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Editorial

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

The long awaited general election results were declared on Friday, 16 May 2014 that marked the installation of a new government in the centre. Mr. Narendra Modi of the Bharatiya Janata Party (BJP) took over as Prime Minister of the country, as a wave of saffron swept over India, lifting the BJP to an absolute majority, even without the support of its pre-poll alliance partners. This has paved the way for a spell of stability at the Centre, after over 2 decades of coalition politics. It is widely hoped that this would mean a free hand to the Government in taking major policy decisions, which obviously bodes well for the business environment. However, one needs to be realistic – there are several things that need to be fixed on the ground, and that will take time. The big challenge before the new government would be to marry high expectations with the reality of the magnitude and number of problems faced, and hard decisions to take to kick the country into a higher growth orbit.

Two Reports released have laid down an agenda of regulatory and tax reform for the new Government. The Dr. Mayaram Panel, chaired by the Finance Secretary, Dr. Arvind Mayaram, has suggested, *inter alia*, in its Report that foreign investment of over 10% should be treated as FDI rather than as portfolio investment, and investments on non-repatriable basis by Non-Resident Indians (NRIs) be treated as domestic investment. The Tax Administration Reforms Commission, headed by Dr. Parthasarathi Shome, has issued its first Report, a nearly 600-page document. This Report makes insightful, wide ranging recommendations under 6 broad heads. The major recommendations include a suggestion that the Central Board of Direct Taxes (CBDT), and the Central Board of Excise and Customs (CBEC) should gradually converge, beginning with assessing large taxpayers jointly, and that the post of Revenue Secretary be abolished. Measures to overhaul taxpayer services and human resource policies have also been recommended. It has also made important recommendations to improve disputes resolution and key internal processes. Underlying all these is the stress on the rising importance of better use of Information and Communications Technology.

The task for the incoming finance minister, Mr. Arun Jaitley, is already cut out. Emphasis has to be laid on revival of growth well beyond 5% in the current financial year, while keeping a tight leash on inflation. The new Government is expected to usher in a friendlier environment for both domestic and international investors, and improve India's perception as a destination for doing business. The slowdown in the economy has been a result of both, external and domestic factors, like reduced development expenditure by the government and the long list of stalled projects. Also, with *El Nino* expected to cause a below-

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Shyamal Mukherjee

normal monsoon this year, it could have a bearing on India's economic growth and inflation in fiscal year 2014-15. The increasingly unstable situation in Iraq can put a spanner in India's plans of procuring oil cheaply. Similarly, happenings in Ukraine are casting a long shadow over mainland Europe's access to competitively priced gas.

In terms of global economic growth prospects, after very long, the West is looking sprightlier than the Far East. In 2014, the United States of America is expected to add more to the global economy than China, and Japan is expected to add more than India. The American economy has added jobs in the last 2 years and is anticipated to create more in 2014. Rising shale gas production in the United States is driving down energy costs, making American manufacturing more competitive, while in Europe, government deficits have fallen by half. Productivity is said to have improved, unit labour costs are falling, and for once, large current-account deficits in Italy, Spain and Portugal are disappearing.

In order to simplify the existing External Commercial Borrowing procedure, the Reserve Bank of India (RBI) has delegated power to Authorised Dealer Banks to approve certain specific cases under the automatic route, *viz.*, companies belonging to manufacturing, infrastructure, hotels, hospitals and software sectors, for borrowings from indirect equity holders and group companies. The permitted purposes borrowing also includes miscellaneous services from direct/ indirect equity holders and group companies.

The Bombay High Court (HC), in the case of Set Satellite (Singapore) Pte Limited, held that payment for grant of cricket telecast rights by the taxpayer was not taxable in India since there was no economic link between the payment and taxpayer's permanent establishment (PE) in India. The liability to pay had occurred in connection with the broadcasting operations in Singapore, which had no connection with the marketing activities carried out through the taxpayer's PE in India. In another ruling in the case of R & B Falcon Offshore Limited, the Uttarakhand HC held that for the purpose of determining the existence of a PE under the India-USA double taxation avoidance agreement, the period during which a rig was unused due to maintenance had to be excluded from the threshold period of 120 days in any 12-month period for determining existence of PE. Therefore, rigs 'ready to use' and not 'used' were held not to constitute PEs in India. See page no.6 for a detailed analysis of these rulings.

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

Ketan Dalal and Shyamal Mukherjee
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Analysing tax issues
Corporate tax

Case law

Permanent establishment

Rigs 'ready for use' and not 'used' do not constitute PE under the India-USA tax treaty

DIT *v.* R & B Falcon Offshore Limited [TS-233-HC-2014(Uttarakhand)]

Facts

A non-resident taxpayer brought in a rig and operated the same for and on account of its clients in India. The rigs remained unused on the dates on which they were deployed on account of maintenance and repair. The tax officer (TO) opined that Article 5(2)(j) of the India-USA Double Taxation Avoidance Agreement (tax treaty) did not define the word 'use' and hence resorted to the Act which contained the term 'ready for use'. According to the TO, even when the rig was undergoing repair and maintenance, it was lying *ready for use* and, as such, the rig having been used for more than 120 days during the relevant assessment years (AYs), the taxpayer had a PE in India in the form of the said rig under Article 5(2)(j) of the tax treaty.

Held

The Income-tax Appellate Tribunal (the Tribunal) had held that the word *used* had been sufficiently explained in the agreement, and required no further explanation, leaving no scope for reference to the Act. The Tribunal held that the word, *used* had been used in conjunction with 'an installation or structure for exploration or exploitation of natural resources and only if so used for a period of more than 120 days in 12 months period' and thereby, made it absolutely clear that used in the agreement meant user of installation and structure for exploration or exploitation of natural resources and not merely *being ready for use*. Thus, the rigs had to be used and not ready for use. The HC confirmed the Tribunal's order holding that there was no scope to refer to the Act when Article 5(2)(j) of the tax treaty provided the relevant meaning and context of the word, *used*. Consequently, on facts, it was held that the taxpayer had no PE in India as rigs were not used in terms of the tax treaty.

Royalty

Payments made for telecasting rights acquired by non-resident taxpayer to another non-resident – no withholding tax in absence of economic link

DIT *v.* Set Satellite (Singapore) Pte Limited [TS-250-HC-2014(Bombay)]

Facts

The taxpayer, a non-resident company, was engaged in the business of acquiring rights in television programs, motion pictures and sports events and exhibiting the same on its television channels from Singapore. The taxpayer had entered into an agreement with Global Cricket Corporation Private Limited (GCCPL), also a tax resident of Singapore. As per this agreement, GCCPL had granted the taxpayer telecasting rights of cricket matches throughout the licensed territory, which included India. The Revenue claimed that tax should have been withheld on the payment made to GCCPL.

Held

Both, the Commissioner of Income-tax (Appeals) [CIT(A)] and the Tribunal, held that the payment for the cricket rights was made only for broadcasting operations of the taxpayer, which were carried out from Singapore. The liability for the payment was incurred by the taxpayer in connection with the broadcasting operations in Singapore and not with the marketing activities carried out through its alleged PE in India. The finding that there was no economic link between the payments and the Indian operations, even assuming that the payments were in the nature of royalties paid out of India, could not be termed as perverse. Such a link was entirely with the taxpayer's head office in Singapore. The payment to GCCPL could not be said to have been incurred in connection with its PE in India. The liability to pay royalty had not been incurred in connection with, and had not been borne by, the taxpayer's PE in India.

Tax holiday

Benefit of section 10A tax benefit allowed to taxpayer even though it began production of software in the years prior to the relevant AY as required under the Act

CIT *v.* Quantum Coders Limited [TS-119-HC-2014(Delhi)]

Facts

The taxpayer had received an approval certificate for setting-up of software

technology parks (STP) in India on the basis of which it claimed deduction for its income from software exports for the relevant AY. The TO allowed deduction on pro-rata basis for a specified period on the basis of the letter of permission which stated that it was valid for 3 years from the date of issue. However, the CIT(A) denied the entire benefit on the ground that though the STP approval was granted, production could not be said to have commenced during the relevant AY in terms of section 10A(2)(i) of the Income-tax Act, 1961 (the Act). In fact, the production had commenced much earlier in AY 2000-01. The Tribunal allowed the taxpayer's claim after relying on the decision in the case of Nagesh Chundur *v.* ACIT [2011-TIOL-695-ITAT-MADRAS].

