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India Spectrum

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In this issue

Editorial

We are delighted to present another issue of India Spectrum.

The Finance Minister has proposed a string of measures to boost the economy along with the confidence of foreign investors. Not only does he propose to revisit the Direct Taxes Code Bill, he has also put his strength behind the positive recommendations on the General Anti Avoidance Rules (GAAR) in the report released by the Dr Parthasarathi Shome Committee. The guidelines on GAAR are expected to be released by the government by end-October.

In addition, the notification on the Advance Pricing Agreement (APA) Rules providing the manner and mode for the application and administration of APAs is one more step to bring certainty the Transfer Pricing space.

The government announced the much-awaited foreign direct investment (FDI) guidelines in multi-brand retail permitting up to 51% FDI, subject to government approval. The policy allows FDI in multi-brand retail only in select cities with a population of one million or more. Simultaneously, the sourcing restriction under the single-brand retail trade is eased to 30% sourcing to be undertaken from anywhere in India from any Indian enterprise. This was earlier required to be sourced from small scale industries only. On the other hand, the Reserve Bank of India (RBI) cut the cash reserve ratio by 0.25% leading to expectations of banks easing lending rates. Prime lending rates were left untouched due to high inflation.

On the global front, the decision of the German Constitutional court to allow Germany to enter into a European Stability Management Treaty and announce a fiscal pact will help decide the permanent rescue fund plan for the Eurozone. The Eurozone bailout for Spain and Greece is expected to boost the respective economies and affect the world economy positively.

Ketan Dalal

Shyamal Mukherjee

While the RBI has been receiving representations conveying challenges in complying with the original framework, it has issued a framework to regulate non-banking financial company-micro finance institutions. The Securities and Exchange Board of India has also put in place a system to monitor the qualifications contained in the auditors' reports on the financial statements submitted by listed companies.

The Mumbai Bench of Tribunal in the case of Channel Guide India Ltd held that payment for use of transponder facility for uplinking and broadcasting is not taxable in India under the India-Thailand tax treaty, and the amended definition of ruling by the Finance Act, 2012 is not applicable. The Tribunal emphasised that the law cannot compel a person to do something which is impossible and held that the taxpayer cannot be held liable to withhold tax based on a retrospective amendment. One may note that the Delhi High Court in case of Nokia Networks OY recently held that retrospective amendment to domestic tax law would not affect treaty benefit. In another case, the Bangalore Bench of Tribunal in the case of Jeans Knit Pvt Ltd held that mere quality-testing services provided by a non-resident agent cannot be treated as technical or managerial services for the purpose of taxing it as fees for technical services. Please refer to page no 7 for a detailed analysis of these rulings.

We hope you enjoy this issue. As always, we look forward to hearing from you.

Ketan Dalal and Shyamal Mukherjee
Joint Leaders, Tax and Regulatory Services

Analysing tax issues
Corporate tax

Tax treaties

Income not taxable under specific Articles cannot be taxed under the Other Income Article of a tax treaty

The taxpayer, a trader and exporter of seafood, had carried out huge derivative transactions. It had paid consultancy charges to G Ltd (a Singapore-based company) for these transactions.

The tax officer (TO) treated the consultancy charges as fees for technical services (FTS) under section 9(1)(vii) of the Income-tax Act, 1961 (the Act) and disallowed it on the basis that the taxpayer failed to withhold tax on such charges.

On appeal by the taxpayer, the Commissioner of Income-tax (Appeals) (CIT(A)) held that the services rendered did not involve any transfer of technology and hence were not covered within the scope of FTS under Article 12 of the India-Singapore Double Taxation Avoidance Agreement (the tax treaty). Furthermore, since G Ltd had no permanent establishment (PE) in India, its income could not even be taxed as 'business profits' under Article 7 of the tax treaty.

The revenue authorities appealed to the Income-tax Appellate Tribunal (the Tribunal) against the CIT(A) order, contending that since the income of the non-resident is not taxable under Articles 6 to 22, it would be taxable as residuary income under Article 23, which states that residuary income is subject to the domestic laws of the source state.

The Tribunal observed that a service would be taxable as FTS under Article 12 of the tax treaty only if it enables the person acquiring the services to apply the technology. However, in the case of the taxpayer, the services rendered did not involve any transfer of technology and hence could not be taxed as FTS. Furthermore, since G Ltd did not have a PE in India, its business profits were not taxable under Article 7 of the tax treaty.

The consultancy charges are expressly covered under Articles 7, 12 and 14 of the tax treaty and therefore cannot be treated as residuary income under Article 23 of the tax treaty, even though they are not taxable under the specific Articles. Therefore, the Tribunal held that since G Ltd had no taxable income in India, it was not required to withhold tax. Hence, the disallowance was deleted.

DCIT *v.* Andaman Sea Food Pvt. Ltd. [TS-440-ITAT-2012 (Kol)]

FTS/Royalty

Income received as FTS or royalty from an Indian PE assessable as business income under the India-Singapore tax treaty

The taxpayer, a tax resident of Singapore, was rendering certain general, accounting and legal services to its 100% subsidiary in India. The TO held that fees received by the taxpayer from the Indian subsidiary were in the nature of FTS in terms of Article 12(4)(b) of the India-Singapore tax treaty. The TO held that as the taxpayer was providing various support services to its subsidiary in India, the Indian subsidiary constituted the taxpayer's service PE in India. Hence, the fees received were to be taxed as business profits under Article 7 of the tax treaty. Accordingly, the TO treated 25% of the fees as FTS and the remaining amount as business receipts. The CIT(A) upheld the TO's order.

The Tribunal observed that under Article 12(6) of the tax treaty, where an taxpayer has a PE in India, the income from royalty or FTS would be assessed as business profits under Article 7 of the tax treaty and not as royalty or FTS under Article 12 of the tax treaty.

Furthermore, even the TO had held in the assessment order that the Indian subsidiary constituted the taxpayer's service PE in India and therefore the fees received, even though in the nature of FTS, were taxable as business profits under Article 7 of the tax treaty.

ADIT *v.* Bunge Agribusiness Singapore Pte Ltd [2012] 24 taxmann.com 212 (Mum)

No FTS where overseas agent responsible only for quality-testing services

The taxpayer, a 100% exported-oriented undertaking, is engaged in the business of manufacturing and export of garments. The taxpayer appointed S Ltd, a Hong Kong resident, as its agent to render various services such as inspection of material at the time of dispatch and timely supply for the import of fabrics and accessories. The taxpayer made payments to the agent without withholding tax on the basis that the services were not in the nature of FTS.

The TO held that the inspection of fabric requires technical knowledge, skill and experience. Hence, the services rendered by S Ltd were technical in nature. He also held that the services were in the nature of managerial and consultancy services, which are taxable under section 9(1)(vii) of the Act. The TO raised a demand under section 201(1) and levied interest under section 201(1A) for not withholding tax. The CIT(A) upheld the order of the TO.

The Tribunal observed that the agent was responsible only for the shipment of material according to specifications and ensuring timely delivery of goods. Identification of the manufacturer, quality and price was done by the taxpayer, and as the agent was not involved in this activity, its services were not consultancy in nature.

Furthermore, the agent was only responsible for physically inspecting and comparing the quality specified by the taxpayer with the actual order, which required only basic technical knowledge. It did not have to employ any technical personnel to render such services. Lastly, the services were also not managerial in nature since the agent was only acting on behalf of its principal and did not have to apply independent thought in any of the activities. Therefore, it was held that the definition of FTS did not apply to the case and there was no liability to withhold tax.

