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India Spectrum

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In this issue

Editorial

We are delighted to present another issue of India Spectrum.

The Indian government has continued with its wave of reform measures to shore up the economy and build investor confidence. In this backdrop, the government announced a major cabinet reshuffle inducting new ministers to manage crucial portfolios such as foreign affairs, petroleum, power and mining.

The reforms by the government also received a fillip from the Supreme Court (SC) as it considered a Special Leave Petition on the recently announced liberalised foreign direct investment policy in retail, aviation, broadcasting and power. The SC directed that the Reserve Bank of India (RBI) should amend its regulations to give the policy legal sanction.

As another key initiative, the Union Cabinet has approved relaxation of foreign investment rules for insurers and pension fund managers, cleared the amendments suggested to the Companies Bill 2011 and also approved the amendment to the Competition Act 2002. These positive measures have led to the appreciation of the Indian rupee against the US dollar by 7% as against a continued fall over the last year.

On the global front, the International Monetary Fund assessment has forecast the UK economy to shrink by 0.4% this year as against 1.7% growth last year. As the superstorm Sandy lashed the eastern coastline of the US, it caused one of the costliest disaster which may have implications for the US economy and possibly other major nations too. On the positive side, the level of unemployment in US was at its lowest in September 2012 since January 2009, while retail sales saw the sharpest rise by 1.1% in September 2012.

The RBI, in its second quarter review of the monetary policy, announced a rate cut of 25 basis points to 4.25% for the cash reserve ratio, maintaining all other rates at previous levels. The RBI promises to cut the key rates in early 2013 if inflation eases.

Ketan Dalal

Shyamal Mukherjee

The index of industrial production was up by 2.7% in August 2012, a leap forward from 0.1% in July 2012. Significant growth was witnessed with the eight core sectors growing by 5.1% in September 2012. India's Gross Domestic Product is estimated to rise by 6.5% subject to the country being self-sufficient in crude oil production according to PwC India's recent report on Energy, Utilities and Mining (refer to http://www.pwc.com/en_IN/in/assets/pdfs/publications-2012/e-p-report-8.pdf).

The Expert Committee formed under the chairmanship of Dr. Parthasarathi Shome recently released a report suggesting that the amendments relating to taxation of indirect transfer of shares or interest in a foreign entity which derived its value from assets in India should be prospective as against retrospective. It is expected that the Central Board of Direct Taxes may partly accept the recommendations which can bring certainty and stability in tax law.

On the judicial front, the Madras High Court (HC), in the case of Singapore Airlines Ltd, held that landing and parking charges paid by a foreign airline to the International Airport Authority of India were in the nature of payment to contractors liable to withholding tax under section 194C of the Income-tax Act, 1961 and not in the nature of rent. In another ruling in the case of Besix Kier Dabhol SA, the Bombay HC held that in the absence of thin capitalisation rules in India, interest payment cannot be disallowed on account of high debt-equity ratio. Please refer to page... 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

Fees for technical services

ISO certification, being a professional service, not taxable as fees for technical services

The assessee, a tax resident of Germany, is in the business of ISO 9000 quality system certification through its branch office in India. Under the certification procedure, the quality systems auditor of the assessee would conduct a pre-assessment and certification audit and prepare a report which would then be sent to Germany for verification. After verification, an ISO certificate with a validity of three years would be issued. The assessee submitted that the certification business was carried out through the assessee's permanent establishment (PE) in India. Hence, the profits attributable to the PE were to be taxed as business income under Article 7(1) of the Double Taxation Avoidance Agreement (tax treaty) between India and Germany.

The tax officer (TO) without providing any reason to reject the assessee's contention, treated the certification services to be in the nature of fees for technical services (FTS) under Article 12(5) of the tax treaty read with Article 7(3). Accordingly, the AO taxed the receipt at 20% applying provisions of the section 44D of the Act. The Commissioner of Income-tax (Appeals) (CIT(A)) upheld the order of the TO.

The Tribunal observed that according to the provisions of Article 12 of the tax treaty, which are similar to the provisions of section 9(1)(vii) of the Income-tax Act, 1961 (the Act), FTS refers to the consideration received for providing 'technical', 'managerial' or 'consultancy' services. The Tribunal observed that the services rendered by the assessee were not technical, managerial or consultancy services since technical services involve the provision of technical expertise. In the assessee's case, no technology was transferred. Though the managerial services involve running and managing the client's business, the assessee was not involved in the management of the client's business. Consultancy services refer to advisory services provided for the client's business.

In the assessee's case, the audit work carried out may involve some incidence of advice at the time of evaluation but it cannot be termed as consultancy services since its basic and major function is only to evaluate the quality and environmental system. Therefore, services rendered by the assessee were not technical but professional services. Hence, these services were taxable as business income under Article 7(1) of the tax treaty and not as FTS under Article 12 of the tax treaty.

TUV Bayren (India) Ltd *v.* DCIT [TS- 476-ITAT-2012 (Mum)]

Independent service contract, not connected to installation of machinery, taxable as FTS

The assessee, a Netherlands tax resident company, had entered into two contracts with an Indian company (G Ltd)–one for the supply of machinery, spares and technical documentation and the other for the supply of project services for the erection and installation of the machinery.

The assessee made an application before the Authority for Advance Rulings (AAR) seeking a ruling on the payment received under the second contract. It contended that the payment was only ancillary and inextricably and essentially linked to the sale of machinery, which is excluded by Article 12(6)(a) of the India-Netherlands tax treaty. Hence, it was not taxable in India.

The revenue authorities contended that since there was a separate contract for supply, erection and

commissioning, it cannot be considered as 'sale of property' under Article 12(6)(a) of the tax treaty.

The AAR noted that the nature of services were in the nature of FTS. It observed that the contract for supply was completed in 2009, whereas the contract for erection and installation commenced in 2011. Hence, there was lack of proximity between the two contracts.

The AAR held that the splitting-up was totally artificial and had been adopted to ward off liability to tax on the whole transaction. It noted that the assessee had entered into two independent contracts deliberately and it could not be said that the second contract was ancillary and inextricably and essentially linked to the sale of property. Hence, it was not covered by the exception under Article 12(6)(a) of the tax treaty. Under the second contract, the assessee had agreed to undertake design, engineering, supply and delivery of machinery and supply of technical documentation, which cannot be considered as sale of property. Therefore, the AAR held that the services provided were in the nature of FTS, chargeable to tax in India.

HESS ACC Systems BV, *In re* [2012-TII-45-ARA-INTL]

Receipts from providing seismic data services taxable as FTS

The assessee, an Austrian tax resident, had entered into an agreement with an Indian company to provide detailed design, plan and execute the acquisition of 3D seismic data and other related services. The assessee had sub-contracted the work to another company. During the year, the Indian company paid the assessee after withholding tax under section 195 of the Act. The assessee made an application to the AAR, seeking a ruling to ascertain the characterisation of the consideration received from providing seismic data services.

Before the AAR, the assessee contended that seismic data services are not covered by the definition of FTS in terms of Explanation 2 to section 9(1)(vii) of the Act. Hence, these services were covered by the provisions of section 44BB of the Act which contains special provisions on the computation of profits and gains 'in connection' with the business of exploration, etc., of mineral oil.

The AAR noted that while the services rendered were in the nature of FTS, the assessee was merely gathered seismic data for a contractor who had undertaken the mining project. Hence, the assessee could not be said to covered by the exception to the Explanation 2 to section 9(1)(vii) of the Act, since it had not undertaken the mining activity. Therefore, the services rendered by the assessee would be FTS under section 9(1)(vii) of the Act.

