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In this issue

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Editorial

We are delighted to bring to you the latest issue of India Spectrum.

The New Year brings hope, with the rupee gaining some ground and the Reserve Bank of India adopting a few measures to restore confidence with positive messages and policies. Indian politics are seen to be undergoing a dramatic change with the Aam Aadmi Party coming into power in Delhi, driving home the message that India now wants transparency and is tired of corruption. However, the uncertainty surrounding the outcome of the Central elections still looms in the background. Both, global and domestic investors are playing a wait-and-watch game until the election results.

After Cyprus, the Finance Minister has now intensified pressure on Switzerland to provide information on tax evaders and Indian bank account holders, apparently because Swiss banking authorities have not been forthcoming or co-operative enough, despite the India-Switzerland tax treaty being rewritten to enhance information exchange.

The index of industrial production for December 2013 contracted to negative 0.6% as compared to 2.1% in November and 1.8% in October 2013. The shrinkage can be ascribed to weak festive demand and sluggish investment activity. Nine months into the financial year and the government has managed to raise 60% of its direct tax collection targeted for the year, putting it on track with the budgeted figure, given that direct tax collections are observed to be highest in the last quarter. The net direct tax collection after refunds was up by 12.53% in April-December 2013. The only area from which it anticipates facing a shortfall is from its indirect tax collection. However, tax collection pressures have eased somewhat by the collections from the 900 MHz and 1800 MHz spectrum auction, announced as we go to press. A radical proposal briefly considered by a prominent political party, to abolish several direct and indirect taxes, to be replaced by a banking transactions tax, has been dropped.

Ketan Dalal

Shyamal Mukherjee

The European Central Bank (ECB) maintained its benchmark interest rate at 0.25% as the eurozone economy grew only 0.1% in the third quarter, while inflation was at 0.8%, still remaining below the ECB's goal of 2%. The ECB maintained its rate of interest and the unemployment rate remained persistently unmoved for eight months in a row. A green shoot was the news that sales of non-food products excluding car fuel rose by 1.4% month-on-month. This is the biggest rise since November 2001.

The Securities and Exchange Board of India (SEBI) introduced a new regime for overseas investments in Indian capital markets by way of foreign portfolio investor (FPI) regulations to put in place an easier registration process and operating framework for such entities. This new class of investors, FPIs, will encompass all foreign institutional investors, their sub-accounts and qualified foreign investors, and be divided in three categories according to their risk profile. "Know your client" requirements and other registration procedures are expected to become much simpler than the current dispensation, for FPIs. The SEBI has also decided to grant permanent registration, as against the current practice of granting approvals for one year or five years to overseas entities seeking to invest in Indian markets.

The Goa High Court (HC) in the case of Hede Consultancy Company Pvt. Ltd., allowed the set-off of long-term capital loss against short-term capital gains based on the findings of the lower authorities that the transaction in question was not dubious, and was not intended to avoid tax. In another ruling in the case of Valentine Maritime, the Mumbai Bench of the Income-tax Appellant Tribunal (the Tribunal) held that the contractual receipts of the taxpayer from a turnkey contract were assessable under the Income-tax Act, 1961 (the Act). It held that the turnkey contract under consideration was a composite contract with a lump sum consideration, and all receipts from it were taxable under section 44BB of the Act. See page nos.8 and 7 respectively 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

Direct Tax

Withholding of tax

Tax not to be withheld if payment is only for reimbursement of expenses

DCIT *v.* Dhaanya Seeds Pvt. Ltd. [TS-503-ITAT-2013 (Bangalore – Tribunal)]

The taxpayer is engaged in development as well as in production of seeds. While completing the assessment, the tax officer (TO) disallowed the reimbursement of expenses made to clearing and forwarding (C&F) agents under section 40(a)(ia) of the Act on the ground that tax was not withheld under section 194C of the Act while making these payments.

The Tribunal observed that though section 194C of the Act required tax to be withheld while paying "any sum" to a resident in pursuance of a contract, "any sum" does not cover even those expenses which were incurred on behalf of the client and reimbursement of the same. Hence, reimbursement of expenses by C&F agents is not a contract/ service covered by section 194C of the Act. In this case, C&F agents were appointed to provide the service of carrying out sales for which service charges were paid after withholding tax, and not for the purpose of incurring expenses on behalf of the taxpayer. Reimbursement expenses were incurred by the C&F agents on behalf of the taxpayer, and claims were made on actuals basis, and separately billed. Therefore, tax was not required to be withheld while making reimbursement of expenses. Accordingly, the TO's disallowance of expenses under section 40(a)(ia) of the Act was deleted by the Tribunal.

Fees for technical services

Commission to foreign agent of a software company having a fixed place of business in India to be treated as Fees for Technical Services

ITO *v.* Device Driven (India) Pvt. Ltd. [TS-613-ITAT-2013 (Cochin – Tribunal)]

The taxpayer is engaged in development and sale of software. During the year, it had paid export commission to Mr. B, a resident of Switzerland who was also one of its directors, which was claimed as a deduction.

The TO observed that Mr. B was the taxpayer's sole foreign commission agent, and that Mr.B was a qualified architect and had vast experience in the technical field. Also, on examination of the commission agency agreement, the TO observed that in this case, the terms of the commission agency were beyond the scope of a normal commission agency agreement. Hence, the TO held that Mr. B's technical skills were utilised by the taxpayer, and payment made to Mr. B should be treated as income accruing or arising in India under section 9(1)(vii) of the Act. Since the taxpayer had failed to withhold tax, export commission paid to Mr. B was disallowed under section 40(a)(i) of the Act.

The Commissioner of Income- tax (Appeals) (CIT(A)) examined Article 14 of the India – Switzerland Double taxation Avoidance Agreement (the tax treaty) which laid down two conditions for making "Income from Independent Personal Services" taxable in India: (a) having a fixed base regularly available to him in India; or (b) staying for a period or periods aggregating to 183 days or more in India. In this case, Mr. B, being a director of the taxpayer company, was required to attend Board meetings regularly and was required to hold regular meetings for monitoring the progress and status of projects undertaken by the taxpayer. Accordingly, the CIT(A) took the view that the taxpayer must have provided a fixed base in the form of office to Mr. B. Accordingly, the CIT(A) held that Mr. B had a fixed base in India, which was regularly available to him for performing his activities. Accordingly, the CIT(A) held that payments made to him were taxable in India in accordance with Article 14 of the tax treaty. Therefore, the TO's order disallowing the export commission was upheld.

The Tribunal observed that software was a highly technical product and its development had to be in accordance with customers' requirements. Even after development, it required constant monitoring. Hence, in case of software companies, the sales agent needed to possess the required technical knowledge; only then could he understand the clients' needs and procure orders for the company.

In this case, Mr. B had vast technical knowledge and experience. He was responsible for securing orders and had to assist the taxpayer company in all respects, including identifying markets, making introductory contacts, arranging meetings with prospective clients, and assisting in preparation of presentations for target clients. He had to monitor the status and progress of the projects. Hence, the payment made to Mr. B was payment made towards technical services.

As a director, Mr. B was required to monitor the affairs of the taxpayer-company. Hence, the office of the taxpayer-company could be treated as a fixed base for Mr. B. Accordingly, it was held that tax was required to be withheld under section 195 of the Act on the payments made to Mr. B, on the failure of which, disallowance of expenses under section 40(a)(i) of the Act was justified.

Income from providing services in connection with the business cannot be taxed as fees for technical services relying on certain terms and conditions of the contract alone

ADIT *v.* Valentine Maritime [TS-605-ITAT-2013 (Mumbai – Tribunal)]

The taxpayer, a foreign company incorporated in the United Arab Emirates (UAE), was engaged in the business of providing technical/ engineering services. During the year under consideration, it had entered into a contract with Engineers India Ltd. for laying/ installation of pipelines for three pipeline projects in Mumbai High North field.

During the year, the taxpayer had received payments under various heads, such as material, mobilisation, installation, etc., and these were offered to tax under section 44BB of the Act.

The TO observed that according to various clauses of the agreement relating to the scope of services rendered by the taxpayer, it also provided technical services along with a turnkey project for laying and installation of pipelines. Therefore, the TO taxed the taxpayer's total income as deemed income under section 44BB of the Act, and fees for technical services (FTS) under section 9(1)(vii) of the Act.

The Tribunal held that according to the sub-contract agreement between Engineers India Ltd and the taxpayer, the taxpayer was given a turnkey project for laying and installation of pipelines, and it was a settled proposition of law that when a contract consisted of a number of terms and conditions, each condition cannot form a separate contract. The contract had to be read as a whole. Since the taxpayer was engaged in the business of providing services or facilities **in connection with** its business, section 44BB of the Act would apply. The TO, without pointing out which part related to FTS, held that part of the income was FTS. Therefore, the taxpayer was correct in offering the entire income from the contract for material, mobilisation, installation, etc., to tax under section 44BB of the Act.

Income accrued *v.* Hypothetical income

Income accrues only if it becomes due and is accompanied by a corresponding liability

CIT *v.* Excel Industries Ltd. [2013] 38 taxmann.com 100 (SC)

The taxpayer-company was maintaining its accounts on a mercantile basis. In its tax return for assessment year (AY) 2001-02, it had claimed deductions of 'advance license benefit' receivable and 'duty entitlement pass book benefit' receivable on the ground that such benefits related to entitlement to import duty-free raw material under the relevant import and export policy by way of reduction from raw material consumption. Since such income could not be said to have accrued until imports were made and the raw material consumed, the amounts were claimed as deduction.

The TO disallowed the deduction claim on the ground that these benefits were taxable under section 28(iv) of the Act.

The CIT(A), the Tribunal and the HC, relying upon the orders passed in earlier years in the taxpayer's case, held that these benefits could not be brought to tax in the relevant AY.

The Supreme Court (SC) held that an income accrued to the taxpayer only when it became due, and it must also be accompanied by a corresponding liability of the other party, as income tax could not be levied on hypothetical income.

In this case, even if the taxpayer was entitled to the benefits under the advance licences and the duty entitlement pass book in the relevant AY, there was no corresponding liability on the customs authorities to pass on the benefit of duty-free imports to the taxpayer until the goods were actually imported and made available for clearance, which made the same a hypothetical income which may not materialise, and its money value was therefore not the taxpayer's income.

Further, in earlier AYs also, a consistent view had been taken in the taxpayer's favour that the benefits under the advance licences or under the duty entitlement pass book did not represent the taxpayer's real income. Hence, in the relevant AY, there was no reason to take a different view unless there were very convincing reasons.

The taxpayer would be required to pay tax in a subsequent year when it had imported goods and derived benefits under the advance license and the duty entitlement pass book. Therefore, the revenue's submission that in view of section 28(iv), the value of the benefit obtained by the taxpayer was its income liable to tax under the head 'Profits and gains of business or profession' could not be accepted.

Penalty for concealment

Penalty for concealment of income cannot be levied if the taxpayer discharges initial onus

CIT *v.* Gem Granites [TS-609-HC-2013 (Madras – High Court)]

The taxpayer owned quarries and was also a dealer in granite. During search proceedings, "on-money" transactions in real estate dealings were found and cash was seized. The taxpayer had accepted that cash found during the search represented "on-money" but workings done on paper were not relevant as there was a mistake in the entries of sale of flats to one party who produced documents stating that no "on-money" was paid to the taxpayer. Therefore, it was contended that the onus was on the department to prove that the non-disclosure of the income was deliberate and intentional.

The TO rejected the taxpayer's explanation on the ground that it was not credible. Therefore, the TO completed the assessment, initiated penalty proceedings under section 271(1)(c) of the Act and passed a penalty order.

