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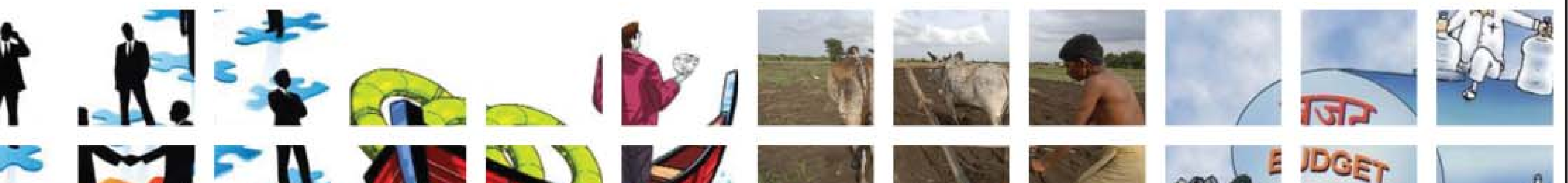


# Mirage....

A lot was expected from the Finance Minister P. Chidambaram in the budget that he presented today. However contrary to expectations, the only positive seems to be that thankfully there are no major shockers compared to that in the previous budget of the then Finance Minister.

Few of the important amendments are: investment allowance for manufacturing sector, reduction in Securities Transaction Tax, continuity of existing slab rates, proposal to offer tax breaks on home loans to first time home buyers, re-confirmation of postponement of GAAR, withholding tax on transfer of immovable property, introduction of Commodity Transaction Tax and no changes in the rate of customs duty, excise and service tax.

While the budget has tried to address the sectors under stress such as infrastructure, capital goods, housing etc, in our view, it falls woefully inadequate in the context of current world scenario & the urgent need to attract large amount of foreign direct investment.

The Shome Committee Report recommended the reversal of the controversial retrospective amendments made last year. Unfortunately, the Finance Minister has not mentioned a word regarding this which means that the Retro stays. Further, the small shockers in the budget like increase in TDS on Royalty Fees, increase to Dividend Distribution Tax by Debt Funds, no increase in Tax Slabs etc were more disappointments. TDS on sale / transfer of immovable property introduced in the last budget and dropped finds its way back in this Budget. The stock market reaction is a clear reflection of the disappointment.

Our kites and hopes which wanted to soar high in the sky are ***Kai Po Che!!***
(Read: cut even before they took off!!)

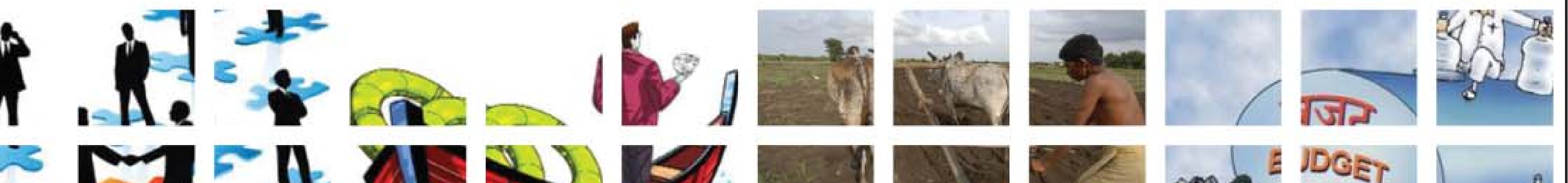
Thursday, February 28, 2013
Mumbai
INDIA

## Executive Summary

### Direct Taxes

- A surcharge at 10 per cent is levied for individuals and HUFs whose taxable income exceeds Rs. 1 crore.
- Surcharge is increased from 5 per cent to 10 per cent on Dividend Distribution Tax
- In case of Foreign Companies, surcharge is increased from 2 per cent to 5 per cent if taxable income exceeds Rs. 10 crore.
- The additional surcharge will be applicable only for one year i.e. A.Y.2014-15.
- A tax credit/rebate of Rs. 2,000 will be provided to individual whose total income does not exceed Rs. 5 lakh.
- Benefits of Rajiv Gandhi Equity Scheme extended to investments in listed units of equity oriented funds. Further, threshold of gross total income for eligibility increased from Rs. 10 lakhs to 12 lakhs. The benefit would now be available for three consecutive assessment years.
- Additional one-time interest deduction of Rs. 1 lakh on home loan will be available to first time home buyers subject to fulfillment of specified conditions.
- Deduction for donations made under National Children Fund is proposed to increase from 50 per cent to 100 per cent.
- Tax at 1 per cent to be deducted by the resident transferee while making payment of consideration exceeding Rs. 50 lakhs for the transfer of immovable property (other than agricultural land) to a resident transferor.
- For Domestic Companies, Surcharge is increased from 5 per cent to 10 per cent if taxable income exceeds Rs. 10 crores.
- A new tax called Commodities Transaction Tax (CTT) at 0.01% on the specify amount of transaction is proposed to be levied on commodities transactions traded on a recognised association.
- The modified provisions of GAAR, as recommended by Shome Committee Report, to come into effect from 01.04.2016.
- It has been proposed to amend the law to provide that a Foreign Company securing TRC shall not be a sufficient condition for claiming any relief under the Tax Treaty.
- Tax rates on payment for Royalties and Fees for Technical Services to non residents proposed to be increased from present 10 per cent to 25 per cent.





## Service Tax

- Service tax is proposed to be levied on restaurants with air-conditioning
- Several exemptions are being withdrawn on few services
- Voluntary Compliance Encouragement Scheme proposed to be introduced for filing of service tax returns since 01st October 2007.

## Excise

- Full exemption from excise duty is being provided on tapioca sago (sabudana) and tapioca starch manufactured and consumed captively in the manufacture of tapioca sago & henna powder or paste, not mixed with any other ingredient.
- Excise duty on SUVs is proposed to be increased from 27% to 30%.
- Excise duty of 4% is proposed to be levied on silver manufactured from zinc/lead smelting.
- Excise duty on mobile phones of retail sale price exceeding Rs 2000/- is proposed to be increased from 1% to 6%.

## Customs

- Basic customs duty on dehulled oat grain is proposed to be reduced from 30% to 15%.
- Basic customs duty on hazel nuts is proposed to be reduced from 30% to 10%.
- Export duty of 10% on de-oiled rice bran oil cake is proposed to be withdrawn.

# BACKDROP TO THE BUDGET AND RECENT DEVELOPMENTS

## INCOME TAX

### DOMESTIC TAXATION

RECENT CIRCULARS/NOTIFICATIONS

**Clarification on issuance of TDS Certificates in Form No. 16A downloaded from TIN website**

With a view to further strengthen the administration of the issue of TDS and for proper administration of the Act, the CBDT, in exercise of powers under Section 119 of the Act, decided the following:-

Issue of TDS Certificate in Form No. 16A

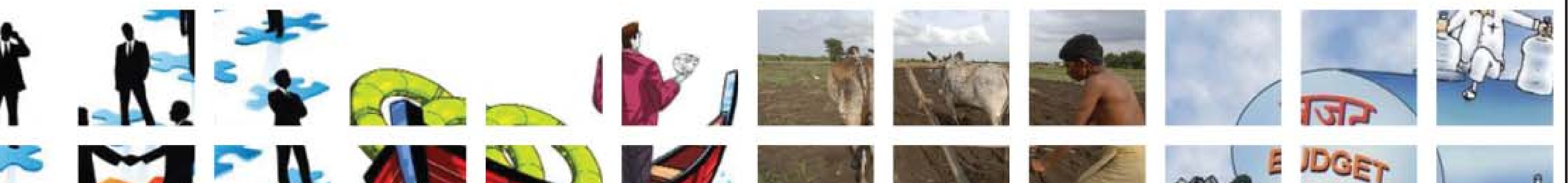
- For deduction of tax at source made on or after 01.04.2012: All deductors (including government deductors who deposit TDS in the Central Government Account through book entry) shall Issue TDS certificate in Form No. 16A generated through TIN central system and which is downloaded from the TIN website with a unique TDS certificate number in respect of all sums deducted on or after the 1st day of April, 2012 under any of the provisions of Chapter XVII B other than Section 192.
  In other words, the issuance of duly verified TDS certificate in Form No. 16A, by the deductor of any category shall henceforth be only through TIN Central System. The deductor shall therefore, download such certificate from the TIN Central System, verify the correctness of the contents mentioned therein and authenticate the correctness of the contents before issue of the said certificate.
- For deduction of tax at source made between 01.04.2011 to 31.03.2012: The stipulation prescribed in para 4.1 of the Circular No. 3/2011 dated 13.05.2011 shall continue to apply.

Authentication of TDS Certificate in Form No. 16A

- The deductor, issuing the TDS certificate in Form No.16A by downloading from the TIN website shall authenticate such TDS certificate by either using digital signature or manual signature.

Where the deduction has been done between 1st April, 2011 and 31st March, 2012 and the deductor being other than a company/bank or banking Institution/a co-operative society engaged in carrying the business of banking and who do not issue the TDS Certificate in Form No.16A by downloading from the TIN website shall authenticate such TDS certificate in Form No.16A by manual signature only.





**The Central Government has notified that no deduction of tax shall be made on the following specified payment under Section 194J of the Act, namely :**

Payment by a person (the transferee) for acquisition of software from another person, being a resident, (the transferor), where-

- The software is acquired in a subsequent transfer and the transferor has transferred the software without any modification,
- Tax has been deducted -
  - ✓ under Section 194J on payment for any previous transfer of such software; or
  - ✓ under Section 195 on payment for any previous transfer of such software from a non-resident, and
- The transferee obtains a declaration from the transferor that the tax has been deducted either under Section 194J / 195 as aforesaid, along with the Permanent Account Number of the transferor.

In such cases, deduction of tax shall not be made under Section 194J of the Act.

This notification has come into force from the 1st day of July, 2012.

**Section 119 of the Income-tax Act, 1961 - Income-tax authorities - Instructions to subordinate authorities - Authorization of AOs in certain cases to rectify/reconcile disputed arrear demand**

- The CBDT authorized the AOs to make appropriate corrections in disputed arrear demands, irrespective of the fact that the period of limitation of four years as provided under Section 154(7) of the Act had elapsed.
- After due verification of claim of the assessees on merits, the AO shall issue refund of the excess amount, if any, so adjusted by CPC due to inaccurate figures of arrear demand uploaded by the AO. The AO, in appropriate cases, will also upload amended arrear demand on the FAS portal of CPC, Bengaluru, wherever there is balance outstanding arrear demand after aforesaid correction.
- Where the assessee had disputed and requested for correction of arrear demand, whether uploaded on CPC or not and still lying in the records of the AO, the jurisdictional AO shall verify the claim of the assessee on merits and after due verification of such claim, will make suitable correction in the figure of arrear demand in his records and upload the correct figure of arrear demand on CPC portal.
- These would apply only to the cases where the figures of arrear demand is to be corrected - whether such arrear demand has been uploaded by the AO on to FAS of CPC or it is still in the records of the AO.

**Inadmissibility of expenses incurred in providing freebies to Medical Practitioners by pharmaceutical and allied health sector Industry.**

- It was brought to the notice of the Board that some pharmaceutical and allied health sector Industrieswere providing freebies to medical practitioners and their professional associations in violation of the regulations issued by the Medical Council of India (the 'Council').
- The council amended its regulations imposing a prohibition on the medical practitioners and their professional associations from taking any Gift, Travel facility, Hospitality, Cash or monetary grant from the pharmaceutical and allied health sector IndustrieSec.
- Section 37(1) of Income Tax Act provides for deduction of any revenue expenditure (other than those failing under Sections 30 to 36) from the business Income if such expense is laid out/expended wholly or exclusively for the purpose of business or profession. However, the explanation appended to this Sub-Section disallows claim of any such expense, if the same has been incurred for a purpose which is either an offence or prohibited by law.
- Thus, the claim of any expense incurred in providing above mentioned or similar freebies in violation of the provisions of Indian Medical Council Regulations, 2002 shall be inadmissible under Section 37(1) of the Income Tax Act being an expense prohibited by the law. This disallowance shall be made in the hands of such pharmaceutical or allied health sector Industries or other assessee which has provided aforesaid freebies and claimed it as a deductable expense in its accounts against income.
- It has also been clarified that the sum equivalent to value of freebies enjoyed by the aforesaid medical practitioner or professional associations is also taxable as business income or income from other sources as the case may be depending on the facts of each case. The Assessing Officers of such medical practitioner or professional associations should examine the same and take an appropriate action.

**Certificate from a Chartered Accountant ('CA') to be obtained in case of default in payment of TDS/TCS**

CBDT has introduced provisions to sub-Section (1) of Section 201 & to sub-Section (6A) of Section 206C w.e.f. 01.07.2012 by which an assessee who has defaulted in payment of TDS / TCS will not be deemed to be a 'person in default' on fulfilling certain conditionSec. The person in respect of whom default is committed should furnish a certificate from a CA giving the following declarations:

1. He has furnished his return of income under Section 139;
2. He has taken into account such sum for computing income in such return of income; and
3. He has paid the tax due on the income declared by him in such return of income

CBDT issued the format of such certificates vide Form 26A for default in Payment of TDS & Form No. 27BA for default in Payment of TCSec.

**Approval of loan agreements/ long term infrastructure bonds and rate of interest for the purpose of Section 194LC of the Income-tax Act, 1961**

A new Section 194LC has been introduced in the Finance Act 2012. This Section provides for lower withholding of tax at the rate of 5% on interest payments to foreign companies / non-residentSec. Such borrowings should be made under a loan agreement or by way of issue of long term infrastructure bondSec.

In order to mitigate the compliance burden and hardship, the CBDT has granted a general permission for reduced tax withholding, to borrowing arrangements fulfilling specified condition Sec.

## CBDT FAQs on Tax Framework applicable to QFIs

The Government of India, through Budget 2012, had proposed to allow a specified class of foreign investors called 'Qualified Foreign Investors (QFIs)' to directly invest in Indian capital markets. All transactions by QFIs have to be necessarily carried out by a Qualified Depository Participant ('QDP') registered with the Securities and Exchange Board of India ('the SEBI'). A QFI has to open a demat account with a QDP. A QDP is either a clearing bank or clearing member of any of the clearing corporations which has appropriate arrangements for receipt and remittance of money with a designated Authorised Dealer ('AD') Category - I bank.

The Central Board of Direct Taxes (CBDT) has recently issued a set of Frequently Asked Questions (FAQs) on the tax framework applicable to QFIs. The following note will provide a brief summary of those FAQs.

### Information on PAN

- According to the current provisions under the Income Tax Act, 1961 ('the Act'), QFIs would be required to obtain Permanent Account Number (PAN) card. PAN is a ten-digit alphanumeric number, issued by the Income Tax Department of India to any "person" to facilitate him in making tax payments filing, returns and claiming refunds. The number, along with other relevant details, is printed on a card called PAN card. The process of obtaining a PAN card is simple and user friendly. An application can be filed by a foreign investor online and the process can be completed within 2 to 3 weeks.
- In order to facilitate QFIs in applying for a PAN as well as to comply with Know your Customer (KYC) norms of the Securities Exchange Board of India (SEBI), a combined form (FORM 49 AA) has been notified by the Central Board of Direct Tax (CBDT), details of which are available at the following links:

http://law.incometaxindia.gov.in/DITTaxmann/IncomeTaxRules/pdf/itr62form49aa.pdf

http://law.incometaxindia.gov.in/DITTaxmann/IncomeTaxRules/pdf/Not58_2011.pdf

- Application for allotment of PAN can also be made online through the Internet. Further, requests for changes or correction in PAN data or request for reprint of PAN card (for an existing PAN) may also be made through the Internet. Online applications can be made through intermediaries such as National Securities Depository Limited (NSDL)/ UTI Infrastructure Technology and Services Limited (UTITSL).
- Rule 114 of the Income Tax Rules, 1961 read with Form No. 49AA requires following documents to be submitted to obtain a PAN Card:

| Legal Status of QFI | Supporting Documents |
|---|---|
| Individual | Copy of Passport (without any attestation as both proof of identity and proof of residence) |
| Other than individuals | Copy of Certificate of Registration duly attested by an "apostille" or at the Indian Embassy in that country |

- QFIs that have a PAN card would be eligible for tax deduction at source (TDS) as per the rates applicable in the Double Taxation Avoidance Agreement (' the DTAA') of the country of which the QFI is a resident, if it is more beneficial than the rate prescribed under the domestic law. If a QFI has not obtained a PAN card it would be subject to a tax deduction under Section 206 AA of the Act. Such deduction would be higher of the following rates:

  i. Rate specified in the relevant provision of the Act, or

  ii. Rate or rates in force, or

  iii. 20 per cent

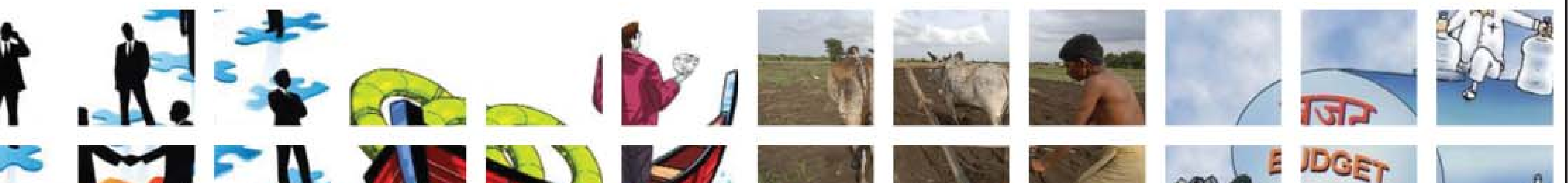
## Role and Responsibilities of QDPs

The QDPs have been assigned the responsibility to act as a single point of contact for QFIs for all purposes, in order to facilitate investments by QFIs.

Some of the important responsibilities assigned to QDPs are mentioned as below:

- A QDP will facilitate the QFI to obtain a PAN card
- QDPs will be treated as a representative assessee/agent of the QFI (a declaration in this regard is required to be submitted by the QDP)
- Obligation to deduct and deposit tax
  - QDPs will be responsible for deduction and deposition of withholding tax on QFI transaction before making remittance to QFIs





- A QDP may ensure that the broker engaged by it for undertaking QFI transactions deducts and deposits tax at source failing which the QDP should deduct and deposit the tax on such transactions.

- Income from investment from mutual fund may arise to a QFI by way of distribution of profits by the fund or by way of redemption by the fund or by way of sale of units of the fund. In case of distribution of profits by the mutual fund, the mutual fund itself pays tax on distribution of profits. In case of sale of units of the fund, the QDP would be required to withhold tax if the buyer of the mutual fund units has not deducted tax. In case of redemption of units by the fund or sale of units of the fund, the QDP would be required to withhold the tax.

- The responsibility of tax deducted at source by the QDP in the case of sale consideration received by a QFI on account of an open offer or a buyback of shares would depend upon the facts of the case. In case the purchaser of shares is crediting the sum to the account of the QFIs or making payment to QFIs, the purchaser would be required to deduct the tax. However, if the QDP is crediting the sum to the account of the QFIs or making payment to the QFIs, the QDP would be required to deduct the tax.

- The withholding tax on QFI income will be computed on settlement basis.

- Any loss of current year available at the time of deducting tax would be eligible to be set off against the income on which TDS is required to be deducted. The TDS shall be effected on net basis. However, TDS once effected cannot be reduced by the deductor even if there is loss in subsequent transaction.

  For example, in a given year, a QFI makes three settlements; it earns profit of Rs. 200 on day one settlement, incurs a loss of Rs. 250 on day two settlement and earns profit of Rs. 100 on day three settlement. The TDS would be deducted on credit of net profit of Rs 200 whereas, no TDS shall be effected against profit of Rs. 100 as at time of credit of Rs. 100 a loss of Rs. 250 is available for set off and net basis there is no amount chargeable to tax.

- For computing tax deducted at source (withholding tax) QDPs can set off profits earned by the QFI in one security against losses earned in another security as long as these securities are subject to Securities Transaction Tax (STT). However, this would not be applicable in case of QFI investments in bonds as bond transactions are not subject to STT

- Further, a QDP cannot set off losses of a previous year of a QFI against profits earned in the current year by the QFI while computing the tax liability for deduction at source.

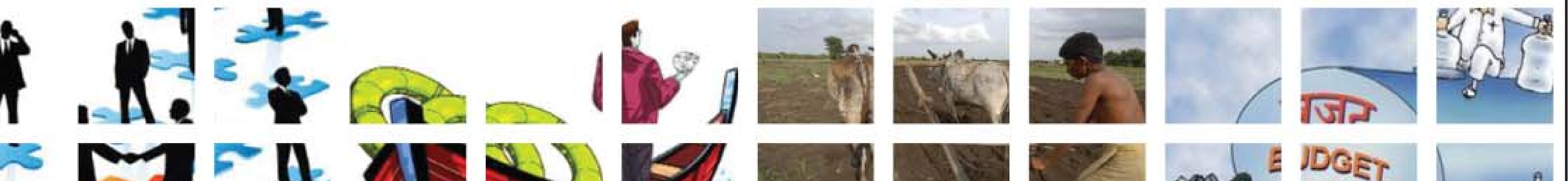
However, QFIs can themselves set off their profits earned in the current year against losses incurred in previous years. For this purpose, QFIs need to file return for the relevant year within the time limit stipulated under the Act.

- QDP can itself determine the amount chargeable to tax and deduct tax thereon or take help of Chartered Accountant in this behalf. However, in case there is complexity in determining such income the QDP should approach the Assessing Officer for determination u/s 195(2).
- QDP, being a deductor, shall be liable for any short deduction or non-deduction of tax even after the QFI ceases to be the client of QDP.

- Availment of treaty benefit
  - There is no standard set of documents on the basis of which the DTAA treaty benefit can be said to have been rightly allowed. It depends on the facts of each case. The treaty benefit is to be claimed by the person concerned before it can be allowed. For this purpose, the QDP should obtain the Tax Residency Certificate from the QFI.
  - Prima facie, the Tax Residency Certificate is evidence of residence in a particular country and the QDP may rely on such a certificate. However, as per Explanatory Memorandum to the Finance Bill, 2012, the amended section 90 and 90A of the Income-tax Act makes submission of Tax Residency Certificate containing prescribed particular, as a necessary but not sufficient condition for availing benefits of the tax treaties.

## Clarification on general tax queries of QFIs

- Generally, income earned by a QFI would be in the nature of capital gains or business income. Determination of the nature of such income will depend on facts and circumstances of each case (eg: number and frequency of transactions etc.)
- Cost of acquisition of securities, expenditure incurred and full value of consideration shall be reconverted in Indian currency for the purpose of computation of income from capital gains arising on sale of shares.
- Deductibility of expenditure would necessarily depend on whether the income has been determined as Income from Business / Profession or Income from Capital Gains. Expenses like brokerage fees would be allowed in general.
- The applicable rates of taxation in the case of investment from a country with which India has a DTAA will be at the rate provided in the Act or the rate provided in the relevant DTAA, whichever is more beneficial to the investors.
- In order to claim refund from Income Tax Department, QFI would have to file its return of Income in India for that year.



## SUPREME COURT DECISION

**Section 271(1)(c)- No penalty for a "bona fide/ inadvertant/ human error"**

In the case of Price Waterhouse Coopers Pvt. Ltd vSec. CIT, the assessee filed a return of income along with the Tax Audit Report. In the Tax Audit Report, provision for gratuity was reported to be disallowable u/s 40A(7), however, in the computation of income, the said amount was not disallowed. The AO too did not make the disallowance. Subsequently, the AO reopened the assessment u/s 147, disallowed the expenditure and levied penalty u/s 271(1)(c). The assessee explained that the omission to make a disallowance had occurred because:

- It had a separate accounts department and there was "some confusion"
- The return was prepared by a non-CA and was signed a director who proceeded on the basis that the return was correctly drawn up

Supreme Court held that :

- Though the assessee is undoubtedly a reputed firm, even the assessee could make a "silly" mistake. Since the Tax Audit Report filed along with the return stated that the provision for payment was not allowable u/s 40A(7), it indicates that the assessee made a computation error in its return of income. Further, the AO who framed the original assessment order made a mistake in overlooking the contents of the Tax Audit Report which suggest that there is no question of the assessee concealing its income or furnishing any inaccurate particularSec. Hence, it was a bona fide and inadvertent error for not adding the provision for gratuity to its total income, therefore, given the peculiar facts of this case, the imposition of penalty on the assessee is not justified.

## HIGH COURT DECISIONS

**Section 80-IB(10): Multiple housing project on 1 acre land are eligible for deduction**

In case of CIT vSec. Vandana Properties, Bombay High Court held as follows:

- Construction of even one building with several residential units of the size not exceeding 1000 square feet would constitute a 'housing project' u/s 80IB (10);
- The additional building is an independent housing project and not an extension of the housing project already existing on the plot because when the earlier plans were approved; additional building was not even contemplated and came into existence much later. The fact the approval was granted on the same terms as that granted to the other buildings does not make it an "extension;
- Sec. 80IB (10)(b) specifies the size of the plot of land but not the size of the housing project. While the plot must have a minimum area of one acre, it need not be a vacant plot. The object of Sec. 80IB (10) is to boost the stock of houseSec. There can be multiple housing projects on a plot of land having minimum area of one acre;

- On facts, as there was no merger of flats and no application was made to the local authority seeking merger of two flats, there was no violation.

**Transaction within four corners of law can be treated as "sham" & "colourable device" by looking at "human probabilities"**

In the case of Killick Nixon Ltd. vSec. DCIT, the assessee borrowed from the G.K. Rathi group and used that to buy shares @ RSec. 150 per share in three 100% subsidiary companies though the fair value of the shares was RSec.24. The amount received by the said subsidiary companies was transferred back to another company of the G.K. Rathi goup. Thereafter, the said shares were sold for RSec. 5 each and a short-term capital loss was claimed and this was set-off against other long-term capital gainSec. The Bombay High court affirmed that on the facts the purchase and sale of shares was found to be a sham, the loss cannot be allowed. It observed that whenever there are reasons to believe that the apparent is not real; then the taxing authorities are entitled to look into surrounding circumstances to find out the reality and apply the test of human probabilitieSec.

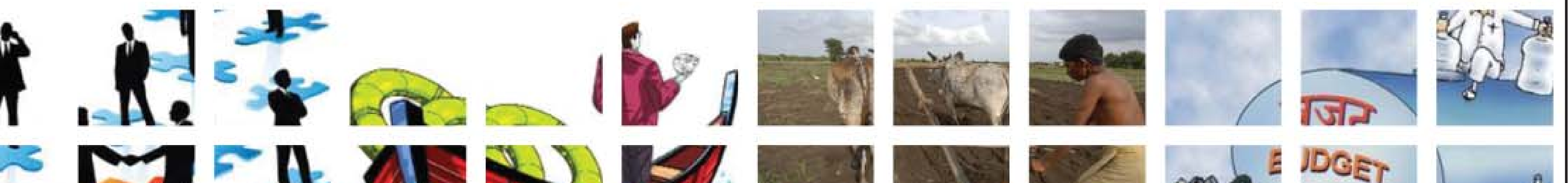
The judgement of the Supreme Court in Vodafone International vSec. UOI makes it clear that a colourable device cannot be a part of tax planning. Where a transaction is sham and not genuine, it cannot be considered to be a part of tax planning or legitimate avoidance of tax liability. It was clarified that there is no conflict between McDowell (154 ITR 148 (SC)), Azadi Bachao Andolan (263 ITR 706 (SC)) & Mathuram Agarwal.

**Section 32(1)(ii) – Depreciation allowable on business claims, business information, business records, being "intangible assets"**

In case of Areva T&D India Limited vSec. Dy. CIT, the assessee acquired a going concern business for a lump sum consideration of RSec. 44.7 CroreSec. The net tangible assets were valued at RSec. 28.11 crores and the balance of RSec. 16.58 crores was allocated by the transferee towards acquisition of bundle of "business and commercial rights" being business information; business records; contracts; employees etc, compendiously termed as "goodwill" and claimed depreciation u/s 32(1)(ii).

Delhi High Court observed that "The fact that after the specified intangible assets [in Sec 32(1)(ii)] the words 'business or commercial rights of similar nature' have been additionally used, clearly demonstrates that the legislature did not intend to provide for depreciation only in respect of specified intangible assets but also to other categories of intangible assets, which were neither feasible nor possible to exhaustively enumerate."

High Court relied upon SC ruling in Techno Shares and Stocks Ltd. v. CIT (327 ITR 323). SC had held that intangible assets owned by the assessee and used for the business purpose, which enables the assessee to access the market and has an economic and money value, is a "license" or "akin to a license", which is one of the items eligible for depreciation u/s 32(1)(ii) of the Act. HC observed that "The aforesaid intangible assets are, therefore, comparable to a license to carry



out the existing transmission and distribution business of the transferor. In the absence of the aforesaid intangible assets, the assessee would have had to commence business from scratch and go through the gestation period whereas by acquiring the aforesaid business rights along with the tangible assets, the assessee got an up and running businesSec."

High Court thus ruled that the specified intangible assets acquired under the slump sale agreement, were in the nature of "business of commercial rights of similar nature" specified in Sec. 32(1) (ii) of the Act and eligible for depreciation.

**Unaccounted expenditure to be set-off against unaccounted income despite Explanation to Section 37(1) & proviso to Section 69C**

In the case of CIT vSec. P. D. Abrahm, pursuant to a search u/s 132, an assessments u/s 158BC was made and various additions were made. One of the issues was whether if the AO makes an addition of unaccounted income on the basis of seized records, he is required to give a deduction for the unexplained expenditure shown in the same records for which the Kerala High Court ruled as under:

- When the Department relies on the seized records for estimating undisclosed income, there is no reason why the expenditure stated therein should be disbelieved merely because there is no written agreement and that payments were not made through cheques or demand draftSec.
- The statute authorizes assessment of "undisclosed income" which has to be arrived at after allowing expenditure incurred by the assessee whether it be accounted in the regular books or not.
- The Explanation to Sec. 37(1) does not apply because the unaccounted business is not an "illegal business" and the proviso inserted to Section 69C by the Finance (No.2) Act, 1998 w.e.f. 1.04.1999 does not cover excess expenditure over accounted expenditure in businesSec.

**Section 10A/ 10B deduction allowable without set off of losses of non-eligible units**

In case of CIT vSec. Black & Veatch Consulting Pvt. Ltd, the Bombay High Court dismissed the appeal of the Department against the decision of the Tribunal that Section. 10A deduction had to be allowed before set-off of the brought forward unabsorbed depreciation and losses of the unit non-eligible for Section 10A. It observed as under:

- Sec. 10A is a deduction provision and not an exemption provision. It has to be given effect to at the stage of computing the profits and gains of business and before the application of the provisions of Sec. 72 for carry forward and set off of business losseSec.
- A distinction has been made by the Legislature while incorporating the provisions of Chapter VI-A. Sec. 80A(1) stipulates the deductions specified in Sec. 80C to 80U shall be allowed from the gross total income at the time of computation of income. Sec.

80B(5) defines "gross total income" as the total income computed in accordance with the provisions of the Act, before making any deduction under the Chapter.

It is not permissible to telescope the provisions of Chapter VI-A in the context of the deduction u/s 10A unless a specific statutory provision to that effect is made.

**Section 54EC: Exemption is available when capital gain is invested in bonds after 6 monthSec.**

In the case of CIT v. Cello Plast, the assessee sold factory building on 22.3.2006 and earned LTCG which was invested in bonds of Rural Electrification Corporation ("REC Bonds") on 31.1.2007 which was beyond the period of 6 months (21.9.2006) specified in Sec. 54EC.

The assessee claimed since the bonds were not available for the period from 4.8.2006 to 22.1.2007, he made the investment when the bonds were available and hence the delay. The Tribunal allowed assessee's claim against which the Department appealed before the Bombay High Court. The department argued that the REC Bonds were available for some time in the period after the transfer (1.7.2006 to 3.8.2006) and further, National Highway Authority (NHAI) bonds were available as an alternative hence, the assessee could have made investment in time.

The Hon'ble Court dismissed the Department's appeal and observed as under:

- The assessee was entitled to wait till the last date (21.9.2006) to invest in the bondSec. As of that date, REC bonds were not available. The fact that they were available in an earlier period after the transfer makes no difference because the assessee's right to buy the bonds up to the last date cannot be prejudiced.
- Further, the Revenue cannot insist that the assessee ought to have invested in the NHAI bonds as Sec. 54EC confers a choice investing either in the REC bonds or NHAI bondSec.

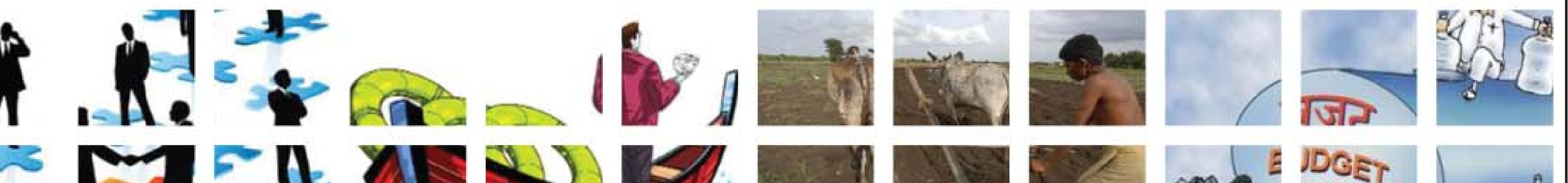
**Section 391-394: Scheme of arrangement is not a "tax avoidance scheme"**

In the case of Vodafone Essar Gujarat Ltd v. Dept of Income-tax; Vodafone Essar Gujarat (Transferor) filed a petition u/Sec. 391 to 394 of the Companies act, 1956 to transfer its 'Passive Infrastructure Assets' Vodafone Essar Infrastructure Ltd (Transferee).

- The corresponding liabilities were not to be transferred.
- No consideration was payable by the transferee nor were any shares to be allotted to the members of transferor.
- Post de-merger, the transferee was to be made a substantially owned company of a new company to be formed by all or some of the shareholders of the transferee.
- Thereafter, the transferee was to be amalgamated/ merged into Indus Towers Ltd.

The application was opposed by the Income Tax authorities on following grounds:





- No consideration was involved the transaction was ultra viruSec.
- The transaction did not fall in ambit of Sec. 391 to 394 and it was a simple transfer between two separate entities to evade taxeSec.
- The Company judge concluded that the transferee was a paper company and the sole object of the scheme was to avoid taxes so he did not sanction the scheme.

The Gujarat High Court held that:

- The scheme cannot be said to have no purpose or object and that it is a mere device/ subterfuge with the sole intention to evade taxeSec.
- It was held in Vodafone International Holdings B.V. by the Supreme Court that Revenue should apply the "look at" test to ascertain its true legal nature.
- Tax planning may be legitimate if it in the framework of law though a "colourable device" cannot be a part of tax planning. A similar scheme has been sanctioned by the Delhi High Court.
- The Revenue's argument that the transfer is void for want of consideration is not acceptable because it is not a party to the transaction, even a consideration of one rupee can be a valid consideration and its not necessary that monetary consideration has to be there.
- In a reconstruction, there is a give and take and mutual/reciprocal promises and obligations, which can be consideration for each other, even most trifle benefit can be consideration so as to avoid impact of Section 25 of the Contract Act.

**Section 40(b)(v): Non business income also needs to be considered for limits u/s 40(b)(v)**

In the case of Md. Serajuddin & Brothers v. CIT, the Calcutta High court had to consider whether the term "book profit" meant the profit as per P&L a/c, including non-business income or the "profits & gains of business as computed u/c. IV-D. The Section permits a firm to claim deduction of remuneration paid to a working partner up to certain limits of the "book profit" which is defined to mean "the net profit, as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in Chapter IV-D … ".

The High Court, relying on Apollo Tyres Ltd, held as under:

- Chapter IV-D nowhere provides that method of accounting for the purpose of ascertaining net profit should be the only income from business and not from other sourceSec.
- Sec. 29 provide how the income from profits and gains of business should be computed and this has to be done as provided u/s 30 to 43D.
- By virtue of Sec. 5, the total incomes of any previous years include all income from whatever source derived.

- Thus for the purpose of Sec. 40(b)(v) read with Explanation, there cannot be a separate method of accounting for ascertaining net profit and/or book-profit.
- The said Section nowhere provides that the net profit as shown in the P&L A/c is not the profit computed under the head profit and gains of businesSec. The AO is not entitled to recompute the P&L profitSec.

**Section 32(1)(ii): A "non-compete right" is not an intangible asset**

In the matter of Sharp Business System vSec. CIT, the facts were that the assessee, a joint venture of Sharp Corp, Japan, and L&T Ltd, paid to L&T a consideration for not competing with the assessee for 7 yearSec. The assessee claimed that the non-compete fee was revenue in nature. It also claimed, in the alternative, that the rights under the non-compete agreement were an "intangible asset" u/s 32(1)(ii) eligible for depreciation.

The appeal by the assessee in the Delhi High Court which observed as under:

- The advantage derived by the assessee from the non-compete agreement entered into with L&T is for a substantial period of 7 years and ensures a certain position in the market by keeping out L&T. The advantage cannot be regarded as being merely for facilitation of business and ensuring greater efficiency & profitability. The advantage falls in the capital field
- The non-compete rights cannot be treated as an "intangible asset" u/s 32(1)(ii) because:
  - (a) the nature of the rights mentioned in the definition of "intangible asset" spell out an element of exclusivity which enures to the assessee as a sequel to the ownership. In the case of a non-competition agreement, it is a right "in personam" where the advantage is restricted & does not confer an exclusive right to carry-on the primary business activity.
  - (b) Another way of looking at the issue is whether such rights can be treated or transferred. Every species of right spelt-out such as know-how, franchise, license etc. and even those considered by Courts, such as goodwill, can be said to be alienable. Such is not the case with an agreement not to compete which is purely personal.

**Section 40(a)(ia): No disallowance for short-deduction TDS default**

In the case of CIT vSec. M/Sec. Sec. K. Tekriwal, the assessee paid machinery hire charges on which it deducted TDS at 1% u/s 194C. According to AO the amount was in the nature of "rent" and TDS at 10% ought to have deducted u/s 194-I. Hence, he made a proportionate disallowance u/s 40(a)(ia) on the ground that there was a "failure" to deduct TDS on the payment. The Tribunal upheld the assessee's plea that Sec. 40(a)(ia) disallowance could not be made when there was a shortfall in TDS deduction.

The Calcutta High Court observed that Section 40(a)(ia) can be invoked only when the two conditions, namely, that tax is deductible at source and such tax has not been deducted is satisfied. Hence, where tax is deducted by the assessee under a wrong provisions of TDS and there is a shortfall, Sec. 40(a)(ia) disallowance cannot be made.

### Section 271(1)(C): Surrender of income without explanation attracts penalty.

In the case of CIT vSec. MAK Data Ltd., in the course of a survey u/s 133A conducted on the assessee's premises, certain documents belonging to certain entities who had applied for shares in the assessee were found. The AO called upon the assessee to prove the nature and source of the monies received as share capital, the creditworthiness of the applicants and the genuineness of the transactionSec. The assessee offered a certain sum as income from other sources "to avoid litigation and to buy peace" and made it was made clear that there was no admission of concealment in making the surrender. The AO added the said sum to the income of the assessee and levied penalty u/s 271(1)(c) for furnishing inaccurate particulars of income. It was observed by the Delhi High Court that:

- When the AO called upon the assessee to produce the evidence to substantiate the nature and source of amount received as share capital, creditworthiness of applicants and the genuineness of the transactions, assessee surrendered a particular amount by merely stating that it wanted to "buy peace".
- The assessee did not provide any explanation in respect such surrendered income. Hence, the absence of any explanation is statutorily considered as amounting to concealment of income under the first part of clause (A) of the Explanation to Section 271(1)(c) because the nature and source of the amount surrendered are facts material to the computation of total income and penalty has to be levied.

## TRIBUNAL DECISIONS

### Section 50B: Negative net worth to be added for the purposes of computing capital gains on slump sale of business

In case of Dy. CIT vSec. Summit Securities Limited, there was a slump sale of the undertaking having negative net worth. For the purpose of capital gains u/s 50B, the assessee considered net worth as nil and the entire sales consideration for the undertaking was offered to tax as long term capital gainSec. The Special Bench Mumbai ITAT held that in the case of a slump sale, one lump sum value of the undertaking is arrived at, derived by adding all the assets and reducing all the liabilitieSec. This is the "full value of consideration". If one adds the liabilities to this value, one is arriving at the consideration for the "assets" but not the consideration for the "undertaking". Also, once the sale consideration has been approved by the High Court, the "full value of the consideration" has to be restricted only to the actual amount received or accruing to the assessee.

The Special Bench held that to contend that the cost or the net worth can never be in negative, is too wide a proposition to be accepted in the case of the capital asset in the nature of undertaking. The Special Branch further held that if the book value of all the liabilities is more than the book value/written down value of all the assets, it is quite natural that the capital gain on the transfer of undertaking will be more than the full value of consideration because of the reason that the value of liabilities undertaken by the transferee stands embedded in and has the effect of reducing the full value of consideration.

The Special Bench concluded that though, in ordinary parlance, the terms “cost” & “net worth” may not have a negative value, in the context of Sec. 50 B, if the liabilities exceed the assets, there would be a negative net worth. The said negative net worth has to be “deducted from” (i.e. “added to”) the full value of consideration.

### Rectification of depreciation claim without filing revised return allowed

In case of ITO vSec. Sri Balaji Sago and Starch Products, the assessee claimed depreciation on windmill @ 15% in the return, which later filed an application to rectify the depreciation rate to 80%.

Chennai Tribunal observed that there is a genetic difference in the concept of deduction by way of statutory allowance and deduction by way of other expenditure. The assessee has not made any fresh claim, as far as depreciation is concerned. It has already made a claim for statutory allowance of depreciation, subject to the mistake occurred in choosing the correct rate. The ratio of the decision of the Supreme Court in case of Goetze (India) Ltd. v. CIT (284 ITR 323) needs to be carefully applied in the matters of statutory allowances available to an assessee.

The Tribunal observed that since depreciation was a mandatory allowance, the AO was bound to apply the correct rate of depreciation and allow the same.

**Section 32(1)(II)- Website being an intangible asset would be eligible for depreciation at rate of 25 per cent**

Incase of Makemytrip (India) Pvt. Ltd. vSec. Dy. CIT, Delhi Tribunal held that the assessee was doing its business of tour and travel, through its website and, therefore, the website development cost represents business asset falling under the block of intangible assets and would be eligible for depreciation at the rate of 25%.

**Conditions to invoke Section 68**

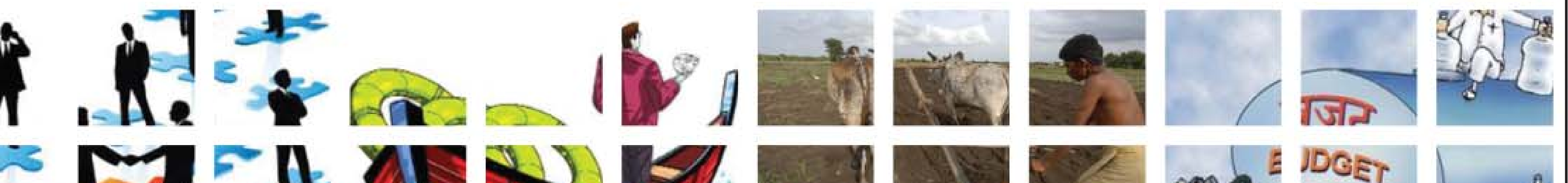
In case of ITO vSec. Anant Shelters Pvt. Ltd., Mumbai Tribunal enumerated the following three conditions to invoke Section 68-

(a) When there is credit of amounts in the books maintained by the assessee

(b) Such credit has to be a sum of money during the previous year

(c) Either the assessee offers no explanation about the nature and source of such credits found in the books or the explanation offered by the assessee, in the opinion of the AO,





is not satisfactory. It is only then that the sum so credited may be charged to income-tax as the income of the assessee of that previous year.

In respect of the above conditions, the Hon'ble ITAT also clarified as follows:

- The opinion of the AO for not accepting the explanation offered by the assessee as not satisfactory is required to be based on proper appreciation of material and other attending circumstances available on record.
- The opinion of the AO is required to be formed objectively with reference to the material on record file. The evidence produced by the assessee cannot be brushed aside in a casual manner. Assessee cannot be asked to prove the impossible. Explanation about 'source of source' or 'origin of the origin' cannot and should not be called for while making inquiry under the Section.
- In the matters related to Section 68, burden of proof cannot be discharged to the hilt- such matters are decided on the particular facts of the case as well as on the basis of preponderance of probabilitieSec. Credibilty of the explanation, not the materiality of evidences, is the basis for deciding the cases falling under Section 68.
- Assessee has to establish identity and creditworthiness of the creditor as well as the genuineness of the transaction.
- All the three ingredients are cumulative and not exclusive.

## Section 54: Exemption not limited to one house subject to certain conditions

In the case of ACIT v. Deepak Sec. Bheda, the assessee earned capital gain from sale of ancestral property and purchased four flatSec. The assessee converted four flats into one residential unit and claimed exemption u/s 54F. The AO allowed exemption only in respect one flat by holding that flat were separate and independent residential unit having separate kitchen and entrance and thus, according to him flat could not be said as adjacent flats even though builders had referred them as composite unit.

Mumbai Tribunal allowed the claim of the assessee and observed that if requirement of assessee family was met out only by enlarging residential unit by merging four flats and that too prior to handing over of the possession of said residential unit, then said converted residential unit would be treated as a residential house as stipulated u/s 54F.

## Section 43B: Conversion of interest dues payable to bank into equity shares is not actual payment

In case of Income Tax Officer vSec. Glittek Granites Ltd., the assessee issued share of the company towards discharging interest liability on loan taken from a scheduled bank and claimed deduction u/Sec. 43B. The Kolkata Tribunal relied on CBDT's Circular No.7/2006 dated 17-7-2006 and held that there is indeed a significant difference in discharging a debt by giving away an asset, such as securities, and by issuing capital. Discharging a debt by issuing capital would not amount to repayment. Accordingly, it cannot be allowed as deduction u/s 43B of the Income Tax Act.

## Section 14A: No disallowance in absence of "live nexus" between expenditure & tax free income

In case of Justice Sam P Bharucha vSec. ACIT, Mumbai Tribunal held that no disallowance u/Sec. 14A can be made in absence of live nexus between expenditure incurred by assessee and exempt income received by him. It observed that on facts of the case and from the details of the expenditure, it is clear that the expenditure incurred by the assessee has direct nexus with the professional income of the assessee. It is not the case of the revenue that the assessee has used his official machinery and establishment for earning the exempt income. Further, The AO did not give any finding that any of the expenditure incurred and claimed by the assessee is attributable for earning the exempt income.

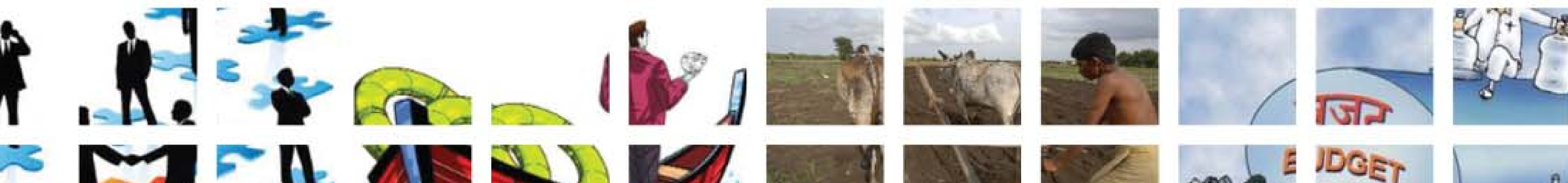
The Hon'ble ITAT further observed as under:

- Section 14A has within it, implicit notion of apportionment in cases where expenditure is incurred for composite/indivisible activities in which taxable and non-taxable income is received. But where actual expenditure can be determined or where no expenditure has been incurred in relation to exempt income, principle of apportionment does not apply. For Section 14A to apply, there should be a proximate relationship between the expenditure and the tax-free income.
- If assessee claims that no expenditure has been incurred for earning the exempt income, AO has to determine whether the assessee has incurred any expenditure and if so, quantify the disallowance of expenditure u/s 14A for which there has to a live nexus between expenditure incurred and exempt income.
- No notional expenditure can be apportioned for the purpose of earning exempt income unless there is an actual expenditure in relation to earning tax free income.
- If expenditure is incurred to earn taxable income and there is apparent dominant and immediate connection between the expenditure and taxable income, then no disallowance can be made u/Sec. 14A just because exempt income is received by him.

## Section 115JB: SEZ units continue to be exempt from MAT

Facts in the case of Genesys International Corpn. Ltd. vSec. ACIT was that the assessee had two undertakings which were eligible for deduction u/s 10A, one of which was a SEZ unit and the other which was a STPI unit. By the Finance Act, 2007, clause (f) to explanation (1) to Section 115JB (2) was amended w.e.f. 1.4.2008 so as to delete the words "Sections 10A or 10B" though sub-sec (6) of Section 115JB was retained. The AO & CIT(A) held that the effect of the deletion of the reference to Section 10A & 10B in Section 115JB meant that the units which were eligible for Sec. 10A & 10B deduction were no longer exempt from Sec. 115JB and only units which were eligible for Sec. 10AA deduction would be exempt from Sec. 115JB.