Jeans Knit Pvt Ltd *v.* DCIT [TS-500-ITAT-2012(Bang)]

Tax withholding

Payment for satellite up-linking and telecasting programmes not taxable as royalty or fees for technical services

The taxpayer-company, a producer and distributor of internet media, had entered into an agreement with S Ltd., a tax resident of Thailand, to use satellite up-linking and telecasting programmes.

The TO held that services rendered by S Ltd. were consultancy in nature within the meaning of FTS as defined in section 9(1)(vii) of the Act. On failure of the taxpayer to withhold tax, the TO disallowed the payment under section 40(a)(i) of the Act.

On appeal, the CIT(A) upheld the order of the TO and alternatively held that since the taxpayer could uplink or downlink the programme signals only by using the scientific equipment owned by S Ltd, consideration for such use was taxable as royalty under Article 12 of the Double Taxation Avoidance Agreement entered between India and Thailand (the tax treaty).

On appeal to the Tribunal, the taxpayer contended the following:

- It had no possession/ control of the equipment and therefore the payments were not for use of or right to use any industrial, scientific or commercial equipment and would not qualify as royalty
- The services availed did not involve imparting any technical know-how by S Ltd and hence cannot be considered as FTS
- In the absence of a FTS clause in the tax treaty, the payments made to S Ltd would be taxable as business income, and in the absence of S Ltd having a permanent establishment in India the consideration would not be taxable in India in accordance with Article 7 of the tax treaty

The Revenue contended the following:

- The up-linking or down-linking of signals was not possible without the taxpayer having control of the transponder and the expression 'process' has been defined by the Finance Act, 2012 in Explanation 6 to section 9(1)(vi) of the Act with retrospective effect and includes up-linking and down-linking of signals.
- In the absence of a FTS clause in the tax treaty, the income would be taxable as other income under Article 22 of the tax treaty.

The Tribunal referred to the case of Asia Satellite Telecommunication Co. Ltd. [TS-29-HC-2011(Del)] wherein it was held that while providing transmission services, the control of the satellite or the transponder always remains with the satellite operator and the customers are merely given access to the transponder capacity. Since the taxpayer had not utilised the process or equipment involved in its operations, the charges paid to S Ltd cannot be treated as royalty under section 9(1)(vi) of the Act. As no technical services were rendered, the question of it being taxable as FTS under section 9(1)(vii) of the Act does not arise.

Payment for services, when not in the nature of royalty or FTS constitutes business income and is covered by Article 7 of the tax treaty. Thus, recourse to Article 22 of the tax treaty cannot be taken since it covers only income not expressly covered by any other Article of the tax treaty.

The Tribunal emphasised that the law cannot compel a person to do something which is impossible to perform. Thus, it was held that the taxpayer cannot be held liable to withhold tax relying on an amendment to the definition of royalty made by the Finance Act, 2012 with retrospective effect. Consequently, the taxpayer was not required to withhold tax on payment made towards satellite up-linking and telecasting programmes.

ACIT *v.* Channel Guide India Ltd. [TS-662-ITAT-2012(Mum)]

Penalty

Time limit for passing penalty order to be considered from the date of original assessment order and not rectification order

The taxpayer, a foreign bank, had conducted a large number of transactions on a ready forward basis in approved as well as unapproved securities. The TO treated the losses incurred by the taxpayer as speculative and held that these could not be set-off against business income. On further appeal, the CIT(A) as well as the Tribunal affirmed the order of the TO. The taxpayer preferred a Miscellaneous Application following the Tribunal's order on some other issues.

In the interim, the TO had initiated penalty proceedings on the basis that the taxpayer had furnished inaccurate

particulars of income relating to ready forward transactions. However, the order levying penalty under section 271(1)(c) of the Act was passed after the disposal of the Miscellaneous Application by the Tribunal.

The taxpayer challenged the penalty order on the basis that it was barred by limitation under section 275 of the Act (i.e. the penalty order has to be passed within six months from the date of the original Tribunal order and not from the date of the Miscellaneous Application order). On appeal, the CIT(A) was of the view that time limit for finalising the penalty order was to be calculated from the date of the Miscellaneous Application order.

On further appeal, the Tribunal, relying on the decision of the SC in the case of CIT v. Alagendran Finance Ltd [2007] 162 Taxman 465 (SC) and the case of Oriental Insurance Co Ltd v. ACIT [ITA No. 212/Delhi/2008], held that the limitation prescribed in section 275(1)(a) of the Act would not extend the time limit until the Miscellaneous Application was disposed of. The Tribunal further held that taking the limitation from the order passed by the miscellaneous application was not according to the law and therefore the penalty order was time-barred.

Hong Kong & Shanghai Banking Corp Ltd *v.* DDIT (IT) [2012] 136 ITD 357 (Mum)

Concealment penalty applicable where the provisions are clear and unambiguous

The taxpayer, a company engaged in the business of providing financial services, earned bill-discounting charges in the year and characterised them as 'interest-others' in its books. These charges were not offered to tax under the Interest-tax Act, 1974, as the taxpayer believed that it was not chargeable to tax.

The TO held that the discounting charges were in the nature of 'interest' and hence were taxable. This was also confirmed by the Tribunal. The TO therefore levied a penalty under section 13 of the Interest-tax Act, 1974, for concealment or furnishing of inaccurate particulars of income.

On appeal, the CIT(A) deleted the levy of penalty and held that there was difference of opinion on treating the discounting charges as interest; hence, no penalty can be imposed. The Tribunal also upheld the order of the CIT(A).

The HC observed that the expression 'interest' defined in section 2(7) of the Interest-tax Act, 1974, includes 'discount on bills of exchange', and hence, the meaning was absolutely clear and unambiguous that interest was taxable. Therefore, it was not a case of bona fide or a plausible different interpretation on the characterisation of the bill-discounting charges to be regarded as 'interest'. Therefore, the HC held that the levy of penalty was justified.

CIT *v.* Fortis Financial Services Ltd. [TS-477-HC-2012 (Del)]

Squaring-off of loans through book entries not liable to penalty

The taxpayer, a public limited company, is a member of the National Stock Exchange (NSE) and also a merchant banker. It was engaged in the business of investment and trading in shares and securities.

The taxpayer had accepted an amount of INR 42.905 million as a loan or inter-corporate deposit from the Investment Trust of India (ITI). During the year under review, the taxpayer transferred 199,300 shares of Rashal Agrotech Ltd to ITI for a consideration of INR 42.90 million. Later on, both the taxpayer and ITI agreed

to set-off this amount in their respective books by way of a journal entry and pay the balance amount by an account payee cheque. Accordingly, the taxpayer paid the differential amount of INR 5,000 by a crossed cheque to ITI.

The TO considered the repayment of loan by way of journal entry as a violation of the provisions of section 269T of the Act (i.e. repayment of loan or deposit in a manner other than by an account payee cheque or an account payee bank draft) and imposed a penalty of INR 42.90 million on the taxpayer under section 271E of the Act.

The HC observed that the expression 'reasonable cause' appearing in section 273B of the Act had wider connotation and was to be construed liberally. It also observed that the set-off of claim or counterclaim in a manner other than by account payee cheque or bank draft was legally permissible in commercial transactions as also in the accounting practice. Furthermore, with regard to the commercial dealings between the parties, there was a reasonable cause for the failure to comply with the provisions of section 269T of the Act; hence, no penalty under section 271E of the Act could be imposed.