Against the quantum assessment, the HC held that the taxpayer had neither examined its accountant with regard to the wrong entries nor produced any evidence to substantiate what could be the correct value of the property sold to one party. Hence, "on-money" was rightly added to the taxpayer's income.

In penalty proceedings, the Tribunal observed that there was a huge difference in the rate of sale of the flat recorded to different parties, and hence the possibility of wrong entry could not be ruled out. Also, quantum assessment could not automatically lead to an inference of concealment and consequent imposition of penalty. For sustaining the penalty under section 271(1)(c) of the Act, the taxpayer's explanation must be looked at, so that the contumacious conduct was proved.

Reliance was placed on the decision in the case of Mak Data Pvt. Ltd. *v.* CIT [TS-545-SC-2013] where the SC had held that if the taxpayer had offered an explanation for concealment of particulars of income or furnishing inaccurate particulars of income, and the explanation raised a presumption of concealment, when the TO notices difference between the reported and assessed income, the burden is on the taxpayer to show cogent and reliable evidence. When the initial onus had been discharged by the taxpayer, the onus shifted onto the Revenue to show that the amount constituted the taxpayer's income.

In this case, the onus placed upon the taxpayer has been discharged by giving a cogent and reliable explanation. Therefore, penalty under section 271(1)(c) of the Act could not be levied on the taxpayer.

Genuineness of sales transaction

Tax planning is legitimate and legal if it is within the framework of law

CIT *v.* Hede Consultancy Co. Pvt. Ltd. [TS-532-HC-2013 (Goa – High Court)]

The taxpayer was in the business of travel agency and consultancy. In the relevant year, it had sold shares of its group company, making long-term capital loss (LTCL) and also sold shares of another company (M Ltd.), earning short-term capital gain (STCG). The LTCL was set off against the STCG.

The TO disallowed the set-off on the ground that the transaction was a colourable device, as it was made with the sole purpose of evading taxable capital gains.

The CIT(A) observed that the purchase and sale price of the shares was not in dispute as the sale of shares of M Ltd. was at the price quoted on the stock exchange, and sale of shares of the group company was at a low price since the company was making losses. Further, the sales transaction resulting in LTCL had preceded the sales transaction resulting in STCG, which showed that the transaction resulting in LTCL was not influenced by the gain transactions. The CIT(A) held that the transactions were genuine, and, accordingly, allowed the set-off of LTCL against the STCG. The Tribunal upheld the CIT(a)'s order.

The revenue appealed to the HC under section 260A of the Act against the Tribunal's order.

The HC upheld the CIT(A)'s observation that the transaction resulting in LTCL was not influenced by the gain transactions. It also noted that the transactions were genuine and the prices at which the shares were sold were not inflated.

Further, the HC observed that the Tribunal's findings of fact were not disputed by the revenue. Hence, these could not be re-assessed by the HC. Reliance was placed on the decision in the case of M. Janardhana Rao *v.* JCIT [2005] 2 SCC 324 (SC), wherein it had been held that there was no scope for the HC's interference with a finding recorded when such finding could be treated as a finding of fact. The HC also relied on the observations of the SC in Vodafone

International Holdings BV *v*. UOI [TS-23-SC-2012], wherein the SC had held that tax planning may be legitimate provided it was within the framework of law and colourable devices could not be part of tax planning.

Accordingly, the HC upheld the Tribunal's order as the transactions were genuine and legitimate within the framework of law. Thus, set-off of LTCL against STCG was allowed to the taxpayer.

Penalty

Where the claim of set-off of brought forward loss was not disallowed initially, making a similar claim again would not amount to furnishing of inaccurate particulars of income so as to justify a penalty

CIT *v.* Makino Asia Pvt. Ltd. [2013] 40 taxmann.com 169 (Karnataka)

The taxpayer submitted its belated tax return for AY 1998-99, claiming loss which was sought to be carried forward. The TO had not taken any action accepting/ rejecting the claim in spite of the taxpayer's request to complete the assessment.

Thereafter, the taxpayer submitted its tax return for AY 2002-03, wherein it again claimed set-off of loss carried forward from AY 1998-99.

The TO passed a penalty order for raising a false claim of carry forward and set-off of business loss and held that this claim was rejected since the tax return for AY 1998-99 was submitted belatedly.

The CIT(A) and the Tribunal reversed the TO's order on the ground that the claim of carry forward of loss was never disallowed by the TO in the tax return of AY 1998-99.

The HC observed that despite the written request made by the taxpayer, no assessment order was passed for the AY 1998-99 and, therefore the taxpayer had to submit a revised return to claim set-off of the loss carried forward.

The HC placed reliance on the decisions of Dharamendra Textile Processors [2007] 295 ITR 244 (SC) and UOI *v*. Rajasthan Spg. & Wvg. Mills [2009] 13 SCC 448 (SC) wherein it had been held that merely because the taxpayer had claimed expenditure which was not accepted or was not acceptable to the revenue, penalty under section 271(1)(c) of the Act could not be levied.

In this case, the TO had not held that information given in the tax return was either incorrect or inaccurate, and hence the details mentioned in the tax return for AY 2002-03 in respect of the loss suffered in the AY 1998-99 were factually correct. Section 271(1)(c) did not define 'inaccurate particulars', therefore claiming of set-off of the loss carried forward, in the present case, would not by itself amount to furnishing inaccurate particulars.

Since it was not disputed that the taxpayer did suffer the loss shown in the tax return for the AY 1998-99, the claim for set-off of the loss carried forward would not amount to furnishing inaccurate particulars. Accordingly, the claim of set-off of brought forward loss was allowed.

Applicability of tax treaty

Substantial beneficiary of freight should be the owner, and not the charterer, of the ship

Marine Links Shipping Agencies *v.* CIT [2013] 40 taxmann.com 88 (Karnataka)

The taxpayer-company, a ship broker, engaged a ship to carry granite blocks from India to other countries. The owner of the ship was an Iranian company and the ship was chartered by P BV, a Netherlands-based shipping company. The taxpayer claimed itself to be an agent of P BV and had shown P BV as a beneficiary of the freight in the return of freight submitted for the AY 2009-10 on behalf of P BV.

The taxpayer claimed that it was entitled to the benefit of the India-Netherlands tax treaty, which stipulated that income from operation of ships in international traffic shall be taxable only in the state in which the place of effective management of the enterprise is situated. Since the beneficiary of freight was P BV, a Netherlands-based company, the freight income was taxable in Netherlands, and not India.

The TO noticed that according to the charter party agreement executed by the Iranian company and P BV, the Iranian company was the ship owner. Also, the India-Netherlands tax treaty could be applied only if the owner of the ship was the beneficiary of the freight. In this case, since the owner of the ship, i.e. the Iranian company, should be the beneficiary of the freight and not P BV, the benefits of the India-Netherlands tax treaty were not available.

The HC upheld that the Tribunal's order which stated that in accordance with the charter party agreement, the risks and liabilities undertaken by the charterer - P BV, the Netherlands entity, were limited only to a situation where the tonnage carried by the vessel was less than 19,500 tonnes. Therefore, the substantial freight beneficiary was the owner of the ship, the Iranian entity. Accordingly, relief under the India-Netherlands tax treaty was not allowable in this case.

Taxability on forfeited Dividend

Dividend forfeited not taxable, as it is provided for from profits subject to tax

ACIT *v.* Sunderlal Sawji Urban Co-op Bank Ltd [TS-583-ITAT-2013 (Pune - Tribunal)]

Facts

The taxpayer had forfeited an amount of INR 0.921 million on account of dividend payable. This forfeited dividend was transferred/ credited to the general reserve fund. The TO considered the forfeited dividend as income directly related to the business of the taxpayer and that is should be liable to tax under section 28 of the Act. The TO's contention was based on section 41(1) of the Act, under which any allowance or deduction made in any previous years for any trading liability would be deemed to be profits and gains of business or profession in the year in which the taxpayer received the benefit of such trading liability by way of remission/ cessation. The TO passed an order making an addition of INR 0.921 million as income from business and profession. The TO relied on the SC ruling in the case of CIT *v.* T.V. Sundaram Iyengar & Sons Ltd. [1996] 222 ITR 344 (SC). The taxpayer filed an appeal before the CIT(A). The taxpayer claimed that the dividend payable or paid was not claimed as deduction while computing the income. Further, the payment of the dividend was related to the distribution of profits, and out of the profit and loss appropriation account which has already been taxed. Also, section 41(1) of the Act was not applicable when dividend was forfeited. The CIT(A) deleted the TO's addition on the ground that the taxpayer-bank had made provision for distribution of dividends to its members out of profit which had already been assessed as income. The unclaimed dividend amounted to excess provision of dividend which had been reversed, and there was no transfer of profits to the Reserve Fund as such. The TO appealed before the Tribunal.

Held

The Tribunal held that section 41(1) of the Act was not applicable. The Tribunal confirmed the CIT(A)'s order holding that the forfeited dividend was not liable to tax.

Editor's note: *This judgement has distinguished this decision from that in the case of T.V. Sundaram Iyengar & Sons Ltd. (above) on the grounds of the applicability of section 41(1) of the Act, providing clarity on appropriation of unclaimed dividend transferred to reserve.*

Capital Gains

Short-term capital loss arising from transactions on which securities transaction tax has been paid can be set off against short-term capital gain arising from non-STT transactions

Capital International Emerging Markets Fund *v.* DDIT [2013] 145 ITD 491 (Mumbai – Tribunal)

Facts

The taxpayer, a foreign institutional investor (FII), engaged in the business of share trading, had claimed a set-off of short-term capital loss subjected to securities transaction tax (STT) against the short-term capital gain arising on non-STT transactions. The TO rejected the claim, holding the view that set-off of short-term capital loss subjected to STT paid transactions against short-term capital gains not subjected to STT was not proper in the light of section 70(2) of the Act.

Held

The Mumbai Tribunal upheld the taxpayer's claim, relying on the decision in the cases of First State Investments (Hong Kong) Ltd. *v.* ADIT [2011] 8 ITR 315 (Mumbai) and DWS India Equity Fund [IT Appeal No. 5055 (Mum.) of 2010], wherein it had been held that the provisions of sections 45 to 55A of the Act fell within the meaning of the phrase, "under similar computation". The Tribunal also held that the matter of computation of income was a subject which came anterior to the application of the rate of tax, which was contained in sections 110 to 115BBC of the Act. The Tribunal further held that merely because the two sets of transactions were liable for different rates of tax, it could not be said that income from these transactions did not arise from similar computation as, in both the cases, computation had to be made in a similar manner, under the same provisions. Accordingly, the Tribunal held that the short-term capital loss arising from STT-paid transactions could be set off against short-term capital gain arising from non-STT transactions.

Editor's note: *This judgment has again brought to light the controversy regarding the allowability of inter se set-off between STT-paid and non-STT paid transactions. This judgment will be welcome news for all FII investors who generally have both kinds of sale transactions (i.e. STT-paid and non-STT paid). The Mumbai Tribunal has categorically held that losses arising from STT-paid transactions can be set off against gains arising from non-STT transactions.*

Intangible Assets

Payment made for acquisition of client base – an intangible asset eligible for depreciation

SKS Micro Finance Ltd. *v.* DCIT [2013] 145 ITD 111 (Hyderabad - Tribunal)

Facts

The taxpayer company was engaged in the business of microfinance lending services. The taxpayer company purchased another company in the same business by way of slump sale. Over and above the sale consideration, an amount of INR 37.9 million was paid towards acquisition of the seller's client base. The taxpayer capitalised this payment in its books as an 'intangible asset' and claimed deprecation on it.

