Voices on Reporting

10 November 2020

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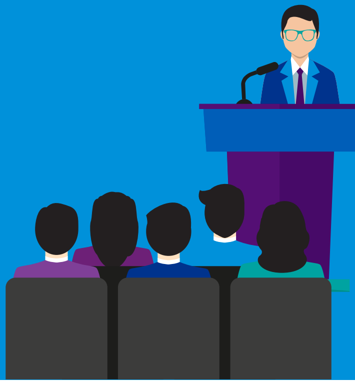
Welcome

01

Series of knowledge sharing calls



02

Covering current and emerging reporting issues

03

Scheduled towards the end of each month

04

Look out for our Accounting and Auditing Update, First Notes and Voices on Reporting publications

Speaker for the webinar

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KPMG in India

Case studies

SEZ reinvestment reserve

Tax holiday: Section 10AA - Special provisions in respect of newly established Units in Special Economic Zones (SEZ).

Eligibility for Section 10AA deduction	In order to claim deduction under section 10AA of the Income-tax Act, 1961 (IT Act) SEZ units are required to satisfy certain specified conditions.
Amount of deduction	The amount of deduction available under this section would be as follows: • First five years - 100 per cent of export profit • Next five years - 50 per cent of export profit • Next five years - Amount not exceeding 50 per cent of export profit. This amount has to be transferred to a SEZ reinvestment reserve account.
SEZ reinvestment reserve account	Section 10AA provides following conditions for utilisation of amount credited in 'SEZ reinvestment reserve account': i. For the purposes of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created and ii. Until the acquisition of the machinery or plant as mentioned above, can be used for the purposes of the business of the undertaking other than for distribution by way of dividends, profits or for remittance as profits outside India, or for the creation of any asset outside India.

Case study 1: SEZ reinvestment reserve

Company X started its operations on 1 April 2010 with a unit set up in SEZ.

X claimed exemption on profits under Section 10AA as per IT Act for 10 years:

- Year 1 to 5 – 100 per cent
- Year 6 to 10 – 50 per cent

In Year 11, as per the requirement of the IT Act, the company claimed a 50 per cent profit exemption to arrive at the taxable income and correspondingly transferred an equivalent amount to the SEZ reinvestment reserve from retained earnings.

Discussion points

- Accounting treatment of the conditional exemption claimed under section 10AA of the IT Act for the units falling under years 11 to 15.
- Plant and machinery eligible for exemption under section 10 AA.

Key considerations

- Assessment of the conditional exemption of Section 10AA of IT Act.
- Evaluation of whether to take the deduction in current period or defer it till actual investments are made.
- Eligible investments as per the requirements of the Section 10AA of IT Act.

The Taxation Laws (Amendment) Ordinance, 2019

Lower tax rates from FY 2019-20

Option of tax rate of 22 per cent

- Option available to **any domestic company** subject to the condition that it will **not avail certain specified deductions/ incentives**.
- Effective tax rate would be 25.17 per cent inclusive of surcharge and cess.
- Not required to pay MAT.

Option of tax rate of 15 per cent

- Applicable to **new domestic manufacturing company incorporated on or after 1 October 2019** and commences **its production on or before 31 March 2023.**
- **Not allowed to avail certain specified deductions/incentive.**
- Effective tax would be 17.16 per cent inclusive of surcharge and cess.
- Not required to pay MAT.

**Specified deductions inter alia, include Special Economic Zone (SEZ) benefit, additional depreciation, including set-off of loses arising from these deductions/incentives.*

Case study 2: Change in tax rates

Company X, an IT Company is in its 12th year of operations.

- The company claims exemption under Section 10AA of IT Act that reduces its effective tax rate from 35 per cent to 20 per cent.
- The company has estimated that for next 3 years, the effective tax rate would be below the concessional tax rate of 22 per cent and hence the shift to the new tax rates would be postponed.
- Based on this estimation, the company calculated its current tax of INR100,000 and deferred tax of INR150,000 at the existing rate of 35 per cent.

Discussion points

- Points to be considered for evaluating the shift to new tax rates.
- Estimation of amount of deferred tax in the above example.