Mumbai Tribunal held that Section 115JB (6) does not refer to either Section 10A or Section 10AA but simply provides that the MAT provisions shall not apply to income arising from any business carried on in an unit located in a SEZ. Consequently, despite the fact that an amendment was made in clause (f) of Explanation (1) to Sec. 115JB(2) to provide that MAT shall apply to units eligible for Section 10A or 10B, a unit which is situated in a SEZ will continue to be exempt from MAT by virtue of Sec. 115JB(6).

### Despite set aside for "de novo consideration", AO cannot look at fresh issues

In the case of Gemini Oils Pvt. Ltd vSec. ITO, CIT (A) disposed off the appeal filed by the assessee by observing "A perusal of the above additions clearly show that the AO has made the assessment in a very casual manner … Considering the heavy additions made and the necessity for making adequate enquiries into the matter, it is considered necessary to set aside the assessment for denovo consideration". In the order passed pursuant to the said order of the CIT (A), the AO made additions on issues other than those that were covered in the first order. The assessee challenged this on the basis that even though the CIT(A) had set aside for "denovo consideration", the AO could not look into new issueSec.

Mumbai Tribunal held as under:

- The scope of proceedings after remand depends on the terms of the remand order. If the appellate authority has set aside the assessment and directed the making of a fresh assessment without imposing any restrictions or limitations, the AO has the same powers in making fresh assessment as he originally had. However, if any restrictions are placed, the AO cannot travel beyond those restrictionSec.
- The scope of the remand order has to be determined depending on the subject matter of the appeal and the appellate order read as a whole in its proper context.
- On facts, a perusal of the findings of the CIT (A) shows that he was concerned with the additions made in the original assessment order and it was in the light of the additions made therein, that the assessment was set aside for denovo consideration. This clearly shows that the directions of the CIT (A) for denovo assessment were restricted to the additions made by the AO in the original assessment order and, therefore, the AO had no jurisdiction to look at other issueSec.

### Section 24(b) & 48: Interest paid on borrowing for acquiring house deductible u/s 24(b) & 48

In case of ACIT vSec. C. Ramabrahmam, Chennai Tribunal held that the assessee is entitled to claim deduction u/Sec. 24(b) for interest paid on loan for purchasing the house and it can also include the interest in cost of the asset while calculating capital gains u/Sec. 48. The assessee borrowed funds for purchasing a house and claimed deduction u/s 24(b) for the interest paid on it. When the house was sold, the said interest was treated as "cost of acquisition" and claimed as

a deduction u/s 48 to which the AO objected stating that as the interest had been allowed as a deduction u/s 24(b), it could not be allowed again in computing capital gainSec.

Chennai Tribunal observed that a deduction u/s 24(b) is claimed when the assessee computes income from 'house property', whereas, the cost of the same asset is taken into consideration when it is sold and capital gains are computed under Section 48. Neither of them excludes the other. The interest expenditure was incurred by the assessee in acquiring the asset and since both provisions are altogether different, the assessee is entitled to include the interest at the time of computing capital gains u/s 48.

### Section 50C does not apply to transfer of FSI & TDR.

In the case of ITO vSec. Prem Rattan Gupta, the assessee owned a plot of land of which a part was acquired by the Municipality for development purposes and in lieu of it the assessee received TDR/ FSI. The assessee sold the development rights to the said property for RSec. 20 lakhs and computed capital gains on that basiSec. However, for purposes of stamp duty, the property was valued at RSec. 1.19 croreSec. The AO held that the value of the property as adopted by the stamp duty authorities had to be taken as the consideration u/s 50C for purposes of capital gainSec. The Mumbai Tribunal held that:

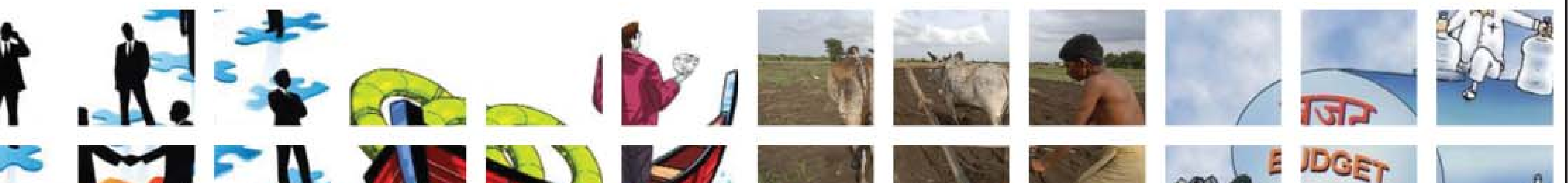
- Section 50C applies only to the transfer of "land or building" and not to the transfer of all "immovable property". Though FSI and TDR is "immovable property", it is not "land or building" and so cannot be the subject matter of Section 50C.
- The property acquired from the assessee, in lieu of FSI/TDR, for development also cannot be considered even though it continues to stand in the assessee's name in the property recordSec.
- The property should be valued by the Valuation Officer net of the land transferred to the Developer by the assessee after considering the acquisition made by the Government & the Municipal Corporation and also excluding the value of TDR or additional FSI included in the consideration shown in the Development Agreement.

**Section 43(5): Loss on derivatives carried out electronically on screen based system and through recognized stock exchange is not disallowable as speculative**

In the case of Vibha Goel v. JCIT, the assessee claimed business loss from derivative trading in futures and options and set it off against the business profit. The AO disallowed the claim.

It was held by Chandigarh Tribunal that the assessee complied with the conditions and the provisions of Section 43(5)(d) of the Income Tax Act, 1961 by carrying out derivative transactions electronically on screen based system and through recognized stock exchange. The assessee had maintained each and every record of the documentation provided by the sub-broker like trade conformation report, bills etc. Thus, relying on the intention of Section 43(5)(d) and Memorandum explaining provisions of Finance bill, 2005, the claim of assessee could not be disallowed.





## CIRCULARS

### Treaty between India and Tanzania enters into force

On 12 December 2011, the India - Tanzania Income Tax Treaty (2011) entered into force. The treaty will be in force from 1 January 2012 for Tanzania and from 1 April 2012 for India. From these dates, the new treaty will replace the India - Tanzania Income Tax Treaty (1979), as amended by the 1980 exchange of noteSec.

### Exchange of information agreement between India and Argentina signed

On 21 November 2011, India and Argentina signed the Argentina - India Exchange of Information Agreement (2011), in Buenos AireSec.

### Highlights of the Advance Pricing Agreement (APA) Notification

Advance Pricing Agreement (APA) Scheme was introduced in the Finance Act 2012 w.e.f. 1st July 2012. The APA program is certainly seen as one of the more positive amendments introduced by the Finance Act 2012. As per the Notification No. 36 of 2012 dated 30th August 2012, detailed rules have been prescribed. The said notification was eagerly awaited since APA provisions had been made valid for consecutive 5 yearSec. With the introduction of detailed rules as per the notification, APA program appears to be a positive development and taxpayers at large would surely benefit from the introduction of this form of international dispute resolution mechanism.

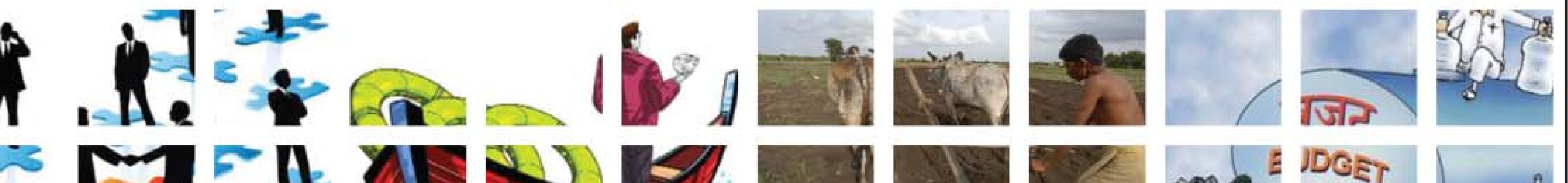
The salient points of the Notification are as follows :

- The APA process is voluntary and will supplement appeal and other Double Taxation Avoidance Agreement (DTAA) mechanism for resolving transfer pricing dispute.
- Unilateral, bilateral and multilateral APAs may be entered into:
  - For Unilateral APA, application to be filed before Director General (International Tax).
  - For bilateral or multilateral APAs, application to be filed before Competent Authority (CA) i.e. Joint Secretary FT&TR-I, New Delhi.
- APA application must be filed before start of the financial year in respect of ongoing transactionSec. In respect of new transactions, the application must be filed before undertaking the same. Roll back of the APA is not permissible.
- The schedule of fees payable at the time of making the application is as under:

| Amount of international transaction entered into or proposed to be undertaken in respect of which an agreement is proposed during the proposed period of agreement. | Fees in Indian Rupees |
|---|---|
| Amount not exceeding RSec. 100 crores | 10 lakhs |
| Amount not exceeding RSec. 200 crores | 15 lakhs |
| Amount exceeding RSec. 200 crores | 20 lakhs |

- Pre-filing Consultation available - Every person proposing to enter into an APA shall be able to make an application in writing, requesting for a pre-filing consultation in Form No. 3CEC to the DGIT.
- In case of anonymous pre-filing, no names of the applicant taxpayer or the associated enterprise ('AE') are to be given. However, details of the authorized representatives of the applicant taxpayer who would be appearing before the authorities for the pre-filing discussions would need to be furnished.
- Assessee to furnish Annual Compliance Report (in Form 3CEF) within 30 days of the due date of filing return or within 90 days of entering into an agreement, whichever is later.
- The Transfer Pricing Officer ('TPO') shall carry out a compliance audit for each year covered in the agreement. Time limit for completion of the same is 6 months from the end of the month in which annual compliance report is filed. Regular audit not to be undertaken for transactions covered by the APA.
- APA shall not be binding on the Board or the taxpayer if there is a change in any of the critical assumptions - "Critical assumptions" means the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed.
- Revision of APAs is possible in case of:
  - Change in critical assumptions;
  - Change in law;
  - Request from competent authority of other country in case of bilateral and multilateral agreementSec.
- The Board may cancel the APA for:
  - Failure of the taxpayer to comply with the terms of the agreement
  - Failure to file the annual compliance report in time;





- Annual compliance report filed contains material errors;
- The taxpayer does not agree for revision of the APA.

- For bilateral and multilateral APAs, the AE would be required to initiate the APA process in the other country. The Indian Competent Authority shall consult and ascertain willingness of the Competent Authority in the other country for initiation of negotiationSec. The Applicant taxpayer shall not be entitled to be part of discussion between the Competent Authority in India and the Competent Authority in the other country or countrieSec.
- Applicant taxpayer needs to communicate acceptance or otherwise to the APA agreed between competent authorities within 30 daySec.

## Our Comments :

- India is generally regarded as among the more difficult transfer pricing destinations, with more than half the transfer pricing audits facing adjustments resulting in an additional tax demand and litigation.
- The introduction of APAs earlier this year and the above notification of the Rules is indeed a very positive step towards reducing the current onerous litigation in the Indian transfer pricing arena.
- APA could become the forum of choice for the well-heeled among non-residents and AAR could be consigned to the role of addressing the queries of lesser mortalSec.
- The Rules provide greater clarity on the implementation of the APA and the introduction of Bilateral and Multilateral APAs should also certainly assist in eliminating economic double taxation.
- Further, the feature of anonymous pre-filing meetings is also welcome as this will give comfort and confidence to taxpayers to explore the APA as an option to proactively avoid Transfer Pricing disputes without worrying about the confidential nature and facts of their respective cases being disclosed.
- Also, the inclusion of economists, statisticians and possibly other industry experts as part of the APA team should hopefully provide the required objectivity needed to resolve complex Transfer Pricing issues in a balanced manner.
- The procedure to renew the APA is tedious and seems like a fresh APA – Internationally, there is flexibility and ease to seek renewals as an APA is supposed to be a win- win proposition for the tax payer and the government.

- Government needs to move away from the mindset of looking over the tax payers' shoulder and APA is a good start. After all, the FM has promised last week that honest tax payers would not be hounded by the tax man.

## GAAR

- Shome Committee's Draft Report on GAAR implementation
  - **Background :**

    The Expert Committee for GAAR was set up on 17th July, 2012 on the recommendation of the Prime Minister with the objective of undertaking stakeholder's consultations to finalize the guidelines for GAAR and chart out a roadmap for implementation. The committee was chaired by Dr. Parthasarathi Shome. The committee submitted a draft report on September 1, 2012 on the basis of consultations received from various stakeholders, professionals, foreign investor associations, industrialists and so otherSec.

    The draft report has recommended certain amendments in the Income-tax Act, 1961; guidelines to be prescribed under the Income-tax Rules, 1962; circulars to clarify GAAR provisions along with illustrations; and other measures to improve tax administration specifically oriented towards GAAR matterSec.

  - **Highlights of the report :**

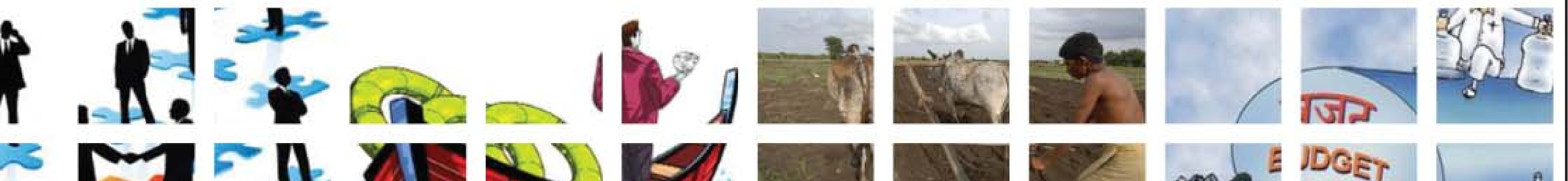
    Few important highlights of the Expert Committee report are summarized as below:

    - **Recommendations for amendments in the Income-tax Act, 1961**

      - GAAR should be deferred for 3 yearSec. However, the guidelines for the year 2016-17, should be announced now, so that it could apply from A.Y. 2017-18. Pre-announcement will help in better understanding and implementation of the guidelineSec.
      - Tax on gains from listed securities shall be abolished for residents as well as non-residentSec. Government may consider increasing the rate of Securities Transaction Tax (STT) appropriately.
      - Arrangements with "main" purpose of avoiding tax only should be covered under GAAR.
      - GAAR approving panel should consist of 5 members including 2 external experts; ought to be headed by retired High Court judge.

    - Recommendations for guidelines to be prescribed under Income-tax Rules





- Tax mitigation should be distinguished from tax avoidance before invoking GAAR.

An illustrative list of tax mitigation or a negative list for invoking GAAR shall include selection of one of the options offered in law, timing of a transaction, or amalgamations and demergers as approved by the High Court.

- GAAR should not be invoked in intra-group transactions (i.e. transactions between associated persons or enterprises) which may result in tax benefit to one person but overall tax revenue is not affected either by actual loss of revenue or deferral of revenue.
- Monetary threshold of RSec. 3 crore of tax benefits to be applied. Tax benefit to be determined based on the present value of money. This would in turn affect companies having Profit Before Tax (PBT) in a year of more than RSec. 10 crore in the initial 5 years to minimize any adverse impact on smaller taxpayerSec.
- All investments (though not arrangements) made by a resident or non-resident and existing as on the date of commencement of the GAAR provisions should be grandfathered so that on exit (sale of such investments) on or after this date, GAAR provisions are not invoked for examination or denial of tax benefit.
- Factors like existence of arrangement, payment of taxes, exit route relevant but may not be "sufficient" to apply GAAR.
- GAAR should not apply in case of SAAR or where Limitation of Benefit (LOB) test is prescribed under DTAA. But GAAR can override DTAA in case of impermissible arrangement(s).
- Recommends time –bound action plan while invoking GAAR.

➢ **Recommendations for clarifications and illustrations through circular**

- GAAR should not apply to examine the genuineness of "residency", if Mauritian TRC is obtained pursuant to CBDT Circular no. 789/2000.13.
- GAAR shall apply to income of the previous year, relevant to the assessment year in which GAAR becomes effective, and subsequent yearSec.

➢ **Recommendations in respect of tax administration:-**

- AAR mechanism should be strengthened so that advance ruling can be obtained within the statutory time frame of 6 monthSec.

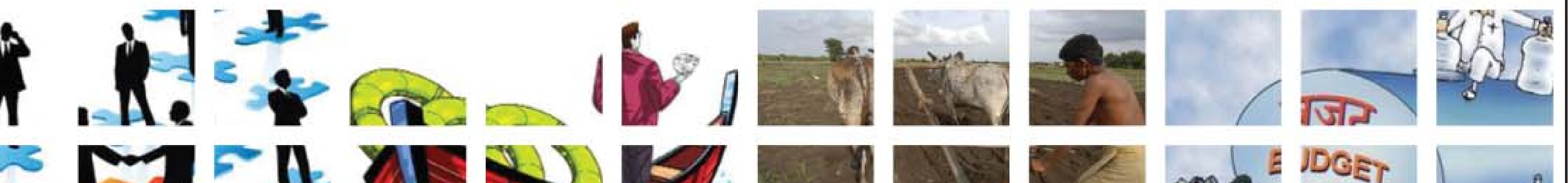
- Recommends greater training on international tax to tax officers and information sharing within the IT Department.

➢ **Other recommendations**

- While determining tax consequences of an impermissible avoidance arrangement, corresponding adjustment should be allowed in the case of the same taxpayer in the same year as well as in different years, if any. However, no relief by way of corresponding adjustment should be allowed in the case of any other taxpayer.
- GAAR should not apply to FIIs investing in listed securitieSec. In other cases, safe harbor rules shall be provided to FIISec.
- Diverting profits from non-SEZ unit to SEZ unit should not be subject to GAAR where the units have complied with the Transfer pricing regulationSec.
- Doubtful debt transactions can be re-characterised as equity, applying GAAR.

❍ **Our Comments**

- The Committee has recommended that GAAR should be deferred for a period of 3 yearSec. It notes that investors and taxpayers are justified if they undertake tax mitigation provided that they do not use highly abusive, contrived or artificial schemeSec. The Committee has rightly suggested that a targeted approach to GAAR with abundant safeguards is critical to address investor concernSec.
- In our view, the committee came out with the guidelines in a very short time which needs to be appreciated. But the most important aspect of 'accountability' is still missing. If GAAR is recommended but the action is found to be untenable by the GAAR committee, then the responsible commissioner must be answerable and accountable. An officer who proposes the application of GAAR should not be held accountable but his superiors approving the matters previously questioned for misuse and abuse of powers, should be held accountable.
- Important observations have also been made with respect to investments by holding companies, funds and FIIs from countries such as Mauritius and Singapore. It has been recommended that all direct and indirect investments into FIIs should be exempt from GAAR. Other key recommendations include grandfathering of prior investments, provision of safe harbours, respect for tax treaty benefits and safeguards to ensure fairness and objectivity in application of GAAR.
- Recommendation of a 5 member panel is based on best practices, and also the



head of such panel being a retired HC judge is a welcome step. Having persons from private sectors is big foresightedness and will boost confidence of the tax payer community.

- The limit of transactions involving RSec. 3 crore tax effect has been incorrectly fixed. In our opinion, 90% of tax in India is paid by handful of tax payerSec. First of all, GAAR should have been applied to them. Then, based on experience, if they find the provisions of law are abused by such tax payers by entering into impermissible avoidance arrangements, all such arrangements must be notified by the tax department and GAAR shall apply to every tax payer irrespective of size or limit.

- Unfortunately, the committee thinks that corresponding adjustments should not be allowed. The analogy given i.e. existing Transfer Pricing Regulations have no corresponding adjustment, is totally incorrect. The major tax treaties India has with important trade partner countries have provision of corresponding adjustment. Hence if both tax payers involved are Indian, a corresponding adjustment needs to be granted. However the penalty provisions take care of loss of revenue and also act as a deterrent factor.

- Most significant recommendation of the committee, which needs to be accepted immediately, is abolition of all taxes on capital market transactionSec. This will reduce all sorts of litigation. Loss of revenue will be easily removed through STT without any cost of collectionSec.

- It is a difficult task for auditors to report transactions undertaken with the objective of tax avoidance, unless such transactions are notified by the revenue in advance.

- Amidst the prevailing uncertainty in India's legal and tax environment, the Committee's report will surely spread positive vibes across the global investor community.

## Certificate of Residence

An assessee being an Indian resident shall obtain a certificate of residence for the purposes of an agreement referred in section 90 and section 90A by making an application in Form No. 10FA to the Assessing Officer and on being satisfied he shall issue a certificate of residence in respect of the assessee in Form No. 10FB.

## DTAAs/Protocols Signed and Notified

- **India-Switzerland: Protocol to the DTAA**

  India has signed a Protocol amending the DTAA with Switzerland, notified on 27-12-2011, effective from 01-04-2012 (and, in respect of Exchange of Information Article 26, effective from 01-04-2011). Some of the noteworthy changes are as follows:

  - International Traffic to include transport via ship
  - Non-discrimination clause:

    Article 24 of the India-Swiss Protocol has incorporated the changes on the basis of agreement which is line with the USA.

  - Definition of the term "Resident of a Contracting State" in Article 4 (1) expanded:

    A new paragraph is added to the Protocol, which expands the scope of the term "Resident of a Contracting State" or pension scheme in that Contracting State.

  - Conduit Arrangement:

    This provision is a anti-abuse provision, It states that benefits under Articles to (Dividends), Article 11 (interest), Article 12 (Royalty) and Article 22 (Other Income) would not be available, where such sums are received under a "conduit arrangement".

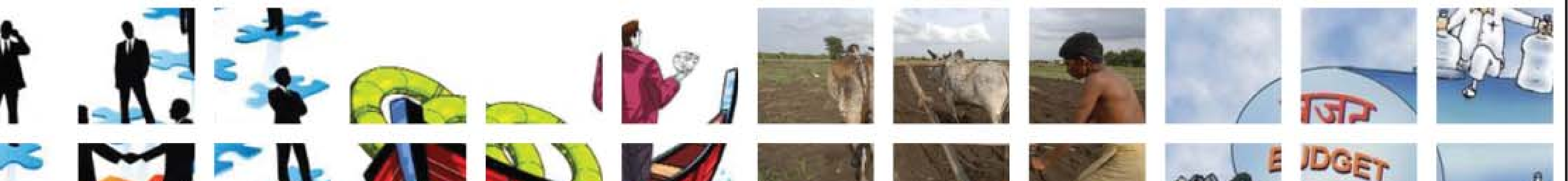
- **India-Lithuania: Protocol to the DTAA**

  - India signed a DTAA with Lithuania on 26-07-2011 and notified on 26-07-2012, effective from 01-04-2013. Lithuania is the first Baltic country with which a DTAA has been signed by India.
  - The Agreement provides for fixed place PE, building site, construction & installation PE, service PE, Off-shore exploration/exploitation PE and agency PE.
  - Dividends, interest and royalties & fees for technical services income, will be taxed both in the country of residence and in the country of source. The low level of withholding rates of taxation for dividend (5% & 15%), interest (10%) and royalties & fees for technical services (10%) will promote greater investments, flow of technology and technical services between the two countrieSec.

- **India-Mozambique: Protocol to the DTAA**

  - India has notified the DTAA with Mozambique on 31st May, 2011, effective from 1st April, 2012.





- The DTAA provides that profits of a construction, assembly or installation project will be taxed in the state of source, if the project continues in that state for more than 12 monthSec.
- The DTAA provides that profits derived by an enterprise from the operation of ships or aircraft in international traffic, shall be taxable in the country of residence of the enterprise. Dividends, interest and royalties income will be taxed both in the country of residence and in the country of source. However, the maximum rate of tax to be charged in the country of source will not exceed 7.5% in the case of dividends and 10% in the case of interest and royaltieSec. Capital gains from the sale of shares will be taxable in the country of source.

- **India-UK: Protocol to the DTAA**
    - India has signed a protocol dated 30th October, 2012 with UK and Northern Ireland amending the DTAA. This Protocol amends the DTAA which was signed on 25th January, 1993. ***However, the same is not yet notified.***
    - The Protocol streamlines the provisions relating to partnership and taxation of dividends in both the countrieSec. Now, the benefits of the DTAA would also be available to partners of the UK partnerships to the extent income of UK partnership are taxed in their handSec. Further, the withholding taxes on the dividends would be 10% or 15% and would be equally applicable in UK and in India.
    - The Protocol also incorporates into the DTAA anti-abuse (limitation of benefits) provisions to ensure that the benefits of the DTAA are not misused.

## DTAA - Notified 'Specified Territory'

- In exercise of the powers conferred by Explanation 2 to section 90 of the Income- tax Act, 1961(43 of 1961), the Central Government hereby notifies “Sint Maarten”, a part of Kingdom of Netherlands, the area outside India as the 'specified territory' for the purposes of the said section.
- This notification shall come into force with immediate effect.

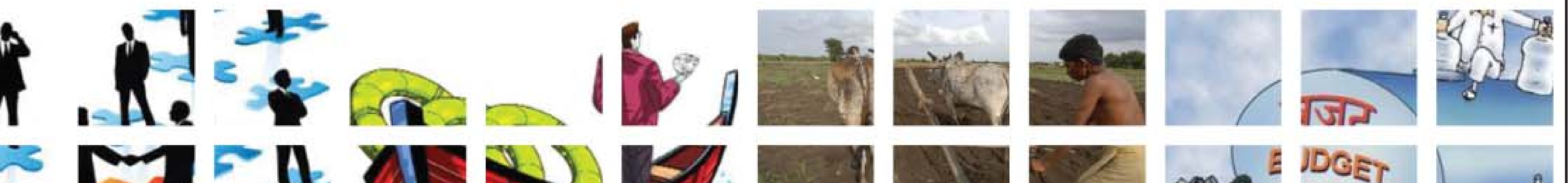
## General Anti Avoidance Rule (GAAR) updates

The General Anti Avoidance Rules have been introduced via Direct Tax Code in 2009. These provisions have been introduced to eliminate the aggressive tax planning and curb the impermissible avoidance arrangement entered into by person to avoid taxeSec. As per the current provisions, the provisions of GAAR have been dealt with under Chapter – X and would come into force with effect from 01st April 2014. A committee was issued by Dr. Partasarathi Shome

to undertake stakeholders' consultations and finalize such guidelineSec. The Government has accepted the major recommendations of the Expert Committee with some modificationSec. The Finance Minister has therefore issued a statement on 14th January 2013 setting out the decisions taken by the Government in the context of the recommendations of the Expert Committee constituted to review GAAR provisionSec.

The following decisions have been taken by the Government :

- The GAAR provisions would come into effect from **01st April 2016.**
- A **monetary threshold of 30 million rupees** of tax benefit in the arrangement will be provided in order to attract the provisions of GAAR.
- An arrangement, the main purpose of which is to obtain a tax benefit, would be considered as an impermissible avoidance arrangement substituting the current provision prescribing that it should be "the main purpose or one of the main purposes".
- The investments made **before 30th August 2010** (date of introduction of Direct Taxes Code Bill, 2010) **will be grandfathered.**
- The two separate definitions in the current provisions , namely, " associated person " and " connected person " will be combined and **there will be only one inclusive provision defining a "connected person".**
- GAAR **will not apply to such FII's that chose not to take any benefit under an agreement** under section 90 or section 90 A of the Income Tax Act, 1961. GAAR will also **not apply** to non-resident investors in FIISec.
- Where a part of the arrangement is an impermissible avoidance arrangement, GAAR will be restricted to the tax consequence of that part which is impermissible and not to the whole arrangement.
- While GAAR and SAAR (Special Anti Avoidance Rules) both are in force, **only one of them will apply to a given case,** and guidelines will be made regarding the applicability of one or the other.
- The assessing officer shall have an **opportunity to prove** that the arrangement is not an impermissible avoidance arrangement.
- The directions issued by the Approving Panel shall be **binding on the assessee as well as the Income-tax authoritieSec.** The current provision that it shall be binding only on the Income-tax authorities will be modified accordingly.
- Section 245N (a) (iv) that provides for an advance ruling by the Authority for Advance Rulings (AAR) whether an arrangement is an impermissible avoidance arrangement will be retained and the administration of the **AAR will be strengthened.**
- The tax auditor will be required to **report any tax avoidance arrangement.**



## Comments :

- As a welcome move, the Government has accepted to the Committee's recommendations that GAAR would be deferred till Assessment Year 2016-17.
- The Government has not commented upon the Shome Committee's recommendation regarding the Limitation on Benefit provision in applicable tax treaties / CBDT Circulars on Mauritius treaty should prevail over GAAR.
- Shome Committee had recommended that GAAR would not apply in cases where SAAR applieSec. The Government has merely stated that only one of them would apply in a particular case. Further clarity would be required on the interplay between GAAR and SAAR.

GAAR shall not apply to a FII which subject itself to domestic tax laws and chooses not to benefit from a tax treaty. When a FII opts for tax treaty benefits GAAR provisions may be invoked on it but not on its non-resident investorSec.

## HIGH COURT DECISIONS

**Netapp BV vSec. AAR (Delhi High Court)**

- Application for advance ruling cannot be admitted under section 245Q of the Income Tax Act if the applicant has already filed an income-tax return

  The assessee filed its return of income under section 139(1) of the Act on March 31, 2010. The transactions which formed the basis of the application before the Authority for Advance Ruling (AAR) were entered into in April 2008 and November 2008. The application for advance ruling was filed on June 17, 2010.

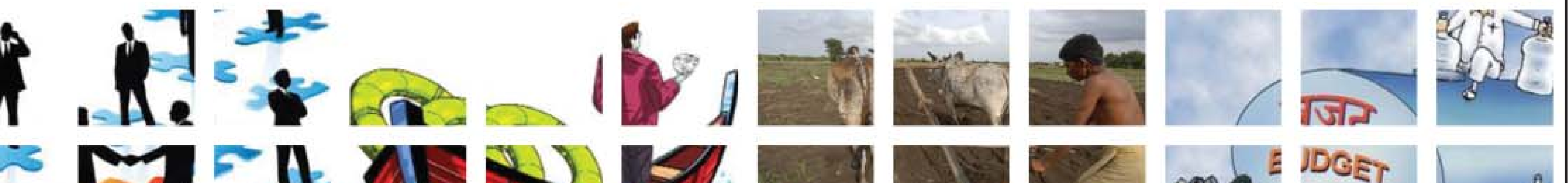
  - The Delhi High Court held that once the return of income is filed by the assessee, it is considered as question pending before the Income tax authority and therefore the AAR cannot allow the application for advance ruling.
  - The rationale of the High Court was that the assessee can make an application with the AAR to consider the wider tax ramifications of particular transactions, so that its affairs can be planned in advance.
  - However, once the assessee proceeds to file a return, or take a similar step, the AAR's jurisdiction to entertain the application for advance ruling is taken away, because the income tax authority concerned would then be seized of the matter, and would potentially possess a multitude of statutory powers to examine and rule on the return.
  - Accordingly, if the AAR is approached before an income tax return is filed or any other income tax authority is approached, the application can be entertained.

- The High Court had observed the decision of Monte Harris where the AAR held that the term 'already pending' is to be interpreted to mean already pending as on the date of the application and not with reference to any future date.
- It is relevant to note that the AAR in the case of SEPCOIII Electric Power Construction Corporation held that the application filed to seek the advance ruling cannot be admitted under Section 245Q of the Act if the applicant has already filed an income-tax return under Section 139(1) of the Act.

**Balaji Shipping UK Ltd. Bombay High Court**

- 'Operation of Ship' - Meaning to be construed from the Indian Income-Tax Act, 1961 and ownership of vessel not a requirement under Article 9 of the India-UK DTAA.
  - The assessee, Balaji Shipping UK Ltd, an entity incorporated in UK, is engaged inter-alia in the international transportation of goods by sea. During the relevant assessment years, the assessee transported cargo's in international waters in the following two scenarios:
    - Cargo was transported from Indian ports to hub ports outside India under slot hire agreements ('SHAs') with third party ship ownerSec. Thereafter, the cargo was transported from hub ports to final destination ports outside India on owned/ chartered vessels (Case I).
    - Cargo was transported from Indian ports to final destination ports outside India under SHAs with third party ship owners (Case II).
  - The gross receipts pertaining to freight collected by the assessee was claimed exempt under Article 9 of India-UK Double Taxation Avoidance Agreement ('DTAA').
  - The assessee filed its return of income computed as per provisions of section 44B of the Act i.e. computed its profits and gains chargeable to tax at 7.5% of the gross receiptSec. The assessee claimed exemption under Article 9 of the India-UK DTAA. The Assessing Officer ('AO') held that the assessee was not entitled to the benefit of the DTAA. The Commissioner of Income Tax (Appeals) and the Tribunal however, held the assessee to be entitled to the benefit of the DTAA.
  - On appeal before the Hon'ble High Court, the issue under consideration was whether the income of the assessee under SHAs in Case I and Case II would form a part of income from operations of ships exempt under Article 9 of the India-UK DTAA? It was held that in Case I, the carriage of goods by availing of the slot hire facility is an integral part of the contract of carriage of goods by sea without which the business of the assessee would be greatly hampered. Accordingly, income from transactions under Case I shall be covered by Article 9 of the India-UK DTAA.





- Further, in Case II there is some difficulty while evaluating applicability of Article 9 of the India UK DTAA. However, considering the ambit of Article 9 as expounded by the commentaries and the decision of the Delhi HC in the case of KLM Royal Dutch Airlines, Case II would also fall within the ambit of Article 9 of the India-UK DTAA in respect of an enterprise that carries on business of operation of ships in international traffic. However, the benefit would be available only if such an arrangement is ancillary and has nexus to the main business of operation of ships by the enterprise.
- While deciding the issue, Hon'ble HC held that under Article 9 of the India-UK DTAA, income earned by an enterprise of UK from operation of ships in international traffic is taxable only in UK. The phrase 'operation of ships' has not been defined in the said DTAA and, accordingly, by virtue of the definition clause of the India-UK DTAA, the meaning to the term 'operation of ship' as ascribed under the ITA can be considered. Under the ITA, income earned by a non resident ('NR') from the business of operation of ships is taxed on a presumptive basis (i.e. @ 7.5 percent of gross receipts).
- Further, though the phrase 'operation of ship' is specifically not defined under the ITA as well, the income tax provisions which taxes non residents on presumptive basis specifically uses the phrase 'business of operation of ships'. The phrase 'operation of ships' as used in the DTAA and the ITA is in a similar context, namely , 'income' (as used in the DTAA) or 'profits and gains' (as used in the ITA) from 'operation of ships'.
- Therefore, provisions under the DTAA and ITA relate to the same subject and the AO had not disputed that revenue from slot chartering arrangements are taxed on gross basis under section 44B of ITA provisionSec. Hence, under DTAA the term shall be given the same meaning. Consequently, operations of the assessee, including transportation of cargos by hiring the vessel space under SHA will fall within the purview of 'operation of ships' both under ITA and DTAA.
- Further, Article 9 of the India-UK DTAA does not require the ship to be owned by the taxpayer. It merely requires the income to be 'from the operation of ships in international traffic'. There is no warrant for adding the requirement of the ship being owned by the taxpayer. Accordingly, Article 9 of the India-UK DTAA includes within its ambit income from operation of ships 'chartered' or otherwise 'controlled and managed' by the taxpayerSec. Thus, Article 9 of the India-UK DTAA should not be construed in narrow sense to cover taxpayers who own vesselSec.
- Hon'ble HC held that SHAs have been and remain a regular feature of the shipping industry for decadeSec. Enterprises, operating in any mode or manner, do not always ply their own ships all over the globe. Even if they do, their ships may not be readily available when required on a particular route in connection with a contract of carriage of goodSec. It is necessary, therefore, in such cases, to resort to SHAs which enable taxpayers to transport goods in their own name on behalf of their clientSec.

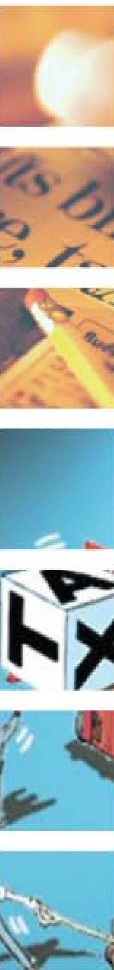
- The contract of carriage of goods by sea is, thus, performed by such enterprises on a principal to principal basis with their clients and not as agents of the owners of the ships and/ or their clientSec. The SHAs are, therefore, at least indirectly, if not directly, connected and interlinked with and are integral to the taxpayer's business of operating shipSec. Without entering into SHAs, the taxpayer, in most cases, would not be able to carry on its business, resulting in a loss of businesSec.
- Even though business expediency is irrelevant for interpretation of the DTAA, it does indicate the close nexus between slot hires and the business of operation of ships in international traffic. If the DTAA is construed to include activities directly or indirectly connected with the operation of ships, it would also include slot charterSec. SHAs have a nexus to the main business of the operation of ships and they are ancillary to and complement to the main operationSec.
- However, the Bombay HC has specifically stated that this decision would not apply to those taxpayers who carry on the business of shipping cargo 'only' by availing the slot hire facilities obtained by them.

## DIT vSec. Guy Carpenter & Co Ltd (Delhi High Court)

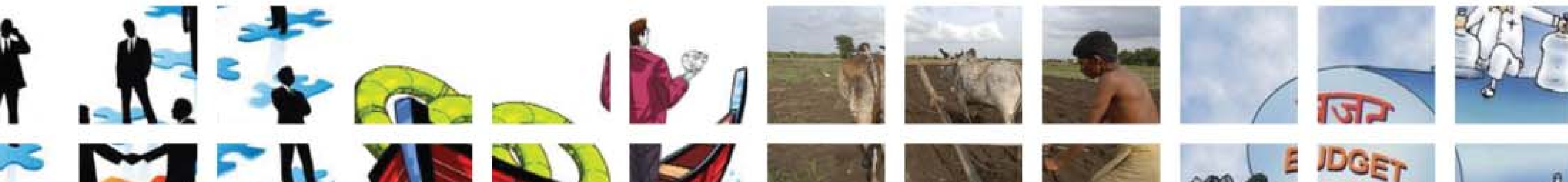
- Commission/brokerage received by an international reinsurance broker not taxable as 'fees for technical services' under Article 13 of India-UK DTAA; To "make available" technical knowledge, mere provision of service is not enough, the payer must be enabled to perform the service himself

  The assessee, a UK based reinsurance broker, received commission from several Indian insurance companies for arranging reinsurance contractSec.

  - The AO held that the commission was assessable to tax in India as 'fees for technical services' (FTS) u/s 9(1)(vii) read with Article 13 of the DTAA. On first appeal, CIT (A) upheld the view of AO. On further appeal to tribunal, it is held that in order to fit the terminology "make available" in Article 13, mere provision of technical services is not enough but the technical knowledge must remain with the payer, and he must be equipped to independently perform the technical function himself without the help of the service provider. It was held that as the nature of services rendered by the assessee was not technical or consultancy services which made available technical knowledge etc to the payer, the commission was not assessable to tax.
  - On appeal by the department, the Delhi High Court held that the tribunal conclusions are based on an assessment of the factual matrix of the case at hand and are factual in nature. As there is no perversity in the findings, it does not give rise to a substantial question of law and hence the revenue appeal is dismissed.







## EKL Appliances Ltd (Delhi High Court)

- **Transfer Pricing: TPO cannot examine the necessity of, or rewrite, the transaction; OECD Guidelines be relied upon as they have been recognized in India's tax jurisprudence, though in a different form.**

  The assessee entered into an agreement pursuant to which it paid brand fee/ royalty to an associated enterprise. The TPO disallowed the payment on the ground that as the assessee was regularly incurring huge losses, the know-how/ brand had not benefited the assessee and so the payment was not justified. On appeal, this was reversed by the CIT(A) and the same was upheld by the tribunal on the ground that as the payment was genuine, the TPO could not question commercial expediency. On appeal by the revenue to High Court, it has been held that the "transfer pricing guidelines" laid down by the OECD make it clear that barring exceptional cases, the tax administration cannot disregard the actual transaction or substitute other transactions for them and the examination of a controlled transaction should ordinarily be based on the transaction as it has been actually undertaken and structured by the associated enterpriseSec.

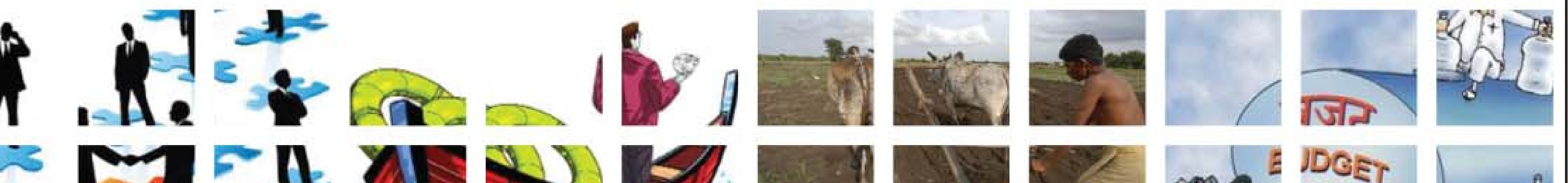
  - The guidelines discourage re-structuring of legitimate business transactions except where (i) the economic substance of a transaction differs from its form and (ii) the form and substance of the transaction are the same but arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner. The OECD guidelines should be taken as a valid input in judging the action of the TPO because, in a different form, they have been recognized in India's tax jurisprudence.
  - It is well settled that the revenue cannot dictate to the assessee as to how he should conduct his business and it is not for them to tell the assessee as to what expenditure the assessee can incur. Even Rule 10B(1)(a) does not authorize disallowance of expenditure on the ground that it was not necessary or prudent for the assessee to have incurred the same.
  - Further, the court held that apart from the legal position stated above, even on merits the disallowance of the entire brand fee/ royalty payment was not warranted. The assessee has furnished copious material and valid reasons as to why it was suffering losses continuously. Full justification supported by facts and figures has been given to demonstrate that the increase in the employees cost, finance charges, administrative expenses, depreciation cost and capacity increase have contributed to the continuous losseSec.

- Further, there is no material brought by the revenue either before the CIT (Appeals) or before the Tribunal or even before High court to show that the figures demonstrate by the assessee are incorrect figures or that even on merits the reasons for the losses are not genuine. Accordingly, honorable upheld the order of tribunal.

## Nokia Networks OY and others

- **Where assessee-foreign company elects to be governed by tax treaty, payments for supply of software is not taxable as 'royalty' by invoking the retrospectively amended provisions of the domestic law.**
  - Nokia Networks OY (the 'Assessee'/ 'Nokia'), incorporated in Finland, is a leading manufacturer of GSM equipment used in fixed and mobile phoneSec. It is also a tax resident of Finland as per India-Finland Double Taxation Avoidance Agreement ('India-Finland tax treaty'). During the previous year relevant to assessment years 1997 - 1998 and 1998 - 1999, Nokia maintained a Liaison Office ('LO') which undertook advertising activities and also had a subsidiary in India, presently known as Nokia India Private Limited ('NIPL'). During this period, Nokia carried out offshore supplies and NIPL undertook onshore services as under:
  - Offshore sale by Nokia - GSM equipment manufactured in Finland was sold to Indian telecom operators outside India on a principal to principal basis, under independent buyer-seller arrangementSec.
  - Onshore services by NIPL - Installation activities were undertaken by Indian subsidiary under its independent contracts with Indian telecom operatorSec.
  - Given the above, the key issues raised before the Delhi High Court were - whether the LO or NIPL constituted permanent establishment ('PE') of Nokia in India and on the taxability of offshore supplies, onshore services and software paymentSec.
  - Relying on the findings of the Delhi ITAT, the Delhi High Court held that in Nokia's case, the LO is neither its business connection nor a PE of Nokia in India. The LO merely carried on advertising activities for Nokia in India. Thus, the LO did not undertake any business activity but its role was limited to assist Nokia in preliminary and preparatory work. The LO did not violate any regulation of the Reserve Bank of India which stipulates that a LO is not permitted to carry out any business activity of a foreign enterprise. While upholding the Delhi ITAT's ruling, the Delhi High Court observed that the finding of facts arrived at by the Delhi ITAT was correct and final and cannot be disturbed by the Delhi High Court especially where there was no evidence with the Revenue Authorities to show that the Delhi ITAT's findings where perverse.





- For Software payments not taxable as 'royalty' under India-Finland tax treaty, as per the Act (as amended by Finance Act, 2012 with retrospective effect from 1 June 1976), the term 'royalty' is defined to mean consideration for transfer of all or any rights (including the granting of any license) in respect of any copyright. It has been clarified that the transfer of all or any right in respect of any right, property or information includes right for use/ to use computer software (including granting of a license) regardless of the medium through which the right is transferred. The India-Finland tax treaty defines the term 'royalty' to mean consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work. The definition of 'royalty' under the India-Finland tax treaty is narrower than the definition provided under the Act. Accordingly, Nokia opted to be governed by the India-Finland tax treaty, it being a tax resident of Finland. Nokia contended that the amendments in the Act cannot be read into a double taxation avoidance agreement relying on the decision of Bombay High Court in case of Siemens Aktiongesellschaftt. The Delhi High Court, in case of Ericsson, on similar facts, has held that payment received by the assessee was towards the title and GSM system of which software was an inseparable parts incapable of independent use and it was a contract for supply of goodSec. Therefore, no part of the payment therefore can be classified as payment towards royalty.
- Considering the above, the Delhi High Court held that a copyrighted article does not fall within the purview of 'royalty' and accordingly not taxable in India.
- For Offshore sale not taxable in India, the Delhi High Court held that income from supply of equipment was not taxable in India because of the following reasons/ observations:
- The places of negotiation, place of signing the contract formal acceptance thereof or overall responsibility of the Assessee are irrelevant circumstanceSec. Since the transaction relates to the sale of goods, the relevant factors and determinative factors are where the property in the goods passeSec. Further, it was observed that the equipment was ready in the premises of the assessee at the time of entering into the contract.
- Even in case of composite contracts, supply would have to be segregated from the installation and only then the question of apportionment would have to be considered having regard to provisions of section 9(1)(i) of the Act.
- Performance of the acceptance test for equipment in India was not material event in passing of title or risk in equipment supplied. The only consequence of the acceptance test was that the operators could call upon Nokia to cure defects by replacing or repairing the defective part. Further, the damages were provided for delay caused on

account of non-compliance of the acceptance test. But there was no right to reject equipment based on acceptance test.

- HC observed that the 'overall agreement' did not result into accrual of income in India. Such agreement was entered into out of commercial considerations, as the Indian operators were desirous of having a single entity contact for liasioning.
- The Revenue Authorities contention that the overall agreement shall be treated as a composite contract and accordingly a 'look at' approach (as per the Supreme Court's Ruling in case of Vodafone should be adopted whereby separate contracts should not be dissected and be treated as a whole was not accepted by the Delhi High Court.
- In respect of NIPL to not constitute a PE, the Delhi High Court did not rule on this aspect and remanded this question back to the Delhi ITAT for consideration.

## Vodafone Essar Gujarat Ltd. V. Department of Income-Tax (GUJ)

- **A demerger cannot be said to be solely motivated by "tax avoidance" merely because scheme transfers only assets of the transferor company without transferring its liabilitieSec. The sanction from High Court cannot be refused on grounds of "tax avoidance" unless tax avoidance is the sole motive**
  - Vodafone Essar Gujarat Ltd ("transferor") filed a Petition u/s 391 to 394 of the Companies Act, 1956 to transfer its 'Passive Infrastructure Assets' to Vodafone Essar Infrastructure Ltd ("transferee") without consideration and without any allotment of shareSec. The corresponding liabilities were not to be transferred. Post de-merger, the transferee was to be made a substantially owned company of a new company to be formed by all or some of the shareholders of the transferee. Thereafter, the transferee was to be amalgamated/ merged into Indus Towers Ltd. The application was opposed by the income-tax department on the ground that since no consideration was involved; the transaction was floated with the sole purpose of avoiding the tax. It was also claimed that the transaction did not fall within the ambit of section 391 to 394. The Company Judge came to the conclusion that:
  - Transaction is void under section 281 of the income-tax Act, 1961.
  - Since the liabilities are not to be taken over nor shares were bring issued, it could not satisfy the condition of demerger and therefore the only option was to transfer it as a gift as a tax planning device. By doing so it is creating a conduit avoiding the capital gain tax at this stage and further in the next stage the transferee is sought to be merged with Indus which transaction will again be exempt under section 47 and thus would be avoiding capital gain tax at that stage as well.

- The transferee was a paper company and that the sole object of the Scheme was to avoid taxes on income, stamp duty and VAT. He accordingly refused to sanction the arrangement.

*On appeal by the Company, it was held reversing the Company Judge that:*

- The Scheme cannot be said to have no purpose or object and that it is a mere device/ subterfuge with the sole intention to evade taxeSec. While it is true that the Scheme may result into tax benefit or saving of tax or into tax avoidance, it cannot be said that the only object of the Scheme is tax avoidance. Tax planning may be legitimate provided it is within the framework of law [Vodafone International Holdings B.V v. Union of India and Another [2012] 341 ITR 1 (SC)].
- The Revenue's argument that the transfer is void for want of consideration is not acceptable because it is not a party to the transaction. Even a consideration of one rupee can be said to be a valid consideration and it is not necessary that consideration is always a monetary consideration. In a reconstruction there is a give and take and mutual/reciprocal promises and obligations, which can be said to be consideration for each other. Even the most trifle benefit can be consideration so as to avoid the impact of section 25 of the Contract Act. There is no requirement for monetary consideration and even a promise to induce the company to carry on its business could be considered as sufficient consideration.
- Further based on judicial comity and principles of parity, since the other Courts had sanctioned identical Schemes, consent to the Scheme is given.

