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Editorial

I am delighted to bring to you the latest issue of India Spectrum.

The New Year brought a ray of hope, with the Prime Minister, Narendra Modi daring to dream big and laying down a grand economic and development vision at the Economic Times Global Business Summit held at New Delhi from 16 to 17 January 2015.

This Issue comes just a few weeks before what could be a trend-setting Budget from a new Government headed by a leader on whom more hopes ride than on any other leader India has seen in decades. 'Make in India' is the vehicle of the Modi-led government to give manufacturing activity in India a new lease of life and create millions of new jobs. The current government is all set to initiate 'Make in India' in its upcoming 2015-16 Budget with tax breaks and other measures for several sectors.

It is expected that India would become the fastest-growing big economy in the world in the fourth year of the Modi government, edging past China. The World Bank anticipates that it is set to clock a 7% rise in the GDP in 2017, vis-à-vis 6.9% in case of China. It is expected that India would recover to 6.4% in the current fiscal year itself, resulting from higher export growth and investor confidence, with the election of a reform-minded government at the Centre.

Industrial growth rebounded to a surprise five-month high in November 2014, while consumer inflation did not accelerate to the extent anticipated in December, 2014. The industrial growth rose by 3.8% in November, 2014, reversing the sharp 4.2% contraction in the previous month, leaving an optimistic feeling that factory output is on the mend. Consumer inflation rose to 5% in December 2014 from 4.38% in November 2014, largely due to the base effect. Inflation based on wholesale price index also rose only 0.11% in December 2014, compared to no change

in November, 2014. Favourable inflation rate figures put renewed pressure on the RBI for a cut in the key interest rates in its monetary policy. The RBI responded in a surprise move, reducing benchmark interest rates by 25 basis points a fortnight ahead of its scheduled February monetary policy announcement.

The World Bank expects global growth to rise moderately to 3% in 2015 from 2.6% in 2014, and to increase further to 3.3% in 2017. Significant divergence in trends is widely expected, and the oil price collapse would result in winners and losers.

With the objective of improving ease of doing business in India, the government has mapped sectors which need compliance with the FDI Policy to the National Industrial Classification, 2008. FDI is being permitted in manufacture of medical devices, including brownfield investments, under automatic route from 21 January 2015 onwards.

The Andhra Pradesh and Telangana HC, in the case of The Elegant Chemicals Enterprises Private Limited, concluded that compensation received by the taxpayer, a contract manufacturer, from its principal to compensate cost of sterilization of certain assets following its decision to not go ahead with manufacture of new products, was a capital receipt not liable to tax. In another ruling in the case of Bartronics India Limited, the Hyderabad bench of the Tribunal held that when it paid for certain software, the right to use a copyrighted material or article was transferred, which was clearly distinct from transfer of the copyright itself. This did not give rise to any royalty income, and hence would be classified as business income.

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

Shyamal Mukherjee
Leader, Tax and Regulatory Services

Analysing tax issues
Corporate tax

Case law

Liaison office

Activities of LO were not just preparatory or auxiliary, hence income attributable to LO taxable in India

Brown and Sharpe Inc. *v.* CIT [2014] 51 taxmann.com 327 (Allahabad)

Facts

The taxpayer-company, incorporated in the US, established a LO in India. During assessment, the TO contended that the LO's activities extended to searching for prospective buyers and promoting the taxpayer's sales in India. The TO posed a few queries to the taxpayer's CRO, of which one pertained to remuneration schemes for the employees. The CRO explained that employees were entitled to sales incentives to the extent of 25% of their annual remuneration. Further, the performance of employees was judged by the number of direct orders received by them. The CRO further explained that the incentive plan was a standard term which was inadvertently included in the offer letters given to the employees. In fact, no such incentive was given to any employees during the year. The TO however held that the activities of the LO were not limited to preparatory or auxiliary activities in India, but had extended to marketing and promotional activities as well. Accordingly, he held that the income attributable to the LO in India would be taxable in India. The Tribunal held that the LO had received an amount in excess of what was actually incurred by way of expenditure and hence, the TO had correctly taxed the amount received by the taxpayer over and above reimbursement of expenses. On appeal, the taxpayer contended that it's LO was engaged merely in acting as a communication link between the HO and prospective buyers in India, and the activities carried out in India were not in the nature of marketing activities.

Held

There was no perversity in the Tribunal's approach, nor had it misapplied itself either on fact or in law. The HC distinguished two decisions, namely, UAE Exchange Centre Limited *v.* UoI [2009] 313 ITR 94 (Delhi) and DIT *v.* Nokia Networks OY [2012] 253 CTR 417 (Delhi), to conclude that in the present case, the LO's activity during the relevant year was not of such preliminary or preparatory nature as to attract the exclusion under Article 5(3)(e) of the India-US tax treaty.

With regard to the alternative submission, the HC observed that the TO had not applied his mind to the following crucial requirements: the profits of the enterprise may be taxed in the other state under Article 7(1) of the tax treaty, but only so much of it as is attributable to: (a) that PE; or (b) sales in the other state of goods or merchandise of the same or similar kind as those sold through that PE; or (c) other business activities carried on in the other State of the same or similar kind as those effected through that PE. The TO had followed a simple course of action, i.e. deducting expenses from the HO's receipts. Whether any part of the profits were attributable to the PE had not been considered, either in the TO's order or, for that matter, by the Tribunal. The matter was remanded to the TO for fresh determination of the extent of taxable income, having due regard to Article 7 of the tax treaty.

Royalty

Payment to a group concern for procuring a standardized software license subject to withholding tax, being 'royalty'

ITO *v.* F. L. Smidth Limited [TS-719-ITAT-2014(Chennai-Tribunal)]

Facts

The taxpayer was engaged in the business of consulting engineers and architects. It remitted an amount to its Denmark-based group concern in July 2003. The Danish group entity had executed agreements with all its associate concerns worldwide and placed a global indent on Microsoft Corporation (Microsoft), a US-based technology provider, for procuring standardized software licenses. Microsoft had executed an enrolment agreement in 2002 with the Danish group entity that the Danish entity would get technical upgrades from Microsoft by way of language and software applications of its various programs, such as 'Office Professional', etc. The Danish group entity intimated to the taxpayer that in lieu of providing various software licenses and assurances from Microsoft, it would be invoicing on a

yearly basis. For AY 2004-05, the Danish group entity provided 2003 Microsoft licensing for 270 sets of MS Office, Windows and Cals, and invoiced an amount. The taxpayer remitted the aforesaid amount without withholding any tax. The TO proposed to treat the taxpayer as a 'taxpayer-in-default' under section 201(1) of the Act, for not withholding tax on this payment. The taxpayer contended that remittance did not contain income components incurred towards acquiring and sharing the software license. There was no 'royalty' element involved, as no copyrights were involved. The taxpayer submitted that there was a mere right to use the copyrighted software. The taxpayer had only purchased standardised software of the nature of goods, as per Customs and Excise laws and Sales Tax laws. Relying on the India-Denmark tax treaty and on the OECD Model Convention, the taxpayer also contended that the payment was made for use of a copyrighted article only, and not in lieu of a copyright itself; and that there was only a transfer of limited rights to reproduce the computer programs on hard drives. However, rejecting the taxpayer's contentions, the TO held that the remittance pertained towards acquisition of a software license. The TO treated the remittee Danish group entity as a distributor/ agent of Microsoft, and observed that since both entities were non-residents, tax had to be withheld even in an instance of forwarding of payments. The CIT(A) ruled in favour of the taxpayer, holding that the taxpayer had acquired a readymade, off-the-shelf computer program for use in its business. No right was granted to the taxpayer to utilize the copyright of the copyrighted program. The taxpayer had merely purchased a copy of the computer article, namely a computer program which was called software. Therefore, the remittance made by the taxpayer for purchase of the software did not constitute income in India attracting Explanation (2) to section 9(1)(vi) of the Act.

