2021 providing explanation for the term 'Electronic Mode' under Rule 2(1)(h) of Companies (Specification of definitions details) Rules, 2014 and under Rule 2(1)(c) of Companies (Registration of Foreign Companies) Rules, 2014.

According to the explanation, electronic based offering of securities, subscription thereof or listing of securities in the IFSC set up under section 18 of the Special Economic Zones Act, 2005 shall not be construed as 'Electronic Mode'.

Further, MCA vide. notification S.O. 3156 dated 5 August 2021, has exempted foreign companies and a company incorporated or to be incorporated outside India from the provisions relating to offering for subscription of securities, requirements related to the prospectus, and all matters incidental thereto in the IFSCs set up under section 18 of the Special Economic Zones Act, 2005.

As a result of these amendments, foreign companies desirous of raising funds shall not be required to comply with various provisions under the Companies Act such as maintaining accounts in India, dating and registration of prospectus with ROC and other related compliances.

[4] Notification No. 90/2021 F. No. 370142/20/2021-TPL

03

Direct Tax

I. Tribunal allows treaty benefits on re-domiciliation of offshore entities

Re-domiciliation of a company from one country to another by itself cannot lead to denial of tax treaty benefits. Mumbai bench of the ITAT rejects Revenue's objection in the case of Asia Today[5] for denial of treaty benefits under India-Mauritius DTAA due to change of company's place of incorporation from British Virgin Islands (BVI) to Mauritius, holds re-domiciliation to be the way of life for offshore entities.

Background

- Asia Today Ltd (assessee) registered as an 'international business company' in November 1991 in the BVI.
- The Assessee redomiciled to Mauritius on June 29, 1998, and its registration was cancelled by the Registrar of Companies in BVI from June 30, 1998. The Mauritius Revenue Authorities issued a TRC to the Assessee in July 1999.
- The Revenue contended that the Assessee being originally a BVI company was not entitled to treaty benefits under the India-Mauritius tax treaty for AY 2000-01 to 2003-04.
- Further, the Assessee in its response submitted that even though initially it was incorporated in the BVI but at the time of claiming treaty benefits it was registered in Mauritius and its TRC was not in question. Accordingly, the assessee contended that the fact of re domiciliation does not affect its eligibility to treaty benefits.

Tribunal's Judgement

- The Tribunal elaborates that "Corporate re-domiciliation, also referred to as 'continuation', is explained as the process by which a company moves its 'domicile' (or place of incorporation) from one jurisdiction to another by changing the country under whose laws it is registered or incorporated, whilst maintaining the same legal identity".
- Further notes that for re-domiciliation, the existing jurisdiction (where the company is currently registered) and the target jurisdiction (where the company is to be 'continued') need to be on the list of countries where re-domiciliation is possible and not all the countries allow re-domiciliation whereas many popular offshore centres not only permit but also facilitate the re-domiciliation and BVI and Mauritius are such jurisdictions.
- Tribunal takes into account the ease with which the Assessee was re-domiciled in Mauritius and the fact that TRC was effective from a date prior to the completion of the re-domiciliation process and thus, expounds, "The attachment with the jurisdiction of incorporation in these cases appears to be as ephemeral as required by the exigencies of treaty shopping, and this concept of re-domiciliation of the companies also appears to be an antithesis of the very justification of the situs of incorporation of a company being linked with the treaty entitlements".

[5] Asia Today Limited [TS-620-ITAT-2021(Mum)]

II. Retrospective amendment taxing 'indirect transfers' made in 2012 withdrawn

Taxation Laws (Amendment) Bill, 2021 has been introduced in the Lok Sabha withdrawing the retrospectivity to the amendment brought about vide Finance Act 2012, which clarified that gains arising from sale of shares of a foreign company were always taxable in India if such shares, directly or indirectly, derive its value substantially from assets located in India.

Background

- The issue of taxation of 'indirect transfer' has been a matter prone to long-drawn litigation in India. In 2012, while the Supreme Court ruled in favour of the taxpayers, the government found the judgement to be against legislative intent. Consequently, a retrospective amendment was brought about vide Finance Act 2012, to 'clarify' that gains arising from sale of shares of a foreign company shall be taxable in India if such shares, directly or indirectly, derive its value substantially from assets located in India. Provisions were also introduced for validation of demand for cases relating to indirect transfer of Indian assets.

- The matter was also deliberated upon by the Arbitration Tribunal under Bilateral Investment Protection Treaty and was decided against the Indian government in the case of Vodafone and Cairn.

- The Taxation Laws (Amendment) Bill, 2021 has now been introduced in the Lok Sabha withdrawing the retrospectivity to the amendment brought about vide Finance Act 2012.