Note: This High Court judgment coupled with the Expert Committee report on General Anti-Avoidance Rule (GAAR), could act as a breather for the Assessee at large to demonstrate that even a transaction which is permissible under the law and which provides a tax benefit to the Assessee should not fall within the purview of GAAR.

## DIT v. Chiron Bearing GmbH & Co.

**Facts of the case :**

- The taxpayer, a foreign limited partnership, claimed the benefit of Article 12(2) of the tax treaty between India and Germany in respect of royalties and FTS in its return of income for the A.Y. 2002-03. The Assessing Officer (AO) held that the taxpayer, being a limited partnership, was not eligible to claim the benefit of the tax treaty since it was not liable to tax in Germany.

- The Commissioner of Income-tax (Appeals) [‘CIT (A)’] held that the taxpayer was paying trade tax in Germany. Trade tax can be defined as a tax paid on the profit of the business and is covered by Article 2 of the tax treaty. TRC (Tax Residency Certificate) issued by the German tax authorities were also taken into consideration and thus, the CIT (A) held that the taxpayer is entitled to claim the benefit of lower rate of tax in respect of royalties and FTSec.
- The findings of CIT (A) were upheld by the Tribunal.

**High Court Decision:**

- The High Court referred to Article 12 of the India – Germany tax treaty. Article 12 of the tax treaty says that royalty and FTS received in India by a person resident outside India are not liable to tax in India in excess of 10 percent of the gross amount received.
- Examination of the treaty clarified that the trade tax paid in Germany is one of the taxes to which tax treaty applieSec.
- ‘Person’, as per Article 3(d) of the tax treaty, includes any entity treated as a taxable unit in Germany. 'Resident' in terms of Article 4 of the tax treaty means ‘any person who is liable to tax by reason of his domicile, residence, place of management or any criterion of a similar nature under the laws of Germany.
- The CIT (A) and the Tribunal found that taxpayer was filing trade tax return in Germany and therefore was paying tax to which the tax treaty applieSec. Also, it was seen in the TRC that the taxpayer was considered as a taxable unit under the taxation laws of Germany. Therefore, the tax treaty was applicable to the taxpayer and the benefit of Article 12(2) of the tax treaty could not be denied.
- Thus, as per the tax treaty, the taxpayer is eligible for the benefit of lower tax rate on royalty and FTS earned in India.

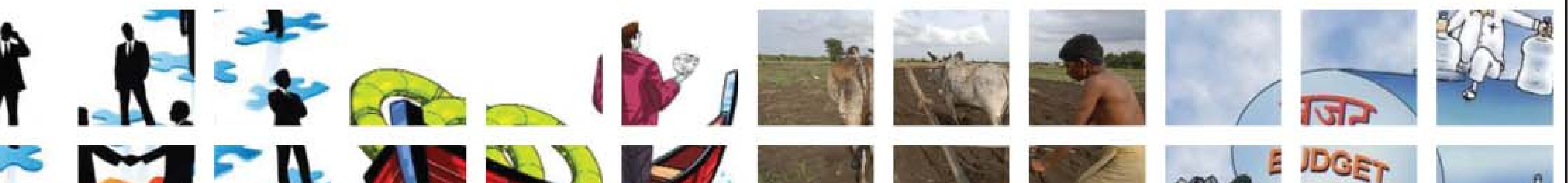
## INCOME TAX APPELLATE TRIBUNAL

**Allianz SE (Formerly known as Allianz AG) Vs Asst. Director of Income-tax (Pune ITAT)**

- **License charges received for transfer of ‘user right’ in software not taxable as ‘royalty’ as it is for use of a copyrighted article and not for use of the copyright itself; Ruling in favour of the assessee to be preferred in case of conflicting rulings from different HCs**

  The appellant, Allianz SE, a company incorporated in Germany and engaged in the business of providing insurance and other financial services, entered into a software license agreement for OPUS software with its two Indian affiliates viz. Bajaj Allianz Life Insurance Company





Ltd. and Bajaj Allianz General Insurance Company Ltd. and received license charges from them. OPUS software is an insurance business software solution, based on Global Insurance Operating Software (GIOS software). GIOS is software used by insurance companies across the world and its copyright is owned by its developer, CGI Group (Europe) Ltd. The Allianz SE Group acquired the user rights of GIOS software from CGI. It extended the functionality of certain modules of GIOS to suit the business requirements of its group companieSec. This was referred to as 'OPUS Software' which could not be used independent of GIOS software. Under the license agreement, the appellant granted to its Indian affiliates a simple, non-exclusive and non-transferrable right to use the OPUS software for unlimited number of personal computerSec. Further, the Indian affiliates were authorized to modify/customize the software to meet the local requirementSec. However under the agreement, they were prohibited from selling, renting or leasing the software. Further, under the 'confidentiality' clause of the agreement, the Indian affiliates had also agreed not to share any information/ knowledge regarding software with the third partieSec.

- The appellant contented that the license charges received from Indian affiliates is for the use of OPUS software i.e. use of a copyrighted article and not for use of the copyright itself therefore it should be treated as business profits and thereby claimed as exempt from tax as there was no PE.
- The Assessing officer held that the license charges received by the appellant was taxable as royalty u/s 9(1)(vi) of Income Tax Act, 1961 as well as India-Germany tax treaty. The Assessing officer contended that Indian affiliates were using the software for business purposes and hence, it amounted to commercial exploitation of the software. On appeal to before tribunal, it upheld the view of the assessee and held that the software license fees was received by the assessee for grant of use of a copyrighted article and not for use of the copyright itself and therefore, it could not be taxed as royalty under ITA as well as India-Germany DTAA.
- Though there were contrary views on the above issue by different High Courts, the Pune ITAT in line with the recent judgement of Mumbai ITAT, upheld the view favourable to the assessee.

## Armayesh Global v ACIT (Mum)

- **Payment made to overseas commission agent – whether managerial fees**

The taxpayer, a firm engaged in the business of manufacturing and exporting of hand embroidery and handicraft items was using the services of an overseas commission agent for executing export sales in several other countrieSec. The agent was paid commission only on actual export sales executed for customers routed through it without deduction of tax at source.

- The AO opined that the services rendered by the agent were managerial in nature and the taxpayer was liable to deduct tax, thereby making disallowance under section 40(a)(i) of the Act to the extent of payment made. On appeal to the CIT(A) upheld the disallowance made by the AO holding that the overseas agent was providing composite services comprising commission agency as also services for promoting sales of the taxpayer in foreign countries and, thus, the payment fell within the meaning of 'fees for technical services'.
- On appeal to the Tribunal held that the overseas agent did not render any service in India and had no Permanent Establishment in India. The orders were sent directly by the foreign purchasers and the payment for export was received by the taxpayer in foreign currency directly from foreign purchasers and the commission was paid to the overseas agent thereafter as a percentage of sales in terms of the agency agreement. The payment made to overseas agent was not for any technical / managerial serviceSec.
- Therefore, in the absence of any service having been rendered in India, no part of the commission paid to the overseas agent could be said to be chargeable in India and therefore, no disallowance was called for.

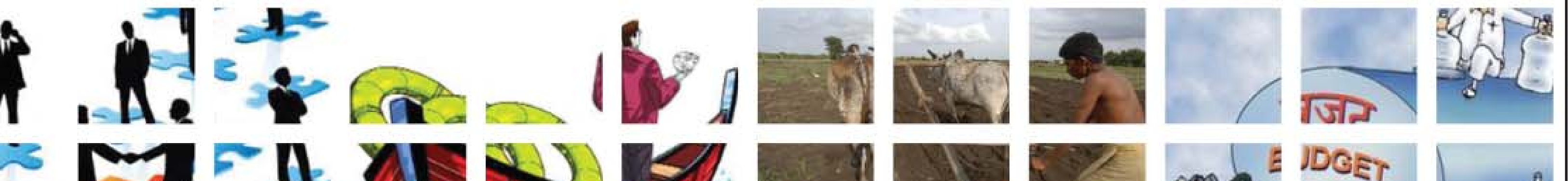
**Dy. Director of Income – Tax Vs M/s Sumitomo Mitsui Banking Corporation (ITAT Mumbai)**

- **While interest paid by PE of foreign bank to H.O. is deductible in hands of PE, same interest is not taxable in hands of H.O.**

  The assessee, a Japanese bank, carrying on business through a PE in India, paid interest of RSec. 5 crores to its H.O. & other brancheSec. The assessee, in computing the profits assessable to tax in India, claimed that while the interest received by the H.O. & other branches from the PE was not chargeable to tax in India on the principle that the PE & H.O. were one & the same entity, the PE was entitled to claim a deduction under Article 7 of the DTAA.

  - The AO held that the PE & the H.O. were deemed to be separate entities and that while the interest received by the H.O. from the PE was taxable under Article 11, deduction for that interest could not be allowed to the PE u/s 40(a)(i) as it had failed to deduct TDSec. The CIT (A) followed the verdict of the Special Bench in ABN Amro Bank 98 TTJ 295 (Kol) (partly affirmed in ABN AMRO 198 TM 376) and held that the interest was neither chargeable to tax nor allowable as a deduction.
  - On appeal to the Tribunal, the matter was referred to a 5 Member Special Bench and held by the Special Bench that in view of all the facts of the case and the legal position mandating from the interpretation of the relevant provisions of domestic law as well as





that of the treaty, we are of the view that although interest paid to the head office of the assessee bank by its Indian branch which constitutes its PE in India is not deductible as expenditure under the domestic law being payment to self, the same is deductible while determining the profit attributable to the PE which is taxable in India as per the provisions of article 7(2) & 7(3) of the Indo- Japanese treaty read with paragraph 8 of the protocol which are more beneficial to the assessee.

- The said interest, however, cannot be taxed in India in the hands of assessee bank, a foreign enterprise being payment to self which cannot give rise to income that is taxable in India as per the domestic law. Even otherwise, there is no express provision contained in the relevant tax treaty which is contrary to the domestic law in India on this issue. This position applicable in the case of interest paid by Indian branch of a foreign bank to its Head Office equally holds good for the payment of interest made by the Indian branch of a foreign bank to its branch offices abroad as the same stands on the same footing as the payment of interest made to the Head Office.
- Having held that the interest paid by the Indian branch of the assessee Bank to its head office and other branches outside India is not chargeable to tax in India, it follows that the provisions of section 195 would not be attracted and there being no failure to deduct tax at source from the said payment of interest made by the PE, the question of disallowance of the said interest by invoking the provisions of section 40(a)(i) does not arise.

**Manpreet Singh Gambhir Vs Deputy Commissioner of Income-tax (ITAT Delhi)**

- Assessee can avail proportionate credit of taxes paid in foreign country

  The assessee received salary income from India as well as from USA. The assessee has received salary of RSec. 7,22,850/- in USA and paid tax in USA of RSec. 2,36,406/- i.e. 1,75,739/- as a Federal income tax and 60,667/- as a State income tax. The Assessee claimed a deduction of RSec. 4,54,555/- u/s 80RRA from the salary income received from USA of RSec. 7,22,850/- while filing the return of income in India and claimed full tax credit of RSec. 2,36,406/- paid in USA.

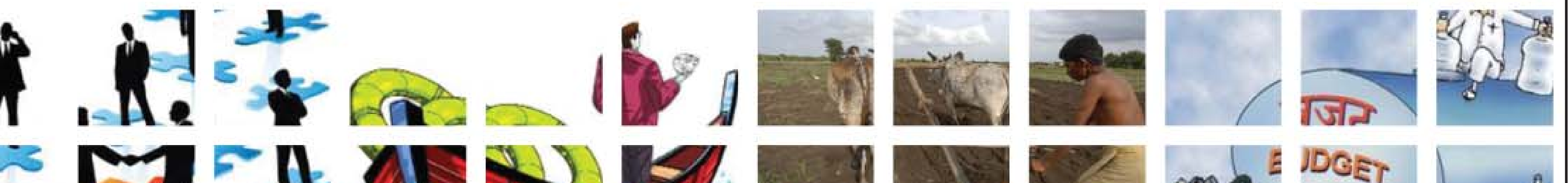
  - The Assessing Officer allowed credit of taxes paid in USA to the extent the tax was attributable on the Income-tax in USA. The income so worked out by Assessing Officer after allowing deduction of RSec. 4,54,555 under section 80RRA stood at RSec. 2,68,260 and tax attributable to income of RSec. 2,68,260 in USA was computed at RSec. 80,478 only.

- The Assessing Officer allowed credit of this tax to the appellant as per Article 25(2)(a) of the Double Taxation Avoidance Agreement between India and USA. On appeal before the CIT (Appeal) for not allowing the full credit of tax paid in USA of RSec. 2,36,406/-, CIT(Appeal) upheld the order of assessing officer. Further on appeal before the tribunal, it was held that the assessee can get only proportionate tax credit to the extent of income is taxable in India after claiming the deduction u/Sec. 80RRA and which was correctly calculated by the assessing officer.

**RBS Equities (India) Ltd vSec. ACIT (ITAT Mumbai)**

- Simple average and not weighted average is to be adopted for determining arm's length price. When data for internal CUPs are available for the comparability analysis, CUP should be the most appropriate method
  - The assessee was engaged in the business of broking and trading in shares as a corporate member of Bombay Stock Exchange and National Stock Exchange. For AY 2003 - 2004 and AY 2005 - 2006, the assessee provided stock broking services in respect of clearing house trades to its FII Associated Enterprise ('AE') in MauritiuSec. It earned brokerage for such services @ 0.24 per cent.
  - On reference to the TPO, he noted that the assessee had transacted with both Foreign Institutional Investors (FIIs) and Financial Institutions (FIs) and the average brokerage charged from top 10 FII clients was 0.40 per cent. Since the rate charged to the FII AE was much lower than the average rate charged to other FIIs, the TPO made an addition to the assessee's income. According to the TPO, since the assessee was undertaking trades for AEs and foreign FIIs, who were operating from the similar geographical regions, without being present in India, their perception of the Indian Market in terms of risks and rewards would be the same. Therefore, the TPO was of the view that there were no material differences and rejected the contention of the assessee that CUP method was not the most appropriate and since internal comparables were available and the data maintained by the assessee for such uncontrolled transaction would be more complete and reliable, the TPO rejected TNMM method adopted by the assessee in determining arms length price. The TPO also rejected the assessee's claim for volume adjustment, holding that it had not been able to substantiate that its AE had 'committed' any volume of transaction with it.
  - The assessee preferred an appeal before the CIT (A) against the order passed by the AO u/s 143(3) contending that TNMM method as applied by it for transfer pricing study was most appropriate method and the TPO was not justified in adopting CUP method for determining the arm's length brokerage rate. Without prejudice to this





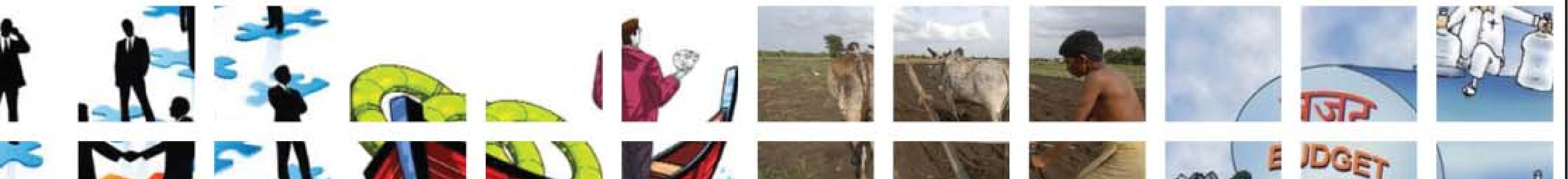
main argument, it was submitted on behalf of the assessee that even if CUP method was to be considered as the most appropriate method, volume adjustments should have been provided by the TPO. It was further submitted that there was an error in the working of the TPO in as much as simple average of brokerage rates was taken into consideration by him for determining the arm's length brokerage rate instead of weighted average. The CIT (A) upheld the additions made by the AO. He held that the facts and circumstances of the assessee's case fully justified adoption of CUP method for TP analysis and the TPO was fully justified in not allowing any volume adjustment in the facts of the assessee's case. As regards the claim of the assessee for adoption of weighted average arithmetical mean instead of simple average arithmetical mean, the CIT (A) held that what is contemplated in the statute is adoption of arithmetic mean only and the concept of weighted average is not recognized by the statute.

- Regarding the method to be adopted for comparability analysis, the learned Bench of the Tribunal held that CUP is the most appropriate method in the facts and circumstances of the case including especially when the data for internal CUPs is available for the comparability analysiSec. As regards the claim of the assessee for adopting weighted average arithmetic mean of brokerage rate of 10 FIIs as against simple average arithmetic mean of such rates taken by the TPO, it was held that the first proviso to section 92C speaks about taking arithmetic mean of more than one ALPs determined by the most appropriate method and there is nothing to suggest that volume of the relevant transactions also has to be taken into consideration for the purpose of computing such arithmetic mean.
- Further regarding the adjustments claimed by the assessee for marketing function, for research functions and for differences in volumes, the ITAT after holding that comparable uncontrolled price is required to be adjusted as per Rule 10B(1)(a)(ii) to account for difference, if any, between the international transaction and the comparable uncontrolled transaction which could materially affect the price in the open market remitted the matter back to the AO with a direction to consider such claims after verifying the details and documentary evidence furnished by the assessee.
- Separately, ITAT also upheld the disallowance made by the AO in respect of advances written off. ITAT held that the amount was neither allowable as bad debts nor business losSec. ITAT also directed the AO to re-compute disallowance u/s 14A on a reasonable basiSec.

## GAP International Sourcing (India) Pvt Ltd.

- **ITAT upheld appropriate PLI will be the net profit /total cost and not the percentage of FOB value of goods sourced by AE.**
  - The assessee, GAP International Sourcing (India) Pvt. Ltd, is a wholly owned subsidiary of GAP International Sourcing Inc, USA and is engaged in facilitating sourcing of apparel merchandise from India for the GAP Group. The assessee for the AY 2006 - 2007 and AY 2007 - 2008, had adopted TNMM with cost plus 15% remuneration for computing ALP. The TPO, on the grounds that the assessee had borne substantial risks and had developed intangible assets in the form of supply chain, human intangibles etc disregarded the FAR profile of the assessee and rejected the assessee's claim of cost plus 15% ALP. He further held that commission at 5% of the FOB value of goods by the AE through Indian Venders was the most appropriate PLI for determining ALP and made upward adjustmentSec. The TPO also stated that since the assessee operated in a low cost economy, the location savings generated should included in the remuneration model of the appellant.
  - On the above, the assessee filed its objections with the DRP. The assessee stated that it operated as a limited risk bearing support service provider and strictly performed low routine and value adding activitieSec. Its AE had borne all the relevant risks in connection with undertaking operations related to the business and thus no risk was attributable to the assessee. In addition, the assessee also contended that the AE provided information to it about the vendor lists, business information, etc relating to sourcing activitieSec. The qualifications of the employees deployed by it were general and routine in nature. There was no decision making or entrepreneurial role embedded in the work profiles of the employees employed Thus the relevant intangible assets like vendor lists, business information, human intangibles, etc required for the business were developed and owned by the AE and not the assessee. Further, in context of selecting the PLI as operating profit/total cost the assessee stated that its only costs were operating costs/ value added cost as it did not pay for the price of the goods sourced by GAP group and therefore, never carried the cost in relation to price of goodSec. Thus the PLI used by it in its own case is actually, OP/TC since its total value added cost is equal to the total cost. The assessee also stated that to survive in the stiff competition the advantage of location savings is passed onto the end customer in the form of low sales priceSec. Therefore, there is no question of any allocation attributable for location savings to it since the assessee had no role in the sale priceSec. On hearing upon the assessee and the TPO the DRP affirmed with the view of the TPO and made similar adjustmentSec. Hence the assessee was in appeal before the ITAT.





- In a sweeping manner the ITAT held that as functions follows risks and since the handbook and guidelines clearly stated that the assessee had no discretion or wisdom in carrying out key functions it had not borne consequent risks as well. Further ITAT also upheld the contentions of the assessee that routine activities carried out by the assessee under the instructions of the AE did not lead to the creation of any intangibles in the form of human asset or supply chain. Further, the ITAT accepted assessee's argument that the intent of sourcing from low cost countries for a manufacturer / retailer is to survive in stiff competition by providing a lower cost to its end-customerSec. The arm's length principle requires benchmarking to be done with comparables in the jurisdiction of tested party and the location savings, if any, would be reflected in the profitability earned by comparables which are used for benchmarking the international transactionSec. Thus in view of the ITAT, no separate / additional allocation is called for on account of location savingSec. Regarding the selection of PLI the ITAT held that PLI used should not lead to manifestly absurd results, so as to put one of the parties to transactions at abnormally higher profitability and the other party at significant losSec. If a particular PLI results in abnormal results then one should move on to choose a method and PLI which provides rational resultSec. Absurd and distorted (results) lead to create aberrations in dispensation of tax administrationSec. They reflect an adversarial approach on the part of administrators which best should be avoided. ITAT ruled that the PLI of percentage of FOB value of goods procured by parent results in net profit / total cost of assessee at 830 per cent and 660 per cent for AY 2006 - 2007 and AY 2007 - 2008. The use of this PLI has resulted in absurd and distorted resultSec. The PLI and percentage proposed by department as the arm's length price may have demanded consideration provided it produced procurement service provider comparables which follow percentage based model and at the same time end up earning exorbitant mark-up over costSec.

**DDIT, Circle 3(2), (DEL) vSec. M/S Mitchell Drilling International Pty. Ltd.**

- Service tax cannot be included in the total receipts for determining the presumptive income under section 44AB.
    - The assessee, a company incorporated in Australia providing equipment on hiring and manpower etc. for exploration and production of mineral oil and natural gas received the following amounts from its customers in India:

| Sr. No. | Particulars | Amount (in RSec.) |
|---|---|---|
| 1. | Income from drilling operations | 13,95,28,845 |
| 2. | Income from exploration of Mineral Oil | 2,40,33,727 |
| 3. | Reimbursement of mobilization expenses | 1,00,86,965 |

- The assessee offered its income to tax on gross basis under sub-section (1) of section 44BB and 10 per cent of the gross receipts was deemed to be the income chargeable to tax. However, while computing its total income, it did not include the amount of RSec.2, 09, 24,553/- in the gross receipts, being service tax received from its customerSec. The Assessing Officer rejected the contention of the assessee and added the amount of service tax collected by the assessee to its gross receipts to compute its total income.

- The assessee took up the matter in appeal. The CIT(A) upheld the appeal on the basis of the facts that the assessee being a service provider acts as an agent of the government in collecting service tax on its behalf and thus does not form part of the assessee's income. Aggrieved by the order of the CIT (A), the department appealed before the ITAT.

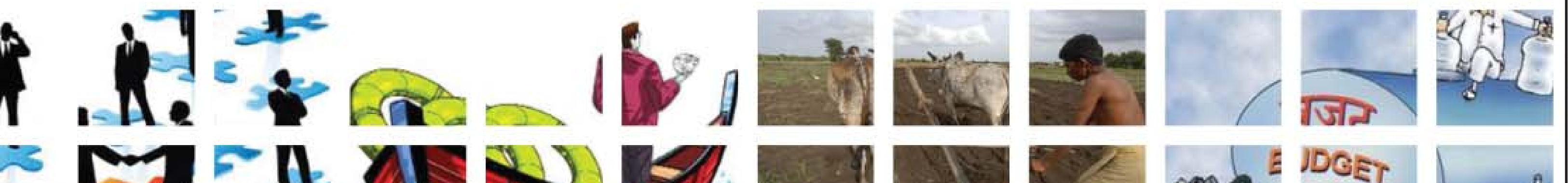
- ITAT held that section 44BB is a special provision, whereby 10% of the aggregate amount specified in sub-section (2) of section 44BB as deemed profits and gains of the non-resident. The ITAT relied upon the decision of Uttarakhand High Court in DIT & Anr. v. Schlumberger Asia Services Ltd., 317 ITR 156 (Uttarakhand) in which it is held that custom duty being a statutory liability cannot form part of assessee's deemed profits u/s 44BB. It held that service-tax is a statutory liability like custom duty and reimbursement of custom duty & service-tax paid by the assessee cannot form part of amount for the purpose of deemed profits u/s 44BB as it does not involve any element of profit. It also relied upon the decision of 'G' Bench of the ITAT in the case of Sedco Forex International Drilling Inc. vSec. Addl. DIT (International Taxation) which holds the same view in a similar issue. Accordingly, it cannot be included in the total receipts for determining the presumptive income.

## Prudential Assurance Co. Ltd. vSec. ADIT (ITAT MUMBAI)

- **Section 90(2): Assessing Officer ('AO') cannot thrust provision of DTAA on an assessee, who has chosen to be governed by the provision of income-tax act, 1961 ('Act').**

  - The assessee is a foreign company having residential status of 'non-resident' is engaged in portfolio investment in India. The assessee for the AY 2003 - 2004, disclosed loss from sale of shares in the return of income at Rs 48.80 crore falling under the head 'profits and gains of business or profession' and thereafter claimed set-off of such loss under





the head 'Income from other sources' amounting to Rs 12.57 crore, thereby declaring total loss of Rs 36.22 crore eligible for carry forward to subsequent years as per the provisions of the Act. The treatment of negative income from sale of shares falling under the head 'Profits and gains of business or profession' was done in conformity with the ruling rendered by the Authority for Advance Rulings ('AAR') in assessee's own case holding that the profits arising from realization of portfolio investments in India will be treated as part of company's business profitSec.

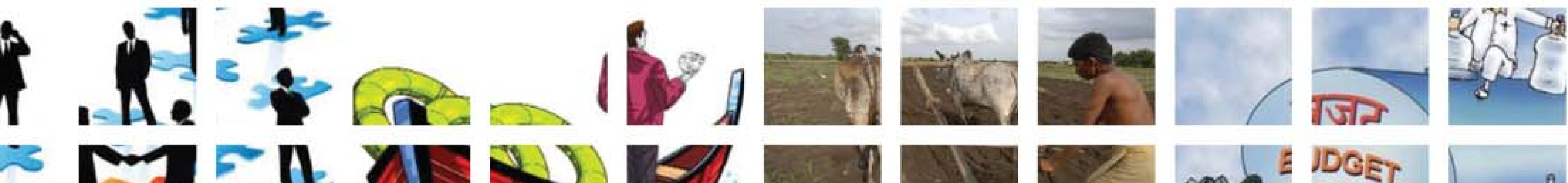
- As the AO did not allow the carry forward of the unabsorbed business loss in the original assessment order, the assessee filed application u/s 154. During the pendency of such application for disposal, the AO initiated reassessment proceedings by issuing notice u/s 148 relying on the subsequent ruling of the AAR in the case of Fidelity Northstar Fund, which clarified the law on the subject as to the taxability and nature of income as applicable to the facts of the assessee as well and held that the profits derived on account of purchase and sale of equities is 'Capital Gain' and chargeable to tax accordingly. Once such loss was considered under the head 'Capital gain', there was no question of allowing set off of such loss against 'income from other sources'.
- The Director of Income Tax ('DIT') initiated the proceedings u/s 263 of the Act for AY 2004 - 2005 and 2005 - 2006 on the similar grounds on which the AO initiated proceedings u/s 147 for the instant year. The assessee filed writ petition before the Bombay High Court ('HC') against the initiation of proceedings u/s 263 in respect of the subsequent two assessment yearSec. The question before the Bombay HC was – Whether any subsequent ruling has the effect of overruling the ruling given in assessee's own case which ceases to be applicable any more.
- The Bombay HC held that any ruling given in a particular case cannot be characterized as suffering from any infirmity by reason of some other ruling rendered in another case or otherwise, unless the procedure under Rule 18 of the Authority for Advance Rulings (Procedure) Rules, 1996 is adopted. It is only the authority who is competent to modify the ruling laid down by it. Such modification may be done by the authority suo motu or on application filed by the assessee or the department.
- In this view, the ruling in case of Fidelity Northstar Fund cannot displace the binding character of advance ruling rendered in assessee's own case. On the basis of Bombay HC judgment for the AY 2004 - 2005 and AY 2005 - 2006, the AO in the AY 2003 - 2004, held that the loss from sale of equities was correctly declared under the head 'profits and gains of business or profession'. However, he held that since the assessee had no PE in India in the previous year relevant to the assessment year under consideration, such business loss which was set off against the 'Income from other sources' by applying the provisions of section 71 of the Act, was incorrect.

- On appeal, the question raised was – Whether the assessee, who is a non-resident, is bound by the DTAA or can choose to be governed by the provisions of the Act. The Mumbai ITAT held that – Section 90(2) of the Act, clearly indicates that the DTAA is entered into between two countries 'for granting relief of tax'. Secondly, the manner of granting relief is also enshrined in the provision itself which states that 'provisions of this Act shall apply to the extent they are more beneficial to that assessee'. Ordinarily, but for such provision, an assessee to which the DTAA applies shall be subjected to tax in India as per the provisions of the Act. If, however, the provisions of the DTAA are more beneficial to the assessee, then such provisions, shall override the corresponding provisions of the Act. Thus if the income itself is not chargeable to tax under the Act, then the DTAA cannot create a liability to tax by roping in such income under any of its relevant articleSec. Further, from the prescription of section 71, it is palpable that there is no bar in allowing set-off of loss under the head 'Profits and gains of business or profession' against income under the head 'Income from other sources'. This section applies to all assessee's, whether resident or non-resident, as long as income of non-resident assessee is computed under the provisions of the Act.
- In view of the above, it becomes manifest that the statute by way of section 90(2) has itself given an option to an assessee to be ruled either by the Act or the DTAA, whichever is more beneficial to him. Such an option lies with the assessee and not with the revenue. In the present case, assessee has chosen to be covered under the Act. The AO cannot thrust the provision of DTAA on an assessee, who has chosen to be governed by the Act.

**P.Sec.I. Data System Ltd**

- **Payment made by assessee to non-resident for purchase of software would constitute "royalty" under section 9 hence liable to deduct tax at source**
  - The Bangalore Income-tax Appellate Tribunal held that the assessee is not liable to deduct tax at source in respect of payments made for purchase of software as the same cannot be treated as income liable to tax in India as royalty or scientific work under section 9 of the Income-tax Act, 1961 read with Double Taxation Avoidance Agreements and treatieSec.
  - On appeal by the Revenue, the Karnataka High Court following the Judgment in case of Samsung Electronics Co Ltd and in view of retrospective amendment in section 9 Explanation 4 and explanation from 1 June 1976, decided the issue in favour of the Revenue. The Karnataka High Court held that the assessee is liable to deduct tax at source.





**BNP Paribas SA V. DY Director of income-tax (international taxation) (MUM) (TRIB)**

- **Interest paid by the Indian Branches of the assessee bank to its head office and other overseas branches cannot be taxed in India being payment to self which did not give rise to taxable income in India**

  - The assessee was a commercial bank having its head office in France. It carries on the normal banking activities in India through its eight branches in India. The assessee paid interest to the branches to head office and overseas branches and claimed as deduction while determining the profits attributable to the Indian brancheSec. The AO treated the interest paid by Indian branches to head office and overseas branches as income chargeable to tax in India and, accordingly, made addition. Further, on appeal, the assessee contended that the Head office of the assessee bank as well as all its branches being the same person and one taxable entity as per the Indian Income-tax Act, interest paid by Indian Branches to head office and other overseas Branches was payment to self, which did not give rise to any income as per the Income-tax Act. However, the CIT (A) upheld the order of AO.

  - On appeal to the Tribunal, it was held that the issue involved in this appeal of the assessee now stood squarely covered by the decision of Special Bench of the ITAT in the case of Sumitomo Mitsui Banking Corporation. v. Dy. DIT [2012] 136 ITD 66 (Mum) (SB) wherein it was held, after elaborately discussing the legal position emanating from the interpretation of relevant provisions of Indian Income-tax Act as well as treaty, that interest paid to the head office of the assessee bank as well as its overseas branches by the Indian branch cannot be taxed in India being payment to self which does not give rise to income that is taxable in India as per the domestic law or even as per the relevant 'tax treaty'.

  - Hence, the Tribunal respectfully followed the said decision of Special Bench of the Tribunal which was directly applicable to the present case and deleted the addition made by the AO.

## ADIT vSec. Mediterranean Shipping Co. Sec.A (ITAT Mumbai)

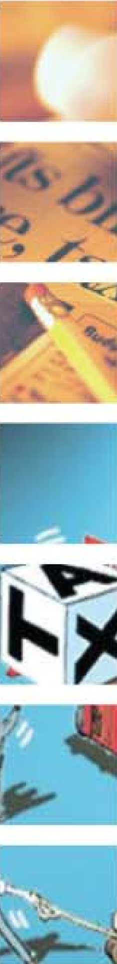
- **Shipping Profits Earned by Swiss Company Shall Not Be Taxable in India in View of Indo-Swiss DTAA**

  **Facts of the Case :**

  - The assessee in the present case is a Company incorporated in Geneva (Switzerland) engaged in the business of operations of ships in international waterSec. During the year under consideration, the assessee had total collection of freight amounting to

RSec.295.63 crores on account of exports/imports however in the return of income the assessee declared total income at Nil on the grounds that Article 7 of the Indo-Swiss DTAA dealing with business profits specifically excluded profits from the operation of ships in international traffic. Also, Article 22 of the said DTAA dealing with other income subjected to tax shipping profits only in the State of residence viz. Swiss confederation. The stand of the assessee thus was that the international shipping profit was not taxable in India and the entire tax paid was liable to be refunded.

- This stand was not accepted by the AO in view of the CBDT Circular No. 333 dated 02-04-1982 whereby it was clarified that where there is no specific provision in the agreement, it is the basic law, the Income Tax Act, which will govern the taxation of income. Thus the AO contended that the profits were taxable in India u/s 44B of the Act.
- Certain information of the assessee was forwarded by ACIT, Mumbai to AO, gist of which is as under:
  - M/s Samsara Shipping Private Limited is the shipping agent for multinational companies, one of them being M/s Mediterranean Shipping Co. Sec.A., Switzerland.
  - From AY 03-04 M/s Mediterranean Shipping Corporation has appointed another agent namely, M/s MSC Agency India Pvt. Ltd.
  - The entire business of M/s Samsara Shipping Pvt. Ltd. has been taken over by M/s MSC Agency India Pvt. Ltd. which means that M/s Samsara Shipping Pvt. Ltd. is not an independent agent of M/s Mediterranean Shipping Co., Sec.A.
  - It also does not have any control over the Management, Finances and Administration of their Company which makes it a permanent establishment of M/s Mediterranean Shipping Co., Sec.A.
- In view of the above, profits calculated at 7.5% of the total collection of freight was brought to tax in India by the AO in the hands of the assessee u/s 143(3).



### Tribunal's Ruling :

- The Tribunal is of the view that the right or property in respect of which the shipping income is earned by the assessee i.e. ships cannot be said to be effectively connected with the permanent establishment in India. Such income, therefore, will not fall under Article 22(2) but will fall under Article 22(1) and accordingly shall be taxable only in the State of residence of the assessee company i.e. Switzerland and not in India.

- Article 22 (1) provides that such items of income of a resident of Switzerland shall be taxable only in that State "which are not dealt with" in the foregoing Articles of the DTAA. The department's argument that by agreeing to exclude shipping profits from Article 8 as well as Article 7 of DTAA, it has been "dealt with" and, therefore, Article 22(1) shall not apply is not correct. The expression "dealt with" contemplates a positive action and it is necessary that the relevant Article must state whether Switzerland or India or both have a right to tax such item of income. To avoid inference by implication, vesting of such jurisdiction must positively and explicitly be stated. It is also the view of the Competent Authorities that shipping profits would be governed by Article 22 & not sec. 44B of the Act.
- The agent was legally and economically dependent on the assessee and the assessee, through the said agent, also managed and controlled some of its business operations in India and hence the agent did constitute a PE as per Article 22(2). However, the property in respect of which the shipping income was received by the assessee was not "effectively connected" with the PE. To apply the concept of "effectively connected with" economic ownership has to be taken as the criteria. It cannot be said that the property in the said ships is "effectively connected" with the PE in India since the economic ownership of the ships cannot be allocated to the PE but always remained with the assessee.

## eBay International AG vSec. ADIT (ITAT Mumbai)

- **What Constitutes a "Dependent Agent Permanent Establishment (DAPE) "& "Place Of Management (POM)"**

  **Facts of the case :**

  - The eBay AG is a company incorporated under the law of Switzerland and is a tax resident of Switzerland. The return of income was filed declaring RSec. NIL as total income. Such return was accompanied by a note, inter alia; stating that during the previous year relevant to assessment year under consideration eBay AG operated India specific websites providing an online platform for facilitating the purchase and sale of goods and services to users based in India.
  - eBay AG entered into a Marketing Support Agreement with eBay India Private Limited ( `eBay India') and eBay Motors India Private Limited (`eBay Motors') which are eBay group companies, for availing certain support services in connection with its Indian specific websiteSec. The assessee, eBay AG earned revenue amounting to RSec. 4,94,27,530/- from the operations of its websites in India. It was claimed that such

revenue is taxable as business profits in India as per the provisions of Article 7 of the Double Taxation Avoidance Agreement between India and Switzerland (`the DTAA') only if it has a Permanent Establishment (`PE') in India as per the provision of Article 5 of the DTAA. It was claimed that assessee did not have any PE in India and as such no amount was taxable. During the course of assessment proceedings, the Assessing Officer (`the AO') observed that the assessee signed agreements with eBay India and eBay Motors for providing certain services to it in respect of its Indian specific operationSec.

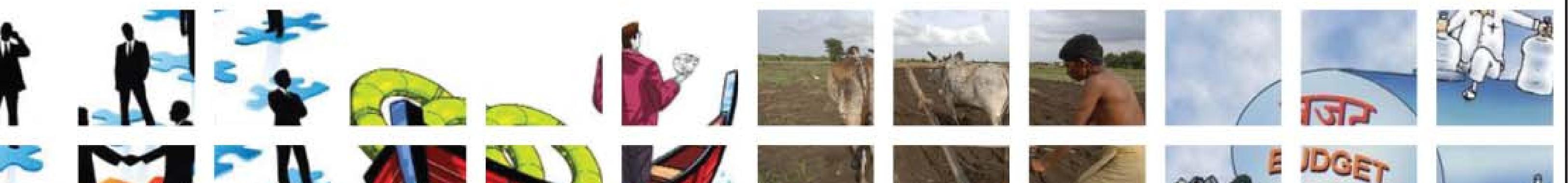
**Analysis of the case :**

- In order to constitute a "DAPE" of the assessee under Article 5(5) of the DTAA, it is essential that the agent should "habitually exercise an authority to negotiate and enter into contracts for or on behalf of the assessee". On facts, though eBay India & eBay Motors conducted activities exclusively on behalf of the assessee and thus became its dependent agents, they did not constitute a "DRPE" because they did not conduct any of the activities set out in the three clauses of Article 5(5) of the DTAA. By simply providing marketing services to the assessee or making collection from the customers and forwarding the same to the assessee, it cannot be said that eBay India entered into contracts on behalf of the assessee. There are also no examples of any contract entered into by eBay India or eBay Motors for or on behalf of the assessee. Thus the test laid down in Article 5(5)(i) of the DTAA is not satisfied.
- eBay India & eBay Motors also do not constitute a "PoM" so as to be a PE under Article 5 (2)(a) of the DTAA. A "PE" ordinarily refers to a place where overall managerial decisions of the enterprise are taken. eBay India & eBay Motors are not taking any managerial decision. They are simply rend marketing services to the assessee in the form of collection of amount from the customers and remitting the same to the assessee, apart from creating awareness amongst the Indian sellers about the availability of the assessee's websites in India. All business decisions and deals are settled through the assessee's websiteSec. eBay India & eBay Motors have no role to play either in the maintenance or the operation of the websiteSec. They have absolutely no say in the matter of entering into online business agreements between the sellers and the assessee or the finalization of transactions between the buyers and sellers resulting into the accrual of the assessee's revenue. Consequently, they are not a "PoM" of the assessee's overall businesSec.

**Decision by Mumbai Tribunal :**

- The Mumbai Tribunal held that though eBay India and eBay Motors are dependent agents of the assessee, but do not constitute DAPE of the assessee in terms of Article 5 of the DTA. Further, these concerns cannot be treated as the PEs of the assessee in





terms of Article 5(2)(a) of the DTAA. Since the assessee has no PE as per Article 5 of the DTAA, there can be no question of computing business profits of the assessee as per Article 7 of the DTAA in relation to the revenue generated from India.

- The Tribunal did not examine the case under section 9(1)(i) of the Act because there is no finding given by the authorities below on the same. Thus, they have restricted themselves in considering the taxability or otherwise of the revenue earned by the assessee from its Indian operations as per DTAA alone. Since the assesee is found to be not taxable as per the DTAA, no tax can be charged even if the assessee's revenue is found to be taxable under the provisions of the Act.

## ADIT vSec. Maersk Line UK Ltd (ITAT Kolkata)

- **Consideration of Tax Advantage on Long Term Capital Gains after Distribution of Dividend under Section 143 (3) of the Income Tax Act, 1961.**

**Facts of the Case :**

- The assessee has distributed the tax-free dividend prior to the sale of shares to its parent company and this result in reduction of Fair Market Value (FMV) of the share.
- The assessee has computed the long term capital gains on sale of these shares, which worked out to RSec.2,58,76,351. However, the distribution of dividends, @RSec. 140 per equity share aggregates to RSec. 14,99,988,800 before the sale transaction between the assessee and the parent company.
- According to the Assessing Officer (AO), the distribution of dividend was nothing but a colourable device to deny legitimate share of revenue in capital gains of the assessee, which should be ignored while computing long-term capital gains in the hands of the assessee and also the AO held that there was a tax evasion.

**Decision by ITAT (Kolkata) :**

- A transaction can be regarded as a "sham" or "colourable device" where "the document is not bona fide nor intended to be acted upon, but is only used as a cloak to conceal a different transaction".
- The assessee claims that while changing the ownership, it declares all, or most of, such available funds, as 'dividends' to the existing shareholders and it also claims that the tax advantage was accompanying to their reorganisation work out
- The rationale of ITAT was the assessee (WOS) had sufficient reserves and cash surplus for the distribution of dividend and the assessee (WOS) paid dividend distribution tax which was duly accepted in its assessment.

- The ITAT has declared that the income tax department cannot treat every transaction that results into a tax advantage for a company as a sham, unless there is evidence to suggest that the company tried to conceal the true nature of the transaction.

## RBS Equities (India) Ltd vSec. ACIT (ITAT Mumbai)

- **Applicability of Transfer Pricing Methods Viz. Comparable Uncontrolled Method (CUP) and Transactional Net Margin Method (TNMM) Using Weighted Average Arithmetic Mean under Income Tax Rule 10b (1) (a) (ii)**

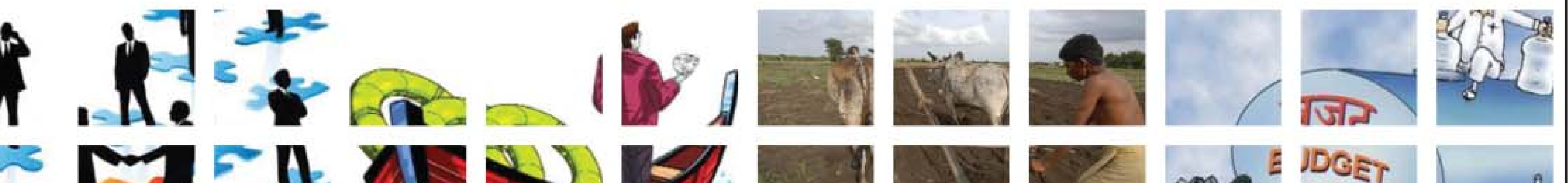
  **Facts of the case :**

  - The assessee had earned a brokerage at the rate of 0.24% amounting to RSec.4,22,84,486/- for its Associated Enterprise (AE), which constitutes more than 35% of the total income of the assessee.
  - The Assessing officer (AO) referred the matter to the Transfer Pricing Officer (TPO) in order to determine the Arm's Length Price (ALP) of the transactions
  - The assessee had transacted with both FIIs and FIs, so the TPO directed the assessee to furnish the details of top 10 clients and the TPO have observed that there was a wide difference of average brokerage rate's between FIIs (0.44%) and FIs (0.22%).
  - The assessee explained that they have applied TNMM for its relaxed standard of comparability as well as they explained that CUP was not applicable due to difference between AE and third party.
  - The TPO have taken the CUP method without allowing any volume of adjustments and therefore the assessee have submitted an appeal that the TNMM method was the most appropriate method and the TPO was not justified in adopting the CUP method.

  **Ruling by ITAT, Mumbai :**

  - According to the nature of assessee's business the volume factor was of no importance and the TPO was fully justified in not allowing any volume of adjustment.
  - The CUP method being the traditional method was most direct and reliable for transfer pricing analysis especially for comparative analysis and also the concept of weighted average is not recognized by the statute.
  - Regarding the claim of the assessee for adjustment on account of research function, marketing function and for differences in volumes was of no basis to justify and as per rule 10B (1) (a) (ii) the assessee has to submit relevant evidence and it is subject to verification by the AO.





- The Mumbai Tribunal has concluded that the CUP method is the most appropriate method in determining the ALP and it also highlights the importance of submitting the documents as evidence for any claim.

## National Petroleum Construction Company vSec. ADIT (ITAT Delhi)

- **Composite Contract can be Divisible into Offshore and Onshore ActivitieSec. Income from Offshore Supplies is not taxable in India. Further Section 44BB is not Applicable to the Fabrication and Installation of Onshore and Offshore Oil Facilities**

  **Facts of the case :**

  - The taxpayer entered into a Turnkey Contract with ONGC for fabrication and installation of on-shore and off-shore oil facilities and pipelineSec. Contact was sub-divided into two parts, one for designing, fabrication and supply of material (carried out exclusively in Abu Dhabi) and the other for installation and commissioning of the project.
  - Since the work relating to designing, fabrication and supply of material was carried outside India, the tax payer believed that such income wasn't taxable in India. He also believed that his establishment couldn't be considered as an installation Permanent Establishment (PE) in India as the commissioning and installation activity was carried for less than 9 monthSec. The taxpayer's return of income consisted of income relating to installation and commissioning carried in India.
  - The assessing officer said that the Indian project office of the tax payer should be considered as a fixed base PE in India under the India UAE tax treaty. He also stated that such project being turnkey basis couldn't be divisible and it should be liable to tax in India. Also consideration for various activities had been stated separately in the contract.

  **Tribunals ruling :**

  - The assessee's project office in India constituted a PE. It also had a "Dependent Agent Permanent Establishment (DAPE)" and also a "construction and installation PE" under Article 5(2) (h). Also the taxpayer had stated that the Mumbai's office was its PO for the project undertaken with ONGC in its letter to RBI. The establishment couldn't be considered as a PE as the taxpayer didn't produce any evidence to establish that the PO was only for auxiliary activitieSec.
  - The tribunal held a meeting for the same and accordingly concluded that the project office was a taxpayer's PE in India.

- Though the contract was on a "turnkey" basis, it had to be regarded as an "umbrella contract" yet a divisible contract as the consideration for various activities had been stated separately.
- ONGC had the discretion to take only the platform erected by the assessee in Abu Dhabi without having installation thereof as it had a right to terminate on its own violation.
- The segregation of the contract revenues into offshore and onshore activities was made at the stage of awarding the contract. The total consideration was earmarked towards different activities and separate payment had to be made on the basis of work of design, engineering, procurement and fabrication. These operations had been carried out and completed outside India.
- The PE was in respect of the installation and commissioning work done in India and the activities carried outside India were not attributable to the said PE.
- The taxpayer did not have a PE in respect of erection and fabricating the platform. The taxpayer had a PE in respect of installation and commissioning.
- Relying on various decisions the Tribunal held that erection and fabrication cannot said to be attributable to PE in India. All the activities prior to installation and commissioning are carried out in UAE and thus having regard to Article 7 of the tax treaty no income can be attributed to the PE in India.
- The profits could be attributed to the PE in India only in respect of installation and commissioning activitieSec.
- Accordingly, the profits attributable to the offshore supplies i.e. erection and fabrication of the profits was not taxable in India
- The work of installation of the platform done inside India does not fall u/s 44BB because the activity cannot be regarded as a "facility in connection with the prospecting for, of extraction or production of, mineral oils".

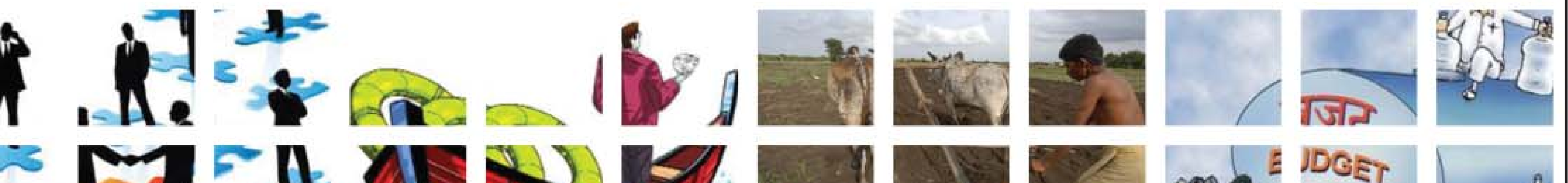
### Adidas Sourcing Limited vSec. ADIT (ITAT Delhi)

- Services Rendered Under A Buying Services Agency Agreement Does Not Constitute "Fees for Technical Services" u/s 9(1) (vii).

  **Facts of the Case :**

  - Assessee, Adidas Sourcing Limited ('ASL') is a tax resident of Hong Kong, provides buying agency services to various customers including Adidas India Marketing Private Limited ('AIMPL').





