Be in the know

India Spectrum

Volume 6 Issue 6
June 2013

pwc

In this issue

Editorial

We are delighted to present another issue of India Spectrum.

The Finance Minister (FM) has promised to roll out a series of reforms to halt the despondency that has grasped markets and investors due to the depreciating value of the Rupee and sluggish industrial growth. The measures suggested include removing caps on foreign direct investment in various sectors, introducing easier entry norms for portfolio investors and a framework to set the price of coal and gas, and for allocating coal mines. The FM has also given his word to nudge banks to pass on interest rate cuts to consumers, which could help boost economic growth.

On the domestic economy front, India's Index of Industrial Production rose to 2.3% in April 2013. According to use-based classification, the growth rates in April 2013 over April 2012 were revised to 2.1% in basic goods, 1% in capital goods and 2.4% in intermediate goods. Inflation as measured by the wholesale price index eased to 4.7% in May 2013, as against the lowest recorded since October 2009 at 1.46%. The rupee strengthened by 40 paise to INR 57.60 to a dollar, as banks and exporters sold dollars. The World Bank lowered India's growth forecast for the current fiscal from 6.1% to 5.7%, in view of the lowered growth projection of the world economy from 2.4%, as estimated at the beginning of the year, to 2.2%.

On the global economic front, the Public Accounts Committee of United Kingdom's (UK) Parliament continues to be focussed on the alleged 'contrived' arrangement to avoid tax by Google Inc. in respect of its UK sales. This keeps the spotlight on corporate profit shifting to low tax countries.

Ketan Dalal

Shyamal Mukherjee

The Securities and Exchange Board of India (SEBI) has notified a new set of regulations to govern issuance and listing of non-convertible preference shares. This is a move to increase transparency in raising funds through such securities. To safeguard the interest of small investors from such high risk securities, SEBI has provided that the listing of privately placed non-convertible redeemable preference shares would require a minimum application of INR 10 lakh for each investor.

On the judicial front, the Mumbai bench of the Income-tax Appellate Tribunal, in the case of Abacus International Pvt. Ltd., held that the benefit of the lower rate of withholding tax on interest under the India-Singapore tax treaty was not available without evidence of remittance of money from India to Singapore. In another ruling, the Delhi High Court in the case of Dhoomketu Builders and Development Pvt. Ltd. held that the date of initiation of one the first activities essential to the commencement of a company's business should be considered as the date of setting up. See page no.6 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

Availability of Treaty Benefits

Singapore treaty benefits not available if money not remitted to Singapore

Abacus International (P) Ltd. *v.* DDIT [2013] 34 taxmann.com 21 (Mum-Trib.)

The taxpayer, a Singapore tax resident, was engaged in the business of computerised reservations for airlines. The taxpayer was granted a refund by the revenue, which included interest. The taxpayer offered such interest for taxation, but @ 15 per cent as per Article 11 of the India-Singapore tax treaty (Singapore tax treaty). The TO denied this claim as, in his opinion, the basic condition for extending the benefit of Article 11 was that the income must have been remitted to or received in Singapore based on Article 24 of the Singapore tax treaty. As the taxpayer did not furnish any proof of remittance to Singapore, the TO taxed it at @ 20 per cent in accordance with section 115A of the Act, denying the benefit of the Singapore tax treaty on the grounds that the company did not furnish any proof of remittance of interest to Singapore.

The Tribunal held that the basic condition for availing the benefit extended by Article 11 of the Singapore tax treaty was that the income must have been remitted to, or received in, Singapore, without which the Singapore tax treaty cannot apply. Further, the Tribunal held that "Article 24 of the tax treaty made it clear beyond any shadow of doubt that the receipt or remittance of income in Singapore was *sine qua non* to claim the benefit of lower rate of tax on the interest income from India." The burden lay on the taxpayer to prove that the income was remitted to, or received in, Singapore. Accordingly, the Tribunal concluded that the company was not entitled to reduced tax rate on interest on income-tax refund and would be taxed @ 20 per cent as per the provisions of the domestic tax laws.

Set up of business

Business of real estate developer 'set up' when steps taken to acquire land – 'ready to commence' stage

CIT *v.* Dhoomketu Builders & Developers Pvt. Ltd. [2013] 216 Taxman 76 (DEL)

The taxpayer was a company incorporated for carrying on the business of real estate development. In its first year of existence, it had obtained loan from its parent company for making deposit towards a tender for purchase of a land. However, the taxpayer was unsuccessful in obtaining the tender and it had received back the deposit money alongwith interest thereon.

It had also paid interest to its parent company for loan obtained and the excess interest paid over and above the interest received on deposit money was claimed as a business loss and was carried forward.

The TO contended that since the taxpayer was not successful in acquiring the land, mere act of participating in the tender and obtaining loan for the same would not amount to setting-up of business. Accordingly, it disallowed the interest expense and taxed the interest income as 'income from other sources'. While holding so it also referred to the tax auditor's report which stated that the taxpayer had not commenced any business activity.

On appeal, the CIT(A) allowed deduction for the interest expense under the head 'income from other sources' but rejected the taxpayer's claim for carry forward of the loss. On further appeal, the Tribunal ruled in the taxpayer's favour.

The High Court held that the Tribunal had rightly observed the following instead of,

- Upon participating in the tender process, one of the activities had been initiated for the development of real estate, which would enable the assessee to acquire the land for development.
- Commencement of real estate business started with the acquisition of land and hence if the assessee started

performing certain acts towards the acquisition of land, then business had been set up.

- The observation made in the tax audit report was with respect to commencement of business and not to its being set up.

The HC also referred to the decision in the case of Western India Vegetable Products Ltd. v. CIT [1954] 26 ITR 151 (Bombay) wherein it was held that when a business was established and was ready to commence, then it could be said that business was set up.

Considering the above, the HC held that the taxpayer was entitled to claim the business loss and also to carry it forward in the subsequent years.

Tax withholding

Payment for 'testing services' for products does not make available technical skill, knowledge or expertise, not subject to withholding tax

DCIT *v.* Dr. Reddy's Laboratories Ltd. [2013] 35 taxmann.com 339 (Hyd-Trib)]

The taxpayer was engaged in the business of manufacturing, trading and export of bulk drugs and pharmaceuticals. For marketing its products in USA and Canada, the taxpayer was required to get an approval from the respective regulatory authorities. For this purpose, the taxpayer had got its products tested through a 'bio-equivalence study' done by specialised organisations in USA called contract research organisations (CROs). During the test, the CROs conducted clinical research and analysed the impact of the drug in human beings and submitted a report to the taxpayer that contained the findings. For this purpose, the taxpayer had made payments to four USA and Canada based CROs without withholding tax. The TO was of the view that such payment was in the nature of 'fee for included services' (FIS) as per Article 12 of the India-USA (USA treaty) and India-Canada (Canada treaty) tax treaties. The taxpayer contended that the payments were not FIS under Article 12 but were 'business profits' in the hands of the CROs as per Article 7 of the USA treaty and Canada treaty. Also, since the CROs did not have any permanent establishment (PE) in India, the amounts were not taxable in India. The TO rejected the taxpayer's contention and ordered payment of withholding tax and interest under section 201(1A) of the Act.

The Tribunal stated that since there was no technical skill, knowledge, expertise or plans or designs made available, the amounts paid by the taxpayer could not be termed as FIS under Article 12 of the USA treaty and Canada treaty but were covered by Article 7 thereof. The taxpayer did not get any benefit from such services of CROs except help in getting the product registered with regulatory authorities. Accordingly, the amount paid to CROs was in the nature of business receipts in the hands of the CROs, and since they did not have a PE in India, there was no requirement to withhold tax on the said payments.

Permanent establishment

Liaison Office doesn't create PE despite subsequent branch set-up

St. Jude Medical (Hong Kong) Ltd. *v.* DDIT [TS-229-ITAT-2013(Mum-Trib.)]