Amendment vide The Taxation Laws (Amendment) Bill, 2021

- The Bill proposes to amend the Income Tax Act, 1961, so as to provide that going forward, no tax demand shall be raised on the basis of the said retrospective amendment for any indirect transfer of Indian assets, if the transaction was undertaken before May 28, 2012, (i.e., the date when the Finance Act 2012 received President's assent).

- It has also been proposed that any demand raised for indirect transfer of Indian assets made before May 28, 2012, shall be nullified on fulfilment of specified conditions.

- Further, it has been proposed to refund the demand collected /refund adjusted in these cases, however, without any interest under section 244A of the Act.

- Finance Act 2012 has also been proposed to be modified, so as to provide that the validation of demand, etc., under section 119 shall cease to apply on fulfilment of 'specified conditions'

Specified Conditions

- Withdrawal or submission of an undertaking to withdraw:
  - any appeal before an appellate forum or any writ petition before the High Court/ Supreme Court against any order on such income, in prescribed form/ manner
  - any claim in any proceedings for arbitration/ conciliation/ mediation/ notice under any law or agreement entered into by India with any other foreign country, for protection of investment or otherwise

- Furnishing of an undertaking in prescribed form and manner, waiving the right, whether direct or indirect, to seek/ pursue any remedy or any claim in relation to the said income, which may otherwise be available, under any statute or agreement between India and a foreign country, for protection of investment or otherwise

04

Indirect tax

I. CBIC issued clarification on scope of 'Intermediary services' in GST law

In response to the representations citing ambiguity caused in interpretation of the scope of 'intermediary services' in GST law, the Ministry of Finance issued a clarification on the scope of intermediary services vide Circular[6] dated 20 September 2021. The Circular acknowledge that there are no differences between the definitions of intermediary under the service tax regime vis-à-vis the GST regime except the addition of supply of securities in the definition of intermediary in the GST Law. The Circular has provided much needed clarification with regard to the prerequisites for service to qualify as an intermediary service which are summarised below:

- Involvement of three parties - To qualify as intermediary service, the arrangement should involve minimum of three parties, two of them transacting in the supply of goods or services or securities (the main supply) and one arranging or facilitating (the ancillary supply) the said main supply. An intermediary essentially 'arranges or facilitates' the main supply and, does not himself provide the main supply.

- There should be two distinct supplies - Main supply and Ancillary services
  - Main Supply between two principals.
  - Ancillary Supply which is service of facilitating or arranging the main supply. This ancillary supply is intermediary service and is clearly identifiable and distinguished from main supply.

- Role of intermediary should partake the character of agent, broker or any other similar person - The Intermediary' definition is not an inclusive definition and does not expand by any known expression of expansion. The use of the expression "arranges or facilitates" in the definition of "intermediary" suggests a subsidiary role for the intermediary.

- It does not include a person who supply the goods/services on his own account.

- Sub-contracting is not intermediary - Sub-contracting of services either fully or partially do not qualify as an intermediary service as the supply is made on principal-to-principal basis.

- The specific provision of place of supply of 'intermediary services' under Section 13 of the Integrated Goods and Services Tax Act, 2017 shall be invoked only when either the location of supplier of intermediary services or location of the recipient of intermediary services is outside India.

II. Government notifies list of eligible services and rates under SEIS for services rendered in FY 2019-20

The Government of India vide notification dated 23 September 2021[7] has notified list of eligible services and rates under Service Export from India Scheme for services rendered in FY 2019-20.

SEIS Scheme was notified under the Foreign Trade Policy 2015-20 (extended) with an objective to promote export of notified services from India. The eligible service exporters are issued freely transferable duty credit scrip computed as a percentage of net foreign exchange earned during a financial year. The eligibility of notified services is determined basis the Central Product Classification Provisional Code.

Though the SEIS scheme is part of the Foreign Trade Policy 2015-20, list of eligible services and rates are notified annually by way of notification. For services rendered in FY20, eligible services and rates are notified through the Notification.