- ASL entered into a ‘Buying Agency Services Agreement’ with AIMPL where ASL provides services which include centralized media and advertisement planning, market research, Public Relations, sports marketing and other marketing services ,on which ASL receives buying commission @ 8.25% of the value of merchandise.
- Assessing Officer (AO) held that the buying commission income received by the assessee is in the nature of Fees for Technical Services (‘FTS’) and the same should be taxable in India in the hands of ASL.

**Taxpayer’s Contentions :**

- The Buying Agency Services provided by the Taxpayer are not managerial in nature as the said services are provided under the instruction and overall control and supervision of AIMPL.
- The services are not technical in nature as no technical knowledge belonging to Art, Science or Profession was required.
- The CBDT circulars 23 of 1969 and 786 of 2000 were issued in the context of sales commission payable by a resident exporter to the agents outside India is not taxable if the operations are carried out by the agent outside India.
- The nature of operation undertaken by a sales agent are similar to a buying agent and therefore, if the income of a sales agent cannot be taxed in India then the income of buying agent also cannot be taxed in India.
- Even though these circulars have been withdrawn by the CBDT Circular 7 of 2009, the said withdrawal is prospective from 22 October 2009 and would not alter the situation for the relevant assessment year.

**Tax department’s Contentions :**

- The Explanation 2 to Section 9(1)(vii) of the Act provides inclusive definition of the term FTS and applying this inclusive test the payments received by the taxpayer are treated as FTSec.
- The compensation of the taxpayer from AIMPL is more towards the efforts of the taxpayer in relation to the manufacture rather than buying. The Cost of manufacturing technology is also built in the cost of products and the commission paid to taxpayer thereby inferring that the payment of commission also includes payment for technology which gave rise to FTS

**Tribunal's ruling :**

- To constitute "fees for technical services", it is necessary that some sort of 'managerial', 'technical' or 'consultancy' services should have been rendered in consideration.
- The terms 'managerial', 'technical' or 'consultancy' do not find a definition in the Income-tax Act, 1961 and need to be interpreted based on their understanding in common parlance.
- Services rendered under a Buying Services Agency agreement are routine services offering procurement assistance. They consist of negotiating between the Principal and the manufacturers for purchase of merchandise. The fees for such services does not constitute "fees for technical services" u/s 9(1)(vii).

## Hindustan Unilever Limited, Mumbai VSec. ACIT

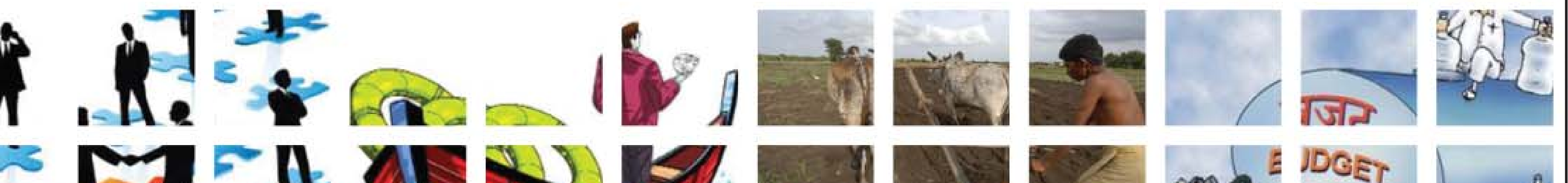
**Facts of the Case :**

- The main business of the assessee, Hindustan Unilever Ltd., (which is India's largest Fast Moving Consumer Goods Company) is export and import of home and personal care products, beverages, rice and marine products, soap and toiletrieSec.
- The assessee's 51.55% stake is held by Unilever PLC ('AE').
- The assessee had also been paying royalty to the AE on domestic and export saleSec.
- The assessee had made international transactions with the AE during the year.
- The assessee has challenged the transfer pricing adjustment of RSec. 368 Cr on the international transaction values on the basis of various sub-groundSec.

**Tribunal Ruling :**

- The Mumbai Tribunal held that Transfer pricing adjustment shall be restricted to transactions with Associate Enterprise and shall not be made on entire turnover
- At the entity level, the assessee's transactions were falling within the range of +/- 5%. Therefore, the entire adjustment made by the TPO was covered within the safe harbour of +/- 5%..
- Thus, transfer pricing adjustment cannot be made since assessee's transaction price is determined within 5% of Arm's length pricing by Transfer Pricing Officer. Thus the additions made by the TPO were deleted.





## M/Sec. Trilogy E-business Software VSec. DCIT

**Facts of the Case :**

- During the financial year 2006-07, the assessee provided software research & development support services to its Associated enterprises (AE) outside India and was remunerated on a 'cost plus' basiSec.
- The total value of international transaction with respect to the provision of software research & development support services by the assessee to its AE was RSec.47 crore.
- The assessee claimed that the price charged by it for services rendered to its AE was at Arms Length Price ('ALP'), the assessee filed a report under section 92E of the Act in Form 3EB together with detailed analysiSec.
- The Transfer Pricing Officer ('TPO') rejected the comparables chosen by the assessee. On the basis of the TPO's study, the Assessing Officer ('AO') arrived at RSec.6.20 crore as an addition by way of adjustment to ALP.

**Tribunal ruling :**

- The Bangalore Tribunal held the following:
  - 17.5% cost-plus mark-up was applied for IT development services as against 24% applied by TPO after extensive discussion of comparable companies
  - Companies deriving more than 75% revenue from onsite development were not comparable with assessee deriving revenues from offshore development.
  - There was a significant difference in the pricing structure, projects cost & prevailing market conditions in onsite and offshore projectSec.
  - Functionally comparable abnormal profit/ loss making companies could be considered under Indian TP regulation to compute 'arithmetic mean'.
  - Celestial Labs (Engaged in clinical research & manufacture of bio product) was not comparable to assessee. Companies providing software testing services /ITES / deriving revenue from software product were also liable to be excluded.

## M/s Everest Kanto Cylinder Ltd. VSec. DCIT

**Facts of the Case :**

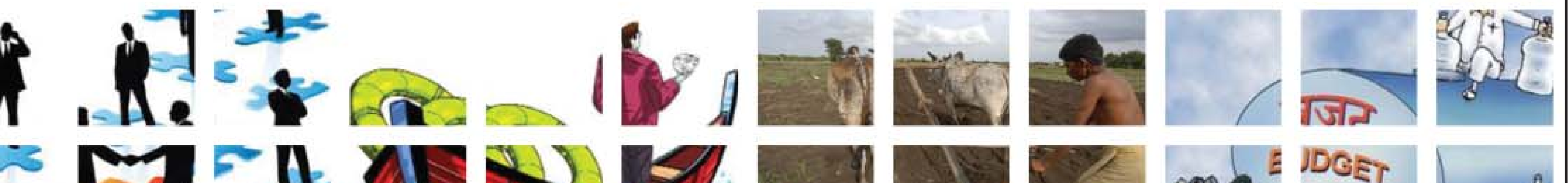
- The assessee was primarily engaged in manufacturing high pressure seamless gas cylinders, and entered into various international transactions with its associated enterpriseSec.

- The only international transaction in dispute was that of guarantee commission charged by the assessee from an associated enterprise in Dubai (the AE).
- The AE had obtained a loan from ICICI Bank, Bahrain branch (the Bank), for which, the assessee provided the Bank with a corporate guarantee. For this, the assessee charged the AE a 0.5% guarantee commission.
- The assessee did not benchmark the guarantee commission and considered the arm's length price (ALP) to be Nil on the pretext that it had not incurred any cost in providing the bank guarantee to the AE.
- The TPO rejected 0.5% commission, and gathered information on guarantee commission rates charged by various banks (including HSBC, Allahabad Bank, Exim Bank, etc.).
- From the information gathered, the TPO found that guarantee commission rates ranged from 0.15% to 3%. Using Comparable Uncontrolled Price (CUP) method, the TPO considered 3% to be the arm's length guarantee charge.
- Aggrieved with the decision of the TPO the assessee appealed to the Commissioner of Income-tax Appeals (CIT (A)), who upheld the adjustment. Aggrieved with the decision of CIT (A), the assessee then appealed to the Tribunal.

**Tribunal ruling :**

The Mumbai Tribunal held the following :

- In view of the amendment brought by the Finance Act, 2012 with retrospective effect from 1-4-2002, payment of guarantee fee is included in the expression 'international transaction' in view of the Explanation i(c) of section 92B of the Act. Once the guarantee fee falls within the meaning of 'international transaction', then the methodology provided in the rules also become applicable. The transaction being an international transaction, Comparable Uncontrolled Price (CUP) was the most appropriate method for it.
- The Tribunal stated that a universal application of 3% for guarantee commission cannot be upheld in every case, as the charge for guarantee commission depends upon the individual transactions and the mutual understanding and relationship between the partieSec. Guarantee commission was largely dependent on the terms and conditions of the loan, risk undertaken, relationship between the bank and the client, and economic and business interestSec. In the instant case, while applying external comparables, i.e., guarantee commission rates charged by banks, the TPO had not brought anything on record regarding the terms, conditions and circumstances, under which banks have been charging a rate of 3%.



- The Tribunal did not agree to the assessee's contention that there could not be any cost or charge of providing a corporate guarantee, as there is always an element of benefit or cost while providing such kind of guarantee to AE. The assessee has itself charged 0.5% guarantee commission from its AE.
- In an independent transaction, the assessee had paid 0.6% guarantee commission to ICICI Bank India for its credit arrangement. This was considered to be a good parameter by the Tribunal and an internal comparable for the transaction of the assessee with the AE. The charging of 0.5% guarantee commission from the AE was quite close to 0.6%. The difference of 0.1% was considered to be on account of differential rate of interest charged on the two underlying loans and was ignored.
- In view of the above, the Tribunal deleted the adjustment on account of guarantee commission.

## M/Sec. Brigade Global Services Pvt. Ltd. vSec. ITO

**Facts of the Case :**

- The assessee had entered into international transactions with its Associated Enterprise M/Sec. Webhelp Inc, USA, value of which was shown at RSec. 13 crore. In conformity with the order passed by the Transfer Pricing Officer (TPO), the Assessing Officer ('AO') made an addition of RSec. 4.68 crore to the income of the assessee, towards adjustment to the Arm's Length Price ('ALP') of such international transactions u/Sec. 92CA of the Income Tax Act ('the Act').
- Regarding adjustment under ALP of the international transactions u/Sec. 92CA of the Act, the assessee challenged selection of comparableSec. The assessee followed Transactional Net Margin (TNM) Method for the purpose of analyzing the transfer pricing. For comparability analysis the assessee used data belonging to the period April 2001 to February, 2004 and had selected 17 comparables for A.Y. 2004-05. However, the TPO considering the provisions of Rule 10B(4) of the Income-tax Rules, 1962, further considering the data belonging to the financial year 2003-04, had excluded the companies from the list of comparables originally selected and furnished the comparative results in respect of 8 companieSec.
- Out of the 8 companies in respect of which the assessee furnished the financial data, taking into account the financial results for the financial year 2003-04, the TPO selected two companies and rejected the other six companieSec. Further he selected another six companies for the purpose of comparable analysis for the A.Y. 2004-05.
- Taking into account the PLI for the financial year 2003-04 in respect of the above 8

comparables, he arrived at the average profit margin i.e., Arithmetic Mean PLI at 36.82% after allowing deduction of 2% towards working capital adjustment, he arrived at the adjusted Arithmetic Mean PLI at 34.82%. Further, though the assessee furnished the operating expenses at RSec. 11.74 crore, the AO considered the operating cost at RSec. 13.15 crore. After applying the above adjusted arms-length margin of 34.82% to such operational cost the TPO computed the ALP of the international transactions entered by the assessee with its AE at RSec. 17.73 crore. Since the assessee had shown such price at RSec. 13.05 crore, he added RSec. 4.68 crore towards adjustment u/Sec. 92CA of the Act. However, he has accepted the value of transactions shown under Recharges at RSec. 19, 16,518.

**Tribunal ruling :**

The Hyderabad Tribunal held the following:

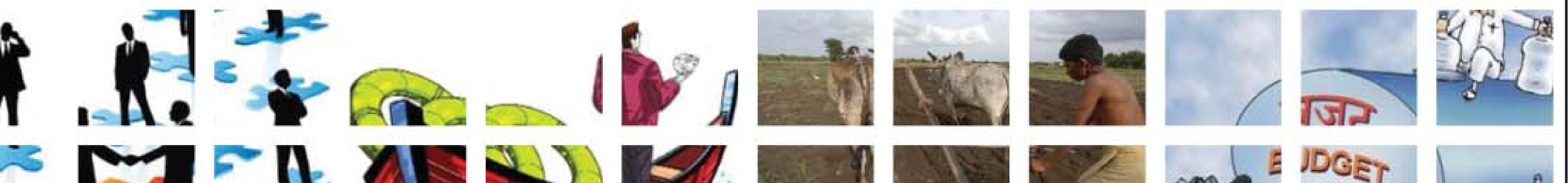
- Only companies incurring 'abnormal / continuous' losses should be excluded from list of comparables, however, comparable companies incurring loss in ordinary course of business can be considered.
- Foreign exchange fluctuation arising in normal course should be considered while computing net margin
- Comparable having very low employee cost ratio of 2% to be excluded, where industry average works out to 30-40%
- Companies having huge turnover shall also to be excluded.

## M/Sec. Toyota Kirloskar Motors Pvt Ltd. vSec. ACIT

**Facts of the Case :**

- The assessee company is an Indian company engaged in the manufacture and trading of automobileSec. The major shareholder of the assessee is Toyota Motor Corporation, Japan (hereinafter referred to as 'TMC') with 74% foreign equity participation and Kirloskar Systems India Ltd.; with 26% holding.
- The assessee imports components from TMC and TMC provides the assessee with technical know- how for which it is paid Royalty and Fees for technical assistance received.
- The assessee filed its return of income for A.Y. 2003-04 declaring a loss of RSec.6.21 crore. The assessee also filed the report as required under section 92E of the Act.
- The Assessing Officer (‘AO’) referred the case to the Transfer Pricing Officer (TPO) to determine the Arms Length Price (ALP) in respect of the international transactions of





manufacturing segment and trading segment of the assessee.

- The T.P. documentation of the assessee was prepared on a consolidated basis, without segmentation between the manufacturing and trading businesSec.
- The TPO called for segmental bench marking analysiSec. In response of the segmented financials of the assessee, the TPO issued a show cause notice to the assessee rejecting the customs duty and excise duty adjustments and making an operating expense adjustment.
- The TPO proposed an adjustment of RSec.196.09 Crores and required the assessee to show cause as to why the import prices of materials imported from AE should not be reduced.
- The TPO, after considering the submissions filed, passed an order under section 92CA of the Act computing the ALP of foreign transactions and proposing an adjustment of RSec. 196.09 Crores which was arrived at by adopting the Transaction Net Margin Method after making adjustment of the profits of comparable companies on account of differences in 'Operational efficiency' and depreciation.
- On receipt of the TPO's order under section 92CA of the Act, the AO passed the order of T.P. adjustment of RSec.196.09 Crores on account of the proposed adjustment to the ALP by the TPO and also disallowed expenditure amounting to RSec. 9 lacs incurred on software, holding it to be capital in nature and allowed depreciation thereon.

**Tribunal's Ruling :**

The Tribunal held as follows:

- ALP for manufacturing and trading segment should be computed together, since part of assessee's trading activity is result of manufacturing activity.
- Excise duty adjustment was to be allowed.
- 'Pass through' costs like excise duty were not to be considered for computing profit margin.
- Depreciation adjustment made by TPO was upheld, assessee being in asset intensive automobile industry, TPO directed to recompute adjustment for custom duty & operating efficiency

## Clearwater Technology Services Pvt Ltd v ITO

- Fees for technical services do not include voice charges paid to a foreign telecom company.

  **Facts of the Case :**

  - The taxpayer, an Indian company, provided services to its clients in USA, the services being voice based call centerSec. The Indian company was assisted by an American telecom voice service provider (US company) to connect to the telecom network in America with respect to the calls made to or received from USA by the taxpayer.
  - During the year, the taxpayer made payments to the US Company towards voice chargeSec. However, the taxpayer did not withhold tax from such payments made to the US Company for its services, the reason being, the US Company had no Permanent Establishment (PE) in India.
  - As stated by the Assessing Officer (AO), the nature of payments made by the taxpayer to the US company was that of 'Fees for Technical Services' and liable for TDS under section 195 of the Income Tax Act. Since no TDS was effected on those payments, the AO disallowed the entire expenditure incurred under section 40 (a) (i).

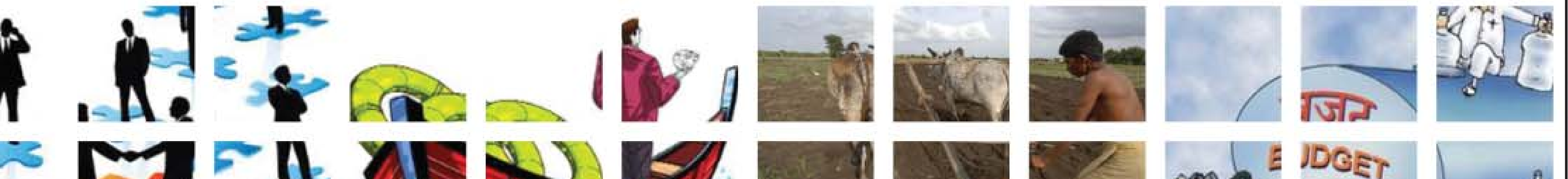
  **Tribunal Ruling :**

  - The US Company had not rendered any service of managerial, technical or consultancy in nature and hence the services did not get covered under the expression 'Fees for Technical Service'. The Tribunal observed that neither the Income Tax Act nor the DTAA has defined the term technical, managerial or consultancy service. According to well established dictionaries, the meaning for managerial relates to 'a manager or management, managerial responsibilities/decisions/skills etc.' In the present case, the payment made to the US company in respect of telecom voice services availed outside India could not be termed as 'fees for technical services'.

  **Following important decisions were also referred :**

  - In CIT v De Beers India Minerals P Ltd services were not considered as FTS even though they were performed using technical knowledge since they were not 'made available';
  - In DCIT v Sandoz (p) Ltd the Tribunal held that in the absence of PE in India, even the payment for advertisement which could be assessed as business profits would not be chargeable to tax;
  - In GE India Technology Centre P Ltd v CIT the Supreme Court held that if the income is chargeable to tax then only will the obligation to withhold tax u/s 195 arise. Also, provisions of section 40(a) (i) do not apply if income is not chargeable to tax.





- In an overall consideration of the facts and circumstances of the issue the Tribunal held that the taxpayer had no obligation to withhold tax on the payments made to the US Company for their services since the US company did not have PE in India. Further, the payment could not be disallowed under section 40 (a) (i), since there was no obligation to withhold tax.

## Linklaters & Paines v. ITO

**Facts of the case :**

- The taxpayer is a partnership firm with its head office at United Kingdom and it does not have its physical presence at India.
- During the assessment year under consideration, the taxpayer carried out certain work for projects at India through few of its employees who visited for a short period of time, but the majority of work for the project was done at United Kingdom.
- The Tribunal has held that the entire income earned by the taxpayer from its Indian projects would be taxable in India owing to Article 7 of the tax treaty in view of the force of attraction principle.
- Thus the tax payer filed a Miscellaneous Application and sought rectification of the mistake alleged to have crept in the order of the tribunal.

**Tribunal's Ruling :**

- Tribunal has explained that Article 7 (1) of the tax treaty provides that if the enterprise carries on business through a Permanent Establishment (PE) , the profits of the enterprise may be taxed in the other state , to the extent it is 'directly or indirectly' attributable to the PE. The inclusion of profits indirectly attributable to the PE incorporates a force of attraction principle in the tax treaty.
- In addition to the profits attributable to the PE the taxability of PE profits would also extend to the sales in the other state of goods or merchandise of the same or similar kind as those sold through the PE or also to the other business carried on in that other state of the same or similar kind as those effected through the PE.
- The tribunal has explained that when an enterprise sets up a PE in another country, it brings itself within the jurisdiction of that another country to such a degree that such another country can properly tax all profits that the enterprise derives from that country, even if the transactions were not routed through the PE.

- In consideration of the facts of the present case, any income in respect of services rendered for an Indian project, similar to the services rendered by the PE, would also be taxable in India in the hands of the taxpayer, without consideration of the fact that the services are rendered through the PE or directly by the general enterprise.
- The indirect attribution of the services is enough to bring the income from such services within the ambit of taxability of these services in India.
- The twin conditions to be satisfied for taxability of related profits are:
  - The services should be similar to / relatable to the services rendered by the PE in India
  - The services should be 'directly or indirectly' attributable to the Indian PE
- Thus the entire profits relating to services rendered by the taxpayer, rendered in India or outside India, in respect of Indian projects would be taxable in India.
- As regards to the case law of Ishikawajima Harima Heavy Industries, it was decided that income can be taxed in India only to the extent as attributable to the part played by the PE in the relevant transaction as per Article 7 of the India – Japan tax treaty.
- In the case of Roxon OY the Tribunal has held that the scope of Article 7 extends only to those activities carried out by a foreign enterprise in the Source state which are of the similar kind as carried on through its PE in Source State and not to all the activities of such an enterprise.
- It is pertinent to note a recent trend in the Indian tax treaties i.e. under India – Norway tax treaty where the force of attraction rule in relation to taxation of sales as well as other business activities of same or similar kind not sold / effected through a PE in that state, has been removed from a new tax treaty which has come into effect from 1 April 2012.

## WNS North America Inc vSec. ADIT

- Taxability of royalty under retrospective law & reimbursement of expenses

  **Facts of the case :**

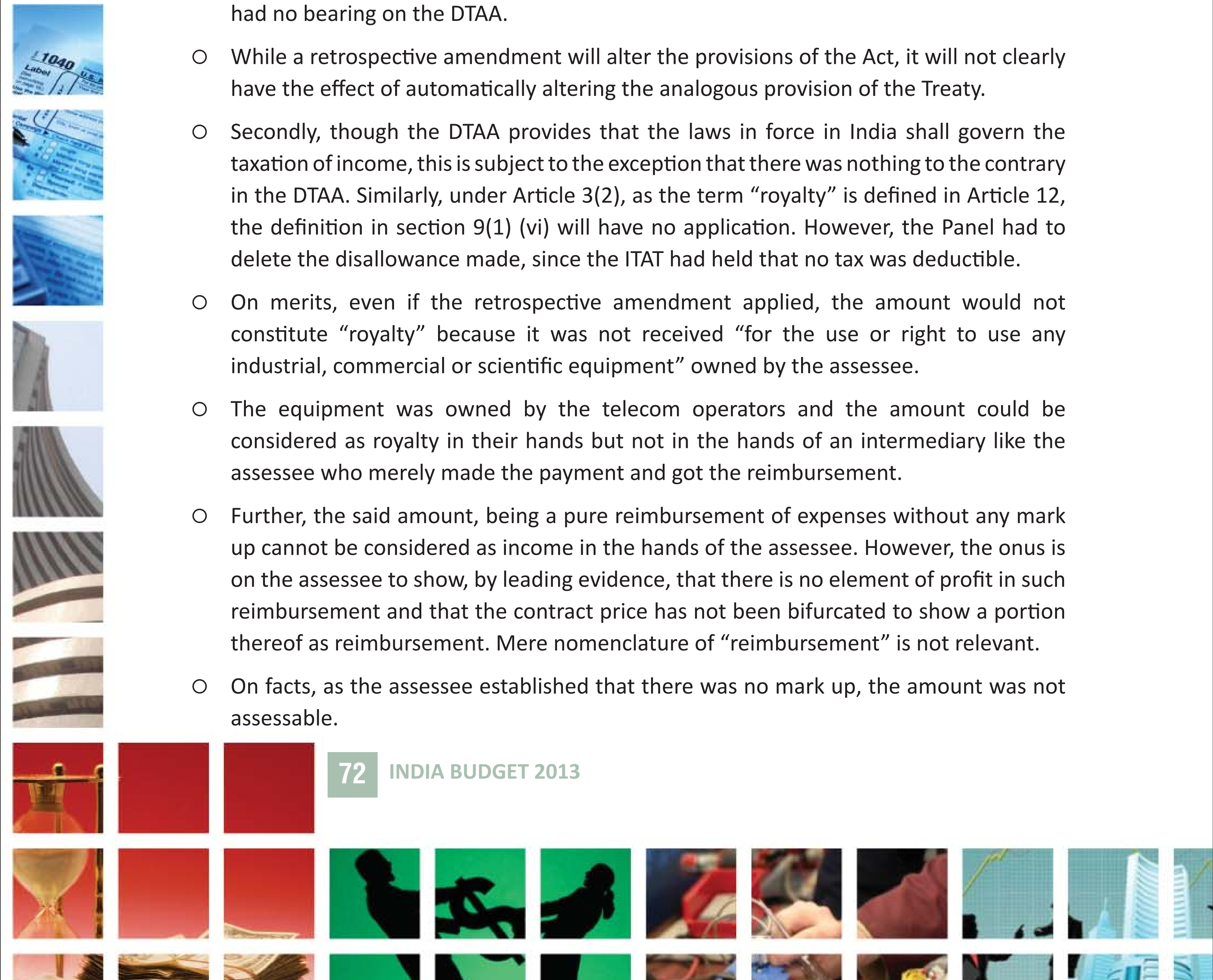
  - The assessee, WNS North America Inc, a USA company, filed its return declaring income of RSec. 2.38 croreSec.
  - The assessee received RSec. 6.41 crores towards reimbursement of international telecom connectivity chargeSec. It was a "reimbursement of expenses" for the services provided, the services being, carrying out marketing and sales promotion activities on

behalf of WNS India, appointing advertising agencies to prepare, plan, direct and execute all the advertising of WNS India's business, providing consultancy services, discussing, negotiating and entering into business proposals and contracts with the customers in the name of the assessee on behalf of WNS India, performing administrative, sales support and account handling services and providing managerial serviceSec.

- It was claimed by the assessee that the same did not fall within the definition of "royalty" in Article 12 of the India-USA DTAA and thus was not treated as an income. The department claimed that the said amount had to be assessed as "royalty", irrespective of the position under the DTAA, in view of the retrospective insertion of Explanation 5 to section 9(1)(vi) by the Finance Act, 2012, w. r. e. f. 1.6.1976.

**The Tribunal held the following after allowing the appeal by the assessee:**

- Section 90(2) makes it clear that the provisions of the Act shall apply only to the extent that they are beneficial to the assessee and thus a retrospective amendment to the Act had no bearing on the DTAA.
- While a retrospective amendment will alter the provisions of the Act, it will not clearly have the effect of automatically altering the analogous provision of the Treaty.
- Secondly, though the DTAA provides that the laws in force in India shall govern the taxation of income, this is subject to the exception that there was nothing to the contrary in the DTAA. Similarly, under Article 3(2), as the term "royalty" is defined in Article 12, the definition in section 9(1) (vi) will have no application. However, the Panel had to delete the disallowance made, since the ITAT had held that no tax was deductible.
- On merits, even if the retrospective amendment applied, the amount would not constitute "royalty" because it was not received "for the use or right to use any industrial, commercial or scientific equipment" owned by the assessee.
- The equipment was owned by the telecom operators and the amount could be considered as royalty in their hands but not in the hands of an intermediary like the assessee who merely made the payment and got the reimbursement.
- Further, the said amount, being a pure reimbursement of expenses without any mark up cannot be considered as income in the hands of the assessee. However, the onus is on the assessee to show, by leading evidence, that there is no element of profit in such reimbursement and that the contract price has not been bifurcated to show a portion thereof as reimbursement. Mere nomenclature of "reimbursement" is not relevant.
- On facts, as the assessee established that there was no mark up, the amount was not assessable.



## DDIT v Euro RSCG Worldwide

- Consideration received from group entities for services provided to it in India are not chargeable to tax in India

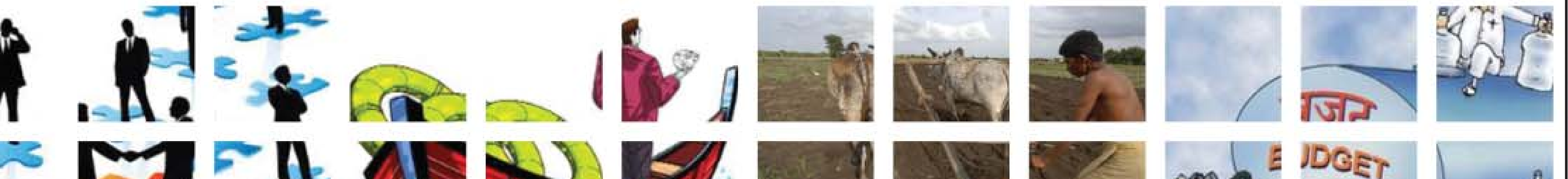
  **Facts of the case :**

  - The taxpayer was an American company, which was a resident of USA. The US Company performed the role of a communicating interface between Euro entities and multinational clients and for this it had set up a team of persons to coordinate.
  - The Euro entities were charged for the coordination services as the US Company incurred expense on it. They were also provided with need-based business development and managerial assistance. During the year, a Euro entity in India (Indian company) received assistance and the payment was split into coordination fees, creative fees and database costSec.
  - According to the AO, the consideration received as creative fees, database costs and co-ordination fees was chargeable to tax @ 15% under India-USA DTAA since it was in nature of royaltieSec.

  **Tribunal Ruling :**

  - The tribunal was of the opinion that the services provided by the US Company did not include consideration for use of, or right to use, any of the specified terms mentioned in the definition in the India-USA DTAA. Thus, the consideration was taxable under business profits and not royaltieSec.
  - On this, the US Company contended that it was not taxable as business profits since it did not have a PE in India.
  - As per Article 12(2)(b) of the tax treaty, the rate of 10 percent is applicable in the case of royalty referred to in Article 12(3)(b) and FIS as defined under this Article that are ancillary and subsidiary to the enjoyment of the property for which payment is received under Article 12(3)(b) of Article. Since the amounts were not royalty being considered either under Article 12(3) (a) or 12(3) (b), the rate of 10 percent on FIS was not correct. There was nothing on record that indicates that the rate specified under Article 12(2)(b) of the tax treaty was applicable and not rate specified under Article 12(2)(a)(ii) of the tax treaty. Therefore, the creative fees and database cost were taxable at the rate of 15 percent.





## ACIT v Tex Technology International Pvt Ltd

- **Payments made by the Indian Company with respect to agreements whether included under the definition of FTS under the tax treaty**

  **Facts of the case :**

  - The taxpayer, an Indian company having a subsidiary American company (US Company), had a business of e-publishing. Three Agreements were executed by the Indian company with the US Company, the agreements being:
    - Overseas Services Agreement- For e-publishing and preparation of typesetting from manuscripts, printing pages and shipping it back to clientSec.
    - Offshore Development Agreement- For scanning of manuscripts and uploading it to India and also for notifying the taxpayer through e-mail. Once the taxpayer had done the typesetting in India and uploaded it back to Tex Tech Inc, they were to download such formatted pages, print the pages and courier it to the ultimate customers
    - Marketing Agreement- To provide support to the customers with regard to billing, collection of such amounts and payment to the taxpayer. As per this agreement, the Tex Tech Inc was required to provide market information as and when required by the taxpayer
  - During the relevant year, taxpayer filed tax return without deducting TDS on outsourcing costs paid to US Company. According to the taxpayer, since the services were provided outside India no tax was chargeable in India and thus it was not liable to deduct TDSec. The AO held that since the US Company was rendering technical services which fall u/s 9(i) (vii) of the Act and did not withheld TDS, the expense was to be disallowed u/s 40(a)(i).
  - The CIT (A) held that definition of FTS under Tax Treaty did not include the payments made by the taxpayer and thus the payments were to be allowed as deduction.

  **Tribunal Ruling :**

  - The entity abroad should 'make available' technical knowledge, know-how, skill or process; or the services rendered abroad should consist of development and transfer of technical plan or design to fall under Article 12(4)(b) of the tax treaty.
  - As per Overseas Service Agreement, the US Company had to use its expertise, tools and infrastructure to provide service. Hence the whole work was done at the US Company and it could not be said that any technical knowledge, know how or skill was received by the taxpayer.

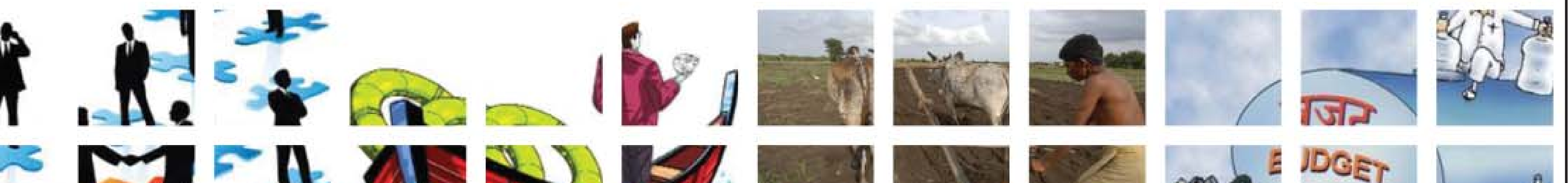
- In Marketing Agreement no technical service was involved or made available to the tax payer.
- Thus, with regard to Marketing and Overseas Service Agreement, no part of income was taxable in India and the tax payer was not liable to deduct tax.
- As per Offshore Development Agreement clause 3.1 and 3.3, service included technical know-how but no technical knowledge was made available to taxpayer to give him an enduring benefit. Clause 3.2 of the agreement said that the US Company had to provide instructions and files to the Indian company for carrying out some specific serviceSec. If these instructions were in nature of technical knowledge and gave an enduring benefit to the taxpayer then it would fall under definition of FIS in Article 12(4)(b) of the Treaty.
- Separate invoices were raised by the US Company and thus three agreements were not a composite one.
- In Offshore Development Agreement, a part of income may be taxable in India and thus this issue was remitted back to the AO.

## Qualcomm Incorporated vSec. ADIT (ITAT Delhi)

➢ **The use of know-how for sale of products in India will not make the royalty earned by non-resident from another non-resident taxable.**

**Facts of the case :**

- Qualcomm Incorporated (appellant), a company incorporated in USA, engages in the design, development, manufacture, marketing and licensing of digital wireless telecommunication products and services based on Code Division Multiple Access (CDMA) technology. In consideration for a royalty, it has also granted a non-exclusive and non-transferable worldwide license of its patents developed on CDMA technology to unrelated wireless Original Equipment Manufacturers ('the OEMs') to make, import, use and sell CDMA handsets and wireless equipment (the 'Products'). Such OEMs are not residents of India and are situated outside India.
- The licenses were used for manufacturing of handsets and network equipments which were sold to various parties located worldwide. It was clarified that royalty did not accrue on sale of handsets but only on manufacture of handsets/ equipmentSec.
- After considering the available facts and conditions the AO came to the conclusion that the royalty paid by the OEMs to Qualcomm for licensing of patents to manufacture CDMA handsets is taxable in India u/s 9(1)(vi) ( c ) of the Act and under Article 12(7)(b) of the DTAA



**Tribunal Ruling :**

The Tribunal held in favour of assessee as under:

- When such products which were manufactured outside India were sold to parties in India, it couldn't be said that OEMs had done business in India since the license to manufacture products had not been used in India;
- No patents of the appellant had been used for customization of handsets and thus, sale in India without any operations being carried out in India would amount to business 'with' India and not 'in' India.
- Licensing its CDMA technology and collection of royalty from OEMs on these products ended the role of the appellant;
- There was no finding that the OEMs had carried on business in India. Moreover, to hold that the appellant was taxable was not correct when OEMs itself were not brought to tax.
- The provision of Section 9(1)(vi)(c) has two limbs:
  - The first covers cases where the right, property or information has been used by the non-resident payer (OEM) itself in the business carried on by OEMs in India. In the present case, the OEMs had not carried on business in India and thus they couldn't be said to have used the appellant's patents for the purpose of business in India;
  - The second limb covers a case where one would earn or make income from a source in India through right, property and information. In the present case, the right, property or information is licensed to OEMs related to the manufacture of the products and, hence, the source was the activity of manufacturing. The Indian parties would not constitute source of income for the OEMs since the source of royalty was the place where manufacturing activity took place and it was outside India.
- On the basis of agreement between OEMs and Indian parties, the ITAT held that the software didn't have an independent use but was an integral part of the hardware without which the hardware couldn't function. The software supplied was not a copyright right but a copyrighted article;
- The software was only used with the hardware and was not independent of the equipment. The sale couldn't be bifurcated into different components since no separate consideration was paid by Indian parties and the consideration was paid only for the equipment which had numerous patented technologieSec.

- Thus, the royalty earned by the appellant couldn't be brought to tax in India under Section 9 of the Act.

## AUTHORITY FOR THE ADVANCE RULING

**Shell Technology India P Ltd. (AAR)**

- **Applicability of treaties on branches of foreign companies**

  The Shell Technology India Private Limited ('Shell') was a company incorporated in India and a tax resident of India. It mainly rendered technical services to overseas Shell group companies using desktop based IT applicationSec. Shell had set up Shell Shared Services (Asia) BV ('SSSABV') as a part of its global finance functional plan. SSSABV which was incorporated in Netherlands had set up a branch office in Philippines to provide a range of business support services to various Shell Group entitieSec.

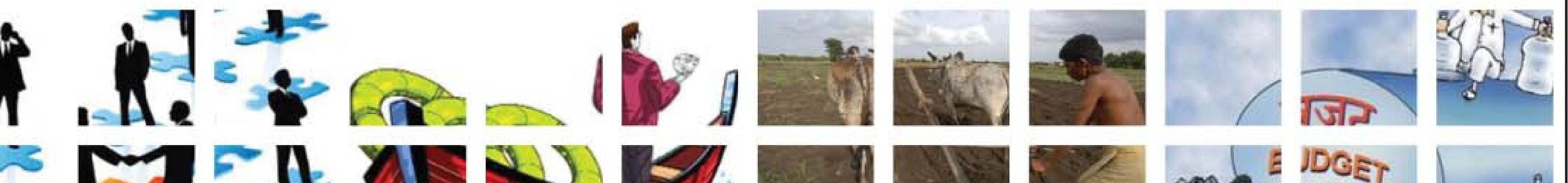
  Shell had entered into a service level agreement with the SSSABV Philippines branch, whereby that branch provided business support services to Shell. For rendering these services, SSSABV charged a monthly operation fee based on the on-going charges/ rates agreed on the basis of the full time equivalent resources allocated for the serviceSec.

  Shell approached AAR with a view to ascertaining the taxability in India of the payments being made to SSSABV Philippines branch and consequently on its obligation, if any, for withholding tax.

  The Indian company took the matter to AAR to decide whether the payment made by the Indian company would fall in the category of "fees for technical services" in terms of Article 12 of India-Netherlands DTAA. However, the real issue before the AAR was whether the India-Netherlands DTAA would be applicable or whether India-Philippines treaty would be applicable, since the transaction was undertaken between Shell (India) and SSSABV Phillipines branch.

  The AAR analysed the legal position in India. According to the India - Netherlands DTAA treaty, the amount paid by the Indian company to the foreign company would not be taxable in India because of the concept of 'make available' prevailing in the DTAA. On the other hand, if India-Philippines DTAA was applicable, then such amount paid by the Indian company would be taxable in the hands of foreign company because the concept of 'make available' does not exist in India-Philippines DTAA. The Authority ruled that since the services were rendered by the Netherland company through its branch in Philippines, the DTAA between India and Philippines would not be applicable.





- **Analysis of the case :**
  - The aforesaid ruling of the AAR does not provide any sound legal basis for the decision. For a legal basis, analysis and interpretation of DTAAs is required to be done.
  - As per the Article 1 of all DTAAs, the DTAA is applicable to the persons who are 'residents' of one or both of the contracting stateSec. The Article 4 of DTAAs deals with the concept of 'resident'. The treaties which have been designed on the OECD Model Convention contain an additional condition while defining the term "resident" as compared to the treaties which have been designed on UN Model. While defining the term "resident" the additional condition as aforesaid provides that "This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein". Significance of the above condition is that where the treaty seeks to exclude a person from being treated as "resident" who is liable to tax in the Contracting State only in respect of income from sources in that State, a branch office may not qualify as a "resident" of the State where the branch is situated. In such cases, the branch shall be treated as "resident" of the State where the head office of the branch is situated. Therefore, the treaty with head office country will apply.
  - This analysis can be better explained through an example. Consider an Israel company whose branch is situated in Germany. The India-Germany DTAA contains the aforesaid additional condition; therefore, branch of Israel company shall not be treated as resident of Germany, i.e. the place where it is located. The DTAA between India-Israel (i.e. head office country) will apply.
  - However, in the reverse situation i.e. where the branch is in Israel and the head office is in Germany, branch would be treated as resident of Israel and accordingly, the DTAA between India-Israel (i.e. branch country) would apply. This would be since the DTAA between India and Israel does not contain the aforesaid additional condition.
  - The decision of the AAR in Shell Technology case (supra), though correct, has been rendered without referring to the above legal position. As per the decision of the AAR, wherever a transaction is entered into with the branch of a foreign company, the treaty with the head office-country would apply. However, the correct legal position will depend upon the provisions contained in the domestic law and the treaty with the country where the branch is situated.

## 'A' Systems, In re( 2012) (AAR)

- **Consideration for use of process or formula developed by research member would constitute royalty under India – Germany DTAA**

  The applicant was a German company engaged in the business of executing contracts for assembly and supervision of paint shop, including supply of materials and supervision of installation for various automobile companieSec. A group of companies were its affiliateSec. The group companies had formulated a research and development policy. As per the policy all Research and development activities for the group were coordinated through the applicant. Entire cost was to be shared by the parties to the agreement based on key allocation. The participants were allowed unlimited access to the research results including any Intellectual Property Rights generated from the research and development for a contribution.

  Though all were joint owners of the Intellectual Rights, the rights were registered in the name of the applicant. The applicant approached the Authority for a ruling whether the payments made to the applicant by "A" India, in terms of the cost allocation agreement can be treated as income in the hands of the applicant and whether it was not merely reimbursement of the expenses incurred for the research and development activitieSec.

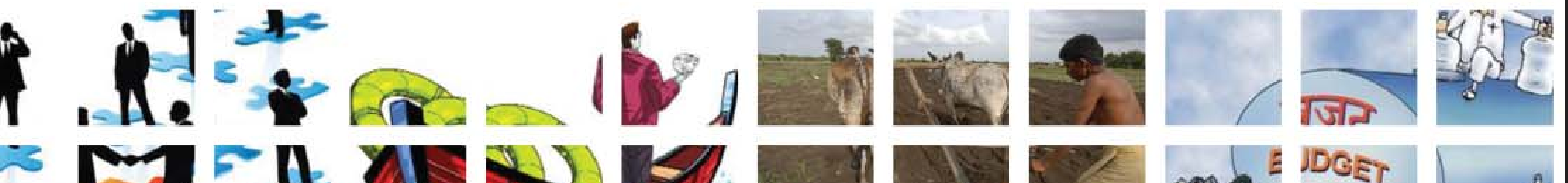
  The AAR held that in terms of the agreement it was apparent that the agreement to share product of research and development by paying a consideration for use described as contribution costs of research incurred by researching party was incorrect. The AAR observed that such payment can occur only on use of product of research and not otherwise. Thus on facts of the case under consideration, payment made by any party to the applicant was in the nature of consideration for use of process or formula developed by researching member and thus, would satisfy definition of royalty under Explanation 2 to section 9(1) (vii) of the Income Tax Act. Therefore, payment received by applicant from 'A' India under agreement would be royalty in terms of Article 12 (3) of India – Germany DTAA and section 9(1) (vii).

## AAR's ruling in Schellenberg Wittmer

- **AAR denies tax treaty benefit to fiscally transparent Swiss partnership**

  The Authority for Advance Rulings ("AAR") in Schellenberg Wittmer has held that a Swiss partnership, fiscally transparent in that country, is not eligible for the benefits of the DTAA between India and Switzerland. It further held that fee received by such partnership for representation services to an Indian company in adjudication proceedings outside India is taxable in India under the provisions of the Income-tax Act, 1961 ("Act"). The Applicant, a Swiss based law partnership (along with its partners), was engaged by Siemens India





Limited, to render representation services in relation to adjudication proceedings, arising out of an agreement entered into with another Indian company. All the partners of the firm were residents of Switzerland. The representation activities were to be carried out by the Applicant primarily in Switzerland/ Germany. The Applicant did not have any physical presence in India. Also, it did not render any services in India, except for a short period of 6 daySec. A ruling was sought by the Applicant inter-alia on its eligibility to claim benefits of the Treaty and taxability of the legal fee ("Fee") in relation to the services rendered by it to Siemens India Ltd.

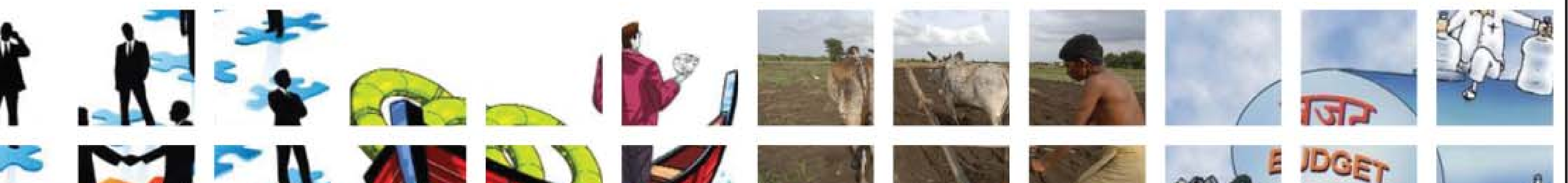
- AAR observed that under Article 3(d) of the DTAA, a 'body of persons' or 'any other entity' would not be regarded as a 'person', unless it constitutes a taxable entity under the laws of the concerned State. Accordingly, it was held that the Swiss partnership, not being taxable in Switzerland, did not qualify as person and was not entitled for relief under the DTAA.
- The Commentary on Article 3 of the Model Tax Convention on Income and on Capital by OECD ("OECD Commentary") says that a fiscally transparent partnership should be treated as a person. The applicant placed reliance on this commentary to prove that the partnership should be treated as a person. However, the applicant's argument was rejected on the ground that India has expressed its reservation to the view expressed by OECD.
- Further, it was held that since the income was not received by the partners, but by the partnership, the Treaty benefit could not be extended to them as well.
- On the same reason as above, the AAR rebutted the reliance placed by the Applicant on the OECD Commentary which recommends that in case of fiscally transparent partnerships, the partners, who are residents in that jurisdiction and liable to tax, should be entitled for tax treaty relief as regards their share of income.
- Thus, it was held that the source of income to the Applicant was in India and the income arose in India. The AAR was of the view that since the services related to dispute arising out of a contract between Indian residents, for a project executed in India and the payment was made by an Indian resident; the fact that primarily the services were rendered outside India could not alter the source or accrual of income. Accordingly, the Fee was held to be taxable in India as accruing in India under the provisions of the Act. The AAR did not consider the applicability of section 9(1)(vii) of the Act, dealing with income deemed to arise in India on account of thiSec.
- The issue was considered by the Mumbai Bench of the Income tax Appellate Tribunal in the case of Linklaters LLP . The Tribunal, in that case, held that a fiscally transparent

UK LLP would be eligible for the benefits under the India-UK DTAA, as long as profits of the partnership firm was liable to tax in UK, whether in the hands of the firm itself or the partners directly. The Tribunal relied on the 'locality related attachment' concept for determining if an entity was liable to tax in a jurisdiction and thus entitled to treaty benefitSec. The AAR has, however, ruled to the contrary.

## CASTLETON INVESTMENTS LIMITED

- The applicant, Castleton Investment Ltd, a company incorporated in Mauritius, held shares in an Indian listed company (Indian company). The applicant proposed to transfer its investment in the Indian company at a fair market value to an associated enterprise in Singapore ('Singapore AE'), through an off-market transaction. The applicant, the Indian company and the Singapore AE are all parts of the same group. In this regard, following questions were raised before AAR
- Will the investment held by the applicant in equity shares of the Indian company be considered as 'capital asset' under section 2(14) of the Income-tax Act, 1961 ('Act'?) – Held YES and Will the capital gains on transfer of shares be taxable in India? – Held NO
- The AAR characterized the shares of the Indian company as capital assets, relying upon the contention of the applicant that the shares were held for long term benefit as investment and that it did not wish to trade in those shareSec. Any income generated through the sale of capital asset would be taxable as capital gains as per the provisions of the Act. In view of the above, the AAR held that the transfer of shares of the Indian company by the applicant would be liable to capital gains tax in India in accordance with the provisions of the Act.
- However, as per the provisions of Article 13(4) of the India-Mauritius Double Taxation Avoidance Agreement ('India-Mauritius DTAA'), capital gains arising to a Mauritian resident on the transfer of shares in an Indian company would be taxable only in MauritiuSec. The AAR, relying upon the ruling of the Supreme Court of India in the case of Azadi Bachao Andolan (263 ITR 706), held that the applicant can claim exemption under the beneficial provisions of the India-Mauritius DTAA on capital gains arising on transfer of shares of an Indian company.
- Even where the transfer of shares by the applicant to the Singapore AE is not taxable, whether the provisions of section 92 to section 92F of the Act relating to transfer pricing ('TP') would be applicable? – Held YES
- Section 92 of the Act reads as "Any income arising from an international transaction shall be computed having regard to the arms length price." Going by the general meaning and by the defined meaning of 'income' under the Act and also from sections 92A to 92C of the





Act, there is no need to restrict the scope of the term 'income' appearing under section 92 of the Act in a manner that it does not include "capital gains". The AAR observed that the AAR ruling in case of Vanenburg Group BV (289 ITR 464) relied upon by the applicant did not discuss this aspect.