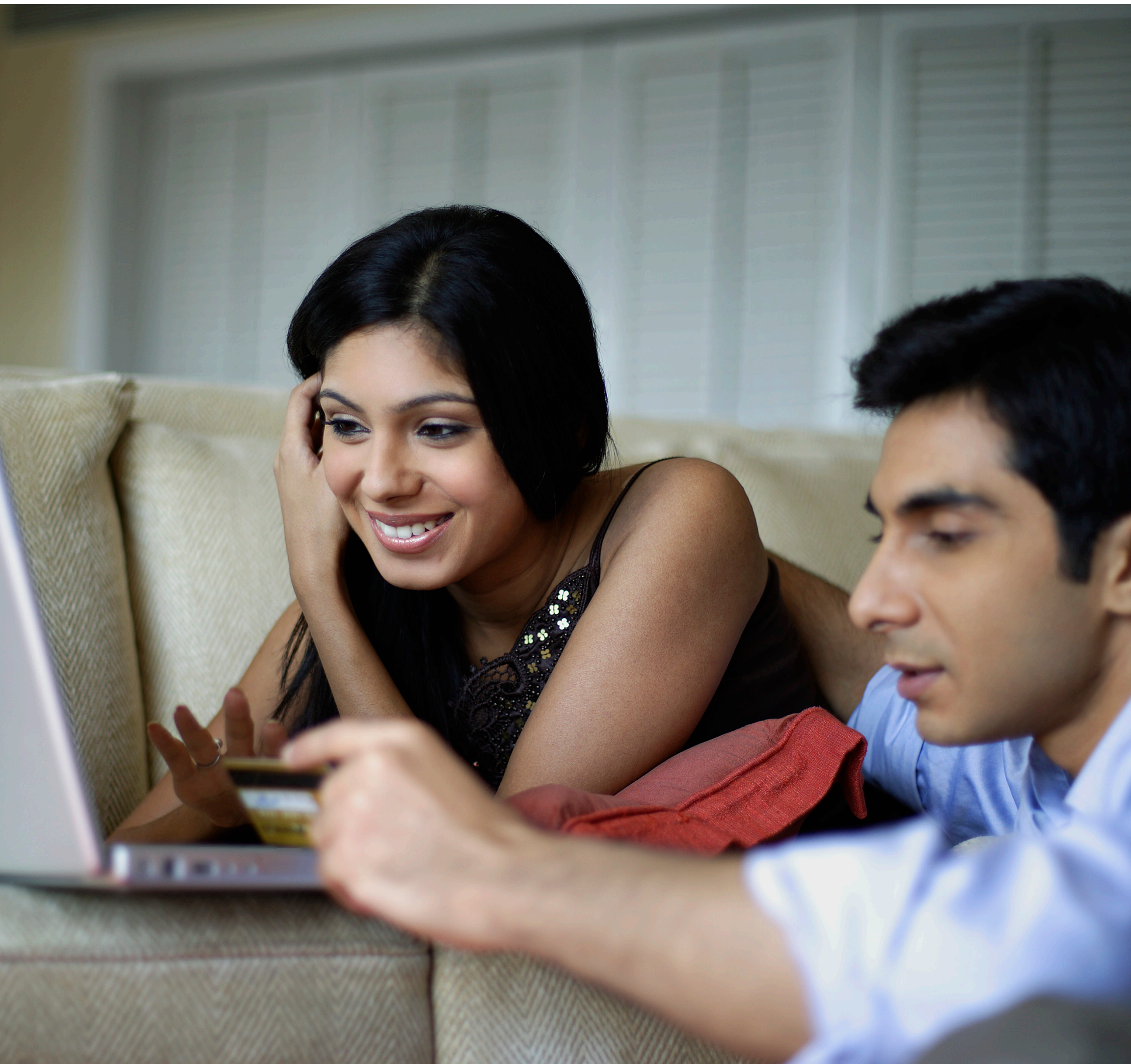
The TO rejected the taxpayer's claim for depreciation on the basis that the intangible asset claimed to have been acquired by the taxpayer was not covered by any of the identified asset categories appearing in the depreciation schedule.

The CIT(A), while sustaining the TO's disallowance, was of the view that the customer base acquired by the taxpayer could not be termed as know-how, patent, etc.. Further, relying on the decision of the Bombay HC in CIT *v*. Techno Shares & Stocks Ltd. [2009] 184 Taxman 103 (Bombay), the CIT(A) held that the payment made by the taxpayer could not be considered as a license or business or commercial rights of similar nature as it did not relate to intellectual property as required by section 32(1)(ii) of the Act.

Held

The Tribunal observed that the Bombay HC decision on which the CIT(A) had relied had been reversed by the SC in the case of CIT *v*. Techno Shares & Stocks Ltd. [2010] 327 ITR 323 (SC). The Tribunal, while upholding the taxpayer's claim, relied on various judicial precedents, and specifically relied on the judgment of the Mumbai Tribunal in the case of India Capital Markets Pvt. Ltd. *v*. DCIT [2013] 29 taxmann.com 304 (Mumbai – Tribunal) where, while considering a similar nature of acquisition of clientele, the Tribunal held that acquisition of such clientele would come within the expression 'any other business or commercial rights of similar nature' as the rights over the clients were used by the taxpayer as tools to carry on the business, and as such, depreciation was allowable on such an intangible asset.

Editor's note: *This judgment of the Hyderabad Tribunal has further clarified what constitutes 'any other business or commercial rights of similar nature' for the purpose of being eligible for depreciation. The Mumbai Tribunal, following its own judgment, held that payment for acquisition of clientele would classify as an intangible asset falling within the purview of 'any other business or commercial rights of similar nature.' Since this judgment, another judgment of the Pune Tribunal (Cosmos Co-op Bank) has also been published, a case with almost identical facts wherein the Tribunal has echoed the Mumbai and Hyderabad Tribunals' decisions.*



Assessing personal tax

Personal taxes

Despite no employer-employee relationship, ESOP income taxable as salary

ACIT *v*. Chittaranjan A. Dasannacharya [TS-560-ITAT-2013 (Bangalore - Tribunal)]

Facts

The taxpayer was in employment in India with Aerospace Systems Pvt. Ltd. (ASPL) and went on deputation as an independent consultant to SIRF Technology, USA (SIRF) for the period of 1995 to 1998. SIRF granted stock options to him on 4 October 1996 under its stock option plan. He exercised his right under the Stock Option Plan in March, 2006 and received 7,000 shares of SIRF and sold them on the same day in a 'Cashless Exercise'. He contended that since he was an employee of ASPL and not SIRF, there was no employer-employee relationship and hence the income could not be taxed as 'Salaries'. Thus, the gains were considered by him as capital gains arising on transfer of stock options. Also, he contended that the Stock Options were held for nearly ten years, i.e., from the grant date. Hence, the entire stock income of INR 12.7 million was offered as long-term capital gains. The taxpayer invested part of the consideration in the construction of a residential property and claimed benefit of INR 6.2 million under section 54F of the Act. His submissions were rejected and the TO considered that "employee" according to the ESOP plan included a consultant who performed services for the company or its subsidiaries. Further, the TO contended that the difference between the sale price of shares and the fair market value (FMV) of shares on the date of exercise was a short-term capital gain and hence denied the exemption under section 54F of the Act.

Held

The Tribunal relied on the case of Sumit Bhattacharya *v*. ACIT [2008] 300 ITR (AT) 347 (Mumbai - SB) wherein it had been held that even in the absence of an employer-employee relationship, income on stock appreciation rights (SAR) was assessable under the head 'Salaries'. In the present case, the Tribunal noted that under the ESOP plan of SIRF, independent consultants had to be considered as "employees" for purposes of grant of the benefit. The Tribunal observed that the first event of taxability was triggered on the date when the option to acquire the shares was exercised. Up to that time, the taxpayer had no right to any shares of SIRF. The benefit arising to an employee (being the difference between the FMV and exercise price on the date of exercise) would be subject to tax as salary income, negating the taxpayer's arguments regarding no 'employer-employee' relationship.

The Tribunal noted that the option to purchase shares could only be exercised and not be alienated. To fall under the head capital gain, there must be a transfer of a capital asset. It was concluded that exercise of options to acquire shares was not capable of being assessed under the head "Capital Gain", as there was no transfer of capital asset.

It further held that the income had to be treated as taxable under the head, Salaries. The next event of taxability under the stock options arose on sale/transfer of shares. The difference between the sale price and the FMV on the date of exercise would be treated as capital gain. As the shares were sold on the same day that the option was exercised on, the Tribunal held the gain to be "short term". Consequently, deduction under section 54F of the Act was denied.

With regard to levy of interest under section 234B of the Act, the Tribunal ruled in favour of the taxpayer by confirming that as the income was assessed as "Salary", it was the employer's duty to deduct tax at source. The taxpayer could not be penalised for non-deduction of tax at source by the employer. The Tribunal also deleted the penalty under section 271(1)(c) of the Act as the employee had furnished all facts with regard to stock options, and the benefit he received.

Date of 'registration deed' is relevant for property acquisition to claim the exemption under section 54F of the Act

Gopilal Laddha *v.* ACIT [TS-589-ITAT-2013(Bangalore – Tribunal)]

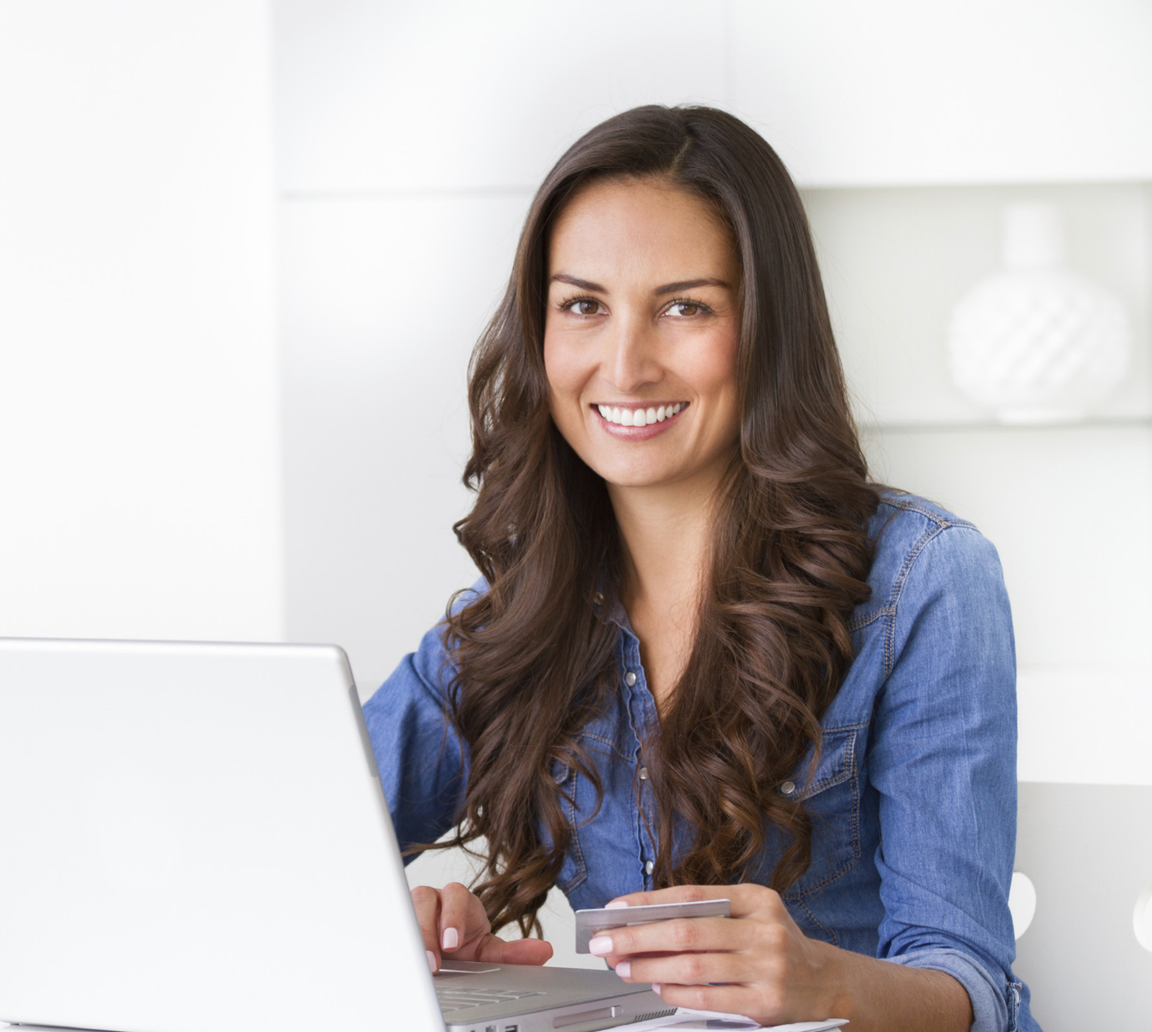
Exemption under section 54F of the Act will be allowed if the registration of the new property is done within the time specified, irrespective of the time of entering into the builder-buyer agreement.