Held

The benefit under section 10A(1) of the Act was subject to certain conditions. It extended to deduction of profits and gains derived from export of articles or things, or computer software for a period of 10 years. The second proviso visualised a situation where an undertaking initially located in a Free Trade Zone which was subsequently located in Special Economic Zone became entitled to claim the benefit. Parliament stated that in such an eventuality, the period of 10 consequent years would be reckoned from the AY relevant to the previous year in which the undertaking began manufacture or production of articles or things or computer software, etc.. Accordingly, the HC rejected the Revenue's interpretation based on this proviso, as Parliament had restricted the benefit only in respect of the contingency, i.e., in the event of conversion of one kind of zone to another. Therefore, section 10A(1) of the Act could not be read in the restrictive manner as was being suggested. Further, the HC rejected the Revenue's submission with regard to section 10A(2) of the Act, as it would result in giving undue stress and be entirely dependent on the expression, 'during the previous years' relevant to the AYs. The other aspect relevant to 'commencement on or after' required equal emphasis. Therefore, the HC upheld the Tribunal's decision following its previous decision in the case of Nagesh Chundur (*supra*).

Depreciation

Renovation expenditure incurred by tenant under 9-year lease held to result in capital expenditure entitled to depreciation

Rohit Bal Designers Private Limited *v.* DCIT [TS-186-ITAT-2014(Delhi – Tribunal)]

Facts

The taxpayer was engaged in manufacture and sale of high fashion garments. The taxpayer had taken a premises on lease for 3 years, extendable for a further 6 years, in the previous year. It incurred renovation expenditure on the said premises on taking possession of the same and claimed the expense as revenue in nature. When asked for an explanation by the TO to support its claim of 100% depreciation, the taxpayer stated that it had incurred expenditure on renovation consisting of civil work, flooring work, miscellaneous accessories and lighting etc., the normal life of which was between one to two years. The TO did not accept the taxpayer's explanation and held that such expenditure should have been eligible for depreciation at 10% per annum, and disallowed the taxpayer's claim.

Held

The Tribunal relied on the decision in the case of Bigjo's India Limited *v.* CIT [2007] 293 ITR 170 (Delhi) which had an almost similar situation to that in the present case. In Bigjo's case (*supra*) the taxpayer had licensed the showroom, erected new counters and built a new lift shaft at a new site. It held that such expenditure was not in the nature of current repairs but capital expenditure not deductible in full. Like in the case of the taxpayer, in the case of Bigjo's (*supra*) it had incurred renovation expenditure soon after taking on the premises on lease. Further, as per Explanation 1 to section 32 of the Act, if expenditure was incurred by the taxpayer on a building not owned by him, in which, it carried on business, it would be considered as the owner of the building to the extent of amounts spent on the structure or for renovation, extension or improvement to the building. The Tribunal distinguished the ruling in Joy Alukkas India Private Limited *v.* ACIT [TS-144-HC-2014(Kerala)]where it had been held that if the item resulting from the expenditure was irretrievable at the end of the lease period, then the expenditure would be considered as revenue expenditure. The Tribunal applied the retrieval test to point out that in the Joy Alukkas' case (*supra*), the lease was for a period of 1 year, whereas in the present case, the lease was for 9 years. Therefore, based on the retrieval test laid down by the Delhi HC read along with the Explanation 1 to section 32 of the Act the Tribunal held that the capital expenditure incurred by the taxpayer for renovation of the premises would be treated as capital expenditure for depreciation.

Capital gains

Profit on sale of shares through a discretionary PMS taxable as capital gains

Radials International *v.* ACIT [TS-238-HC-2014 (Delhi)]

A Portfolio Management

Scheme (PMS) agreement was a mere agreement of agency and could not be used to infer the taxpayer's intention to make profit. Tests such as the nature of the transactions, their frequency and volume, the intention of the taxpayer etc., were to be assessed according to the facts of each case, and the way in which such tests were to be applied had been clearly laid out in CBDT Circular no. 4 of 2007 dated 15 June 2007.

Facts

The taxpayer, a partnership firm, had earned profit on the sale of shares through a discretionary PMS. This income had been offered to tax as 'capital gains' in its return of income. Upon scrutiny assessment of the return, the TO assessed the said income as 'business income' earned by way of adventure in the nature of trade, on the basis that the purpose of a portfolio manager was to optimise returns of the investor and therefore the motive of the transactions was to earn profits and not dividends. The CIT(A) and the Tribunal confirmed the TO's order. Aggrieved, the taxpayer preferred an appeal before the Delhi HC.

Held

Based on the terms of the PMS agreement, it was evident that the portfolio manager had full discretion as to the investments to be made with the taxpayer's funds. Consequently, while it may be concluded that the PMS agreement was a mere agreement of agency, it could not be used to infer that the intention of the taxpayer was to make profit.

Furthermore, since the actual purchase or sale was at the discretion of the portfolio manager, the intention of the taxpayer could not be determined at the time when money was deposited in the PMS. The intention must be inferred holistically, from the conduct of the taxpayer, the circumstances of the transactions, and not just from the seeming motive at the time of depositing the money.

To decide whether transactions were in the nature of an adventure in the nature of trade or investments, crucial tests on factors such as the nature of transactions, their frequency and volume, etc., along with the taxpayer's intention, needed to be evaluated. How such tests were to be applied had been clearly explained in the *CBDT Circular no. 4 of 2007 dated 15 June 2007.*

In the taxpayer's case, the sources of funds for the investment were its own funds, and about 71% of the shares invested under PMS had been held for a period longer than 6 months. Such shares had resulted in about 81% of the taxpayer's gains. Hence, based on such specific facts, the HC set aside the Tribunal's order and held that the taxpayer's income was in the nature of 'capital gains'.

Editor's Note: *This ruling provides much needed clarity on the issue of characterisation of income in the hands of investors investing through the PMS route.*

Characterisation of transactions in shares as business income or capital gains depends on various factors besides from the duration of holding

CIT *v.* Devasan Investment Private Limited [TS-224-HC-2014 (Delhi)]

No single factor or criterion ought to be given undue weight while determining whether the income constituted business income or capital gain. The characterisation would depend in each case on the total impression and effect of all relevant factors and circumstances. A fair application of various tests such as frequency, volume, object, etc., would be required to determine the nature of income.

Facts

Devasan Investment Private Limited, the taxpayer, earned income from the sale of shares and units of mutual funds during the AY 2006-07 and AY 2007-08. The taxpayer claimed an exemption from long-term capital gains (LTCG) under section 10(38) of the Act and declared short-term capital gains to be taxable under section 111A of the Act.

The TO observed that the taxpayer did not maintain separate accounts for its investments in shares, and had also frequently sold and purchased shares. Therefore, TO held that the profits earned on the sale of shares by the taxpayer were in the nature of business income and not capital gains. On the other hand, he accepted that the gains from mutual funds were in the nature of capital gains.

On appeal, the CIT(A) directed the TO to treat the income from the sale of shares as capital gains for both the AYs under consideration. The revenue then appealed to the Tribunal, which dismissed its appeals for both years. Aggrieved, the revenue filed an appeal with the Delhi HC.

Held

Relying on the CBDT Circular No. 4 dated 15 June 2007 and various other rulings, the HC held that undue emphasis could not be given to one factor to determine whether income constituted business income or otherwise. The characterisation of income as business income or capital gains would depend on a fair application of various tests, specifically the volume and frequency of transactions, the duration of holding test, the source of funds (owned or borrowed), the objects of the enterprise, the nature

of the taxpayer's business, previous history of such transactions, etc.

In the given case, the conclusions of the CIT(A), endorsed by the Tribunal after its independent analysis of the circumstances, did not disclose any error of law warranting interference by the HC.