The taxpayer was a non-resident company based in Hong Kong engaged in the business of selling heart valves in the Asian region including India. It was a wholly-owned subsidiary of St. Jude Medical Inc., USA (SJMI USA). The taxpayer had set-up a liaison office (LO) in India with the permission of the Reserve Bank of India (RBI). Although it had an LO, the taxpayer and SJMI USA were conducting their sales through a network of distributors. Considering the potential in India for life-saving medical products, the LO was coordinating the market survey, propagation, etc., as permitted by the RBI. Thereafter, the LO was closed and a branch office was set up with RBI permission. For the tax years 1999-2000 and

2000-01, the taxpayer declared taxable income at nil as its operations in India were restricted to act as an LO that had not earned any income in India. The TO held that the LO was involved in business activity that was a 'business connection' and hence, created a PE of the Hong Kong taxpayer in India. Therefore, the TO estimated profit on the sales made by the taxpayer and SJMI USA. The TO adopted a gross profit rate of 40 per cent on global sales for the tax year 1999-2000, and 20 per cent for the tax year 2000-01.

The Tribunal observed that the TO's approach to tax incomes attributable to sales made by both, the taxpayer and SJMI USA in a single assessment order was inappropriate. It observed that there should have been separate proceedings for two separate companies established in different countries. This contention had also been accepted in the taxpayer's own case for earlier years, which the revenue had not appealed against. Accordingly, the Tribunal directed the TO to exclude the profits of SJMI USA from the taxpayer's taxable income. It held that the taxpayer was involved in liaison activities upto 31 March 1999 and not in sales activity, relying on the survey statement and documents impounded. It observed that all documents relied on by the revenue pertained to the establishment of the branch office, and none of them established that the taxpayer was involved in business activities before it became a branch. Therefore, for the tax year 1999-2000, the Tribunal directed deletion of profits attributed to the taxpayer. For the tax year 2000-01, the Tribunal directed the TO to examine sales made during the three months in which the taxpayer had established a branch and arrive at profits 10 per cent as determined by CIT(A).

Taxability of income from shipping

Slot charter constitutes charter for availing profit exemption under Article 8 of the India-Singapore tax treaty

APL Co Pte Ltd. *v.* DDIT(IT) [2013] 142 ITD 498 (Mum-Trib)]

The taxpayer, a tax resident of Singapore was engaged in ship operation for transporting cargo in international traffic. The taxpayer was allocated a slot in a feeder vessel for transporting the cargo from an Indian port to the mother feeder hub for its onward transportation to the final destination. The profits from the ship operations were claimed as exempt in India under Article 8 of the India-Singapore tax treaty (Singapore tax treaty), on the ground that they were taxable in Singapore.

The TO held that the risks and rewards of the ship operations were not undertaken by the taxpayer. Therefore, it was neither the owner nor the charterer of the ship, but a mere slot charterer and hence ineligible for exemption under Article 8 of the tax treaty. While holding so it relied on DIT(IT) *v.* CIE DE Navegacao Norsul [2009] 121 ITD 113 (Mum) wherein it had been held that cargo transportation by feeder vessels to the mother vessels not owned/ leased/ chartered by the taxpayer was not eligible for profit exemption under Article 8 of the India-Brazil tax treaty.

The Tribunal observed that Article 8 of the Singapore tax treaty and of the India-Brazil tax treaty were worded differently. In the India-Brazil tax treaty, Article 8 refers to the profits from 'business of transportation of ships' whereas the India-Singapore tax treaty refers to the profits from 'operation of transportation of ships'. Also the India-Singapore tax treaty extended the exemption under Article 8 to cover 'any other activity directly connected with the transportation'.

In DIT(IT) *v.* Balaji Shipping UK Ltd. [2012] 211 taxman 535 (Bombay) Lloyd Law Reports, it was held that there was no difference in principle between slot charter and voyage charter and hence slot charter is charter *per se*.

Accordingly, even though the taxpayer was a slot charterer, it was held to be entitled to exemption under Article 8 of the Singapore tax treaty.

Royalty/FTS

Royalty payment to non-resident as percentage of sales deductible as revenue expenditure

DCIT *v.* Carraro India Ltd. [ITA. No. 1384 & 1385/PN/2010]

The taxpayer-company had entered into an agreement with a non-resident for availing licensed technology for manufacturing goods. The royalty paid for the same was claimed as revenue expenditure.

The TO treated the royalty payment as capital expenditure on the basis that the taxpayer had the absolute right to use the technology. The CIT(A) allowed the royalty payment as deductible revenue expenditure.

The Tribunal observed that as per the agreement, the right to use the technology was confined to taxpayer only. It had no right to sub-license the technology or to use it beyond the terms of the agreement without prior consent of the technology provider. Therefore, the taxpayer had only a limited right to use the technology, with several restrictions. Furthermore, the taxpayer was required to manufacture the goods only in the specified territory and the royalty was linked to the sales turnover in the specified territory.

In the case of Climate Systems India Ltd. *v.* ACIT [2010] 2 ITR 168 (Del-Trib.), it had been held that royalty for using technology paid to foreign collaborators at a specified percentage of sales was allowable as revenue expenditure. The Tribunal therefore held that royalty paid to the non-resident for obtaining non-exclusive right to use technology, that was calculated based on sales turnover, was deductible as revenue expenditure.

Commission paid to non-resident sub-arrangers to mobilise deposits not taxable in India

Credit Lyonnais (through their successors: Calyon Bank) *v.* ADIT [2013] 35 taxmann.com 583 (Mum-Trib)]

The taxpayer-bank, appointed by the SBI as an arranger for mobilising deposits under its deposit scheme, received commission for rendering such services. The taxpayer appointed sub-arrangers in and outside India for mobilising the scheme and paid commission to sub-arrangers.

The TO held that the payments of commission to sub-arrangers were in the nature of FTS and hence, tax was required to be withheld under section 195, which was disallowed under section 40(a)(i), as tax had not been withheld.

The CIT(A) held that sub-arrangers' fees were in the nature of brokerage and commission and not FTS. Therefore, no tax was required to be withheld and accordingly, the commission expenditure was allowed.

The Tribunal observed that the taxpayer was only acting as commission agent/broker, entitled to commission. The taxpayer and sub-arrangers provided services of soliciting NRI customers for IMD Scheme of SBI, which were only a small part of management of the IMD issue.

In Mahindra and Mahindra Ltd. *v.* DCIT [2009] 122 TTJ 577 (Mum) and R. Dalmia *v.* CIT [1977] 106 ITR 895 (SC), it had been held that doing small parts of an activity could not be regarded as rendering managerial services. Furthermore, reliance was placed on Circular No. 786 dated 7 February, 2000 which stated that commission paid to non-resident agents was not chargeable to tax in India as they operated outside the country and no part of their income arose in India.

The Tribunal held that since services rendered by the taxpayer and sub-arrangers were not covered by the definition of FTS in section 9(1)(vii), no tax was required to be withheld under section 195 while making payment to non-resident sub-arrangers.

Payment by the branch to HO not taxable under the Act as it is a payment to self

Lloyds Register *v.* DDIT [2013] 33 taxmann.com 296 (Mum)

The taxpayer, a UK- based company, provided services like classification, carrying out statutory instructions and surveys of all types of ships, crafts and vessels and also issued certificates of surveys and inspections carried out by it. While computing income of its Indian branch PE, technical expenses paid to head office (HO) were claimed as deduction.

The tax officer (TO) disallowed the deduction on the ground that such expense was 'fees for technical services' (FTS). Since the taxpayer failed to withhold tax while making payment, same was disallowed under section 40(a)(i) and taxed the FTS at the rate of 15 per cent.

The CIT(A) held that technical fees paid to HO was not deductible as it was a payment to self. Similarly, it was not taxable in the hands of HO as the amount was not deductible in the hands of PE.

The Tribunal observed that there was no correlation between actual expenses and the re-imbursement from branch to HO, as the HO was charging 40 per cent of gross revenue of branch irrespective of actual expenditure incurred by it, which was 32 per cent. Hence, the HO was charging the Indian PE with a profit element. Therefore, it could not be held that technical expenses paid were re-imbursement of actual expenses of the HO. However, in ABN Amro Bank NV *v.* ADIT [2005] 97 ITD 89 (Kol.) (SB), it had been held that a branch of the taxpayer-bank could not be treated as an entity separate from its HO since transactions between HO and branches were to be viewed as transactions with self. Hence, technical expenses in this case could neither be allowed as deduction in the hands of Indian branch nor be considered as income in the HO's hands. Once deduction was not allowed, section 40(a)(i) could not apply.