Furthermore, as the services rendered 'in connection with' the mining activity are covered by the provisions of section 44BB(1) of the Act, and as the proviso to section 44BB excludes cases of technical services which are specifically covered by section 44DA of the Act, it was held that the receipt would be taxable as FTS and not as business income.

C.A.T Geodata Gmbh *v.* DIT, *In re* [2012] 346 ITR 549 (AAR)

Interest on debt capital

Interest paid on excess debt capital cannot be disallowed in absence of thin capitalisation rules

The assessee, a Belgium tax resident company is engaged in construction of fuel jetty in India. It had borrowed from its shareholders and its debt-to-equity ratio for the year was 248:1. During the year, it paid interest on the borrowings.

The TO disallowed the interest payment on the ground that the payment was made in violation of RBI regulations. The interest

paid to the head office by its branch is a case of payment to self, and hence not allowable as a deduction in terms of Article 7(3)(b) of the India-Belgium tax treaty. The CIT(A) upheld the TO's order.

On appeal before the Tribunal, the revenue authorities contended that the borrowings were in fact the equity capital of the assessee. They were brought under the nomenclature of loan only to claim interest expense. Hence the interest paid should be disallowed.

In relation to the issue regarding violation of the regulations, the Tribunal held that only if the amount is in violation of any law can it be disallowed. However, the interest paid by the assessee was deductible under section 36(1)(iii) of the Act and was not an allowable deduction under section 37 of the Act.

The Tribunal held that in the absence of provisions on thin capitalisation rules in India, interest cannot be disallowed by treating debt as equity. The Tribunal noted that the thin capitalisation rules are proposed in the Direct Tax Code 2010, under General Anti Avoidance Rule (GAAR), where an arrangement may be declared as an impermissible avoidance arrangement and may be redetermined by recharacterising any equity into debt or vice versa.

On further appeal, the HC upheld the order of the Tribunal that in the absence of thin capitalisation rules in India, interest payment on debt capital cannot be disallowed.

DIT *v.* Besix Kier Dabhol SA [TS-661-HC-2012 (Bom)]

Tax withholding

Payment for landing, parking and navigation of aircrafts liable to withholding tax as payment to contractors

The assessee, an international airline, had claimed deduction for payment made to the IAAI towards the landing, parking and navigation of its aircrafts.

The TO held that the payment made to the IAAI for the use of the runway for landing and take-off as well as the use of parking space constituted 'rent' liable to withholding tax under section 194I of the Act. The TO treated the assessee as an assessee-in-default under section 201(1) of the Act. The CIT(A) confirmed the order of the TO.

The Tribunal, following the decision of the Delhi Bench of the Tribunal in the case of DCIT v. Japan Airlines [2005] 92 TTJ 687 (Delhi), held that landing and parking charges were not 'rent' but payment to contractors. Hence, withholding tax under section 194C of the Act would be applicable.

On appeal, the HC observed that the definition of 'rent' under section 194I of the Act is an exhaustive definition and includes payment made for the use of any land or building and land appurtenant thereto under a lease or sub-lease or tenancy agreement or arrangement. Therefore, only when an agreement or arrangement has the characteristics of a lease or a sub-lease or a tenancy for use of the land, would the charges levied be covered by the definition of 'rent'. The usage of the runway by an aircraft is the same as the usage of a road by any vehicle and cannot be termed as 'use of land' so as to treat it as payment of rent.

The charges were not for any specified land usage or area allotted but towards a number of facilities such as landing and take-off, taxiways with necessary air traffic control, etc. which were in compliance with various international protocol. Therefore, such charges were in the nature of fees for services offered rather than in the nature of rent. Hence, the Tribunal

was justified in treating such charges as payment to contractors liable to tax withholding under section 194C of the Act.

CIT *v.* Singapore Airlines Ltd [TS-620-HC-2012 (Mad)]

No tax withholding on reimbursement of repair and maintenance charges to foreign company

The assessee-company is in the business of onshore drilling services and had entered into an agreement with S Ltd, a non-resident, to acquire rigs on lease for its drilling operations outside India.

The assessee had made reimbursements to S Ltd towards repairs and maintenance charges (RMC) of the rigs which were claimed as deduction.

The TO held that the drilling units were in full possession and control of the assessee (i.e. lessee) who was required to maintain them. The RMC were thus the liability of the lessee. The TO disallowed the claim of the RMC under section 40(a)(i) of the Act as the payment was made to S Ltd without withholding tax.

The CIT(A) accepted the assessee's contention that the RMC incurred were in the course of business and allowable as business expenditure. He held that the payment made to S Ltd was not taxable under sections 9(1)(i) or 9(1)(vii) and therefore not liable to withholding tax. Hence, he deleted the disallowance under section 40(a)(i) of the Act.

Before the Tribunal, the TO contended that the scope of work was in the nature of technical services such as testing, recertification of equipment, etc. Since the assessee had failed to obtain a certificate from the TO under section 195(2) of the Act for not withholding tax, the assessee was required to withhold tax on the payment.

The assessee contended that it was not liable to withhold tax as the amount was not taxable in India under sections 9(1)(i) or 9(1)(vii) of the Act.

The Tribunal observed that, according to the agreement, the lessee was to maintain the drilling units in operating condition but was under no obligation to carry out periodical overhauling. Hence, the RMC were for the purpose of the assessee's business and allowable under section 37(1) of the Act.

The rigs were leased outside India. Therefore, income received by S Ltd would not be taxable under sections 9(1)(i) or 9(1)(vii) of the Act since S Ltd did not have a business connection in India and income received by S Ltd would not be considered as FTS.

The assessee was under a *bona fide* belief that no tax was required to be withheld. Hence, it had no obligation to obtain any certificate from the TO under section 195(2) of the Act for not withholding tax.

In this regard, the decision in the case of ITO *v.* Prasad Production Ltd [2010] 125 ITD 263 (Chennai) was relied on, where it was held that where an assessee was under a *bona fide* belief that tax was not required to be withheld on whole or any part of the payment made to a non-resident, it was not required to obtain a certificate under section 195(2) of the Act.

ACIT *v.* Saipem Aban Drilling Co Pvt Ltd [TII-84 -2012-ITAT (Mad)]

Loan appraisal fee

Loan appraisal fee not to be considered as interest or FTS under the India-UK tax treaty but as business income

The assessee, a UK company, is engaged in providing loan facilities to Indian companies. It charges an upfront appraisal fee from the applicant to examine credit-worthiness on

the basis of which the eligibility to grant the loan is determined. This fee is charged whether or not the loan is sanctioned.

The assessee treated the annual appraisal fee to be in the nature of business income and in the absence of a PE in India held that it would not be taxable in India.

The TO held that the fee would be either interest as defined in Article 12(5) or in the nature of FTS as defined in Article 13(4) of the India-UK tax treaty.

The CIT(A) decided in favour of the assessee. This decision was later upheld by the Tribunal.

The appraisal fees were payable irrespective of whether the loan facility was sanctioned. Therefore, the appraisal fees could not be said to be in the nature of interest.

The HC further held that no technical or consultancy services were provided by the assessee while determining the credit-worthiness and thus the taxability of the appraisal fees as FTS does not arise.

Therefore, the HC held that the fees were in the nature of business income which would be taxable only where the assessee had a PE in India.