Editor's note: *This decision reiterates various past rulings and upholds the principle that the characterisation of income cannot be concluded based on any single factor such as a short duration of holding of shares. There is no straightforward formula to decide the nature of income from share purchase and sale transactions. A holistic analysis of the facts and circumstances of each case is essential to determine the nature of income.*

Personal taxes

Case law

Capital gains indexation

Indexed cost of acquisition to be determined by providing indexation on each installment in case property is purchased under installments payment scheme

Anuradha Mathur *v.* ACIT [TS-222-ITAT-2014 (Delhi-Tribunal)]

Facts

The taxpayer, an individual, became a member/ shareholder of a society to purchase a flat under a drawing-of-lots scheme and made payment through installments for purchase of the property. The taxpayer had entered into an agreement and paid the first installment during the financial year (FY) 1989-90 and also paid the subsequent installments till FY 1995-96. The draw of lot was held on 17 March 1996 and the taxpayer finally got the possession of flat on 1 August 1997. The taxpayer disclosed LTCG *qua* sale.

As per the TO, since possession of flat was given on 1 August 1997, indexation of cost of acquisition was to be allowed from FY 1997-98 i.e. the year of flat allotment. Accordingly, the TO recomputed LTCG. On appeal to the CIT(A), the taxpayer's plea was rejected on the grounds that mere ownership of shares did not confer the benefit to enjoy the flat, unless the same had been physically handed over, and hence the TO was correct in treating the date of possession as the date on which the house was vested in the control of the taxpayer.

Aggrieved by the CIT(A)'s order, the taxpayer preferred an appeal before the Tribunal. The taxpayer argued that indexation should be allowed from the date of first installment, on the entire cost, i.e., installments. The taxpayer submitted that by virtue of the definition of 'indexed cost of acquisition' under section 48 of the Act, indexation was to be applied from the year in which the asset was 'held' by taxpayer. It was further submitted that the taxpayer became member of cooperative society, acquired the shares and held an interest in allotment of the flat. The taxpayer argued that being a shareholder, she had the right to make a part payment for the flat as determined by the society. The taxpayer contended that the word 'held' in ordinary parlance included a right in the form of acquisition of flat. The learned counsel on behalf of the taxpayer submitted that the payments made by the taxpayer over a period were towards the right of holding the flat. Hence, these installments should have been considered for suitable indexation.

Held

The Tribunal held that there was no case to allow indexation on the entire cost of acquisition from the date of payment of first installment i.e. FY 1989-90, thus rejecting taxpayer's argument. The meaning of the word, 'held' could not be extended to the part payments which were not even paid by the taxpayer. However, there was no dispute that the taxpayer made part payment by way of installment towards the acquisition of the flat by becoming shareholder and the member of society through a recognised and bye-laws approved method, of a co-operative housing society.

The individual payments of the actual amounts for holding an asset deserved to be indexed from the date of actual payment of each installment. Thus, instead of extreme stands from the revenue and the taxpayer, the Tribunal held that indexation should have been allowed from the date of payment of each installment. The TO was directed to re-work LTCG by providing indexed cost of acquisition *qua* the actual payment of each installment.

Return filing due date

The relevant date for investment in residential house for claiming exemption under section 54F is the due date for filing the original tax return under section 139(1), and not extended due date for filing belated tax return under section 139(4)

Dr. Xavier J. Pulikkal *v.* DCIT [TS-151-HC-2014 (Kerala)]

Facts

The taxpayer sold his property on 16 March 2007. He purchased land, along with a house, alleged to have been renovated by him, on 5 September 2007 and claimed deduction under section 54F of the Act for the AY 2007-08 on the ground that he had spent money for construction of residential premises before the due date mentioned in section 139(4)

of the Act.

The TO disallowed the claim on the ground that the investment was made after the due date of filing the tax return, which was 31 July 2007, and that the due date mentioned in section 54F(4) of the Act was one falling under section 139(1) and not section 139(4) of the Act.

On appeal to the CIT(A), the taxpayer's claim was allowed. On further appeal by the revenue to the Tribunal, the matter was remanded back to the TO by placing reliance on the Supreme Court (SC) decision in case of Prakash Nath Khanna & another *v.* CIT [2004] 266 ITR 1 (SC).

Aggrieved by the Tribunal's order, the taxpayer preferred an appeal before the Kerala HC and contended that the question before SC in Prakash Nath's case (*supra*) was with reference to section 276CC and not section 54F of the Act. Therefore, the issue of prosecution for non-filing of tax return could not be equated to a situation when tax return was filed in accordance with section 139(1) of the Act.

The revenue argued that section 54F(4) of the Act clearly indicated that filing of return would mean filing within due date mentioned in section 139(1) of the Act and not in section 139(4) of the Act. The revenue also argued that although the decision in Prakash Nath (*supra*) was with reference to section 276CC of the Act, section 139 of the Act was discussed with reference to word "due date", and therefore, the reliance placed was justified.

Held

Section 54F(4) of the Act provided that if the taxpayer had not appropriated the net consideration towards purchase/ construction of a new residential house before the due date of filing tax return under section 139 of the Act, the same had to be deposited in the capital gains account scheme. Such deposit was required to be made before furnishing the tax return under section 139(1) of the Act.

The HC in the present case held that it was possible that facts of the other appeal considered by the Tribunal along with appeal of the revenue could be different. The scheme for depositing capital gain was contemplated under section 54F(4) of the Act, and it depended upon when the taxpayer's property was sold and when exactly the amounts were invested, whether it was invested in a residential house or otherwise.

All these facts had to be considered with reference to section 54F(4) of the Act along with section 139(1) of the Act, as the due time would be under section 139(1) of the Act only, not under section 139(4) of the Act. The HC also noted that Tribunal had allowed one more opportunity to the taxpayer to place all the relevant records so that he could distinguish his case from the other two appeals before the TO. The HC directed the TO to dispose off the case in the light of observations made after considering the interdependence of facts of the other connected cases.

Editor's Note: *In yet another decision in the current case, it has been made clear by the HC that the due date for the purpose of section 54F of the Act would mean the due date as per section 139(1) of the Act and not the extended due date under section 139(4) of the Act.*

Structuring for companies
Mergers and acquisitions

Case law

Interest expenditure incurred in relation to earning income eligible for deduction under chapter VI-A is tax deductible

CIT *v.* Banaskantha District Cooperative Milk Producers' Union Limited [TS-193-HC-2014 (Gujarat)]

Facts

The taxpayer was a co-operative society engaged in the business of procuring, processing, manufacturing and supply of milk and milk products. During AY 2005-06, the taxpayer claimed deduction under section 80P(2)(d) of the Act on account of interest and dividend income derived by the taxpayer from its investments in co-operative societies. The taxpayer had also claimed a deduction of interest expense incurred on borrowed funds.

The TO disallowed the interest expense by invoking section 14A of the Act on the ground that the same had been incurred in relation to income which did not form part of total income chargeable to tax.

On appeal by the taxpayer, the CIT(A) deleted the disallowance under section 14A of the Act by giving detailed reasoning. On appeal by the revenue, the Tribunal upheld the CIT(A)'s decision by relying on the Chennai Tribunal's decision in the case of ACIT *v*. Tamil Nadu Silk Producers Federation Limited [2007] 105 ITD 623 (Chennai) wherein it had been held that section 14A could not be applied to the provisions of Chapter VI-A.

Held

The HC observed that while computing the total income chargeable to tax, deductions permissible under Chapter VI-A resulted in reduction of the total income, which could not be compared with income which was exempt from tax and did not form part of the total income at all under the Act. Thus, there was a marked difference between the exempt income and income eligible for deductions provided under Chapter VI-A.

The HC further observed that section 14A of the Act had been introduced retrospectively with effect from 1 April 1962, for the purpose of computing total income under Chapter IV, and any expenditure in relation to exempted income would not be allowed as a deduction. However, there was no reference in section 14A of the Act to deductions under Chapter VI-A while computing the total income.

The HC also noticed that the taxpayer had sufficient funds of its own as compared to the quantum of its investments in shares of co-operative societies. Following the ratio of Delhi HC ruling in case of CIT *v.* Kribhco [TS-522-HC-2012(Delhi)] decided on the identical question of applicability of section 14A of the Act in relation to deductions under Chapter VI-A, the HC upheld the Tribunal's order in favour of the taxpayer.