CIT *v.* Triumph International Finance India Ltd [TS-400-HC-2012 (Bom)]

Disallowance

No disallowance of interest under section 14A on dividend income earned from shares held as stock-in-trade

The taxpayer, a dealer in shares, had invested in shares of various companies in the assessment year (AY) 2007-08. To finance these investments, it availed an interest-free loan of INR 140 million from Kitchen Appliances Pvt Ltd and paid INR 2.8 million as broking charges for the loan. The taxpayer sold 63% of the shares purchased in the same year and the remaining 37% shares yielded dividend income of INR 4.6 million.

The TO disallowed INR 2.7 million out of the amount paid as broking charges under Rule 8D of the Income-tax Rules, 1962 (the Rules), contending that this part of the expenditure was relatable to the dividend income. The CIT(A) confirmed the order of the TO.

The Tribunal held that the broking charges should be divided between expenses relating to business purposes and expenses for earning dividend income and allowed in accordance with law.

The taxpayer filed an appeal with the HC, contending that income from sale of 63% was offered to tax as business income and only the 37% shares remaining unsold yielded the exempt dividend income. No expenditure was incurred for earning the said dividend income and accordingly, no expenditure could be attributed to the dividend income.

The HC held that when no expenditure has been incurred by the taxpayer in relation to earning dividend income, no notional expenditure could be deducted. Furthermore, the HC held that in this case, shares were not retained with the intention of earning dividend income and that the dividend income is incidental to business. Accordingly, the expenditure cannot be apportioned to the extent of dividend income and no disallowance under section 14A of the Act can be made.

CCI Ltd. *v.* JCIT [2012] 250 CTR 291 (Kar)

Deemed dividend

No deemed dividend on loan provided by a subsidiary to a holding company diverted to another subsidiary in the ordinary course of business

The taxpayer, a private limited company, was

mainly functioning as the holding company of a number of 100% subsidiary companies. The taxpayer had received loans from its wholly-owned subsidiaries during the year. The TO, during the course of assessment proceedings, held that the loans from the subsidiaries were in the nature of a deemed dividend under section 2(22)(e) of the Act and therefore liable to be taxed. The CIT(A) upheld the TO's order. Aggrieved by the decision of the CIT(A), the taxpayer filed an appeal before the Tribunal.

The Tribunal observed that, in its status as a holding company, the taxpayer was also managing the financial affairs of its subsidiaries. The taxpayer was monitoring the inflows and outflows of the subsidiary companies in its attempt to utilise the funds available to the maximum advantage of the group companies. The taxpayer as a holding company, in exercising management and control over its subsidiaries, would quite naturally monitor all activities of the subsidiaries, including treasury matters. The Tribunal also observed that when a holding company was carrying out business in the aforesaid manner, it would be necessary for the taxpayer company to arrange for long-term and short-term funds for the purpose of carrying out the business of its fully owned subsidiaries. The Tribunal observed that one of the methods of arranging the finances was by re-distributing the funds available with some of its subsidiaries to other subsidiaries.

The Tribunal further observed that the taxpayer company had neither received any benefit out of the loans, nor had it retained those funds for its own activities. All the loans had been re-distributed to the subsidiaries.

In light of the above facts, the Tribunal held that it was not proper for the lower authorities to hold that these routine transactions undertaken by the taxpayer as a holding company are in the nature of deemed dividend under section 2(22)(e) of the Act.

Farida Holdings (P.) Ltd *v.* DCIT [2012] 51 SOT 452 (Chennai)

Income from house property

Rental income not taxable as business income merely because unsold flats were treated as stock-in-trade in wealth-tax proceedings

The taxpayer, a property developer and a builder, constructed a building for sale. During the year under consideration, the taxpayer had disclosed rental income from unsold flats under the head 'income from house property' and had claimed statutory deduction on account of repairs.

The TO disallowed the claim of the taxpayer and treated the rental income as business income on the basis that the taxpayer had, under the wealth-tax proceedings, pleaded that the unsold flats were stock-in trade of its business. The TO hence disallowed the statutory deduction claimed by the taxpayer.

The CIT(A) upheld the order of the TO. On further appeal, the Tribunal reversed the order of CIT(A).

On appeal, the HC held that the various sections of the Act are mutually exclusive and when a particular income falls under a specific head, it has to be charged under that head and nowhere else. The HC observed that the ownership of the unsold flats was still with the taxpayer and was not transferred to the buyer. As the rental income earned by the taxpayer was primarily from letting of property, the income ought to be taxed under section 22 of the Act under the head 'income from house property'.

Azimganj Estate Pvt Ltd *v.* CIT [2012] 206 Taxman 308 (Cal)

Unrealised loss

Unrealised loss on valuation of an interest rate swap contract is tax deductible in the year of accrual and not the year of actual settlement

The taxpayer, a dealer in interest-bearing securities, had claimed a deduction in respect of valuation loss incurred in respect of interest rate swaps. The TO held that the loss on valuation of interest rate swaps was a contingent liability and therefore would not be deductible while computing the taxpayer's business income. The CIT(A) confirmed the TO's order.

On further appeal, the Tribunal held the following:

- The valuation of an interest rate swap as on the balance sheet date indicates the computation of profit or loss as on that date.
- The loss on the valuation of interest rate swaps as on the balance sheet date was to be squared up by a transfer to the actual profit or loss on settlement.
- Anticipated losses and anticipated profits were not treated in the same manner while computing business profits. An anticipated loss, even if not crystallised in the relevant previous year, was to be allowed as a deduction while computing business profits.
- In the case of DCIT *v.* Bank of Bahrain & Kuwait [2010] 41 SOT 290 (Mum), the Tribunal had held that loss incurred on the valuation of a forward contract due for maturity subsequent to the end of the accounting period would be allowable.
- The real issue was not about the deductibility of the loss but only about the year of the deduction. Hence, the loss computed in relation to the variation as at the end of the relevant financial year (FY) would be deductible in the relevant FY only.

ABN Amro Securities India Pvt Ltd *v.* ITO [ITA No.264/Mum/2008]

Treatment of investment as stock according to regulatory directions irrelevant for tax purposes

The taxpayer, a bank, had claimed a deduction for the loss on revaluation of securities classified as permanent assets for AY 1993-94. The investment in the securities was under the Reserve Bank of India (RBI) instructions, which required the taxpayer company to invest a minimum percentage of its total deposits in such securities. The taxpayer had claimed that the securities were held as stock-in-trade and hence should be valued at cost or market value, whichever is lower.

The TO rejected the taxpayer's claim since the securities were held as investments and not as stock in-trade. On appeal, the CIT(A) agreed with the TO's view. On further appeal, the Tribunal held that the taxpayer was entitled to the claim the loss as business loss.

Before the HC, the taxpayer stated that the RBI had instructed banks to treat the securities held as stock-in-trade and treat the loss thereon as loss on account of stock. The HC, relying on the judgement in the case of Southern Technologies Ltd *v.* JCIT [2010] 320 ITR 577 (SC), held that the directives issued by the RBI cannot have a bearing on the provisions of the Act. The HC further held that goods or securities do not get the character of stock-in-trade merely because they were so designated, unless they were so held as part of the trading stock, and the taxpayer treated them as such.

In view of the above, the taxpayer's claim for deduction of revaluation loss on investments was rejected by the HC.