Held

On facts, the Tribunal noted that the actual owner of the software products was Microsoft, and the remittee (the Danish group entity) only placed an indent for all its group concerns for appropriate internal arrangement and convenience. Therefore, the Tribunal held that Article 5 of the tax treaty did not help the taxpayer, as operation of Articles 1 and 2 were only excluded when the beneficiary of the royalty was resident in the other Contracting state. The tax treaty clauses supported the Revenue *qua* taxability of the 'royalty' element in India. The Tribunal observed that granting of the license was included as a right in Explanation 2 clause (i) and (v), forming part of royalty. Guided by the nature of software technology availed, the fact that invoice raised specifically quoted license-only, and the right of usage embedded therein, the Tribunal observed that the license in this case would also enable the taxpayer to make use of the 'shrink-wrapped software' availed. The Tribunal relied on two Karnataka HC rulings, namely, CIT *v.* Samsung Electronics Company Limited [TS-696-HC-2011(Karnataka)] and CIT *v.* Synopsys International Old Limited [TS-182-HC-2010(Karnataka)]. It also relied on the Mumbai Tribunal ruling in the case of DDIT *v.* Reliance Infocom Limited [TS-433-ITAT-2013(Mumbai)] to hold that the taxpayer had paid a 'royalty' sum to its Danish group concern in lieu of acquiring the software license for "2003 Microsoft licensing for 270 sets of MS Office, Windows and Cals".

Thus, the Tribunal held that tax was liable to be withheld on the payment to the Danish group concern for acquiring Microsoft's software license, as such payment was 'royalty'

Right to use a smart card source code, a copyrighted article, does not give rise to royalty income

ACIT *v.* Bartronics India Limited [TS-712-ITAT-2014(Hyderabad-Tribunal)]

Facts

The taxpayer was a company engaged in the business of providing enterprise solutions based on smart cards, bar coding, biometrics, etc. A survey was conducted and the TO noted from the taxpayer's books of accounts that payments were made/ payable to Gamma Machinery and Equipment Pte Limited (Gamma) and Intra Asia Trading Pte Limited (Intra). The payments were made for the purpose of completing a source code for contact/ contact-less smart card operating systems for transport applications conforming to National Informatics Centre, Government of India standards. The TO noted that the source code, testing, soft- and hard-masking process instructions and user documentation for various companies' IC modules/ micro-controller range of various EEPROM sizes were all in place. Finally, the TO concluded that the payments made/ payable by the taxpayer were liable to withholding tax under section 195 of the Act. The TO worked out the liability under section 201(1) and interest under section 201(1A) of the Act. The CIT(A) held that the foreign companies had transferred the software to the taxpayer in their capacity as trading agencies and intermediaries, and it could not be said that they had parted with exclusive rights, entitling them to a royalty.

Held

The Tribunal referred to the ruling in Tata Consultancy Services *v.* State of AP [2004] 271 ITR 401 (SC) wherein it had been held that computer programs were the product of an intellectual process, but once implanted in a medium, they were widely distributable to computer owners. It further held that the fact that a computer program could be copyrightable as intellectual property did not alter the fact that once in the form of a floppy disc or other medium, the program was tangible, movable and available in the marketplace. The Tribunal perused various clauses of the licensing agreement between the taxpayer and foreign entities. The agreement showed that the license was non-exclusive, non-transferable and the software had to be used in accordance with the agreement. The buyer-taxpayer was permitted only to make a copy of the software and associated support information for backup purposes. The software was to be used only for the Licensee's own business. Without the seller's consent, the software could not be loaned, rented, sold, sub-licensed or transferred to any third party, or used by any parent, subsidiary or affiliated entity of the Licensee. The Licensee was further restricted from making copies, decompiling, disassembling or reverse-engineering the software without the written consent of the seller. All copyrights and intellectual property rights in and to the software, and copies made by the Licensee, were owned by or duly licensed by the seller. Copyright was an intangible incorporeal right in the nature of a privilege, quite independent of any material substance, such as a manuscript. It did not amount to transfer of all or any right, including the license in respect of copyright. Copyright, or even the right to use copyright, was distinguishable from the sale consideration paid for a "copyrighted" article. This sale consideration was for the purchase of goods and was not royalty. Thus, it was held that what was transferred was neither the copyright to the software nor the use of the copyright to software, but the right to use the copyrighted material or article, which was clearly distinct from the rights to a copyright. The right transferred was not a right to the copyright, but was only the right to use the copyright material, and its transfer did not give rise to any royalty income and would be classified as business income.

Capital receipt

Compensation received for sterilization of assets consequent upon unilateral termination of contract was in the nature of capital receipt

The Elegant Chemicals Enterprises Private Limited *v.* ACIT [TS-808-HC-2014(Andhra Pradesh & Telangana)]

Facts

The taxpayer was a manufacturer of pharmaceutical formulations. Most of its business was to undertake custom manufacturing of products. It entered into a contract with P&G to manufacture various forms of Vicks 500 products. This required installation of new machinery. The taxpayer entered into a contract with P&G to bear the expenditure to install the new machinery and to place orders for ensuring viable production thereon. Subsequently, the taxpayer acquired new machinery and a test run was also conducted. At that stage, P&G expressed its inability to proceed with the contract and rescinded the contract. The taxpayer claimed compensation for unilateral termination of the contract. After negotiation, P&G paid an amount towards sterilization of assets of the company and towards reimbursement of interest and other revenue expenditure. The taxpayer claimed the compensation received from P&G as a capital receipt, but the TO treated it as a revenue receipt.

Held

The taxpayer had been manufacturing the product as and when orders were placed in the ordinary course of business. P&G wanted the taxpayer to produce a product for which the taxpayer had no arrangement/ machinery to manufacture. Equipment with altogether different specifications had to be acquired only to meet the requirement of P&G. Barring that, there was no other necessity for the taxpayer to install that machinery. Obviously for that reason, the agency agreed to provide funds for installation. The machinery was installed and before the test run was completed, P&G rescinded the contract. Realizing its obligations under the law, P&G paid the amounts demanded. The basis for the Revenue to treat the amount as revenue receipt was that – (a) a sample of the product, which was required to be manufactured through machinery, was already produced; (b) the machinery was being put to use even after cancellation of the contract. The production of the item was not on a commercial scale but was only as a sample. A sample could be manufactured with ordinary techniques and once it was approved, specialized machinery was required to be installed, for commercial production. With regard to the second, the observation of the Commissioner was that though this was for the manufacture of the same product, for which the machinery was meant, it was

being used to produce other drugs. When actually the entire machinery was installed in connection with a typical product to be produced on a commercial line, the inference drawn by the authorities could not be sustained in law.

It was not disputed that the new machinery that the taxpayer installed was exclusively for manufacturing a specialized product, and the contract was terminated even before its production had commenced. The machinery installed for manufacturing the new product had already become part of the taxpayer's assets. The amount received from P&G certainly deserved to be treated as capital receipt. However, the said amount could not be kept outside the purview of taxation. Under the Act, the WDV of the assets had been fixed. Once the taxpayer had the advantage of receiving the sum towards installation of machinery alone, this deserved to be deducted from the WDV, to the extent it had been added to the value of the block of assets. It would have its own impact upon the amount of depreciation to be allowed on the block of assets. The HC concluded that the compensation received by the taxpayer on installation of new machinery for sterilization of assets was capital receipt not liable to tax.

Principles of natural justice

In absence of reasons for rejecting taxpayer's contention, AAR's ruling set aside and de novo *consideration directed on account of breach of natural justice*

NEO Path Limited *v.* DIT [TS-783-HC-2014(Bombay)]

Facts

The taxpayer was a company incorporated in Mauritius. In terms of Article 13(4) of the India-Mauritius tax treaty, it claimed that capital gains on sale of shares were not chargeable to tax in India. The taxpayer had sold equity shares of an Indian company to a Singaporean company, yielding long-term capital gains. The Singaporean company, while paying sale consideration for the equity shares of the Indian company to the taxpayer, withheld tax on this and paid it to the credit of the Government of India as tax withheld on long-term capital gains. The taxpayer applied for an advance ruling before the AAR under section 245-Q(1) of the Act stating that it should not be subjected to capital gains tax in India as it was a tax resident of Mauritius. The AAR had concluded that the view canvassed by the Revenue established a *prima facie* design to avoid tax, and there were no reasons provided for rejecting the taxpayer's contentions.