Editor's note: *This is a ruling by the Gujarat HC which rightly distinguishes that section 14A of the Act disallowance does not apply in case of deduction availed under Chapter VI – A of the Act.*

Circular/ Notification

CBDT circular directs CITs to send objections/ comments to Regional Director, MCA, on proposed merger/ amalgamation/ demerger schemes

Circular No. F.No. 279/ Misc./M-171/2013-ITJ dated 11 April 2014

Discussion

In a recent case of proposed amalgamation, the income-tax department noted that the scheme was being carried out with retrospective effect, in order to avail the set-off of losses against the profits of another company, thus, adversely impacting public revenue.

The department filed an intervention application opposing such amalgamation before the HC. However, the HC rejected the application on the ground that the department had no *locus standi* in the matter and that the power in this regard has been delegated to Regional Director, MCA (RD).

Taking cognizance of the above issue, the MCA has issued Circular No. 1/2014 dated 15 January 2014 to RDs which lays down that the RD, while furnishing his report to the HC on the proposed scheme, has to seek comments of the income-tax department within 15 days of receipt of the notice, to ensure that the proposed scheme has

not been designed to defraud the revenue or is otherwise prejudicial to the interests of the revenue.

Accordingly, the CBDT issued a circular directing Commissioners of Income-tax (CITs) to send their comments/ objections, if any, on any proposed scheme to concerned RD.

Editor's note: *MCA, vide its circular, has provided an upfront opportunity to the income-tax department to provide their objections/ comments on proposed schemes and accordingly, corporates need to be mindful of this development.*

CBDT clarifies that section 195 TDS applicable only to taxable portion and not to whole sum

CBDT Instruction No. 2/ 2014

The CBDT has issued directions to all Chief Commissioners and Director Generals of income-tax applicable in cases where the taxpayer fails to withhold tax under section 195 of the Act. In such situations, the TO shall determine the appropriate proportion of sum chargeable to tax as mentioned in section 195(1) of the Act and ascertain the tax liability. On this amount, the deductor shall be deemed to be the taxpayer-in-default under section 201 of the Act. The appropriate proportion of the sum chargeable to tax will depend on the facts and circumstances of each case, taking into account nature of remittances, income component therein and other relevant factors while determining such appropriate proportion.

The directions are in the wake of the recent rulings in the case of GE India Technology Pvt. Ltd. *v.* CIT [2010] 7 taxmann.com 18 (SC) and Transmission Corporation of AP Ltd. *v*. CIT [1999] 239 ITR 587 (SC) which indicate that tax has to be withheld under section 195(1) of the Act only on the portion of foreign remittance that represents the sum "***chargeable to tax***" in India, and not on the entire sum.

Pricing appropriately Transfer Pricing

Prelude

With the much awaited results of the national elections declared in May, India has witnessed emergence of a single largest party with an absolute majority in Parliament. For now, we are looking forward to the key tax reforms that are to be unveiled in the upcoming months, and those which have been pending for years, including resolving the pile-up in transfer pricing litigation during the past decade.

We have summarised below the observations of the various Tax Courts across the country on various Transfer Pricing cases.

Case law

Delhi Tribunal - Upholds PSM over TNMM; adopts residual profit based benchmarking considering each entity's contribution

Global One India Private Limited *v.* ACIT [TS-115-ITAT-2014(Delhi-Tribunal)-TP]

The taxpayer was engaged in providing services of seamless connectivity and transmission of data for their global customers. During the year, the taxpayer, along with other subsidiaries had contributed to, and participated in, creation of unique intangibles, being the valuable network to the Group. The transactions between the taxpayer and its associated enterprises (AEs) were so inter-related that the same could not be examined separately to determine arm's length price of the transaction under any "one-sided" testing. Hence, the Group had adopted residual profit split method (PSM) as the most appropriate method for all its subsidiaries situated across the world by providing routine returns for the routine functions performed, and thereafter splitting the overall residual profits/ losses of the Group amongst the various subsidiaries in proportion to actual costs incurred by each of the subsidiaries, after giving common weightages to the significant intangibles. During the assessment proceedings, the transfer pricing officer (TPO) rejected the PSM adopted and adopted transactional net margin method (TNMM), thereby determining an upward adjustment. This was upheld by the dispute resolution panel (DRP). Aggrieved, the taxpayer appealed to the Tribunal.

On appeal, the Tribunal:

- Accepted the factual matrix as presented by the taxpayer, with the resultant corollary that the case of the taxpayer *per se* was covered within the ambit of PSM and not TNMM.
- Held that where a case deserved to be otherwise covered by either contribution PSM or residual PSM, then it should not be denied such methodology merely due to the fact that the Indian TP regulations provided for the mandatory usage of comparable PSM as a supplement.
- Impossibility of performance provided under a statute had to be dispensed with; and a purposive interpretation, which would give "life and force" to the statute without changing its basic fabric, should be adopted.
- Insertion of the "other method" might need to be construed with retrospective effect from AY 2002-03, given its curative nature. The case of the taxpayer would in any event, be covered by such "other method" and accepted even for the earlier AYs under consideration.

Editor's Note: *The Tribunal has dealt with the application of PSM with great maturity in this ruling. It not only accepted the purposive interpretation for a meaningful application of residual PSM, but also accepted the alternative argument that if the residual PSM did not fall within the strict definition of PSM provided in rule 10B(1)(d) of the Income-tax Rules, 1962 (the Rules), then the same could be considered as the "other method" (sixth method), as provided in rule 10AB of the Rules, and be applied retrospectively as the insertion of the sixth method could be considered as curative in nature.*

Mumbai Tribunal – No notional interest applicable on delay in issuance of shares by AE after payment of share application money

The taxpayer was engaged in business of manufacturing biscuits. During the year under consideration, the taxpayer had paid share application money to its AEs. However, there were procedural delays in issuance of shares by the AEs. During the assessment proceedings, the TPO rejected the explanations offered by the taxpayer for the delay in issuance of shares and

accordingly treated the share application money paid up to the date of allotment of shares as loan and computed notional interest by considering London Inter Bank Offered Rate (LIBOR) plus basis points as the arm's length interest rate. This was upheld by the DRP. Aggrieved, the taxpayer appealed to the Tribunal

On appeal, the Tribunal held:

- There was no deeming fiction under the Indian transfer pricing legislation to treat transactions in the nature of capital contributions as transactions in the nature of lending or borrowing due the delay in allotment of shares.
- Even if arm's length price had to be determined in respect of such deemed interest-free loan on allotment of shares under comparable uncontrolled price (CUP) method, it had to be done on the basis as to what would have been the interest payable to unrelated share applicants in case of such delays.
- It was unreasonable and inappropriate to treat a transaction in the nature of capital contribution as partly in the nature of interest-free loans to AE. The very foundation of the impugned ALP adjustment was devoid of legally sustainable merits.

Gujarat High Court– Authentic and reliable price quotations by organisations based outside India can be used as CUP

The taxpayer was engaged in the business of manufacturing, refining and trading of edible oil. The taxpayer had entered into a purchase agreement with its associated enterprise based in Malaysia for the purchase of edible oil and had adopted the CUP Method, using the average of two sets of prices obtained from price quotations published by the Malaysian Palm Oil Board (MPOB) and Oil World. While the MPOB was a Malaysia-based organisation, Oil World was based in Germany.

During the assessment proceedings, the TPO totally discarded the price quoted by Oil World on the ground that Oil World did not have any statutory authority and that the prices quoted by it were not relevant to the oil prices in Malaysia because the organisation was not registered in Malaysia. On appeal, the CIT(A) deleted the adjustment made by the TPO. The Tribunal also upheld the view of the CIT(A). Aggrieved, the revenue appealed to the HC.

The HC dismissing the appeal held:

- The price publications can be used as relevant material to benchmark the transactions as long as they were authentic and reliable. The location of the organisation was of no consequence. Further, unless proved that the quotations lacked basis, they could be used as an authentic CUP.
- Objections made by the advocate during the course of the appeal, and which were not forming part of the grounds of appeal, would be rejected.
- The objections raised by the revenue did not involve substantial question of law.