DIT *v.* Commonwealth Development [TS-610-HC-2012 (Mum)]

Capital gains

Income from discretionary portfolio scheme taxable as capital gains and not as business income

The assessee is an individual engaged in the business of share-trading. The assessee declared income under the head of 'capital gains' on investment made through the portfolio investment scheme (PIS). Besides this, the assessee also held a portfolio wherein income from transaction in securities was declared as business income. According to the TO, the transactions in shares were carried through an agency of the portfolio management scheme (PMS) provider, were high in volume and frequency. The PMS provider carried out the organised and systematic activity of transacting in shares on behalf of the assessee, akin to business activity. On appeal to CIT(A), the assessee contended that the entire activity of investing through the PMS provider was carried on out of its own funds and that there were no borrowings. The assessee also invested in mutual funds to obtain the benefits of dividend income and appreciation in capital. Under the PMS scheme, the assessee cannot dictate to the PMS provider as to which shares and securities were to be transacted.

The CIT(A) agreed with the assessee's contentions and held that the income is liable to be assessed as capital gains. Also, the CIT(A) relied on the decision of the Pune Bench of the Tribunal in the case of KRA Holding and Trading Pvt Ltd in ITA no 500/PN/08 and held that PMS is a scheme for an activity of wealth maximisation rather than profit maximisation. Accordingly, gain from such activity should be considered as derived from an activity of investment and not trading. The revenue authorities appealed to the Tribunal.

The Tribunal upheld the order of the CIT(A) and observed that the services engaged by the assessee were in the nature of discretionary PMS wherein the PMS provider had absolute independence in taking decisions on the investments. The decisions taken by the PMS provider were not specific to any single client but were for a whole range in its portfolio. The Tribunal held that the dominant intention of the assessee was the maximisation of wealth and not merely the encashing of profits with a view of trade. Also, the volume and frequency of transactions

sought to be made out by the TO with regard to this activity stood on an entirely different footing and were quite distinct from the activity in the trading of shares carried out by the assessee.

DCIT *v.* Apoorva Patni [TS-452-ITAT-2012 (Pun)]

Tax refund

No interest on tax refund after the date of refund order

The assessee-company was entitled to a tax refund based on the excess payment of advance tax or Tax Deducted at Source (TDS). A refund order was passed in favour of the assessee by the tax department. However, there was a delay in the payment of the refund amount to the assessee.

Before the SC, the assessee sought relief and an order directing the tax department to pay the interest on the unpaid refund. The assessee relied on a SC decision in the case of Sandvik (Asia) Ltd v. CIT & Ors [2006] 280 ITR 643 (SC), where it was held that the assessee would be entitled to interest for the delay in the payment of the tax refund on the basis of equity and Article 265 of the Constitution.
The SC referred to the provisions of section 214 of the Act which provides for payment of interest on excess tax paid and observed that section 214 of the Act does not provide for payment of interest where a refund order has already been issued.

The SC also referred to its decision in the case of Modi Industries Limited *v.* CIT [1995] 6 SCC 396 (SC) where it was held that advance tax and TDS loses its identity when adjusted against the liability created by the assessment order. Hence, the assessee would not be entitled to interest after the date of the refund order. Hence, the SC held that the assessee was not entitled to interest on the tax refund for the period after the date when the refund order was passed by the revenue authorities.

CIT *v.* Gujarat Flouro Chemicals [TS-644-SC-2012]

Disallowance

Interest paid to or received from branch outside India not taxable

The assessee is a banking company. As part of its business activities, it grants advances and receives loans from its Singapore branch. The TO disallowed interest paid to the Singapore branch under section 40(a)(i) of the Act. Simultaneously, interest received by the Singapore branch was taxed as interest income in the hands of the assessee under the provisions of Article 11 of the tax treaty between India and Canada. The CIT(A) upheld the order of the TO. Aggrieved, the assessee appealed to the Tribunal.

Before the Tribunal, the assessee relied on the Special Bench decision in the case of Sumitomo Mitsui Banking Corporation holding that interest paid by a PE to the head office or to other branches outside India is deductible in the hands of the PE. The same interest is not taxable in the hands of the head office. The assessee further submitted that the language of the tax treaty with Japan was considered by the Special Bench in the case of Sumitomo Mitsui Banking Corporation (supra) along with its protocol. This is similar to the language of the tax treaty between India and Canada. Therefore, a similar view could be taken in the case at hand as well.
The Tribunal held that as the revenue authorities accepted the contention of the precedent in Sumitomo Mitsui Banking (supra), no interest paid or received by the assessee was chargeable to tax.
DDIT (IT) v. Toronto Dominion Bank Ltd. [2012] 33 CCH 241 (Mum)

Foreign currency loans

Benefit arising on account of interest rate difference on foreign currency loans not taxable

The assessee company is engaged in leasing finance, trading in trade securities and investing in shares. During the assessment proceedings for assessment year (AY) 2006-07, the TO observed that the assessee is a 50% shareholder in PT Minda Asian Automotive Ltd, Indonesia (PTM). Apart from the capital contribution, the joint venture (JV) partners had also given a loan to PTM. The TO was of the view that the assessee had paid interest at 9% per annum on the loan taken by it whereas it had charged interest at 6.5 to 7% from PTM. The TO further observed that by charging a lower rate of interest, the assessee had extended benefit to the JV company. Hence, the provision of section 40A(2)(a)(b) of the Act was applicable. The assessee contended that section 40A(2)(a)(b) is applicable only where payment is made to any person covered by the section and which is excessive in nature. In the given case, the assessee did not pay any interest but had received interest income. The TO cannot compel the assessee to earn higher interest income. Also, the loan was given to a foreign company in US dollars and the interest rate charged was higher than the London Interbank Offered Rate (LIBOR) rate. The assessee further contended that the amount was given out of the business consideration on account of business exigencies with PTM. The CIT(A) observed that the explanation given by the assessee that it will receive a return in future was not tenable. Aggrieved, the assessee appealed to the Tribunal.

The Tribunal held that the assessee is a 50% shareholder of the JV company exploring the business possibility. In such a situation, even if it had charged a lower rate of interest, the interest rate cannot be disallowed in view of the SC decision in the case of S.A. Builders (supra). The Tribunal observed that since the loan was given in foreign currency, the TO ought to have compared the LIBOR rate prevalent in the international market at that point of time. Therefore, no disallowance was called for on account of the interest rate difference.

Note: In this judgment, the implications, if any, under the transfer pricing provisions were not part of the issues under appeal.

Minda Investments Ltd *v.* Addl. CIT [ITA No. 2635/Del/2011]

Business expenses

Interest on optionally convertible debentures an allowable expense, not a contingent liability

The assessee company issued 6% optionally convertible debentures (OCDs) and claimed interest on them as expense in its profit and loss account (P&L). The TO disallowed the interest on the ground that it is a contingent liability since conversion or non-conversion of OCDs into shares is at the option of the debenture-holder. On appeal before the CIT(A), the assessee submitted complete details of the terms and conditions of the OCDs as contained in a board resolution passed for the purpose, working on the interest paid on such debentures, details of TDS deducted and deposited and, lastly, the auditors' certification that no contingent liability had been debited to the P&L. The CIT(A) considered these submissions and allowed deduction of such interest paid on OCDs. Aggrieved by the CIT(A)'s decision, the revenue authorities filed an appeal before the Tribunal.