- Even where section 92 to section 92F of the Act are machinery provisions, capital gains cannot be determined without resorting to them. Only on determining whether capital gains have arisen, would the question of its chargeability arise. The question of chargeability to tax would arise only at a later stage. Therefore whether ultimately the gain or income is taxable in the country or not, section 92 to section 92F of the Act would apply if the transaction is one coming within those provisionSec. Applicability of section 92 of the Act does not depend upon the chargeability under the Act. Where there is no liability, the purpose of undertaking a Transfer Pricing exercise is not a question that would affect a statutory provision.
- Therefore the provisions of section 92 to section 92F in connection with transfer pricing are applicable even if capital gains may not be chargeable to tax in India either as per the Act or applicable tax treaty. The aspect that the exercise of these provisions may not be fruitful in this case cannot affect the applicability of these statutory provisionSec.
- Whether the sale consideration receivable by the applicant should suffer any withholding tax as per Section 195 of the Act? – Held NO
- The AAR, relying on the decision of the Supreme Court in the case of GE Technology Centre Pvt Ltd (327 ITR 456), ruled that there is no obligation to withhold tax, if such income is not chargeable to tax under the provisions of the Act.
- Whether the applicant is required to file any return of income under section 139 of the Act even where the transfer of shares is not taxable in India? – Held YES
- The applicant contended that filing of return of income under section 139 of the Act is not obligatory as the income on the transfer of shares is ultimately not taxable in India. Agreeing with the contention of the Revenue Department, the AAR held that the applicant is bound to file a tax return in India to claim the benefit of the India-Mauritius DTAA. Hence, the obligation under section 139 of the Act cannot simply disappear on account of the beneficial provisions of the India-Mauritius DTAA.
- Whether the provisions of Minimum Alternate Tax ('MAT') under section 115JB of the Act shall be applicable to the applicant? – Held YES
- The applicant relying on the ruling in case of Timken Co argued that the MAT provisions are

applicable only to domestic companieSec. Deviating from its earlier ruling in the case cited by the applicant, the AAR held that the term 'company' as referred to under section 115JB of the Act would not limit its applicability to domestic companieSec. In view of the above, the AAR ruled that the MAT provisions are prima facie applicable to every company under the Act and includes a foreign company. Further, the fact that the foreign company does not have a permanent establishment in India does not make a difference to the applicability of the MAT provisionSec. The AAR also held that there is no reason to limit the applicability of the MAT provisions owing to the practical difficulties for foreign companies to prepare their accounts in terms of Schedule VI to the Companies Act, 1956.

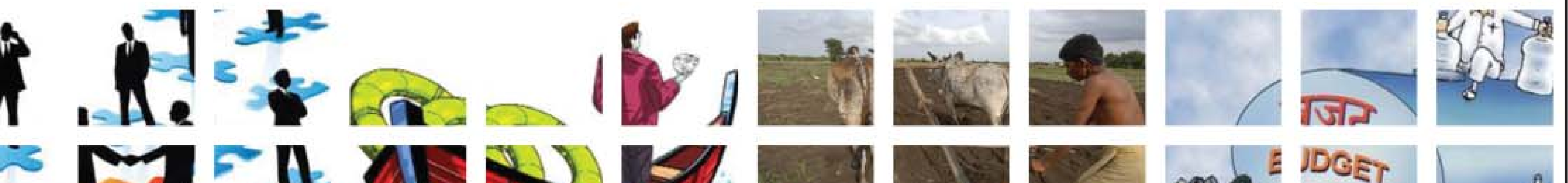
## In Re Roxar Maximum Reservoir Performance WLL (AAR)

- **A composite contract for installation & commissioning cannot be split so as to exempt the profits from offshore supply of goods**

  The Applicant entered into a contract with ONGC Ltd. for *"services for supply,* installation and *commissioning of 36 manometer gauges"* for enabling the later in carrying out its operations in India. The applicant claimed that the contract, though composite, had to be split into various components **in line with the earlier rulings of the Supreme Court,** and that the income attributable to the supply of manometer gauges was not taxable in India because the title to the goods had passed outside India & the payment was received outside India.

  - The AAR rejected the plea and held that though in Ishikawajima-Harima Heavy Industries Company Ltd. vSec. DIT, the Supreme Court had adopted a dissecting approach by dissecting a composite contract into two parts and holding one of the parts not amenable to taxation in India, this cannot be followed in view of the verdict in Vodafone International Holdings vSec. UOI (SC) where it was held that a transaction had to be "looked at and not looked through" and seen as a whole and not by adopting a "dissecting approach".
  - A contract for sale of goods differs from a contract for installation and commissioning of a project. The tests relevant for considering where the title to the equipment passed would not be relevant while construing the terms of a supply and erection contract. On facts, the contract is for erection and commissioning of 36 manometer gauges and not merely for sale of equipment or erection of the equipment. It is a composite & indivisible contract for supply and erection at sites within the territory of India and cannot be split. The payment received by the applicant was assessable u/s 44BB as the





contract was for providing services or facilities in connection with the prospecting and/or extraction of mineral oil.

## In Re RST (AAR)

- Sec. 47(iv) relief not available if holding co and nominees hold 100% of subsidiary

  The applicant, a German company, held 99.99% of the shareholding of an Indian company. The rest of the shares were held by other companies as nominees of the applicant. The Indian company proposed a buy back of shares u/s 77A of the Companies Act which would have resulted in transfer of shares of the Indian company from the applicant to the Indian company at a price to be determined. The applicant claimed that as it and its nominees held 100% of the shares of the Indian company, the exemption conferred by Sec. 47(iv) on transfers between holding company and 100% subsidiary applied and Sec. 46A would not apply. On application before the Authority for Advance Rulings, it was held that

  - Sec. 47(iv) exempts a transfer of a capital asset by a company to its subsidiary if "the parent company or its nominees hold the whole of the share capital of the subsidiary company". The word used is "or" and not "and". The assessee held only 99.99% of the shareholding. The shares held by the nominees cannot be considered as held by the assessee. If, under Indian law (Sec. 49 (3) of the Companies Act), a company cannot by itself hold 100% of the shares in a subsidiary, it would only mean that Parliament did not intend to confer the benefit of Sec. 47(iv) on such a parent company. Though this approach confines the relief to a particular species of parent companies, it does not mean that the provision is unworkable.

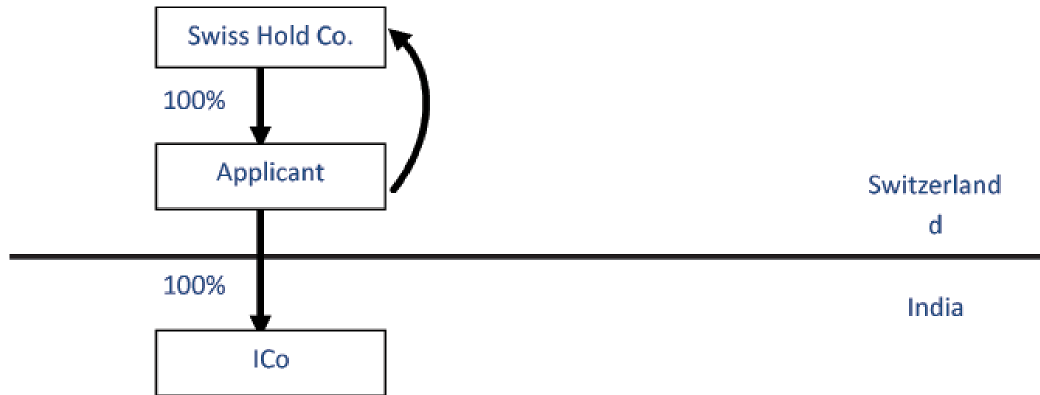
  - If the nominees are treated as holding the shares benami for the parent company, it would offend the Benami Transactions (Prohibition) Act, 1988 and also violate Sec. 49(3) of the Companies Act. The nominees can also not be regarded as a trustee in view of Sec. 153 of the Companies Act. The result is that the applicant does not hold 100% of the share capital of the subsidiary and so Sec. 47(iv) is not attracted;

Sec. 46A, which provides that in the case of a buyback, the difference between the consideration and the cost of acquisition shall be deemed to be capital gains is a special provision and prevails Sec. 45. Sec. 47 overrides Sec. 45 but not Sec. 46A. There is no reason to enquire whether Sec. 46A is a charging section or not. The result is that even if the exemption in Sec. 47(iv) is held applicable, it does not override Sec. 46A and the applicant is subject to capital gainSec.

## Credit Suisse (International) Holding AG (AAR)

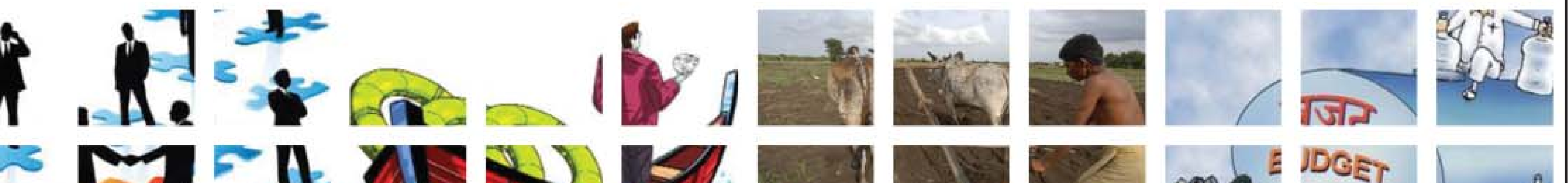
- The Applicant was a company incorporated under the laws of Switzerland and is a wholly owned subsidiary of another company incorporated in Switzerland ('Swiss Hold Co'). The Applicant had set up a wholly owned subsidiary in India ('ICo'). Swiss Hold Co and the

Applicant intend to merge into a single legal entity by means of a merger by absorption as per the Swiss Merger Act. Thereby, all the assets and liabilities of the Applicant would be assumed by 'Swiss Hold Co' and the Applicant would be dissolved without liquidation. No consideration would pass to the Applicant consequent on the merger in view of the Swiss Merger Act.




- The Applicant approached the Authority for advance rulings on the questions raised by it in the context of the taxability of above merger.
  - Whether any capital gains under section 45 of the ITA arises to the Applicant as a result of such amalgamation
  - Whether the vesting of shares of I Co. held by the Applicant in Swiss Hold Co, pursuant to a scheme of amalgamation is exempt from capital gains tax under section 47(via) of the ITA?
  - Whether the rate of tax applicable to the Applicant is 20% as per the provisions of section 112(1) of the Act after giving effect to the first proviso to section 48 of the Act?
  - Whether there is any requirement on Swiss Hold Co to withhold taxes in accordance with the provisions of section 195 of the ITA?
  - Whether the Applicant is required to file a return of income under section 139 of the Act?
  - Whether the provisions of section 92 to 92F of the Act are attracted in case of the Applicant as a result of vesting of shares of ICo. held by the Applicant, in Swiss hold Co pursuant to the scheme of amalgamation?
- **The primary arguments of the Applicant were :**
  - The transaction is not a transfer in the eye of law;





- Even if there was a transfer, No consideration accrued to the Applicant and
- In any event, such a transaction was exempted from the operation of section 45 of the Act, by section 47 (via) of the Act and therefore no income was taxable under the head 'Income from Capital Gains'.

- Reliance was placed on Ruling in Hoechst GmbH, AAR No.728 of 2006 and two decisions of the Supreme Court referred to in that Ruling. However the revenue contended as follows;

**Primary Contentions of the Revenue were :**

- The transaction is considered as a transfer in terms of section 2(47) of the Act. The Indian company is prosperous and it continues to exist in spite of the so-called merger.
- There is a consideration in law for the transfer easily capable of being quantified and
- The transaction is taxable in India under the Act. Section 47 (via) of the Act is not applicable to the present case.
- It was held that for the purposes of the ITA, transfer in relation to a capital asset is defined in section 2(47) of the Act. It is an inclusive definition and not a restrictive definition. It includes the sale, exchange or relinquishment of an asset or the extinguishment of any right therein. Hence, the transition would amount to transfer. Reliance was placed on the Ruling in P.3 of 1994, In re (240 ITR 518) where it was held that the change of ownership of the shares from the applicant to the amalgamated company would involve a transfer of shares by the applicant to the amalgamated company. It does not appear to be necessary to pursue that aspect, since the question in this case is whether the transfer has generated any income liable to be charged under section 45 of the Act. On question No.1, it was held no capital gain arises to the Applicant as a result of the merger since the gain, if any, in this case is not determinable within the scope of section 45 and section 48 of the Act as postulated in the Ruling in Dana Corporation (AAR No.788 of 2008). The condition no. (iii) of Section 2(1B) of the ITA on amalgamation is not satisfied since the shareholders of the Applicant merging with 'Swiss Hold Co' do not or cannot become shareholders of company 'C' as company 'C' is the only shareholder of the Applicant and hence section 45 of the ITA would be attracted. Reliance was placed on the High Court of Bombay in Forbes Forbes Campbell & Co. Ltd. v. CIT (150 ITR 529). Hence, on question no. 2 it is ruled that the merger involved in this case is not exempt from capital gains tax under section 47(via) of the Act In view of the ruling on question no.1, question no. 3 need not be ruled on. On question no.4 the ruling is that there is no obligation on 'Swiss Hold Co' to withhold taxes under section 195 of the Act. On question No 5 and 6, nothing was ruled since they were not pressed.

### Our Comments

- The AAR has differed yet again from its earlier ruling given in the case of Hoechst GmbH, AAR No.728 of 2006.
- This ruling has provided an immense observation about the tax liability that would arise in India due to an overseas merger of the subsidiary company with its holding company. It has opened a plethora of questions by ruling that such merger does not qualify as an amalgamation under Section 2(1B) of the ITA.
- As per the newly inserted Section 50D of the ITA, where the consideration is not ascertainable, then the fair market value of the asset shall be deemed to be considered. Hence, in view of such insertion, now such transactions may be liable to capital gains as the gains shall become determinate.

## INBOUND AND OUTBOUND POLICY

### IMPORTANT RECENT DEVELOPMENTS IN INBOUND INVESTMENTS POLICIES :

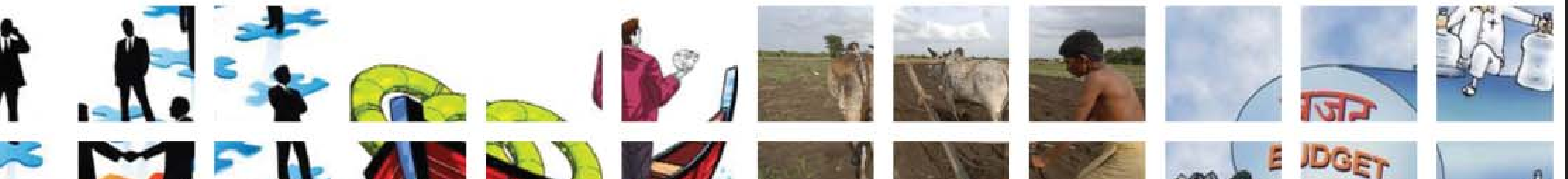
## FDI AND FII RELATED DEVELOPMENTS :

#### FOREIGN INVESTMENT IN SINGLE–BRAND PRODUCT RETAIL TRADING/ MULTI-BRAND RETAIL TRADING / CIVIL AVIATION SECTOR / BROADCASTING SECTOR / POWER EXCHANGESec.

The foreign direct investment policy has been reviewed and it has been decided as follows:

- FDI up to 100 per cent is now permitted in Single–Brand Product Retail Trading by only one non-resident entity, whether owner of the brand or otherwise, under the Government route.
- FDI up to 51 per cent is now permitted in Multi-Brand Retail Trading under the Government route.
- Foreign airlines are permitted FDI up to 49% in the capital of Indian companies in Civil Aviation Sector, operating scheduled and non-scheduled air transport, under the automatic/Government route.
- FDI up to 49% is permitted in Power Exchanges registered under the Central Electricity Regulatory Commission (Power Market) Regulations, 2010, under the Government route.
- Foreign investment in Mobile TV is permitted up to 74%. Foreign investment is permitted upto 49% under the automatic route while foreign investment beyond 49% and up to 74% is permitted under the approval route.





## SETTING UP OF STEP DOWN OPERATING SUBSIDIARIES BY NON BANKING FINANCE COMPANIES (NBFCS) – FOREIGN DIRECT INVESTMENT (FDI) POLICY

Presently in terms of FDI policy only 100% foreign owned NBFCs with a minimum capitalization of US $ 50 million are allowed to set up step down subsidiaries for specific NBFC activities, without any restriction on the number of operating subsidiaries and without bringing in additional capital. The Government of India has now reviewed the present policy and decided to permit NBFCs having foreign investment above 75 % and below 100% with a minimum capitalization of US$ 50 million to set up step down subsidiaries with other condition remaining same. Consequently, the RBI has on October 10, 2012 amended the relevant conditions of AP (DIR series) circular No. 137 dated June 28, 2012 dealing with FDI in NBFC.

Even the conditions of compiling with relevant sectoral conditions on entry route, conditionality's and caps, with regards to such step down subsidiaries by an Indian Company which is owned and / or controlled by Non – Resident entities shall not apply.

## FOREIGN DIRECT INVESTMENT (FDI) IN INDIA - ALLOTMENT OF SHARES TO PERSON RESIDENT OUTSIDE INDIA UNDER MEMORANDUM OF ASSOCIATION (MOA) OF AN INDIAN COMPANY - PRICING GUIDELINES

- A person resident outside India or an entity incorporated outside India may purchase shares or convertible debentures of an Indian company under Foreign Direct Investment Scheme, subject to compliance with the issue price.
- Further it has been decided that where Non-residents (Including NRIs) make investment in an Indian company in compliance with the provisions of the Companies Act, 1956, by way of subscription to the Memorandum of Association, such investments may be made at face value subject to their eligibility to invest under the FDI scheme.

## FOREIGN DIRECT INVESTMENT (FDI) IN ASSETS RECONSTRUCTION COMPANIES (ARCs)

Presently, FDI in ARCs is allowed upto 49% and investment the Foreign Institutional Investors (FIIs) in security Receipts (SRs) issued by ARCs is allowed upto 49% of each tranche of scheme of SRs. The Government of India has now, in consultation with the stake holder and the sector regulators reviewed the ceilings of FDI and the Foreign Institutional Investors (FII) as under:

- The ceiling for FDI in ARCs has been increased from 49% to 74% subject to the condition that no sponsor may hold more than 50% of the shareholding in an ARC either by way of FDI or by routing through an FII. The foreign investment in ARCs would need to comply with the FDI policy in terms of entry route conditionality and sectoral caps.
- The foreign investment limit of 74% in ARC would be combined limit of FDI and FII. Hence, the prohibition on investment by FII in ARCs will be removed. The total shareholding of an

individual FII shall not exceed 10% of the total paid up capital.

The limit of FII investment in SRs may be enhanced from 49% to 74%. Further, the individual limit of 10% for investment of a single FII in each tranche of SRs issued by ARCs may be dispensed with. Such investment should be within the FII limit on complied with.

## AMENDMENTS RELATED TO FIIs:

### FOREIGN INVESTMENT IN INDIA BY SEBI REGISTERED FIIS IN GOVERNMENT SECURITIES AND CORPORATE DEBT

The present limit for FIIs investments in Government securities in USD 20 billion and for corporate debt is USD 45 billion including sublimit of USD 25 billion for the bonds of the infrastructure sector.

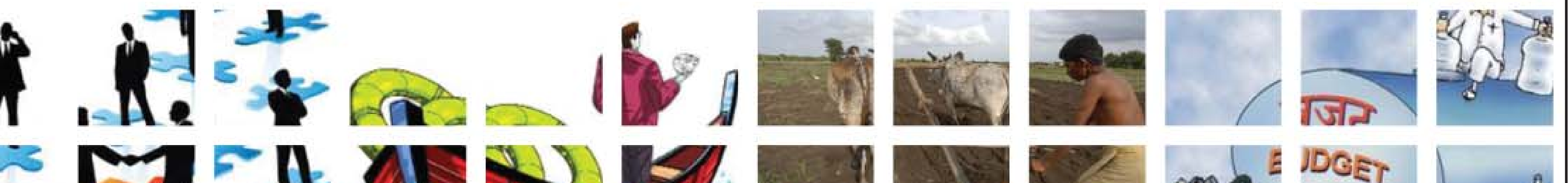
It has now been decided to implement the following changes:

#### Government Securities

- The sub-limit of USD 10 billion for investment by FIIs and the long –term investors in dated Government securities stands enhanced by USD 5 billion, i.e. from USD 10 billion to USD 15 billion. Accordingly, the total limit for investment in Government Securities stands enhanced from USD 20 billion to USD 25 billion.
- The condition of three- year residual maturity of the Government securities at the time of first purchase for the above sub limit shall no longer be applicable. Thus, residual maturity condition shall not be applicable for the entire sub –limit of USD 15 billion but such investments will not be allowed in short-term paper like Treasury Bills, as hitherto.
- A summary of revised position for Government Securities is given below:

| Instrument | Limit | Investor | Conditions | Remarks |
|---|---|---|---|---|
| Government securities | USD 10 Billion | FIIs | No Conditions | - |
| Government dated securities | USD 15 Billion | FIIs and SWF, Multilateral Agencies, Pension / Insurance/ Endowment Funds, Foreign Central Banks | Investments in short term paper like Treasury Bills not permitted | No residual Maturity requirement |





- **Corporate Debt**
  - The limit for FII investment in corporate debt in other than infrastructure sector stands enhanced by USD 5 billion, i.e., from USD 20 billion to USD 25 billion. However, the enhanced limit of USD 5 billion shall not be available for investment in Certificate of Deposit (CD) and Commercial Paper (CP). Accordingly, the total corporate debt limit stands enhanced from USD 45 billion to USD 50 billion with sublimit of USD 25 billion each for infrastructure and other than infrastructure sector bonds. In addition as hitherto, Qualified Foreign Investors (QFIs) shall continue to be eligible to invest in corporate debt securities (without any lock-in or residential maturity clause) and Mutual Fund debt schemes subject to a total overall ceiling of USD 1 billion in terms of A.P. This limit of USD 1 billion shall continue to be over and above the revised limit of USD 50 billion for investment in corporate debt.
  - The revised limit of USD 25 billion for corporate bonds for other than infrastructure sector shall be available for investment by FIIs and the long term investors like Sovereign Wealth Funds (SWFs), Multilateral Agencies, Endowment Funds, Insurance Funds, Pension Funds and Foreign Central Banks registered with SEBI.
  - As a measure of further relaxation, it has also been decided to dispense with the condition of one year lock-in period for the limit of USD 22 billion (comprising the limits of infrastructure bonds of USD 12 billion and USD 10 billion for non-resident investment in IDFs) within the overall limit of USD 25 billion for foreign investment in infrastructure corporate bonds. The residual maturity period (at the time of first purchase) requirement of entire limit of USD 22 billion for foreign investment in infrastructure sector has been uniformly kept at 15 months. The 5 years residual maturity requirement for investment by QFIs within the USD 3 billion limit has been modified to 3 years original maturity.

A summary of revised position for corporate debt limits is given below:

| Instrument | Limit | Investor | Conditions | Remarks |
|---|---|---|---|---|
| **A. Non-Infrastructure Sector** | | | | |
| (i) Listed NCDs/ bonds, CPs | USD 20 billion | FIIs | Investment in CDs not permitted. | No lock-in period requirement; |

| Instrument | Limit | Investor | Conditions | Remarks |
|---|---|---|---|---|
| (ii) Listed NCDs/ bonds | USD 5 billion | FIIs, SWFs, Multilateral Agencies, Pension/ Insurance/ Endowment Funds, Foreign Central Banks | Investments in CPs and CDs not permitted | No lock-in period requirement; |
| (iii) Security Receipts, Perpetual debt instruments, units of domestic mutual funds; "to be listed | Within the total limit of USD 25 billion for non-infrastructure sector | FIIs | - | No Lock-in period, |
| **B. Non-Infrastructure limit for Qualified Foreign Investors (QFIs)** | | | | |
| Listed NCDs, listed bonds, | USD 1 billion | QFIs | - | No Lock-in period and |
| listed units of mutual funds debt schemes, "to be listed corporate bonds" | | | | no residential maturity requirements; |
| **C. Infrastructure Sector** | | | | |
| Listed NCDs/ bonds, NCDs/ bonds of NBFC-IFC and unlisted NCDs/ bond in infrastructure sector | USD 12 billion (within the total limit of USD 25 billion) | FIIs | Indian Companies in infrastructure sector-infrastructure sector defined in the ECB guidelines and Non Banking Financial Companies (NBFCs) defined as IFCs. | No Lock-in period requirement; |

| Instrument | Limit | Investor | Conditions | Remarks |
|---|---|---|---|---|
| Corporate Debt non – convertible debentures/ bonds, non – convertible debentures/ bonds of NBFCs-IFC, Units of Domestic Mutual fund Debt schemes | USD 3 billion (within the total limit of USD 25 billion) | QFIs | NBFCs defined as IFCs – MF schemes that hold at least 25% of debt or equity or both in mutual funds in infra | No lock in period requirement. |
| IDF – Rupee bonds/ units registered as NBFC or Mutual Funds | USD 10 billion (within the total limit of USD 25 billion) | FIIs, NRIs, SWFs, Multilateral Agencies, Pension/ Insurance/ | Infrastructure as defined in the EBC guidelines IDFs set up as NBFCs may invest in debt securities of PPP | No lock in period requirement. |
| | | Endowment Funds, HNIs registered with SEBI, sub-account of FII or FDI | infra projects and should have completed one year of commer-cial operations; IDFs set up as Mutual Funds would invest 90% in debt se-curities of infra companies/ SPV | |

(It seems RBI has liberalized the conditions for investment in debt markets with the hope to improve the balance of payment position as financial year end is approaching fast.)

## PRIOR INTIMATION TO THE RESERVE BANK OF INDIA FOR RAISING THE AGGREGATE FOREIGN INSTITUTIONAL INVESTORS / NON-RESIDENT INDIAN LIMITS FOR INVESTMENTS UNDER THE PORTFOLIO INVESTMENT SCHEME:

Registered Foreign Institutional Investors (FII) and Non-Resident Indians (NRI) are allowed to purchase/sale shares and convertible debentures of an Indian company (through registered brokers) on recognized stock exchanges in India subject to, inter-alia, aggregate investment limit of 24 per cent and 10 per cent, respectively, of the paid up equity capital or value of each series of convertible debentures of the Indian company.

Indian company raising the aggregate FII investment limit of 24 per cent to the sectorial cap/ statutory limit, as applicable to the respective Indian company or raising the aggregate NRI investment limit of 10 per cent to 24 per cent, should necessarily intimate the same to the Reserve Bank of India, immediately, as hitherto, along with a Certificate from the Company Secretary stating that all the relevant provisions of the extant Foreign Exchange Management Act, 1999 regulations and the Foreign Direct Policy, as amended from time to time, have been complied with.

### FOREIGN EXCHANGE DERIVATIVE CONTRACT:

A registered FII is permitted to enter into foreign currency – rupee swaps for hedging the transient capital flows relating to the Initial Public Offers (IPO) under the Application Supported by Blocked Amount (ASBA) mechanism

A non-resident importer / exporter may enter into a forward contract with rupee as one of the currencies or a foreign currency – rupee option contract with an Authorized Dealer in India to hedge the currency risk in respect of exports from and imports to India, invoiced in Indian Rupees

### FACILITIES FOR PERSONS RESIDENT OUTSIDE INDIA –FIIS

Presently, FII are permitted to hedge the currency risk on the market value of their entire investment in equity and /or debt in India, as on a particular date, only with designated bank branches.

FII are permitted to hedge the currency risk on the market value of their entire investment in equity and /or debt in India, as on a particular date, with any bank, subject to certain conditions.

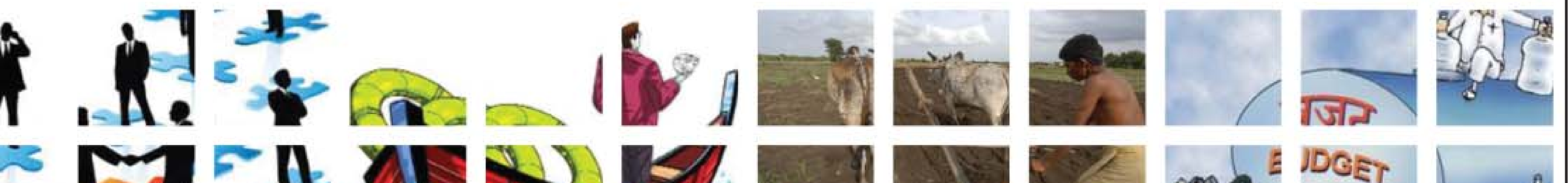
However, when the FII undertakes hedge with a non –designated bank branch, the same has to be settled through the special Non-Resident Rupee A/c maintained with the designated bank through RTGS/NEFT

## SCHEME FOR INVESTMENT BY QUALIFIED FOREIGN INVESTOR (QFI'S) IN INDIAN CORPORATE DEBT SECURITIES.

Presently, QFI's are permitted to invest only in rupee denominated units of domestic Mutual Funds and listed equity shares.

The definition of QFI is revised and now the Revised definition has permitted them to also invest on repatriation basis debt securities subject to certain terms and conditions .QFI can now invest up to $ 1 billion in corporate debt securities (without any lock in or residual maturity clause) and mutual fund debt schemes. This limit shall be over and above $ 20billion for FII investment in corporate debt. For this purpose, QFI must open a single non-interest bearing Rupee Account with a bank in India for investment in all 'eligible securities for QFI's





**As per the revised definition, QFI shall mean the person who fulfills the following criteria:**

- Resident in a country that is a member of Financial Task Force (FATF) or a member of a group which is a member of FATF; and
- Resident in a country that is a signatory to IOSCO's MoU (Appendix A signatories) or signatory of a bilateral MoU with SEBI

PROVIDED that the person is not resident in a country listed in the public statements issued by FATF, from time to time, on jurisdiction having a strategic AML/CFT deficiencies to which counter measures apply or that have not made sufficient progress in addressing the deficiencies or have not committed to an action plan developed with the FATF to address the deficiencies

PROVIDED that such person is not resident in India;

PROVIDED FURTHER that such person is not registered with SEBI as a Foreign Institutional Investor (FII) or Sub-Account of an FII or Foreign Venture Capital Investor (FVCI)

**Explanation – for the purposes of this clause:**

- "Bilateral MoU with SEBI shall mean a bilateral MoU between SEBI and the overseas regulator that, inter alia, provides for information sharing arrangements.
- Member of FATF shall not mean an associate member of FATF

**Foreign Investment by Qualified Foreign Investors (QFIs) – Hedging facilities:**

The Qualified Foreign Investors (QFIs) are permitted to hedge their currency risk for the following:

- Entire investment in equity and/or debt in India as on a particular date through foreign currency – INR options.
- Initial Public Offers (IPO) related transient capital flows under the Application Supported by Blocked Amount (ASBA) mechanism through Foreign Currency – INR swaps.

## OVERSEAS DIRECT INVESTMENTS BY INDIAN PARTY – RATIONALIZATION

The guidelines related to submission of Annual Performance Report (APR) is amended as under:

An Indian party, which has set up/acquired a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) overseas, will have to submit to its designated bank every year, an Annual Performance Report (APR) in Form ODI Part III in respect of each JV or WOS on or before 30th June each year. The APR, so required to be submitted, has to be based on the latest audited annual accounts of the JV / WOS, unless specifically exempted by the Reserve Bank.

**AMENDMENTS IN ECB POLICY :**

## REFINANCING / RESCHEDULING OF EXTERNAL COMMERCIAL BORROWINGS (ECBs) UNDER THE APPROVAL ROUTE

It is permitted for borrowers desirous of refinancing existing ECB, to raise fresh ECB at a higher all in cost/ reschedule an existing ECB at a higher all in cost under the approval route subject to the condition that the enhanced all in cost does not exceed the all in cost ceiling prescribed as per the extant guidelines.

## ENHANCEMENT OF REFINANCING LIMIT FOR POWER SECTOR

Indian companies in the power sector would be allowed to utilize 40% of the fresh ECB raised, towards refinancing of the Rupee Loan/s availed by them from the domestic banking system, under the approval route, provided that at least 60% of the fresh ECB proposed to be raised should be utilized for fresh capital expenditure for infrastructure projects.

## EXTERNAL COMMERCIAL BORROWINGS (ECBs) FOR MAINTENANCE AND OPERATION OF TOLL SYSTEMS FOR ROADS AND HIGHWAYS UNDER AUTOMATIC ROUTE

ECB would be allowed for capital expenditure under automatic route for the purpose of maintenance and operation of Toll systems for roads and Highways provided they form the part of original project. Existing ECB and reporting requirements would remain unchanged

## CIVIL AVIATION SECTOR AUTHORISED UNDER APPROVAL ROUTE TO RAISE EXTERNAL COMMERCIAL BORROWINGS (ECBs) FOR WORKING CAPITAL AS END USE.

Companies in civil aviation sector are now permitted to raise ECB for working capital as permissible end use for civil aviation sector under approval route and also to refinance the outstanding working capital rupee loan availed from the domestic banking system, subject to following conditions:

Airline Company should be registered under Companies Act, 1956 and also should possess permit license from Directorate General of Civil Aviation (DGCA) for passenger transportation.

ECB should be raised within 12 months from the date of issue of this circular (24th April, 2012) and minimum average maturity period of three years. Overall ceiling for the entire civil aviation sector would be USD 1 Billion and the maximum permissible ECB that can be availed by an individual Airline company will be USD 300 Million. The ECBs availed shall not be allowed to be rolled over.

ECB will be allowed to Airline Company based on cash flow, foreign exchange earnings and its capability to service the debt.

The application for such ECB should be accompanied by a certificate from a Chartered Accountant confirming the requirement of the working capital loan and the projected foreign exchange cash flow / earnings which would be used for servicing the loan. It should be ensured that liability is extinguished only out of foreign exchange earnings of the borrowing company and not accessed from Indian market.

## EXTERNAL COMMERCIAL BORROWINGS (ECB) REPAYMENT OF RUPEE LOANS.

The Indian companies in the manufacturing and infrastructure sector who have consistent Foreign exchange earnings during the last three years to avail, under Approval Route, ECB for repayment of Rupee loan (s) availed of from the domestic banking system and/or for fresh Rupee capital expenditure, provided the companies are not in the default list/caution list of the Reserve Bank of India.

The overall ceiling for such ECB will be US$10 billion and the maximum permissible ECB that can be availed of by an individual company, 75 of the average foreign exchange earnings realized during the immediate past three financial years or 50 per cent of the highest foreign exchange earnings realized in any of the immediate past three financial years, whichever is higher. Draw down to the entire facility must be undertaken within a month after taking the Loan Registration Number (LRN) from RBI

In case of Special Purpose Vehicles (SPVs), which have completed at least one year of existence from the date of incorporation and do not have sufficient track record/past performance for three financial years, the maximum permissible ECB that can be availed of will be limited to 50 per cent of the annual export earnings realized during the past financial year;

The maximum ECB that can be availed by an individual company or group, as a whole, under this scheme will be restricted to USD 3 billion.

Latest circular also grants similar facilities to Indian companies in the hotel sector (with a total project cost of Rs. 250 crore or more). As a result, these companies can now avail of ECB for repayment of outstanding Rupee loan(s) availed of by them from the domestic banking system and/or for fresh Rupee capital expenditure.

## EXTERNAL COMMERCIAL BORROWINGS (ECB) POLICY - ECB BY SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

This circular states that SIDBI has been added as an eligible borrower for availing of ECB up to US$ 500 million per financial year for on –lending, for permissible end uses, to the Micro, Small and Medium Enterprises (MSME) sector, subject to the following conditions:-

- Lending must be done directly to the borrowers, either in INR or in foreign currency (FCY):-
  - Foreign currency risk must be hedged by SIDBI in full in case of on lending to MSME sector in INR ;and
  - On –lending in foreign currency can only be to those beneficiaries who have a natural hedge by way of foreign exchange earnings.
- Availment of ECB, including the outstanding ECB, up to 50% of owned funds, can be availed under the automatic route and ECB beyond 50% of owned funds, can be availed under the approval route.

## EXTERNAL COMMERCIAL BORROWINGS (ECB) POLICY – BRIDGE FINANCE FOR INFRASTRUCTURE SECTOR

Presently, Indian companies in the infrastructure sector can, under the Approval Route, import capital goods by availing of short term credit (including buyers'/suppliers' credit) in the nature of 'bridge finance', subject to the following conditions:-

- Bridge finance must be replaced with a long term ECB.
- ECB must comply with all the extant norms.
- Prior approval; of RBI will have to be obtained for replacing the bridge finance with long term ECB.

The bridge finance (including buyers'/suppliers' credit) availed of for import of capital goods is permitted to be replaced with EBC under the Automatic Route subject to the following:

- Buyers'/suppliers' credit is refinanced through an EBC before the end of the maximum permissible period of trade credit.
- Import of capital goods must be verified from the Bill of Entry by the Bank.
- Buyers'/suppliers' credit availed of its compliant with the extant guidelines on trade credit.
- The goods that are imported, comply with the DGFT policy on imports.
- The proposed ECB must be compliant with all extant ECB guidelines.
- Banks in India cannot provide any form of guarantees for the ECB.

**However, the borrower will still have to obtain prior approval of RBI (under Approval Route) for availing of bridge finance.**

### EXTERNAL COMMERCIAL BORROWINGS (ECB) POLICY FOR 2G SPECTRUM ALLOCATIONS

This circular contains the revised guidelines for availing ECB upto US$ 750 million per company per financial year under the automatic route by successful bidders in the 2G Spectrum auction:-

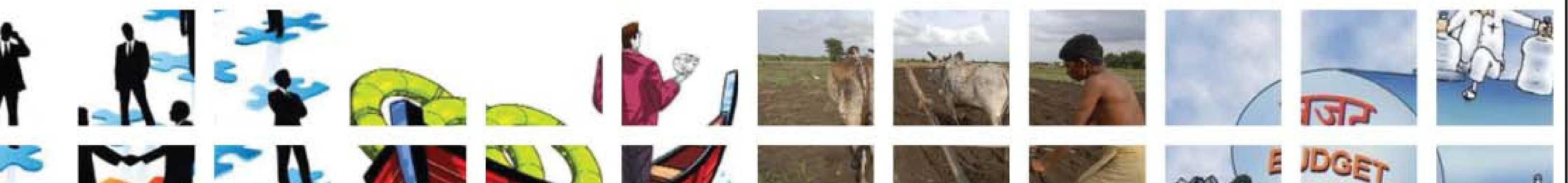
- Refinancing of Rupee resources

Successful players who have made upfront payment for award of 2G spectrum initially out of Rupee loans availed of from the domestic lenders are eligible to refinance such Rupee loans with a long term ECB within a period of 18 months from the date of sanction of such Rupee loans for the stated purpose from the domestic lenders after showing proof of upfront payment to bank

- Relaxation in ECB-liability ratio and percentage of shareholding

Successful bidders are permitted to avail of ECB from their ultimate parent company without any maximum ECB liability-equity ratio, if the lender holds minimum paid up equity of 25% in the borrower company, either directly or indirectly.





- Bridge Finance facility

Successful bidders can avail of short term foreign currency loans in the nature of bridge finance under the 'automatic route' for the purpose of making up-front payment towards 2G spectrum allocation and replace the same with a long term ECB provided the long term ECB is raised within a period of 18 months from the date of drawdown of bridge finance.

## EXTERNAL COMMERCIAL BORROWINGS (ECB) FOR MICRO FINANCE INSTITUTIONS (MFIS) AND NON-GOVERNMENT ORGANIZATIONS (NGOS) ENGAGED IN MICRO FINANCE ACTIVITIES UNDER AUTOMATIC ROUTE

MFIs may be permitted to raise ECB up to US$10 million or equivalent during a financial year for permitted end uses, under the automatic route. With a view to ensure minimization of systemic risk, the maximum amount of foreign currency borrowings of a borrower is capped at US$10 million during a financial year.

## ECB FOR LOW COST AFFORDABLE HOUSING PROJECTS.

In view of the announcement made in the union budget for the year 2012-13, RBI has allowed ECB for low cost affordable housing projects as a permissible end use, under the approval route. ECB can be availed of by developers / builders for low cost affordable housing projects. Housing Finance Companies (HFCs) /National Housing Bank (NHB) can also avail of ECB for financing prospective owners of low cost affordable housing units.

For the financial year 2012-13, an aggregate limit of $ 1 billion is fixed for ECB under the low cost affordable housing scheme which includes EXBs to be raised by developers/builders and NHB/ specified HFCs subject to annual review.

The developers/builders/HFCs /NHB will not be permitted to raise Foreign Currency Convertible Bonds (FCCBs) under this scheme.

To give effect to aforesaid amendment, consequential amendments are made to the Foreign Exchange Management (Borrowing or lending in Foreign Exchange) Regulations, 2000 [Notification No. FEMA 3/2000 –RB dated 3rd May, 2000] vide Notification No. FEMA 246/2012- RB dated 27th November, 2012.

## EXTERNAL COMMERCIAL BORROWINGS (ECB) POLICY-NON BANKING FINANCIAL COMPANY – INFRASTRUCTURE FINANCE COMPANIES (NBFC-IFCS)

As per the guidelines, Non-Banking finance companies (NBFC) categorized as infrastructure Finance Companies (IFC) can avail of ECB, including the outstanding ECB, up to 50% of their owned funds can be availed of under the automatic route and beyond 50% under approval route.

This circular has –

- Raised this limit of 50% under to 75% and hence, permits IFC to avail of ECB, including the outstanding ECB, up to 75% of their owned funds under the Automatic Route.ECB above 75% of their net owned funds can be availed of under the Approval Route.
- Reduced the hedging requirement for IFC for currency risk from 100% of their exposure to 75% of their exposure.

## OTHER AMENDMENTS:

### DELEGATION OF COMPOUNDING PROCESS PERTAINING TO COMPOUNDING OF CONTRAVENTIONS UNDER FEMA, 1999

As a measure of customer service and in order to facilitate the operational convenience the RBI has delegated powers to its Regional Offices to compound the non compliances in relation to FDI contraventions of FEMA involving (i) delay in reporting of inward remittance, (ii) delay in filing of form FC-GPR after allotment of shares and (iii) delay in issue of shares beyond 180 days such as paragraphs 9(1)(A), 9(1)(B) and 8, respectively, of the Schedule I to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000, notified vide Notification No. FEMA 20/2000-RB dated 3 May 2000 and as amended from time to time.

- **For contraventions under (a) Paragraphs 9 (1) (A) and 9 (1) (B) of Schedule I to FEMA 20/2000-RB dated 3 May 2000**

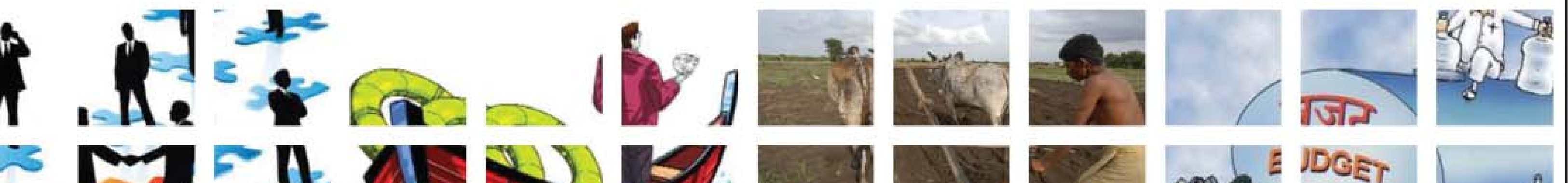
  Bhopal, Bhubaneswar, Chandigarh, Guwahati, Jaipur, Jammu, Kanpur, Kochi, Patna and Panaji for amount of contravention below INR 0.1 million only and

- **For contraventions under (b) Paragraphs 9 (1) (A), 9 (1) (B) and 8 of Schedule I to FEMA 20/2000-RB dated 3 May 2000 –**

Ahmedabad, Bangalore, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi for amount of contravention without any limit.

Accordingly, all applications for compounding whether received on the advice of the Regional Office concerned or suo-moto, relating to the aforesaid contraventions, may be submitted by the companies falling, under the jurisdiction of the aforesaid Regional Offices, directly to the Regional Office concerned, together with the prescribed fee and other relevant documents.

The RBI has also prescribed the list of relevant documents apart from the specified form, which are required to be attached with the application for the compounding in the cases related to Foreign Direct Investment, External Commercial Borrowings, Overseas Direct Investment and branch office/liaison office.



## DEREGULATION OF INTEREST RATES ON NON-RESIDENT (EXTERNAL) RUPEE (NRE) DEPOSITS AND NON-RESIDENT ORDINARY (NRO) ACCOUNTS

With a view to provide increased flexibility to banks in mobilizing non-resident deposits and also in view of the prevailing market conditions, the RBI has decided to deregulate interest rates on NRE Rupee Deposits and NRO Accounts.

Accordingly, banks are free to determine their interest rates on both savings deposits and term deposits of maturity of one year and above under the NRE deposit accounts and savings deposits under NRO accounts with immediate effect. However, interest rates offered by banks on NRE and NRO deposits cannot be higher than those offered by them on comparable domestic rupee deposits.

The revised deposit rates shall apply only to fresh deposits and on renewal of maturing deposits. Further, banks are advised to closely monitor their external liability arising on account of such deregulation and ensure asset-liability compatibility from systemic risk point of view.

## TRANSFER OF FUNDS FROM NON-RESIDENT ORDINARY (NRO) ACCOUNT TO NON-RESIDENT EXTERNAL (NRE) ACCOUNT

On a review, it has been decided that henceforth NRI as defined in Foreign Exchange Management (Deposit) Regulations, 2000 contained in Notification No. FEMA.5/2000-RB dated 3rd May 2000, as amended from time to time, shall be eligible to transfer funds from NRO account to NRE account within the overall ceiling of USD one million per financial year subject to payment of tax, as applicable (i.e. as applicable if funds were remitted abroad). Such credit of funds to NRE account shall be treated as eligible credit in terms of paragraph 3(j) of Schedule-1 of Notification No. FEMA.5/2000-RB dated 3rd May 2000.

NON – RESIDENTS CAN AVAIL EITHER RUPEE LOANS IN INDIA OR FOREIGN CURRENCY LOAN IN INDIA OR OUTSIDE INDIA AGAINST SECURITY OF NON – RESIDENT (EXTERNAL) RUPEE ACCOUNT (NRE) FIXED DEPOSITS / FOREIGN CURRENCY NON RESIDENT (BANK) ACCOUNT (FCNR) FIXED DEPOSITS FROM AUTHORISED BANKS:-

**Non – Residents can avail either rupee loan in India or Foreign Currency Loan in India or outside India against funds held in either NRE Deposits of FCNR Deposits without any ceilings subject to usual margin requirements of Authorized Bank.**

Loan shall include all types of Fund Based and Non – Fund Based Facilities.

## LIAISON OFFICE, BRANCH OFFICE:

## CLARIFICATION ON ESTABLISHMENT OF LIAISION OFFICE/PROJECT OFFICE/BRANCH OFFICE

It is clarified that permission to establish offices, in India by foreign Non-Government Organizations/Non-Profit Organizations/Foreign Government Bodies/Departments, by whatever

name called, are under the Government Route and accordingly, such entities are required to apply to the Reserve Bank for prior permission to establish an office in India, whether Project Office or otherwise.

### TRANSFER OF ASSETS OF LIAISON/BRANCH OFFICE:

Transfer of assets of Liaison / Branch Office to subsidiaries or other LO / BO or any other entity is permitted only with the specific approval of the Central Office of the Foreign Exchange Department, Reserve Bank of India.

### REPORTING TO INCOME TAX AUTHORITIES:

Copies of the Annual Activity Certificate are to be submitted to the Director General of Income Tax (International Taxation). This submission should be accompanied by audited financial statements including receipt and payment account.

## ACCOUNTS, AUDIT AND INVESTMENTS

### RECENT ACCOUNTING DEVELOPMENTS

**Circular/Notifications issued by statutory bodies under various Act**

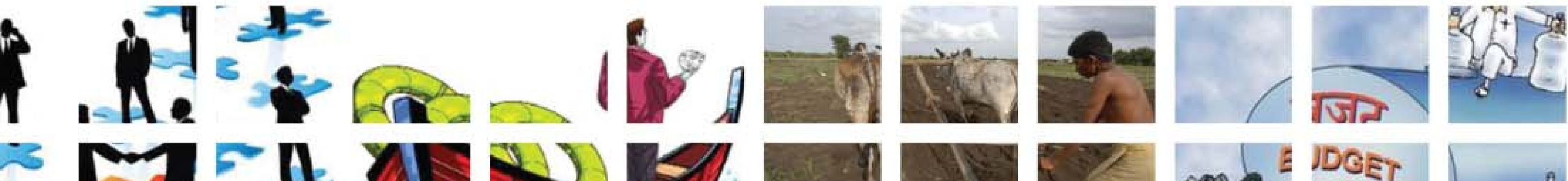
- **Companies Bill 2012**

  The Companies Bill, 2012, is organized as 29 chapters, 470 clauses and 7 scheduleSec. A substantial part of the law will be in form of Rules, to be prescribed separately. It has introduced 33 new definitionSec. Here's a look at some of its key highlightSec.