Chennai Tribunal – Allowance of idle capacity adjustment in the initial years of production is a vital factor which the TPO cannot ignore

The taxpayer was engaged in the assembly of steering columns for supply to original equipment manufacturers. The taxpayer had started manufacturing during the relevant year, and this being the first year of operation, had made an operating loss. During the course of the assessment, the TPO made an adjustment towards international transactions relating to purchase of finished goods, raw materials, payment of royalty, management fees, etc., without issuing any show cause notice to the taxpayer. The DRP rejected the taxpayer's objections and upheld the TPO's decision. Aggrieved, the taxpayer appealed to the Tribunal.

On appeal, the Tribunal held:

- The TPO was not justified in disallowing the idle capacity adjustment claimed by the taxpayer on the ground that the same was not claimed in the initial transfer pricing analysis.
- Under-utilisation of production capacity in the initial years of production was a vital factor which could not be ignored by the TPO. The TPO should have made allowance for the higher overhead expenditure during the initial period of production.
- The TPO could not disallow the idle capacity adjustment only because the installed capacity and the actual production were not given in comparable units. The taxpayer should have been asked to furnish relevant documents to determine the percentage of capacity utilisation.

The Tribunal remitted the matter back to the TPO to determine the idle capacity adjustment and compute arm's length cost associated with the international transactions.

Delhi Tribunal – Upholds royalty payments

The taxpayer was engaged in manufacture of auto components catering to the demand in the Indian market. The taxpayer had entered into a technical collaboration with its AE wherein the AE had allowed the taxpayer to manufacture products using the technology, know-how and technical assistance

licensed to it by the AE. The taxpayer paid royalty to its AE under the agreement. During the assessment proceedings, the TPO contended that as the taxpayer was selling its products to another AE, the payment of royalty was unwarranted, and determined the ALP of the royalty to be nil. On appeal, the CIT(A), held that the TPO had exceeded his jurisdiction by stating that the royalty payment was unwarranted, and hence deleted the entire adjustment made by the TPO. Aggrieved, the revenue appealed to the Tribunal.

On appeal, the Tribunal held:

- Relying on the decision of Delhi HC in the case of taxpayer, it was held that the necessity of payment of royalty has to be decided from a businessman's point of view and could not be questioned or doubted by the revenue authorities;
- Payment of royalty was being claimed and allowed as business expenditure to the taxpayer for earlier AYs. Hence, during the year under consideration, the necessity for payment of royalty could not be questioned unless there existed any new circumstances to demonstrate that no benefit accrued to the taxpayer.

Taxing of goods and services
Indirect taxes

Case law

VAT/ Sales Tax/ Entry Tax/ Professional Tax

Sales by duty free shops at international airport to inbound passengers qualify as sale in the course of imports into India

State of Karnataka *v.* Flemingo Duty Free Shop Private Limited (2014-68-VST-398-Karnataka)

The Karnataka HC held that sales by a duty free shop situated at international airport to inbound passengers were made before the goods had crossed the customs frontiers of India. Consequently, such sales were not liable to sales tax as they qualified as sale in the course of imports into India, covered by section 5 of the Central Sales Tax Act, 1956. The Karnataka HC relied on the SC decision in Hotel Ashoka *v.* Assistant CCT and Anr (2012-VIL-03-SC).

SIM cards used for providing telephone services are not liable to sales tax

Bharat Sanchar Nigam Limited *v.* State of Himachal Pradesh (2014-VIL-93-Himachal Pradesh)

The Himachal Pradesh HC held that no sales tax would be levied on the supply of SIM cards to subscribers as a SIM card had no intrinsic value and it was supplied to the customer for providing telephone services. The Court relied on the SC decision in the case of Idea Mobile Communication Limited (2011-VIL-17-SC-ST).

CENVAT

Process of printing and lamination on plastic/ polyester films amounts to 'manufacture'

Paper Products Limited *v.* CCE (2014-TIOL-373-CESTAT-Mumbai-Tribunal)

The Mumbai Tribunal held that the process of printing and lamination on plastic/ polyester films etc. amounted to manufacture as it changed the character of the films for end users.

Retention of 75% of the sales tax amount under the Sales Tax Incentive Scheme treated as additional consideration for levy of excise duty

CCE *v.* Super Synotex (India) Limited (2013 (301) ELT 273)

The SC held that retention of 75% of the sales tax amount under the Sales Tax Incentive Scheme would be treated as additional consideration, and subject to central excise duty, since deduction of sales tax was available only when it was actually paid to the Sales Tax Department.

Service Tax

Tribunal's order on whether or not an activity can be considered a service, appealable only before the Supreme Court

CST and Ors *v.* Ernst and Young Private Limited and Ors (2014-TIOL-263-HC-Delhi-ST)

The Delhi HC held that an appeal against the order of CESTAT, where the question involved was whether or not an activity could be considered a service, related to 'rate of tax'. Accordingly, the order was appealable before the SC only, and not before the HC.

Rebate claim cannot be denied on the grounds that the service provider was not registered prior to the export of services

Taco Faurecia Design Center Private Limited, Faurecia Technology Centre India Private Limited *v.* CCE (2014-TIOL-318-CESTAT-Mumbai-Tribunal)

The Mumbai Tribunal held that since all the services rendered by the service provider were exported out of India and no tax was payable, the rebate claim filed for export of services could not be denied on the grounds that the service provider was not registered prior to the export of services.

Levy of service tax on supply of food and beverages by hotels, restaurants, etc held to be constitutional

Indian Hotels and Restaurant Association and ors *v.* UoI and ors (2014-TIOL-498-HC-Mumbai-ST)

A two member bench of the Bombay HC upheld the constitutional validity of the levy of service tax on the supply of food and beverages by hotels, restaurants, etc.

The Bombay HC ruled against the decision of the Kerala HC, in Kerala Classified Hotels and Resorts Association *v.* UoI (2013-TIOL-533-HC-Kerala-ST).

'Collection charges' received by airline from AAI on collection of 'passenger service fees' from passengers liable to tax under BAS

Jet Airways (India) Limited *v.* CCE (2014-TIOL-502-CESTAT-Mumbai-Tribunal)

The Mumbai Tribunal held that the collection charges received by the airline from the Airport Authority of India (AAI) on the collection of 'passenger service fees' from the passengers, and their timely remittance back to AAI, were liable to service tax under BAS category.

Customs/ Foreign Trade Policy (FTP)

Transaction value cannot be rejected only because of a high selling price of the imported goods in India

IMCD Group B V India *v.* CC (2014 (301) ELT 259)

The Mumbai Tribunal held that the transaction value could not be rejected merely on the basis of a high selling price of the imported goods in India, where the importer was able to justify its import price on account of expenses incurred in India such as customs duty, local clearance, logistics costs, insurance, etc.

Refund of SAD is admissible where a declaration of non-availment of SAD is not made on a sales invoice, when the dealer is a non-registered dealer under excise

Fossil India Private Limited *v.* CC (2014 (301) ELT 268)

The Bangalore Tribunal held that refund of Special Additional Duty (SAD) of Customs was admissible even when a declaration of the non-availment of SAD was not made on a sales invoice, when the dealer was a non-registered dealer under excise.

Refund cannot be denied on the grounds of unjust enrichment when CA certificate and balance sheet show differential duty as recoverable from the Customs authorities

CC *v.* Kodak India Limited (2014-TIOL-542-CESTAT-Mumbai-Tribunal)

The Mumbai Tribunal held that the refund of extra duty paid could not be denied on the grounds of unjust enrichment when the importer had produced a Chartered Accountant's (CA) certificate and balance sheet indicating the differential duty as 'receivable' from the customs authorities.

Circular/ Notification

Customs

BCD concession increased on import of specified goods into India under India-Japan CEPA

Customs Notification No. 09/ 2014 dated 1 April 2014

The Central Government has reduced the basic customs duty (BCD) on the import of specified products from Japan under the India-Japan Comprehensive Economic Partnership Agreement (CEPA). This notification is effective from 1 April 2014.