The Tribunal agreed with the CIT(A)'s finding that there was no contingency involved in the accrual of liability with reference to the interest on debentures. The Tribunal held that the debentures, whether fully, partly or optionally convertible, are nothing but debt till the date of conversion and any interest paid on these debentures is allowable as normal business expense. The Tribunal further held that the uncertainty involved in conversion of the OCDs into shares will in no way impact the assessee company's liability to pay interest till the date of conversion. Therefore, interest on OCDs was held to be allowable as a deduction while computing the taxable income.

DCIT *v.* UAG Builders Pvt Ltd [TS-605-ITAT-2012 (Del)]

MAT Credit

While computing MAT credit, surcharge and education cess not includible

The assessee company is engaged in the manufacturing and export of garments. It had submitted its tax return claiming minimum alternate tax (MAT) credit under section 115JAA of the Act. The TO did not consider the amount of surcharge and education cess (S & EC) while computing MAT credit.

On appeal, the CIT(A) upheld the order of the TO. It held that the expression 'tax' is not separately defined under section 115JAA of the Act. Hence, its meaning has to be derived from the definition given under section 2(43) of the Act, which provides that tax is income tax chargeable under the provisions of the Act and does not include S&EC.

On further appeal, the Tribunal held that S&EC forms part of 'tax' in terms of Explanation 2 to section 115JB of the Act for computing book profit. The definition provided under Explanation 2 to section 115JB of the Act cannot be adopted for computing MAT under section 115JA of the Act or MAT credit under section 115JAA of the Act. This is because the definition relates to adjustments to be made to compute book profits and not for the computation of MAT payable. As no such specific definition is provided in section 115JAA of the Act, the Tribunal held that the amount of S&EC is not to be considered as part of MAT credit under section 115JAA of the Act.

Richa Global Exports *v.* ACIT [TS-679-ITAT-2012(Del)]

Personal taxes
Assessing personal tax

Case laws

Salary/perquisite

Not ordinary resident status absolves tax on foreign salary in India

In a recent decision, the Delhi HC held that there will be no tax liability on foreign salary received by a Japanese resident if he or she qualifies as not ordinary resident (NOR) in India.

The assessee was a permanent resident of Japan. During the year under consideration, he was employed by Suzuki Motors Corporation, Japan (Suzuki). By virtue of a collaboration agreement between Suzuki and Maruti Udyog Ltd, India (Maruti), the assessee was deputed to India for a period of 273 days to offer guidance and technical assistance in accordance with the terms and conditions of that agreement. The salary for this period was paid to him by Suzuki in Japan. In addition, the assessee was also provided hotel accommodation in India by Maruti.

During the course of assessment proceedings, it was contended by the assessee that the hotel accommodation was provided to him in accordance with the terms of the collaboration agreement and there was no employer-employee relationship between him and Maruti. It was also stated that the rent paid was exempt by virtue of section 10(14) of the Act. However, the TO rejected the contentions of the assessee and considered the rent paid by Maruti, daily allowance and other monetary benefits taxable in the hands of the assessee in India in accordance with Article 15 of the India-Japan tax treaty on the contention that the provisions of the treaty override the provisions of the Act. The CIT(A) partly allowed the assessee's appeal.

Aggrieved, both the tax authorities as well as the assessee approached the Delhi Bench of the Tribunal which ruled in favour of the assessee and held that he was a NOR in India. Therefore, the salary earned in Japan for employment with Suzuki in Japan could not be taxed in his hands in India by virtue of the provisions of section 5(1)(c) read with section 6(6) of the Act. Further, it also held that section 90(2) of the Act clearly states that provisions of the Act shall be applicable to the extent that they are more beneficial to the assessee to whom the relevant tax treaty applies. Since, in this case, the provisions of section 6(6) read with sections 5(1)(c) and 9(1)(i) of the Act were beneficial to the assessee, they should have been preferred over the tax treaty and the income earned by the assessee outside India during the year under consideration would not be taxable in India.

The Delhi HC, by relying on the SC ruling in the case of CIT v. Morgenstern Werner [2003] 259 ITR 486 (SC), affirmed the view taken by the Tribunal and held that the assessee was clearly a NOR in India for tax purposes and hence not liable to tax in India in respect of salary earned outside India.

CIT *v.* Sakakibara Yutaka [TS-581-HC-2012(Del)]

Duration of stay in India decisive criteria for determining residential status

In a recent decision, the Delhi Bench of the Tribunal held that while determining the residential status of an individual, duration of stay in India is the only decisive factor and other factors such as the existence of a dwelling house and social ties are not relevant.

The assessee was regularly assessed to tax in India as a non-resident (NR) over the past several years by way of assessments under section 143(3) of the Act. In February 2007, certain search-and-seizure operations were

carried out on the premises of the assessee. During the proceedings, the TO held that the assessee should be treated as a 'resident' and not as an 'NR' as he was not 'outside India' but was living within India and went abroad only on visits. Thus, he was not eligible for the relaxation provided by clause (b) of the Explanation to section 6(1)(c) of the Act. To support his contentions, the TO also referred to the renovation carried out by the assessee in his farmhouse in India and profound social ties in India. Accordingly, the TO brought his entire global income to tax in India. On further appeal, the CIT(A) confirmed the order of the TO.

Aggrieved by the findings of the lower appellate authorities, the assessee approached the Tribunal which observed that for the last 25 years, the assessee's residential status had been accepted as an NR and the number of days spent in India was not disputed by the revenue authorities. It further observed that the TO's interpretation of the residential status was based on section 6(1)(b) of the Act which was omitted with effect from 1 April, 1983. Referring to the Central Board of Direct Taxes (CBDT) Circular no 684, dated 10 June 1994, the Tribunal held that when the law intends to give the benefit of 182 days to an Indian citizen who leaves India to take up employment or business outside the country, it does not put any restriction on the number of days spent abroad. All it mandates is to look at the 'number of days stayed in India'. Since this is a settled position, factors other than stay criteria like larger presence, business investment, and family ties are of no relevance while determining the residential status of an individual assessee. Accordingly, by relying on the findings of Kerala HC in the case of Abdul Razaq v. [2011] 337 ITR 350 (Ker) and the AAR ruling in the case of Dr Virendra Kumar and Canoro Resources, the Tribunal concluded that the residential status of the assessee was that of an NR and thereby he was taxable only on income accrued in India.

Suresh Nanda *v.* ACIT [TS-539-ITAT-2012(Del)]

Structuring for companies
Mergers and acquisitions

Case laws

No capital gain on investment in shares of a company at a price lower than that of another investor

The assessee, a non-resident, invested in shares of VML and CPL at face value in AY 2004-05. Subsequently, in the same year, the assessee acquired 10% shares in Cheran Enterprise Pvt Ltd (CEPL) at face value of 100 INR per share in exchange for shares of VML and CPL (transferred shares). Thereafter, a Mauritian company, ORE Holding Ltd (ORE), was allotted 45% shares of CEPL at a premium of 504 INR per share.

The TO contended that since the assessee has acquired the shares of CEPL at face value, the assessee has made gross gains of 504 INR per share (i.e. the premium). Accordingly, to compute capital gains on the sale of transferred shares, the AO calculated the sale consideration by multiplying 604 INR (i.e. the price at which ORE subscribed to the shares of CEPL) with the number of acquired shares of CEPL. The CIT(A) upheld the view of the TO.