Key considerations

- Evaluation of conditions attached to the concessional rates.
- Management's assessment of the future projections of tax liability.
- Management's evaluation of the temporary differences reversing in the future period at lower tax rates.
- Evaluate the estimate of deferred tax at each balance sheet date.

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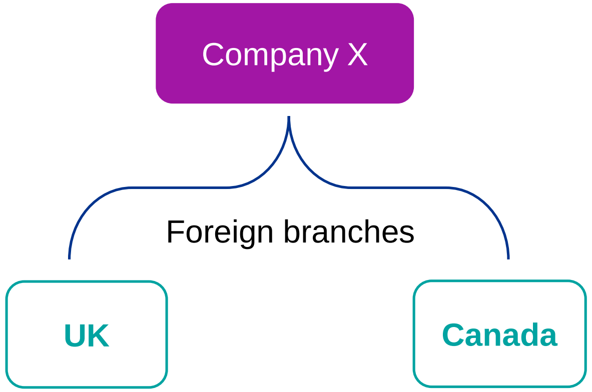
Case study 3: R&D tax credit accounting



The company has claimed the following Research and Development (R&D) tax credit for the financial year 2019-20:

- UK - INR100
- Canada - INR150

Discussion points

- Accounting treatment and classification to be followed to record the R&D tax credits.
- Point of recognition for recording the R&D tax credits in financial statements of company X.

Key considerations

- Identifying countries wherein R&D tax credits can be claimed.
- Assessing the accounting treatment as to whether the credit is received as a cash refund or reduction from tax liability.
- Evaluate the eligible amount based on guidelines issued by the authorities of the foreign countries.
- Evaluate the corresponding impact on foreign tax credit claimed in India tax return.

Case study 4: Interest on tax refunds liability

The closing advance tax or provision for company X, an Indian entity is as follows:

- FY 2016-17: Net advance tax of INR100,000
- FY 2017-18: Net provision for tax of INR10,000
- FY 2019-20: Net advance tax of INR100,000.

The company has accounted for interest expense of INR3,000 on tax provision of FY 2017-18. However, no accounting entry is passed for the interest income of INR8,000 for FY 2016-17 and FY 2019-20.

Discussion points

- Treatment of the interest expense and interest income.

Key considerations

- Interest expense should be accounted for based on management's best estimate.
- Accounting interest income at the time of receipt vs accrual.

Place of Effective Management (POEM)

'A company is said to be resident in India in any previous year, if:
(i) It is an Indian company; or
*(ii) Its **<u>place of effective management, at any time</u>** in that year, is in India.*

CBDT guidelines for determining POEM

CBDT Circular No. 06 of 2017 dated 24 January 2017

The circular deals with Guiding Principles for determination of POEM of a company. The guidance provides various factors that need to be considered such as:

- Active business outside India
- Location criteria – Place where the management decisions are taken
- Location of the board of members or persons taking key decisions
- Location of the head office
- How the board meetings are held.

CBDT Circular No. 08 of 2017 dated 23 February 2017

The circular clarified that the POEM provisions would not be applicable to a company with turnover or gross receipts of INR50 crore or less in a financial year.

Case study 5: POEM

Company X
(Indian company)

Subsidiaries

A (Cost plus entity in USA)

- Provides onsite business support services and cross charges the actual cost incurred plus margin
- Tax rate – 21 per cent
- Net taxable income - INR50 crore

B (Investing entity in Europe)

- No income other than the interest and dividend received from its step-down subsidiary Y
- Tax rate – 25 per cent
- Net taxable income – INR25 crore

Discussion point

- Applicability and accounting of POEM.

Key considerations

- Assess the guidance of circulars issued by CBDT dated 24 January 2017 and 23 February 2017.
- Evaluate active business test outside India.
- Evaluate the place where the key managerial decisions of the company is taken.
- Evaluate whether foreign tax credit would be claimed in India.

Case study 6: Australia royalty taxation

Company X, registered in India carries on business in Australia through a Permanent Establishment (PE).