Following the rulebook
Regulatory developments

FEMA

Foreign Direct Investment (FDI)

FDI in Limited Liability Partnership (LLP)

FEMA Notification No. 289/ 2014 dated 13 March 2014 published *vide* Official Gazette No. 190(E) dated 19 March 2014 and RBI/2013-14/566 A.P. (DIR Series) Circular No. 123 dated 16 April 2014

The RBI has operationalised guidelines in relation to FDI in LLPs permitted by the Government of India under the approval route (Press Note 1/ 2011 dated 20 May 2011) with retrospective effect from 20 May 2011.

Key provisions of the notification have been summarised below:

i. Investment route

Direct or indirect foreign investment (regardless of the nature of 'ownership' or 'control' of an Indian Company) shall require Government/ Foreign Investment Promotion Board (FIPB) approval.

ii. Pricing Guidelines

- **Capital contribution or acquisition/ transfer of profit shares:** At a price more than or equal to the fair price as worked out as per any valuation norm which is internationally accepted/ adopted as per the market practice (Fair Price)
- **Transfer of capital contribution or profit share:**
  - Transfer from a resident to a non-resident – At a price more than or equal to the fair price of the capital contribution/ profit share of the LLP
  - Transfer from a non-resident to resident – At a price less than or equal to the fair price of the capital contribution/ profit share of the LLP
  - The valuation certificate shall be issued by the Chartered Accountant or by a practicing Cost Accountant or by an approved valuer from the panel maintained by the Central Government.

iii. Reporting Requirements - To the Regional office of the RBI through the Authorised Dealer (AD) banks

Transaction to reported	Due date for reporting
Capital contribution by way of acquisition	Within 30 days of receipt of funds (RBI shall allot Unique Identification Number in this regard)
Transfer of the capital contribution/ profit share	Within 60 days from the date of receipt of funds

Furthermore, the RBI has advised existing LLPs which have already received foreign investment to comply with the applicable reporting requirement within 30 or 60 days, as applicable, from 16 April 2014.

Reporting requirement - Acquisition of shares on the stock exchanges

RBI/2013-14/ 577 A.P. (DIR Series) Circular No. 127 dated 2 May 2014

The RBI has decided that in cases where a non-resident investor (including a non-resident Indian) acquires shares through a registered broker on stock exchanges under the FDI scheme, the investee company will be required to report the acquisition in Form FC-TRS with the AD Category-I bank (AD bank) within 60 days.

Furthermore, it has been decided that in all cases where the Form FC-TRS was submitted beyond the prescribed period of 60 days, approval of the Regional office may be obtained instead of the Central Office of RBI.

Foreign Investment in Government dated Securities

RBI/2013-14/ 556 A.P. (DIR Series) Circular No. 118 dated 7 April 2014

The RBI has notified that fresh investment will be permitted only in government dated securities that have a maturity of more than one year. Existing investment in T-bills and government dated securities of less than one year residual maturity will be allowed to taper off on maturity/ sale.

Outbound Investment

Outbound Investment by LLP

Notification No. 299/ 2014-RB dated 24 March 2014 w.e.f. 7 May 2014

The RBI has now included LLP within the meaning of the term 'Indian Party' which would be permitted to make Outbound Investment.

External Commercial Borrowings (ECB)

ECB from Direct / Indirect Foreign Equity Holder and Group Companies – Liberalisation

RBI/2013-14/594 A.P. (DIR Series) Circular No. 130 dated 16 May 2014

The RBI has now delegated powers to the AD banks to permit the following proposals **under the automatic route**:

Refinance / Repayment of Rupee loans raised from the domestic banking system

RBI/2013-14/585 A.P. (DIR Series) Circular No. 129 dated 9 May 2014

The RBI has permitted the refinancing/ repayment of rupee loans availed from the domestic banking system by raising ECB under the following windows subject to prescribed conditions

- Take-out financing scheme;
- Repayment of existing rupee loans for companies in infrastructure sector;
- Repayment of existing rupee loans for consistent forex earners (USD 10 billion window); and
- Spectrum allocation.

Considering that if the ECB is availed from overseas branches/ subsidiaries of Indian banks, the risk remains within the Indian banking system, the RBI has now prohibited availing ECB from overseas branches/ subsidiaries of Indian banks for the above purposes.

Re-schedulement of ECB - Simplification of procedure

RBI/2013-14/584 A.P. (DIR Series) Circular No. 128 dated 9 May 2014

Previously, changes/ modifications in a draw-down and/ or repayment schedule were permitted subject to certain conditions. However, any elongation/ rollover in the repayment on expiry of the original

Sr. No.	Borrower	Lender	Purpose
1	Companies in manufacturing, infrastructure, hotels, hospitals and software sectors	Indirect equity holders Group companies (ECB from direct equity holders already permitted under automatic route)	Permissible purposes as per RBI's directions
2	Companies in manufacturing, infrastructure, hotels, hospitals and software sectors	Direct equity holders	General Corporate Purposes (including working capital requirements)
3	Companies in 'miscellaneous service' sectors (Miscellaneous services mean companies engaged in training activities (but not educational institutes), research and development activities and companies supporting infrastructure sector. Companies doing trading business, companies providing logistics services, financial services and consultancy services are, however, not covered under the facility)	Direct equity holders Indirect equity holders Group companies	Permissible purposes as per RBI's directions
4	Change of lender when the ECB is from direct/ indirect equity holders or group companies		Permissible purposes as per RBI's directions

maturity of the ECB required the prior approval of the RBI.

The RBI has now delegated the power to the AD bank to approve the reschedulement of ECB due to changes in draw-down and/ or repayment schedule. This relaxation is also subject to the following key conditions:

- Any changes in all-in-cost (AIC) would be permitted only if there is a change in the average maturity period (AMP) due to re-schedulement of ECB. There should not be any increase in the rate of interest and no additional cost (in foreign currency/ Indian rupees);
- Revised AIC and AMP should be in conformity with minimum prescribed limits;
- Such re-schedulement will be allowed only once, before the maturity of the ECB; and
- Such changes need to be reported in Form 83.

ECB for Civil Aviation Sector

RBI/2013-14/537 A.P. (DIR Series) Circular No. 113 dated 26 March 2014

The facility of raising ECB for working capital by Civil Aviation Sector has been extended until 31 March 2015.

Review of all-in-cost ceiling - ECB and Trade Credits

A.P. (DIR Series) Circular No. 121 & 122 dated 10 April 2014

The all-in-cost ceiling - ECB and Trade Credits was due for review after 31 March 2014.

The RBI has now reviewed these rates and decided to keep it unchanged until 30 June 2014. The rates will be subject to review thereafter. Thus, all-in-cost ceiling presently applicable is as below:

Average Maturity Period	All-in-cost ceilings over 6 months LIBOR*	
	External Commercial Borrowing	Trade Credits
Up to one year	350 basis points	350 basis points
More than one year and up to three years		
More than three years and up to five years	500 basis points	

Import and Export of Goods and Services

Merchanting Trade Transactions – Revised Guidelines

RBI/2013-14/545 A.P. (DIR Series) Circular No. 115 dated 28 March 2014

The RBI has issued revised guidelines on Merchanting Trade Transactions. Key changes introduced through these guidelines are summarised below:

- Goods should not enter the domestic tariff area and the state of the goods should not transform;
- Compliance with foreign trade policy to be ensured as on the date of shipment (earlier, on the date of contract);
- Short-term credit will be available for merchanting trade only to the extent not backed by advance remittance for the export leg;
- Payment for import leg is now allowed out of the balances in exchange earners foreign currency account;
- Names of defaulting merchanting traders where outstanding reach 5% of their annual export earnings would be caution-listed;
- Short-term deployment of advances against the export leg may be allowed for the intervening period in an interest bearing account (earlier, short term deployment limited to the purpose of import only was permitted);
- Advance payments for the import leg of up to USD 0.2 million per transaction beyond advance towards exports is now permitted based on the commercial judgement of AD bank (earlier, against bank guarantee from international bank of repute);
- Letter of credit to the supplier is permitted against confirmed export order keeping in view the outlay and completion of the transaction within 9 months.