***Incorporation & Capital raising***

- A private company can have a maximum of 200 members, up from 50 in the Companies Act, 1956.
- The concept of One Person Company introduced. It will be a private limited company.
- Concept of dormant companies introduced. It can be formed for a future project or to hold an asset or intellectual property.
- All companies to follow uniform financial year, running from April to March. Exceptions to be made only for certain companies with the approval of NCLT.
- All types of securities to be governed by the Bill.
- The Prospectus has to be more detailed.
- Money raised through a prospectus cannot be used for dealing in equity shares of another company. If a company changes terms of the prospectus or objects for which money is raised, it shall provide dissenting shareholders an exit opportunity.





- ‘Private placement’ defined, with detailed provisions for such placement.
- Apart from existing shareholders, if the Company having share capital at any time proposes to increase its subscribed capital by issue of further shares, such shares may also be offered to employees by way of ESOP, subject to the approval of shareholders by way of Special Resolution.
- NBFCs not covered by the provisions relating to acceptance of depositSec. They will be governed by Reserve Bank of India RuleSec.
- Companies can accept deposits only from its members, that too after obtaining shareholders approval. Acceptance of deposit also subject to compliance with certain conditionSec.
- Public companies can accept deposit from public on complying certain conditions like credit rating.

### *Management & Administration*

- Listed companies required to file a return in a prescribed form with the Registrar regarding any change in the number of shares held by promoters and top 10 shareholders of such company, within 15 days of such change.
- Postal Ballot to be applicable to all the companies, whether listed or unlisted.
- Interim dividend in a current financial cannot exceed the average rate of dividend of the preceding three years if a company has incurred loss up to the end of the quarter immediately preceding the declaration of such dividend.
- Financial statements include Balance Sheet, Profit & Loss Account and cash flow statementSec.
- Provisions for re-opening or re-casting of the books of accounts of a company provided.
- The National Advisory Committee on Accounting Standards renamed as The National Financial Reporting Authority.
- The authority to advice on Auditing Standards and Accounting StandardSec.

### *Auditors & Financial statements*

- Every company is required at its first annual general meeting (AGM) to appoint an individual or a firm as an auditor. The auditor shall hold office from the conclusion of that meeting till the conclusion of its sixth AGM and thereafter till the conclusion of every sixth meeting. The appointment of the auditor is to be ratified at every AGM.
- Individual auditors are to be compulsorily rotated every 5 years and audit firm every 10 years in listed companies & certain other classes of companies, as may be prescribed.

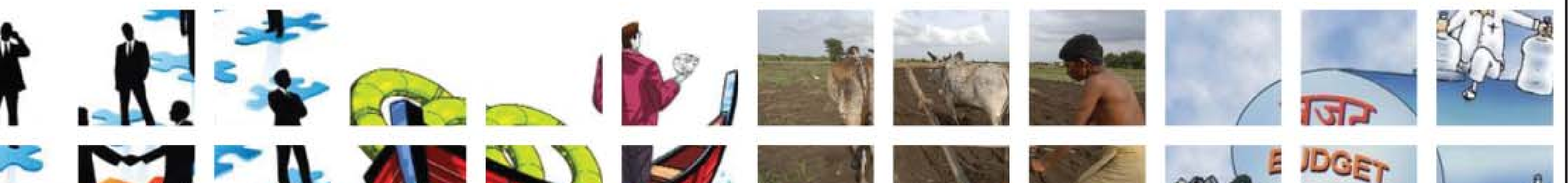
- Auditors have to comply with Auditing StandardSec.
- A company's auditor shall not provide, directly or indirectly, the specified services to the company, its holding and subsidiary company.
- A partner or partners of the audit firm and the firm shall be jointly and severally responsible for the liability, whether civil or criminal, as provided in this Bill or in any other law for the time being in force. If it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, then such partner or partners of the firm shall also be punishable in the manner provided in clause 447.

### *Directors*

- Prescribed class or classes of companies are required to appoint at least one woman director.
- At least one director should be a person who has stayed in India for a total period of not less than 182 days in the previous calendar year.
- At least one-third of the total number of directors of a listed public company should be independent directorSec. Existing companies to get a transition period of one year to comply.
- Liability of independent directors and non-executive directors not being promoter or key managerial personnel to be limited.
- A person can hold directorship of up to 20 companies, of which not more than 10 can be public companieSec.

### *Governance*

- Companies with more than 1,000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year to constitute a Stakeholders Relationship Committee, with a non-executive director as a chairperson and such other members as may be decided by the board.
- No permission of central government required to give a loan to a director.
- The provisions on inter-corporate loans and investment (372A of Companies Act 1956) extended to include loan and investment to any person.
- A company cannot, unless otherwise prescribed, make investment through more than 2 layers of investment companieSec.
- No central government approval required for entering into any related party transactionSec.



- No central government approval required for appointment of any director or any other person to any office or place of profit in the company or its subsidiary.
- Prohibition on forward dealings in securities of company by any director or key managerial personnel.
- Prohibiting insider trading in the company.
- No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the Company's Auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under clause 133.
- Creation of treasury stock/trust shares is prohibited.
- Every listed company or such class or classes of companies, as may be prescribed, to establish a vigil mechanism.
- The Bill makes provision for cross border amalgamations between Indian Companies and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government.

### *Miscellaneous*

- The Bill provides provisions related to Corporate Social Responsibility (CSR).
- The Bill provides for class action suit by specified number of members or depositors against the company except the banking company, which is prevalent in developed countrieSec.
- The Bill provides for specific provisions related to any act of fraud.
- The process for declaring a company sick and its revival and rehabilitation has been rationalized.
- The National Company Law Appellate Tribunal shall now consist of a combination of technical and judicial members not exceeding 11, instead of 2 as provided in the Companies Act 1956.
- The Central Government may establish as many special courts as may be necessary to provide speedy trial of offenceSec.
- The Central Government may establish a mediation and conciliation panel.
- The Bill makes provision for cross border amalgamations between Indian companies and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the central government.

- Where any valuation is required to be made of any property, stocks, shares, debentures, securities or goodwill or any other assets or net worth of a company or its liabilities under the Act, it shall be valued by a registered valuer.

- **Reverse Charge under Service Tax**

  Under the reverse charge mechanism of service tax, instead of service provider, the service receiver is liable to pay service tax. In that case, the service receiver will register himself with service tax authorities and file the required returnSec. The general exemption of RSec. 10 lacs is not available for that. The government has imposed the liability on service receivers before that also such person receiving services by goods transport agencies but these requirements are mandatory for companies and government authorities receiving the services in old daySec.

  The Government has issued Notification where it has given complete list of services that are covered under reverse charge mechanism. In some cases both service receiver and service provider has to pay service tax in prescribed ratio. The complete list is as under :-

| Sr. No. | Description of service | Percentage payable by service provider | Percentage payable by service receiver |
|---|---|---|---|
| 1 | Insurance Agent | Nil | 100% |
| 2 | Goods transport agency (Applicable to transport by road) | Nil | 100% |
| 3 | Sponsorship | Nil | 100% |
| 4 | Arbitral Tribunal | Nil | 100% |
| 5 | Support services by government or local authorities | Nil | 100% |
| 6 | Hiring of motor vehicle to carry passenger on abated value | Nil | 100% |
| | Hiring of motor vehicle to carry passenger on Non-abated value | 60% | 40% |
| 7 | Individual Advocate | Nil | 100% |
| 8 | Supply of man power or security services | 25% | 75% |
| 9 | Works Contracts | 50% | 50% |
| 10 | Import of Services | Nil | 100% |
| 11 | Services by director to company | Nil | 100% |

- **Appointment of Cost Auditor by Companies**

  On 6th November 2012, MCA amended the procedure of Appointment of Cost Auditors by CompanieSec. The company shall, within thirty days from the date of approval by MCA of the application made to the Central Government in the prescribed Form 23C seeking its prior approval for the appointment of cost auditor, issue formal letter of appointment to the cost auditor, as approved by the Board.

  The cost auditor shall, within thirty days of the date of formal letter of appointment issued by the company, inform the Central Government in the prescribed form 23D, along with a copy of such appointment.

- **Cost Accounting Standard 15 – Selling And Distribution Overhead**

  The council of The Institute of Cost Accountants of India has issued Cost Accounting Standard 15 on Selling and Distribution Overheads which will be effective from 1st April 2013 for the preparation and certification of General Purpose Cost Accounting StatementSec. This standard deals with the principles and methods of classification, measurement and assignment of Selling and Distribution Overheads, for determination of the cost of sales of product or service, and the presentation and disclosure in cost statementSec.

- **Certification by Company Secretary**

  For all the companies (except one person companies and small companies), whether private or public, listed or unlisted, the annual return has to be signed by either a company secretary in employment or by a company secretary in practice. This is akin to compliance certificate u/s 383A.

- **Revised computation of provident fund contribution**

  A new circular issued by the Employees Provident Fund Organization (EPFO) dated 30th November 2012 States that basic wages will include all allowances which are paid to the employeeSec. Thus, various allowances such as conveyance, educational allowance, medical allowance, etc., will have to be taken into consideration while computing the PF contribution.

  The circular deals with this "splitting up" practice adopted by the employerSec. It states that basic wages will include all allowances which are "ordinarily, necessarily and uniformly" paid to the employeeSec. Thus, various allowances such as conveyance, educational allowance, medical allowance, etc., will have to be taken into consideration while computing the PF contribution.

- **Amendment to NBFC Factors Directions**

  The RBI has issued Notification No. DNBS (PD) CC. No.303/Factor/22.10.91/2012-2013 dated 14-9-2012 amending the NBFC – Factors (Reserve Bank) Directions, 2012 which were earlier issued on 23-7-2012. This notification is issued to make enabling amendments to the NBFC (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, the NBFC (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 and the NBFC Auditor's Report (Reserve Bank) Directions, 2008. The enabling amendments are to provide definitions in the respective Directions on 'Non-Banking Financial Company - Factor' which means an NBFC as defined in clause (f) of Section 45-I of the RBI Act, 1934 having financial assets in the factoring business at least to the extent of 75% of its total assets and its income derived from factoring business is not less than 75% of its gross income and has been granted a certificate of registration under sub-section (1) of Section 3 of the Factoring Regulation Act, 2011. It is also clarified that for an NBFC-Factor, the certificate of registration will indicate the requirement of holding the certificate of registration under Section 3 of the Factoring Regulation Act. The certificate will also indicate the percentage of factoring assets and income, and that the company fulfils all conditions stipulated under the factoring regulation Act to be classified as an NBFC factor.

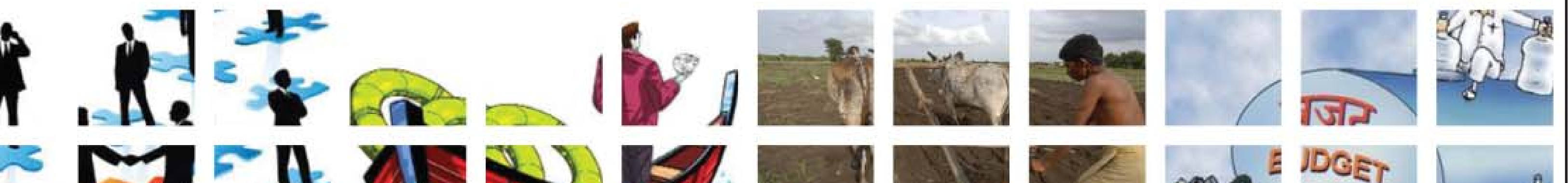
- **Non reckoning fixed deposits with banks as financial assets for NBFC (RBI/2011-12/446 DNBS (PD)CC.No.259/03.02.59/2011-12 dated 15/03/2012**

  In terms of Section 45IA (1) of the RBI Act 1934, no non-banking financial company shall commence business or carry on the business of a non-banking financial institution without (a) obtaining a certificate of registration (CoR) from the Reserve Bank and (b) having a net owned fund of twenty five lakh rupees, which was increased to RSec. 200 lakh with effect from April 21, 1999.

  It has, however, come to the notice of the Reserve Bank that some NBFCs obtain registration from the Bank, park their funds in fixed deposits with commercial banks but do not commence NBFI activities for several years thereafter. The Auditors of the companies have in these cases also certified that the companies are conducting NBFI activities, justifying the continued holding of the CoR issued by the Bank.

  It is clarified, that the Reserve Bank issues a Certificate of Registration for the specific purpose of conducting NBFI activitieSec. Investments in fixed deposits cannot be treated as financial assets and receipt of interest income on fixed deposits with banks cannot be treated as income from financial assets as these are not covered under the activities mentioned in the definition of "financial Institution" in Section 45I(c) of the RBI Act 1934.





Besides, bank deposits constitute near money and can be used only for temporary parking of idle funds, and/or in the above cases, till commencement of NBFI businesSec.

In addition, the NBFC which is in receipt of a CoR from the Bank must necessarily commence NBFC business within six months of obtaining CoR. If the business of NBFC is not commenced by the company within the period of six months from the date of issue of CoR, the CoR will stand withdrawn automatically. Further, there can be no change in ownership of the NBFC prior to commencement of business and regularization of its CoR.

- Amendment to Companies (Issue of Indian Depository Receipts) Rules, 2004

The MCA has issued Notification on 1-10-2012 amending the Companies (Issue of Indian Depository Receipts) Rules, 2004 and now as per the amended rule 10(i), a holder of IDRs may transfer the IDRs, or may ask the domestic depository to redeem them or, any person may seek reissuance of IDRs by conversion of underlying equity shares, subject to the provisions of the Foreign Exchange Management Act, 1999,

Securities and Exchange Board of India Act, 1992, or the rules, regulations or guidelines issued under these Acts or other laws for the time being in force.

# OVERVIEW OF ECONOMIC SURVEY

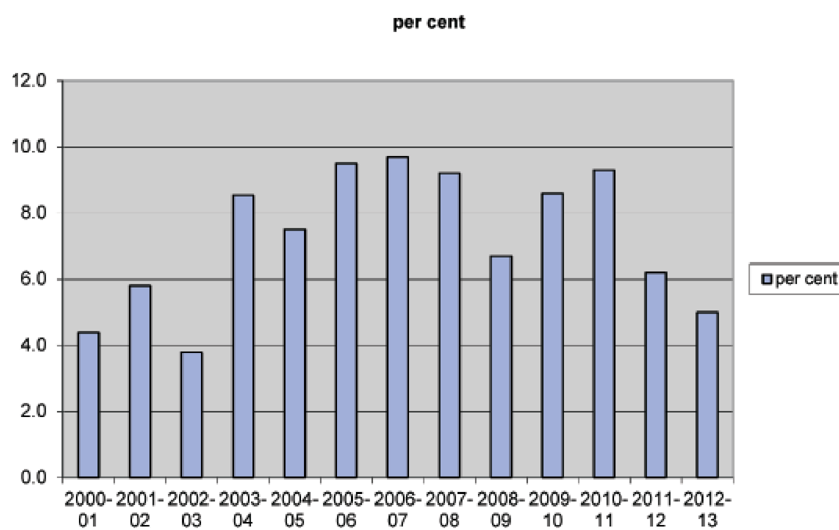
India's recent slowdown is partly rooted in external causes. Domestic causes are also important. The strong post-financial-crisis stimulus led to stronger growth in 2009-10 and 2010-11. However, the boost to consumption, coupled with supply side constraints, led to higher inflation. Monetary policy was tightened, even as external headwinds to growth increased. The consequent slowdown, especially in 2012-13, has been across the board, with no sector of the economy unaffected. Even as the economy slowed, it was hit by two additional shocks: a slowing global economy, weighed down by the crisis in the Euro area and uncertainties about fiscal policy in the United States, and a weak monsoon, at least in its initial phase.

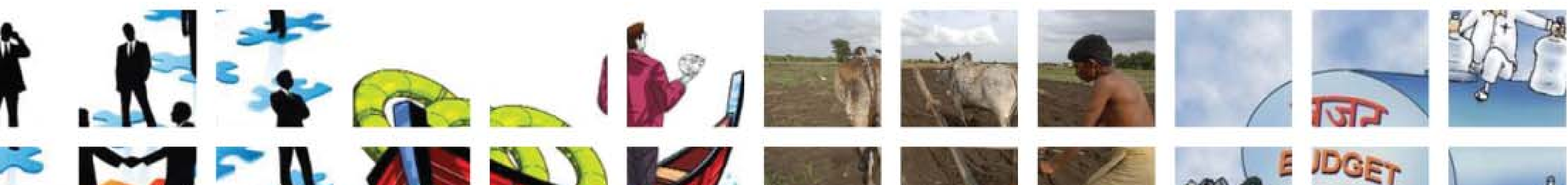
Wholesale price index (WPI) inflation has been coming down in recent months. However, food inflation, after a brief slowdown, continues to be higher than overall inflation. Given the higher weightage to food in consumer price indices (CPI), CPI inflation has remained close to double digits. Another consequence of the slowdown has been lower-than-targeted tax and non-tax revenues.

With the subsidies bill, particularly that of petroleum products, increasing, the danger that fiscal targets would be breached substantially became very real in the current year. With the global economy also likely to recover somewhat in 2013, the measures adopted by the Government should help in improving the Indian economy's outlook for 2013-14.

The Indian economy responded strongly to fiscal and monetary stimulus policies adopted by the Government and achieved a growth rate of 8.6 per cent and 9.3 per cent respectively in 2009-10 and 2010-11. However, with the economy exhibiting inflationary tendencies, the Reserve Bank of India (RBI) started raising policy rates in March 2010.

## GDP GROWTH





High rates as well as policy constraints adversely impacted investment, and in the subsequent two years viz. 2011-12 and 2012-13, the growth rate slowed to 6.2 per cent and 5.0 per cent respectively. Nevertheless, despite this slowdown, the compound annual growth rate (CAGR) for gross domestic product (GDP) at factor cost, over the decade ending 2012-13 is 7.9 per cent.

Growth in net exports can be an important source of demand. Unfortunately for India, net exports growth has been low because of global weakness. As a result of weak growth in trading partner countries, Indian exports also declined.

The dynamic nature of the relationship between macroeconomic outcome and the fiscal outcome was manifest thus the sharp slowdown in industrial output led to a slowdown in overall GDP growth affecting tax revenues, particularly corporate income tax-the hitherto most buoyant source; and continued high levels of global prices of crude oil and fertilizers with Headline WPI inflation remained relatively sticky around 7 to 8 per cent in the current financial year and moderated to a three-year low of 7.18 percent in December 2012. Average headline WPI inflation in 2012 (April-December) moderated to 7.55 per cent from 9.35 per cent in the corresponding period of the previous year.

Rising food inflation has also widened the gap between inflation. However, global commodity prices have remained relatively benign with both energy and non-energy prices registering a decline until recently. As per the World Bank's Global Economic Prospects, except for metals, most global commodity prices are expected to decline further in 2013 and 2014, a silver lining in the tepid global recovery. The impact of benign inflationary expectations internationally will have a moderating impact on domestic prices.

The slowdown in the rate of growth of services in 2011-12, and particularly in 2012-13, from the double-digit growth of the previous six years, contributed significantly to slowdown in the overall growth of the economy. While some slowdown could be attributed to the lower growth in agriculture and industrial activities, given the backward and forward linkages with services, lower demand from the rest of the world could also have played a part.

### Quarterly Trend :

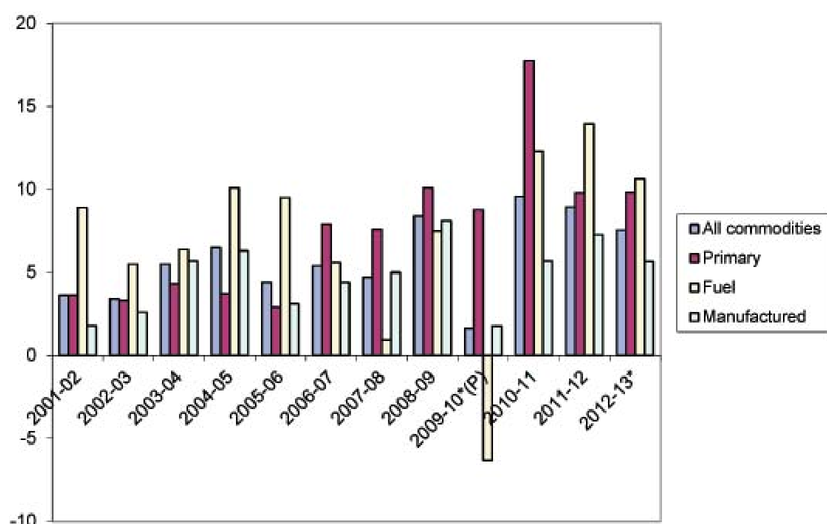
Quarterly GDP growth rate in India declined in each of the successive quarters between the fourth quarter of 2010-11 and the fourth quarter of 2011-12.

## INDUSTRIAL GROWTH

After recovering to a growth of 9.2 per cent in 2009-10 and 2010-11, growth of value added in industrial sector, comprising manufacturing, mining, electricity and construction sectors, slowed to 3.5 per cent in 2011-12 and to 3.1 percent in the current year.

Industrial growth was volatile across all sectors in this period. The seasonally adjusted annualized rate of growth of the Index of Industrial Production (IIP), which had shown a nearly flat trajectory, indicates a downward momentum. This suggests that the IIP growth may perhaps remain sluggish.

## INFLATION



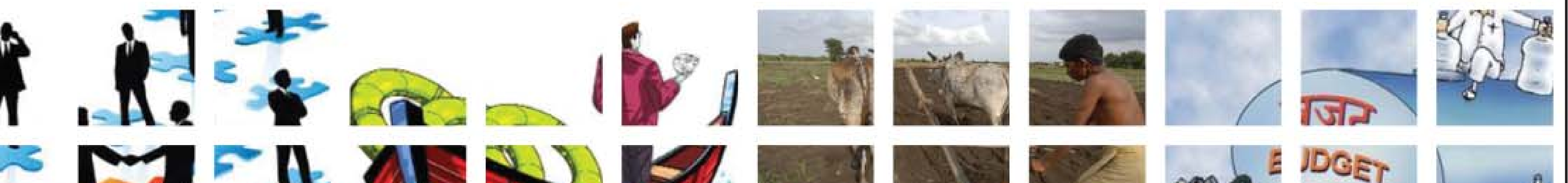

Inflation, as measured by the Wholesale Price Index (WPI), has remained above 7 per cent since December 2009. Food inflation has been particularly elevated over this period, contributing to an average of one third of total inflation.

The financial year 2012-13 started with a headline Wholesale Price Index (WPI) inflation of 7.50 per cent. It has remained in the 7.18 to 8.07 per cent range in the nine months up to December 2012.

For most of the current year, inflation measured in terms of Consumer Price Index (CPIS) for industrial workers (CPIIW) and the new series of CPI has remained in double digits. CPIs for agricultural and rural labourers have also inched up to double digit level in the last two months.

The RBI's monetary policy stance has continued to focus on the twin objectives of containing inflation and facilitating growth. Mounting inflationary pressures during January 2010 to October 2011 required adoption of a tight monetary policy by the Reserve Bank of India (RBI). During this period, RBI raised policy rates (repo rates) by 375 basis points, from 4.75 per cent to 8.5 per cent. There was a moderation in inflation from its peak of 10.9 per cent in April 2010, to an average of 7.6 per cent during April- December 2012. However, increasing risks to growth from external as well as domestic sources and tight monetary policy in face of persistent inflationary pressures has contributed to a sharper slowdown of the economy than anticipated. There has been a shift in the policy stance of RBI since October 2011 wherein it has attempted to balance growth and inflation dynamics. It reduced repo rates by 50 basis points in April, 2012 and again in January 2013 by 25 basis points and reduced the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) to improve liquidity conditions.





The momentum based on seasonally adjusted annualized rate (SAAR) has also been showing a declining trend in the last couple of months for major subgroups of the Wholesale Price Index (WPI). The decline is mainly due to moderation in nonfood manufacturing inflation (core as defined by the RBI). Core inflation remains muted and declined to 4.24 per cent in December 2012 from its peak of 8.35 per cent in November 2011. Apart from monetary measures taken by the RBI, softening of international and domestic prices of metals, chemicals, and textiles products also contributed to the moderation of core inflation. Elevated food inflation, however, remains an area of concern with inflation gradually inching upwards to double digits in December 2012.

Apart from monetary measures taken by the RBI, softening of international and domestic prices of metals, chemicals and textile products also contributed to the moderation in core inflation.

## FINANCIAL INTERMEDIATION AND MARKETS

The capital to risk-weighted assets ratio (CRAR) remained well above the RBI's stipulated 9 per cent for the system as a whole as well as for all bank groups during 2011-12, indicating that Indian banks remained well-capitalized.

Performance of Indian banks during the year 2011-12 was conditioned to a large extent by fragile recovery of the global financial markets as well as a challenging operational environment on the domestic front, with persistent high inflation and muted growth performance. In addition, stressed financial conditions of some State Electricity Boards and airline companies added to the deterioration in asset quality of banks. The consolidated balance sheet of SCBs grew at a slower pace during 2011-12 as compared to the previous year due to slower growth of credit as well as deposits. In addition, net profit of banks slowed down. Though Indian banks remained well-capitalized, concerns regarding growing nonperforming assets (NPAs) persisted.

The economic and political developments in the Euro zone area and United States had their impact on markets around the world including India. The resolution of the 'fiscal cliff' in the US had a positive impact on the market worldwide including in India.

The existence of well-developed and efficient financial markets is critical for achieving real economic growth. The country now has a vibrant and transparent financial market in terms of market efficiency, transparency, and price discovery process.

As far as the banking sector is concerned, the focus continues to be on reform initiatives which will facilitate the flow of credit to critical sectors of the economy including agriculture, infrastructure, micro, small and medium enterprises, housing, and export. The performance of Indian banks during 2011-12 was conditioned to a large extent by the fragile recovery of the global financial markets as well as a challenging operational environment on the domestic front, with persistent high inflation and muted growth performance. Net profit growth of banks slowed down. The modal interest rate on non-resident (external) rupee (NRE) deposits of banks declined by 37 bps during 2012-13 (up to December 15) to 8.71 per cent, reflecting subdued demand for export credit in the economy. Interest rates on foreign currency non-resident (bank) account (FCNR [B])

deposits continue to be regulated by the RBI. With a view to augmenting foreign currency inflows into the economy, effective 5 May, 2012 the interest rate ceiling on FCNR (B) deposits was raised to LIBOR/ Swap rates plus 200 bps for 1-3 year maturity and LIBOR/Swap rates plus 300 bps for 3-5 year. The interest rate ceiling on overseas line of credit arranged by banks for exporters has also remained regulated by the RBI. At present, the prescribed ceiling in this regard is at six-month LIBOR/EURO LIBOR/ EURIBOR plus 250 bps, subject to review as and when warranted.

The Government of India has decided to introduce a Direct Benefit Transfer (DBT) scheme with effect from 1 January 2013. To begin with, benefits under 26 schemes will directly be transferred into the bank accounts of beneficiaries in 43 identified districts across respective states and union territories (UT). Banks will ensure that all beneficiaries in these districts have a bank account. All PSBs and RRBs have made provision so that the data collected by the Departments/Ministries/ Implementing agency concerned can be used for seeding the bank account details in the core banking system (CBS) of banks with Aadhaar. All PSBs have also joined the Aadhaar Payment Bridge of the National Payment Corporation of India for smooth transfer of benefits.

The capital to risk-weighted assets ratio (CRAR) remained well above the RBI's stipulated 9 per cent for the system as a whole as well as for all bank groups during 2011-12, indicating that Indian banks remained well-capitalized.

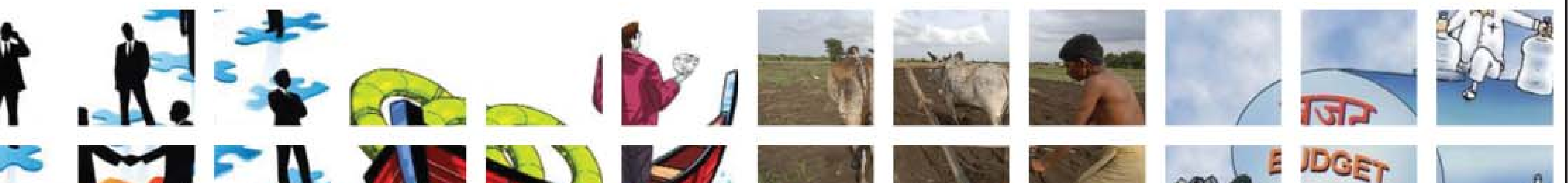
In the overall context of the evolving macroeconomic situation in the country and global financial developments, the government in close collaboration with the RBI and Securities and Exchange Board of India (SEBI) has recently taken a number of initiatives to meet the growing capital needs of the Indian economy. Some of the initiatives taken in this regard are launching of the Rajiv Gandhi Equity Savings Scheme (RGESS) and SME exchange / platform, expansion of the Qualified Foreign Investors (QFIs ) Scheme to facilitate their access to the Indian capital market, progressive enhancement in the quantitative limits for FIIs'

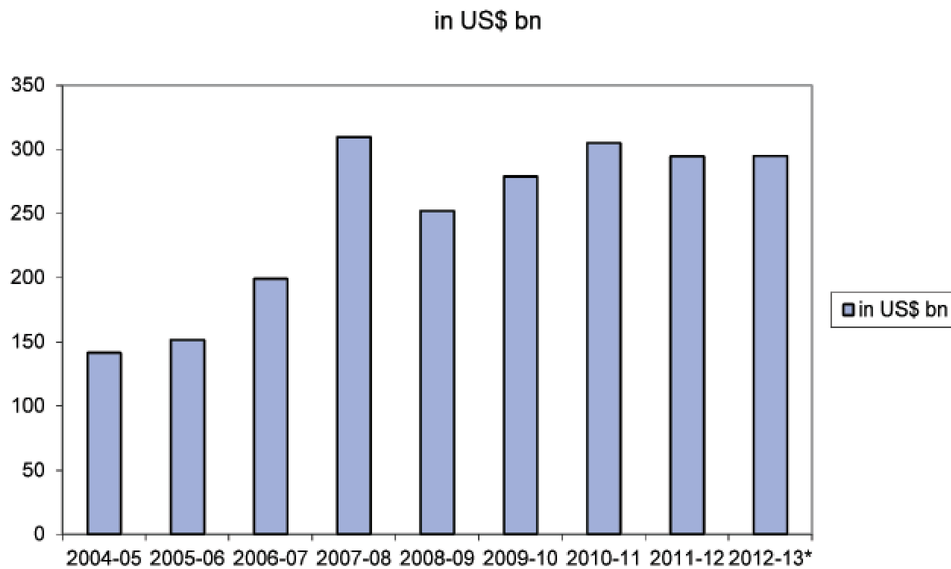
## FOREIGN EXCHANGE

India's foreign exchange reserves comprise foreign currency assets (FCA), gold, special drawing rights (SDRs) and reserve tranche position (RTP) in the International Monetary Fund (IMF).

In the current fiscal, foreign exchange reserves on month-on-month basis remained in the range of US$ 286.0 billion (at end-May 2012) to US$ 295.6 billion (at end-December 2012). At end-December 2012, reserves stood at US$ 295.6 billion, indicating a marginal increase of US$ 1.2 billion from US$ 294.4 billion at end-March, 2012. At this level, reserves provided about seven months of import cover.

India continues to be one of the largest holders of foreign exchange reserves. Country-wise details of foreign exchange reserves reveal that India is the eighth largest foreign exchange reserves holder in the world, after China, Japan, Russia, Switzerland, Brazil, Republic of Korea and China P R Hong Kong at end-December 2012.





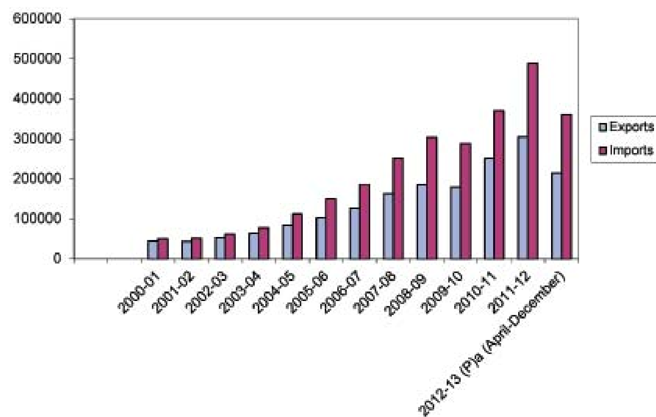

## EXCHANGE RATE

The exchange rate policy is guided by the broad principles of careful monitoring and management of exchange rates with flexibility, while allowing the underlying demand and supply conditions to determine the exchange rate movements over a period in an orderly manner.

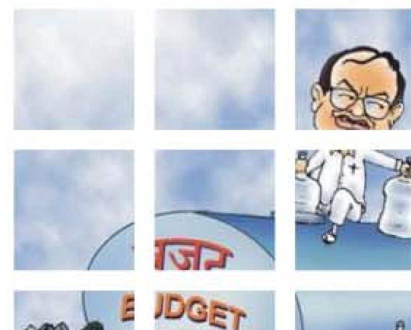
In the month of June 2012, the rupee touched all-time low of Rs. 57.22 per US dollar (RBI's reference rate) on June 27, 2012 indicating 10.6 per cent depreciation over Rs. 51.16 per US dollar on March 30, 2012.

Similarly, monthly average exchange rate of rupee depreciated by 5.3 per cent from Rs. 62.97 in March 2011 to Rs. 66.48 in March 2012 against the euro and against the Japanese yen by 9.9 per cent from Rs. 54.98 per 100 Japanese yen in March 2011 to Rs. 61.03 per 100 Japanese yen in March 2012.

## EXPORTS & IMPORTS



In the first half of FY 2012-13 (April- September 2012), there was a steep decline in exports. Imports did not decline as much in percentage point terms. Inelastic oil imports were the primary reason for the relatively smaller decline of imports. But gold imports, which have surged in recent years on the back of higher perceived returns on gold holdings, contributed significantly to imports, even though they declined in value over the previous year. The net result was an increase in the trade deficit to 10.8 per cent of GDP in H1 of 2012-13 vis-à-vis 9.9 per cent of GDP in H1 of 2011-12.



# DOMESTIC TAXATION

## DIRECT TAXES

### INCOME TAX

The proposals in the Finance Bill shall become applicable from Assessment Year 2014 – 2015 (i.e. the financial year to end on March 31, 2014), unless otherwise specifically stated.

### TAX RATES

There is no revision in either the tax slab or rates of personal Income Tax. Thus it continues to remain the same in A.Y. 2014-15 as was prevailing for A.Y.2013-14.

**FOR INDIVIDUALS, HINDU UNDIVIDED FAMILY, ASSOCIATION OF PERSONS AND BODY OF INDIVIDUALS**

| Income | Existing Rates (%) | | | Proposed Rates (%) | | |
|---|---|---|---|---|---|---|
| | Tax | Education Cess | Total | Tax | Education Cess | Total |
| Rs. NIL to Rs. 2,00,000 | - | - | - | - | - | - |
| Rs. 2,00,001 to Rs. 5,00,000 | 10 | 0.30 | 10.30 | 10 | 0.30 | 10.30 |
| Rs. 5,00,001 to Rs. 10,00,000 | 20 | 0.60 | 20.60 | 20 | 0.60 | 20.60 |
| Rs 10,00,001 and above | 30 | 0.90 | 30.90 | 30 | 0.90 | 30.90 |

1) In the case of a resident woman below the age of sixty years, the basic exemption limit remains same i.e. Rs.2,00,000/-.

2) In the case of a resident individual of the age of sixty years or above but less than eighty years, the basic exemption limit remains same i.e. Rs. 2,50,000/-. For income upto Rs. 5,00,000 tax @ 10% shall be applicable.

3) In the case of a resident individual of the age of eighty years or above, the basic exemption limit remains same i.e. Rs. 5,00,000/-. For income upto Rs 10,00,000 tax @ 20 % shall be applicable.

## FOR CO-OPERATIVE SOCIETIES

| Income | Tax Rates |
|---|---|
| Up to Rs. 10,000 | 10 per cent |
| Rs. 10,001 to 20,000 | 20 per cent |
| Rs. 20,001 and above | 30 per cent |

## FOR LOCAL AUTHORITIES

Local Authorities are taxable at the rate of 30 per cent.

## FOR PARTNERSHIP FIRMS

Partnership Firms are taxable @ 30 per cent.

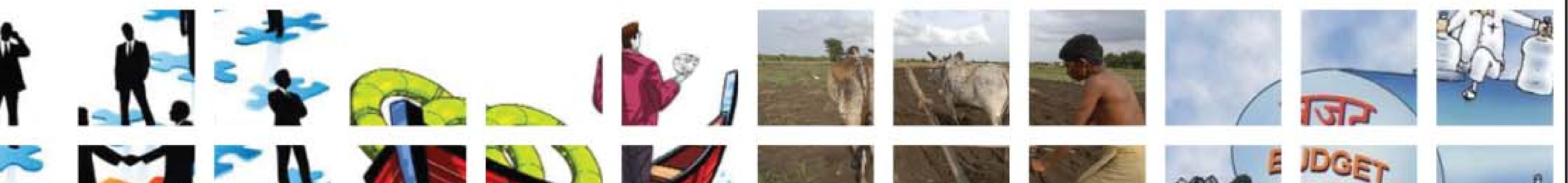
### Surcharge and Education Cess

- The Finance Minister has proposed to levy a surcharge @ 10 per cent (other than Companies) for one year on taxpayers whose taxable income exceeds Rs. 1 crore. It will be applicable only for A.Y.2014-15.
- There is no change in the rate of education cess. It continues to remain same @ 3 per cent.

## FOR DOMESTIC COMPANIES

- The tax rates for Domestic Companies continues to remain same as prevailing for A.Y. 2013-14 i.e. @ 30 percent
- Surcharge is increased from 5 per cent to 10 per cent if taxable income exceeds Rs. 10 crore. Further, surcharge is increased from 5 per cent to 10 per cent on Dividend Distribution Tax and distribution of income by way of buyback of shares by the unlisted company; income distributed by Mutual Funds and Securitization Trust.
- The additional surcharge introduced will be applicable for only one year i.e. A.Y.2014-15.
- There is no change in the rate of education cess. It continues to remain same @ 3 per cent.





## FOR FOREIGN COMPANIES

- The tax rates for Foreign Companies continue to remain same as prevailing for A.Y. 2013-14 i.e. @ 40 per cent.
- In case of Foreign Companies, Surcharge is increased from 2 per cent to 5 per cent if taxable income exceeds Rs. 10 crore.
- There is no change in the rate of education cess. It continues to remain same @ 3 per cent.

## Rebate of Rs. 2,000 for individuals having total income upto Rs. 5 lakh.

- It is proposed to insert a new section 87A to provide rebate to resident individual whose total income does not exceed five lakh rupees.
- The proposed rebate shall be 100% of the tax payable on total income or Rs. 2,000, whichever is less.
- Accordingly, individual earning total income upto Rs. 2,20,000 will not be required to pay any tax and individual earning total income of more than Rs. 2,20,000 but less than Rs. 5,00,000 will get a tax relief of Rs. 2,000.
- This amendment will take effect from 1st April, 2014 (Assessment Year 2014-15).

## Amendment in the definition of Capital Asset :

- It is proposed to amend the definition of capital assets w.e.f. 1st April, 2014 (Assessment year 2014-15) to extend the meaning of urban land.
- The land within specified area (shortest aerial distance) of municipality or cantonment board having specified population will be considered as urban land (i.e. it will not be considered as agricultural land). As per existing provision any land within 8 Kms from the local limits of any municipality or cantonment board is considered as urban land. The proposed specified population and respective specified area is summarized in table below:

| Population | Area |
|---|---|
| Between 10,000 to 1,00,000 | Not more than 2 Kms |
| Between 1,00,000 to 10,00,000 | Not more than 6 Kms |
| More than 10,00,000 | Not more than 8 Kms |

## Keyman Insurance Policy

- It is proposed to amend the provisions of clause (10D) of section 10, w.e.f. 1st April, 2014 (Assessment year 2014-15), to provide that a keyman insurance policy which has been assigned to any person during its term, with or without consideration, shall continue to be treated as a keyman insurance policy.

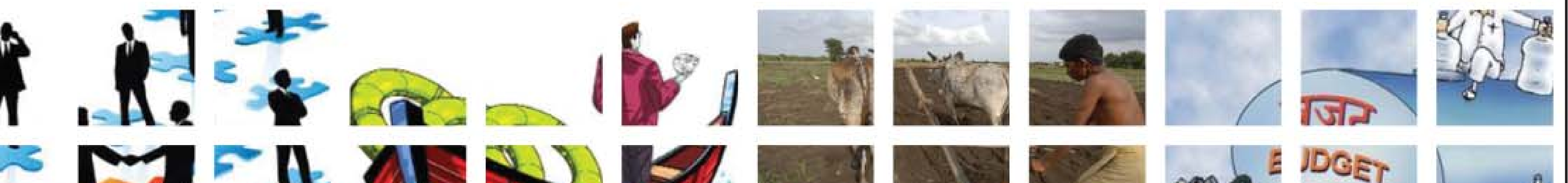
## Exemption to income of investor protection fund of depositories

- It is proposed from 1st April, 2014 and accordingly for assessment year 2014-15 to exempt the income of Investment Protection Fund received by way of contribution by the depository subject to the same conditions as are applicable under section 10 (23EA) in respect of exemption of income of an investment protection fund set up by recognized stock exchanges.
- However, it is also proposed that any amount standing to the credit of the fund and not taxed, is shared wholly or partly with a depository, the amount so shared shall be deemed to be the income of the fund in the previous year in which the amount is so shared.

## Pass through Status to certain Alternative Investment Funds (AIFs)

- In order to provide benefit of pass through to venture capital funds registered under The SEBI(Alternative Investment Funds) Regulations, 2012 and subject to same conditions of investment restrictions in the context of investment in a venture capital undertaking, it is proposed to amend section 10(23FB) to provide that–
  - The existing VCFs and VCCs (i.e. which have been registered before 21/05/2012) and are regulated by the VCF regulations, as they stood before repeal by AIF regulations, would continue to avail pass through status as currently available.
  - In the context of AIF regulations, the Venture Capital Company shall be defined as a company and Venture capital fund shall be defined as a fund set up as a trust, which has been granted a certificate of registration as Venture Capital Fund being a sub-category of Category I Alternative Investment Fund and satisfies the following conditions:-
    - That at least two-thirds of its investible funds are invested in unlisted equity shares or equity linked instruments of venture capital undertaking.
    - No investment has been made by such AIFs in a VCU which is an associate company.
    - Units of a trust set up as AIF or shares of a company set up as AIF, are not listed on a recognised stock exchange.
  - In the context of AIF regulations, the Venture Capital Undertaking shall be defined as it is defined in the Alternative Investment Funds Regulations.
- This amendment will take effect retrospectively from 1st April, 2013 (A.Y. 2013-14).





**Incentive for acquisition and installation of new plant or machinery by manufacturing company**

- It is proposed to insert a new section 32AC w.e.f 1st April, 2014 (Assessment year 2014-15) to provide a following deduction to the assessee company engaged in the business of manufacture of an article or things and invests a sum exceeds Rs. 100 crore in new assets during the period beginning from 1st April, 2013 and ending on 31st March, 2015:
  - for assessment year 2014-15, a deduction of 15% of aggregate amount of actual cost of new assets acquired and installed during the financial year 2013-14, if the cost of such assets exceeds Rs.100 crore;
  - for assessment year 2015-16, a deduction of 15% of aggregate amount of actual cost of new assets, acquired and installed during the period beginning on 1st April, 2013 and ending on 31st March, 2015, as reduced by the deduction allowed, if any, for assessment year 2014-15.
- **New asset means any new plant or machinery but does not include the following :**
  - any plant or machinery which before its installation by the assessee was used either within or outside India by any other person;
  - any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;
  - any office appliances including computers or computer software;
  - any vehicle;
  - ship or aircraft; or
  - any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.
- Further, if any new asset acquired and installed by the assessee during the period beginning on 1st April, 2013 and ending on 31st March, 2015 is sold or otherwise transferred within a period of five years from the date of its installation, the amount of deduction allowed in respect of such new asset in this section shall be deemed to be the income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which such new asset is sold or otherwise transferred, in addition to taxability of gains, arising on account of transfer of such new asset. However, this restriction shall not apply in a case of amalgamation or demerger but shall continue to apply to the amalgamated company or resulting company, as the case may be.

**Limitation given under section 36(1)(vii) cumulatively applicable to all types of provision for doubtful debt provided by Banks - Rural advances or Urban advances**

- It is proposed to insert an Explanation 2 to section 36(1)(vii) w.e.f. 1st April 2014 (A.Y. 2014-15) stating that deduction for banks and financial institutions in respect of bad debts actually written off u/s 36(1)(vii) to be limited to amount by which such bad debts exceed the credit balance in provision made u/s 36(1)(viia) without any distinction between rural advances and other advances.

**Disallowance of certain fees, charges, etc. in case of State Government Undertaking**

- It is proposed to amend section 40 of the Income-tax Act to provide that any amount paid by way of fee, charge, etc., which is levied exclusively on, or any amount appropriated, directly or indirectly, from a state government undertaking, by state government, shall not be allowed as deduction for the purpose of computation of income of such undertaking under the head "Profits and gains of business and profession".
- It is also proposed to define the expression "State Government Undertaking" for this purpose.
- This amendment will take effect from 1st April 2014 (A.Y. 2014-15).

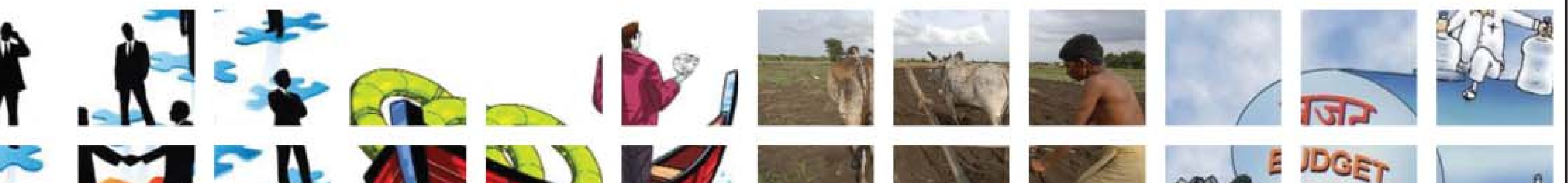
**Immovable property held in stock-in-trade**

- W.e.f. 1st April, 2014 (Assessment year 2014-15), it is proposed to insert section 43CA to adopt the stamp duty value as full value of consideration for the purpose of computing "Income from Business /Profession", where the consideration for the transfer of an asset (other than capital asset) being land or building or both, is less than the stamp value.
- Where the date of agreement fixing the value of consideration for transfer of the asset and date of registration of such transfer are not same, the stamp duty value shall be taken as on the date of agreement of transfer. This exception shall apply only where any part of consideration has been paid by any mode other than cash on or before the date of agreement.

**Taxability of immovable property received for inadequate consideration**

- It is proposed to amend clause (b) of section 56(2)(vii) from Assessment year 2014-15 to include a situation where the consideration received on transfer of immovable property is inadequate i.e. less than the stamp duty value by an amount exceeding Rs. 50,000, the stamp duty value of such property as exceeds such consideration will be chargeable to tax in the hands of individual /HUF as " Income From Other Sources".





### Raising the limit of percentage of eligible premium for life insurance policies of persons with disability or disease

- Under the existing provisions of section 10(10D) as amended in the Finance Act 2012, any sum received under a life insurance policy issued on or after 1st April,2012 is exempt subject to the condition that the premium paid for such policy does not exceed 10% of the 'actual capital sum assured'. Similarly the deduction for such premium paid is allowed under section 80C (3A) to the extent of 10% of the 'actual capital sum assured'.
- It is proposed from 1st April, 2014 and accordingly for assessment year 2014-15 that any sum under life insurance policy issued on or after 1st April 2013, that is received by a person with disability or severe disability under section 80U or by a person suffering from disease or ailment under section 80DDB, shall be exempt subject to the condition that the premium paid for such policy does not exceed 15% of the 'actual capital sum assured'.
- Similarly, the deduction for such premium paid shall be allowed under section 80C (3A) to the extent of 15% of the 'actual capital sum assured'.

### Expanding the scope of deduction and its eligibility under section 80CCG

- It is proposed to liberalize the Rajiv Gandhi Equity Savings Scheme, w.e.f. 1st April, 2014 (Assessment year 2014-15), to enable first time investor to invest in listed units of an equity oriented fund and extended tax benefits to three successive years. The limit for investors wanting to invest in RAJIV GANDHI EQUITY SAVING SCHEME has been raised to Rs 12 lakh from Rs 10 lakh earlier. An individual with an income of less than Rs. 12 lakh would get tax deduction of fifty per cent of the amount invested in such equity shares to the extent such deduction does not exceed twenty-five thousand.

### Deduction for contribution to Health Schemes similar to CHGS under section 80D

- It is proposed from 1st April 2014 and accordingly for assessment year 2014-15 to extend the benefit of deduction under section 80D in respect of any payment or contribution made by the assessee to any other health scheme as may be notified by the Central Government.

### Deduction of interest upto Rs. 1 lakh on Housing Loan sanctioned during F.Y. 2013-14.

- It is proposed to insert a new section 80EE to provide deduction of interest payable on loan taken by an individual from any financial institution for acquisition of a residential property.
- The proposed deduction shall be allowed in computing total income for A.Y. 2014-15 and shall not exceed Rs. 1 lakh. In case where the interest payable is less than Rs. 1 lakh, the individual shall be allowed deduction of the balance amount in A.Y. 2015-16.