Regarding taxability of technical expenses in the HO's hands, such income was not chargeable to tax under the domestic law. Once the amount was not chargeable to tax under the domestic law, the same could not be taxed under tax treaty since reference to tax treaty is made to reduce the tax burden cast by domestic law. If income is not taxable under the domestic law, tax treaty could not cast a fresh obligation of tax independent of any provision under the domestic law. Therefore, technical expenses paid by branch PE to HO were not held taxable in the hands of HO.

Personal taxes
Assessing personal tax

Case law

Salary/perquisite

Employee not liable to penalty for employer's mistake in computing the taxable income under the head 'salary'

Khushboo. P. Shah *v.* DCIT [TS-125-ITAT-2013(Rjt)]

In a recent decision, the Rajkot bench of the Tribunal, while disposing off seven different appeals against a common order, held that no penalty under section 271(1)(c) of the Act can be levied on an employee where the employer has wrongly computed taxable income under the head 'salary' and the employee has disclosed the salary income in his income-tax return as per the salary certificate (form 16) issued by the employer.

The taxpayers in these appeals were employed with Meena Agency Pvt. Ltd., Jamnagar during AY 2008-09 & 2009-10 and had received conveyance, uniform, laundry and medical allowance as part of their salaries from the employer. The employer had claimed these allowances as tax exempt under section 10(14) of the Act and this was reflected in its Form 16. The assessments of all these assesses were framed under section 153C of the Act, because of a search operation that had been carried out on Meena Agency group.

As per provisions of section 10(14) of the Act, allowances or benefits which are given to meet the expenses incurred in performance of duties are exempt from taxation to the extent expenses have actually been incurred by the employee. However, in this case, the TO observed that these payments were lump-sum fixed re-imbursements and, since no actual expenditure was incurred by the employees, exemption under section 10(14) of the Act was not applicable.

Accordingly, these allowances were added back to the income under the head 'salary', and penalty proceedings under section 271(1)(c) of the Act were initiated. Ignoring the submissions made by the assesses that the said amounts were either expended by them or their family members for the purposes for which the same were paid to them by their employer, penalty @ 100 per cent of tax evaded was levied.

Aggrieved by the penalty order, the taxpayers approached the CIT(A), who granted partial relief to them by deleting the additions made on account of the conveyance allowance, to an amount of INR 9,600. Aggrieved, the assessees approached the Tribunal. The Tribunal ruled in favor of the taxpayers and concluded that no penalty under section 271(1)(c) of the Act could be levied on the employee as the income-tax returns were filed as per the salary TDS certificate issued to them by their employer. It was held that an employer's mistake in calculating taxable salary income by incorrectly applying the provisions of the Act could not lead to penalty on employees.

Loan foreclosure charges allowed to be deducted against income under the head 'house property'

Windermere Properties Pvt. Ltd. *v.* DCIT [2013] 34 taxmann.com 109 (Mum - Trib)

In a recent decision, the Mumbai Tribunal held that prepayment charges payable on foreclosure of housing loan qualify as 'interest' and are deductible against house property income ,under section 24(b) of the Act.

During the AY 2006-07, the taxpayer had computed income under the head 'house property', after claiming a deduction of INR 110.5 million on interest amounting to INR 94.8 million paid on a housing loan for the said property and prepayment charges of INR 15.6 million paid during the year for early closure of this loan under section 24(b) of the Act. During the assessment proceedings, the TO disallowed the deduction claimed by the taxpayer as he was of the opinion that only interest payable on capital borrowed for acquiring, constructing, repairing, renewing or reconstructing a house property is allowable as

deduction under section 24(b) of the Act against income from house property.

The order of the TO was upheld by the CIT(A). The taxpayer then filed an appeal before the Tribunal. The Mumbai Bench of the Tribunal ruled in favour of the taxpayer and observed that 'prepayment charges' cannot be considered as *de hors* the loan obtained for acquisition or construction etc. of the property. It further examined the meaning of term 'interest' as defined under section 2(28A) of the Act and observed that the term 'interest' also includes any charges paid for not using the credit facility. Since prepayment charges had a live and direct link with the loan availed for the said property and were covered under the second component of term 'interest', they were deductible from house property income.

Circulars/ Notifications

CBDT makes it mandatory to verify Part 'A' of Form 16 generated online

Circular No. 04/2013 dated 17 April 2013

Earlier this year, the Central Board of Direct Taxes (CBDT) had notified a new format for Form 16 (to be issued by employer) by dividing it into two parts: Part A - containing details of tax deductions and deposits; & Part B (annexure) containing details of income.

In order to further streamline the tax deducted at source (TDS) procedure and align it with the procedure of issuing Form 16A, the CBDT made it mandatory for employers to issue Part A of Form16 by downloading it through the TDS reconciliation analysis and correction enabling system (TRACES) portal. It further requires the employer to authenticate the correctness of the contents mentioned therein and verify them either by using manual signature or by using digital signature, before issuing it along with Part B (prepared manually) to the employees.

Furthermore, only Part A of Form 16 generated in accordance with the provisions of this circular and containing a unique identification number, should be treated as valid compliance of section 203 of the Act read with Rule 31 of Income-tax Rules, 1962 (the Rules).

The CBDT prescribes tax return forms for AY 2013-14

The CBDT recently notified tax return forms for AY 2013-14 vide Income tax (3rd Amendment Rules), 2013 amending Rule 12. In order to further strengthen the e-filing of tax returns, it has now made it mandatory:

- For persons, other than a company and person required to furnish tax return in form ITR 7, having income assessable to tax exceeding INR 5,00,000, to file tax returns electronically;
- To file electronically tax audit certificates, transfer pricing certificates and minimum alternate tax (MAT) certificates under sections 44AB, 92E & 115JB of the Act, respectively;
- For assessees claiming unilateral relief under section 91 of the Act or relief under the bilateral tax treaty under section 90 or 90A of the Act to file tax returns electronically.

Furthermore, form ITR 1/ ITR 4S cannot be used where,

- Assessee is reporting losses under any head of income;
- Income exempt from taxation exceeds INR 5,000;
- Assessee is claiming tax reliefs under section 91, 90 or 90A of the Act.

Structuring for companies
Mergers and acquisitions

Case law

Conversion of shares held as stock-in-trade into investments and subsequent sale

ACIT *v.* Superior Financial Consultancy Services Pvt. Ltd. [ITA No. 4208/Mum/2007]

The taxpayer was engaged in the business of borrowing and lending of funds. It stopped trading in shares and converted its shares held as stock-in trade into investments. Subsequently, the taxpayer sold its investments and claimed long-term capital gains. The TO assessed them as business income, as their conversion was intended to avoid the payment of tax at the higher rate of 35 per cent.

On appeal, the CIT(A), by relying on the decision of the Supreme Court (SC) in the case of Sir Kikabhai Premchand *v.* CIT [1953] 24 ITR 506 (SC), held that there was no specific ban on conversion of stock-in-trade into capital asset or *vice versa*.

The Tribunal held as follows:

The SC in case of Sir Kikabhai Premchand (above) held that such conversion is not something unknown in the commercial world and that there was no legal bar on it.

The CIT(A) had clearly established that the taxpayer had not entered into any sham transactions for avoiding tax, and that the conversion of stock into investment was transparent in the audited accounts of the taxpayer.

Relying on the Tribunal's decision in the case of Vesta Investments & Trading Co. Pvt. Ltd. *v.* CIT [1999] 70 ITD 200 (Chd), the CIT(A) had rightly held that a taxpayer can claim to be an investor in some shares while doing speculation in others.

Allowability of depreciation on goodwill, etc.

ITO *v.* Virbac Animal Health India Pvt. Ltd. [TS-134-ITAT-2013(Mum)]

The taxpayer claimed depreciation on distribution rights, trademarks, technical know-how and goodwill. The depreciation claims were disallowed by the TO, but allowed by the CIT(A).

The Tribunal allowed the depreciation on distribution rights by relying on the decision of Jyoti (India) Metal Industries Pvt. Ltd *v.* ACIT [ITA No.181/M/2008], wherein depreciation was allowed on marketing networks providing the taxpayer with access to representatives, infrastructure, customer lists, marketing strategies etc.