The revised guidelines shall come into effect for merchanting trade transactions initiated after 17 January 2014.

Compounding of Contraventions under FEMA, 1999

RBI/2013-14/553 A.P. (DIR Series) Circular No. 117 dated 4 April 2014

The RBI has delegated further powers to compound the following contraventions under FEMA to its regional offices (except for Kochi and Panaji) without any limit on the amount of contravention

- Violation of pricing guidelines for issue of shares;
- Issue of ineligible instruments such as non-convertible debentures, partly paid shares, shares with optionality clause, etc; and
- Issue of shares without approval of RBI or FIPB respectively, wherever required.

Furthermore, the RBI has

removed the monetary cap of INR 10 million to compound the following contraventions under FEMA by Bhopal, Bhubaneshwar, Chandigarh, Guwahati, Jaipur, Jammu, Kanpur, Patna regional offices:

- Delay in reporting inward remittance received for issue of shares;
- Delay in filing form FC-GPR after issue of shares; and
- Delay in issue of shares/ refund of share application money beyond 180 days, mode of receipt of funds, etc;

Miscellaneous

Booking of Forward Contracts

RBI/2013-14/ 557 A.P. (DIR Series) Circular No. 119 dated 7 April 2014

The RBI has enhanced the limit for all resident individuals, firms and companies, who have actual or anticipated foreign exchange exposures, to book foreign exchange forward contracts **up to USD 0.25 million from USD 0.1 million** on the basis of a simple declaration without any requirement of further documentation.

Crystallization of Inoperative Foreign Currency Deposits

Notification No. FEMA.10A/ 2014-RB dated 21 March 2014 w.e.f. 7 April 2014

The RBI has issued a new notification to promulgate regulations relating to crystallization of inoperative foreign currency deposits (i.e., conversion of credit balances in any inoperative foreign currency denominated deposit into Indian rupee). The key provisions are as under:

- For deposits having a fixed maturity – If such deposits remain inoperative for a period of 3 years from the date of maturity of such deposit, the balances would be converted into Indian rupee at the exchange rate prevailing as on that date
- For deposits having no fixed maturity period – If such deposits remain inoperative for a period of 3 years (debit of bank charges not to be reckoned as operation), the balance would be converted into Indian rupee at the prevailing exchange rate after giving a 3 month notice to the depositor

Thereafter, depositor can claim either the said Indian rupee proceeds and interest thereon, if any, or the foreign currency equivalent (calculated at the rate prevalent as on the date of payment) of the Indian rupee proceeds of the original deposit and interest, if any, on such Indian rupee proceeds.

Financial Services

Facilities to NRIs/ PIOs and Foreign Nationals – Liberalisation – Reporting Requirement

RBI/ 2013-14/ 496 A.P (DIR Series) Circular No. 106, 18 February 2014

AD banks are currently required to furnish to the RBI on a quarterly basis, within 10 days of the reporting quarter, a statement on the number of applicants and total amount remitted, as per proforma annexed to it. With a view to having access to more real time data, it has been decided to collect this information on a monthly basis. Accordingly, AD banks may furnish on a monthly basis, a statement on the number of applicants and total amount remitted, as per the prescribed format, within 7 days of the end of the reporting month.

Call/ Notice Money Market Operations

RBI/ 2013-14/ 504 IDMD/ PCD/ No. 11/ 14.01.01/ 2013-14, 26 February 2014

It has been decided to dispense with the extant practice of banks/ PDs/ co-operative banks approaching RBI for fixing of prudential limits for transactions in call/ notice money market. Banks/ PDs/ co-operative banks may, with the approval of their boards, arrive at prudential limits for borrowing/ lending in call/ notice money market in terms of extant regulations, and the limits so arrived at may be conveyed to the Clearing Corporation of India Limited (CCIL) for setting of limits in NDS-CALL System, under advice to financial markets department (FMD), RBI, with effect from 3 March 2014.

Know Your Customer (KYC) Norms/ Anti-Money Laundering (AML) Standards/ Combating of Financing of Terrorism (CFT)/ Obligation of banks under Prevention of Money Laundering Act (PMLA), 2002 –Recognising E-Aadhaar as an officially valid document under PML Rules

RBI/ 2013-14/ 510 DBOD. AML. BC. No. 100/ 14.01.001/ 2013-14, 4 March 2014

It is clarified that banks may accept e-Aadhaar downloaded from UIDAI website as an officially valid document, subject to the following:

a) If the prospective customer knows only their Aadhaar number, the bank may print the prospective customer's e-Aadhaar letter in the bank directly from the UIDAI portal; or adopt e-KYC procedure as prescribed by RBI.

b) If the prospective customer carries a copy of the e-Aadhaar downloaded elsewhere, the bank may print the prospective customer's e-Aadhaar letter in the bank directly from the UIDAI portal; or adopt e-KYC procedure as mentioned in the circular referred in paragraph 2 above; or confirm the

identity and address of the resident through the simple authentication service of UIDAI.

Money Transfer Service Scheme – Direct to Account facility

RBI/ 2013-14/ 511 A.P. (DIR Series) Circular No. 110, 4 March 2014

To facilitate the receipt of foreign inward remittances directly into the bank account of the beneficiary, it has been decided to allow foreign inward remittances received under money transfer service scheme to be transferred to the KYC-compliant beneficiary bank account through electronic mode, such as NEFT, IMPS etc.

Priority Sector Lending–Targets and Classification–Bank loans to MFIs for on-lending pricing criteria

RBI/ 2013-14/ 515 RPCD. CO.Plan.BC 91/ 04.09.01/ 2013-14, 12 March 2014

It has been decided that banks have to ensure that MFIs comply with the cap on individual loans and margin cap in order to be eligible to classify these loans under priority sector as follows:

(i) Cap on individual loans: The average base rate of the five largest commercial banks by assets multiplied by 2.75 per annum, or cost of funds plus margin cap, whichever is less. The average base rate shall be advised by RBI.

(ii) Margin cap: With effect from 1 April 2014, the margin cap shall not exceed 10% for MFIs having loan portfolio exceeding INR 1000 million and 12% for others, as against 12% for all as of date.

Rupee Drawing Arrangement–Increase in trade related remittance limit

RBI/ 2013-14/ 516 A.P. (DIR Series) Circular No. 111, 13 March 2014

After a review of the permitted transactions under the rupee drawing arrangements (RDAs), it has been decided to increase the limit of trade transactions from the existing INR 0.2 million per transaction to INR 0.5 million per transaction, with immediate effect.

Restructuring Support Finance–participation by investors

RBI/ 2013-2014/ 522 DNBS (PD) CC. No. 36/ SCRC/ 26.03.001/ 2013-2014, 19 March 2014

It has been decided to allow securitisation companies/ reconstruction companies (SC/ RCs) to utilise a part of funds raised under a scheme from qualified institutional buyers (QIBs) for restructuring of financial assets acquired under that scheme, subject to following conditions:

- SC/ RCs with acquired assets in excess of INR 5000 million can float the fund under a scheme for utilisation of part of funds raised from QIBs in terms of section 7(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, for restructuring of financial assets acquired out of such funds.
- Funds utilised for reconstruction purposes should not be more than 25% of the funds raised under the scheme, subject to disclosure requirements
- Framing of a Board-approved policy for utilisation of funds raised under such a scheme

Revision to Guidelines on Securitization Transactions–Reset of Credit Enhancement

RBI/ 2013-14/ 529 DNBS. PD.CC.No.372/ 3.10.01/ 2013-14, 24 March 2014

Guidelines on the reset of credit enhancement issued to banks by the RBI (which cover in detail the manner in which a reset could be carried out) have been extended to securitisation transactions undertaken by non-banking financial companies (NBFCs) as well.