Contract with Australian customer

Contract
AUD100,000

Bifurcation of services

AUD 60,000
(performed from India)

AUD 40,000
(PE in Australia)

Offered only the net income earned by the services performed in Australia i.e., AUD40,000 to the Australia tax authorities.

Discussion point

- Company X did not offer the income earned on services provided from India for taxation purposes in Australia.

Key considerations

- Evaluation of the terms of the contracts entered by India, serviced from both India and Australia.
- Management's assessment of identifying the components of contracts falling under the *definition of royalty as per Article 7 of the Double Tax Avoidance Agreement (DTAA).*
- Assess the impact on foreign tax credits to be claimed in India for the tax on royalty paid in Australia.

Base Erosion Anti-Abuse Tax (BEAT)

Background

- The Tax Cuts and Jobs Act (TCJA) passed in 2017 introduced BEAT, which partially disallow deductions for payments made towards certain related-party transactions, including payments such as royalties and management fees, but excluding cost of goods sold.
- BEAT only applies to domestic corporations in the US (except S Corporations, Regulated Investment Company (RIC) or Real Estate Investment Trust (REIT)) with annual domestic gross receipts in excess of USD500 million and which have a ‘base erosion percentage’ of 3 per cent or higher, for the tax year. The mark up component paid or accrued to a foreign related party is a base erosion payment.
- BEAT functions like a minimum tax, but unlike the Alternative Minimum Tax (AMT) in the old law, there is no interaction through a credit mechanism with the regular tax system.

BEAT computation

- The BEAT liability is 10 per cent of the taxpayer’s modified taxable income (MTI). MTI is the taxpayer’s taxable income, with the base erosion tax benefit amount added back.
- There are certain exemptions available which should be considered while computing the BEAT liability.

Case study 7: BEAT

P Ltd.
(Indian entity)

100% subsidiary

S Ltd.
(IT Company in USA)

Outsource

Contracts with
end customers

Payment to P Ltd. towards the following:

1. Corporate support services such as HR, finance, marketing, etc. - Cross charged at cost plus 6 per cent
2. Application development services - Cross charged at cost plus 20 per cent
3. ITeS services - Cross charged at cost plus 17 per cent.

Discussion points

- Understand the implications of BEAT on S Ltd.

Key considerations

- Evaluate the applicability of BEAT.
- Determine the nature of transactions that may qualify to be exempt for BEAT purposes.
- Compute the modified taxable income for BEAT purposes, compute the base erosion per cent and the related BEAT liability.

Q&A

Links to previous recordings of VOR

Month	Topics	Link
February 2020 (Special session)	• Significant challenges for technology sector in relation to business combination	Click here
April 2020	• COVID-19: Potential financial reporting impacts	Click here
July 2020	• COVID-19: Key financial reporting considerations for interim reporting • CARO 2020 – Key considerations • Ind AS 116, *Leases* – Exposure draft on COVID-19 related rent concessions issued by ICAI • Additional relaxations provided by the Securities and Exchange Board of India (SEBI) and the Ministry of Corporate Affairs (MCA) amid COVID-19.	Click here
September 2020 (Special session)	• Implementation issues relating to CARO 2020 (Session 1 and 2)	Click here
October 2020	• Key updates on the Companies (Amendment) Act, 2020 • Amendments to Ind AS issued by the Ministry of Corporate Affairs (MCA) • Resolution Framework for COVID-19 related stressed assets issued by the Reserve Bank of India (RBI) • Other key amendments and clarifications issued by MCA and the Securities and Exchange Board of India (SEBI) amid COVID-19.	Click here

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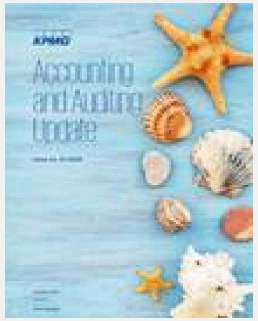
Our publications

Accounting and Auditing Update



First Notes

Coming up next

New issue of:

- Accounting and Auditing Update
- First Notes
- Voices on Reporting - publication

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Voices on Reporting – Quarterly updates publication

Thank you

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