Furthermore, relying on the SC's ruling in the case of Smifs Securities [2012] 210 Taxman 428 (SC), the Tribunal allowed depreciation on goodwill and, relying on the Karnataka HC ruling in the case of B. Raveendran Pillai *v.* CIT [2011] 332 ITR 531 (Kar), depreciation on trademark rights.

Lastly, following the Bangalore Tribunal ruling in the case of DCIT *v.* Hewlett Packard India Sales Pvt. Ltd. [ITA Nos. 249 & 250/Bang/2010], the Tribunal upheld allowability of depreciation on intangible assets.

On similar lines, the Chandigarh Tribunal has also taken a similar view in RFCL Ltd *v.* DCIT [TS-122-ITAT-2013 (Chandi)], allowing depreciation on intangible rights comprising licenses, permissions, health registrations, manufacturing know-how, distribution network comprising wholesale stockists, etc. In this particular case, the 'bundle of rights' was acquired by the taxpayer under a slump sale agreement for 'animal health care and diagnostic business divisions'

Expenses incurred by Indian company as a consequence of a global deal by its parent company not allowable as deduction

Gillette Group India Pvt. Ltd. *v.* DCIT [TS-128-ITAT-2013 (DEL)]

Gillette Group India Pvt Ltd. ("the taxpayer") was engaged in the business of establishing its parent company's business in India through acquisitions and by entering into joint ventures ("JVs") with its Indian partners. During AY 2002-03, the taxpayer's ultimate parent company, Gillette USA, sold its Parker-pen division to a third party. As a result, the taxpayer exited from its JV in India relating to the pen business. In this connection, the taxpayer incurred legal and travelling expenses.

Relying on the decision of the SC in the case of Delhi Safe Deposit Co. Ltd. [1982] 133 ITR 756 (SC), the TO disallowed the expenses, contending that they were not incurred wholly and exclusively for business purposes. The TO observed that taxpayer's exit from the Indian JV resulted in violation of the Indian JV agreement, due to which the Indian party was seeking legal redress. To ensure uninterrupted worldwide sale of the pen division, Gillette USA entered into a 'consent and waiver agreement' with the Indian party and paid non-compete fees to the Indian party through the taxpayer. The said agreement was signed by Gillette USA. The TO thus held that the expenses were incurred at the behest of Gillette USA and not for the business purposes of the taxpayer.

The CIT(A) upheld the TO's decision, observing that the entire sale proceeds of the division were also retained by Gillette USA only.

The Tribunal concurred with the CIT(A) in light of the above contentions.

SEBI Regulations

Scheme of arrangement under the Companies Act, 1956 - Revised requirements for the stock exchanges and listed companies - Clarification

Circular No. CIR/CFD/DIL/8/2013) on 21 May, 2013 (Revised Circular) Source:http://www.sebi.gov.in/cms/sebi_data/attachdocs/1369139160079.pdf

The Securities and Exchange Board of India (SEBI) has issued a Circular (SEBI Circular No. CIR/CFD/DIL/8/2013) on 21 May 2013 (Revised Circular), clarifying and modifying certain clauses of the earlier Circular (SEBI Circular No. CIR/CFD/DIL/5/2013), dated 4 February 2013 (Original Circular), in connection with the requirements for listed companies to obtain approval from SEBI while undertaking a scheme of arrangement for mergers, demergers, capital reductions etc. The revised circular has been introduced with a view to clear ambiguities especially with regards to its applicability and other related operational aspects.

- ***Applicability***

  The language of the original Circular suggested that it was applicable only in the case of companies seeking an exemption from Rule 19(2)(b) of the Securities Contracts (Regulations) Rules, 1957 (SCRR), which applies to the listing of unlisted resulting company's shares without following the process for public issue of shares.

  The revised Circular has now clarified that the requirements of the original Circular are applicable to all listed companies undertaking a scheme of arrangement for mergers, demergers, capital reductions etc. under Companies Act, 1956 and not only to cases where exemption from Rule 19(2)(b) of SCRR is sought from SEBI.

- ***Approval from public shareholders through postal ballot and e-voting***

  The original Circular required listed companies also to approve the scheme of arrangement by way of a special resolution of public shareholders through a postal ballot and e-voting, with a necessary 2/3rd majority of the public shareholders. However, SEBI has now clarified that only such schemes which specifically involve alterations in promoter shareholding (promoters or promoter group entities) would require a resolution of the public shareholders.

  In all other cases, an undertaking duly certified by an auditor and approved by the board of directors must be furnished clearly stating the reasons for the non-applicability of above voting requirement. Such undertaking is to be displayed on the web-site of the stock exchanges as well as the company's, along with the prescribed documents submitted to SEBI and the stock exchange.

- ***Valuation Report***

  The revised Circular provides that a valuation report from an independent Chartered Accountant is not required in cases where there is no change in the shareholding pattern of the listed company/ resultant company.

The revised Circular issued by SEBI has provided much needed clarity on the scope and applicability of the original Circular.

Pricing appropriately
Transfer pricing

Prelude

The CBDT has recently published a comprehensive guidance note and frequently asked questions (the Note) detailing the procedural aspects of unilateral, bilateral or multilateral advance pricing agreement (APA) applications. The Note also addresses many of the questions commonly asked by applicants. The CBDT demonstrates a positive and open-minded approach in defining the procedural and practical aspects of the APA process. The Note would serve as a handy guide to potential APA applicants, providing guidance about the approach, process and the expectations of the APA office. A brief summary of the recently released note is provided in this communiqué.

On the global front, the United Nations (UN) recently released the final version of its "Practical Manual on Transfer Pricing for Developing Countries" (the Manual). As compared to the draft manual which was released in October 2012, the final version is largely similar in content to the draft. This manual endorses the arm's length standard for pricing transactions with multinational enterprises, as do the OECD Transfer Pricing Guidelines, the difference being that the UN Manual is more practical and illustrative, as it attempts to provide solutions and work arounds for developing countries. The Chapter on India primarily discusses some of the emerging transfer-pricing issues in India, as described by the Indian tax administration. Some of the India issues have already been discussed in the Manual, but more importantly, the India Chapter, which is not necessarily endorsed by the UN, provides the Indian Revenue's perspective on various issues that would assist MNEs in their decision-making.

During the past month, different income-tax Tribunals have decided cases involving transfer-pricing issues, which are summarised in this communiqué.

Central Board of Direct Taxes – Publishes APA Guidance with FAQs

Courtesy: PwC Pricing Knowledge Network

The APA provisions were introduced in India with effect from 1 July 2012 by the Finance Minister in the Union Budget 2012. The CBDT, by notification in the Official Gazette dated 31 August 2012, had introduced detailed rules providing the necessary application forms for a unilateral, bilateral or multilateral APA. The CBDT has now published a comprehensive Note detailing the procedural aspects concerned with the unilateral, bilateral or multilateral APA applications. The Note addresses some of the questions commonly asked by applicants. Some of the key points addressed in the Note are worth highlighting, such as:

- That a unilateral APA application can be converted into a bilateral APA before finalisation;
- If bilateral/multilateral negotiations fail, the taxpayer has an option to opt for a unilateral APA or even multilateral APA not involving the country with which agreement could not be reached;
- APA authorities will look at the evidence and information submitted by the taxpayers with an open mind despite any past litigation;
- Tax administration has no particular preference for bilateral APAs over unilateral APAs. The decision lies with the taxpayer;
- Since an APA is transaction specific, the taxpayer can request unilateral APAs for some transactions, and bilateral APAs for others;
- A taxpayer can file an APA request for profit attribution to a PE;
- A request for pre-filing consultation cannot be refused by the APA office;
- While it is the taxpayer's decision to cover certain transactions over others,

if one transaction is intrinsically linked with another or several such that it cannot be benchmarked independently, then both/all transactions may need to be covered.

Mumbai Tribunal – Determination of ALP based on prescribed methods

Cybertech Systems & Software Ltd. *v.* ACIT [2013] 33 taxmann.com 371 (Mumbai - Trib.)