CIT *v.* ING Vysya Bank Ltd [TS-449-HC-2012 (Kar)]

Personal taxes
Assessing personal tax

Case laws

Salary/perquisite

Furnishing of PAN not mandatory for persons with income below the threshold limit of tax

The assessee, a small investor, had earned interest on deposits. Since, the total income of the assessee did not exceed the taxable limit, she submitted Form-15G under section 197A of the Act with the payer for non-withholding of tax under section 193 of the Act. The payer insisted that the assessee submit her PAN with Form 15G of the Act under the provisions of section 206AA of the Act.

The assessee filed a writ petition with the HC on the basis that small investors having income below the taxable limit should not be compelled to obtain a PAN under section 260AA of the Act, as it causes them undue hardship.

The HC observed that the intention behind the introduction of section 206AA of the Act was to make it mandatory for every person to obtain a PAN when he/she proposes to enter into any transaction with any bank or financial institution. Therefore, persons with no taxable income were also required to obtain PAN so as to avoid tax withholding. The HC further observed that the requirement of section 206AA of the Act is contrary to section 139A of the Act which requires obtaining of a PAN only if income exceeds the taxable limit.

Therefore, the HC held that in view of the specific provisions in sections 139A of the Act, the provisions of section 206AA of the Act would be inapplicable to persons with income less than the taxable limit. Therefore, the assessee, whose income was less than the taxable limit, was not required to obtain a PAN. Hence, banking and financial institutions should not insist on the assessee to furnish the same.

A Kowsalya Bai & Ors *v.* UOI [TS-416-HC-2012 (Kar)]

Capital gain reinvested in house property exempt if reinvestment done before extended due date of submitting tax return

In a recent decision, the Chennai bench of the Tribunal held that the amount utilised/invested for acquiring a new residential house is eligible for deduction under section 54F of the Act if done by the due date within which the belated tax return is required to be submitted under section 139(4) of the Act.

In this case, the assesssee derived long-term capital gains from the sale of shares during AY 2008-09. It invested the capital gains in acquiring a residential flat and claimed relief under section 54F of the Act. During the course of assessment proceedings, the TO noted that the due date for submitting the tax return was 31 July 2008. The agreement to acquire new property was executed on 19 September 2008, i.e. after the due date for filing of return of income. Hence, the assessee was denied the deduction under section 54F of the Act. On first appeal, the CIT(A) granted only part deduction of INR 0.3 million paid before the due date of filing return of income.

Before the Tribunal, the assessee argued that it had not filed its return of income for AY 2008-09 within the time as allowed under section 139(1) of the Act. However, it was eligible to file a belated tax return up to 31 March 2009, which was the extended due date under section 139(4) of the Act. Accordingly, it filed the return on 9 January 2009. The assessee contended that it was entitled to exemption under section 54F of the Act, to the extent of the amount paid to the builder for acquiring the property on 31 March 2009 (i.e. INR 1.5 million).

The Tribunal observed that deduction under section 54F of the Act can be claimed if the net consideration which

was not utilised by it for the purchase or construction of a new asset before the date of furnishing the return of income under section 139 of the Act was deposited in an account in any such bank or institution as may be specified in, and utilised in accordance with any scheme which the central government may frame in this regard. Accordingly, the Tribunal held that the amount utilised by the assessee for purchase of a new residential house before the actual date for filing a tax return (i.e. 9 January 2009) qualified for relief under section 54F(1) of the Act.

R.K.P. Elayarajan *v.* DCIT [TS-422-ITAT-2012 (Chny)]

Structuring for companies
Mergers and acquisitions

Case laws

Subvention assistance by holding company to fund losses of subsidiary not taxable

The assessee is a subsidiary of a German holding company (H Co) and engaged in the business of housing finance. During the year, the H Co provided financial assistance to recoup the substantial losses expected to be suffered by the assessee out of its business activity.

The TO taxed the amount of financial assistance as revenue receipt on the basis that it would assist the assessee in continuing its business operation. The CIT(A) held that since the receipt does not fall under section 28 of the Act, it was not taxable.

The Tribunal reversed the order of the TO. It relied on the decision in the case of Handicrafts & Handloom Export Corporation of India *v.* CIT [1983] 140 ITR 532 (Del), and held that a grant by H Co is in the nature of a gift or voluntary payment and does not emerge from any business considerations.

On further appeal, the HC relied on the decision in the case of CIT *v.* Ponni Sugars and Chemicals Ltd [2008] 306 ITR 392 (SC), where it was held that the treatment of subsidy is based on the purpose for which it was received. The financial assistance would not be taxable where the real purpose of rendering the assistance was to protect the investment or to ensure that the liabilities do not adversely implicate the accounts of the subsidiary company. Therefore, the HC upheld the Tribunal's order and held that financial assistance received by the subsidiary was not taxable as a revenue receipt.

ACIT *v.* Deutsche Post Bank Home Finance Ltd [TS-606-ITAT-2011 (Del)]

Sale of business as a going concern taxable as 'capital gains' and not business income

The assessee, an individual, was engaged in the business of providing civil engineering consultancy. The business of the assessee was taken over by a company on a 'going concern' basis with all assets and liabilities for a consideration. According to the agreement, the sale was made for a lump sum consideration, without assigning value to individual assets.

The assessee offered the gains on slump sale as long-term capital gains under section 50B of the Act. However, the TO contended that the consideration received was taxable as business income under section 28(v)(a) of the Act, as the assessee had received a 'compensation' for 'not carrying out any activity in relation to business'. The TO highlighted the terms of the agreement wherein the assessee was to work exclusively as a director of the purchasing company for a minimum period of five years and was not allowed to carry out any activity or business related to the business of company.

The Tribunal observed that the business was sold as a 'going concern' and all documents such as the agreement, disclosure in accounts, etc. indicated the fact of slump sale for a lump sum consideration. The Tribunal held that the consideration received is not for agreeing to not carry out any business activity, but for transfer of business itself for a lump sum consideration and was thus taxable as a capital gain.

The Tribunal also stated that the TO has not argued that the agreement was not made at an arm's length basis or that the transaction was collusive. Therefore, the attempt by the TO to rewrite the agreement was wholly impermissible in law and unwarranted in light of the unambiguous terms of the agreement.

ACIT *v.* Sangeeta Wij [TS-397- ITAT-2012 (Del)]

Pricing appropriately
Transfer pricing

Case laws

Prelude

The Finance Act, 2011, had proposed to come up with an allowable variation for different business activities and types of transactions. Since then, taxpayers had been keenly awaiting the government's notification in this regard for FY 2011-12. The Central Board of Direct Taxes (CBDT) very recently issued notification no. 31/2012 [F.NO. 500/185/2011-FTD I] dated 17 August 2012, maintaining the tolerance band of 5% for FY 2011-12. A summary of the notification is included here.

While on the subject, it is pertinent to mention that the prime minister has constituted a committee consisting of experts from the revenue department to review the taxation of development centres and the information technology sector. The committee will engage in consultations with stakeholders and related government departments to finalise the safe harbour provisions announced in the Budget 2010 for each sector. It will also suggest the approach towards the taxation of development centres. The committee is expected to come out with the first draft for discussion or suggestions by the end of September 2012 for public comment and final provisions by the end of December 2012. The recommendations of this committee will likely form the basis for the notification of the allowable variation, which is limited to 3% in terms of the Finance Act, 2012 (applicable for FY 2012-13 and beyond).

Continuing from our previous publication, we have summarised the observations of the various tax tribunals across the country on the various transfer pricing cases. It is heartening to observe that the tribunals, in their recent rulings, emphasised the need to consider transfer pricing cases in light of business expediency, materiality and economic circumstances.