Held

The HC relied on the decisions of the SC in CCT *v.* Shukla Brothers [2010 (4) SCC 785] and Kranti Associates Private Limited *v.* Masood Alam Khan [2010 (9) SCC 496]. In the Shukla Brothers' case, the court stated that the doctrine of *audi alteram partem* had three basic essentials, i.e., grant of hearing to the person likely to be affected, fair and transparent procedure to be provided by the authority, and disposal of the issue by a reasoned/ speaking order. Recording of reasons was an essential feature of providing justice and, in fact, was the soul of orders. In the Kranti Associates Private Limited's case (*supra*), the court had summarized the principles for recording reasons. The HC found that the AAR's order suffered from the vice of being an order without reasons, and therefore. quashed and set aside the order. The HC directed the AAR to consider the taxpayer's earlier application *de novo*, on the limited issue of this being in breach of the principles of natural justice and restored it for fresh disposal in accordance with law.

Dividend stripping

Purchase date and not the record date relevant for dividend stripping

CIT/ACIT *v.* Sarosh Nowrojee Burjorjee [TS-802-HC-2014 (Karnataka)]

Facts

The taxpayer, in its return of income filed for the AY 2004-05, claimed loss arising on sale of mutual fund units. The taxpayer purchased the units on 17 December 2003 and sold them on 26 March 2004 at a loss. In the interim, the taxpayer had received dividends on such units on 26 December 2003. The TO held that since the mutual fund units had been sold within the period of three months of the record date, the provisions of section 94(7) of the Act shall apply. Consequently, the loss claimed by the taxpayer was not allowed. The CIT(A) confirmed the order passed by the TO. However, the Tribunal held that the period of three months had to be calculated from the purchase date and not the record date. Thus, the Tribunal allowed the claim of loss on such sale.

Held

The legislature had consciously used the words 'record date' in clause (a) and not in clause (b) of section 94(7). Had the intention of the legislature been to mean record date in clause (b), then they would have used the word 'record date' instead of 'such date'. 'Record date' is a definite date, whereas the 'date of purchase' varied from person to person and therefore, 'such date' had been used intentionally in section 94(7)(b) of the Act, as it varied from transaction to transaction. Thus, the word 'such date' in section 94(7)(b) of the Act referred to the 'date of purchase' and not the 'record date'. As the sale of units by the taxpayer was beyond a period of three months from the date of

purchase, the provisions of section 94(7) of the Act would not apply. Accordingly, the loss claimed by the taxpayer was allowed.

Editor's Note

In our view, the ruling appears to be contrary to the plain reading of the law and the general practice followed, which is to compute the three month period both, for the purchase and sale transaction from the record date and not the date of purchase. It is also worthwhile to note that the Karnataka HC has not considered the Delhi HC decision in the case of CIT v. Shambhu Mercantile Ltd [2009] 325 ITR 535 (Delhi), which held that the record date is really the median line for the statutory period prescribed both for the purchase and sale which is three months on either side of the record date.

Deemed dividend

Advance to sister-concern benefitting the lending company's business interest is not deemed dividend

Bagmane Constructions Private Limited *v.* CIT [TS-785-HC-2014 (Karnataka)]

Facts

A closely held company advanced money to its shareholder (having substantial interest) and to its sister concerns (the taxpayers). The taxpayers were advanced money in pursuance to a joint venture agreement, to procure agricultural land in the name of their directors, hold the same as a capital asset and transfer the land back to the closely held company after obtaining a conversion order. This was done as companies in Karnataka were not allowed to buy agricultural land. The TO in its proceeding concluded that the taxpayers submissions were a mere camouflage to evade assessment of the amount as 'deemed dividend' under section 2(22)(e) of the Act. The CIT(A) confirmed the order passed by the TO. However, the Tribunal held that the deeming fiction under section 2(22)(e) would not be applicable as advances were mere funds allocated to the taxpayer during the course of business and were made purely on the business exigencies. The TO appealed before the HC against the Tribunal's order.

Held

In case the intention of such advance or loan was to avoid payment of dividend distribution tax under section 115-O of the Act, then such a payment made by a company certainly constituted deemed dividend. However, if such a payment was made firstly not out of accumulated profits, and secondly, even in case it was out of accumulated profits, it was made as a trade advance as a consideration for goods received or for purchase of a capital asset which indirectly would benefit the company advancing the loan, such advance could not be brought within the word 'advance' used in the aforesaid provision. A trade advance which was in the nature of money transacted to give effect to commercial transactions would not fall within the ambit of the provisions of section 2(22)(e) of the Act.

In addition to the above, relying on the Bombay HC decision in the case of CIT *v.* Universal Medicare Private Limited [2010] 324 ITR 263 (Bombay), it was held that the tax was leviable on the shareholder only and not on the concern receiving any payment covered under section 2(22)(e) of the Act.

Royalty

Payment to non-resident for providing advisory services in relation to investment to be made outside India is not royalty

ACIT *v.* Sundaram Asset Management Company Limited [2014] 52 taxmann.com 466 (Chennai Tribunal)

Facts

The taxpayer was engaged in the business of providing asset management services. It had, during AYs 2009-10 and 2010-11, entered into a service agreement with a French firm to obtain advisory services in relation to making investments outside India. The advisory services involved providing certain data about companies, which facilitated the taxpayer in its investment decisions. The information provided by the French firm in the form of a database was published information which was available in the public domain. For the services rendered by the French firm, the taxpayer paid fees in accordance with the service agreement entered. The TO concluded that the fee paid to the French firm was in the nature of royalty. Consequently, the TO disallowed the amount paid to the French firm under section 40(a)(i) of the Act as no tax was withheld by the taxpayer on such payment. The CIT(A) deleted the disallowance made by the TO relying on the decision pronounced by the Tribunal in the taxpayer's case pertaining to an earlier AY.

Held

The issue in appeal was squarely covered by the decision of the co-ordinate Bench of the Tribunal in the taxpayer's own case on identical facts and circumstances for the earlier AY. The Tribunal in the earlier AY had considered that information provided to the taxpayer in the form of database was published information which was available in public domain and the French firm had merely compiled the information

and transmitted the same to the taxpayer. Thus, the information provided by the French firm in the course of advisory services could not be termed as 'royalty' as defined under the provisions of the Act. Furthermore, the services provided by the French firm were rendered abroad, and therefore no part of income had accrued or arisen in India. Consequently, the taxpayer was not liable to withhold tax at source on the payments so made. The ACIT's appeal was dismissed and the case was decided in favour of the taxpayer on this issue.

Notification

AAR

Important recent AAR-related updates

Notification No. 73/2014/ F. No. 142/6/2014-TPL and Notification No. 74/2014/ F. No. 142/6/2014-TPL

Recently, we have witnessed significant changes in the Authority for Advance Ruling (AAR). Its members have changed; and filing fees increased. Also, rules regarding resident taxpayers' access to the AAR have been issued.

- Justice Mr. V. S. Sirpurkar, retired Judge from the Supreme Court, has taken charge as the Chairman of the AAR. Two other members constitute the AAR, i.e. one each from the Indian Revenue Service and the Indian Legal Service. Mr. Amarendra Kumar Tewary has been appointed by the Central Government as the Revenue Member at the AAR and has taken charge from 31 January 2015.
- The CBDT has notified the category of resident taxpayers that can seek ruling from the AAR. A resident, who in relation to his tax liability arising out of one or more transactions valuing INR 1,000 million or more in total, which has been undertaken or proposed to be undertaken, shall be 'applicant' for the purpose of filing AAR Application.
- Further, the CBDT has notified a significant enhancement in fees for filing application for advance ruling for –
  - Non-resident in respect of its own tax liability;
  - Resident for purpose of TDS on sum paid to non-resident;
  - Resident in respect of its own tax liability where transaction is more than 100 crores.

The revised fees payable is based on the transaction value with minimum fees being INR 0.2 million and maximum being INR 1 million.

- For one or more transactions entered into or proposed to be undertaken, in respect of which ruling is sought involving a sum of less than INR 1000 million, fee payable is INR 0.2 million.
- For one or more transactions entered into or proposed to be undertaken, in respect of which ruling is sought with sum involved being between INR 1,000 million and INR 3,000 million, fee payable is INR 0.5 million.
- For one or more transactions entered into or proposed to be undertaken, in respect of which ruling is sought with sum involved being over INR 3,000 million, fee payable is INR 1 million.
- In all other cases, fee payable is INR 10,000.