The taxpayer (an IT services provider) was delivering services in the US, Asia and Japan. The taxpayer's business in US was through its associated enterprise (AE) in US, whereby the AE received the work orders in the taxpayer's favour from various customers and then an offshore agreement was executed between it and the taxpayer. For its efforts, AE retained 12 per cent of the contract price, i.e., as a return for its services, and remitted the balance to the taxpayer. The taxpayer had a similar arrangement with a third party in US who carried out similar functions and assumed similar risks as the US AE, and operated on the same compensation model, i.e., 12 per cent of the contract price retained by the US third party with the balance being remitted to the taxpayer. In its transfer-pricing study, the taxpayer had adopted a cost plus method (CPM). During assessment proceedings, the transfer pricing officer (TPO) rejected the taxpayer's approach and instead applied an external transactional net margin method (TNMM). The dispute resolution panel (DRP) upheld the TPO's order.

On appeal, the Tribunal held as follows:

- For determination of arm's length price (ALP), conditions in a controlled transactions had to be compared with those in an uncontrolled transaction. ALP had to be determined following any of the prescribed methods. Thus, even if the entire arrangement were transparent, ALP had to be determined as per the prescribed methods.
- Comparable uncontrolled price (CUP) was focused on price and required functional and product comparability. CPM and resale price methods (RPM) required functional rather than product comparability.
- In the taxpayer's case, neither CUP nor CPM would apply as factors required for carrying out comparability under both the methods did not exist. Accordingly, only TNMM would apply.
- Whether the AE was incurring profits or losses cannot be a guiding tool for arriving at the ALP of the taxpayer's international transaction. Furthermore, in this particular instance, the AE was also not the tested party and its margins and expenses were thus not benchmarked.
- Internal comparable was always preferable over external comparable, once all the segmental details were available, as it would require least number of adjustments.

Accordingly, the Tribunal rejected all the contentions of the taxpayer. It did, however, accept that internal TNMM should be applied before applying external TNMM. The matter was thus restored to the file of the TPO to verify the segmental details and carry out comparability.

Note: In the above ruling, the Tribunal eventually accepted internal TNMM – comparing AE segment margins to non-AE segment margins. However, it is respectfully stated that the aspects of characterization of the entities that would lead to the determination of the tested party and eventual application of method were not raised or dealt with in this ruling.

Mumbai Tribunal – LIBOR is an average rate

DDIT *v.* Development Bank of Singapore [2013] 33 taxmann.com 300 (Mumbai - Trib.)

The taxpayer was a multinational bank engaged in banking operations in

India. It had entered into lending and borrowing transactions with its head office and branches through which it had received interest and made interest payments. The benchmarking of the interest payments on borrowings was not disputed. With respect to interest received, the taxpayer had earned interest income at varying rates. The taxpayer benchmarked the interest rate charged on a transaction by comparing it to the relevant LIBOR rate on the transaction date, as extracted from the Reuters database. There were no transactions where the difference between the rate actually charged and the LIBOR rate was greater than 5 per cent. During the assessment proceedings, the TPO did not dispute the applicability of LIBOR as a basis for benchmarking. However, it was concluded that the LIBOR was a single rate and therefore the benefit of the 5 per cent range should not be available to the taxpayer. The TPO proceeded to make an adjustment. However, this addition was subsequently deleted by the CIT(A).

On appeal by the Revenue, the Tribunal held:

- The benefit of the 5 per cent range should be available to the taxpayer and stated that the deletion of the adjustment by the CIT(A) was justified.
- LIBOR could not be considered as a rate in itself at which a bank is willing to borrow/lend, but should be considered an average of rates at which various banks offer to borrow and lend.
- LIBOR was nothing but an arithmetical mean of rates and could not be characterised as one price determined under the CUP method.
- Keeping in view the language used in the amended proviso, the benefit of the ranges should extend not only to a situation where more than one ALP is determined by the most appropriate method, but also where only one price is determined as the ALP.

Note: This ruling of the Mumbai Tribunal is an important and welcome pronouncement in the context of the benchmarking of financial market transactions and other similar situations where a single published market rate (or an average thereof) is used as a CUP. Other than the primary outcome with respect to the LIBOR being an average and not a single rate, the observations of the Tribunal on the amended proviso to section 92C(2) of the Act are also significant, especially for taxpayers who have been denied the benefit of the tolerance band on account of a single uncontrolled price, following the amendment.

Delhi Tribunal – Relevance of FAR analysis discussed

Sojitz India Pvt. Ltd. *v.* DCIT [2013] 33 taxmann.com 299 (Delhi - Trib.)

The taxpayer was a general trading company and its group dealt in a wide range of products and services. The taxpayer was engaged in providing indenting services to its AEs for a commission and was also engaged in trading, purchasing goods and reselling them to third parties. The commission earned by the taxpayer for indenting services accounted for a major portion of its total turnover, while sales from the trading function comprised a much smaller proportion. The taxpayer applied TNMM to benchmark its indenting segment. However, the TPO rejected this approach and instead used internal TNMM, i.e., the gross margin percentage in the trading segment was considered as the arm's length percentage of commission for the indenting segment.

On appeal, the Tribunal held as follows:

- The Tribunal appreciated the detailed functions, assets and risks (FAR) analysis put forth by the taxpayer for its indenting and trading activities. As for indenting, the Tribunal held that the taxpayer was engaged in low-risk activity. For trading, the taxpayer functioned as an entrepreneur.

- There was no reasoning and justification for applying the margins earned in trading activity to indenting activity, as the two were distinct and separate, and cannot be treated at par.
- The TPO had erroneously exercised his power to re-characterize the taxpayer's transaction. The TPO had not demonstrated from facts that the taxpayer, though calling itself a "service provider", was actually acting as a "trader".
- For an indenting service provider, costs would not include FOB value of goods ; they would instead be the taxpayer's operating costs. An entity providing indenting services would not have its funds locked in the cost of goods as the title in the goods would never be vested with the provider of indenting services.
- Based on the detailed FAR analysis of the taxpayer and its AE, that the taxpayer had not created human assets and supply chain intangibles. In fact, the taxpayer was using AE's intangibles.
- As for human intangibles, the level and degree of qualification of taxpayer's personnel was low and so was the skill requirement: no specific skills were required by new personnel.
- The Tribunal allowed the appeal and directed the tax officer to grant necessary relief to the taxpayer.

Delhi Tribunal – Endorses adjustment to account for foreign exchange rate fluctuation

Honda Trading Corporation India Pvt. Ltd. *v.* ACIT [2013] 33 taxmann.com 21 (Del-Trib)

The taxpayer was engaged in the business of buying and selling certain auto components. The taxpayer had determined and agreed its sales price to customers after considering the previous six months' foreign-exchange rate (INR to Thai Baht). However, the taxpayer's imports from its AE were undertaken at the exchange rate prevalent as on the date of transaction (spot rate). Contrary to the taxpayer's expectations, owing to sudden political and economic reform in Thailand, the INR depreciated vis-à-vis the Thai Baht, thereby making imports costlier. However, the sale price had been fixed with customers and could not be changed. As imports became costlier and the sale price did not change, the taxpayer incurred losses. To eliminate the impact of depreciation in the INR, the taxpayer proposed an adjustment and submitted that it would have earned a high profit margin (higher than that of comparables) had the INR not depreciated. During the assessment proceedings the TPO disregarded the adjustment put forth by the taxpayer, and proposed a transfer-pricing adjustment.

On appeal, the Tribunal:

- Acknowledged the depreciation in the INR to be an important factor, materially affecting the price in the open market.
- Held that for a credible comparison with comparables, the difference on account of foreign-exchange-rate fluctuation in favour of the Thai Baht and against the INR should have been removed, and the margin of the taxpayer should have been accordingly adjusted.

Thus, the Tribunal directed the Revenue authorities that necessary adjustments pertaining to the material and abnormal fluctuation in foreign exchange may be allowed to the taxpayer.