CBDT - computation of arm's length price: Notified percentage under second proviso to section 92C(2) of the Act

Prior to the Finance Act, 2011, the second proviso to section 92C(2) of the Act provided for a tolerance band of 5% with respect to the arithmetic mean for the purpose of computing the arm's length price (ALP). The Finance Act, 2011, which was effective from FY 2011-12 AY 2012-13 replaced this tolerance band of 5% with variable percentages for different industries to be notified by the central government from time to time.

In exercise of the powers conferred by the second proviso to section 92C(2) of the Act, the government stipulated that where the variation between the ALP determined under section 92C of the Act and the price at which the international transaction has actually been undertaken does not exceed 5% of the latter, the price at which the international transaction has actually been undertaken shall be deemed to be the ALP for AY 2012-13.

Notification no. 31/2012 [F.NO. 500/185/2011-FTD I], dated 17 August 2012

Economic adjustments while computing comparables is permissible.

The assessee is in the business of providing IT enabled services to its parent company. During the course of assessment proceedings, while determining the ALP, the transfer pricing officer (TPO) was of the opinion that the economic adjustments made to the profit level indicators (PLIs) were not permissible. Also the comparables chosen by the assessee were not close comparables. Based on

this, the TPO proposed an adjustment to the transfer price of the assessee. The Dispute Resolution Panel (DRP) upheld the adjustment proposed by the TPO. Aggrieved, the taxpayer appealed before the Tribunal.

The Tribunal, ruling in favour of the taxpayer, held the following:

- Transfer pricing is to compare like with like and eliminate differences with suitable adjustments. There was sufficient evidence to demonstrate material differences on account of depreciation. Hence adjustments on account of difference in depreciation were warranted. But since it was a factual aspect, it was restored back to the TO to carry out the requisite verification.
- The reason for lower profit margins was due to the start-up costs not fully recovered in the present year itself. The capacity utilisation carried out by the assessee was not satisfactory but its profitability was benchmarked against well-established companies.
- The plea set up by the assessee for economic adjustment on account of capacity utilisation was neither unreasonable nor new to the mechanism of transfer pricing assessments. Hence, the matter required factual appreciation and this was remanded back to the file of the TO.
- Section 92C(2) of the Act had been amended by the Finance Act 2009, with effect from 1 October 2009. Since there was no clear intention of it being retrospective in nature, it would apply to AY 2009-10 and subsequent years thereon. Hence, the TPO was not justified in denying the benefit of +/- 5% to the assessee during the course of assessment proceedings.

Amdocs Business Services Pvt Ltd *v.* DCIT [TS-537-ITAT-2012 (Pun)]

Editor's note: *This case has been argued by the PwC Litigation team.*

A controlled transaction cannot be taken as comparable for determining ALP

The assessee is a multi-discipline engineering company engaged in activities such as turnkey contracts, feasibility studies, engineering design services and supervision services. The assessee's fully-owned subsidiary derived its total revenue from transactions with its associate enterprise (AE). During the course of assessment proceedings, the transactions of the subsidiary with its AE were considered to be at ALP by the TPO. During FY 2004-05, the assessee had rendered services to its group companies. The assessee computed ALP by applying the transactional net margin method (TNMM) using operating profit to cost as PLI. The TPO rejected the comparable companies on the basis that they were functionally different at the entity level. The TPO further held that the assessee's subsidiary was an appropriate internal comparable as its transactions were adjudicated to be at arm's length. On appeal, the CIT(A) disapproved the selection of the assessee's subsidiary as comparable. Aggrieved, the revenue department filed an appeal before the Tribunal.

On appeal, two of the Tribunal members differed on the treatment of the subsidiary as comparable. The third member held as follows:

- Under the TNMM, comparison is to be made with the profit from a comparable uncontrolled transaction. The word 'comparable' may encompass an internal or external comparable. In any case, such comparable must be that of uncontrolled transaction or a number of such uncontrolled transactions. Thus, an internal comparable uncontrolled transaction was found to be more acceptable than an external comparable.
- An uncontrolled

transaction has been defined to mean a transaction between enterprises other than AEs whether resident or non-resident. Thus, if the transaction is between two AEs, it goes out of the ambit of 'uncontrolled transaction'.

- When the provisions of the Act are read harmoniously with the rules, it is clear that in computing the ALP under the TNMM, a comparison of the assessee's net profit margin from international transactions with its AEs has to be compared with that of the net profit margin realised by the same enterprise or an unrelated enterprise determined from an uncontrolled transaction, i.e. a transaction between non-AEs.
- There is no statutory sanction for considering a comparable controlled transaction for the purposes of benchmarking. Thus, a comparable controlled transaction cannot be employed for the purposes of making such a comparison. The prescribed methodology provided by the statute or rules cannot be diluted when such prescription itself serves the ends of justice properly and is infallible.
- The view of the revenue department that a controlled transaction should be considered for the purposes of determining the ALP would render the relevant provisions contained in Chapter X of the Act unnecessary.

Tecnimont ICB Pvt Ltd *v.* ACIT [TS-91-ITAT-2011 (Mum)]

Transfer pricing adjustment will be restricted to international transactions only.

The assessee company is engaged in rendering information IT/ITES services to its AEs and third parties. The assessee had adopted the TNMM for the purpose of determining the ALP. The assessee established the arm's length nature of its transactions on the premise that the operating mark-up on cost earned by it from AEs was higher than that earned from transactions with third parties. However, during the course of assessment proceedings, the TPO had taken a position that the cost allocations between the AE and the third party segment were not submitted by the assessee during assessment proceedings. Therefore, the profit margins earned by the assessee in these two segments could not be relied upon. The TPO carried out a fresh search for comparable companies and re-computed the mark-up thereby proposing an adjustment to the transfer price of the assessee. The DRP upheld the adjustment, aggrieved by which the assessee appealed before the Tribunal.

On appeal, the Tribunal ruled as follows:

- The TPO and the DRP did not comment on the allocation methodology of revenue and costs between the AEs and the third party as was submitted by the assessee. Hence this implied that they were in agreement with the allocation methodology.
- The TPO was not justified in proposing an adjustment on the total transaction value as the adjustment was to be restricted only to the assessee's international transactions with its AEs.
- Without getting into the argument on comparables selected by the TPO, it was held that since the ALP determined by the TPO was within the +/- 5% range, the transaction was held to be at arm's length.
- The Tribunal deleted the transfer pricing adjustment proposed by the TPO.

Lionbridge Technologies Pvt Ltd *v.* DCIT [TS-620-HC-2011(Bom)]

Additional grounds of appeal by the assessee accepted, forex gain or loss will be considered relevant while computing gains and losses of operating margins.

The assessee had filed an application before the Tribunal requesting the submission of additional grounds of appeal relating to the exclusion of a few comparables from the list of comparables included in the order of the CIT(A).

On appeal, the Tribunal held the following:

- Relying on the SC decision in the case of National Thermal Power Corporation Ltd, it was held that additional grounds can be raised by the assessee at any stage of an appeal process. Therefore, the abovementioned grounds were admitted.
- On the matter of foreign exchange (forex) gain or loss, relying on the principle decided in the assessee's own case for AY 2003-04, it was held that forex gain or loss should be considered as an operating item. Hence, it should be considered while determining the operating profit margins of comparable companies.
- On risk adjustment, relying on the case of Intellinet Technologies India Pvt Ltd, the matter was remanded back to the file of the TO for fresh adjudication, to decide on the percentage of risk adjustment taking into account all relevant material.
- On the exclusion of supernormal profitmaking companies, it was acknowledged that the assessee had demonstrated reasons to exclude companies making supernormal profits. However, since the assessee himself had admitted that these rulings were not available to the TPO when the assessment was framed, the matter was remanded back to the file of the TO or TPO.