Implementation of Basel III Capital Regulations in India–Capital Planning

RBI/ 2013-14/ 538 DBOD. No.BP.BC.102/ 21.06.201/ 2013-14, 27 March 2014

Industry-wide concerns have been expressed about the potential stresses on the asset quality and consequential impact on the performance/ profitability of banks. This may necessitate some lead time for banks to raise capital within the internationally agreed timeline for full implementation of the Basel III Capital Regulations. Accordingly, the transitional period for full implementation of Basel III Capital Regulations in India is extended upto 31 March 2019, instead of as on 31 March 2018. This will also align full implementation of Basel III in India closer to the internationally agreed date of 1 January 2019. In addition to the above, certain other aspects of the guidelines, more specifically, those relating to loss absorption features of non-equity capital instruments, have been reviewed in response to clarifications sought in this regard. The revised transitional arrangements along with other modifications have become applicable with immediate effect, and would be incorporated in the subsequent Master Circular on Basel III Capital Regulations.

Differential Rate of Interest for Micro and Small Enterprises (MSEs)

RBI/ 2013-14/ 564 DBOD. Dir.BC.No.106/ 13.03.00/ 2013-14, 15 April 2014

It is advised that while pricing their loans to MSE borrowers, banks should take into account the incentives available to them and provide differential interest rate for such MSE borrowers, as compared to other borrowers. Further, banks are advised to undertake a

review of their loan policy governing extension of credit facilities to the MSE sector, with a view to using Board-approved credit scoring models in their evaluation of the loan proposals of MSE borrowers.

Scaling up of the Business Correspondent (BC) Model–Issues in Cash Management

RBI/ 2013-14/ 570 RPCD. FID.BC.No. 96/ 12.01.011/ 20013-14, 22 April 2014

With a view to scale up the BC model it has been decided that:-

- Boards of the banks must review the operations of BCs at least once every 6 months with a view to ensuring that requirement of pre-funding of corporate BCs and BC Agents should progressively taper down with the passage of time. The Board should also review the position of payment of remuneration of BCs, and should also lay down a system of monitoring by top management of the bank.
- As the cash handled by BCs is bank's cash, the responsibility for insuring this cash should rest with the banks.

Reporting of Cross-Border Wire Transfer Report on FINnet Gateway

RBI/ 2013-14/ 572 RPCD. RRB.RCB.AML.BC.No.97/ 07.51.018/ 2013-14, 25 April 2014

It is advised that the transaction-based reporting format (TRF) already developed by financial intelligence unit – India (FIU-IND) and being used for reporting cash transaction reports, suspicious transaction reports and non-profit organisations transaction reports, may be used for reporting cross-border wire transfers. The information may be furnished electronically in the FINnet module developed by FIU-IND. All regional rural banks and state and central co-operative banks have accordingly been advised to take action as required by FIU-IND, and to ensure that reports are submitted in time, as per the schedule.

Investment through Alternative Investment Funds–Clarification on Calculation of Net Owned Funds of an NBFC

RBI/ 2013-14/ 554 DNBS (PD) CC.No.373/ 03.10.001/ 2013-14, 7 April 2014

It was clarified that while arriving at the net owned funds figure, investment made by an NBFC in entities of the same group concerns shall be treated alike, whether the investment is made directly or through an alternative investment fund/ venture capital funds (VCF), and when the funds in the VCF have come from the NBFC to the extent of 50% or more; or where the beneficial owner, in the case of trusts, is the NBFC, if 50% of the funds in the trusts are from the concerned NBFC. For this purpose, beneficial ownership would mean holding the power to make or influence decisions in the trust and being the recipient of benefits arising out of the activities of the trust.

Registration of Non-Operative Financial Holding Companies (NOFHCs)

RBI/ 2013-14/ 558 DNBS (PD).CC.No. 374/ 03.10.001/ 2013-14, 7 April 2014

It has been decided to create a separate category of NBFCs, a NOFHC. While the NOFHC will be registered as a non-deposit taking NBFC with the department of non-banking supervision of the RBI, the regulatory and supervisory framework of NOFHC, including prudential norms and submission of returns, will be governed by instructions issued by Department of Banking Operations and Development from time to time.

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Date	Name	Subject Line
30 April 2014	HDFC Asset Management Company Limited *v.* ITO [TS-212-ITAT-2014(Mumbai-Tribunal)]	Non-deduction of tax at source in accordance with the provisions of the Income-tax Act, 1961 (the Act), should not result in imposition of penalty under section 271(1)(c) of the Act
30 April 2014	Linde AG, Linde Engineering Division *v.* DCIT [TS-226-HC-2014(Delhi)]	Delhi High Court rules on constitution of an Association of Persons (AOP) and the taxability of offshore supplies and services in a turnkey contract
22 April 2014	Renoir Consulting Ltd *v.* Dy DIT (IT) [TS-211-ITAT-2014(Mumbai-Triunal)]	Use of hotel rooms for the purpose of business could result in a permanent establishment
18 April 2014	Global One India Private Limited *v.* ACIT [TS-115-ITAT-2014(Delhi-Tribunal)-TP]	Tribunal upholds PSM over TNMM; adopts residual profit benchmarking considering each entity's contribution
17 April 2014	Circular No. IWU/7(15)2011/ Gen (Software); C-III/022/3(6)2014/MH and IWU/7(15)2011/ General Software	EPFO introduces online application for a certificate of coverage and issues guidelines on matters of Indian social security
15 April 2014	Amarshiv Construction Private Limited *v.* DCIT [TS-191-HC-2014(Gujarat)]	Release of retention money against a bank guarantee does not result in accrual of income in the receiver's hands, unless the right to receive the income exists at the time of receipt
14 April 2014	Vodafone South Limited *v.* DDIT [TS-173-HC-2014(Karnataka)]	Karnataka HC's passing remark on treaty override by domestic law
10 April 2014	FEMA Notification no 289/ 2014 dated 13 March 2014 published in vide Official Gazette No. 190(E) dated 19 March 2014	Policy for Foreign Direct Investment (FDI) in Limited Liability Partnership (LLP)
07 April 2014	CIT *v.* M/s Abad Constructions Private Limited [TS-178-HC-2014(Kerala)]	Factual situation relevant for allowing deduction under section 80-IB of the Income-tax Act, 1961
2 April 2014	Motif India Infotech Private Limited *v.* ACIT [TS-88-ITAT-2014(Ahmadabad-Tribunal)-TP]	No Transfer Pricing adjustment if the exempt income is lower than the income determined in accordance with the arm's length principle
31 March 2014	India signs it's first 5 APAs in record time	
26 March 2014	Gulshan Malik *v.* CIT [2014] 43 taxmann.com 200 (Delhi)	The period of holding for the purpose of calculation of capital gains on transfer of rights to acquire an immovable property should be considered from the date of the Agreement to buy, and not from the date of allotment/ confirmation letter

Date	Name	Subject Line
25 March 2014	SB refrains from bifurcating KPOs and BPOs, yet allows dissection of ITES based on functional mapping	
24 March 2014	Sudhir Menon HUF *v.* ACIT [TS-146-ITAT-2014(Mumbai-Tribunal)]	Provisions of section 56(2)(vii)(c) are not applicable to issue of additional shares on a pro rata basis
24 March 2014	ADIT *v.* Antwerp Diamond Bank NV [TS-150-ITAT-2014(Mumbai-Tribunal)]	Payment to HO for data processing charges not 'royalty' under the India-Belgium tax treaty; such expense cannot be clubbed under HO expenses under section 44C
20 March 2014	Union of India *v.* Tata Chemicals Ltd [2014] 43 taxmann.com 240 (SC)	Supreme Court allows section 244A interest to tax deductor as 'compensation' for excess taxes deducted
19 March 2014	CIT *v.* Shri Anil H Lad [TS-140-HC-2014(Karnataka)]	Karnataka High Court rejects notional adjustment of section 80IA unit's losses prior to initial assessment year
14 March 2014	POSCO Engineering & Construction Company Limited *v.* ADIT [TS-108-ITAT-2014(Delhi-Tribunal)]	Consideration for offshore supply of equipment not taxable in India though service consideration in-built in offshore equipment supply price to be taxed
13 March 2014	Bharti Airtel Limited *v.* ACIT (ITA No. 5816/Del/2012, [2014] 43 taxmann.com 150 (Delhi-Tribunal), AY 2008-09)	Corporate guarantee not an international transaction
11 March 2014	Marketing intangible issue - How to deal with quandary post SB ruling?	

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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