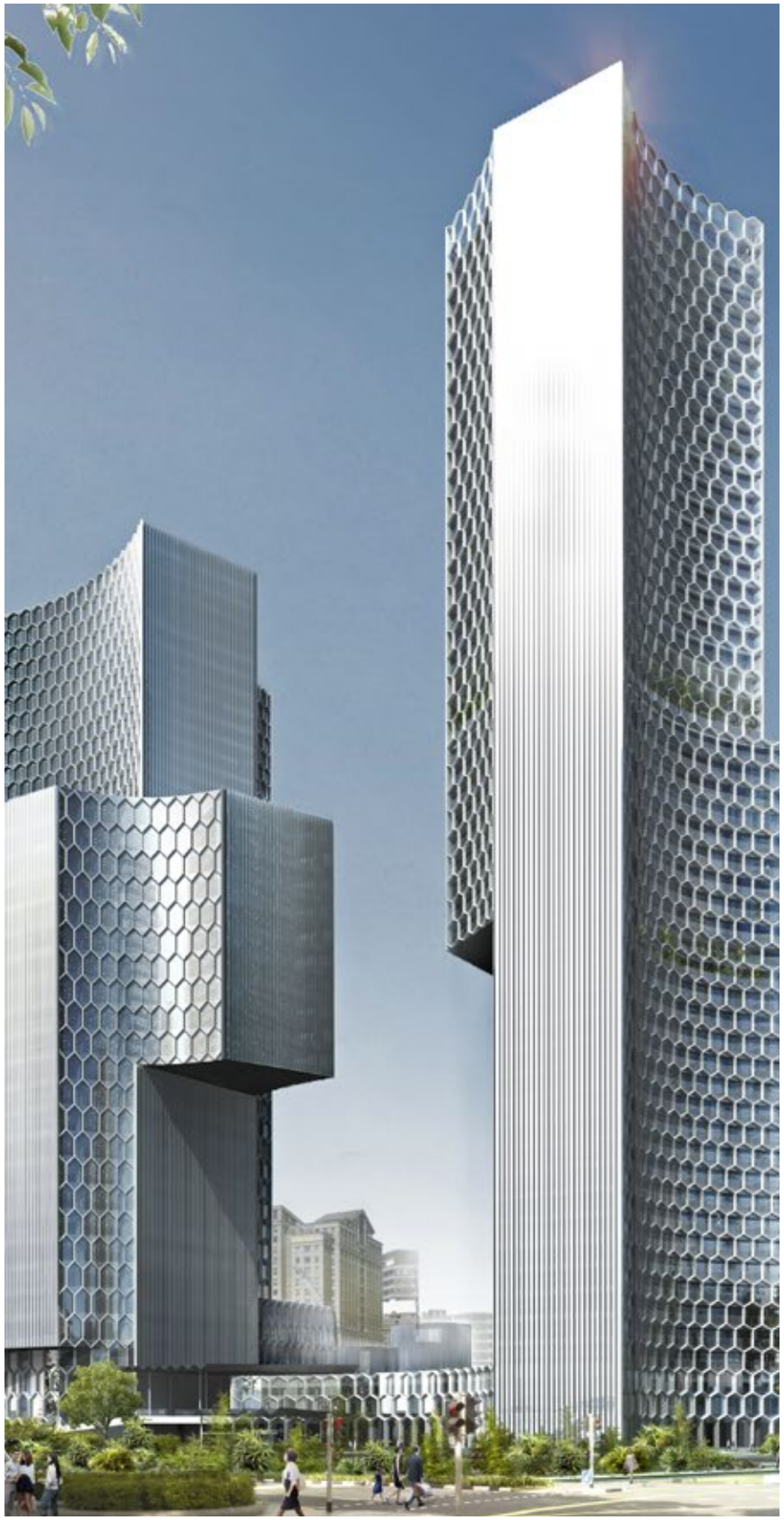
We have provided a gist of the notification and key features below:

- List of notified services and rates under SEIS scheme is provided in Appendix 3X.
- The total entitlement under the SEIS scheme against export of notified services is capped at Rs. 5 crore per Import Export Code.
- Notification also restricts the facility to claim benefits under SEIS on payments in Indian Rupees for notified services rendered in FY 2019-20.
- The application for claiming SEIS benefits FY 2019-20 can be filed by 31 December 2021. In case of non-submission of application by 31 December, there are no late cut provisions for and hence, such applications will become time barred after 31 December 2021.
- Under the revised list of eligible services, certain service categories which were earlier eligible for the SEIS benefits. These service categories include management consulting services, services relating to management consulting, technical testing and analysis services, cargo handling services.

[6] Circular No. 159/15/2021 - GST dated 20 September 2021
[7] Notification No. 29/2015-20 dated 23 September 2021

05

Glossary



Glossary	
Act	Income-tax Act, 1961
AIF	Alternative Investment Fund
AMC	Asset Management Company
CBDT	Central Board of Direct Taxes
CBIC	Central Board of Indirect Taxes and Customs
DTAA	Double Tax Avoidance Agreement
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investors
GST	Goods and Service Tax
IFSC	International Financial Services Centre
IFSCA	International Financial Services Centres Authority
ITAT	Income-tax Appellate Tribunal
InvITs	Infrastructure Investment Trusts
IRDA	Insurance Regulatory and Development Authority
MF	Mutual Fund
PMS	Portfolio Managers Services
PPM	Private Placement Memorandum
RBI	Reserve Bank of India
REITs	Real Estate Investment Trusts
SEBI	Securities and Exchange Board of India
SEIS	Service Exports from India Scheme
SPD	Standalone Primary Dealers
SPV	Special Purpose Vehicle
TRC	Tax residency certificate

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