SAP Labs India Pvt Ltd *v.* ACIT [TS-657-ITAT-2011(Bang)]

Comparables with abnormally high operating margins chosen by the TPO were rejected based on further qualitative analysis

Exchange difference loss to be captured under the purview of non-operating expenses

The assessee was engaged in manufacturing as well as the import and export of diamonds. The assessee had purchased diamonds from its AEs. During the course of assessment proceedings, the TPO accepted the transaction of purchases to be at arm's length. However, for the transaction involving the sale of cut and polished diamonds to AEs, the TPO carried out fresh comparability analysis thereby adjusting the transfer price of the assessee. The adjustment made by the TPO was challenged by the assessee before the CIT(A) where the CIT(A) reworked the ALP eliminating companies earning abnormal profit margins. As the difference between the ALP so worked out by the CIT(A) and the sales shown by assessee was less than the safe harbour limit of 5%, the entire adjustment made was deleted. Aggrieved, the revenue appealed before the Tribunal.

On appeal, the Tribunal ruled the following:

- Taking into effect the exchange difference wrongly included by the TPO in the operating cost of assessee's sales, the difference between the ALP of sales and the sales value as reported by the assessee was less than the safe harbour limit of 5%. Hence, no TP adjustment was required.
- With regard to the comparables chosen by the TPO, it was held that the CIT(A) was fully justified in excluding this for the purpose of comparative study.

Hence, the Tribunal upheld the order of the CIT(A), thereby ruling in favour of the assessee.

ACIT *v.* D.A. Jhaveri [TS-441-ITAT-2012 (Mum)]

Editor's note: There have been recent rulings wherein the Tribunal has adopted differing views in respect of the treatment of forex gain or loss as being part of operating expenses. However, the treatment of forex gain or loss as being an operating item is dependent on who bears the risk of forex fluctuation in a particular transaction. Based on the risk profile of the entities in a transaction, it would be prudent to decide on the operative nature of the forex gain or loss.

In the course of international transactions, the assessee had to pay AEs a higher price in respect of a few items only on account of minimum order quantity restrictions and no adjustment was required to the ALP determined by the assessee

The assessee is engaged in the manufacturing of lingerie for women. The AEs of the assessee were giving designs, placing orders, supplying raw materials substantially and finally purchasing its products. During the course of assessment proceedings, the TPO was of the opinion that there were certain differences in price between similar items purchased by the assessee from non-AEs and AEs. The TPO noted that the assessee had purchased 35 different items from the same AE during the relevant previous year and there was only a difference in price which gave advantage to the AE in six instances. The TPO determined the ALP for purchases effected from AEs in respect of six items, thereby proposing an adjustment to the transfer price of the assessee. The DRP confirmed the adjustment proposed by the TPO. Aggrieved, the assessee filed an appeal before the Tribunal.

On appeal, the Tribunal ruled as follows:

- The assessee had purchased materials falling under 35 item codes from AEs, of which material under six item codes alone were considered for analysis by the TPO. The other 29 items were found to be appropriately priced since no ALP revision was recommended for such items. In such a scenario, it was difficult to believe that the assessee had indulged in a pricing methodology to benefit its AEs with regard to the purchase of material falling in six item codes.
- It was an undisputed fact that the assessee had a substantial volume of international transactions with its AEs except for the six items which were priced higher due to minimum order requirements.
- The AEs of the assessee were providing the designs, placing orders, supplying raw materials substantially and finally purchasing the product. In such a scenario, if the assessee had an intention to price the products and purchases so as to give undue benefits to its AEs outside India, then the assessee could have done so in other voluminous transactions entered into with the AEs.
- The rules clearly mandate adjustment of prices for the difference that could materially affect market prices.
- Even otherwise, if the other material falling under the other item codes purchased from the very same AEs were also considered, in all probability, it would have wiped out the advantage that the assessee derived from any possible overpricing on materials falling in six item codes purchased by it.
- A business person might purchase a number of items from the same person, and he or she

might elect to pay more on some of the items, when he or she finds that on many other items, he or she is getting a benefit due to lower prices. Here, the TPO and the TO stepped into the shoes of the assessee to decide on which items it should pay more and in which items it had paid more, ignoring those items on which it had paid less.

- In the circumstances of this case, where out of 35 items only six were selected to reach an adverse finding, it was opined that the authorities were not right in taking a narrow view without considering the total volume of transactions the assessee had with its AEs.
- Therefore, the addition on account of revision in ALP was not justified and hence the addition for both the years was deleted.

Intimate Fashions (India) Pvt Ltd *v.* ACIT [TS-453-ITAT-2012 (Chny)]

Taxing of goods and services
Indirect taxes

Case laws

VAT, sales tax, entry tax and professional tax

UP tax on entry of goods into Local Areas Act, 2007 held as constitutionally valid

The Allahabad HC relying on the decision in the matter of ITC Ltd v. State of UP [2012] 48 NTN 1, has upheld the constitutional validity of UP tax on entry of goods into the Local Areas Act, 2007.

International Print-O-Pac Ltd v. State of UP [2012] 49 NTN 82 (All)

Jharkhand entry tax on Consumption or Use of Goods Act, 2011, held as unconstitutional

The Jharkhand HC has held that the Jharkhand entry tax on Consumption or Use of Goods Act, 2011 was enacted without the sanction of the President of India under the proviso to Article 304(b) of the Constitution of India and is therefore beyond their power and unconstitutional.

Tata Steel Ltd v. State of Jharkhand [2012] 51 VST 82 (Jharkhand)

Notification/ circular

Amendments notified under Delhi VAT Act, 2012

The following changes have been notified under Delhi VAT Act, 2012:

- The threshold limit for submitting audit reports has been increased to INR 6 million as against the earlier limit of INR 4 million.
- Input tax credit reversal of 2% has been prescribed for inter-state sales made against Form C.

Notification no. 3(4)/ Fin (Rev-I)/2012-13/DS III/461-462 dated 21 June 2012

Case law

CENVAT

CENVAT credit cannot be denied on capital goods used initially in manufacturing exempted goods.

The Karnataka HC has held that CENVAT (central value added tax) credit on capital goods used for the manufacture of a dutiable and exempted final product cannot be denied merely because in the beginning such capital goods were used in the manufacture of exempted goods only.

CCE v. Kailash Auto Builders Ltd [2012] 280 ELT 949 (Kar)

Notification/ circular

New procedure and conditions prescribed for refund of CENVAT credit against exports

The central government has prescribed a new set of procedures, conditions, safeguards and limitations for claiming the refund of CENVAT credit under Rule 5 of the CENVAT Credit Rules, 2004.

Notification no. 27/2012-CE (N.T.) dated 18 June 2012

Case law

Service tax

Value of room rental cannot be included for levying tax under mandap keeper service.

The Delhi Customs, Excise and Service Tax Appellate Tribunal (CESTAT) has held that the amount of room rental recovered by the hotel for letting rooms to customers, who might also organise functions in the hotel, cannot be included in the value for levying service tax under mandap keeper services.