Assessing personal tax
Personal taxes

Capital Gains

Date of the development agreement is relevant to determining the holding period for the purposes of capital gains

CIT *v.* Sri S.R. Jeyashankar [TS-753-HC-2014(Madras)]

The date of acquisition of a property had to be determined from the date the agreement was entered into and not the date when the agreement was registered. The nature of capital gains arising out of the transfer was to be determined with regard to the date when the agreement was entered into and when the allotment letter was given to the taxpayer.

Facts

The taxpayer entered into an agreement in February 2005 with a builder for acquisition of land as well as construction of a residential unit on that land. The taxpayer also paid the first instalment of the purchase consideration at the time of signing that agreement. The entire unit was later sold by the taxpayer in April 2008. Since the unit was sold 36 months after the date of the agreement, the taxpayer claimed capital gains as LTCG. However, since the land was registered in August 2005, the TO held the gains to be short term and made further additions.

On appeal, both, CIT(A) and the Tribunal passed the order in favour of the taxpayer. The Revenue was aggrieved and appealed before the Madras HC.

Held

The HC, relying on Circular No. 471 dated 15 October 1986 and earlier decisions of Punjab & Haryana HC, held that the allottee obtained the title to the property on issue of the allotment letter. The fact that the actual possession was delivered later on did not detract from the fact that the allottee was conferred a right to hold the property on the date of issue of the allotment letter. The payment of balance instalments, identification of flats and delivery of possession were consequential acts. The Madras HC concluded that, in this case, the taxpayer had a right consequent to signing the agreement in February 2005 in respect of the property sold on 10 April 2008, and therefore the taxpayer had rightly claimed the benefit of LTCG.

Editor's Note

This case further reinforces the principle that the date of allotment of property via an allotment letter is important for the purposes of determining the period of holding a property.

Penalty under section 271(1)(c)

Concealment penalty not leviable when intentional suppression of income by taxpayer absent

D. Rama Rao *v.* ACIT [TS-700-HC-2014 (Telangana and Andhra Pradesh)]

The HC deleted section 271(1)(c) penalty in the absence of intentional suppression of income by the taxpayer.

Facts

The taxpayer, Mr. D. Rama Rao, proprietor of a private educational institution, filed his tax return for AY 1995-96 declaring income of INR 75,780/-. A survey under section 133A of the Act was conducted on the premises of the taxpayer and it was pointed out that the taxpayer may have collected a sum of INR 0.92 million whereas receipt of fees of INR 0.391 million was shown in the tax return. On noticing this, the taxpayer filed a revised tax return showing additional income of INR 0.18 million after claiming expenditure. An assessment order accepting the revised tax return and adding a sum of INR 20,000/- towards unapproved expenditure was passed. Subsequently, penalty proceedings were initiated under section 271(1)(c) of the Act and an order was passed for levy of a penalty.

Aggrieved by the penalty order, the taxpayer filed an appeal before the CIT(A), which was allowed. The Revenue's appeal against the order of the CIT(A) was allowed by the Tribunal justifying the levy of a penalty. Aggrieved, the taxpayer lodged an appeal before the Andhra Pradesh HC.

The HC noted that though the appellant had filed a revised tax return as a sequel to the survey conducted, no definite amount was settled on during the survey and no finding as such was recorded to the effect that the amount of INR 0.92 million was collected by the taxpayer towards fees. However, in order to placate the authorities, the taxpayer had filed a revised tax return showing income and an order under section

143(3) was passed accepting the facts and figures provided by the taxpayer.

Held

The HC stated that a penalty could not be levied as a matter of course. By their very nature, tax returns were bound to be at variance with what was contemplated under the Act or the estimates of the TO. The HC also observed that "the very fact that quite large numbers of remedies in the form of appeals at various stages is provided for, discloses that even the understanding of the assessing or adjudicatory authorities is not absolute." The HC observed that "levy of a penalty is not going to settle the matter. It would also expose the taxpayer to prosecution by treating him as an economic offender. The taxpayer can be made to suffer such far-reaching consequences, only if the facts of the case support it, and it emerges that the taxpayer had a clear intention to suppress the income". In the absence of clear intention to suppress income on the taxpayer's part, the HC quashed the penalty and allowed the taxpayer's appeal.

Editor's Note

This judgement reiterates that concealment penalty to be levied only in case of intentional suppression of facts and presence of guilty mind.

Structuring for companies
Mergers and acquisitions

Case law

Premium paid by company on buy-back to get rid of warring shareholder group to be considered as revenue expenditure

DCIT *v.* Bramha Corp. Hotels & Resorts Limited [TS-740-ITAT-2014(Pune - Tribunal)]

The Tribunal held premium paid on share buy-back to get rid of recalcitrant shareholder groups as revenue in nature, since expenditure was incurred out of business expediency.

Facts

The taxpayer, Bramha Corp. Hotels and Resorts Limited, was incorporated in 1987 by the Agarwal Group as its only shareholders. Subsequently, in order to ensure adequacy of funds, the Agarwal group entered into a shareholders agreement with the Mac Charles (India) Limited group (Mac group) and the Gupta group.

During 2001 to 2003, Mac and Gupta groups filed several civil and criminal cases against the Agarwal group and the taxpayer company due to certain disputes. Consequently, both groups filed a petition with the Company Law Board (CLB) invoking sections 397 and 398 of the Companies Act, 1956. The CLB ordered the taxpayer to buy-back shares of the groups at a stipulated price, which was over and above the face value of the shares.

The taxpayer complied with the order of the CLB and bought back its shares from Mac and Gupta groups at a premium of INR 27.3 million and INR 54.3 million respectively. The payment of premium aggregating to INR 81.6 million was claimed as a deduction in arriving at its income for FY 2006-07. The TO rejected the claim of the taxpayer on the basis that the said expense was capital in nature.

Aggrieved by the order, the taxpayer filed an appeal to the CIT(A), which ruled in favour of the taxpayer. The revenue subsequently filed an appeal to the Tribunal.

Held

The Tribunal relied on its own decision (in the case of the same taxpayer for FY 2005-06). It also relied on the Mumbai bench decisions in the case of USV Limited *v.* JCIT [ITA No. 376/M/2001] and Echjay Industries Limited *v.* DCIT [2004] 88 TTJ 1089 (Mumbai - Tribunal) wherein, on similar facts, it was held that expenditure was incurred to facilitate smooth running of the business by getting rid of the recalcitrant shareholders, and therefore, was incurred for purposes of business. The Mumbai bench decision in the case of Echjay Industries Limited had also been affirmed by Bombay HC (ITA No. 237 of 2004). Accordingly, the Tribunal ruled in favour of the taxpayer.

Editor's note

The Tribunal relied on various decisions, including its own decision in the case of the same taxpayer, where it was established that the taxpayer has not obtained any enduring benefit and the expenditure was incurred for protecting the taxpayer's business interests and was incumbent for the smooth running of the business, and thus had to be considered revenue in nature.

Income from tax-free investments – presumption of sufficient capital is insufficient to hold own funds utilized for tax-free investments

Ferani Hotels Private Limited *v.* ACIT [TS-715-ITAT-2014(Mumbai - Tribunal)]

In the case that the taxpayer was unable to show with reference to its books of accounts that borrowed funds had not been utilised for making tax-free investments, it could not be presumed that such investments had been financed from owned capital.

Facts

Ferani Hotels Private Limited (the taxpayer) was engaged in the business of real estate and hotels. During AY 09-10, the taxpayer earned dividend income and income from a partnership firm and claimed these incomes as exempt under section 10 of the Act. However, it did not concede any disallowances for expenditure under section 14A of the Act.

During assessment proceedings, the TO calculated disallowances under section 14A read with Rule 8D. The CIT(A) confirmed the said expenditure as calculated by the TO. Aggrieved, the taxpayer filed an appeal to the Tribunal. Before the Tribunal, the taxpayer contended that it had sufficient capital of its own which was used for making investments in shares and in the partnership firm. Therefore, no funds were borrowed and consequently

no interest incurred for earning exempt income. The taxpayer placed reliance on the Bombay HC ruling in the case of CIT *v.* Reliance Utilities & Power Limited [2009] 313 ITR 340 (Bombay).