- The proposed deduction shall be allowed subject to the following conditions:
    - The loan is sanctioned by the financial institution during the period beginning on 1st April, 2013 and ending on 31st march, 2014;
    - The amount of loan borrowed does not exceed Rs. 25 lakh;
    - The value of the residential property does not exceed Rs. 40 lakh;
    - The individual does not own any residential house property on the date of sanction of the loan.
- It is also proposed that no deduction shall be allowed under any other provisions of Income Tax Act, 1961 in respect of the interest claimed as deduction under the proposed section.
- These amendments will take effect from 1st April, 2014 and accordingly apply to assessment year 2014-15 and subsequent assessment year 2015-16.

### One Hundred percent deduction for donation to National Children's Fund

- It is proposed, w.e.f 1st April, 2014 (Assessment year 2014-15), to allow hundred per cent deduction in respect of any sum paid to NATIONAL CHILDREN'S FUND. No deduction shall be allowed under this section in respect of donation of any sum exceeding ten thousand rupees unless such sum is paid by any mode other than cash.

### Contribution not to be in cash for deduction under section 80GGB & section 80GGC

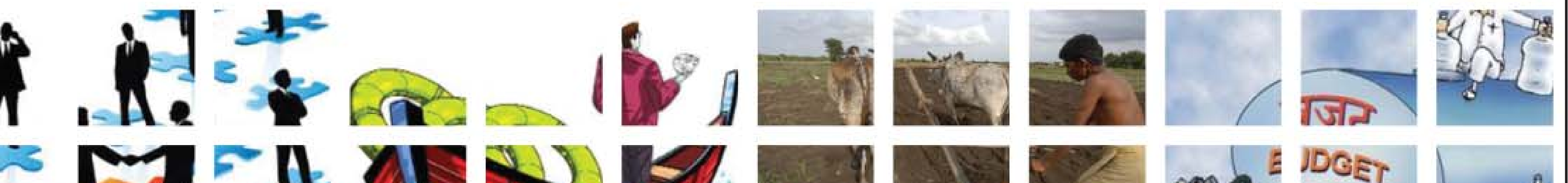
- It is proposed to amend the provisions of sections 80GGB and 80GGC w.e.f. 1st April 2014 (A.Y. 2014-15), so as to provide that no deduction shall be allowed for any sum contributed by way of cash.

### Extension of sunset date for tax holiday for power sector

- It is proposed to amend section 80-IA (4) (iv) to extend the terminal date for a further period of one year, i.e., up to 31st March, 2014. The aforesaid amendment will take effect from 1st April, 2014 (i.e. AY 2014-15).

### Deduction of additional wages in certain cases

- It is proposed to amend the section 80JJAA, w.e.f. 1st April, 2014 (Assessment year 2014-15) so as to provide that the deduction shall be available to an Indian Company deriving profits from manufacture of goods in its factory of an amount equal to thirty per cent of additional wages paid to the new regular workmen employed by the assessee in such factory, in the previous year, for three assessment years including the assessment year relevant to the previous year in which such employment is provided.



- It is also proposed to provide that the deduction under this section shall not be available if the factory is hived off or transferred from another existing entity or acquired by the assessee company as a result of amalgamation with another company.

### Application of seized assets

- It is proposed to insert a new Explanation to section 132B, w.e.f. 1st June, 2013, to clarify that the existing liability does not include advance tax payable in accordance with the provisions of Part C of Chapter XVII of the Act.

### Return of Income filed without payment of self- assessment tax to be treated as defective return

- It is proposed to amend section 139(9) w.e.f. 1st June, 2013 to include new Explanation (aa) so as to provide that the return of income shall be regarded as defective unless the tax together with interest, if any, payable in accordance with the provisions of section 140A (self-assessment tax) has been paid on or before the date of furnishing of the return.

### Direction for special audit before assessment

- It is proposed to amend section 142(2A), w.e.f. 1st June, 2013, to provide that if at any stage of the proceedings the Assessing Officer is of the opinion that it is necessary to get the assessee's accounts audited by an accountant and to furnish a report of such audit, due to the nature and complexity of the accounts, volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialized nature of business activity of the assessee, and the interests of the revenue, he may direct the assessee to get his accounts audited, with the previous approval of the Chief Commissioner or the Commissioner.

### Exclusion of time in computing the period of limitation for completion of assessments and reassessments

- It is proposed to amend clause (iii) of Explanation 1 to section 153, w.e.f. 1st June, 2013, to provide for the exclusion of the period, commencing from the date on which Assessing officer directs the assessee to get his accounts audited under section 142(2A) and ending with the last date on which the assessee is required to furnish a report of audit or where such direction is challenged before a court, ending with the date on which the order setting aside such direction is received by the Commissioner, in computing the period of limitation for completion of assessments and reassessments.

- It is proposed to amend clause (viii) of Explanation 1 to section 153, w.e.f. 1st June, 2013, to provide for the exclusion of the period commencing from the date on which a reference or first of the references for exchange of information is made by an authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information requested is last received by the Commissioner or a period of one year, whichever is less, in computing the period of limitation for completion of assessments and reassessments.
- Similar amendments are also proposed in the Explanation to section 153B relating in computing time limit for completion of search assessment.

**Clarification of the phrase "tax due" for the purposes of recovery in certain cases**

- It is proposed to clarify that for the purposes of section 179 and section 167C, the expression "tax due" shall includes penalty, interest or any other sum payable under the Act.
- These amendments will take effect from 1st June, 2013.

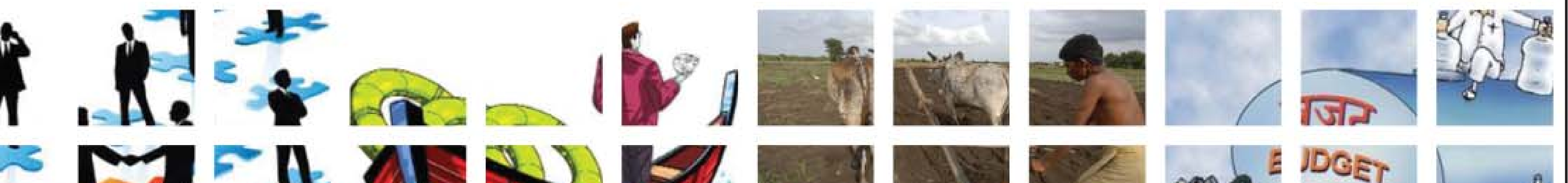
**Tax Deduction at Source on transfer of Immovable properties**

- It is proposed from 1st June, 2013 to insert a new section 194-IA to provide that every transferee shall be required to deduct tax at source @ 1% for the transfer of immovable property(other than agricultural land) at the time of making payment or crediting any sum as consideration for transfer of immovable property to a resident transferor.

**Concessional rate of withholding tax on interest paid by Indian Company on rupee denominated infrastructure bonds.**

- It is proposed to amend section 194LC which, under the existing law, provides for withholding tax at concessional rate of 5% on the interest paid by Indian company to non resident, on loan taken in foreign currency from a source outside India either under a loan agreement or by way of issue of long-term infrastructure bonds, as approved by the Central Government.
- The proposed amendment will extend the benefit of such concessional rate of withholding tax to cases where the non resident deposits foreign currency in a designated account opened with a bank and such money, as converted in rupees is utilized for subscription in long term infrastructure bonds issued by an Indian company. The benefit of concessional rate of tax to the non resident will be available on interest income arising on such subscription.
- It is proposed that the designated account should be solely for the purpose of deposit of money in foreign currency and such money is to be used for payment to the Indian company for subscription in the long term infrastructure bonds issued by it.
- This amendment will take effect form 1st June, 2013.





## Penalty for non-filing of Annual Information Return

- It is proposed to amend the section 271FA so as to provide that if a person who is required to furnish an annual information return under section 285BA (1), fails to furnish such return within the time prescribed under sub-section (2) thereof, the income-tax authority prescribed may direct that such person shall pay, by way of penalty, a sum of one hundred rupees for every day during which the failure continues.
- It is further proposed to provide that where such person fails to furnish the return within the period specified in the notice under section 285BA (5), he shall pay, by way of penalty, a sum of five hundred rupees for every day during which the failure continues, beginning from the day immediately following the day on which the time specified in such notice for furnishing the return expires.
- These amendments will take effect from 1st April, 2014.

## Extension of time for approval in Part A of the Fourth Schedule to the Income-tax Act, 1961

- It is proposed to amend the first proviso to sub-rule (1) of rule 3 retrospectively w.e.f. 1st April 2013, so as to extend the time limit for the provident funds recognised under the Income-tax Act on or before 31st March, 2006, but such provident fund does not satisfy the conditions set out in clause (ea) of rule 4 from 31st March, 2013 to 31st March, 2014 to satisfy the said conditions and such other conditions specified by the Board.

## SECURITIES TRANSACTION TAX (STT)

- It is proposed to reduce Security Transaction tax in the following nature of taxable securities transaction

| Sr. No. | Nature of Taxable Securities transaction | Payable by | Proposed Rates (%) |
|---|---|---|---|
| 1 | Delivery based purchase of units of an equity oriented fund entered into in a recognized stock exchange | Purchaser | **NIL** |
| 2 | Delivery based sale of units of an equity oriented fund entered into in a recognized stock exchange | Seller | **0.001** |
| 3 | Sale of futures in Securities | Seller | **0.01** |
| 4 | Sale of a units of an equity oriented fund to the mutual fund | Seller | **0.001** |

- This amendment will take effect from 1st June, 2013 and will, accordingly, apply to any transaction made on or after that date.

## Introduction of Commodities Transaction Tax

- Commodities Transaction Tax (CTT) is proposed to be levied on taxable commodities transactions
- 'Taxable commodities transaction' would mean a transaction of sale of commodity derivatives in respect of commodities, other than agricultural commodities, traded in recognised associations.
- The tax is proposed to be levied at the rate of 0.01% on the value of taxable commodities transactions being sale of commodity derivative and the said tax would be payable by Seller.
- The value of the taxable commodities transaction shall with reference to such transaction shall be the price at which the commodity derivative is traded.
- The provisions with regard to collection and recovery of CTT, furnishing of returns, assessment procedure, power of assessing officer, chargeability of interest, levy of penalty, institution of prosecution, filing of appeal, power to the Central Government, etc. have also been provided in the Chapter VII of Finance Bill, 2013 contained in section 105 to 124 of the said chapter.
- This tax is proposed to be levied from the date on which Chapter VII of the Finance Bill, 2013 comes into force by way of notification in the Official Gazette by the Central Government.

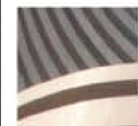
## Deduction of Commodities Transaction Tax Paid

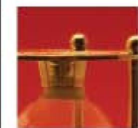
- It is proposed to amend section 36 of the Income-tax Act to provide that an amount equal to the commodities transaction tax paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year shall be allowable as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".
- It is also proposed to insert an Explanation to provide that for the purposes of this clause, the expressions "commodities transaction tax" and "taxable commodities transaction" shall have the meanings respectively assigned to them under Chapter VII of the Finance Act, 2013.
- This amendment will take effect from 1st April, 2014 (A.Y. 2014-15).

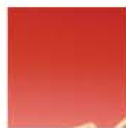
## Enabling Provision for facilitating electronic filing of annexure-less return on net wealth

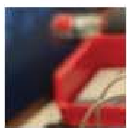
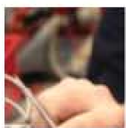
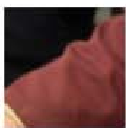
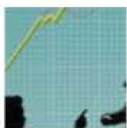
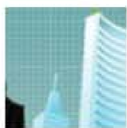
- In order to facilitate electronic of annexure-less return of net wealth, it is proposed to insert section 14A and 14B in Wealth Tax Act on similar line with section 139C and 139D of Income Tax Act.

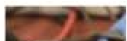
- Consequently, it is also proposed to amend provision of section 46 of the Wealth Tax which provides for rule making powers of the Board.
- This amendment will take effect from 1st June, 2013.

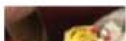










# INTERNATIONAL TAXATION

**Tax Residency Certificate (TRC), a necessary but not a sufficient condition for claiming relief under Double Tax Avoidance Agreements (DTAA)**

- It is proposed to amend section 90 and 90A of the Income Tax Act, 1961(ITA) in order to provide that submission of a TRC is a necessary but not a sufficient condition for claiming benefits under the DTAA.
- It is worth noting that the Memorandum explaining Finance Bill 2012 in the context of insertion of sub section (4) in Section 90 and 90A of the ITA already incorporated the aforesaid intent that TRC is a necessary but not a sufficient condition for availing DTAA relief. Sub section (4) to section 90 and 90 A inserted vide Finance Act 2012 provided submission of TRC as a condition for availing benefits of the agreements referred to in these sections. The intent that TRC is a necessary but not sufficient condition has now been expressly provided by amendment to sub section (4) of section 90 and 90A of ITA.
- The proposed amendment clarifies that though a TRC is submitted, the non resident may be denied the beneficial position provided by DTAA, based on the facts and circumstance of the specific case. The submission of a TRC may not be a conclusive evidence to avail benefits under DTAA. Treaty benefit can be conferred upon satisfaction of the other essential conditions, viz, establishing beneficial ownership, demonstration of substance, etc in addition to furnishing the TRC.
- The proposed amendment by stating that a TRC is necessary but not enough to claim benefits under DTAA and being silent in respect of specific criteria determining the eligibility to avail beneficial provisions of DTAA, thereby widens the discretion of the tax authorities.
- These amendments will take effect retrospectively from 1st April, 2013 and will, accordingly, apply to assessment year 2013-14 and subsequent assessment years.

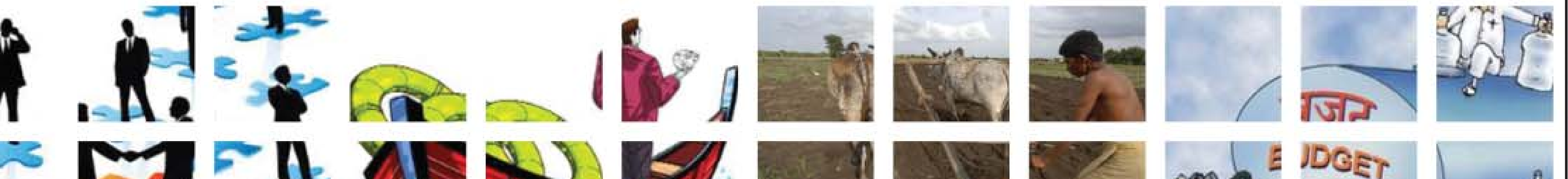
**Taxation of Income by way of Royalty or Fees for Technical Services**

- It is proposed to amend section 115A(1)(b) of the Income-tax Act to substitute following sub-clauses in place of sub-clauses (A), (AA), (B) and (BB):

  "(A) the amount of income-tax calculated on the income by way of royalty, if any, included in the total income, at the rate of twenty-five per cent.;

  (B) the amount of income-tax calculated on the income by way of fees for technical services, if any, included in the total income, at the rate of twenty-five per cent.;".





- Thus the tax rate in case of non-resident taxpayer, in respect of income by way of royalty and fees for technical services as provided under section 115A, is proposed to be increased from 10% to 25% and shall be applicable to any income by way of royalty and fees for technical services received by a non-resident, under an agreement entered after 31.03.1976.
- This amendment will take effect from 1st April, 2014 (A.Y. 2014-15).

## Extension of applicability of Section 115BBD with respect to taxation of dividends received from foreign company

- The benefit of concessional rate of tax at the rate of 15% provided under section 115BBD on dividends received by an Indian company holding 26% or more in the nominal value of equity share capital of the foreign company from the said foreign company is proposed to be extended for the one more year i.e. for the assessment year 2014-15.

## Removal of the cascading effect of Dividend Distribution Tax (DDT)

- It is proposed to amend section 115-O(1A)(i) w.e.f. 1st June, 2013 so as to provide that where the tax on dividends received from the foreign subsidiary (i.e. the foreign company in which domestic company holds more than half of in the nominal value of the equity share capital) is payable under section 115BBD by the holding domestic company then, any dividend distributed by the holding company in the same year, to the extent of such dividends, shall not be subject to Dividend Distribution Tax under section 115-O of the Income-tax Act.

## Special Provisions relating to tax on Distributed Income of Domestic Company for buy-back of unlisted shares

- It is proposed to amend the Act, by insertion of new Chapter XII-DA, to provide that the consideration paid by the company on buy-back of unlisted shares which is in excess of the sum received by the company at the time of issue of such shares shall be regarded as distributed income and the company would be liable to pay additional income-tax @ 20% of the distributed income paid to the shareholder
- The additional income-tax payable by the company shall be the final tax and no credit shall be claimed by the company or any other person in respect of the amount of tax so paid. Also no deduction would be allowed to company or a shareholder in respect of the said distributed income which has been charged to tax under any provisions of Act.
- Provisions with respect to payment, interest, etc. are also proposed to be introduced on similar lines as dividend distribution tax.

- The income arising to the shareholders in respect of such buy back by the company would be exempt where the company is liable to pay the additional income-tax on the buy-back of shares under proposed new sub-section (34A) to section 10.
- These amendments will take effect from 1stJune, 2013.

**Tax on distributed income by Mutual Funds**

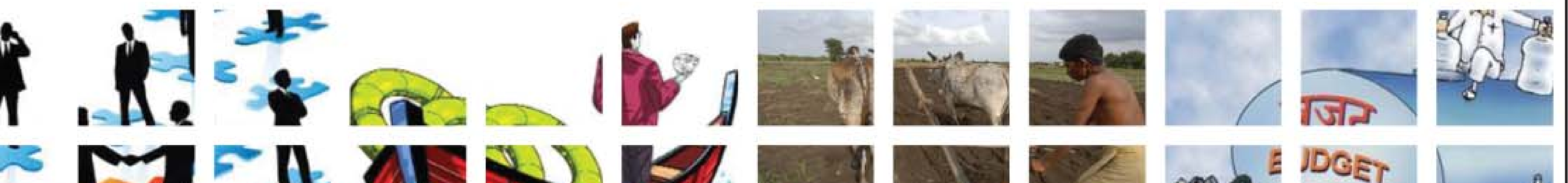
- It is proposed to increase the rate of tax on distribution from 12.5% to 25% in all cases where distribution is made to Individual/HUF by a fund other than equity oriented fund.
- Further it is also proposed to amend section 115R to provide tax @ 5% on the distributed income shall be payable in respect of income distributed by a Mutual Fund under an IDF scheme to a non-resident Investor.
- This amendment will take effect from 1st June, 2013.

**Taxation of Securitisation Trusts: Section 115TA, 115TB and 115TC**

- Income earned from securitisation activity by Securitisation Trusts (regulated by SEBI / RBI) is exempt from tax.
- In line with the Distribution tax levied in case of mutual funds, the securitisation trust is also liable w.e.f. 1st June, 2013 to pay additional income tax @25% in case of distribution made to investors who are individuals/HUF and @30% in other cases. No tax is liable to be deducted in case of distribution to any person whose income is not chargeable to tax.
- The securitization trust will be liable to pay interest @1% for every month or part of the month on the tax not paid within 14 days from the date of distribution or payment of such distribution, whichever is earlier.
- Person responsible for making payment of the income distributed by the securitisation trust has to file on or before 15th day of September furnish a verified statement in prescribed form giving details of the amount distributed to investors and tax paid thereon.
- Consequent to the levy of distribution tax, the distributed income received by the investor will be exempt under section 10(35A).

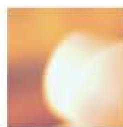
## I-RULE (GAAR)

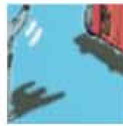
- Under the existing provisions, the substantive provisions and procedural provisions relating to GAAR are contained in the Income Tax Act. However, as per the recommendations of the Expert Advisory Committee as accepted by the government, following amendments are proposed from 1st April, 2016 and accordingly for assessment year 2016-17

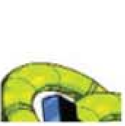
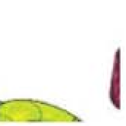


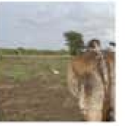
- The provisions of Chapter X-A and section 144BA will come into force with effect from April 1, 2016 as against the current date of April 1, 2014. The provisions shall apply from the assessment year 2016-17 instead of assessment year 2014-15.
- It is proposed to amend the current provision of section 96 to change the definition of impermissible avoidance arrangement to mean arrangement where the main purpose is to obtain tax benefit as against the existing provision which defines impermissible avoidance arrangement to mean arrangement where the main purpose or one of the main purposes is to obtain tax benefit
- It is proposed to amend the current provisions of section 97 to include factors like, period or time for which the arrangement had existed; the fact of payment of taxes by the assessee; and the fact that an exit route was provided by the arrangement, as relevant, though not sufficient, to determine whether the arrangement is an impermissible avoidance arrangement.
- It is proposed to amend section 97 to include that an arrangement shall be deemed to be lacking commercial substance, if it does not have a significant effect upon the business risks, or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained but for the application of Chapter X-A.
- It is proposed to include in the composition of approving panel under section 144BA Chairperson who is or has been a Judge of a High Court; one Member of the Indian Revenue Service not below the rank of Chief Commissioner of Income-tax; and one Member who shall be an academic or scholar having special knowledge of matters such as direct taxes, business accounts and international trade practices as against the current provision in which the approving panel consists of not less than three members being income-tax authorities and an officer of the Indian Legal Service.
- It is proposed to amend section 144BA to the extent that directions issued by the Approving panel shall be binding both on the assessee and the income tax authorities as against the current provision where directions issued by the approving panel are binding only on the income tax authorities.
- It is also proposed to amend the section 144BA to include giving powers to the Central Government to constitute one or more Approving Panels as may be necessary and the term of the Approving Panel shall be ordinarily for one year and may be extended from time to time up to a period of three years.
- It is proposed to amend section 102 to combine the two separate definitions of associated persons and connected person to only one inclusive provision defining a connected person.

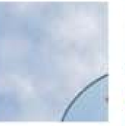
- Further consequential amendments in other sections relating to procedural matters are also proposed.

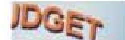










# SERVICE TAX

## LEGISLATIVE CHANGES

### Following changes are being made in the Finance Act, 1994 :

- Changes in relation to the negative list :
  - The definition of approved vocational course in section 65B (11) is being proposed to be changed to:
    - include courses run by an industrial training institute or an industrial training centre affiliated to State Council for Vocational Training; and
    - delete clause (iii) dealing with courses run by an institute affiliated to the National Skill Development Corporation.
  - The definition of "process amounting to manufacture or production" in section 65B(40) is being expanded to include processes under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955
  - The negative list entry in sub-clause (i) of clause (d) of section 66D is being modified by deleting the word "seed". This will allow the benefit to all other testings in relation to "agriculture" or "agricultural produce".
- The penalty under section 77(a) is being restricted to Rs 10,000. A new section 78A is also being introduced to impose penalty on directors and officials of the company for specified offences in cases of willful actions.
- These Changes will be effective from the enactment of Finance Bill. 2013

### Exemptions

The following changes are being made in the exemption notification number 25/2012-ST dated June 20, 2012:

- Auxiliary educational services and renting of immovable property by (and not to) specified educational institutes under Section No. 9 will not be available;
- Copyrights for cinematograph films will now be available only to films exhibited in a cinema hall or theatre. This will allow service providers to pass on input tax credits to taxable end-users;

- Service Tax Exemption only to non air-conditioned (non-centrally air-heated) restaurants; the dual requirement earlier that it should also have a license to serve alcohol is being done away with;
- The exemptions available to transportation of goods by railway and vessel under S. No 20 and services provided by a goods transportation agency (GTA) under S. No.21 are being harmonized. Thus exemption to transportation of petroleum and petroleum products, postal mails or mail bags and household effects by railways and vessels will not be available while the benefit of transportation of agricultural produce, foodstuffs, relief materials for specified purposes, chemical fertilizers and oilcakes, registered newspapers or magazines and defence equipments will be available to GTAs;
- The exemptions under S. No 24 for vehicle parking to general public and S. No 25 for repair or maintenance of government aircrafts are being withdrawn; and
- The definition of "charitable activities" is being changed by deleting the portion listed in sub-clause (v) of clause (k). Thus the benefit to charities providing services for advancement of "any other object of general public utility" up to Rs 25 Lakh will not be available. However the threshold exemption will continue to be available up to Rs 10 lakh.
- These Changes will be applicable **w.e.f April 1, 2013.**

### Abatement

The abatement available under Notification No. 26/2012-ST dated June 20, 2012 for construction of a complex, building, civil structures etc. is being reduced from the existing 75% to 70% for construction other than **residential properties** having a carpet area up to 2000 sq ft or where the amount charged is less than Rs 1 crore. This will come into effect from March 1, 2013.

### Voluntary Compliance Encouragement Scheme, 2013 (VCES)

- A new scheme is proposed to be introduced to encourage voluntary compliance with the following main features:
  - The scheme can be availed of by non-filers or stop-filers or persons who have not made a truthful declaration in their return. However it will not be applicable to persons against whom any inquiry or investigation is pending by the issue of search warrant or summon or by way of audit;
  - The defaulter will be required to make a truthful declaration of all his pending tax dues (from October1, 2007 to December 31, 2012) and pay at least half of that before December 31, 2013; remaining half to be paid by:

– June 30, 2014 without interest; or

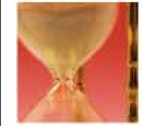
– By December 31, 2014 with interest from July 1, 2014 onwards;

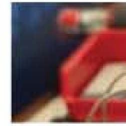
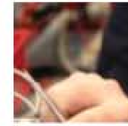
- On compliance with all the requirements the person will have immunity from interest (as specified), penalties and other proceedings;

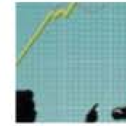
- The scheme will come into force when the Finance Bill is enacted.
- It is clarified that the tax-payers will need to settle their dues for the period after December 31, 2012 under the present law.

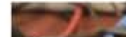
## Advance Ruling Authority

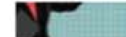
The benefit of Advance Ruling Authority is being extended to resident Public Limited Companies.









# CUSTOMS

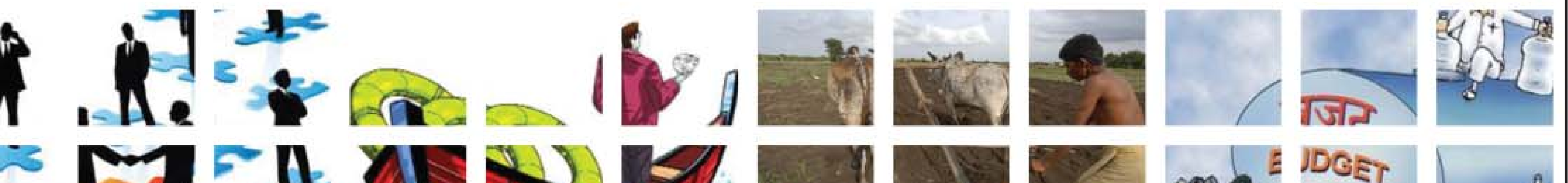
## Changes in Rates

| Particulars | New Rate | Old Rate |
|---|---|---|
| Hazel Nuts | 10% | 30% |
| De-hulled Oat Grain | 15% | 30% |
| Bauxite and unprocessed Ilmenite | 10% | NIL |
| Ilmenite – upgraded | 5% | NIL |
| Bituminous Coal | 2% (CVD – 2%) | 5% (CVD – 6%) |
| Steam Coal | 2% (CVD – 2%) | (CVD – 1%) |
| Raw Silk | 15% | 5% |
| Pre-forms of Precious and Semi-precious stones | 2% | 10% |
| Stainless Steel Wire Cloth Stripe and Wash Coat | 5% | 10% |
| Specified machinery under Notification No.12/2013 – Customs in Leather and Footwear Industry | 5% | 7.5% |
| Textile Machinery and parts thereof | 5% | 7.5% |
| Integrated Decoder Receiver (Set Top Box) | 10% | 5% |
| Petrol-run vehicles having engine capacity of more than 3000cc and diesel-run vehicles having engine capacity of more than 2500cc, having CIF value of more than US $ 40000 | 100% | 75% (on FOB) |
| Import of old car | 125% | 100% |
| New Motorcycles with engine capacity of 800cc | 75% | 60% |
| Yachts and Other Vessels | 25% | 10% |

***Miscellaneous :***

- Exemption from education cess and secondary and higher education cess is being withdrawn on aeroplanes, helicopters and their parts.
- Exemption from education cess and secondary and higher education cess is being withdrawn on soya bean oil, olive oil and few other items.
- Full exemption is being provided to trophy when imported into India by National Sports Federation recognized by the Central Government or any Sports Body registered under any law for the time being in force in connection with international tournament to be held in India.





- Duty free limit on gold raised to Rs. 50,000/- in case of male and Rs. 1,00,000/- in case of female from earlier limits of Rs. 10,000/- and Rs.20,000/- respectively.
- Raw Sugar, white or refined sugar has been included in the Second Schedule to the Customs Tariff Act, 1975 vide clause 77 read with Fourth Schedule of the Finance Bill, 2013 with a tariff rate of 20%. Exemption is however provided under Notification No. 15/2013 – Customs, dated 1st March, 2013. Thus, raw sugar, white or refined sugar will not attract any export duty.
- By virtue of excise duty exemption on ships and vessels, there will no CVD leviable on these ships and vessels. Notification Nos. 19/2012-Customs and 20-2012-Customs, both dated 17th March 2012 and S. No 462 of notification No. 12/2012-Customs, which have become redundant due to excise duty exemption, are being rescinded.

***Good & Services Tax***

- A sum of Rs. 9,000 crore towards the first installment of the balance of CST compensation provided in the budget.
- Work on draft GST Constitutional amendment bill and GST law expected to be taken forward.
- Concessional rate of CST retained @ 2%.

## Change in rates :

| Sector | Product Name | New Rate | Old Rate |
|---|---|---|---|
| Agriculture/ Agro Processing/ Plantation Sector: | tapioca starch | Fully Exempt | 6% |
| | henna powder or paste | Fully Exempt | 6% |
| Automobiles: | SUVs (except registered Taxis) | 30% | 27% |
| | Diesel Truck/Motor Vehicle Chassis | 13% | 14% |
| Metals: | Silver manufactured from zinc/lead smelting | 4% | 4% |
| | stainless steel "Patta Patti" | Rs. 40,000/- per machine per month | Rs. 30,000/- per machine per month |

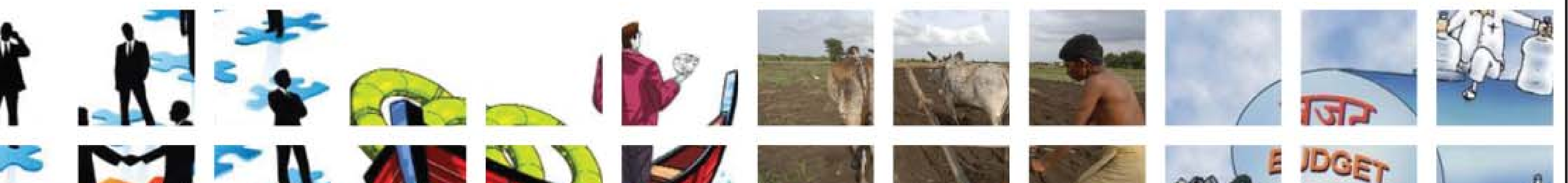
| | | | |
|---|---|---|---|
| | Trimmed or untrimmed sheets or circles<br>of copper, intended for use in the manufacture of handicrafts or utensils(copper means copper and copper alloys including brass) | Rs.3500 per metric tonne | Rs.3500 per metric tonne |
| Aircrafts & Ships: | Ships & Vessels | Fully Exempt | 6% |
| Electronics/ Hardware: | mobile phones of retail sale price exceeding Rs 2000/- | 6% | 1% |
| Others | | | |
| | marble tiles and slabs | Rs 60 per sq. mtr. | Rs 30 per sq. mtr |
| | | | |
| | | Fully Exempt | |
| | | Fully Exempt | Exempt |

All above change of rates applicable w.e.f March 1, 2013

***Miscellaneous***

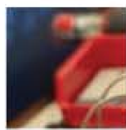
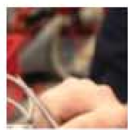
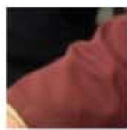
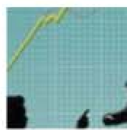
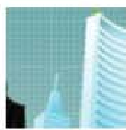
- Full exemption from excise duty is being provided on hand made carpets and carpets and other textile floor coverings of coir or jute, whether or not handmade.
- 'Zero excise duty route', as existed prior to Budget 2011-12, is being restored in respect of branded readymade garments. In the case of cotton there will be zero duty at the fibre stage and, in the case of spun yarn of man made fibres, there will be a duty of 12% at the fibre stage. The 'Zero excise duty route' will be in addition to the CENVAT route now available.
- Excise duty on cigarettes is being increased by about 18% on all cigarettes except cigarettes of length not exceeding 65 mm. Cigars and cigarillos duty is also being similarly raised.





# POLICY ANNOUNCEMENTS FOR FOREIGN INVESTMENTS

- Simplification and uniformity of registration procedures and other norms for entry for foreign portfolio investors.
- In order to remove the ambiguity that prevails under categorization of FDI investments vis a vis FII investments, a committee will be constituted by the Government to examine the application of the broad principle (of treating investments upto 10 percent as FII investments and investments of more than 10 percent as FDI investments) and also to work out other details expeditiously.
- FIIs will be permitted to participate in the Exchange Traded Currency Derivative Segment to the extent of their Indian rupee exposure in India.
- FIIs will also be permitted to use their investment in Corporate Bonds and Government Securities as collateral to meet their margin requirements.
- Designated depository participants will be allowed to register different classes of portfolio investors, subject to compliance with KYC guidelines issued by SEBI.

# INDIA BUDGET 2013

## *- An Analysis*

# INDUSTRY SPECIFIC ANALYSIS

# AUTOMOBILE INDUSTRY

The auto sector is one of the most important sectors in manufacturing, forming around 6% of India's GDP. The more or less stable economy and rise in the disposable income in the hands of Indian middle class families and neo riches and have resulted in the big demand of passenger vehicles in past few years. Lured with increasing demand in local markets many multinational automobile manufacturers have established their own manufacturing facilities in India and others already having their manufacturing facilities here have increased their manufacturing capacities. This has resulted in considerable capital inflow and investments in Indian Industries. India is being deemed as one of the world's fastest growing passenger car markets and second largest two wheeler manufacturer. As per a research report it is also a home for the largest motor cycle manufacturer and the fifth largest commercial vehicle manufacturer. India is expected to become the third largest automobile market in the world. By 2020, the luxury car segment is estimated to be around three per cent of the overall passenger car market in India; this will provide huge opportunity for growth both in investments as well as employments.

India is the largest base to export compact cars to Europe. Moreover, hybrid and electronic vehicles are new developments on the automobile canvas and India is one of the key markets for them. The increased competition has forced global as well as Indian manufacturers to focus their efforts for developing innovative, technologically improved and fuel efficient products and improved supply chains.

As per data published by Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce, the amount of cumulative foreign direct investment (FDI) inflow into the automobile industry during April 2000 to November 2012 was worth US$ 7,518 million, amounting to 4 per cent of the total FDI inflows in terms of US$.

The passenger vehicles segment grew at 9.71 per cent during April-June 2012, while overall commercial vehicle segment registered an expansion of 6.06 per cent year-on-year (y-o-y). Of late due to rising fuel prices and slowdown in global economies and also a more or less stagnant Indian economic situations have resulted in slowdown in demand and thereby lower sales year on year basis both in passenger as well as commercial vehicles.

The slowing demand has lowered industry growth to 4.57% in the first nine months of the current fiscal. According to the recent data released by the Society of Indian Automobile Manufacturers (SIAM).India's scooter and motorcycle manufacturers have registered 4 per cent growth during April-November 2012.

# FORGING INDUSTRY

The Indian Forging industry has now emerged as a major contributor to the manufacturing sector of the Indian economy. The industry, which thrives on 70 per cent of its business coming from automotive sector supplies, With increase in manufacturing capacities in Auto motive Industry the Indian forging industry is also poised to grow at a faster rate. The market potential continues to grow for the auto component sector. The future is undoubtedly contingent on the growth of the automobile industry. The liberalization of automobile industry has resulted in greater opportunities and greater demand potential for the future. The newer generation cars will require better quality forgings. Another advantage is of outsourcing whereby, opportunities for exports are huge.

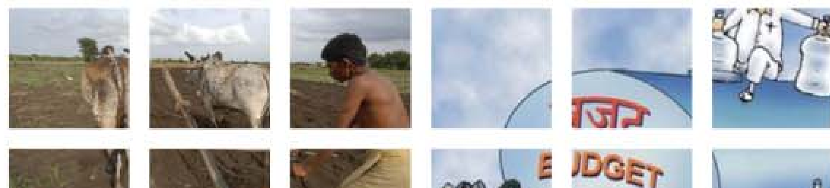
The composition of the Indian forging industry can be categorized into four sectors- large, medium, small and tiny. By and large, the Indian forging industry ( an important segment of the Indian auto component industry) still remains highly fragmented.

The unorganized players (who are mainly small and tiny units) cater mainly to job work and the replacement market. The industry is more labour intensive. As per an estimate the forging industry provides employment direct and indirect to about 200,000 people. The small scale units too are increasing their capital investment to keep pace with increasing demand in the global markets as also broadening the areas of demand for forgings. Many of them are now suppliers to Original Equipment Manufacturers (OEMs) in the Automobile sector, which speaks volumes about their efforts at technology and quality up gradation.

In forging industry a wide range of products are being manufactured, each being a diverse market structure and technology requirement, which has negated any possible concentration of the market in a few hands.

## DIRECT TAX PROPOSALS

- Investment allowance for investments by manufacturing companies of Rs. 100 crores or more in plant and machineries during the period from 1.4.2013 to 31.3.2015 will be eligible for Investment Allowance of 15 % of the invested amount. The proposal will benefit the automobile manufacturers as well as forging units planning to make fresh investments in manufacturing facilities investments
- Proposal to increase surcharge from 5 % to 10 on domestic companies and 2% to 5% in case of foreign companies where their taxable income exceeds Rs. 10 Crores
- Increase in withholding tax rate on royalties and fees for technical services paid to non residents increased to 25% from 10% may impact multinational automobile manufacturers manufacturing vehicles based on designs, pedants' and technical assistance from their holding or associate companies abroad.



## INDIRECT TAX PROPOSALS

- Concession for import of specified spare parts by electric and hybrid vehicles is extended till 31.3.2015.
- Increase in Import Duties on high end motor vehicle from 75% to 100 % and motor cycles with 800CC and capacity from 60% to 75%.
- Excise duty on SUVs other then registered as taxis, increased from 27% to 30%.

## CEMENT INDUSTRY

Cement is one of the core industries which plays a vital role in the growth and development of a nation. The industry occupies an important place in the Indian economy. The Indian cement industry is the 2nd largest market after China accounting for about 7-8% of the total global production. There are 139 large cement plants and over 365 mini cement plants in India. The country has a total of 40 players in the industry currently.

The demand for cement, being a derived one, depends mainly on the industrial activities, real estate business, construction activities and investment in the infrastructure sector. With the ever-increasing requirement for infrastructure, in addition to the onset of various Special Economic Zones (SEZs) being developed across the country, there is a huge demand for cement.

India's 330 million tonne (MT) cement industry grew by 6.4 per cent in FY12, on back of robust demand revival in the second half of the year. The industry sold 223.02 MT of the building material, compared with 209.5 MT in FY11.

Cement is a cyclical commodity with a high correlation with GDP, growing at around 1.2x of GDP growth rate. The housing sectoris the biggest demand driver of cement, accounting for about 64% of the total consumption. The other major consumers of cement include infrastructure (17%), commercial & institutional (13%) and industrial segment (6%).

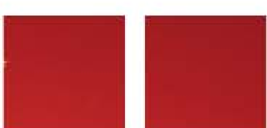
India is also producing different varieties of cement like Ordinary Portland Cement (OPC), Portland Pozzolana Cement (PPC), Portland Blast Furnace Slag Cement (PBFS), Oil Well Cement, Rapid Hardening Portland Cement, Sulphate Resisting Portland Cement, White Cement etc. Production of these varieties of cement conform to the BIS Specifications. Also, some cement plants have set up dedicated jetties for promoting bulk transportation and export.

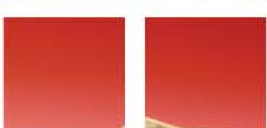
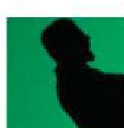
## TRENDS OF CEMENT INDUSTRY

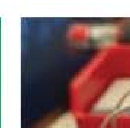
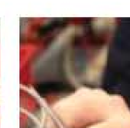
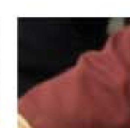
Growth Cycle

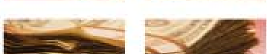
Indian cement industry witnessed 3 different stages:

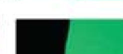
- Control Period 1969-1982 (13 yrs) - During this period many plants started off but growth wasn't there, because of differential pricing mechanism







- Partial decontrol 1982-1989 (7 yrs)- Quota system imposed which enforced 66.6% of sales government and small house builders rest (33.4%) for open market sale.
- Total Decontrol period 1989.... (ongoing )- Free market competition allowed, which enabled free market pricing mechanism. Govt. norms were fulfilled by subsidies.

During the financial year 2011-12 (FY 12), India's cement production grew by 6.2% year-on-year. The muted growth was mainly attributable to slowdown in construction activities, extended monsoon, delay in infrastructural projects and the overall downturn in the economy. As such, the capacity utilization levels stood lower at 73.7%.

The industry witnessed high operating costs, particularly those of energy and freight. The price of imported coal went up sharply. The steep depreciation of the rupee and hike in diesel prices further aggravated the concerns. However, the industry witnessed some recovery in demand from November 2011 onwards.

The cement and gypsum products sector has attracted foreign direct investments (FDI) worth US$ 2,618.30 million between April 2000 to August 2012, according to the data published by the Department of Industrial Policy and Promotion (DIPP).

The demand for cement is expected to grow at 10 per cent over 2011, as per ACC Ltd's annual report. India's total installed capacity of cement stood at 320 million tonnes per annum (MTPA).

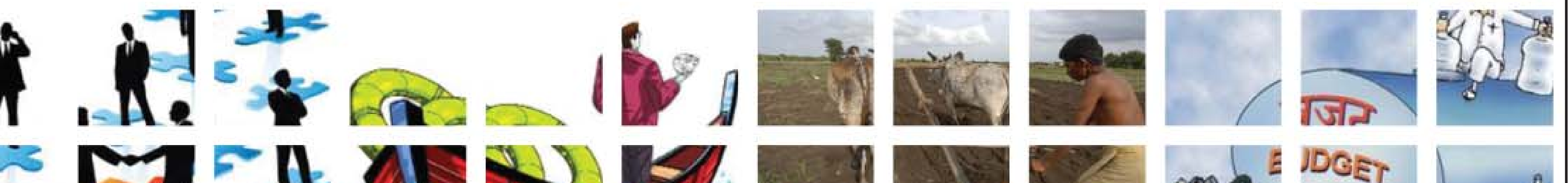
## INDUSTRY EXPECTATIONS

- Review of import duty on key inputs such as coal, pet coke and gypsum which currently have duty of 5%, 2.5% and 2.5% respectively. Since no duty has been imposed on cement import, the government may review import duty on raw materials on which the cement industry is heavily dependant.
- Higher focus for plan expenditure and capital formation will increase demand.
- The industry requires low service tax which will help to keep transportation cost in control.
- Cement should be categorized as Declared Goods so as to bring a uniform tax structure across the country and hence reduce tax burden for companies.

## DIRECT TAX PROPOSALS

- Increase in surcharge from 5% to 10% on domestic companies whose taxable income exceeds Rs. 10 crores. Additional surcharges to be in force for only one year.
- Investment allowance at the rate of 15% of actual cost of new asset acquired to manufacturing companies that invest more than Rs. 100 crore in Plant & Machinery during the period 01/04/2013 to 31/03/2015
- The surcharge applicable on Dividend distribution tax u/s 115-O is increased from 5% to 10%.





- Concessional rate of tax of 15% on dividend received by an Indian Company from its foreign subsidiary proposed to continue for 1 more year.
- TDS at the rate of 1% on the value of the transfer immovable properties where consideration exceeds Rs. 50 Lakhs. Agricultural land to be exempted.
- A final withholding tax at the rate of 20% on profits distributed by unlisted companies to shareholders through buyback of shares.
- Proposal to increase rate of tax on payment by way of Royalty and fees for Technical services to non-residents from 10% to 25%

## INDIRECT TAX PROPOSALS

- Duties on Steam Coal and Bituminous Coal equalised and 2% custom Duty and 2% CVD levied on both the types of coal.
- Export duty is being levied on bauxite at 10%

## STEEL INDUSTRY

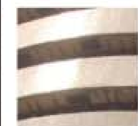
Steel was discovered by the Chinese under the reign of Handy nasty in 202 BC till 220 AD. Prior to steel, iron was a very popular metal and it was used all over the globe. Even the time period of around 2 to 3 thousand years before Christ is termed as Iron Age as iron was vastly used in that period in each and every part of life. But, with the change in time and technology, people were able to find an even stronger and harder material than iron that was steel.

Steel has been the key material with which the world has reached to a developed position. All the engineering machines, mechanical tools and most importantly building and construction structures like bars, rods, channels, wires, angles etc are made of steel for its feature being hard and adaptable. Consumption of steel is taken to be an indicator of economic development.

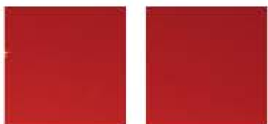
India occupies a central position on the global steel map, with the establishment of new state-of-the-art steel mills, acquisition of global scale capacities by players, continuous modernization and upgradation of older plants, improving energy efficiency and backward integration into global raw material sources.

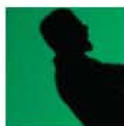
## HISTORY

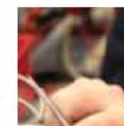
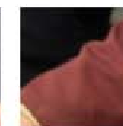
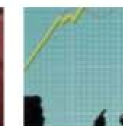
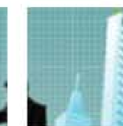
- The liberalization of industrial policy and other initiatives taken by the Government have given a definite impetus for entry, participation and growth of the private sector in the steel industry.

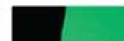
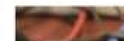


- While the existing units are being modernized/expanded, a large number of new steel plants have also come up in different parts of the country based on modern, cost effective, state of-the-art technologies.





- In the last few years, the rapid and stable growth of the demand side has also prompted domestic entrepreneurs to set up fresh greenfield projects in different states of the country.
- The Indian steel industry has entered into a new development stage from 2007-08, riding high on the resurgent economy and rising demand for steel.
- Rapid rise in production has resulted in India becoming the 4 th largest producer of crude steel and the largest producer of sponge iron or DRI in the world.
- Last five year's production for sale of pig iron, sponge iron and total finished steel (alloy + non-alloy) are given below:

| Indian steel industry : Production for Sale (in million tonnes) | | | | | |
|---|---|---|---|---|---|
| Category | 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2011-12* |
| Pig Iron | 5.28 | 6.21 | 5.88 | 5.68 | 5.78 |
| Sponge Iron | 20.37 | 21.09 | 24.33 | 25.08 | 20.37 |
| Total Finished Steel (alloy + non alloy) | 56.07 | 57.16 | 60.62 | 68.62 | 73.42 |
| Source: Joint Plant Committee; *provisional | | | | | |

## FUTURE OUTLOOK

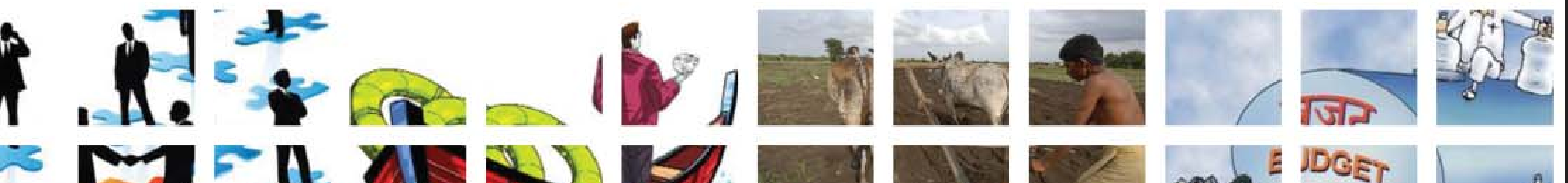
The country is expected to become the 2nd largest producer of crude steel in the world by 2015-16, provided all requirements for creation of fresh capacity are adequately met.

The demand for steel in the country is currently growing at the rate of over 8% and it is expected that the demand would grow over by 10% in the next five years. However, the steel intensity in the country remains well below the world levels. Our per capita consumption of steel is around 110 pounds as compared to 330 Pounds for the global average. This indicates that there is a lot of potential for increasing the steel consumption in India.

It can be seen that there Immense growth potential in Indian Steel Sector

- 222 Memorandum of Understandings (MOU) have been signed with various states for planned capacity of around 276 million tonnes by 2019-20.
- Investments at stake are to the tune of $187 billion in the Steel sector.
- Increase in the demand of steel in India is expected to be 14% against the global average of 5-6% due to its strong domestic economy, massive infrastructure needs and expansion of industrial production.
- Demand of steel in the major industries like infrastructure, construction, housing, automotive, steel tubes and pipes, consumer durables, packaging and ground transportation.
- Target for $ 1 trillion of investments in infrastructure during the 12th Five Year Plan.