Note: After providing its in-principle sanction on adjustments on account of factors such as working capital, capacity utilisation and depreciation, the Tribunal has, with this ruling, endorsed the need to adjust for foreign exchange rate fluctuation, which could have a material impact on prices. This endorsement by the Tribunal is positive and indeed well-timed as Indian importers are already feeling the burden of continued depreciation in the INR on their margins. It may be noted that the mechanics of how to make this adjustment were not discussed in this case

Taxing of goods and services
Indirect taxes

Case law

VAT, sales tax, entry tax and professional tax

Provision of telecom towers and shelter (passive infrastructure) to telecom operators on a sharing basis cannot be taxable under VAT as 'transfer of right to use goods'

Indus Towers Ltd *v.* UOI [Writ Petition(C) 4976/2011]

The High Court (HC) of Delhi has held that provision of telecom towers and shelter (passive infrastructure) to telecom operators on sharing basis cannot be taxable under VAT as "transfer of right to use goods", as the activity does not involve transfer of control and possession of passive infrastructure from one telecom operator to another.

Case law

CENVAT

Assembly of various parts of telephone-exchange system tantamount to manufacture

Bharat Sanchar Nigam Ltd. *v.* CCE [2013] TIOL (474)

The Kolkata CESTAT has held that assembly of various parts by the engineers at the site results in digital local telephone-exchange equipment which is both movable & marketable, and hence this process amounts to manufacture.

Goods to be assessed in the condition in which they are cleared from factory

Mahindra & Mahindra Ltd *v.* CCE [2013] TIOL (169)

The Mumbai CESTAT has held that the goods should be assessed in the condition in which they are cleared from the factory and the value addition on account of the processing carried out by the job worker subsequent to the clearance of the goods should not be taken into account.

Case law

Service tax

Excess tax deposited on account of cancellation of invoices can be adjusted against the service-tax liability of any succeeding period

Aakash the Place to Celebrate *v.* CST [2013] TIOL (516)

The Ahmedabad CESTAT has held that where the service provider has deposited excess tax due to cancellation of invoices and has returned the invoice amount and the service tax collected thereon to the customer, the service provider can adjust this excess amount against its service-tax liability for any succeeding period.

Refund of port services cannot be allowed if the same has not been used in relation to exported goods

Hind Aluminium Industries Ltd *v.* CST [2013] TIOL (615)

The Mumbai CESTAT has held that since the exporter of goods had not used the port services in relation to the export of the goods, basis which the refund claim under service tax Notification No. 41/2007 dated 6 October 2007 has been filed, the refund of the port services cannot be allowed.

Notifications or circulars

Erecting pandal/shamiana to hold events is regarded as a service and does not amount to transfer of right to use service

Circular No. 168/3/2013-ST, dated 15 April 2013

The CBEC has clarified that erecting pandal/shamiana, along with other incidental activities, does not amount to a 'transfer of right to use goods' as the effective possession and control over pandal/shamiana does not transfer to the customer. It has instead been regarded as a service preparing a place to hold a function or event, and hence liable to service tax.

Case law

Customs or Foreign Trade Policy

Royalty/licence fee paid includible in the value of imported goods if the same is a condition of sale of imported goods

CC *v.* Excel Productions Audio Visuals Pvt. Ltd. [2013] TIOL (647)

The Mumbai CESTAT has held that where a CD contains artistic or intellectual inputs, the licence fee/royalty paid separately in relation thereto is includible in the value of goods, as license fee/royalty become a condition of sale.

Importer's goods cannot be detained for recovery of demand against default by the high sea seller in respect of other transactions

Leo Enterprises *v.* CC [2013] (290) ELT (195)

The Madras HC has held that ultimate importer's goods cannot be detained for recovery of demand against the seller of goods on high sea even though the agreement between the parties provide that the importer will undertake to pay entire expenses for goods purchased, as this undertaking cannot be interpreted to include payment of demand against the seller regarding other transactions.

Education cess and secondary & higher education cess shall not be payable for the third time on excise duty on removal of goods from export-oriented unit to domestic tariff area

Kumar Arch Tech Pvt. Ltd. *v.* CCE [2013] TIOL (614)

A larger bench of the Delhi CESTAT has held that education cess and secondary & higher education cess shall not be payable for the third time on excise duty paid, which is equivalent to the aggregate of duties of customs as per the proviso to section 3(1) of the Central Excise Act, 1944, on the removal of goods from an export-oriented unit (EOU) to domestic tariff area (DTA).

CVD is charged at Nil rate even if EOU supplying goods to DTA is located in an area notified for excise duty exemption

Satya Metals *v.* UOI [2013] (290) ELT (514)

The Himachal Pradesh HC held that countervailing duty in lieu of excise duty (CVD) is to be charged at Nil rate if an EOU supplying goods to a DTA is located in an area specified in Notification No. 50/2003, dated 10 June 2003, subject to the fulfillment of other prescribed conditions mentioned in the notification. The benefit of Nil rate of CVD is available to an EOU, irrespective of the fact that a separate notification for it has not been issued in terms of section 5A of the Central Excise Act, 1944.

Notifications/ Circulars

EPCG scheme will not be available for import of capital goods for production or transmission of energy

Notification No. 7 (RE-2013)/2009-2014 dated 18 April 2013

The Central Government has provided that the export promotion capital goods (EPCG) scheme will not be available for the import of capital goods (including captive plants and power generating sets of any kind) for the following:

- Export/deemed export of electrical energy;
- Use of power (energy) in their own unit; and
- Supply/export of electricity-transmission services

Validity of zero duty EPCG authorisation extended from 9 months to 18 months

Public Notice No. 4 (RE-2013)/2009-14 dated 18 April 2013

The Central Government has extended the validity of zero duty EPCG authorisation from 9 months to 18 months.

Financial Services
Regulatory developments

Reserve Bank of India

Core investment companies – guidelines on investment in insurance

[RBI/2012-13/466DNBS(PD) CC.No.322/03.10.001/ 2012-13, 1April 2013]

In view of the unique business model of core investment companies (CICs), it has been decided to issue a separate set of guidelines for their entry into insurance business.

- While the eligibility criteria, in general, are similar to that for other non-banking financial companies (NBFCs), no ceiling is being stipulated for CICs in their investment in an insurance joint venture. Furthermore, it is clarified that CICs cannot undertake insurance-agency business.
- CICs exempted from registration with RBI do not require prior approval, provided they fulfil all the necessary conditions of exemption as provided under/ in CC No. 206, dated 5 January 2011. Their investment in insurance joint ventures would be guided by Insurance Regulatory Development Authority (IRDA) norms.

Priority sector lending targets and classification – revision of limits

(RPCD.CO.Plan. BC 72/04.09.01/ 2012-13 - 3 May 2013)

Priority sector lending limits were increased for the FY 2013-14 as a part of the monetary policy review.

- Agriculture: loan limits for farmers against a pledge of agricultural produce (including warehouse receipts), for a period of not more than 12 months, has been increased to INR 5 million from INR 2.5 million. This is applicable for both direct and indirect agriculture.
- Agriculture: loan limits for sellers and dealers of fertilisers, pesticides, seeds, cattle feed, poultry feed, agricultural implements and other agricultural inputs has been raised from INR 10 million to INR 50 million per borrower.
- Micro and small enterprises (MSEs): bank-loan limits for MSEs have been increased from INR 20 million to INR 50 million per unit, provided investment criteria under the Micro, Small And Medium Enterprises Development Act (MSMED Act), 2006 have been satisfied.

Structured mechanism for monitoring credit growth in the MSE sector

(RPCD. MSME&NFS. BC.No. 74/06.02.31/2012-13 – 9 May 2013)

Following the recommendations of the 14th standing advisory committee on micro, small and medium enterprises (MSMEs), the RBI has determined the following measures to be followed by banks to strengthen their credit-flow monitoring mechanism:

- A comprehensive management information system (MIS) needs to be set up, and performance of the various MSMEs need to be evaluated at specific periods fixed by the bank.
- The credit proposal tracking system (CPTS) of the Bank should be set up so that all physical MSME applications received are entered into the CPTS, following which the CPTS should generate a unique application serial number in acknowledgement of the receipt. Upon submission of the application, banks should accordingly inform the applicant of the appropriate disposal time required. Additionally, banks should make the application status visible to the applicant online, and the status of the application should be

sent directly to the applicant.

- A format has been provided by the RBI to facilitate monitoring the loan disposal system. Data generated via this format will enable banks to conduct a performance review in this regard every month or quarter and take measures accordingly.
- A speedy process of sick-unit identification is to be implemented by banks, before declaring a MSE unit as unviable.
- Banks should constitute a MSE rehabilitation Cell (MRC) at all zonal and circle headquarters to monitor identification of sick units, conduct viability studies and follow-up action for rehabilitation of the identified units.
- Banks are to sensitise their branch level functionaries to the MSE sector requirements and hold appropriate training programs.