Rambagh Palace Hotels Pvt Ltd v. CCE [2012] TIOL 673 (Jaipur)

Notifications/ circulars

Implementation of 'negative list' concept of service taxation with effect from 1 July 2012

The 'negative list' concept of service taxation introduced by the Finance Act 2012 has been made operative with effect from 1 July 2012. A series of notifications has been issued to bring about the following changes in the scheme of service taxation:

- Earlier provisions related to the classification of services under the section 65 and 65A of the Finance Act 1994 has been made inoperative.
- All services except the 17 services enlisted under section 66D 'negative list' of services will be taxable.

- Exemption in relation to R&D cess on the import of technology granted by notification no. 14/2012 – ST – 17 March 2012 will be available.

Notification nos. 18, 19, 20, 21, 22 & 23/2012 – ST all dated 5 June 2012

Mega exemption notification will be effective from 1 July, 2012

The Central Board of Excise and Customs (CBEC) has notified the new mega exemption notification effective from 1 July 2012 in suppression of post budget 2012 mega notification - 12/2012 – ST issued on 17 March 2012, to provide exemption to 39 services as against 34 services listed earlier. The new list includes exemption for:

- Sub-contractors providing works contract services to a contractor who is exempt
- Services by way of transfer of a going concern

Notification no. 25/2012 – ST dated 20 June 2012

Implementation of place of provision of Services Rules 2012 with effect from 1 July 2012

The CBEC has notified the place of provision of Services Rules, 2012 effective from 1 July 2012, which determines the place of provision of service depending on the nature and description of service. These rules supersede the previous Export of Services Rules and Import of Services Rules.

Notification no. 28/2012 – ST dated 20 June 2012

Case laws

Customs/foreign trade policy

Value of software includible in assessable value of hardware in the case software is pre-loaded on hardware

The Bangalore CESTAT has held that the value of software is to be included in the value of the hardware, in the case software is pre-loaded on hardware to arrive at the assessable value for the purposes of levy of customs duty. The duty so levied will be according to the rates applicable to the hardware.

Bharti Airtel Ltd v. CC [2012] TIOL 746 (Bang)

EOU given special dispensation from levy of VAT/sales tax will not be entitled to exemption from SAD on DTA clearances.

The Delhi CESTAT has held that in the case where an export oriented unit (EOU) has been given special dispensation by the State government from levy of VAT/sales tax, such units will not be entitled to exemption from special additional duty (SAD) on domestic tariff area (DTA) clearances. This is on the basis that such units do not fulfill the condition of exemption notification, which stipulates that to avail exemption from SAD, the said goods should not be exempted from payment of VAT/sales tax.

American Power Conversion Pvt. Ltd. v. CCE [2012] 280 ELT 139 (Delhi)

Customs duty cannot be demanded from transferee of advance authorisation in the case of breach by the original license holder

The Mumbai CESTAT has held that customs duty cannot be demanded from the transferee in the case the original advance license holder has contravened any provision of the notification covering the said scheme.

Consumer Plastics Pvt. Ltd. v. CC [2012] TIOL 729 (Mumbai)

Notifications/ circulars

Customs authorities to enhance number of bills of entry for post-clearance audit at customs houses other than for ACP importers

The central government has clarified that since presently on-site post-clearance audit (OSPCA) covers Accredited Client Programme (ACP) importers alone, the percentage of bills of entry for other importers selected for post customs audit at customs house should be suitably enhanced. This step of the government seeks to safeguard revenue interest until such time OSPCA's coverage is extended to all importers.

Circular No. 15/2012 dated 13 June, 2012

Electronic bank realisation certificate system introduced to facilitate trade for claiming benefits under various schemes of free trade policy

The Central government has introduced an electronic bank realisation certificate (e-BRC) system to facilitate the trade for claiming benefits under various schemes of free trade policy. The submission of a physical copy of BRC will not be mandatory after 4 July 2012.

Public Notice No. 02 (RE/2012) /2009-14 dated 5 June 2012

Following the rulebook
Regulatory developments

FEMA

Scheme for prepayment/ buyback of foreign currency convertible bonds: Approval route

The RBI has once again opened the window for Indian companies, enabling them to buyback foreign currency convertible bonds (FCCBs). This window can be accessed under the approval route and needs compliance with the following key conditions:

- The buyback value of the FCCBs shall be at a minimum discount of 5% on the accreted value.
- In the case the Indian company is planning to raise a foreign currency borrowing for buyback of the FCCBs, all FEMA rules/regulations relating to foreign currency borrowing shall be complied with.
- The Indian company would need to submit external commercial borrowings (ECB) return and a report giving details of buyback after completion of buyback.
- The Indian company has the right to initiate prepayment, which would be subject to the bond holder's consent.
- Bonds purchased from the holders must be cancelled and cannot be re-issued/ re-sold.
- The Indian company must open an escrow account for buying back the FCCBs.
- Entire process of buy back should be completed by 31 March 2013.
- Source: A.P. (DIR Series) circular no.1 dated 5 July 2012

Relaxation of ECB norms for refinancing of outstanding rupee loans availed by manufacturing and infrastructure sector borrowers

Specified eligible borrowers in the manufacturing and infrastructure sectors which have earned foreign exchange during the past three FYs and are not on the default/caution list of the RBI have been permitted to avail ECB under the **approval route** for refinancing outstanding rupee loans availed from the domestic banking system and which were utilised for incurring capital expenditure and/or fresh rupee capital expenditure. The borrower would need to comply with the following key conditions:

- Entire amount should be drawn down within one month of obtaining the loan registration number.
- ECB liability (prinicipal+interest) should be repaid only out of foreign exchange earnings.

The overall ceiling for all specified eligible borrowers is 10 billion USD and the individual corporate ceiling is 50% of the average annual export earnings during the past three FYs.

Existing facility for repayment of rupee loans availed for capital expenditure (as tabulated below) by raising fresh ECB will continue to be available to companies in the infrastructure sector.

Resident foreign currency accounts

The RBI has withdrawn the following recent restrictions placed on resident foreign currency (RFC) account holders:

- RFC account holders were required to surrender 50% of their forex earnings for conversion to rupee balances. Going forward, they would be able to credit 100% of their forex earnings into the RFC account.
- RFC account holders were required to purchase foreign exchange only after fully utilising the available balances in the RFC accounts. Thus, fresh foreign exchange could be purchased pending utilising of balances in the RFC account.

Source: A.P. (DIR Series) Circular No.8 dated 18 July 2012

Sector	Utilisation of fresh ECB proceeds	
	Refinancing of rupee loan (for capital expenditure) availed from domestic banking system	Fresh capital expenditure
Power sector companies	Up to 40%	At least 60%
Infrastructure sector companies (other than power sector)	Up to 25%	At least 75%

Note: Infrastructure sector is defined to include power, telecommunication, railways, roads (including bridges), sea ports and airports, industrial parks, urban infrastructure (water supply, sanitation and sewage projects), mining, refining and exploration and cold storage or cold room facility, including for farm level pre- cooling, for preservation or storage of agricultural and allied produce, marine products and meat.

Source: A.P. (DIR Series) circular no.134 dated 25 June 2012

Financial services

Enhancement of investment limit in government securities for foreign institutional investors

The RBI has enhanced the limit of 15 billion USD for foreign institutional investor (FII) investment in government securities with immediate effect to 20 billion USD. It has also been decided to rationalise the conditions governing the investments under this scheme by making the residual maturity of the instrument at the time of first purchase by FIIs and SEBI registered eligible non-resident investors in infrastructure debt funds (IDFs) and foreign central banks to be at least three years for a sub limit of 10 billion USD.