Facts

The taxpayer filed his return for the AY 2009-10 declaring total income of INR 2.64 million. The taxpayer was joint owner of a property, which was acquired by Karnataka Industrial Area Development Board (KIADB) in August 2008 on payment of compensation of INR 8.46 million. He purchased a flat for INR 5.09 million by registered sale deed dated 11 September 2008 and claimed an exemption of INR 4.61 million under section 54F of the Act. During scrutiny proceedings, the TO observed that the flat was booked in January, 2006 and the amount was paid in FY 2006-07 (i.e. one year prior to the sale of land) and INR 0.40 million was for electrical/ water connections, which did not qualify for exemption under section 54F of the Act. Further, the taxpayer had paid INR 4 million from a housing loan and thus only INR 0.62 million qualified for exemption under section 54F. The TO further disallowed set-off of LTCL on sale of shares and STT paid against Long-term capital gain (LTCG) arising on sale of land. The CIT(A) upheld the TO's order. Aggrieved, the taxpayer preferred an appeal before the Tribunal.

Held

The Tribunal observed that amounts paid by the taxpayer on booking of the flat in January 2006 and the housing loan of INR 4 million for investment in the purchase of the flat had not vested the taxpayer with ownership of the new asset. The taxpayer was vested with ownership of the flat only by virtue of the registered sale deed dated 11 September 2008. Thus, the Tribunal held that the taxpayer had invested in the new property within two years from August, 2008 (i.e. the date of sale of the land) and would be eligible for exemption under section 54F of the Act. Further, in respect of disallowance of set-off of LTCL against LTCG, it held that the set-off of LTCL on sale of listed securities, income from which is exempt under section 10(38) of the Act, against LTCG on an immovable property as claimed by the taxpayer, was contrary to law and the intention, object and purpose of the Legislation in introducing clause 10(38) of the Act, and hence should be disallowed.



Non-compete fee is a capital receipt not liable to tax

Transaction value for sale of shares cannot be substituted with FMV

CIT *v.* Wintac Ltd [2013] 40 taxmann.com 534 (Karnataka - High Court)

Amount forfeited on account of cancellation of a Sale Agreement in excess of the agreement amount was held to be a revenue receipt liable to tax. Also held that the non-compete fee received to discontinue the business for three years is a capital receipt not liable to tax. As regards a transaction of share sale, the HC held that in absence of any finding that the transaction was a colourable device, the price of shares could not be substituted with the fair market value.

Facts

During the AY 2001-02, Wintac Ltd (the taxpayer) entered into an agreement for sale of its two units to Tumkur Chemicals Limited (TCL) for INR 57.5 million. Subsequently, the agreement was cancelled, and the taxpayer forfeited INR 11 million from the advance paid by TCL. The taxpayer treated the amount as a capital receipt, not liable to tax. However, the TO treated the same as a revenue receipt liable to tax.

The taxpayer also received INR 40 million from Recon Health Care Limited (RHC) towards a non-compete fee to discontinue the business for three years, and treated this as a capital receipt. However, the TO treated the amount as a revenue receipt liable to tax.

Further, the taxpayer received INR 250 million from RHC towards transfer of technical know-how, which was offered to tax by the taxpayer in its return. However, during assessment proceedings, the taxpayer claimed the amount to be a capital receipt exempt from tax. The TO rejected the revised claim and taxed the same amount as a revenue receipt.

During FY 1997-98 and FY 2000-01, the taxpayer acquired equity shares of its subsidiary. During FY 2000-01, these shares were sold to its Managing Director at 1% of the cost paid. On sale of shares, the taxpayer claimed long term capital loss of INR 31 million and short term capital loss of INR 9.9 million. The TO rejected the taxpayer's claim on the ground that the transaction was between interested persons and the taxpayer had failed to adduce evidence that valuation of shares was done at arm's length.

Held

With regard to the forfeited amount of INR 11 million, the HC referred to the agreement with TCL and noted that on the purchaser's failure to perform his part of the contract, the vendor was entitled to claim INR 3 million as liquidated damages from the advance consideration. Accordingly, the HC held that according to the agreement, the taxpayer was entitled to forfeit only a sum of INR 3 million and the remaining amount of INR 8 million has to be treated as revenue receipt chargeable to tax.

With regard to non-compete fees, the HC relied on the SC ruling in Guffic Chemic (P) Ltd. *v.* CIT [TS-97-SC-2011] and held in the taxpayer's favour. It held that the non-compete fee received to discontinue the business for three years was a capital receipt not liable to tax.

For computing capital gains on sale of shares of the subsidiary, the HC referred to section 48, and noted that there was no provision to substitute the consideration received with fair market value of the asset sold.

The HC also noted that the subsidiary was making losses, and the taxpayer's corporate guarantee to the Bank and its suppliers had been invoked. The taxpayer sold the shares to stabilize its financial position. Accordingly, the HC confirmed the Tribunal's finding and held that long-term and short-term capital loss be allowed as claimed to the taxpayer.

With regard to technical know-how, the HC relied on the Madras HC ruling in the case of Indo Tech Electric Co. *v.* DCIT [2011] 237 CTR 227 (Madras) wherein it had been held that 'technical know-how' was an intangible asset liable to be taxed under the head, 'capital gains'. Accordingly, the HC ruled in the favour of the revenue and held that this was chargeable to capital gains tax.

Editor's note: *The decision reaffirms the positions regarding imputation of fair value in case of sale of shares as well as treatment* *of non-compete fees paid on discontinuation of business.*

Capital Gains

Transfer of revaluation gains on land to current accounts of partners and treatment of such current account balances as loans in books of the converted company breaches conditions of section 47(xiii) of the Act

K.T.C. Automobiles Pvt. Ltd. v. DCIT [2014] 41 taxmann.com 160 (Coachin - Tribunal)

Facts

The taxpayer-firm was a dealer of Hyundai Motors. The taxpayer converted the partnership firm into a private limited company and claimed exemption from capital gains on transfer of assets of the partnership firm to the newly formed private limited company in accordance with section 47(xiii) of the Act. During this process, the taxpayer revalued land and credited the revaluation amount to the partners' current accounts. These transfers to the current accounts were treated as loans in the books of the converted private limited company.

A question arose as to the taxability of such transfer of assets from a partnership firm to the newly formed private limited company.

The taxpayer contended that the transfer was for business purposes. According to the taxpayer, the conversion was undertaken at the instance of the firm's principal and its bankers. The taxpayer rebutted the revenue's claim that the transfer and revaluation was a mechanism to transfer the gains of appreciation of the land to the partners.

Held

The Tribunal held that according to section 47(xiii) of the Act, to avail the exemption from capital gains, there were two pivotal conditions: *firstly*, all the assets and liabilities before the transfer should become the assets and liabilities of the private limited company, and, *secondly*, the partners of the firm should not receive any benefit other than the shares of the private limited company in the ratio of their capital account on such transfer. In the present case, the land was revalued and gains were credited to the current accounts of the partners, which were further treated as loans in the company's books, thereby breaching these conditions and creating a new liability in the books of the company. Also, by treating the transfers to current accounts as loans, in substance the partners became entitled to interest on these loans, and they could redeem this loan from the company whenever they wanted.

Based on the above, the Tribunal held that such conversion was liable to capital gains tax as the conditions of section 47(xiii) of the Act had not been satisfied.

Editor's note: *This ruling aims at curbing accounting techniques being used by taxpayers to transfer gains to partners without paying any taxes.*

Money distributed to retiring partners on retirement not taxable in firm's hands

CIT *v.* Dynamic Enterprises [2013] 40 taxmann.com 318 (Karnataka - High Court)

Money distributed to retiring partners on retirement would not attract capital gains tax in the firm's hands under section 45(4) of the Act.

Facts

The taxpayer, a partnership firm, came into existence in 1985. The firm was reconstituted in 1987 whereby land was purchased with the capital contributed by the new partner. The firm was again reconstituted in 1993 whereby five partners belonging to another business group were inducted into the firm. Before reconstitution, the assets of the firm were revalued. In 1994, the old partners of the firm retired through a deed of retirement and received money in accordance with the enhanced value of the property. The TO held that the retirement and introduction of new partners was merely a device adopted to transfer the immovable property held by the firm. Accordingly, the TO treated the reconstitution of the firm in 1994 as transfer of property from the old firm to the new firm and held it taxable in the hands of the firm as capital gains under section 45(4) of the Act.

Held

The assets purchased by the firm were the property of the firm and did not stand in the names of the individual partners. Further, to attract capital gains under section 45(4) of the Act, there should be transfer of a capital asset from the firm to the retiring partner, whereby the firm ceases to have any right in the transferred asset and the retiring partner acquires absolute right in the asset. In the present case, the retiring partners were given money against the balances in their capital accounts and no capital assets were transferred to them. The firm did not cease holding the immovable property, and its right in the property remained unaffected. Hence, no capital gains arose in the hands of the firm since section 45(4) was not attracted.

Editor's note: *This is a guiding decision for analysing the tax impact in the hands of a firm on retirement of a partner. However, since the question did not involve taxability of money distributed in the hands of the retiring partners, it is not clear whether the Act envisages any tax impact on retirement of partners in the retiring partners' hands.*

Non-compete fee

Non-compete fee paid akin to commercial right, eligible for depreciation

Pentasoft Technologies Ltd. *v.* DCIT [TS-578-HC-2013(Madras – High Court)]

The non-compete fee paid by the taxpayer to strengthen its rights with respect to other intangibles such as patents, trademarks, etc., acquired on purchase of business is an intangible asset eligible for depreciation under section 32 of the Act.

Facts

The taxpayer company entered into an agreement with Pentamedia Graphics Limited (PGL) for acquiring the software development and training division of PGL for INR 6260.80 millions. The consideration included INR 1800 million paid towards non-compete fee, INR 3642.1 million towards brand IPRs and INR 818.7 million towards the excess of the transfer price over fixed assets.

The taxpayer claimed depreciation on IPRs and non-compete fee for AYs 2001-02 and 2002-03. The TO rejected the taxpayer's claims. The CIT(A) reversed the TO's order. On further appeal, the Tribunal upheld the CIT(A)'s order in relation to IPRs but reversed the order in relation to the non-compete fees.