The Tribunal held that statutory approvals and other procedural evidence showed that transactions by the assessee and ORE were independent. The AO has not computed the value of the CEPL shares by using any method acceptable for share valuation and had presumed the value at 604 INR per share. Furthermore, a private company is free to allot its shares to different shareholders at different rates with or without premium. The Tribunal also noted that ORE was granted additional rights and has a dominant position in corporate and operational matters. Accordingly, additions made by the TO towards short-term capital gains in the hands of the assessee were deleted.

Athappan Nandakumar *v* ITO [2012] 21 Taxmann 177 (Chennai)

No disallowance under section 14A on investments with potential of earning both taxable and exempt income

The assessee companies were investment and trading companies which issued unsecured optionally convertible premium notes (OCPN) to Reliance Chemicals Ltd. The proceeds of such notes were used by the assessee to invest in the shares and debentures of Reliance Utilities and Power Ltd (RUPL). During the years under consideration (AYs 2003-04 and 2004-05), the assessee redeemed these notes at a premium and claimed them as business expenditure under section 36(1)(iii) of the Income-tax Act, 1961 (the Act).

The dividend and interest income arising from the investment was exempt under section 10(23G) of the Act. Thus, the TO disallowed the deduction for premium paid on notes under section 14A of the Act. The CIT(A) upheld the order of the TO.

On further appeal, the Tribunal observed that the exemption under section 10(23G) of the Act was initially granted only for AYs 1999-00 and 2001-02 and was later extended till AY 2004-05. The exemption was available only on certain conditions being satisfied. Thus, the Tribunal held that the premium paid by the assessee cannot be regarded as incurred exclusively for earning exempt income, where such exemption was itself subject to uncertainties and contingencies. The Tribunal further observed that no taxable or exempt income was earned by the assessee from the investment during the relevant AY and that it had the potential of generating exempt as well as taxable income such as short-term capital gains, income from stocklending, fees for providing shares as collateral, etc. Therefore, relying on the decision of the Bombay HC in CIT v. Delite Enterprises Pvt Ltd [ITA No. 110 of 2009], disallowance made by the TO on account of redemption premium was deleted.

Avshesh Mercantile Pvt Ltd *v.* DCIT [TS-417-ITAT-2012(Mum)]

No capital gains relief on sale of shares pursuant to an IPO

During AY 2006-07, Punj Lloyd Ltd (PLL) came up with an initial public offering (IPO) and the assessee also offered his shares to public. Pursuant to the IPO, the assessee transferred the shares to the account of the registrars to the issue on 28 December, 2005 when the basis of allocation was approved by the stock exchange. Subsequently, the shares were transferred to the applicants in the IPO and the shares were listed on 6 January, 2006.

The assessee claimed exemption from capital gains on the transfer of shares under section 10(38) of the Act.The TO disallowed the exemption under section 10(38) of the Act on the ground that that sale of shares did not take place on the stock exchange. The CIT(A) and the Tribunal upheld the view of the TO and also held that since the shares were not listed at the time of sale by the assessee, tax on the capital gains was payable at 20%.The assessee contended that since the consideration for sale of shares was transferred to his account on 6 January, 2006, the transfer was completed only after the shares were listed.The HC held that the shares had been transferred to the demat account of allottees before 5 January, 2006 and the contract of sale of shares was not contingent on the receipt of consideration by the assessee. The HC held that the transfer on the stock exchange would necessarily imply the use of the trading system of the stock exchange for the purpose of sale and purchase of shares. Accordingly, the HC held that the shares were not sold on the stock exchange and exemption under section 10(38) of the Act was not available to the assessee. Additionally, since the shares were not listed at the time of sale, tax was payable at 20% and not at 10%.

Uday Punj *v.* CIT [TS-484-HC-2012(Del)]

SEBI

Takeover code triggers notwithstanding increase in overall shareholding of the promoter group within the creeping acquisition limit of 5%

The promoter group, along with the appellant H (individually holding 36.62%), held 49.62% shares in the target company S. Subsequent to a preferential allotment by S to H, the individual shareholding of H increased by 6.25%, whereas the overall shareholding of the promoter group increased by only 4.97%. As H's shareholding has increased by more than 5%, the board considered that H is required to make an open offer under regulation 11(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (TOC).

H contended that the TOC is not triggered as the increase in the overall promoter holding is within the creeping limit of 5% as per regulation 11(1) of the TOC. The board contended that the Supreme Court, in the case of Swedish Match AB v. SEBI [Appeal No.2361 of 2003], has held that TOC gets triggered even when a single acquirer acquires more than 5% voting rights, notwithstanding the fact that the increase in the total voting rights of the promoter group is less than 5%.

The SAT, relying on the decision of the Supreme Court in the above case, held that Regulation 11(1) of the TOC applies to an acquirer in three different situations i.e. acquisition may be (a) by the acquirer himself (b) through PACs with him, or (c) with PACs with him. Thus, when H acquired shares in S increasing its shareholding by more than 5%, it was required to make an open offer under the TOC.

It is important to note that as per the new takeover code, an acquirer is required to make an open offer if his or her individual shareholding exceeds the stipulated threshold, irrespective of whether there is a change in the aggregate shareholding with persons acting in concert.

Hanumesh Realtors Pvt Ltd [SAT Order dated 25 July 2012]

Pricing appropriately
Transfer pricing

Case laws

Prelude

The Central Board of Direct Taxes (CBDT or Board) has introduced detailed rules providing the procedures and administration of APA in India. We are all well aware that transfer pricing has been a significant source of tax controversy in India and the lack of clarity in matters relating to it has pushed back several large investment proposals of foreign MNEs in India. However, after reviewing the detailed rules notified by the government, one can infer that the government has demonstrated its resolve towards implementing a successful APA programme. While clarification on certain aspects will be required, the government has provided constructive rules primarily in line with the mature jurisdictions which will encourage MNEs to opt for the APA process. It is heartening to note that the APA team of the revenue authorities includes economists, statisticians, lawyers and other professionals thus making clear the government's intent of creating a conducive environment. Continuing from our previous communiqué, we have summarised the observations of various tax tribunals across the country.

APA rules notified

The APA is an arrangement between the taxpayer and the tax authority covering future transactions, with a view to solve potential transfer pricing disputes in a cooperative manner. APA provisions were introduced in India with effect from 1 July 2012 in the Union Budget of 2012. The CBDT, by notification in the official gazette, has introduced the detailed rules providing the procedures and necessary forms for the application and administration of APAs. The rules have provided for unilateral, bilateral or multilateral APAs. The salient features of the procedures laid down for APA are described below:

- ***Pre-filing consultation:*** The process of the APA starts with the pre-filing consultation meeting. The taxpayer can request for a pre-filing consultation meeting which is held with the objective of determining the scope of the agreement, understanding the transfer pricing issues involved and examining the suitability of international transactions for the APA. The taxpayer also has the option of applying for a pre-filing consultation on an anonymous basis. The pre-filing consultation neither binds the board nor the taxpayer to initiate or enter into an APA.
- ***Application for APA:*** After the pre-filing meeting, if the taxpayer wishes to apply for the APA, an application would be required to be made in specified form. For continuing transactions, the APA can be applied for the period starting from 1 April 2013. Prior to such date and for a proposed (new) transaction, the APA can be applied at any time before undertaking the acutal transaction.