Held

The Tribunal did not accept the taxpayer's argument of sufficient capital being applied towards investments yielding tax exempt income. It held that if the taxpayer with reference to its books was unable to show that investments had been financed from its own capital, any presumption with regard to borrowed capital not being utilised would not hold, and the rule of apportionment prescribed under Rule 8D would apply. Accordingly, the Tribunal remanded the matter back to the TO to allow the taxpayer an opportunity to present and exhibit its case.

Editor's note

It is abundantly clear from the judgement that for the taxpayer to take the plea of having sufficient capital to make investments yielding exempt income, the books of accounts of the taxpayer have to demonstrate the same. In case this is not so evident from the books, the proportionate disallowance of interest expenditure under section 14A has to be calculated in accordance with Rule 8D.

Regulatory update

Important amendments to the Companies (Amendment) Bill, 2014

The Companies (Amendment) Bill, 2014

- **Requirement for minimum paid-up capital for companies**

  As per the Companies Act, 2013, private and public companies had a minimum paid-up capital requirement of INR 0.1 million and INR 0.5 million respectively. Through the Companies (Amendment) Bill, 2014, the minimum paid-up capital requirement is proposed to be removed.

- **Related Party Transactions**

  As per section 188(1) of the Companies Act, 2013, no contract or arrangement exceeding specified limits shall be entered into except with the prior approval of the company by a special resolution passed by non-related shareholders. However, as per the proposed amendments vide the Companies (Amendment) Bill, 2014, companies can now enter into Related Party Transactions by taking approval from non-related shareholders by ordinary resolution instead of special resolution. Furthermore, as per the proposed amendment to section 177(4) of the Companies Act, 2013, the Audit Committee has been empowered to give omnibus approvals for related party transactions subject to prescribed conditions.

- **Writing off past losses/ depreciation before declaring dividend for the year**

  Rules relating to section 123(1) of the Companies Act, 2013 provided that no company shall declare dividend unless carried-over previous losses and depreciation not provided in the previous year or years are set off against profit of the company for the current year. This has now been proposed to be included in the principal Act.

- **Loan/ Guarantee by holding company to/ for subsidiary company**

  As per section 185(1) of the Companies Act, 2013, no company shall advance any loan to any of its directors or to any other person in whom the director is interested, or give any guarantee or provide any security in connection with any loan taken by him or such other person. However, any loan/ guarantee by the holding company to/ for the subsidiary company is kept out of the purview of this section, provided the loans are utilised by the subsidiary company for its principal business activities. This was provided for in the Rules but is now proposed to be included in the principal Act.

Pricing appropriately
Transfer Pricing

Prelude

Recent months have seen some major developments on the administrative front of the revenue department. The DRP has now become a permanent body, as the CBDT restructured the composition, jurisdiction and control of the DRP across the country. This change is intended to address the long-standing issue of conflicts of interest arising from panel members holding dual responsibilities, as well as to ensure regular hearings and disposals, evenly spread out across the year. There will be five panels across the country – two each in Delhi and Mumbai and one in Bengaluru.

On the global front, the United Kingdom (UK) has become the first country to introduce a legislation to implement Country by Country Reporting (CbCR) in line with the Action Plan of the OECD relating to BEPS. The legislation, which will be included in the Finance Act 2015, will require UK parented multinational enterprises to provide CbCR tax related data. The Australian tax office has finalised its guidance on transfer pricing (TP) documentation and penalties under the new TP regime. The new guidance enacted to encourage the taxpayers to correctly self-assess their tax positions under the TP rules, is expected to provide exemptions from preparing TP documentation for certain categories of taxpayers and transactions. Furthermore, a broad agreement has been reached between India and USA on the framework for resolving pending Mutual Agreement Procedure (MAP) cases in Information technology/ Information technology enabled-services (IT/ ITeS) space after many rounds of talks and continuous engagement between the Competent Authorities of India and USA over the past 18 months. It is reported that USA has also agreed to accept Bilateral Advance Pricing Agreements (BAPAs) with India. It is a welcome step, which will provide certainty in some of the largest TP disputes and increase investor confidence in India.

Given below are summaries of a Tribunal ruling passed recently on a case involving TP issue and related update.

Jaipur Tribunal – Deleted royalty adjustment as substantial technical support was received from AEs

ACIT *v.* Sakata Inx (India) Limited [ITA No. 376/JP/2012 dated 14 November 2014]

The taxpayer was engaged in the manufacturing of printing inks for packaging industry and printing industry. During the relevant year, the parent company had provided the necessary technology to the taxpayer for producing offset and gravure ink, which was being used by the taxpayer for its business operations in India. The parent company also provided continous technical support for the technology and product related issues to the taxpayer. The taxpayer had paid a royalty to its parent company towards the relevant technology and technical support services received from its parent company. During assessment proceedings, the TPO contended that the taxpayer had failed to demonstrate the substantial benefit which accrued to the taxpayer through the payment of royalty to its parent company and, accordingly, by applying Comparable Uncontrolled Method (CUP), determined the arm's length royalty amount to be Nil. The CIT(A) held that the taxpayer had derived significant benefits from the payment of royalties to its parent company, as almost every product manufactured by the taxpayer required continous support from its parent company, and accordingly deleted the entire adjustment determined by the TPO.

On appeal, the Tribunal held as follows:

- The products manufactured by the taxpayer were developed using the technology and technical support provided by the parent company. It would not have been possible to the taxpayer to manufacture the products without continous support from its parent company
- The cost-benefit test worked out by the TPO was not based on a proper appreciation of the facts, and thus the CUP method applied by the TPO was not justifiable
- Various judicial precedents relied upon by the CIT(A) as well as the taxpayer support the view upheld by the CIT(A), and accordingly the appeal of the Revenue was dismissed

Singapore – Revised TP Guidelines

Revised TP Guidelines by Inland Revenue Authority of Singapore

In the month of January, the Inland Revenue Authority of Singapore (IRAS) released revised TP Guidelines (the Guidelines), as an update to those first published in February 2006. These guidelines make broad changes and provide clarification to the Singapore TP reporting and compliance framework, as well as the application of the arm's length principle. These changes and clarifications in turn affect the IRAS' position with regard to the mechanisms available for taxpayers to adjust their TP, and the dispute resolution process. The most notable change is the requirement for the taxpayers to prepare contemporaneous TP documentation.

The key revisions are summarised below:

- **Reporting and compliance framework -** The changes in this regard are threefold:
    - Emphasis on the contemporaneous nature of TP documentation and record keeping requirements for Singapore taxpayers.
    - Helpful guidance on when the IRAS expects contemporaneous TP documentation to be prepared.
    - A clear move towards increased disclosure of the context of a related-party transaction within TP documentation.
- **Application of arm's length principle -** The Guidelines endorse the arm's length principle for related party transactions. In doing so, the IRAS has made clear its position with regard to the conduct of a comparability/ economic analyses and application of the TP methodologies.
- **Other changes**
    - The Guidelines consolidate the previous circulars on TP consultation, Advance Pricing Agreements (APAs) and the TP of related party loans and services, which were released subsequent to the 2006 version of the Guidelines
    - Based on the guiding principles in the OECD guidelines, these Guidelines provide step-by-step processes for MAP and APAs
    - The IRAS has provided clarity regarding TP adjustments, offering guidance to taxpayers on managing their TP
    - The IRAS has provided additional guidance with respect to related party loans and services
    - The Guidelines state that no further attribution of profits to permanent establishments is required, provided certain conditions are met

Editor's note

The issuance of the Guidelines is a clear indication of the IRAS' endorsement of international best practice in relation to the preparation of TP documentation, to ensure that local taxpayers maintain adequate and appropriate analysis and documentation to demonstrate compliance with the arm's length principle in the context of a changing global tax environment. The Guidelines are likely to require increased visibility of Group TP policies. The Guidelines appear to prepare local taxpayers for the recent outcomes we have observed under BEPS with regard to master file, local file documentation and CbCR, and the likely reaction from other tax authorities.