It has also been decided to allow long-term investments by sovereign wealth funds, multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks to be registered with SEBI, in government securities within this enhanced limit of 20 billion USD.

The conditions for the limit of 22 billion USD including the sub-limit of 5 billion USD with one year lock-in/residual maturity requirement and 10 billion USD for non-resident investment in IDFs have been changed as follows:

- The lock-in period for investments under this limit has been uniformly reduced to one year.
- The residual maturity of the instrument at the time of first purchase by an FII/ eligible IDF investor would be at least 15 months.

Also, as a measure of relaxation, qualified foreign investors (QFIs) can now invest in those mutual fund schemes that hold at least 25% of their assets (either in debt or equity or both) in the infrastructure sector under the current 3 billion USD sub-limit for investment in mutual funds related to infrastructure. However, this relaxation would be subject to review by the RBI.

RBI Circular – RBI/2011-12/618 [A.P. (DIR Series) circular no.135] dated 25 June 2012

Prudential guidelines on capital adequacy – treatment of head office debit balance – foreign banks

A few banks represented that debit balances in the head office account due to placements with the head office/overseas branches may happen as a part of normal banking business and complete denial of such exposure may not be practical and consistent with the principle of non-disruptive regulation.

Accordingly, the RBI has vide this circular advised that:

- If net overseas placements with head office/other overseas branches/other group entities (placement minus borrowings,

excluding head office borrowings for tier I and II capital purposes) exceed 10% of the bank's minimum capital to risk weighted assets ratio requirement, the amount in excess of this limit would be deducted from tier I capital.

- For the purpose of the above prudential cap, the net overseas placement would be the higher of the overseas placements as on that date and the average daily outstanding over year to date.
- The overall cap on such placements/investments will continue to be guided by the present regulatory and statutory restrictions, i.e. net open position limit and the gap limits approved by the RBI, and section 25 of the Banking Regulation Act, 1949. All such transactions should also be in conformity with other FEMA guidelines.

These guidelines will be effective from 30 September 2012.

RBI circular – RBI/2012-13/121 [DBOD.No.BP. BC.No.28/21.06.001/2012-13] dated 09 July 2012

Scheme for investment by QFIs in Indian corporate debt securities

The RBI has decided to allow QFIs to purchase on a repatriation basis debt securities subject to certain terms and conditions such as:

- Eligible instruments and eligible transactions: QFIs shall be permitted to invest through SEBI registered qualified depository participants (defined under the extant SEBI regulations) in eligible corporate debt instruments, viz. listed non-convertible debentures, listed bonds of Indian companies, listed units of mutual fund debt schemes and 'to be listed' corporate bonds (hereinafter referred to as 'eligible debt securities') directly from the issuer or through a registered stock broker on a recognised stock exchange in India.
- QFIs shall also be permitted to sell 'eligible debt securities' so acquired by way of sale through registered stockbroker on a recognised stock exchange in India or by way of buyback or redemption by the issuer.
- Mode of payment/ repatriation: A QFI may open a single non-interest-bearing rupee account with an authorised dealer category-I bank in India, for the limited purpose of routing the receipt and payment for transactions relating to purchase and sale of units of domestic mutual funds (in terms of A.P. (DIR Series) circular no.8 dated 9 August 2011 and A.P. (DIR Series), circular no. 42 dated 3 November 2011), equity shares of listed Indian companies (in terms of A.P. (DIR Series) circular No.66 dated 13 January 2012) and eligible debt securities (as in (i) above), subject to certain specified conditions.

Pursuant to the above circular, the SEBI has vide its circular dated 18 July 2012, framed rules for QFIs investments in Indian corporate debt securities.

RBI Circular – RBI/2012-13/134 [A.P. (DIR Series) Circular No.7] dated 16 July 2012

- Investment by QFIs in Indian corporate debt

The SEBI has, in consultation with the Government of India and the RBI, decided to allow QFIs to invest in Indian

corporate debt securities and debt schemes of Indian mutual funds.

The QFI transactions shall be limited to the following debt securities:

- Purchase and sale of corporate debt securities listed on recognised stock exchange(s)
- Purchase of corporate debt securities through public issues, if the listing on recognised stock exchange(s) is committed to be done under the extant provisions of the Companies Act,
- Sale of corporate debt securities by way of buyback or redemption by the issuer
- Purchase and sale of units of debt schemes of Indian mutual funds

The provisions relating to FIIs in the case of non-listing of 'to be listed' corporate bonds within 15 days shall also be applicable to QFIs.

The SEBI has also prescribed a total overall ceiling of 1 billion USD for QFI investment in corporate debt securities (without any lock-in or residual maturity clause) and mutual fund debt schemes along with guidelines on monitoring and allocating the aforementioned ceiling. Under these guidelines, QFIs can invest without obtaining prior approval until the aggregate QFI investments reaches 90% of 1 billion USD, i.e. 0.9 billion USD.

The RBI has also prescribed 'know your customer' norms and reporting requirements for QFIs.

SEBI circular: CIR/IMD/FII&C/17/2012 dated 18 July 2012

Corporate law developments

SEBI

Transfer of legal possession without proprietorship rights or beneficial ownership will also attract the Takeover Regulations

The appellant had refinanced the shareholders of the target company and on non-repayment of the finance, the appellant was given possession of the shares, which resulted in increase in his shareholding by 17.77% and led to a breach of the threshold limit of 15% set by the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (the Takeover Code). However, the appellant did not make any public announcement regarding this.

The appellant contended that the shares acquired did not amount to an acquisition of shares in the true sense, as he was not the beneficial owner (declaration under section 187-C(1) of the Companies Act, 1956 (the Companies Act), was filed with the company declaring that the beneficial interest in respect of shares vest with a person other than the appellant) and was only in possession of the shares. The shares were obtained without any corresponding consideration to secure repayment of the finances and he had no intention of making substantial acquisition of the shares or to acquire control of the company.

The Securities Appellate Tribunal (SAT) held that the transfer of shares to the demat account of the appellant is an acquisition within the scope of the Takeover Code. The intention of the appellant is immaterial. Also, once the requirement of the definition of 'acquirer' is satisfied, the declaration filed by the appellant is immaterial. As the shares were transferred to secure the finances of the appellant, it cannot be said that the acquisition was without consideration. Accordingly, the SAT upheld the order of the adjudicating officer on the issue of violation of the Takeover Code.

Rakesh Ramniklal Sheth [SAT order dated 12 April 2012]

Glossary

AY	Assessment year
CBDT	Central Board of Direct Taxes
CENVAT	Central value added tax
CESTAT	Customs, Excise and Service Tax Appellate Tribunal
CIT(A)	Commissioner of Income-tax (Appeals)
Companies Act	Companies Act, 1956
FTS	Fees for technical services
FY	Financial year
HC	High Court
ODIs	Offshore derivative instruments
OECD	Organisation for Economic Co-operation and Development
PAC	Person acting in concert
PE	Permanent establishment
RBI	The Reserve Bank of India
SAD	Special Additional Duty of Customs
SC	Supreme Court
SEBI	The Securities and Exchange Board of India
The Act	The Income-tax Act, 1961
The tax treaty	Double Taxation Avoidance Agreement
The Tribunal	The Income-tax Appellate Tribunal
TO	Tax officer
TPO	Transfer pricing officer

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