- ***Filing fee:*** The fee for an APA is linked to the value of the transaction undertaken or proposed to be undertaken. The fee as provided in the chart below ranges between 1 million INR and 2 million INR per transaction. Such fee is payable at the time the APA application is filed.
- ***Withdrawal of APA application:*** The taxpayer has an option to withdraw the application anytime before the finalisation of the terms and conditions of the agreement. However, the filing fee will not be refunded in case of withdrawal.
- ***Defective application:*** In case of any defect in the application, the taxpayer will be served a deficiency letter within one month from the date of receipt of application. The taxpayer will be given 15 days from the date of service of the letter to make good the deficiency. If not corrected within 15 days (extendable to 30 days), the application will be rejected, in which case the filing fee will be refunded to the taxpayer.
- ***Procedure:*** Once the application is accepted, the APA team will hold meetings with the applicant and undertake necessary inquiries for the case. Post discussion and inquiries, the APA team will prepare a draft response to be provided to the competent authority or Director General of Income Tax (DGIT) as the case may be. Based on this, a draft agreement will be prepared, which post the approval of the central government will be entered into between the board and the applicant.
- ***Compliances post-APA:*** The taxpayer will be required to file an annual compliance report (ACR) to the DGIT within 30 days of filing the return of income or 90 days of entering into the APA, whichever is later. The TPO will conduct the compliance audit based on the details provided in the ACR and furnish a report within six months to the DGIT or competent authority.
- ***Cancellation of APA:*** The board can cancel the APA, in case the taxpayer fails to furnish the ACR, if there are material errors in the ACR, if the TPO finds that there is a failure on the part of the taxpayer to comply with the terms and conditions of the APA or on account of fraud or misrepresentation of facts by the taxpayer.
- ***Revision and renewal of APA:*** The APA can be revised in case there is change in the critical assumptions or the law under which the agreement is covered or in the case of a request from the competent authority in the other country. After the completion of the APA term, the taxpayer also has the option to apply for renewal of the APA using the same procedure as provided for an original application.

Amount of international transaction	Fee
Amount not exceeding 1000 million INR (approximately 20 million USD)	1 million INR (approximately 20,000 USD)
Amount exceeding 1000 million INR (approximately 20 million USD) but not exceeding 2000 million INR (approximately 40 million USD)	1.5 million INR (approximately 30,000 USD)
Amount exceeding 2000 million INR (approximately 40 million USD)	2 million INR (approximately 40,000 USD)

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Arm's length price for sourcing services – cost-based remuneration model adjudged most appropriate for limited risk procurement support service provider

The taxpayer was engaged in facilitating the sourcing of apparel from India for its group companies. The primary activity of

the taxpayer comprised assistance in identification of vendors, assistance to vendors in procurement of apparel, inspection of quality control and coordination with vendors to ensure delivery of goods to group companies. The necessary technical and intellectual inputs for the discharge of these services were provided by the group companies. The taxpayer adopted the transactional net margin method (TNMM) to benchmark the service fee determined at full cost plus mark-up from the group company. During the transfer pricing audits for FYs 2005-06 and 2006-07, the TPO was of the view that the taxpayer's function, asset and risk (FAR) profile was substantially higher than those of limited risk support service providers and held that the cost plus remuneration did not take into account substantial intangibles owned by the taxpayer. These intangibles were primarily construed by the TPO to be in the nature of human asset intangibles, supply chain intangibles and location savings. The TPO ascertained a commission on free on board (FOB) value of goods procured by the group companies, thereby proposing an adjustment to the transfer price of the taxpayer. The taxpayer initially approached the Dispute Resolution Panel (DRP) for FY 2005-06 which confirmed the adjustment vide a non-speaking order. Subsequently, in response to an appeal made before the Tribunal, the subject matter was restored to the DRP for fresh adjudication. The DRP upheld the adjustments made by the TPO for both the years. Aggrieved, the taxpayer appealed before the Tribunal.

On appeal, the Tribunal held as follows:

- No supporting material had been brought on record by the revenue authorities that taxpayer had borne any business risks arising from its activities with the group company.
- The evidentiary documents filed by the taxpayer made it clear that the taxpayer had no wisdom or discretion to take key business risks and that the revenue authorities had drawn a flawed correlation to conclude that the taxpayer had undertaken key functions and had therefore also borne the consequent risks.
- On the development of human resource intangibles, the revenue authorities had failed to demonstrate that any of the employees on the payroll of the taxpayer were acclaimed personalities or indispensable in the garment procurement trade so as to constitute any human intangibles, as alleged.
- Continuing on the issue of supply chain intangibles, the Tribunal noticed that the taxpayer's role and activities and suppliers were already identified and earmarked by the group company and merely following the guiding instructions could not result in the creation of supply chain intangibles.
- The Tribunal observed that location savings to developing economy arise to the industry as a whole. Therefore there was nothing on record to show that the taxpayer was the sole beneficiary. It was noted that the very objective of moving to a low-cost location was to survive stiff competition by providing a lower cost to end-customers. Thus, the advantage of location savings was passed on to the end-customer through a competitive sales

strategy. It was concluded that no additional allocation was needed for location savings.

- On the choice of profit level indicator (PLI) under TNMM, it was ruled that the method and the PLI used should not lead to manifestly absurd results, which may put one of the parties at abnormally higher profitability.
- The ITAT also noted that the revenue authorities had failed to produce a single comparable supporting its stand with respect to the use of PLI of the percentage of FOB value of goods procured by the group company.

GAP International Sourcing (India) Pvt Ltd v. ACIT [TS-667-ITAT-2012(DEL)-TP]

Editor's note: The Tribunal has differentiated between the facts in the case of Li & Fung *v.* DCIT [TS-583-ITAT-2011(DEL)] and those of the taxpayer. In the current case, all significant directions relating to the procurement of goods from third-party vendors in India were provided by the group company. For such pre-ordained support services, the taxpayer could not be held to be entitled to remuneration in terms of Li & Fung's case on the FOB value of goods procured by the group company from third-party vendors in India. This was because in the case of Li & Fung India, the Indian company actually carried out significantly value-added functions in India. The Tribunal upheld the use of the PLI, being operating profit/value-added expenses, being a dialect of the Berry ratio and in the process, arrived at a reasonable cost plus mark-up which should have been earned by the taxpayer. It also referred to the ruling in DCIT *v.* Cheil Communications [2011] 137 TTJ 539 (Del), upholding the pass-through nature of costs with respect to purchases from external vendors, while accepting the validity of the Berry Ratio. By linking the compensation model to the functional analysis (low-risk service provider), the ruling provided significant relief to the taxpayer amounting to 4.87 billion INR (or 98% of the adjustment).

This has been one of the largest and most complex transfer pricing cases argued by the PwC Litigation team.

Transfer pricing provisions applicable even if the income (capital gains) not liable to tax

The applicant, a company incorporated in Mauritius held shares in an Indian listed company. The applicant had proposed to transfer its investment at fair value to its AE in Singapore through an off-market transaction. The applicant, the Indian company as well as the Singapore company were all part of the same group. One of the key issues before the AAR was whether the transfer pricing provisions would be applicable even when the transfer of shares by the Mauritius company to the Singapore company was not taxable in India. The AAR ruled the following:

- As per section 92 of the Act, any income arising from an international transaction shall be computed having regard to the arm's length price. Going by the general meaning and by the defined meaning of 'income' under the Act and also from a reading of sections 92A to 92C of the Act, there was no need to restrict the scope of the expression 'income' appearing in section 92 of the Act.
- Even if sections 92 to 92F of the Act are machinery provisions, capital gains cannot be determined without resorting to them. Only on determining whether capital gains have arisen would the question of its

chargeability arise. The question of chargeability to tax would arise only at a later stage.