The taxpayer filed an appeal before the HC against the Tribunal's order.

Held

After going through the facts of the case, the HC held that the non-compete fee was paid by the buyer under a composite agreement to strengthen its rights over copyrights, trademarks, etc, acquired as a part of the transaction, and to restrain the transferor from using these. Thus, the HC held that the non-compete clause under the agreement should be read as a supporting clause to the transfer of copyrights and trademarks, etc.

In view of the above, the HC held that the non-compete fee paid by the taxpayer was a part of a bundle of other intangible rights obtained on purchase of the software development and training division of PGL, and was therefore eligible for depreciation under section 32 of the Act.

Editor's note: *This is a landmark ruling which may be welcome news for companies who pay non-compete fees as part of a purchase consideration. This also provides guidance on whether the non-compete fee paid is capital or revenue in nature.*

However, we would like to highlight that the Tribunal in the case of Mylan Laboratories Ltd. [TS-24-ITAT-2014(HYD)] and the Chennai Tribunal in the case of Arkema Peroxides India Pvt. Ltd. v. ACIT [ITA. No.2212/ Mad/ 2006] have given unfavorable rulings and held that, "the non-compete fee does not represent any intangible asset, such as, know-how, patents, copyrights, trademarks, licences, franchises, etc." Therefore litigation on such a matter cannot be ruled out.

A public shareholder will not become a part of a promoter group merely by acquisition of substantial shareholding pursuant to an open offer

Informal Guidance – R Systems International Ltd. dated 8 January 2014

The promoters held 45% stake in the target company, R Systems International Ltd. (RSIL). One of the existing public shareholders, X, made an open offer for acquisition of 26% stake in RSIL. After the open offer, the promoter's and X's holdings became 50% and 35% respectively, and the public shareholding (other than X) was reduced below 25%.

Issue: Whether X's shareholding will be treated as non-public shareholding as contemplated under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ('SAST') and whether X was required to reduce its shareholding by such percentage so that the non-public shareholding of RSIL does not exceed 75%?

Informal Guidance – SEBI: According to the definition under SAST, 'acquirer' means any person, which includes both, a promoter and a member of the public. Thus, the definition of the term, 'acquirer' does not make any distinction between a promoter and the public. Promoters are defined as persons who are in control of the company. The point of concern was that, by virtue of substantial shareholding in RSIL, X may have an ability to exercise significant influence over the company's affairs.

However, SEBI observed from the letter of offer made by the acquirer that the prime objective behind the acquisition was investment value in the equity shares of the target company and not substantial holding of shares/ voting rights/ control or management of RSIL.

Thus, X's shareholding in RSIL should fall under the category of "public shareholding". Hence, X was classified as a public shareholder and the shareholding of X was very much a part of the public shareholding of the company; since there was no breach of the minimum public shareholding limit, X was not required to reduce its shareholding.

Editor's note: *It is clear from the above informal guidance issued by SEBI that a public shareholder will not become a part of a promoter group merely by acquisition of substantial shareholding pursuant to an open offer.*

Pricing appropriately

Transfer Pricing

Prelude

Once again, this edition brings you a snapshot of key tribunal rulings. It is interesting to note that, increasingly, the Tribunal are either ruling cases in favour of the taxpayers or sending the cases back to the Revenue Authorities for fresh examination. Therefore, a question arises as to whether the Transfer Pricing Officers (TPOs) are ignoring fundamental points during audits, such as the facts of a case and business/ economic reasons behind the international transactions, and are proposing adjustments in a pre-determined manner, with an intent to adjust the transfer price of taxpayers.

Chennai Tribunal – Non-reporting of segmental results in audited financial statements cannot be a basis for rejecting segmental results prepared for transfer pricing purposes

Honeywell Electrical Devices & Systems India Ltd. v. ACIT [TS-345-ITAT-2013(Chennai)-TP]

The taxpayer was engaged in the business of providing switches and cable management solutions in the global market for commercial as well as domestic applications. During the year under consideration, the taxpayer was broadly involved in manufacturing and trading activities. For transfer pricing purposes, the taxpayer had classified its manufacturing activities under two segments, *viz*., contract manufacturing (i.e., export of products to Associated Enterprises (AEs)) and local manufacturing for sale to independent parties in domestic markets. For benchmarking the transactions with AEs, the taxpayer had applied the internal Transactional Net Margin Method (TNMM) as the Most Appropriate Method (MAM), where the margin earned in the contract manufacturing segment was compared with that of the local manufacturing segment. During the assessment proceedings, the TPO rejected the taxpayer's segmental financials on the basis that the segmental accounts were not reported in the audited financials, and allocation of expenses between the contract manufacturing segment and domestic segment was not done scientifically. Accordingly, the TPO proposed an adjustment by comparing the mean margin of external comparable companies at an entity-wide level. The Dispute Resolution Panel (DRP) upheld the TPO's approach.

On appeal, the Tribunal:

- held that even though the segmental financials were not shown in the audited financial accounts, they had to be accepted for testing the arm's length nature of transactions.
- held that the margins earned by external comparable companies had to be compared with margins declared by the taxpayer in respect of its AE transactions excluding the domestic transactions.
- observed that in the previous AYs and for the year under consideration, the revenue authorities had accepted the taxpayer's segmental results while computing the deduction under sections 10A/ 10B of the Act, and hence there could not be any reason for rejecting this, especially where there was no change in the facts and circumstances of the case.

Mumbai Tribunal – Bank guarantees and corporate guarantees distinguished

Glenmark Pharmaceuticals Limited *v.* ACIT [2013] 37 taxmann.com 138 (Mumbai - Tribunal)

The taxpayer was primarily engaged in the business of manufacturing and marketing pharmaceutical products and related research and development activities. The taxpayer had charged guarantee fees to its AEs in connection with loans availed by them and letter of credit facility availed by AEs from third party banks and guaranteed by the taxpayer. During assessment proceedings, the TPO rejected the arm's length guarantee fees as determined by the taxpayer, and gathered information on guarantee commission rates charged by various banks from their websites. Accordingly, the TPO, using the Comparable Uncontrolled Method (CUP), determined the arm's length guarantee charge and thereby proposed an upward adjustment. The CIT(A) upheld the TPO's approach.

On appeal, the Tribunal held:

- Guarantee commission rates available on websites of various banks, which were referred to by the TPO as external comparables, were not good comparables.
- There exists a conceptual distinction between bank guarantees and corporate guarantees. Corporate guarantees, which were given to banks for safeguarding the interests of the banks, were not given on commercial considerations, unlike bank guarantees.
- Naked bank quotes available on public websites could not be used as external CUPs, unless adequate adjustments for various factors such as the risk profile/ functional position of the applicant, terms of the guarantee, securities involved, etc., were made to make the two comparable.

***Editor's note:** In the above ruling, the Mumbai Tribunal has established a conceptual and legal difference between the nature of bank guarantees and corporate guarantees. However, the Tribunal has not discussed the appropriateness of the various approaches to determine the arm's length price internationally. In this instance, it would be important to consider global precedents and address the appropriateness and reliability of various approaches in order to pave the way for future cases concerning guarantee fees and charges.*

Delhi Tribunal – Special Bench ruling on LG Electronics is applicable to all classes of taxpayers, whether they are licensed manufacturers or distributors, irrespective of their risk profile

Casio India Co. Pvt. Ltd. *v.* ACIT [TS-340-ITAT-2013(Delhi)-TP]

The taxpayer was primarily engaged in distribution of watches, consumer information products and other related products supplied by it to its AE. The taxpayer adopted the TNMM to justify the arm's length nature of its international transactions. During assessment proceedings, the TPO did not challenge the taxpayer's profitability, but questioned the advertising, marketing and promotional (AMP) expenses incurred by the taxpayer. The TPO held that the taxpayer had incurred excessive AMP expenses and these should be recovered from its AE along with an arm's length mark-up. On appeal, the CIT(A) held that the benefit of AMP expenses was primarily to the taxpayer and any benefit to the AE was incidental.

On appeal by the Revenue, the Tribunal held as follows:

- it seconded the examination of 14 parameters for a taxpayer to correctly determine the arm's length price of AMP expenses as laid down by the Special Bench (SB) in the case of LG Electronics.
- it discussed the first two parameters laid down by the SB and concluded that the SB ruling was applicable with full force to all classes of taxpayers, whether they were licensed manufacturers or distributors, irrespective of their risk profile.
- it ruled against the taxpayer's reliance on the BMW India [I.T.A. No. 5354/ Del/ 2012] ruling and considered the SB order in LG Electronics to have more force and binding effect over the Divisional Bench order on the same issue.

***Editor's note:** From the above ruling, it can be noted that the two division benches of the Tribunal have interpreted the SB ruling differently. In the case of BMW India, the Tribunal opined that the SB ruling was applicable to the facts of the licensed manufacturer and not to the facts of the distributor. However, in the above ruling, the Tribunal espoused the 14 parameters laid down by the SB ruling and inferred that the SB ruling was applicable to manufacturers as well as distributors, irrespective of their functional and risk profile. In such a scenario, the whole issue would be reduced to a mechanical calculation wherein overseas brand owners would be asked to compensate the Indian AE for AMP expenses even if they have already reduced import prices as a compensation for the marketing efforts of the Indian AE. With the cloud of uncertainty with regard to the issue of marketing intangibles hovering over the transfer pricing litigation arena, taxpayers grappling with this issue may need to look beyond the normal litigation process to resolve these issues.*

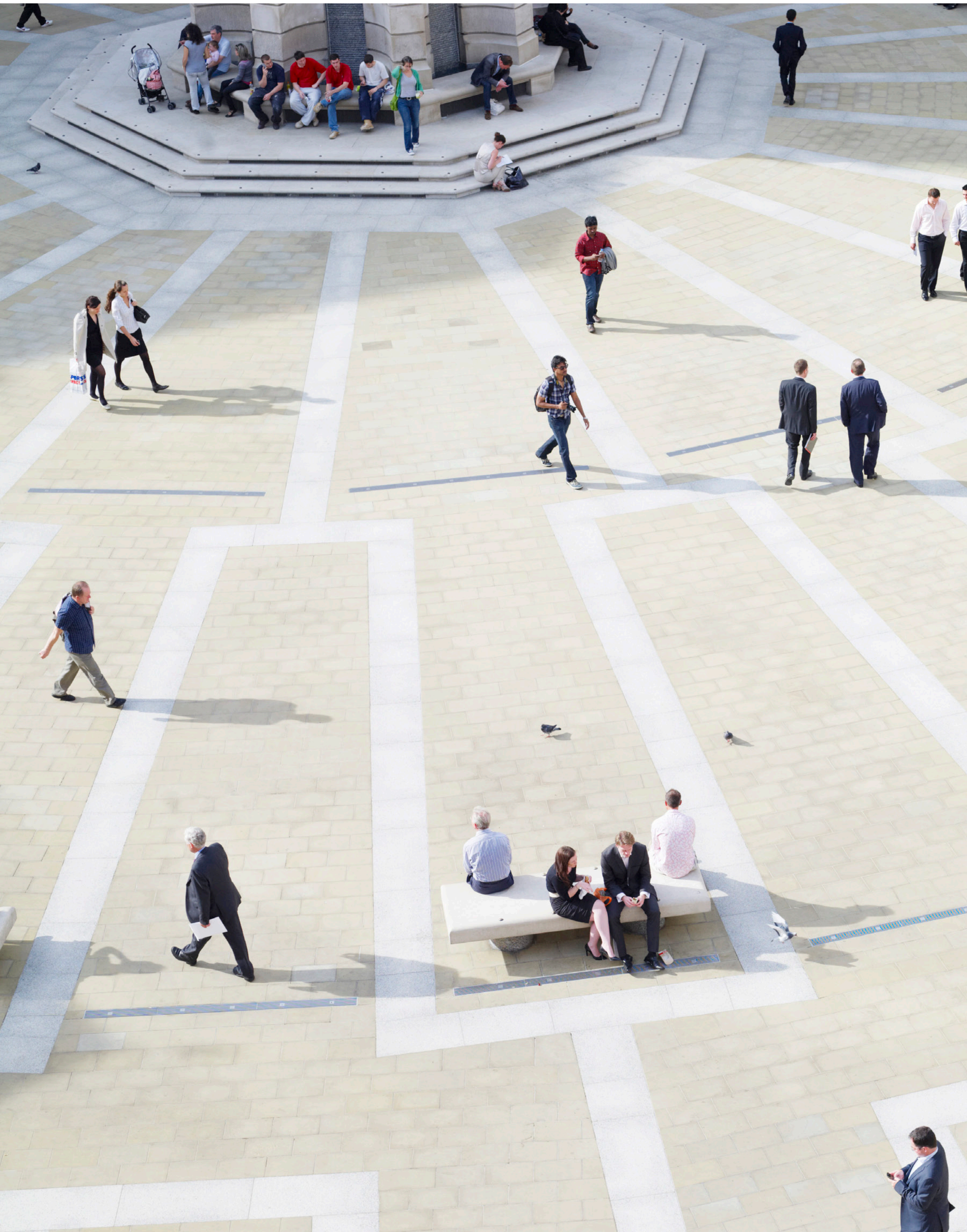
Bombay High Court – Jurisdictional requirement for applicability of TP provisions to be established, if raised by the taxpayer, before considering the issue of valuation