Taxing of goods and services
Indirect taxes

Case law

VAT/ sales tax/ entry tax/ professional tax

In the case of the non-production of C forms, interest payable from the due date of payment of tax

State of Karnataka *v.* Bharat Heavy Electricals Limited and Others (TS-499-HC-2014-KAR-VAT)

The Karnataka HC held that in the case of the non-production of C forms, interest would be payable from the date the dealer was liable to pay tax. However, in case the C forms that were filed were found to be defective at a later date, the interest would be payable from the date of such determination during the assessment.

Profit retained by the contractor on a works contract completely executed through a sub-contractor is not liable for VAT in the hands of the main contractor

Surya Constructions *v.* State of Kerala (TS-552-HC-2014(KER)-VAT)

The Kerala HC held that no VAT was payable on the profit margin earned by a contractor where the entire contract had been sub-contracted to a third party sub-contractor. The HC observed that in the absence of sale of material by the contractor to the contractee no tax liability could be fastened on the contractor.

CENVAT

The time limit of six months for availing CENVAT credit on inputs applicable even for consignments which had arrived before introduction of procedural restriction

Ashok Leyland Limited *v.* CCE (2014-TIOL-2102-CESTAT-MUM)

The Mumbai Tribunal held that the time limit of six months under the erstwhile MODVAT provisions, for availing CENVAT credit on inputs, would apply even to consignments which arrived before the introduction of the procedural restriction.

CENVAT credit on inputs could not be denied on the grounds that activity undertaken by the supplier did not amount to manufacture

CCE *v.* GKW Limited (2014 (308) ELT 759)

The Mumbai Tribunal held that CENVAT credit on inputs could not be denied on the grounds that activity undertaken by the supplier did not amount to manufacture, particularly when no action was taken by the Revenue at the supplier's end.

Amount paid to the dealer for after-sales service not includible in the assessable value

Eicher Tractors Limited *v.* CCE (2014-TIOL-2389-CESTAT-DEL)

The Delhi Tribunal held that the amount paid to the dealer for after-sales service was not includible in the assessable value, as the appellant had paid the dealer, and not the other way round.

Service tax

Levy of service tax on the sale of food and other articles for human consumption in restaurants held ultra vires *the Constitution*

Union of India *v.* Kerala Bar Hotels Association and others (2014-TIOL-1913-HC-KERALA-ST)

The two-member bench of the Kerala HC upheld the decision of the single member bench, wherein it was held that the levy of service tax on sale of food and other articles for human consumption in restaurants and on consideration received for providing accommodation in hotels was *ultra vires* the Constitution of India. Since the State Government had the specific legislative competence to levy taxes on these transactions, it was not open to the Central Government to characterise these transactions as services liable to service tax.

Commitment charges received by banks are liable to service tax

Punjab National Bank *v.* CCE (2014-TIOL-2080-CESTAT-DEL)

The Delhi Tribunal held that commitment charges collected by the bank from borrowers who had failed to withdraw the entire amount of a loan, was a service in relation to the lending of money, and therefore held liable to service tax.

Levy of service tax on legal services rendered by advocates held constitutional

P C Joshi *v.* Union of India and others (2014-TIOL-2279-HC-MUM-ST)

The Bombay HC upheld the constitutional validity of section 65(105)(zzzzm) of the Finance Act, 1994, confirming the levy of service tax on legal services rendered by advocates.

Customs/ foreign trade policy (FTP)

Consideration paid in terms of a management consultancy services agreement was held not includible in the assessable value of imported goods, as there was no nexus of the same with imported goods

Alcan India Limited *v.* CC (2014-TIOL-2292-CESTAT-MUM)

The Mumbai Tribunal held that the consideration paid in terms of a management consultancy services agreement was not includible in the assessable value of imported goods, as there was no nexus of the same with imported goods.

Amendment in a bill of entry held allowable even though goods were out of a customs charge, on the basis of documentary evidence warranting such an amendment

Reiter India Private Limited *v.* CC (2014 (309) ELT 277)

The Mumbai Tribunal held that an amendment in a bill of entry had to be allowed even though goods were out of a customs charge, on the basis of documentary evidence warranting such an amendment.

Tribunal was held to have the power to remand the matter back to the competent authority that had jurisdiction to pass an order, and it was not warranted to remand to the authority which has passed the order

C P Aqua Culture (India) Private Limited *v.* CESTAT Chennai and Ors (2014-TIOL-2170-HC-MAD-CUS)

The Madras HC held that in the case the Tribunal found that there was an error in an order, the Tribunal had the power to remand the matter back to the competent authority that had the jurisdiction to pass an order, and it was not warranted to remand it to authority which had passed the order.

Notifications/ circulars

VAT/ sales tax/ entry tax/ professional tax

VAT rate on diesel increased from 9.75% to 11.25% in Punjab

Notification No. S.O. 177/P.A.8/ 2005/S.8/201 dated 15 November 2014

Effective from 15 November, 2014, the VAT rate on diesel other than premium diesel has been increased from 9.75% to 11.25%.

Service tax

The STR have been amended to enable the officer or the audit party to conduct audit/ verification of records

Notification No. 23/2014-ST dated 5 December 2014 and Circular No. 181/7/2014-ST dated 10 December 2014

The service tax rules (STR) have been amended to enable the officer or the audit party deputed by the Commissioner or the Comptroller and Auditor General of India, or a cost accountant or chartered accountant nominated under section 72A of the Finance Act, 1994 to conduct the audit/ verification of records maintained by the person liable to pay service tax, to ensure compliance with service tax provisions.

This amendment has been brought in following a decision of the Delhi HC in Travelite (India) (2014-TIOL-1304-HC-DEL-ST) wherein Rule 5A(2) of the STR had been quashed on the ground that the powers to conduct an audit envisaged in the rule did not have appropriate statutory backing.

Following the rulebook
Regulatory developments

FEMA

Foreign Direct Investment (FDI)

Mapping of sector specific FDI policy with NIC Code

Press Note No. 1 (2015 Series) dated 5 January 2015

With the objective of improving ease of doing of business, the Government has mapped the sectors which need compliance with the FDI Policy with the National Industrial Classification, 2008.

FDI Pharmaceutical Sector – a carve out for medical devices

Press Note No. 2 (2015 Series) dated 6 January 2015

With effect from 21 January 2015, FDI is permitted in manufacturing of medical devices (as defined in the policy) (including brownfield investments) under automatic route.

FDI in Railway Infrastructure – Permitted under automatic route

Press Note No. 8 – 2014 dated 27 August 2014 and A.P. (DIR Series) Circular No. 47 dated 8 December 2014

The Government has permitted 100% FDI in Railway Infrastructure sector (as specific in the policy) under automatic route, subject to prescribed conditions. FDI beyond 49% in the investee-operating company in sensitive areas (from a security point of view) will be approved by the Cabinet Committee on Security (CCS). FDI in this sector (other than Mass Rapid Transport Systems) was not permitted prior to this liberalisation.

FDI in Defense Sector – Limit increased to 49%

A.P. (DIR Series) Circular No. 46 dated 8 December 2014 and Press Note No. 7 – 2014 series dated 26 August 2014

Presently, FDI up to 26% is permitted under Government route in Defense industry subject to Industrial license. With effect from 26 August 2014, foreign investment upto 49% is permitted in defense sector subject to prescribed conditions. Portfolio investment and FVCI investment will be restricted to 24% of the total equity of the investee company.

Further, while portfolio investment will be under automatic route, Government approval would be required for FDI/ FVCI investments.

Department of Defense Production under the Ministry of Defense has finalised a list of items which requires Industrial license. Industrial license will not be required for items not specified in this list. Also, dual use items, i.e. items having military as well as civilian application, other than those specifically mentioned in the list, would not require Industrial license from defense angle.

Overseas Direct Investment (ODI)

ODI by Alternative Investment Fund

A.P. (DIR Series) Circular No. 48 dated 9 December 2014 and Notification No. FEMA. 326/ RB-2014 dated 12 November 2014

In addition to Domestic Venture Capital Funds (DVCFs) registered with SEBI, the RBI has permitted Alternative Investment Fund (AIF) registered with SEBI to invest in equity and equity-linked instruments of off-shore venture capital undertakings, subject to an overall limit of USD 500 million and SEBI regulations.