- Applicability of section 92 of the Act does not depend on the chargeability under the Act. Where there is no liability, the purpose of undertaking a transfer pricing exercise is not a question that would affect the operation of a statutory provision.
- Therefore, the provisions of section 92 to 92F of the Act are applicable. The fact that the exercise might not be fruitful in this case cannot affect the applicability of the statutory provisions.

Castleton Investment Ltd, *In re* [TS-607-AAR-2012]

Editor's note: This ruling is contrary to the ruling in Vanenburg Group BV *v.* CIT [2007] 289 ITR 464 (AAR), wherein the AAR held that TP provisions are machinery provisions and would not be triggered where there was no tax liability arising from the transaction in India.

Hong Kong: First advance ruling on transfer pricing

Amidst all the uncertainties prevailing in the complex world of transfer pricing, the Hong Kong Inland Revenue Department (IRD) with its first transfer pricing advance ruling case has provided greater certainty to the taxpayer. The taxpayer concentrating on the profit levels of its ongoing intercompany transactions, decided to apply for the advance ruling.

The IRD ruled that if the profit levels of the taxpayer were not less than the ordinary profit which might be expected, then neither the provisions of the arm's length price nor the general anti-avoidance provision could be applied to the covered transactions. This could be equivalent to unilateral advance pricing arrangement as the IRD has effectively demonstrated the calculation methods for the covered transaction.

Besides providing certainty, this ruling has also shown the willingness of the IRD to work with the taxpayers.

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Taxing of goods and services
Indirect taxes

Case laws

VAT, sales tax, entry tax and professional tax

Benefit of sale in course of import not to be claimed in the absence of inextricable link between actual sale and import of goods into India

The Madras HC has disallowed the benefit of sale in the course of import under section 5(2) of the Central Sales Tax Act (CST) in the absence of an inextricable link between actual sale and import of goods into India. The HC observed that an inextricable link was missing in the present case, as there was no condition in the sale agreement, which prohibited the diversion of goods to any third party after import.

State of Tamilnadu *v.* TVL Steel Authority of India Ltd [2012] VIL 46 (Mad)

Sale and lease back transaction structured to raise funds to carry on business in substance a financial transaction not liable to VAT

The Karnataka HC has held that a sale and lease back transaction executed to raise requisite funds for carrying on the business is in substance a loan transaction not liable to value added tax (VAT). The HC has the power to go behind the documents and determine the nature of the transaction, whatever be the form of the documents.

State of Karnataka *v.* Khoday India Limited [2012] 52 VST 204 (Kar)

Notifications/ circulars

Amendments notified under Delhi VAT Act

Information pertaining to central declaration forms already submitted by dealers for the years 2009-10 and 2010-11 has been prescribed to be uploaded online by 31 July 2012. Default assessment to the extent of missing forms shall be made by the department based on the information uploaded by the dealer.

Circular no 10 of 2012-13 dated 13 July 2012

It has been clarified that interest shall be payable in case of failure to furnish central declaration forms in support of any concessional or exempt sale or stock transfer made by a dealer.

Circular No. 6 of 2012-13 dated 6 July 2012

Case laws

CENVAT

Royalty charges for technical assistance in manufacture includible in valuation of goods cleared for captive consumption

The Mumbai Central Excise and Service tax Appellate Tribunal (CESTAT has held that royalty charges for technical assistance in manufacture is includible in the assessable value of excisable goods cleared for captive consumption.

Otis Elevator Co (I) Ltd *v.* CCE [2012] 280 ELT 531 (Mumbai – CESTAT)

No interest payable when wrongly taken CENVAT credit reversed before utilisation

The Bangalore CESTAT has held that no interest would be payable when wrongly taken CENVAT credit was reversed before utilisation. The decision has also been affirmed by the Karnataka HC [2012] 281 ELT 192.

Pearl Insulations Pvt Ltd *v.* CCE [2012] 280 ELT 559 (Bangalore – CESTAT)

Case law

Service tax

Extended period of limitation not to be invoked in relation to tax liability arising consequent to withdrawal of clarification issued earlier

The Ahmedabad CESTAT has held that where the appellant has relied on a clarification issued by the department, extended period of limitation cannot be invoked in relation to tax liability arising as a result of withdrawal of clarification on later date.

Gujarat State Seeds Certification Agency *v.* CCE [2012] TIOL 791 (Ahmedabad – CESTAT)

Where service tax paid by mistake, it would be outside purview of limitation period prescribed for filing refund claim

The Karnataka HC has held that where the service tax was not payable but was paid by mistake, the department has no authority to retain it. It would be outside the purview

of the limitation period prescribed in law for filing refund claim.

CCE (A) *v.* KVR Construction [2012] 36 STT 33/22 taxmann.com 408 (Kar)

Notifications/ circulars

No service tax on amount of foreign currency remitted to India from overseas

The Central Board of Excise & Customs (CBEC) has clarified that there is no service tax per se on the amount of foreign currency remitted to India from overseas. It is merely a transaction in money, excluded from the definition of 'service' effective from 1 July, 2012.

Circular no. 163/14/2012 – ST dated 10 July 2012

New scheme notified to grant rebate of service tax paid on taxable services used for export of goods

The CBEC has notified the scheme to grant rebate of service tax paid on taxable services received by an exporter of goods and used for export of goods. The rebate can be claimed by way of refund based either on a specified rate of drawback or on an actual basis on the production of requisite documents.

Notification no 41/2012 – ST dated 29 June 2012

Case laws

Customs/foreign trade policy

Transaction value of imported goods not to be rejected merely based on price list of the foreign supplier

The Mumbai CESTAT has held that the transaction value of imported goods cannot be rejected merely based on the price list of the foreign supplier in the absence of any evidence of payment over and above the transaction value.

Vasco Da Gama Distelleries Pvt Ltd *v.* CC [2012] TIOL 831 (Mumbai – CESTAT)

Importer entitled to benefit of exemption notification, may entitle higher relief

The Ahmedabad CESTAT has held that where there are two exemption notifications that cover the goods, the importer would be entitled to the benefit of the exemption notification, which may give him or her higher relief.

CC *v.* Mangalam Alloys Ltd [2012] TIOL (737) (Ahmedabad - CESTAT)

Customs authorities not to deny benefits available under duty exemption entitlement certificate when not disputed by DGFT

The Mumbai CESTAT has held that the customs authorities cannot deny the customs duty benefits available under the Duty Exemption Entitlement Certificate (DEEC) scheme merely on the ground that the importer had contravened the terms and conditions of a licence when it was not disputed by the Director General of Foreign Trade (DGFT).

Hindustan Lever Ltd *v.* CC [2012] 281 ELT 241 (Mumbai - CESTAT)

Notifications/ circulars

Personal vehicles not permitted to be imported against Served from India Scheme scrips

The central government has clarified the following regarding Served From India Scheme (SFIS):

- Vehicles in the nature of professional equipment such as airfield fire fighting and rescue vehicles, heavy duty modulator trailer combination, reach stackers, ambulances, sewage disposal trucks, refuse disposal vehicles, etc. can be imported against SFIS scrips
- Personal vehicles such as motor cars, SUVs, etc are not permitted to be imported against SFIS scrips.