Vodafone India Services Pvt. Ltd. *v.* UOI [TS-687-HC-2012 (Bombay – High Court) – TP]

The taxpayer issued equity shares at a premium over its face value to its holding company. The transaction was disclosed as an "international transaction" in Form 3CEB along with a note explaining that the impugned transaction did not have a bearing on the taxpayer's income, and that this was reported out of abundant caution. During assessment proceedings, a reference was made by the TO to the TPO for determining ALP of the international transaction. The TPO held that the valuation of the shares should have been on Net Asset Value (NAV) basis after considering the TP adjustments in the preceding years. On this basis, the TPO enhanced the value of each share, thereby, treating the shortfall as a deemed loan by the taxpayer to its holding company, and charged notional interest. The taxpayer raised a preliminary question as to whether the transaction would fall within the ambit of taxation by applying the TP provisions. However, the AO passed a draft assessment order holding that he was bound by the TPO's order. Aggrieved, the taxpayer filed a writ petition challenging the jurisdiction before the HC.

The HC held:

- Remanded the matter to the DRP to give preliminary findings on applicability of transfer pricing regulations to the alleged shortfall in share premium.
- There must be income arising/ potentially arising from an international transaction for the application of the transfer pricing provisions, else the entire exercise of determining the ALP would be academic in nature.
- Revenue should be more sensitive to the demands of the taxpayer and not treat them as an adversary who had to be taxed. In this particular case, it was natural for the taxpayer to feel harassed as neither the TO nor the TPO gave a hearing or dealt with the taxpayer's preliminary objection.



Taxing of goods and services

Indirect Taxes

Case law

Value Added Tax (VAT)/ Sales Tax/ Entry Tax/ Professional Tax

Recorded DVDs and CDs are taxable at residual rate and not at concessional VAT rate applicable to Information Technology products

Makdani Entertainment [2012] NTN (Vol 53-57)

The Commissioner of Uttar Pradesh clarified that recorded DVDs and CDs used for entertainment were different from Information Technology products which covered DVDs and CDs within its ambit. Therefore, recorded DVDs and CDs were taxable at the residual VAT rate and not at the concessional VAT rate applicable to IT products.

Optional service charges recovered from buyers for extended warranty benefit will not be included in sale price

Assistant Commercial Tax Officer *v.* Electrolux Kelvinator Ltd [2013] NTN (Vol 53-210)

The Rajasthan HC held that optional service charges recovered from buyers who intend to avail the benefit of the extended warranty period could not be included in the sale price. The Court observed that the definition of sale price clearly envisaged only that amount which was paid or payable to a dealer as consideration for sale of goods (including the amount charged for anything done by the dealer in respect of goods at the time of, or before, the delivery of goods) be included in the sale price. The optional service charges were recovered for future acts and not for goods delivered, and thus could not be included in the sale price.

CENVAT

Value of the tool kits cleared by the Spares Division not includible in the assessable value of the vehicle

Piaggio Vehicles Pvt. Ltd. *v.* CCE [2013] TIOL (1831)

The Mumbai CESTAT held that the value of tool kits cleared by the spares division of the appellant could not be included in the assessable value of a vehicle merely because the manufacturers were mandatorily required to supply tool kits along with the vehicle in accordance with the Motor Vehicle Rules, and also when such tool kits were not supplied along with the vehicle at the time of clearance from the factory.

Interest is not payable on belated payment of interest

CCE *v.* Mahavir Crimpers [2013] TIOL (1690)

The Ahmedabad CESTAT held that there were no provisions in the Central Excise Act, 1944 to grant interest on belated payment of interest.

Service Tax

Hiring employees of foreign holding and other group companies on a full-time employment basis is not liable to service tax

Volkswagen India Pvt. Ltd. *v.* CCE [2013] TIOL (1640)

The Mumbai CESTAT held that the arrangement for hiring employees of foreign holding and other group companies on a full-time employment basis created an employer-employee relationship between the appellant and the employees hired. Despite the fact that a portion of the salary of such employees had been paid at their home location through the concerned holding/ group company, the reimbursement of this cost to the concerned foreign companies by the appellant could not be held liable to service tax under 'manpower supply services'.

Order rejecting application under Service Tax Voluntary Compliance Encouragement Scheme, 2013 (STVCES) is an appealable order

Barnala Builders & Property Consultant *v.* DCCEST [2013] TIOL (1016)

The Punjab & Haryana HC held that the order passed by the designated authority, rejecting the application under the STVCES, was appealable under section 86 of the Finance Act, 1994.

Splitting of different activities under a composite contract for classification under different service categories is not allowed

Associated Soapstone Distributing Co Pvt. Ltd. *v.* CCE [2013] TIOL (1850)

The Delhi CESTAT held that though separate consideration was paid for different activities of site formation, excavation, clearance, earthmoving, etc., in the contract, the real essence of the contract was to render mining services. Accordingly, it was held to be a composite contract and splitting of different activities for classification under different service categories was not allowed.

Customs/ Foreign Trade Policy (FTP)

Customs duty is payable on the re-negotiated price paid as consideration to the supplier of goods

Choudhary Ship Breakers *v.* CC [2013] TIOL (1736)

The Mumbai CESTAT held that customs duty was leviable on the re-negotiated price paid as consideration to the supplier, and not on the higher price that was never paid, since in terms of the Customs Act, 1962 the duty is payable on the price paid.

Principle of unjust enrichment is not applicable to a case of refund of penalty

Veekay Products Pvt. Ltd. *v.* CC [2013] (296) ELT (363)

The Mumbai CESTAT held that the refund of a fine or penalty amount could not be credited to the Consumer Welfare Fund, as the principle of unjust enrichment as in the case of refund of duty, was not applicable in the case of refund of a penalty amount.

Benefits available to Domestic Tariff Area units became applicable to Export Oriented Unit post fulfilment of duty obligation

Ginni International *v.* CC [2013] TIOL (1570)

The Delhi CESTAT held that the benefit available to Domestic Tariff Area (DTA) units became applicable to an Export Oriented Unit (EOU) unit once it had discharged the duty obligation even before approval for final de-bonding.

CVD not leviable on a Maximum Retail Price basis when goods were not covered under the Legal Metrology (Packaged Commodity) Rules, 2011

Legrand (India) Pvt. Ltd. *v.* CC [2013] TIOL (1800)

The Mumbai CESTAT held that the importer was not liable to pay CVD on Maximum Retail Price (MRP) basis where the packing of the goods was meant for ease of transportation and not for retail sale, since such goods were not covered under the Legal Metrology (Packaged Commodity) Rules, 2011.

Refund cannot be denied when substantive conditions of Notification are fulfilled

Singhania Chemicals *v.* CC [2013] TIOL (1853)

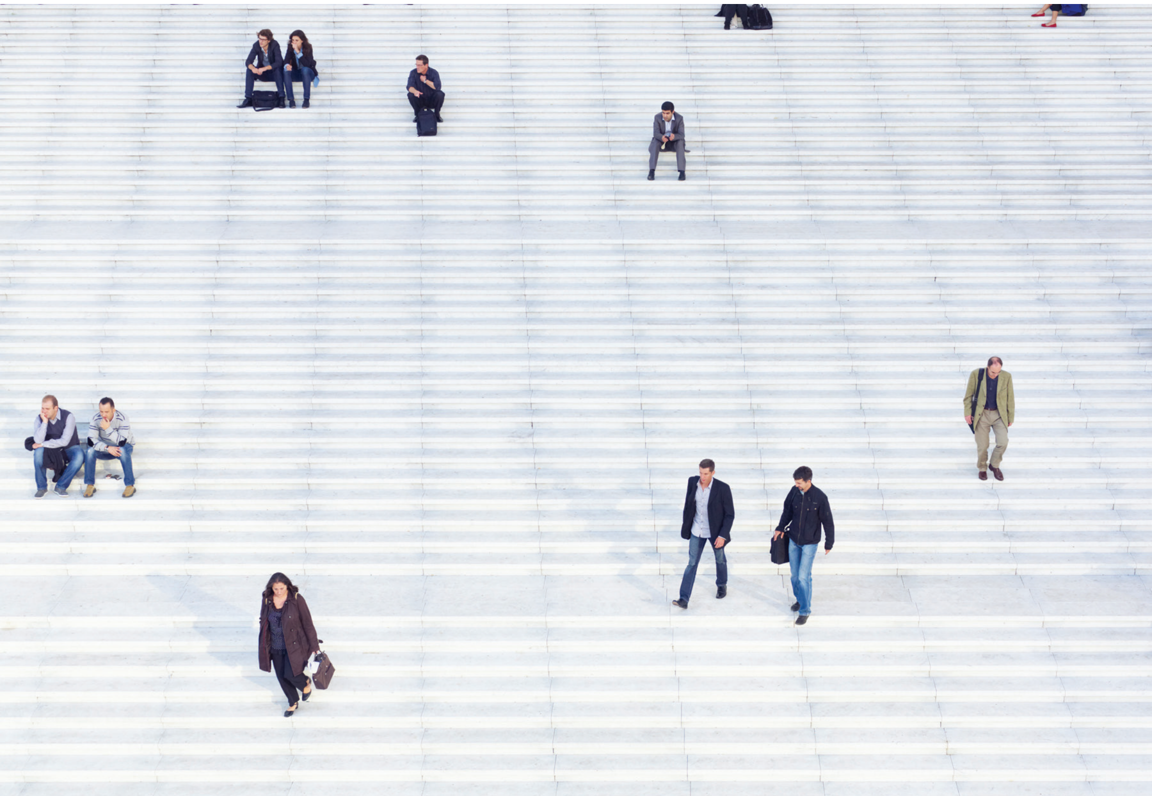
The Delhi CESTAT held that a refund claim in respect of Special Additional Duty of Customs (SAD) could not be rejected merely on the ground that endorsement on the sale invoice about non-admissibility of CENVAT credit was not in the language required according to the relevant notification, since the substantive condition of the said notification was fulfilled.