Import of gold by nominated banks/agencies

(RBI/2012-13/499 – 13 May 2013)

Following the recommendations of the working group on gold, restrictions have been imposed by the RBI on import of gold. Gold import has been restricted to imports on a consignment basis to meet the needs of gold-jewellery exporters.

Foreign direct investment (FDI) – Issue of equity shares under FDI scheme allowed under government route against pre-operative/pre-incorporation expenses

(RBI/2012-13/502 A.P. (DIR Series) Circular No. 104 – 17 May 2013)

Amendments have been issued under sections 10(4) and 11(1) of the foreign exchange management Act (FEMA Act), 1999. Payments can now be made by a foreign investor to a company directly, or through a bank account opened by the foreign investor, as provided under FEMA regulations.

Prudential guidelines on capital adequacy and market discipline - new capital adequacy framework (NCAF) - parallel run and prudential floor

(DBOD.BP.BC. No.95/21.06.001/2012-13 – 27 May 2013)

The parallel run and prudential floor (80 per cent of minimum capital requirement) for implementation of Basel II *vis-à-vis* Basel I has been withdrawn.

Lending against gold

(DBOD. No. Dir. BC. 96 /13.03.00/ 2012-13 – 27 May 2013)

- Schedule commercial banks (SCBs) are advised that while granting advance against the security of specially minted gold coins sold by them, they should ensure that the weight of the coin(s) does not exceed 50 grams per customer and that the amount of loan to any customer against gold ornaments, gold jewellery and gold coins (weighing up to 50 grams) should be within the Board-approved limit.
- It is clarified that the restriction on grant of loan against "gold bullion", stipulated in terms of our circular dated 22 July 1978 referred to at para 2 above, will also be applicable to grants of advance against units of gold ETFs and units of gold Mutual Funds.

NBFC finance for the purchase of gold

(DNBS.CC.PD. No.326/03.10.01/2012-13 – 27 May 2013)

It is clarified that no advances should be granted by NBFCs for purchase of gold in any form, including primary gold, gold bullion, gold jewellery, gold coins, units of gold exchange traded funds (ETF) and units of gold mutual funds.

Branch authorisation policy- front loading of branches in unbanked rural centers

(DBOD.NO.BAPD.BC. 97 /22.01.001/2012-13 – 28 May 2013)

- Under their individual financial inclusion plans (FIPs), banks may prioritise the opening of branches in unbanked rural centers over a 3 year cycle co-terminous with their FIP.
- Credit will be given for branches set up in unbanked rural centers in excess of 25 per cent requirement norm and will be carried forward to the subsequent annual branch expansion plan (ABEP)/FIP year.

Guidelines on composition of capital disclosure requirements

(DBOD.No.BP. BC.98/21.06.201/2012-13, 28 May 2013)

- Following the Basel Committee on Banking Supervision's (BCBS) issuance of guidelines on composition of capital requirements , the RBI has issued Pillar 3 disclosure requirements for the Indian banking sector.
- These guidelines have been issued to ensure the comparability of capital adequacy of banks across jurisdictions, to improve consistency and ease of use of disclosures, and to mitigate risk of inconsistent reporting format.
- Guidelines have been provided for templates to be used for reporting, giving recommendations for the frequency of reporting and for disclosure requirements.

Review of prudential guidelines on restructuring of advances by banks and financial institutions

(DBOD.BP.BC.No.99/ 21.04.132/2012-13, 30 May 2013)

'Prudential guidelines on restructuring of advances by banks/financial institutions' have been revised, taking into account the recommendations of the working group constituted in this regard and the comments received on the draft guidelines issued by the RBI.

- The revised guidelines address issues of regulatory forbearance, changes in date of commencement of commercial operations (DCCO), provisions for restructured standard accounts and diminution in the fair value of restructured advances, and give criteria for upgrading of accounts classified as non-performing assets (NPA) on restructuring.
- Additionally, the guidelines also provide benchmarks on viability parameters, incentives for quick implementation of restructuring packages, roll-over of short term loans, promoters' sacrifices, conversion of debt into equity/ preference shares, re-compensation rights and promoters' personal guarantees.

Guidelines on composition of capital-disclosure requirements

(DNBS (PD) CC.No.327/03.10.038/ 2012-13 – 31 May 2013)

- Margin caps for all NBFCs, irrespective of size, will be 12 per cent until 31 March 2014.
- From 1 April 2014 margin caps should not exceed 10 per cent for large MFIs (loan portfolios in excess of INR 1 billion) and 12 per cent for others.

Import of gold by nominated banks or agencies

(A.P. (DIR Series) Circular No.107 – 4 June 2013)

- Import of gold on a consignment basis by both nominated agencies and banks shall now be permissible only to meet the needs of exporters of gold jewellery.
- It has further been decided that all letters of credit (LC) to be opened by nominated banks/agencies for import of gold under all categories will be

only on the basis of 100 per cent cash margin. Furthermore, all imports of gold will have to be on the basis of documents against payment (DP). Accordingly, gold imports on the basis of documents against acceptance (DA) will not be permitted. These restrictions will, however, not apply to the import of gold to meet the needs of exporters of gold jewellery.

NBFCs not to be partners in partnership firms- clarifications

(DNBS.PD/CC.No. 328 /03.02.002/2012-13 – 11 June 2013)

- NBFCs are prohibited from contributing capital to any partnership firm or to be partners in partnership firms, including limited liability partnership (LLP) firms.
- This prohibition is also applicable with respect to association of persons.
- NBFCs that have already contributed capital to LLPs or association of persons or are a partner in LLPs or association of persons are to seek early retirement from these associations.

Processing and settlement of export-related receipts facilitated by online payment gateways – enhancement of the value of transaction

(RBI/2012-13/528 A.P. (DIR Series) Circular No. 109 – 11 June 2013)

The permitted value of transactions for export-related remittances conducted via online payment gateway service providers (OPGSPs) has been raised to USD 10,000 from USD 3,000.

FDI – reporting of issue/ transfer of shares to/by a foreign venture capital investors (FVCI)

(RBI/2012-13/529 A.P. (DIR Series) Circular No.110 – 12 June 2013)

- Transfer of shares of an Indian company from a non-resident Indian to a resident Indian, or *vice versa,* has to be reported to the RBI through an authorized dealer bank within 30 days of the transaction.
- Wherever a SEBI-registered FVCI acquires shares of an Indian company under the FDI Scheme in terms of Schedule 1 of Notification No. FEMA 20/2000-RB, dated 3 May 2000, as amended from time to time, those investments have to be reported in form FC-GPR/FC-TRS. Where the investment is under Schedule 6 of the Notification *ibid*, no FC-GPR/FC-TRS reporting is required. These transactions would be reported by the custodian bank in the monthly reporting format as prescribed by RBI.

Foreign investment in India by SEBI-registered long-term investors in government-dated securities

(RBI/2012-13/530 A.P. (DIR Series) Circular No.111 – 12 June 2013)

The limit for foreign investment in government-dated securities has been increased to USD 30 billion from USD 5 billion

Prudential norms for off-balance-sheet exposures of banks – deferment of option premium

(DBOD.No.BP. BC.102/21.04.157/2012-13 – 18 June 2013)

The option of deferring the premium on plain vanilla options sold to users by banks has now been extended to cost-reduction forex option structures, (in which the liability of the users never exceeds the net premium payable to the bank under any scenario) subject to the following conditions:

- Banks need to carry out necessary due diligence to ascertain the ability of users to adhere to the premium payment schedule.
- The payment of the premium for an option structure with maturity of more than 1 year may be deferred, provided

the premium payment period does not extend beyond the maturity date of the contract.

- The premium should be received on a regular basis over the maturity of the contract, at least once every quarter.
- This facility should not be allowed for contracts on a past performance basis.

