Between the lines...

VAISH ASSOCIATES ADVOCATES
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The team of Vaish Associates, Advocates wishes you a happy and prosperous Year 2016!

Highlights

I. Salaries of expats not subject to service tax

The Authority for Advanced Ruling (AAR) has recently held that there should be no liability to pay service tax on the salary and allowances payable by expatriates in terms of the dual employment agreement.

In the case of **North American Coal Corporation India Pvt. Ltd., Pune v. Commissioner of Central Excise, Pune,** there was a tripartite agreement between North American Coal Corporation ("NAC") USA, NAC India and Mr. Sloan. Under this agreement, Mr. Sloan's (who is on the permanent roll of the NAC USA) services were to be utilized by NAC India for a particular term.

Based on the agreement, NAC India was supposed to pay all his salaries. The agreement further states that the social security interests of Mr. Sloan would be paid by NAC USA and there is no provision for reimbursement of the same by NAC India to NAC USA. The company argued that since Mr. Sloan is providing service in his capacity as an employee which is clear from the wordings of the agreement, there is no possibility of any service tax provision being applicable to the salary paid to Mr. Sloan. The revenue department however argued that NAC USA is bearing the social security, which tantamount to a consideration paid by the NAC India for employing the services of Mr. Sloan and, therefore, this will not amount to a pure service as contemplated in Section 65 (44)(b) of the Finance Act.

The judge concurred with the company's reliance on the definition of service and more particularly on the exclusion provision which is under Section 65(44)(b), which suggests that a provision of service by an employee to the employer in the course of or in relation to his employment shall not be included in the definition of service. The judge stated that the agreement is very clear to suggest that so long as Mr. Sloan is serving in India, he will be treated to be the employee of the applicant though his interests as the employee of NAC USA, insofar as the social security interests are concerned, will be taken care of by NAC USA.

Source: THE AUTHORITY FOR ADVANCE RULINGS, (Central Excise, Customs & Service Tax) NEW DELHI, November 6, 2015, Ruling No.AAR/ST/13/2015 in Application No. AAR/44/ST/2/2014

VA View

Service tax authorities have been taking a view that where an employee of a group company is deputed to work in an associate company for a specified period assignment, the transaction amounts to creating a service provider-service recipient relationship between the two companies therefore amenable to service tax.

In some recent instances, tax authorities have issued notices to MNCs where an expat employee who has received payments from the parent in his home country. They argue that salaries paid for work in India and transferred to foreign accounts by the parent company which then get reimbursed to it by the Indian subsidiary make it akin to supply of manpower and therefore should be taxable.

The decision of AAR is significant as it brings some relief to MNCs that have been served with notices in similar cases.

II. Rules for omnibus approval of related party transactions

The Ministry of Corporate Affairs has prescribed the rules for omnibus approval of related party transactions. Under the newly inserted Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014, all related party transactions shall require approval of the Audit Committee and the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company. The Audit Committee shall, after obtaining approval of the Board of Directors, specify the criteria for making the omnibus approval which shall include the following, namely:-

- maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year;
- the maximum value per transaction which can be allowed;
- extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval;
- review, at such intervals as the Audit Committee may deem fit, related party transaction entered into by the company pursuant to each of the omnibus approval made;
- transactions which cannot be subject to the omnibus approval by the Audit Committee.

The criteria for omnibus approval can be either specified by the Board or can be a part of the policy for related party transactions of the Company. The Audit Committee shall consider (a) repetitiveness of the transactions (in past or in future) and (b) justification for the need of omnibus approval, while specifying the criteria for making omnibus approval. The Audit Committee shall satisfy itself on the need for omnibus approval for transactions of repetitive nature and that such approval is in the interest of the company.

The omnibus approval shall contain or indicate the following: -

- name of the related parties;

- nature and duration of the transaction;
- maximum amount of transaction that can be entered into;
- the indicative base price or current contracted price and the formula for variation in the price, if any; and
- any other information relevant or important for the Audit Committee to take a decision on the proposed transaction.

There is no separate reporting to be done to the Board. The minutes of the Audit Committee are placed before the Board, by virtue of which the Board is informed about the approvals granted and review thereof.

It has been provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, the Audit Committee may make omnibus approval for such transactions subject to their value not exceeding INR 10 million per transaction.

Omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year. Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

Source: http://egazette.nic.in/WriteReadData/2015/167149.pdf

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Listed companies under SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 had the advantage of omnibus approval policy, however, certain other public companies which are also required to have an audit committee (depending upon the criteria as provided by the rules), did not have the benefit of such omnibus approval policy until this amendment, and related party transactions in such companies required approval of the audit committee on case to case basis.

There was a confusion earlier that only those related party transactions which are covered under section 188 of the Companies Act, 2013 and not exempted from the compliance of the said section are the only ones which needs to be approved by the audit committee under section177 of the Companies Act, 2013. With a clear language under newly inserted rule 6A, it has been clarified that 'all' related party transactions are required to be approved by the audit committee.

III. Fraud reporting by auditors

Under Section 143 of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.

This was amended by Section 13 of the Companies Amendment Act, 2015 and this has been recently brought into force along with consequential changes to Companies (Audit and Auditors) Rules. Now, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving or is expected to involve individually an amount of INR 10 million 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.

The auditor shall report the matter to the Central Government as under:-

(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 (two) days of his knowledge of the fraud, seeking their reply or observations within forty-five days;

(b) 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 15 (fifteen) days from the date of receipt of such reply or observations;

(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 (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;

(d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgment Due or by Speed Post followed by an e-mail in confirmation of the same;

(e) 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; and

(f) the report shall be in the form of a statement as specified in Form ADT-4.

The Amendment Act also provided that in case of a fraud involving lesser than INR 10 million, the auditor shall report the matter to the company's audit committee constituted or to the Board, if there is no audit committee.

Furthermore, the companies, whose auditors have reported frauds to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report. In case of a fraud involving lesser than INR 10 million, the auditor shall report the matter to Audit Committee or to the Board immediately but not later than 2 (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 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 actions taken.

The provision of this rule shall also apply, mutatis mutandis, to a Cost Auditor and a Secretarial Auditor.

Source: http://www.mca.gov.in/Ministry/pdf/Amendement_Rules_14122015.pdf

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Statutory auditors will now have to mandatorily report to the Centre all corporate frauds amounting to INR 10 million or above. By specifying a threshold of INR 10 million, the Corporate Affairs Ministry (MCA) has now done away with the requirement to report immaterial frauds to the Centre. For frauds involving amounts lower than INR 10 million, the statutory auditors now need to report this matter only to the audit committee of the company.

Prior to this Ministry move, the company law required statutory auditors to report to the Centre all frauds by the company or against it. By imposing a limit in terms of the amount on reporting of fraud to the Central Government will reduce the burden of the Auditors to report all immaterial frauds. The amendment has also brought more clarity on the format of reporting, particulars to be reported and the manner of reporting.

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