Notification/ Circular

Limited Liability Partnership (LLP) firms included in definition of "Group Company" under FTP

Notification No. 58 (RE-2013)/ 2009-14 dated 18 December, 2013

The Central Government has amended the definition of a "Group Company" under FTP to include Limited Liability Partnership (LLP). However, neither a partnership nor a proprietorship firm would fall within the ambit of the definition of a "Group Company".



Following the rulebook

Regulatory developments

FEMA

Foreign Direct Investment (FDI)

FDI Policy – Liberalisation

Notification No. FEMA 294/ 2013 dated 12 November 2013 notified *vide* G.S.R No. 805(E) dated 30 December 2013 and A.P. (DIR Series) Circular No.86 dated 9 January 2014

With a view to liberalising FDI Policy, the Reserve Bank of India (RBI) has permitted Indian Companies to issue shares (equity/ preference) or convertible debentures containing an optionality clause to foreign investors. Further, it is provided that all existing contracts will have to comply with the prescribed conditions.

Instruments with an optionality clause could, however, be issued providing the non-resident investor is not guaranteed any assured exit price at the time of making such investment/ agreements. Further, the exit needs to comply with the requirements summarised below:

- **Minimum lock in period:** One year or a lock in period as may be applicable under sectoral guidelines, whichever is higher.
- **Pricing guidelines:**

Instrument	Pricing guidelines
Equity shares	of listed company At the market price determined on the floor of the recognised stock exchanges of unlisted company At a price not exceeding that arrived at on the basis of Return on Equity (RoE) according to the latest audited balance sheet. RoE for this purpose shall mean Profit after tax/ Net worth, whereby Net worth would include all free reserves and paid-up capital
Preference shares or Debentures	At a price worked out in accordance with any internationally accepted pricing methodology at the time of exit, duly certified by a Chartered Accountant or a SEBI-registered Merchant Banker.

Issue of non-convertible/ redeemable preference shares or debentures as a bonus to non-residents from general reserve under Scheme of Arrangement approved by Court

Notification No. FEMA 291/ 2013 dated 4 October 2013 notified *vide* G.S.R No. 818(E) dated 31 December 2013 and A.P. (DIR Series) Circular No. 84 dated 6 January 2014

With a view to rationalising and simplifying the procedures, the RBI has permitted Indian companies to issue non-convertible/ redeemable preference shares or debentures as a bonus to non-resident equity shareholders, including the depositories that act as trustees for the American Depositary Receipt (ADR)/ Global Depositary Receipt (GDR) holders.

However, this needs to be by way of distribution as a bonus from its general reserve under a Scheme of Arrangement approved by a court in India under the provisions of the Companies Act. Further, no-objection from the income-tax authorities would be required.

The RBI has clarified that issuance of Preference shares (non-convertible/ redeemable preference shares) and convertible debentures (optionally convertible/ partially convertible debentures) otherwise than by way of bonus would continue to be governed by the External Commercial Borrowings (ECB) regulations.

FDI in Financial Sector – Transfer of Shares

Notification No. FEMA 290/ 2013 dated 4 October 2013 notified *vide* G.S.R No. 682(E) dated 11 October 2013 and A.P. (DIR Series) Circular No.72 dated 11 November 2013

Transfer of shares from Residents to Non-Residents, where the investee company is in the financial services sector, requires a No Objection Certificate (NoC) from the respective financial sector regulator/ regulators of the investee company, as well as from the transferor and transferee entities. Further, the NOC needs to be filed along with form FC-TRS.

The RBI has now done away with the requirement of filing the NOC along with Form FC-TRS.

However, any 'fit and proper/ due diligence' requirement as regards the non-resident investor as stipulated by the respective financial sector regulator shall have to be complied with.

Foreign investment in India – participation in credit enhanced bonds

Notification No. FEMA 289/ 2013 dated 4 October 2013 notified *vide* G.S.R No. 681(E) dated 11 October 2013 and A.P. (DIR Series) Circular No.74 dated 11 November 2013

The RBI has permitted SEBI-registered Foreign Institutional Investors, Qualified Foreign Investors and long term investors registered with SEBI viz. Sovereign Wealth Funds, Multilateral Agencies, Pension/ Insurance/ Endowment Funds, and foreign Central Banks to invest in credit enhanced bonds up to a limit of USD 5 billion within the overall limit of USD 51 billion earmarked for corporate debt.

Overseas Direct Investments (ODI)

Rollover of Guarantees

A.P. (DIR Series) Circular No. 83 dated 3 January 2014

In August 2013, the RBI had reduced the ceiling for overseas investment (equity/ loan/ guarantees) by an Indian entity from 400% of its net worth to 100%.

The RBI has now clarified that renewal/ rollover of an existing/ original guarantee, which is already part of the total financial commitment of the Indian party, will not be treated as a fresh financial commitment (for evaluating the 100% limit) if the following key conditions are satisfied:

- the existing/ original guarantee was issued in terms of the prevailing FEMA guidelines
- there is no change in the end use of the guarantee, i.e. the facilities availed by the joint venture/ wholly owned subsidiary/ step-down subsidiary
- there is no change in the terms and conditions of the guarantee (including the amount) except the validity period
- rollover of the guarantee would be continued to be reported as a fresh financial commitment in Part II of Form ODI

If all the conditions stated in the circular are not met, the Indian party would need to obtain prior RBI approval for rollover/ renewal of the existing guarantee.

ECB

ECB for Special Purpose Vehicles (SPVs) in infrastructure sector

A.P. (DIR Series) Circular No. 78 dated 3 December 2013

Under the extant ECB Guidelines, utilization of ECB proceeds for on-lending or investment in the capital market including investment in SPVs or acquiring a company (or a part thereof) in India is prohibited. The RBI has now permitted raising ECB for project use in SPVs in the infrastructure sector under the automatic route/ approval route, as the case may be.

Key features of this window are as follows:

- **Eligible Borrower:** Holding companies/ core investment companies (CICs) falling under the regulatory framework of the RBI.
- **End Use:** Project use in SPVs established extensively for implementing the project in the infrastructure sector ('Infrastructure sector' is defined to include energy, communication, transport, water and sanitation, social/ commercial infrastructure, mining, exploration and refining. The detailed definition of 'infrastructure sector' can be referred in the RBI's A.P. (DIR Series) Circular No.48 dated 18 September 2013). The SPV can use the ECB proceeds for fresh capital expenditure/ refinancing of existing Rupee loans availed from the domestic banking system for capital expenditure (refinancing permissible under the approval route subject to existing limits, *viz*., 40% of ECB raised for the power sector and 25% of ECB for other infrastructure sectors).
- **Undertaking by the SPV:** No other method of funding, such as trade credit (if for import of capital goods), etc, will be utilized for that portion of fresh capital expenditure financed through ECB proceeds.
- **Escrow account:** The ECB should be parked in a separate escrow account pending utilisation.
- **Timeline:** The ECB can be raised up to three years after the Commercial Operations Date of the SPV.

Additional conditions for CICs falling under the regulatory framework of the RBI:

- **Leverage Ratio:** The prescribed leverage ratio needs to be complied with, i.e. outside liabilities including ECB should be less than 2.5 times their adjusted net worth as on the date of the last audited balance sheet.
- **Hedging:** For CICs with asset size below INR 1000 million, the ECB availed should be on a fully hedged basis.

These amendments would be effective immediately and all other aspects of extant ECB guidelines remain unchanged.

Liberalisation of definition of Infrastructure sector

Notification No. FEMA 281/ 2013 dated 19 July 2013 notified *vide* G.S.R No.

627(E) dated 12 September 2013 and A.P. (DIR Series) Circular No. 85 dated 6 January 2014

The RBI has expanded the ambit of the transport sector of Infrastructure for the purpose of ECB by including 'Maintenance, Repairs and Overhaul' (MRO) as a part of airport infrastructure. Accordingly, MRO services which are distinct from the related infrastructure services will be considered as a part of the sub-sector of airport in the transport sector of Infrastructure and thereby eligible to avail ECB both under the automatic/ approval route.

Conversion of foreign currency denominated payable/ liability into equity

A.P. (DIR Series) Circular No.94 dated 16 January 2014

The RBI has issued the following clarification in connection with conversion of any foreign currency denominated payables/ liability by an Indian company viz. ECB, lump sum fees/ royalties, etc, into equity shares:

- The exchange rate to be applied for conversion could be the rate prevailing on the date of the agreement between the parties concerned;
- Based on mutual agreement with the lender, the Indian company is free to issue equity shares of rupee amount less than that arrived at as above; and
- The fair value of equity shares to be issued needs to be calculated with reference to the date of conversion only.

Import and export of goods and services

A.P. (DIR Series) Circular No. 95 dated 17 January 2014

The RBI has amended guidelines relating to merchanting/ intermediary trade transactions (transaction). Key provisions/ changes are summarised below:

- Both the legs of the transaction should be routed through the same Authorised Dealer (AD) bank;
- Entire transactions should be completed within an overall period of nine months (previously six months) and foreign exchange outlay should not be beyond four months (previously three months).
- It has been clarified that the commencement of the transaction would be the date of shipment/ export leg receipt or import leg payment, whichever is first, and the completion date would be the date of shipment/ export leg receipt or import leg payment, whichever is the last;
- Short-term credit either by way of suppliers' credit or buyers' credit is now made available for the transactions including the discounting of export leg Letter of Credit (LC) by an AD bank;
- Merchanting traders have to be genuine traders of goods and not mere financial intermediaries and should earn reasonable profits by undertaking such transactions;
- The inward remittance from the overseas buyer should preferably be received first and the outward remittance to the overseas supplier will be made subsequently. Alternatively, an irrevocable LC should be opened by the buyer in favour of the merchant, on the strength of which the merchant in turn may open an LC in favour of the overseas supplier;
- Advance receipt against the export leg may be held in a separate deposit/ current account in foreign currency or Indian Rupees and should be earmarked till the payment of import; and
- Advance against the import leg, if demanded by the overseas seller, should be paid against a bank guarantee from an international bank of repute.

Miscellaneous

RBI Approval for establishment of Liaison Office (LO)/ Branch Office (BO)/ Project Office (PO) in India by foreign entities

Notification No. FEMA 293/ 2013 dated 12 November 2013 notified *vide* G.S.R No. 767(E) dated 6 December 2013 and A.P. (DIR Series) Circular No. 93 dated 15 January 2014

It has been notified that citizens of Hong Kong or Macau would require the approval of the RBI for establishing an Liaison Office (LO)/ Branch Office (BO)/ Project Office (PO) or any other place of business in India. Previously this restriction applied only to citizens of Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran and China.

Joint bank account maintained by residents in India with non-residents – Liberalisation

A.P. (DIR Series) Circular No. 87 dated 9 January 2014

Presently, non-resident close relative(s) (relatives as defined in section 6 of the Companies Act, 1956) of resident Individuals can be joint holders of resident savings bank accounts on a "former or survivor" basis. Such non-resident Indian close relatives are, however, not eligible to operate the account during the lifetime of the resident accountholder.

The RBI has permitted Non-Resident Indians (NRIs) to operate such accounts on an "Either or Survivor" basis subject to compliance with prescribed conditions.

Hold, own, transfer foreign assets under section 6(4) of FEMA – Clarification

A.P. (DIR Series) Circular No. 90 dated 9 January 2014

A person resident in India is permitted to hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if that currency, security or property was acquired, held or owned by that person when he was resident outside India or was inherited from a person who was resident outside India.