Risk weights on deposits placed with NABARD/ SIDBI/NHB in lieu of shortfall in achievement of priority-sector lending targets/sub-targets

(DBOD.BP.BC. No.103/ 21.06.001/2012-13 – 20 June 2013)

- Claims on public sector entities (including NABARD, SIDBI, NHB, etc.) are required to be weighted for risk in a manner similar to claims on corporates as per the ratings assigned by rating agencies registered with the SEBI and accredited by the RBI.
- If the conditions indicated (in para 6.8 of Master Circular on Prudential Guidelines on Capital Adequacy and Market Discipline – New Capital Adequacy Framework, dated 2 July 2012) are not satisfied, the rating applicable to the specific debt cannot be used and the claims on NABARD/SIDBI/ NHB on account of deposits placed in lieu of shortfall in achievement of priority sector lending targets/sub-targets shall be risk weighted as unrated claims, i.e. at 100 per cent.

Housing sector: new sub-sector CRE (Residential Housing) within CRE & rationalisation of provisioning, risk-weight and LTV ratios

(DBOD.BP.BC.No. 104/08.12.015/2012-13 – 24 June 2013)

- It has been decided to carve out a separate sub-sector called "commercial real estate – residential housing" (CRE-RH) from the CRE Sector. CRE-RH would consist of loans to builders/developers for residential housing projects (except for captive consumption) under CRE.
- Such projects should ordinarily not include non-residential commercial real estate. However, integrated housing projects comprising some commercial space (e.g. shopping complex, school, etc.) can also be classified under CRE-RH, provided that the commercial area does not exceed 10% of the total floor space index (FSI) of the project. If the FSI of the commercial area in the predominantly residential housing complex exceeds the ceiling of 10 per cent, the project loans should be classified as CRE and not CRE-RH.
- The CRE-RH segment will attract a lower risk weight of 75 per cent and lower standard asset provisioning of 0.75 per cent, as against 100 per cent and 1.00 per cent for the CRE segment.

SEBI

Rationalisation of existing debt limits

(CIR/IMD/FIIC/6/2013, 1 April 2013)
(RBI/2012-13/465 A.P. (DIR Series) Circular No.94, 1 April 2013)

- Existing debt limits have been merged into two broad categories – government securities of USD 25 billion and corporate bonds of USD 51 billion.
- On account of the room created by unifying the debt categories, the current SEBI auction mechanism, of allocating debt limits for corporate bonds, shall be replaced by the 'on tap system' currently in place for infrastructure bonds.

Circular on infrastructure debt fund (IDF)

(CIR / IMD / DF / 7 / 2013, 23 April, 2013)

- In the case of IDF, private placement to less than 50 investors has been permitted as an alternative to new fund offers to the public. In the case of private placement, the mutual funds would have to file a placement memorandum with SEBI instead of a scheme information document and a key information memorandum.
- Only foreign central banks, governmental agencies, sovereign wealth funds, international/ multilateral organizations/agencies, insurance funds and pension funds will be designated as long term investors for the purpose of IDF.

Broad guidelines on algorithmic trading

(CIR/MRD/DP/ 16 /2013 – 21 May 2013)

Extant guidelines have been amended following suggestions received by stock brokers and trading members, as follows:

- Stock brokers and trading members providing the facility of algorithmic trading shall subject their algorithmic trading system to a system audit every six months.
- This system audit shall be undertaken by a system auditor who possesses either a Certified Information System Auditors (CISA) certification from Information System Audit And Control Association (ISACA), DISA from Institute of Chartered accountants of India (ICAI), Certified Information Securities Manager (CISM) from ISACA or a Certified Information Systems Security Professional (CISSP) from International Information Systems Security Certification Consortium (ISC).
- Deficiencies or issues identified during the audit shall be reported by the stock broker/ trading member to the stock exchange immediately on completion of the audit and corrective measures should be taken.
- In case of serious deficiencies or issues or failure of the stock broker or trading member to take satisfactory corrective action, the stock exchange shall not allow the individual concerned to use the trading software till the issues are rectified and a satisfactory system audit report is submitted to the stock exchange. Suitable penalties may be imposed on the individual by the stock exchange.
- Necessary steps are to be taken by stock exchanges to ensure effective monitoring and surveillance of orders and trades resulting from trading algorithms.
- Stock exchanges are directed to double the existing rates of 'charges to be levied per algo orders' specified in their circulars/notices.
- In order to discourage repeat instances of a high daily order-to-trade ratio, stock exchanges shall impose an additional penalty in the form of suspension of proprietary trading rights for the first trading hour on the next trading day if a stock broker or trading member is penalized for maintaining high daily order-to-trade ratio, provided penalty was imposed on the individual concerned on more than ten occasions in the previous thirty trading days.

Clarification on SEBI's Circular dated 13 August 2012 providing for the "Manner of dealing with audit reports filed by listed companies"

(CIR/CFD/DIL/9/2013 – 5 June 2013)

- It is mandated for listed companies to submit either Form A or Form B; qualified audit reports will be scrutinised by a qualified audit review committee (QARC).
- Restatement of book accounts shall mean that the company is required to disclose immediately to shareholders the effect of revised financial accounts by way of revised pro-forma financial results through stock exchanges.

Enhancement in foreign investment limits in government debts

(CIR/IMD/FIIC/8/2013 – 12 June 2013)

- Government debt limits have been enhanced by USD 5 billion, which shall be available for investments only to those foreign institutional investors (FIIs) that are registered with SEBI under the categories of Sovereign Wealth Funds (SWFs), Multilateral Agencies, Endowment Funds, Insurance Funds, Pension Funds and Foreign Central Banks.
- A total of USD 5 billion together with the unutilized limit of USD 6.2 billion is to be made available immediately for investment on tap by eligible investors.
- With regard to those FIIs which have exhausted their reinvestment limits, as a one-time measure, a special window of up to USD 250 million per FII was made available till the date of the next auction i.e. 20 June 2013, subject to the aggregate investments in Government debt by all FIIs/QFIs being limited to USD 25 Billion. These investments are subject to a lock-in period of 90 days and are not eligible for re-investment facility.

Glossary

AE	Associated enterprise
ALP	Arm's length price
AY	Assessment year
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
The Act	Income tax Act, 1961
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
TNMM	Transaction net margin method
TO	Tax officer
TPO	Transfer pricing officer
VAT	Value added tax
TPO	Transfer pricing officer
VAT	Value added tax
FIS	Fees for included services

Notes

About PwC

PwC* helps organisations and individuals create the value they're looking for. We're a network of firms in 158 countries with more than 180,000 people who are committed to delivering quality in assurance, tax and advisory services.

PwC India refers to the network of PwC firms in India, having offices in: Ahmedabad, Bangalore, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, please visit www.pwc.in.

*PwC refers to PwC India and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.

You can connect with us on:


facebook.com/PwCIndia


twitter.com/PwC_IN


linkedin.com/company/pwc-india

youtube.com/pwc

You can also to write to us on
pwctrs.knowledgemanagement@in.pwc.com

Our Offices

Ahmedabad
President Plaza, 1st Floor
Plot No. 36, Opposite Muktidham Derasar
Thaltej Cross Roads, S G Highway
Ahmedabad 380054
Phone: +91 79 3091 7000

Bangalore
6th Floor,Tower 'D',The Millenia
1 & 2 Murphy road,Ulsoor
Bangalore 560008
Phone: +91 80 40796000

Chennai
8th Floor, Prestige Palladium Bayan
129-140 Greams Road,
Chennai 600 006, India
Phone: +91 444228 500

Hyderabad
8-2-293/82/A/113A
Road No.36, Jubilee Hills
Hyderabad 500 034
Phone: +91 40 6624 6600

Kolkata
56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake.
Kolkata - 700 091, West Bengal, India
Phone: +91-033 - 2357 9101/4400 1111

Mumbai
PwC House, Plot No.18/A
Gurunanak Road (Station Road)
Bandra (West)
Mumbai 400 050
Phone: +91 22 6689 1000

New Delhi /Gurgaon
Building 10, 17th Floor
Tower -C, DLF Cyber City
Gurgaon 122002
Phone: +91 124 330 6000

Pune
GF-02, Tower C
Panchshil Tech Park
Don Bosco School Road
Yerwada, Pune - 411 006
Phone: +91 20 4100 4444

www.pwc.in

AK 66 - August 2013 Spectrum_June.indd
Designed by: PwC Brand and Communications, India