Creation of charge on overseas and domestic assets

A.P. (DIR Series) Circular No. 54 dated 29 December 2014

The RBI has now permitted creation of charge under the automatic route as follows:

- Creation of charge for securing the funded and/ or non-funded facility to be availed of by Indian investee company or by its group companies/ sister concerns/ associate concerns or by any of its overseas JV/ WOS/ Step Down Subsidiary(SDS) (irrespective of level) on
  - Shares in overseas JV/ WOS/ SDS (irrespective of level) in favour of a domestic or overseas lender
  - Other overseas assets of such overseas entity in favour of a domestic lender
- Creation of charge for securing the funded and/ or non-funded facility to be availed of by the JV/ WOS/ SDS (irrespective of level) of the Indian party on the domestic assets of an Indian party or its group companies/ sister concerns/ associate concerns, including the individual promoters/ directors in favour of an overseas lender

The aforesaid liberalisation is permitted subject to compliance with prescribed conditions, including a key condition that loan/ facility availed by the overseas

entity needs to be utilised only for its core business activities overseas, and not for investing back in India.

External Commercial Borrowing (ECB) - Parking of ECB proceeds in rupee term deposits

A.P. (DIR Series) Circular No. 39 dated 21 November 2014

Indian borrowers are now permitted to park ECB proceeds (raised under the automatic or approval routes) in term deposits with AD Category- I banks in India for a maximum period of six months pending utilisation for permitted end uses, subject to certain specified conditions, *viz.,* term deposit is kept unencumbered and would be liquidated as and when required.

Pre-liberalisation, ECB proceeds meant for Rupee expenditure were required to be immediately credited to Rupee accounts of the borrower.

Export of Goods and Services – Period of Realisation

A.P. (DIR Series) Circular No. 37 dated 20 November 2014

Exporters, including units in SEZs, EHTPs, STPs and BTPs, Status Holder Exporters, and EOUs are required to realise and repatriate proceeds in connection with export of goods/ software/ services to India within a period of nine months from the date of export.

RBI Clarification - Routing of funds raised abroad to India

A.P. (DIR Series) Circular No. 41 dated 25 November 2014

RBI has clarified that Indian Companies or AD Category - I banks are not allowed to issue any direct or indirect guarantee, or create any contingent liability, or offer any security in any form for overseas borrowings done by their overseas holding/ associate/ subsidiary/ group companies except for the purposes explicitly permitted in the relevant FEMA regulations.

Further, overseas funds so raised cannot be used in India unless such usage complies with general or specific permission granted under FEMA regulations.

RBI Clarification - Non-resident guarantee for domestic non-fund based facilities

A.P. (DIR Series) Circular No. 56 dated 6 January 2015

The RBI has clarified that a resident subsidiary of multinational company can hedge its forex exposure through permissible derivative contracts on the strength of guarantee of its non-resident group entity.

Financial Services

Change in bank rate

RBI/2014-15/406 DBR.No.Ret. BC.61/12.01.001/2014-15 dated 15 January 2015

As announced in the Press Release 2014-2015/ 1486 dated 15 January 2015, the bank rate stands adjusted by 25 basis points from 9% to 8.75% with effect from 15 January 2015. All penal interest rates on shortfall in reserve requirements, which are specifically linked to the bank rate, also stand revised as indicated in the circular.

Liquidity adjustment facility – repo and reverse repo rates and Marginal standing facility

RBI/2014-2015/403 FMOD.MAOG. No. 104/01.01.001/2014-15 dated 15 January 2015 and RBI/2014-2015/404 FMOD.MAOG. No.105/01.18.001/2014-15 dated 15 January 2015

The repo rate has been reduced under the liquidity adjustment facility (LAF) by 25 basis points from 8% to 7.75% with immediate effect. Consequent to the change in the repo rate, the reverse repo rate under the LAF will stand adjusted to 6.75% and the marginal standing facility (MSF) rate will stand adjusted to 8.75% with immediate effect.

All other terms and conditions of the current LAF scheme and MSF scheme will remain unchanged.

Standing liquidity facilities for banks and primary dealers

RBI/2014-15/402 REF.No.MPD.BC. 375/07.01.279/2014-15 dated 15 January 2015

The standing liquidity facilities provided to banks under export credit refinance (ECR) and to primary dealers (PDs) (collateralised liquidity support) from the Reserve Bank will be available at the revised repo rate, i.e., at 7.75% with effect from 15 January 2015.

Implementation of Basel III Capital Regulations in India – revised framework for leverage ratio

RBI/2014-15/396 DBR.No.BP. BC.58/21.06.201/2014-15 dated 8 January 2015

The revised framework for leverage ratio has been issued, and will come into effect from 1 April 2015

The formula for calculating the leverage ratio is capital measure divided by exposure measure. The capital measure for the leverage ratio is the Tier I capital of the risk-based capital framework, taking into account various regulatory adjustments/ deductions and transitional arrangements.

The general measurement principles for exposure measure relatively remain unchanged.

A bank's total exposure measure is the sum of the following:

- On-balance sheet exposures
- Derivative exposures
- Securities financing transactions exposures
- Off-balance sheet items

Revised format of reporting - representative offices of foreign banks in India

RBI/2014-15/374 DBR.IBD. No.9745/23.13.001/2014-15 dated 31 December 2014

Representative offices (RO) of foreign banks in India are currently required to submit the following information/ documents on an annual basis to the RBI:

- a certificate from the auditor to the effect that during the year, no income was earned by/ accrued to the office in India,
- certified copy of the audited final accounts of the office in India,
- details of remittances received from abroad duly supported by bank certificates, and
- an annual report of the work done by the office in India.

It has now been decided to revamp the existing system of reporting. The revised format of reporting is prescribed in the circular, and will be effective from the next reporting cycle. The revised format is divided into four parts – information about RO, data-set, information about bank/ group and other information.

F-TRAC – counterparty confirmation

RBI/2014-15/361 FMRD. FMID.01/14.01.02/2014-15 dated 19 December 2014

It has been decided to waive the requirement of exchange of physical confirmation of trades matched on F- TRAC, subject to the following conditions:

- Participants entering into a one-time bilateral agreement for eliminating the exchange of confirmation;
- Participants adhering to the extant laws such as stamp duty as may be applicable; and
- Participants ensuring adherence to a sound risk management framework and complying with all the regulatory and legal requirements and practices in this regard.

The dispensation with respect to waiver of physical confirmation will be subject to review in case of any change in ownership of the F-TRAC platform or reporting arrangements thereof.

Flexible structuring of existing long term project loans to infrastructure and core industries

RBI/2014-15/354 DBR.No.BP. BC.53/21.04.132/2014-15 dated 15 December 2014

Banks are now allowed to flexibly structure their existing project loans to infrastructure projects and core industries projects, with the option to periodically refinance the same as per the norms given below:

- Only term loans to projects, in which the aggregate exposure of all institutional lenders exceeds INR.5 billion, in the infrastructure sector and in the core industries sector (published by the Ministry of Commerce and Industry), will qualify for such flexible structuring and refinancing;
- Banks may fix a fresh loan amortisation schedule for the existing project loans once during the life time of the project, after the date of commencement of commercial operations (DCCO), based on the reassessment of the project cash flows, without this being treated as 'restructuring', subject to the conditions mentioned in the circular.

White Label ATMs in India – guidelines

RBI/2014-15/338 DPSS.CO.PD. No.1025/02.10.003/2014-2015 dated 5 December 2014

Based on a review of the operations of White Label ATMs (WLA) as well as representations received from the stakeholders, it has been decided to -

a. Allow WLAs to accept international credit/ debit/ prepaid cards. The cards issued under card payment network schemes (authorised under the PSS Act 2007) will be allowed for this purpose.

b. Permit the facility of Dynamic Currency Conversion (DCC) for the use of international cards at WLAs if the operator so decides to implement the DCC facility. The currency conversion rate can only be obtained from an authorised dealer bank.

c. Enable delinking cash supply from that of sponsor bank arrangements. A White Label ATM Operator (WLAO) may now tie up with other commercial banks for cash supply at WLAs. While the cash would be owned by the WLAO, the responsibility of ensuring the quality and genuineness of cash loaded at such WLAs would be that of the cash supplier bank.

d. WLAOs who have been authorised under PSS Act 2007 and have commenced operations are required to inform RBI regarding commencement of the services indicated in paragraphs (a), (b) and (c) above.