Circular no 18/2012 dated 5 July, 2012

Central government issued guidelines for banks and exporters with respect to e-BRC system

The central government has issued the following guidelines for banks and exporters with respect to electronic bank realisation certificate (e-BRC) system:

- Exporters are obliged to provide the details of commission paid with respect to the export product at the time of filing of application to avail various export benefits under the free trade policy (FTP).
- The BRC issued manually after 1 April 2012 will be converted into a digital format by the banks and uploaded on the DGFT website.
- While granting benefits under Chapter 3 of the FTP including Focus Market Scheme, FPS and MLFPS, the DGFT authorities will consider the net foreign exchange earnings. In case of a shortfall in foreign exchange realisation with respect to the shipping bill, FOB value, pro rata distribution of realised foreign exchange against each export item will be made by the system itself.

Policy circular no 1(RE-2012)/2009-14 dated 18 June 2012

Following the rulebook
Regulatory developments

FEMA

Investment ties with Pakistan

The government of India has permitted citizens of Pakistan or entities incorporated in Pakistan to invest in India, under the Government Approval (Foreign Investment Promotion Board) route. This investment can be made in any sectors or activities other than defence, space and atomic energy in compliance with the sectoral policy.

Further, overseas direct investment by Indian parties in Pakistan would also be considered by the RBI under the approval route.

DIPP Press note no 3/2012 dated 1 August 2012, RBI A.P. (DIR Series) Circular no 25 dated 7 September 2012 and Circular no 16 dated 22 August 2012

Retention of foreign exchange in foreign currency accounts

The RBI has, effective 1 August 2012, revised the provisions for the retention of foreign currency in exchange earners foreign currency (EEFC) account, resident foreign currency (RFC) account and diamond dollar account (DDA) as under the following:

- EEFC/RFC/DDA account holders may credit 100% of their foreign exchange earnings to their respective foreign currency accounts.
- Net balance outstanding in the account (after considering utilisation and forward commitments, if any) at the end of the calendar month should be either converted into Indian rupees or utilised for approved purposes on or before the last day of the succeeding calendar month.
- EEFC/DDA accountholders would be restricted from the purchase of foreign exchange until full utilisation of balance in the EEFC/DDA accounts.
- AP (DIR) Series Circular no 12 dated 31 July 2012

Guarantee by non-resident permitted for domestic non-fund credit facilities

The RBI has now permitted persons resident outside India to issue guarantees even for non-fund based facilities (such as letters of credit, guarantees, letters of undertaking and letters of comfort) entered into between two residents in India.

A.P. (DIR Series) Circular no 20 dated 29 August, 2012

Indian Depository Receipts: Two-way fungibility norms liberalised

The Indian Depository Receipts (IDR) framework allows eligible foreign companies to raise funds from Indian capital markets and enable domestic investors to invest in the securities of major MNCs listed on well-developed markets.

To improve attractiveness, the IDR regime is further liberalised as under the following:

- All IDRs (even those which are frequently traded) can now be redeemed into underlying equity shares to the extent of 25% of the IDRs originally issued.
- Re-issuance of IDRs would now be permitted to the extent of IDRs that have been redeemed or converted into underlying shares and sold.
- Fresh issue of IDRs and conversion of IDRs into underlying equity shares would continue to be governed by the provisions of A.P. (DIR Series) Circular no 5 dated 22 July 2009.

Overall cap for raising of capital by the issuance of IDRs by eligible foreign companies in Indian markets would be 5 billion USD.

RBI A.P. (DIR Series) Circular no 19 and SEBI Circular CIR/CFD/DIL/10/2012 dated 28 August 2012

Hedging of export exposure

Hedging of foreign exchange exposure

In order to provide operational flexibility to exporters, the RBI has permitted them to cancel and rebook forward contracts to the extent of 25% of the contracts booked in a financial year for hedging their contracted export exposures.

Source: RBI A.P. (DIR Series) Circular no 13 dated 31 July 2012

Hedging facilities for foreign investment by qualified foreign investors

The RBI has permitted qualified foreign investors (QFIs) to hedge their currency risk exposure on account of their permissible rupee denominated investments (in Indian mutual funds, listed equity shares and debt securities) by way of forward foreign exchange contracts with rupee as one of the currencies or foreign currency-INR options.

IPO related flows can also be hedged using foreign currency-INR swaps.

The above facility is subject to compliance with operational guidelines and prescribed terms and conditions.

RBI A.P. (DIR Series) Circular no 21 dated 31 August 2012

Compounding of contravention under FEMA - position on 'technical' contravention and subsequent compounding thereof

The RBI has clarified the possible course of action to be adopted with respect to contraventions which are technical or minor in nature. Further, it is clarified that in case the contravention is identified by the applicant by filing the compounding application, it will not be considered 'technical' or 'minor' in nature and the compounding process shall be initiated.

AP (DIR) Series Circular no 11 dated 31 July 2012

Financial services

Manner of achieving minimum public shareholding in a listed company

The SEBI has issued a circular pursuant to amendments to clause 40A of the listing agreement to facilitate listed entities to comply with the minimum public shareholding requirements within the period specified by the Securities Contracts (Regulation) Rules, 1957. The following are the additional methods prescribed in the circular:

- Rights issues to public shareholders, with promoters or promoter group shareholders foregoing their rights entitlement
- Bonus issues to public shareholders, with promoters or promoter group shareholders foregoing their bonus entitlement

Henceforth, listed entities desirous of achieving the minimum public shareholding requirement through other means or seeking any relaxation from the available methods would need to approach the SEBI. On receiving the request, the SEBI will consider it on merit and will communicate its decision within 30 days.

SEBI Circular no CIR/CFD/DIL/11/2012 dated 29 August 2012

Know-your-client requirements for foreign investors

The SEBI has issued a circular on know-your-client norms for the securities market clarifying certain operational issues in relation to FIIs, sub-accounts and QFIs. The SEBI has also indicated that the intermediaries shall strictly follow the risk-based due diligence approach as prescribed earlier by the SEBI in a master circular. The intermediaries shall conduct ongoing client due diligence based on the risk profile and financial position of the clients as prescribed in this circular. The requirements of this circular would apply to both new and existing clients.

SEBI Circular no CIR/MIRSD/11/2012 dated 5 September 2012

Sector	Nature of contravention	Fresh capital expenditure
By RBI or by applicant (otherwise than through compounding application)	Technical and/or minor in nature	Can be dealt with by way of an administrative/cautionary advice from RBI
	Material Issues involved are sensitive/serious in nature	Compounding procedure would follow Reference to the Directorate of Enforcement

Glossary

AAR	Authority for Advance Rulings
AE	Associated enterprise
ALP	Arm's length price
APA	Advance pricing agreement
AY	Assessment year
CBEC	Central Board of Excise and Customs
CBDT	Central Board of Direct Taxes
CENVAT	Central value added tax
CESTAT	Customs, Excise and Service Tax Appellate Tribunal
CIT(A)	Commissioner of Income-tax (Appeals)
Companies Act	Companies Act, 1956
FTS	Fees for technical services
FY	Financial year
HC	High court
IPO	Initial public offering
JV	Joint venture
ODIs	Offshore derivative instruments
OECD	Organisation for Economic Co-operation and Development
PAC	Person acting in concert
PE	Permanent establishment
RBI	The Reserve Bank of India
SAD	Special Additional Duty of Customs
SC	Supreme Court
SEBI	The Securities and Exchange Board of India
The Act	The Income-tax Act, 1961
The tax treaty	Double Taxation Avoidance Agreement
The Tribunal	The Income-tax Appellate Tribunal
TO	Tax officer
TPO	Transfer pricing officer
VAT	Value added tax

Contacts

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

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
Telephone: +91-033 - 2357 9101/4400 1111
Fax: (91) 033 - 2357 2754

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

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