The RBI has clarified that the following will be covered under this permission:

i. Foreign currency accounts opened and maintained by such a person when he was non-resident;

ii. Income earned through:

- Employment or business or vocation outside India taken up or commenced while such a person was non-resident, or
- Investments made while such a person was non-resident,
- Gifts or inheritance received while such a person was resident outside India;

iii. Foreign exchange, including any income arising therefrom and conversion or replacement or accrual to the same, held outside India by a person resident in India acquired by way of inheritance from a person resident outside India.

Persons resident in India can freely utilise all their eligible assets abroad as well as income on such assets or sale proceeds thereof received after their return to India for making any payments or to make any fresh investments abroad without approval of the RBI. However, the cost of such investments and/ or any subsequent payments received therefore needs to be met exclusively out of funds forming part of the eligible assets held by them. Further, the transaction should not be in contravention of extant FEMA provisions.

Financial Services

Union Budget – 2013-14 interest subvention scheme

RBI/ 2013-14/ 398RPCD. No.FSD.BC.71/ 05.04.02/ 2013-14 dated 4 December 2013

Interest subvention of 2% p.a. will be made available to Public Sector Banks (PSBs) and Private Sector Scheduled Commercial Banks (in respect of loans given by their rural and semi-urban branches) on their own funds used for short-term crop loans up to INR 0.3 million per farmer, provided the lending institutions make available short-term credit at the ground level at 7% p.a. to farmers. Besides this, additional interest subvention at 3% p.a. will be available to prompt-paying farmers from the date of disbursement of the crop loan up to the actual date of loan repayment by farmers or up to the due date fixed by the bank for repayment of the crop loan, whichever is earlier, subject to a maximum period of one year from the date of disbursement.

Reporting platform for OTC foreign exchange and interest rate derivatives

RBI/ 2013-14/ 400FMD. MSRG.No.94/ 02.05.002/ 2013-14 dated 4 December 2013

CCIL has operationalised the platform with effect from 30 December 2013 for reporting of the following transactions in OTC derivatives:

- Inter-bank and client transactions in Currency Swaps
- Inter-bank and client transactions in FCY FRA/ IRS
- Client transactions in INR FRA/ IRS

The threshold for reporting the transactions with clients in Currency Swap and FCY FRA/ IRS shall be USD 1 million and equivalent thereof in other currencies. The transactions with a value equal to or exceeding the threshold shall be reported to CCIL. The reporting shall be on a prospective basis for transactions with clients in Currency Swap and FCY FRA/ IRS and banks are not required to report the details of the outstanding transactions, i.e. transactions entered into prior to 30 December 2013.

Novation of OTC derivative contracts

RBI/ 2013-14/ 406 DBOD. No.BP.BC.76/ 21.04.157/ 2013-14 dated 9 December 2013

The Reserve Bank of India (RBI) has issued operational guidance on novation of OTC derivative contracts. The RBI has specified that novation may be used for management of counter-party exposure and counter-party credit risk, to deal with events such as winding-up of business/ lines of business by banks and mergers/ acquisitions. The Transferor bank can novate a derivative contract only after the contract has been held by Transferor in its books for a minimum period of:

- six months for contracts with original maturity of up to one year, and
- nine months for contracts with original maturity of more than one year.

However, this condition would not apply in cases where the transferor bank is winding up the business or put under liquidation. The transferee bank can undertake novation only if the remaining party is its constituent borrower. The detailed guidance on the mechanism for novation can be referred to in the circular.

Participation in interest rate futures

RBI/ 2013-14/ 410IDMD. PCD.09/ 14.03.01/ 2013-14 dated 19 December 2013

Subsequent to RBI directions on cash settled Interest Rate Futures (IRF) on ten-year Government of India securities issued on 5 December 2013 for all market participants, RBI clarified that banks are permitted to participate in IRF both for the purpose of hedging the risk in the underlying investment portfolio and also to take a trading position. However, banks are not allowed to undertake transactions in IRFs on behalf of clients. Similarly, stand-alone Primary Dealers are allowed to deal in IRF for both hedging and trading on their own account and not on their client's account.

Deferred tax liability on special reserve created under section 36(1)(viii) of Act

RBI/ 2013-14/ 412DBOD. No.BP.BC.77/ 21.04.018/ 2013-14 dated 20 December 2013

Banks are advised that, as a matter of prudence, a deferred tax liability (DTL) should be created on a Special Reserve. For this purpose, banks may undertake the following:

a) If the expenditure due to the creation of the DTL on Special Reserve as at 31 March 2013 has not been fully charged to the Profit and Loss account, banks may adjust this directly from Reserves. The amount so adjusted may be appropriately disclosed in the Notes to Accounts of the financial statements for the financial year 2013-14.

b) The DTL for amounts transferred to the Special Reserve from the year ending 31 March 2014 onwards should be charged to the Profit and Loss Account of that year.

In view of the requirement to create a DTL on a Special Reserve, banks may reckon the entire Special Reserve for the purpose of computing Tier-I Capital.

Adoption of ISO 20022 messaging standard in new RTGS System

RBI/ 2013-14/ 413 DPSS (CO) RTGS No.1357/ 04.04.017/ 2013-14 dated 20 December 2013

The RBI had advised the participants of the RTGS system to be ready to handle the ISO 20022 message format by 31 March 2013. However, banks have not taken enough measures to handle ISO 20022 standard messages and are relying on temporary solutions provided by their IT/ service providers for conversion of messages from/ to the "R" series message, as was being used in the earlier version of the RTGS. Hence, on request the RBI has decided to extend the time for adoption of ISO 20022 messaging seamlessly without conversion from/ to "R" series formats up to 31 March 2014 by RTGS member banks.

Prudential norms on income recognition, asset classification and provisioning pertaining to advances – credit card accounts

RBI/2013-14/414DBOD.No.BP.BC.78/21.04.048/2013-14 dated 20 December 2013

The RBI has advised that a credit card account will be treated as a non-performing asset if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the next statement date. The gap between two statements should not be more than a month. Banks should follow this uniform method of determining the overdue status for credit card accounts while reporting to credit information companies and for the purpose of levying of penal charges, viz. late payment charges, etc., if any. The RBI has come up with this guidance since it noticed that divergent practices are followed by banks with regard to the asset classification status of credit card accounts if the minimum amount due is not paid on the specified due date.

Basel III Capital Regulations – Capital requirements for credit valuation adjustment risk on OTC derivatives and for banks' exposure to central counterparties

RBI/ 2013-14/ 424DBOD. No.BP.BC.81/ 21.06.201/ 2013-14 dated 31 December 2013

According to the RBI clarifications on Implementation of Basel III Capital Regulations in India dated 28 March 2013, banks were advised that the credit valuation adjustment (CVA) risk capital charge on OTC derivatives would become effective from 1 January 2014, keeping in view the introduction of mandatory inter-bank forex forward guaranteed settlement through a central counterparty, i.e. Clearing Corporation of India Ltd. (CCIL). As this process would take some time, it has been decided to implement the CVA risk capital charge on OTC derivatives from 1 April 2014, instead of 1 January 2014.

Advances guaranteed by Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) – Risk weights and provisioning

RBI/ 2013-14/ 425DNBS. PD.363/ 03.10.38/ 2013-14 dated 1 January 2014

The Ministry of Housing & Urban Poverty Alleviation, Government of India has set up the CRGFTLIH dated 21 June 2012 for the purpose of providing a guarantee in respect of low income housing loans. On the issue of assignment of the appropriate risk weight for loans guaranteed by CRGFTLIH and prescription of requisite provisioning norms for such loans on the lines of credit facilities guaranteed by the Credit Guarantee Fund Trust for Micro and Small Enterprises. The RBI has decided that NBFC-MFIs may assign zero risk weight for the guaranteed portion. The balance outstanding in excess of the guaranteed portion would attract a risk weight in accordance with the extant guidelines. If the advance covered by CRGFTLIH guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for in accordance with the extant guidelines on provisioning for non-performing advances.

Banks' exposure to central counterparties (CCPs) – Interim arrangements

RBI/ 2013-14/ 430DBOD. No.BP.BC.82/ 21.06.217/ 2013-14 dated 7 January 2014

The recent financial crisis has highlighted the need to promote a central clearing of standardized OTC derivative products through a Central Counterparty (CCP). It has therefore been decided that, as an interim measure, a bank's clearing exposure to a Qualifying CCP (QCCP) will be kept outside of the exposure ceiling of 15% of its capital funds applicable to a single counterparty. Clearing exposure would include trade exposure and default fund exposure as defined in the guidelines on capital requirements for banks' exposure to CCPs. Other exposure to QCCPs, such as loans, credit lines, investments in the capital of the CCP, liquidity facilities, etc., will continue to be within the existing exposure ceiling of 15% of capital funds to a single counterparty. However, all exposure of a bank to a non-QCCP should be within this exposure ceiling of 15%.

Lending against security of single product – Gold jewellery

RBI/ 2013-14/ 435 DNBS. CC.PD.No. 365/ 03.10.01/ 2013-14 dated 8 January 2014

The LTV ratio for NBFCs for loans against the collateral of gold jewellery has been increased from 60% to 75% with immediate effect. It is clarified that the value of the jewellery for the purpose of determining the maximum permissible loan amount will be only the intrinsic value of the gold content therein and no other cost elements (such as making charges) should be added thereto. It is clarified that the need to give a certificate on the purity of gold cannot be dispensed with. Also, NBFCs are required to give a certificate on the purity of gold accepted as collateral. The certified purity shall be applied for determining the maximum permissible loan and the reserve price for auction. NBFCs can, however, include suitable caveats to protect themselves against disputes on redemption. The detailed guidance on the verification of ownership of gold and the auction process and procedures can be referred to in the circular.

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Date	Name	Subject Line
24 Dec 2013	I.T.A. No. 6135/Del/2012 & I.T.A. No. -5166/Del/2012	Special Bench ruling on LG Electronics is applicable to all classes of assessees, whether they are licensed manufacturers or distributors, irrespective of their risk profile
16 Dec 2013	CIT v. M/s MWP Ltd [TS-617-HC-2013(KAR)]	Clear and unambiguous direction is a must to initiate penalty proceedings
11 Dec 2013	Glenmark Pharmaceuticals Limited v. ACIT [TS-329-ITAT-2013(Mum)-TP]	Bank guarantees and corporate guarantees distinguished / Naked bank quotes not Good External CUP's
9 Dec 2013	Platinum Asset Management Ltd. v. DDIT [TS-610-ITAT-2013(Mum)]	Income of Foreign Institutional Investors from dealing in derivatives taxable as capital gains and not business income
5 Dec 2013	KBD Sugars & Distilleries Ltd v. ACIT [TS-595-ITAT-2013 (Bangalore-Trib.)]	Going concern test applies to transfer, not to the demerged unit
28 Nov 2013	Just Lifestyle Pvt. Ltd v. DCIT [TS-562-ITAT-2013(Mum)]	Change in shareholding triggers section 79 of the Income-tax Act 1961 even if within the group
8 Nov 2013	London Star Diamond Company (I) Pvt. Ltd. v. DCIT [2013] 38 taxmann.com 338 (Mum-Trib)	Loss incurred on forward contracts to hedge losses on forex receivables is a business loss, and not a speculative loss

Glossary

AE	Associated enterprise
ALP	Arm's length price
AY	Assessment year
CBDT	Central Board of Direct Taxes
CENVAT	Central value added tax
CESTAT	Customs, Excise and Service Tax Appellate Tribunal
CIT(A)	Commissioner of Income-tax (Appeals)
DRP	Dispute Resolution Panel
FTS	Fees for technical services
FY	Financial year
HC	High Court
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

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