Issuance and operation of Pre-paid Payment Instruments in India- relaxations

RBI/2014-15/333 DPSS.CO.PD. No.980/02.14.006/2014-15 dated 3 December 2014

Amendments to existing guidelines

The limit of Pre-paid Payment Instruments (PPIs) that can be issued has now been enhanced from INR 0.05 million to INR 0.1 million. The balance in the PPI should not exceed INR 0.1 million at any point in time.

The maximum validity of the gift cards has been enhanced from one year to three years.

It has been decided to

introduce a new category of open system prepaid payment instrument, subject to the conditions prescribed in the circular.

Banks are permitted to issue open system rupee denominated as non-reloadable (a) PPIs to NRIs and foreign nationals visiting India and (b) PPIs co-branded with exchange houses/ money transmitters (approved by RBI) to NRIs and foreign nationals visiting India, subject to the conditions prescribed in the circular.

The above changes will come into effect from the date of issue of the circular. The other provisions of the master circular dated 1 July 2014 will remain unchanged.

Implementation of Bharat bill payment system – guidelines

RBI/2014-15/327 DPSS.CO.PD. No. 940 /02.27.020/2014-2015 dated 28 November 2014

Based on the public comments received on the draft guidelines for implementation of the Bharat Bill Payment System (BBPS), the final guidelines have been issued in the circular. The National Payments Corporation of India (NPCI) will function as the authorised Bharat Bill Payment Central Unit (BBPCU) to set the standards for BBPS processes which need to be adhered to by all operating units under the system. NPCI, as the BBPCU, will also undertake clearing and settlement activities related to the BBPS as outlined in the guidelines.

Banks which are desirous of operating as Bharat Bill Payment Operating Units (BBPOUs) would need to obtain approval from the RBI under the PSS Act, 2007. For non-bank entities seeking to operate as BBPOUs, the entity should be a company incorporated in India and registered under the Companies Act 1956/ Companies Act 2013. The Memorandum of Association (MOA) of the applicant-entity must cover the proposed activity of operating as a BBPOU and should have a net worth of at least INR 1 billion as per the last audited balance sheet. In case of any foreign direct investment (FDI) in the applicant entity, necessary approval from the competent authority as required under the policy notified by the Department of Industrial Policy and Promotion (DIPP) under the consolidated policy on FDI and regulations framed under the Foreign Exchange Management Act (FEMA) must be submitted while seeking authorisation. In addition, the company must have domain experience in the field of bill collection/ services to billers, and relevant experience in transaction processing for a minimum period of one year, and the entity must seek authorisation under the PSS Act, 2007 from the RBI for its operations.

Prospective participants of the BBPS system are advised to interact with the NPCI to work out the modalities for the BBPS and also keep themselves in readiness to apply for authorisation / approval, as the case may be, under the PSS Act, 2007. The applications for authorisation can be submitted to the RBI from the first quarter of 2015.

Basel III framework on liquidity standards – Liquidity Coverage Ratio, liquidity risk monitoring tools and LCR disclosure standards

RBI/2014-15/328 DBR.BP.BC. No.52/21.04.098/2014-15 dated 28 November 2014

In addition to the extant guidelines, banks will be permitted to reckon government securities held by them up to another 5 percent of their Net Demand and Time Liabilities (NDTL) within the mandatory SLR requirement as Level 1 High Quality Liquid Assets (HQLA) for the purpose of computing their liquidity coverage ratio (LCR). For the purpose of computing the LCR, such reckoned government securities within the mandatory SLR requirement should be valued at an amount no greater than their current market value (irrespective of the category of holding the security, i.e. Held to Maturity (HTM), Available for Sale (AFS) or High Frequency Trading (HFT).

Banks will be permitted to avail a liquidity facility against such securities under a special facility to be called ‘facility to avail liquidity for liquidity coverage ratio’ (FALLCR), the essential features of which are given below:

i Eligibility: Availing of liquidity against such securities would be permitted to banks only under conditions of stress as described under paragraph 4.3 of the above-mentioned circular dated 9 June 2014, and after the utilisation of all other HQLAs (including securities permitted under MSF). Banks will be required to furnish a declaration to this effect that they have exhausted their all other HQLAs before availing of the FALLCR.

ii Tenor: This facility can be availed/ rolled over up to a maximum period of 90 days.

iii Haircut: Liquidity against securities under FALLCR will be available after applying haircuts as stipulated for Marginal Standing Facility (MSF).

iv Facility rate: The rate of interest on the funds availed under this facility will be 200 basis points (bps) above the prevailing LAF repo rate, up to a period of 90 days, or as decided by the RBI from time to time.

v Effective date: The above facility will be effective from 1 January 2015

Issue of long term bonds by banks – financing of infrastructure and affordable housing

RBI/2014-15/320 DBR.BP.BC. No.50/08.12.014/2014-15 dated 27 November 2014

In order to provide liquidity to retail investors in such bonds, it has been decided that banks can extend loans to individuals against long-term bonds issued by them under the provisions of the above-mentioned circular. Boards of the banks should lay down a policy in this regard prescribing suitable margins, the purpose of the loan and other safeguards. Furthermore, such loans should be subject to a ceiling, say, INR 1 million per borrower, and the tenure of loan should be within the maturity period of the bonds. Banks are not permitted to lend against such bonds issued by other banks.

Furthermore, in the formula for eligible credit (EC), the definition of EC till March 2015 is B – 0.84A (one of the two factors of EC), which has been explained as outstanding 'standard' loans to the infrastructure sector (project loans) and affordable housing on the date of issuance of the bonds. It has been decided that 'B' should be now read as outstanding 'standard' loans to the infrastructure sector (project loans) and affordable housing on the date of reporting to RBI (reporting on Fridays for reserve requirements and on 31 March of a year for computing priority sector obligation).

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16 Dec 2014	Mrs. Jyoti Arun Kothari *v*. ITO [TS-737-ITAT-2014(Mum)]	Investment in property under construction is not to be treated as a ‘purchase’; qualifies for a 3 year investment period (for construction) for claiming exemption under section 54F of the Act
16 Dec 2014	http://mha1.nic.in/pdfs/ResidentialPermitJapaneseNational_091214.pdf	Government of India relaxes immigration norms for Japanese nationals
4 Dec 2014	Press Note 10 of 2014	Liberalisation of FDI norms in Construction Development Sector
4 Dec 2014	CIT-IV *v*. Holcim India Private Limited [TS-640-HC-2014(Delhi)]	No disallowance under section 14A unless exempt income is earned during the year
28 Nov 2014	Shell India Markets Private Limited *v.* ACIT [2014] 51 taxmann.com 519 (Bombay HC)	Shell follows Vodafone on issue of shares – Chapter X applies when income arises and is chargeable to tax
22 Nov 2014	CIT *v.* Van Oord ACZ Equipment BV [TS-695-HC-2014(Madras)]	Madras High Court provides clarity on taxation of bareboat charter hire charges
20 Nov 2014	CBEC Circular No. 990/14/2014-CX-8, dated November 19, 2014	CBEC has issued clarification regarding re-availment of CENVAT credit post expiry of 6 months
13 Nov 2014	Xander Advisors India Private Limited *v*. ACIT [TS-361-ITAT-2014(DEL)-TP]	Tribunal lays down fundamental differences between merchant banking and private equity fund related activities and accepts mark up earned by the taxpayer for sub-advisory services
10 Nov 2014	CBDT Press Release dated 7 November 2014	CBDT has issued instructions to Income-tax Officers - an attempt towards a non-adversarial tax regime
5 Nov 2014	DCIT *v*. India Advantage Fund-VII [ITA No. 178/Bang/2012]	Income earned by a fund set up as a revocable trust to be taxed only in the hands of the beneficiaries as per the provisions of sections 61 to 63

Glossary

AE	Associated enterprise
ALP	Arm's length price
AY	Assessment year
BEPS	Base Erosion and Profit Shifting
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)
DRP	Dispute Resolution Panel
FTS	Fees for technical services
FY	Financial year
HC	High Court
HO	Head Office
LO	Liaison Office
LTCG	Long Term Capital Gains
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
PSS	Payment and Settlement Systems
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
VAT	Value added tax
WDV	Written Down Value

Notes

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