- Infrastructure projects (like Golden Quadrilateral and Dedicated Freight Corridor) will give boost to the demand in the steel sector in near future.
- Projected New Greenfield & up-gradation of existing Airport shall keep the momentum up.
- As per the report of the Working Group on Steel for the 12 th Plan, there exist many factors which carry the potential of raising the per capita steel consumption in the country, currently estimated at 55 kg (provisional). These include among others, an estimated infrastructure investment of nearly a trillion dollars, a projected growth of manufacturing from current 8% to 11-12%, increase in urban population to 600 million by 2030 from the current level of 400 million, emergence of the rural market for steel currently consuming around 10 kg per annum buoyed by projects like Bharat Nirman, Pradhan Mantri Gram Sadak Yojana, Rajiv Gandhi Awaas Yojana among others.

Steel production in India has increased by a compounded annual growth rate (CAGR) of 8percent over the period 2002-03 to 2006-07. Going forward, growth in India is projected to be higher than the world average, as the per capita consumption of steel in India, at around 46 kg, is well below the world average (150 kg) and that of developed countries (400 kg). Indian demand is projected to rise to 200 million tonnes by 2015. Given the strong demand scenario, most global steel players are into a massive capacity expansion mode, either through brownfield or Greenfield route. By 2012, the steel production capacity in India is expected to touch 124 million tonnes and 275 million tonnes by 2020. While greenfield projects are slated to add 28.7 million tonnes, brownfield expansions are estimated to add 40.5 million tonnes to the existing capacity of 55 million tonnes.

## INDUSTRY EXPECTATIONS

- The steel industry in India is adversely affected given the shortage of iron ore and continued delays in project approvals. In this scenario, the reduction in the import duty on iron ore from the current rate of 2.5% is expected. The industry is also asking for a cut in the import duty on steel grade limestone and dolomite from the current level of 5.0%. Forging body seeks low costs, ban on ore export in Budget
- With a view to control exports of iron ore, the Government over the years has raised the duty on iron ore from 0.0% in FY09 to 5.0% in FY10 to 30% in FY12, which has resulted in fall in exports. The industries wants reduction in export duty on iron ore fines to 5.0%.
- Removal of basic custom duty of 5% on import of non-coking coal will benefit aluminum and steel producers.
- A roadmap towards policy actions for increasing domestic coal supply will benefit the entire steel industry.
- An increase in import duty on HRC Steel from present 5% to 10%.

## DIRECT TAX PROPOSALS

- Increase in surcharge from 5% to 10% on domestic companies whose taxable income exceeds Rs. 10 crores. Additional surcharges to be in force for only one year.
- Investment allowance at the rate of 15% of actual cost of new asset acquired to manufacturing companies that invest more than Rs. 100 crore in Plant & Machinery during the period 01/04/2013 to 31/03/2015
- The surcharge applicable on Dividend distribution tax u/s 115-O is increased from 5% to 10%.
- Concessional rate of tax of 15% on dividend received by an Indian Company from its foreign subsidiary proposed to continue for 1 more year.
- TDS at the rate of 1% on the value of the transfer immovable properties where consideration exceeds Rs. 50 Lakhs. Agricultural land to be exempted.
- A final withholding tax at the rate of 20% on profits distributed by unlisted companies to shareholders through buyback of shares.
- Proposal to increase rate of tax on payment by way of Royalty and fees for Technical services to non-residents from 10% to 25%

## INDIRECT TAX PROPOSALS

- Duties on Steam Coal and Bituminous Coal equalised and 2% custom Duty and 2% CVD levied on both the types of coal.
- Duty of 10% on export of unprocessed ilmentie and 5% on export on upgraded ilmentie.
- Export duty is being levied on bauxite at 10%
- Full exemption from export duty is being provided to galvanize steel sheets falling under certain sub-headings, retrospectively w.e.f. 01.03.2011.

## PLASTIC

The Indian plastic industry has taken great strides in the last few decades; the industry has grown to the status of a leading sector in the country with a sizable base. The material is gaining notable importance in different spheres of activity and the per capita consumption is increasing at a fast pace. Continuous advancements and developments in polymer technology, processing machineries, expertise, and cost effective manufacturing is fast replacing the typical materials in different segments with plastics.

Today The Indian plastics industry covers around 55,000 plastic processing units of which 75% of units are in the small-scale sector. It accounts for about 25% of the total production. The

industry consists of 2000 fiber processors, of which 80% are in the small-scale sector. Most of the readymade plastic products dumped in India are coming via under-invoicing. In under-invoicing, the importers show lower cost of imports in the invoice and try to save customs, excise and other taxes which makes these products cheaper. The plastic products meet demand of key user industries like automobile, construction, consumer durables etc. Polymers is the basic raw material for manufacturing plastics like poly propylene (PP), high density poly ethylene (HDPE), low density poly ethylene (LDPE), poly vinyl chloride (PVC)

On the basis of value added, share of India's plastic products industry is about 0.5% of India's GDP. The export of plastic products also yields about 1% of the country's exports. The sector has a large presence of small scale companies in the industry, which account for more than 50% turnover of the industry and provides employment to an estimate of about 0.4 million people in the country.

Approximately Rs 100 billion are invested in the form of fixed assets in the plastic processing industry.

Indian plastic industry has made significant achievements in the country ever since it made a promising beginning with the start of production of polystyrene in1957. The industry is growing at a rapid pace and the per capita consumption of plastics in the country has increased several times as compared to the earlier decade. The chronology of production of polymers is summarized as under -

1957 - Polystyrene

1959 - LDPE

1961 - PVC

1968 - HDPE

1978 - Polypropylene

Currently, the Indian plastic industry is highly fragmented with an estimate of around 25,000 firms and over 400,000 employees. The top 100 players of Indian plastic industry account for just 20% of the industry turnover. Barring 10 to 15% of the firms that can be categorized as medium scale enterprises, most of the units operate on a small – scale basis.

## EXPORT :

In the calendar year 2006, the value of world plastic export was US$ 375 billion. However the share of India was less than 1 % with exports of worth US$ 3.187billion. The percentage of growth in export was 21 %.During this trend of growth in exports, the export of plastics raw material increased from 55 % to 60% of the total export of plastic goods, while the export of processed plastic goods has registered a negative growth from 45 % to 9 %. According to recent reports, the industry is said to be losing an opportunity of USD 300 million through value addition on the raw materials that are exported.

The Indian plastic exports were valued at about US$ 532 million during FY 2004(1st half FY2005 exports US $ 295 million). With significant capacity additions leading to over-capacity in domestic markets during FY2001 and beyond, polymer exports have increased considerably. However, due to the lower competitiveness of the plastic products industry, polymers have been exported directly. Last year, India exported nearly USD 7.1 billion plastic products and USD 150 million machinery accounting for 2.3 per cent of the total exports to countries like the US, China, European Union, the Middle East and Africa.

Indian plastic exporters foresee a huge growth potential in Middle East and African markets and eyeing nearly 20 per cent growth in shipment of plastic products and 22 per cent in machinery in the upcoming financial year (2013-14).Plastics Export Promotion Council (PEPC). Executive Director Ranjan Kalyanpur said, "We are expecting about 20 per cent growth (in) plastic products and 22 per cent in machinery exports in FY14," he added.

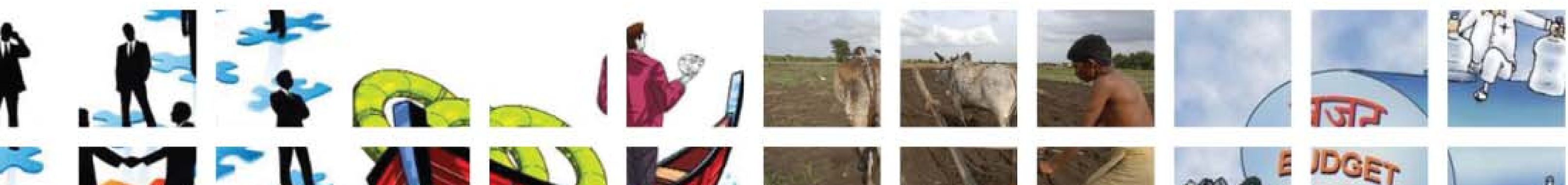
## INDUSTRY EXPECTATIONS :

- De-reserve articles of plastic reserved for the SSI sector in phased manner.
- Explore options of creating Plastics SEZs/clusters around polymer manufacturing facilities.
- Enable technology upgradation by providing interest subsidies.
- Reduce excise from 16% to 8% on polymers and Plastics to:
    - Cut costs of processed foods by 1%
        - Boost demand for processed foods by 1%
        - Assist in achieving MoFPI's vision target
    - Cut costs on plasticulture applications by 4%
        - Decrease farmer's upfront investment in plasticulture applications
- Promote use of plastics in piping applications.
- Mandate the use of geo-synthetics for road construction.
- Correct the inverted duty structure between crude oil and naphtha.

## DIRECT TAX PROPOSALS

- Increase in surcharge from 5% to 10% on domestic companies whose taxable income exceeds Rs. 10 crores. Additional surcharges to be in force for only one year.
- Investment allowance at the rate of 15% of actual cost of new asset acquired to manufacturing companies that invest more than Rs. 100 crore in Plant & Machinery during the period 01/04/2013 to 31/03/2015





- The surcharge applicable on Dividend distribution tax u/s 115-O is increased from 5% to 10%.
- Concessional rate of tax of 15% on dividend received by an Indian Company from its foreign subsidiary proposed to continue for 1 more year.
- TDS at the rate of 1% on the value of the transfer immovable properties where consideration exceeds Rs. 50 Lakhs. Agricultural land to be exempted.
- A final withholding tax at the rate of 20% on profits distributed by unlisted companies to shareholders through buyback of shares.
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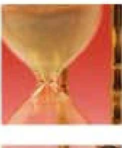
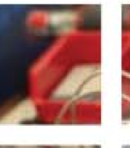
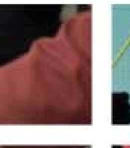
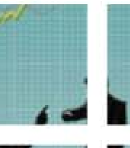
## INDIRECT TAX PROPOSALS

- Duties on Steam Coal and Bituminous Coal equalised and 2% custom Duty and 2% CVD levied on both the types of coal.





# MEDIA & ENTERTAINMENT

With stable economy and rising incomes, and rise in disposable income of income of Indian middle class families has changed lifestyles of common men in India whereby 'entertainment' has gained more important place in their lives Media and entertainment (M&E) industry in India , was pegged at Rs 80, 000 crore in 2011, is largely driven by this new trend. The Indian M&E industry is growing at the fastest rate compared to China at 14 per cent, Russia at 12 per cent and Brazil at11 per cent and as per the study the Indian Entertainment & Media Outlook 2012 report prepared by industry body Confederation of Indian Industry ( CII) and consulting firm PricewaterhouseCoopers (PwC), it is expected to grow at 17 per cent compounded annual growth rate (CAGR) during the period from 2012 to 2016, As per Rising advertising and consumer spends, infrastructure and policy support, have played the major role in growth of the industry which is further expected to be propelled by technological innovation, leading to better quality of media content being consumed with increased internet connectivity and access will be the key enabler.

The advertising segment, a major contributor of about 35 per cent of revenue in the Indian Media and Entertainment industry, is dominated by television (TV) and print that constitute about 80 per cent of the pie, according to the PwC-CII study. The report further pointed out that both the segments will continue to dominate the industry over the next five years. It also estimated that the Indian M&E sector's boom is largely attributed by burgeoning internet segment, which has the potential to outshine the print sector by 2014.

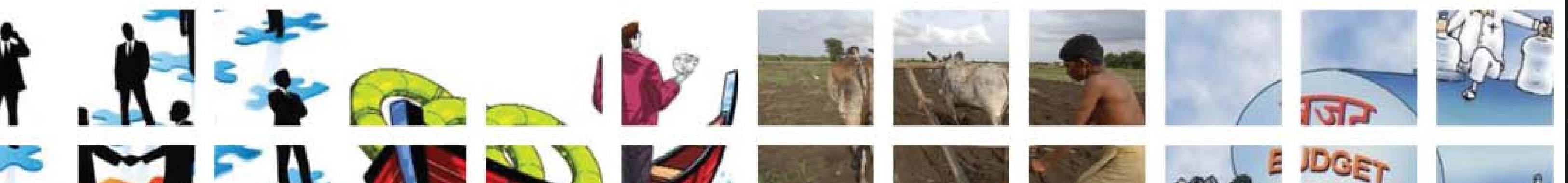
Also internet and gaming has emerged as the fastest-growing segment at 57 per cent and 33 per cent CAGR, respectively. Gaming segment has been recording substantial growth owing to the rising popularity of mobile and online and social media gaming.

## TELEVISION AND PRINT MEDIA

Television still dominates as the most effective medium for video and content consumption followed by the internet, according to Deloitte's State of the Media Democracy Survey - India 2012. TV, along with newspapers has been rated as the most influential way for advertising while almost 72 per cent of the consumers use the web on daily basis.

## RADIO

In Budget the Government has proposed to expand private FM radio services to 294 more cities. About 839 new FM radio channels will be auctioned in 2013-14 and, after the auction; all cities having a population of more than 100,000 will be covered by private FM radio services, Currently 245 FM channels are operational in 86 cities under phase two. The radio broadcasting sector is projected to grow at a CAGR of 16 per cent till phase-three stations commence operations by mid-2013.



## ONLINE AND MOBILE ENTERTAINMENT

TV and mobile devices are being used increasingly for watching online content, according to a latest survey by market researcher NPD Display Search. The study indicates that even though consumers view online content majorly from desktop computers and laptops, mobile devices such as tablets and smart-phones, and television sets are becoming popular medium for the purpose. The study found that 18 per cent of consumers access online content on their television on daily basis.

Another survey conducted by Nielson on behalf of Google India indicated that 7 out of 10 of the buyers know the exact brand and model they want to buy with the help of online research before entering the store. This shift in consumer behavior is attributed to easy access to information on the Internet - which has immensely boosted the concept of 'research online and shop offline'.

## FILMS

The Indian film fraternity will complete its century in 2013. The industry is anticipated to grow by 9 per cent per annum till 2015 to mark US$ 2.8 billion as its value, as per Deloitte study

## INVESTMENTS

Anticipating major cost benefits and effective synergies have seen an increased investments and consolidation in the industry.

Government Initiatives

The Government has recently given its nod to 74 per cent of foreign direct investment (FDI) in direct-to-home (DTH), IPTV, and mobile TV.

## ROAD AHEAD

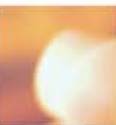
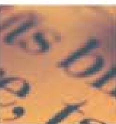
Indian Media and Entertainment industry is expected to touch Rs.1.75 trillion, according to the CII-PwC report. Print and television will continue to be the leaders in the advertising industry, wherein TV would have a 43 per cent share of total advertising in 2016, compared with print's 41 per cent.

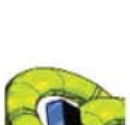
## DIRECT TAX PROPOSALS

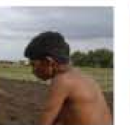
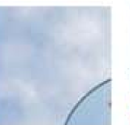
- Proposal to increase surcharge from 5 % to 10% on domestic companies and 2% to 5% in case of foreign companies where their taxable income exceeds Rs. 10 Crores
- Increase in withholding tax rate on royalties and fees for technical services paid to non residents increased to 25% from 10% may impact companies using foreign technical effects and /or assistance or paying royalties abroad for user of IP rights.

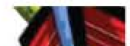
## INDIRECT TAX PROPOSALS

- Custom Duty on Imported Set Top Boxes increased from 5% to 10% may encourage local manufacturing.
- Exemption of Service Tax on Copyrights on cinematography now limited to films exhibited in Cinema Halls or Theatres.





# SUGAR INDUSTRY

In an era where there is a need for inclusive growth, the sugar industry is amongst the few industries that have successfully contributed to the rural economy. It has done so by commercially utilizing the rural resources to meet the large domestic demand for sugar. India is the fourth major sugar producing country in the world, the first three being U.S.S.R, Brazil and Cuba in that order. Sugar industry occupies an important place among organized industries in India. The sugar industry provides direct employment to large number of people and indirect employment to millions. It is the largest among the processing Industries. It is ranked third largest industry in terms of its contribution to the net value added by manufacturing.

Sugar has been manufactured in India since time immemorial. India regarded as the original home of sugarcane and being the largest producer of sugarcane has considerable potential for the development of sugar industry to meet domestic demand and part of the over seas demand. The sugar industry which ranks second among the industries of India makes significant contribution to India's export earnings. Being an industry and producing an essential commodity, its importance need not be emphasized further.

## TRENDS IN SUGAR INDUSTRY :

In last five decades Indian Sugar production share has gone up from 5% to 15% in global sugar production. Indian share is greater than 20% in cane sugar production of globe. For 2011-2012, India produced 24.3 million tones of sugar, according to Industry based data. India's domestic demand for sugar is almost 21-22 million tonne and the balance is available for exports. Around 10 factories have got permits as in December, 2011 to export sugar. Probable Chinese imports of sugar from India, in order to shore up their exhausted stocks may have a positive impact on Indian prices. Other than China, India is expected to sell sugar to Indonesia, east Africa and West Asia.

## INDUSTRY EXPECTATIONS

Total decontrolling: The sugar industry is controlled by the government in terms of the prices, cane prices and levy quota. The sugar industry wants the government to let the market govern the prices of the sweetener, by partially decontrolling the industry and reintroducing sugar futures trading. The government should also do away with the release order mechanism, which may create supply shortages and push up prices, instead of importing high-cost white sugar. Currently, 10% of the sugar produced has to be sold to the government at notified prices for distribution through PDS and the rest is sold through a release order issued by the government.

## DIRECT TAX PROPOSAL

- Increase in surcharge from 5% to 10% on domestic companies whose taxable income exceeds Rs. 10 crores. Additional surcharges to be in force for only one year.

- Investment allowance at the rate of 15% of actual cost of new asset acquired to manufacturing companies that invest more than Rs. 100 crore in Plant & Machinery during the period 01/04/2013 to 31/03/2015
- The surcharge applicable on Dividend distribution tax u/s 115-O is increased from 5% to 10%.
- Concessional rate of tax of 15% on dividend received by an Indian Company from its foreign subsidiary proposed to continue for 1 more year.
- TDS at the rate of 1% on the value of the transfer of immovable properties where consideration exceeds Rs. 50 Lakhs. Agricultural land to be exempted.
- A final withholding tax at the rate of 20% on profits distributed by unlisted companies to shareholders through buyback of shares.
- Proposal to increase rate of tax on payment by way of Royalty and fees for Technical services to non-residents from 10% to 25%

## INDIRECT TAX PROPOSALS

- Duties on Steam Coal and Bituminous Coal equalised and 2% custom Duty and 2% CVD levied on both the types of coal.

# TEXTILE INDUSTRY

Textile Industry contributes 14% to Indian industrial production, 4% to the GDP and around 17% to the total export earnings and is the largest foreign exchange earning sector in the country. Textile Industry has evolved from being a domestic small-scale industry, to the status of supremacy it currently holds. The industry, today, provides direct employment to over 35 million people and is the second largest provider of employment after agriculture. It not only generates jobs in its own industry, but also opens up scopes for the other ancillary sectors.

The Indian textile industry is set for strong growth, buoyed by both strong domestic consumption as well as export demand. Abundant availability of raw materials such as cotton, wool, silk and jute and skilled workforce has made India a sourcing hub. Man made fibres production recorded an increase of 3 per cent during April-December 2012. The potential size of the Indian textile and apparel industry is expected to reach US$ 221 billion by 2021, according to Technopak's Textile and Apparel Compendium 2012.

The textiles sector has witnessed a spurt in investment during the last five years. The industry (including dyed and printed) attracted foreign direct investments (FDI) worth Rs 5656.42 crore (US$ 1.04 billion) during April 2000 to November 2012.

## INDUSTRY EXPECTATIONS :

Customs duty on Catalysts and Chemicals – Spin finish Oil & Titanium Dioxide and VP latex used in the manufacture of synthetic fibres / technical textile fabrics should be on par with raw materials. Custom duty structure for various inputs for manufacture of yarn / fabrics should be on par with raw materials

Interest subsidy of 5% of all capital investments made in MMF sector to achieve Textile Vision 2020.

## DIRECT TAX PROPOSALS

- Increase in surcharge from 5% to 10% on domestic companies whose taxable income exceeds Rs. 10 crores. Additional surcharges to be in force for only one year.
- Investment allowance at the rate of 15% of actual cost of new asset acquired to manufacturing companies that invest more than Rs. 100 crore in Plant & Machinery during the period 01/04/2013 to 31/03/2015
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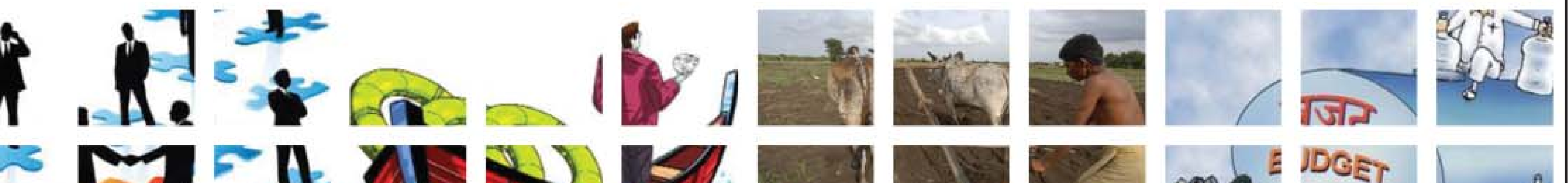
- A final withholding tax at the rate of 20% on profits distributed by unlisted companies to shareholders through buyback of shares.
- Proposal to increase rate of tax on payment by way of Royalty and fees for Technical services to non-residents from 10% to 25%

## INDIRECT TAX PROPOSALS

- Duty on Raw silk increased from 5% to 15%.
- 'Zero excise duty route', as existed prior to Budget 2011-12, is being restored in respect of branded readymade garments and made ups. In the case of cotton there will be zero duty at the fibre stage and, in the case of spun yarn of man made fibres, there will be a duty of 12% at the fibre stage. The 'Zero excise duty route' will be in addition to the CENVAT route now available.
- Handmade carpets and textile floor covering of coir and jute totally exempted from excise duty.
- Duties on Steam Coal and Bituminous Coal equalised and 2% custom Duty and 2% CVD levied on both the types of coal.
- Basic customs duty is being reduced from 7.5% to 5% on textile machinery & parts.



# CAPITAL GOODS & ENGINEERING INDUSTRY

Heavy industry does not have a single fixed meaning as compared to light industry. It can mean production of products which are either heavy in weight or in the processes leading to their production. In general, it is a popular term used within the name of many Japanese and Korean firms, meaning construction for big projects. Alternatively, heavy industry projects can be generalized as more capital intensive or as requiring greater or more advanced resources, facilities or management. The Indian Heavy Industry deals with the following 19 Industrial subsectors:

- Boilers
- Cement Machinery
- Dairy Machinery
- Electrical Furnace
- Freight Containers
- Material Handling Equipment
- Metallurgical Machinery
- Mining Machinery
- Machine Tools
- Oil Field Equipment
- Printing Machinery
- Pulp an Paper Machinery
- Rubber Machinery
- Switchgear and Control Gear
- Shunting Locomotive
- Sugar Machinery
- Turbines & Generator Set
- Transformers
- Textile Machinery

## INDUSTRY PERFORMANCE

During July 2012, IIP (Index of Industrial Production) growth was 0.1 per cent as compared to 3.7 per cent growth during the corresponding period of previous year. In electricity sector, the growth rate in July 2012 was 2.8 per cent and in mining and manufacturing sectors, the growth was negative. Under use-based category, the growth rate in basic goods was 1.5 per cent and consumer goods 0.7 per cent (in consumer durables 1.4 per cent and in consumer non-durables 0.1 per cent) during July 2012. The capital goods and intermediate goods sectors have registered negative growth during July 2012. Further details of the changes in index of Industrial Production are given in the table below.

| **Percentage Change in Index of Industrial Production** | | | | |
|---|---|---|---|---|
| **Industry Group** | **April – July 2011-12** | **April – July 2012-13** | **July 2011** | **July 2012** |
| General Index | 6.1 | -0.1 | 3.7 | 0.1 |
| Mining | 0.6 | -0.9 | 0.7 | -0.7 |
| Manufacturing | 6.5 | -0.6 | 3.1 | -0.2 |
| Electricity | 9.4 | 5.5 | 13.1 | 2.8 |
| Basic Goods | 8.1 | 3.0 | 10.0 | 1.5 |
| Capital Goods | 8.2 | -16.8 | -13.7 | -5.0 |
| Intermediate Goods | 1.3 | 0.3 | -0.1 | -1.1 |
| Consumer Goods | 4.9 | 3.3 | 6.4 | 0.7 |
| Durables | 4.3 | 6.3 | 9.0 | 1.4 |
| Non-durables | 5.5 | 0.7 | 4.1 | 0.1 |

The Indian capital goods sector turned one of its worst performing in first quarters in the past five years, due largely to policy inertia, tight liquidity, stubbornly high inflation and equally high interest rates.

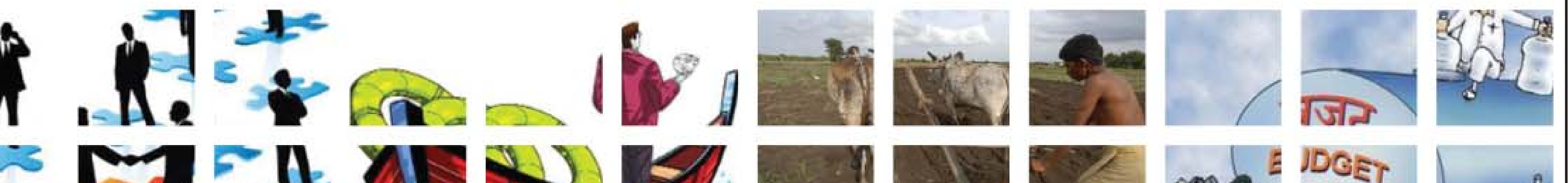
## INDUSTRY EXPECTATION

- Import duty on power equipments to be raised from current 5% to 19%, this move would ensure level playing field for domestic power equipment manufacturers against Chinese and Korean players.
- Technology upgradation Fund for engineering exporters will help engineering export companies to increase its share in world's engineering and capital goods market.

## DIRECT TAX PROPOSALS

- Increase in surcharge from 5% to 10% on domestic companies whose taxable income exceeds Rs. 10 crores. Additional surcharges to be in force for only one year.





- Investment allowance at the rate of 15% of actual cost of new asset acquired to manufacturing companies that invest more than Rs. 100 crore in Plant & Machinery during the period 01/04/2013 to 31/03/2015
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- Proposal to increase rate of tax on payment by way of Royalty and fees for Technical services to non-residents from 10% to 25%

## INDIRECT TAX PROPOSALS

- Period of concession available for specified part of electric and hybrid vehicles extended upto 31/03/2015.
- Duties on Steam Coal and Bituminous Coal equalised and 2% custom Duty and 2% CVD levied on both the types of coal.
- Duty of 10% on export of unprocessed ilmentie and 5% on export on upgraded ilmentie.
- Export duty is being levied on bauxite at 10%
- Basic customs duty is being reduced from 10% to 5% on stainless steel wire cloth stripe and from 7.5% to 5% on wash coat for use in the manufacture of catalytic convertors and their parts.
- Basic customs duty is being reduced from 7.5% to 5% on 20 specified machinery for use in leather and footwear industry.
- Compounded levy of Excise on stainless steel "Patta Patti" is being increased from Rs 30,000 per machine per month to Rs 40,000 per machine per month.

# FINANCE SECTOR

## INTRODUCTION

Efficient intermediation by financial markets leads to higher economic growth by increasing savings and their optimal allocation for productive uses. A shift of our growth trajectory to the pre-crisis level of over 8 per cent and above critically depends on efficient financial intermediation between savers and borrowers. Historically, banks have played this role. However, with the start of the reform process beginning 1990s, the importance and nature of financial intermediation has undergone a transformation with other intermediaries including non-banking financial companies (NBFCs), insurance and pension funds, and mutual funds(MF) emerging as the new mechanisms for channeling savings to investments. These developments have also been accompanied by the emergence of equity and debt markets, financial products like forwards, futures and other derivatives instruments which have the capacity of reallocating risks and putting capital to more efficient use.

## BANKS

Aggregate deposits of the banking sector increased from an average of Rs. 48,019.8 billion in 2010-11 to Rs. 64,362.3 billion during Q3 of 2012-13. Monetary policy started becoming a little more accommodative in 2012-13. A moderation in inflation created space for the Reserve Bank of India (RBI) to reduce policy rates and take other measures for improving liquidity in the system. The policy rates were cut during 2012-13, including a reduction of 75 basis points (bps) in the repo rate in two steps (50 bps in April 2012 and 25 bps in January 2013). The modal interest rate on non-resident (external) rupee (NRE) deposits of banks declined by 37 bps during 2012-13 (up to December 15) to 8.71 per cent, reflecting subdued demand for export credit in the economy.

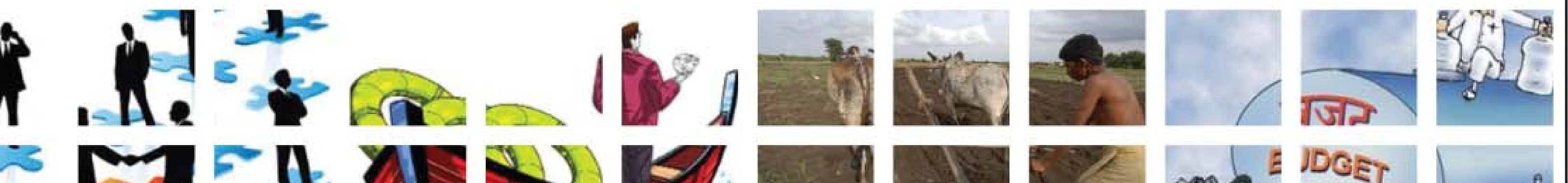
## FINANCIAL PERFORMANCE OF BANKS

Performance of Indian banks during the year 2011-12 was conditioned to a large extent by fragile recovery of the global financial markets as well as a challenging operational environment on the domestic front, with persistent high inflation and muted growth performance. The main reasons for increase in NPAs of banks are (a) switchover to system-based identification of NPAs by PSBs; (b) current macroeconomic situation in the country; (c) increased interest rates in the recent past; (d) lower economic growth; and (e) aggressive lending by banks in the past, especially during good times.

## NON-BANKING FINANCIAL INSTITUTIONS (NBFIS)

As at end-March 2012, there were four institutions, viz. EXIM Bank, NABARD, National Housing Bank (NHB), and the Small Industries Development Bank of India (SIDBI) regulated by the RBI as all-India financial institutions (FIs). Resources raised by FIs during 2011-12 were considerably higher than those raised during the previous year. While the long-term resources and short-term





resources raised witnessed a sharp rise during 2011-12 as compared to a year earlier, foreign currency resources raised declined during the same period of time. The NHB mobilised the largest amount of resources, followed by NABARD and SIDBI.

## CAPITAL MARKET

### *Primary Market*

During financial year 2012-13 (up to 31 December, 2012) resource mobilization through primary market (equity issue) witnessed an upward movement. The cumulative amount mobilised as on 31 December 2012 through equity public issues stood at Rs. 13,050 crore. During 2012-13, 20 new companies [initial public offers (IPOs)] with resource mobilization amounting to Rs. 6,043 crore were listed at the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) with mean IPO size of Rs. 302 crore.

### *Secondary Market*

Indian benchmark indices, i.e. the BSE and NSE closed at 19426.7 and 5905.1 (as on 31 December 2012), gaining 25.70 per cent and 27.70 per cent respectively over the closing value of 15454.9 (Sensex) and 4624.3 (Nifty) on 30 December 2011.

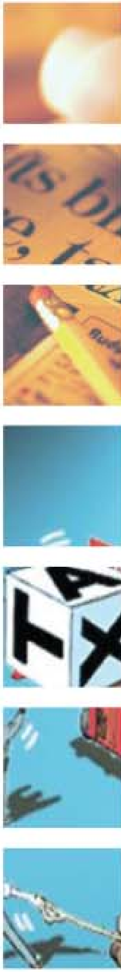
## CHALLENGES AND OUTLOOK

The recent global financial crises have raised certain issues relating to governance of financial intermediaries and awareness of investors. As investors' awareness is a precondition for their protection, attempts are being made to address this issue through the financial literacy campaign. In the global context, the performance of the financial sector in India will be influenced by both short-term and long-term factors. In the long run, a strong growth in global output will be essential for sustaining investment activities across the globe, including India. In the short run, factors like expectation of higher relative returns, risk perception of investors, and global liquidity will decide the level of flow of funds to the domestic equity market. Overall the global economic environment remains fragile and prone to further disappointment, although the balance of risk is now less skewed to the downside than it has been in recent years.

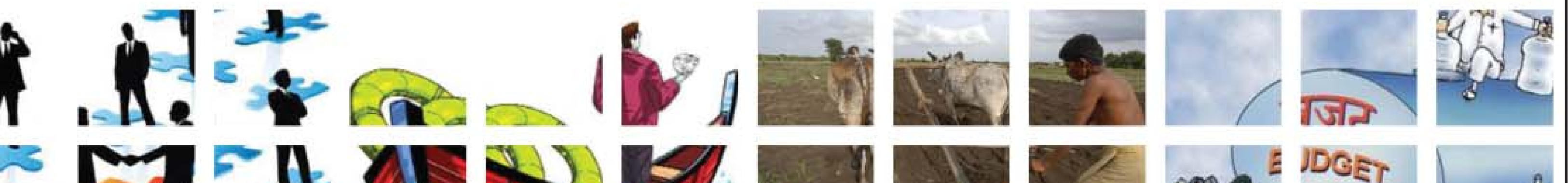
## DIRECT TAX PROPOSALS

- Benefits of Rajiv Gandhi Equity Scheme extended to investments in listed units of equity oriented funds. Further threshold of gross total income for eligibility increased from Rs 10 lakhs to Rs 12 lakhs. The benefit would now be available for three consecutive assessment years.

- In order to provide uniform taxation for all types of funds, other than equity oriented fund, it is proposed to increase the rate of tax on distributed income from 12.50% to 25% in all cases where distribution is made to an individual or a HUF. The rate of tax @ 30% continues for the payments made to persons other than individual and HUF.
- A Category I AIF set up as Venture Capital fund is being allowed pass through status under Income-tax Act subject to fulfillment of certain conditions. This amendment will take effect retrospectively from 01st April 2013 and will accordingly apply for subsequent assessment years.







# RETAIL SECTOR

India is one of the most desirable retail destinations in the world. India has emerged as the fifth most favourable destination for international retailers, outpacing UAE, Russia, Indonesia and Saudi Arabia, according to A T Kearney's Global Retail Development Index (GRDI) 2012. "India remains a high potential market with accelerated retail growth of 15-20 per cent expected over the next five years," highlighted the report.

## MARKET SIZE

India's retail sector is worth US$ 350 billion and has a low organised retail penetration (ORP) of 5 per cent to 8 per cent and is now growing at a compound annual growth rate (CAGR) of 15 per cent to 20 per cent.

The foreign direct investment (FDI) inflows in single-brand retail trading during April 2000 to September 2012 stood at US$ 42.70 million, as per the latest data released by Department of Industrial Policy and Promotion (DIPP).

## E-RETAILING

Retailers are using a mix of formats of which a relatively new but rapidly growing retail format is the online channel, which offers consumers convenience, price benefits and the ability to shop 24 hours a day. Though nascent, India's online retail market is growing at double-digit rates and is likely to be the next format that retailers will incorporate into their array of channels.

As the world's 11th largest economy (and fourth-largest emerging economy after BRIC peers China, Brazil, and Russia), India has started to appear on Ebusiness organization's lists of key international markets. The E-commerce revenues in India is expected to increase more than five times, from US$ 1.6 billion in 2012 to US$ 8.8 billion in 2016, as per a Forrester report titled 'Trends in India's E-commerce Market'. In 2011, venture capitalists invested US$ 177 million in E-commerce in India.

The Indian digital consumer industry, E-retailing is set to become a Rs 53,000 crore (US$ 9.76 billion) market by 2015 from the current Rs 3,600 crore (US$ 662.98 million), as per a November report by Avendus Capital Pvt Ltd.

## RETAIL IN RURAL INDIA

Rural chains in India are focusing on hinterlands in a big way. For many companies, a large portion of their revenues comes from rural sales. This fact is further making marketers focus their strategies according to customers in rural areas.

## GOVERNMENT INITIATIVES

- The Indian retail sector accounts for 22 per cent of India's gross domestic product (GDP) and contributes to 8 per cent of the total employment. India continues to be among the most attractive investment propositions for global retailers
- Till now FDI up to 100 per cent was allowed for cash and carry wholesale trading and export trading under the automatic route, and FDI up to 51 per cent was allowed in single-brand products, with prior government approvals. However, the Government recently passed a cabinet note and permitted FDI up to 51 per cent in multi-brand retailing with prior Government approval and 100 per cent in single brand retailing, thus further liberalising the sector. This policy initiative is expected to provide further fillip to the growth of the sector

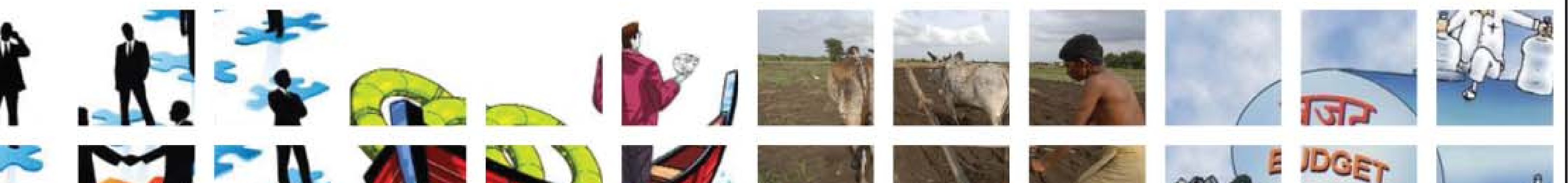
## ROAD AHEAD

The Indian retail sector is evolving rapidly and those who enter the market now can learn about local dynamics, develop market insights and establish leadership positions. Domestic and global retailers who have entered the Indian market are learning about consumer wants, preferences and needs.

Powered by strong internal demand, the country has displayed robust growth which is likely to be sustained in the coming years. Research and development (R&D), innovation and new product development are emerging as key drivers of success. As part of this effort, product localisation has emerged as a driver of sales, customer excitement, customer interest, etc.

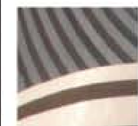
## INDUSTRY EXPECTATIONS

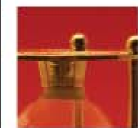
- Formulation of a Retail Policy.
- Permission to operate 24x7.
- Retail and Entertainment Zones (REZ).
- In order to augment the living standards of people in the city, initiatives to create Retail and Entertainment Zones (REZ) similar to SEZ and IT parks is expected. Retailers in REZ to get benefits like exemption from stamp duty, octroi, and cheaper power.
- Consumption Incentive: Providing a consumption incentive in the form of personal income tax relief to consumers, who can spend say up to 25% of their income on consumer goods and services, which can be supported by tax invoices from the retailer/establishment.

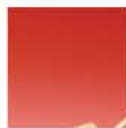


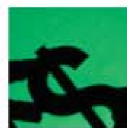
## DIRECT TAX PROPOSALS

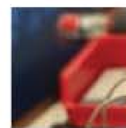
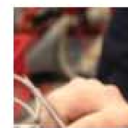
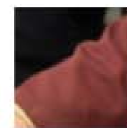
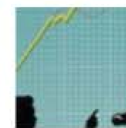
- Increase in surcharge from 5% to 10% on domestic companies whose taxable income exceeds Rs. 10 crores. Additional surcharges to be in force for only one year.
- The surcharge applicable on Dividend distribution tax u/s 115-O is increased from 5% to 10%.
- Concessional rate of tax of 15% on dividend received by an Indian Company from its foreign subsidiary proposed to continue for 1 more year.
- TDS at the rate of 1% on the value of the transfer immovable properties where consideration exceeds Rs. 50 Lakhs. Agricultural land to be exempted.
- A final withholding tax at the rate of 20% on profits distributed by unlisted companies to shareholders through buyback of shares.
- Proposal to increase rate of tax on payment by way of Royalty and fees for Technical services to non-residents from 10% to 25%

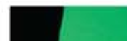
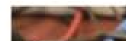


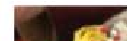








## POWER INDUSTRY

The power sector in India has undergone significant progress after independence. When India became independent in 1947, the country had a power generating capacity of 1,362 MW. Hydro power and coal based thermal power have been the main sources of generating electricity. Generation and distribution of electrical power was carried out primarily by private utility companies. Notable amongst them and still in existence is Calcutta Electric. Power was available only in a few urban centers; rural areas and villages did not have electricity. After 1947, all new power generation, transmission and distribution in the rural sector and the urban centers (which was not served by private utilities) came under the purview of State and Central government agencies. State Electricity Boards (SEBs) were formed in all the states. Nuclear power development is at slower pace, which was introduced, in late sixties. The concept of operating power systems on a regional basis crossing the political boundaries of States was introduced in the early sixties. In spite of the overall development that has taken place, the power supply industry has been under constant pressure to bridge the gap between supply and demand.

### POWER SECTOR REFORMS

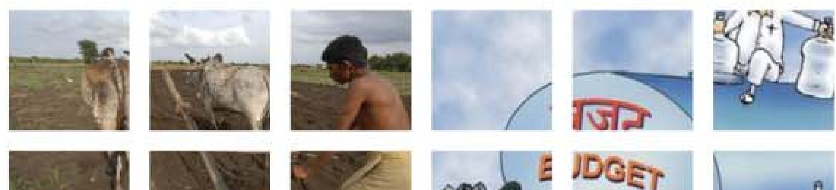
The Orissa Government was the first to introduce major reforms in power sector through enactment of Orissa Reforms Act, 1995. Under this Act, Orissa Generating Company, Orissa Grid Company and Orissa Electricity Regulatory Commission have been formed. Similarly, the Haryana Government has also initiated reform programme by unbundling the State Electricity Board into separate companies and Haryana Electricity Regulatory Commission has already been constituted.

In view of the urgent need to reduce transmission and distribution losses and to ensure availability of reliable power supply to the consumers reforms in the distribution sectors are also been considered by establishing distribution companies in different regions of the State. The entry of private investors will be encouraged wherever feasible and it is proposed to carry out these reforms in a phased manner. The Governments of Orissa and Haryana have already initiated reforms in the distribution sector by setting up distribution companies for each zone within their States.

With these efforts, it is expected that the performance of power sector will improve because of rationalisation of tariff structures of SEBs and adequate investment for transmission and distribution sector.

### PRE BUDGET EXPECTATIONS FOR POWER SECTOR

Amidst other commercial challenges such as coal crisis, forex fluctuation, etc, the termination of tax holiday available to power projects on 31st March 2012 would act as a big set-back. Further, the new Direct Tax Code proposes to substitute the current 10 year profit based tax holiday with new investment based tax incentive which will adversely impact the returns (IRR) from the project. In order to support growth in power sector, this Budget should consider extending the



current tax holiday regime. To address the issue of indigenous coal scarcity, customs duty of 5% on import of coal should be exempted.

Most countries like US, China, Brazil, Spain, etc promote renewable energy through tax incentives. The current accelerated depreciation incentive for renewables loses its shine due to non-availability of generation based incentives and proposed investment based tax incentive. Government should consider providing additional incentives such as low interest loans, tax exemption on sale of carbon credits etc. Considering India's huge energy demand-supply deficit, Government needs to do something special in this Budget to boost the power sector.

## DIRECT TAX PROPOSALS

- Increase in surcharge from 5% to 10% on domestic companies whose taxable income exceeds Rs. 10 crores. Additional surcharges to be in force for only one year.
- Investment allowance at the rate of 15% of actual cost of new asset acquired to manufacturing companies that invest more than Rs. 100 crore in Plant & Machinery during the period 01/04/2013 to 31/03/2015
- 'Eligible Date' for projects in the power sector to avail benefit u/s 80-IA extended from 31/03/2013 to 31/03/2014
- The surcharge applicable on Dividend distribution tax u/s 115-O is increased from 5% to 10%.
- Concessional rate of tax of 15% on dividend received by an Indian Company from its foreign subsidiary proposed to continue for 1 more year.
- TDS at the rate of 1% on the value of the transfer immovable properties where consideration exceeds Rs. 50 Lakhs. Agricultural land to be exempted.
- Generation-based incentives will be available for wind energy projects.
- A final withholding tax at the rate of 20% on profits distributed by unlisted companies to shareholders through buyback of shares.
- Proposal to increase rate of tax on payment by way of Royalty and fees for Technical services to non-residents from 10% to 25%

## INDIRECT TAX PROPOSALS

- Duties on Steam Coal and Bituminous Coal equalised and 2% custom Duty and 2% CVD levied on both the types of coal.

# PHARMACEUTICAL INDUSTRY

The pharmaceutical industry develops, produces, and markets drugs or pharmaceuticals licensed for use as medications. Pharmaceutical companies are allowed to deal in generic and/or brand medications and medical devices. They are subject to a variety of laws and regulations regarding the patenting, testing and ensuring safety and efficacy and marketing of drugs.

The Pharmaceutical industry in India is growing at 11% annually, the Indian Pharmaceutical industry is fourth globally in terms of volume and in terms of value, and it is ranked thirteenth as per the report of Pharmaceutical Directory of India 2012. Most pharma companies operating in India, even the multinationals, employ Indians almost exclusively from the lowest ranks to high level management. Although many of these companies are publicly owned, leadership passes from father to son and the founding family holds a majority share.

## CURRENT STATUS/ INDUSTRY PERFORMANCE

In terms of the global market, India currently holds a modest 1-2% share, but it has been growing at approximately 11% per year and it is now seeking to become a major player in outsourced clinical research as well as contract manufacturing and research. There are 74 U.S. FDA-approved manufacturing facilities in India, more than in any other country outside the U.S. Indian pharma industry is mainly operated as well as controlled by dominant foreign companies having subsidiaries in India due to availability of cheap labour in India at lowest cost.

## FUTURE OUTLOOK

The Indian healthcare industry is showing a strong upward trajectory and the sector is expected to touch US $ 238.76 billion by 2020. The healthcare industry in India has witnessed a remarkable growth of 12% per year, since 2008. This growth has been fuelled by increase in the average life expectancy and average income levels, as well as rising awareness about health insurance among consumers.

The Indian pharmaceutical market is expected to touch US $ 74 billion in sales by 2020 from US $ 11 billion in 2012. The pharmaceutical market has grown at 15.7% during 2011, with major growth drivers being in the area of anti-diabetics, derma and vitamins.

## INDUSTRY EXPECTATIONS

- Change in excise duty structure of formulations (currently at 4%) and API's (currently at 10%) expected.
- Extension of weighted deduction on all expenditure on R&D (currently in-house R&D at 200%) incurred for conducting clinical trials and product registrations overseas.
- Continuation of EOU status for the pharmacy units for the export benefits.

## DIRECT TAX PROPOSALS

- Increase in surcharge from 5% to 10% on domestic companies whose taxable income exceeds Rs. 10 crores. Additional surcharges to be in force for only one year.
- Investment allowance at the rate of 15% of actual cost of new asset acquired to manufacturing companies that invest more than Rs. 100 crore in Plant & Machinery during the period 01/04/2013 to 31/03/2015
- The surcharge applicable on Dividend distribution tax u/s 115-O is increased from 5% to 10%.
- Concessional rate of tax of 15% on dividend received by an Indian Company from its foreign subsidiary proposed to continue for 1 more year.
- TDS at the rate of 1% on the value of the transfer immovable properties where consideration exceeds Rs. 50 Lakhs. Agricultural land to be exempted.
- A final withholding tax at the rate of 20% on profits distributed by unlisted companies to shareholders through buyback of shares.
- Proposal to increase rate of tax on payment by way of Royalty and fees for Technical services to non-residents from 10% to 25%

## INDIRECT TAX PROPOSALS

- MRP based assessment in respect of branded medicaments of Ayurveda, Unani, Siddha, Homeopathy and Bio-Chemic Systems of medicines to reduce valuation disputes.

# REAL ESTATE

The Indian economy has witnessed robust growth in the last few years and is expected to be one of the fastest growing economies in the coming years. Demand for commercial property is being driven by India's economic growth.

The sector is not only the biggest contributor to gross domestic product (GDP) of the country but is also the fourth largest sector in terms of foreign direct investment (FDI) inflows in the country. The two main reasons responsible for boom in Indian real estate sector include liberalisation of Government policies, which has decreased the need for permissions and licenses before taking up mega construction projects and the expanding industrial sector.

Urbanisation and increasing household income are some of the major factors that influence demand for residential real estate and growth in the retail sector.

## MARKET SIZE/ GROWTH PROSPECTS

As per a study report, the Indian real estate market size is expected to touch US$ 180 billion by 2020. In fact, the demand is expected to grow at a compound annual growth rate (CAGR) of 19 per cent between 2010 and 2014, with tier I metropolitan cities projected to account for about 40 per cent of this.

Growing infrastructure requirements from sectors such as education, healthcare and tourism are providing numerous opportunities in the sector. Further, India is going to produce an estimated two million new graduates from various Indian universities during this year, creating demand for 100 million square feet of office and industrial space. In addition, presence of a large number of Fortune 500 and other reputed companies will attract more companies to initiate their operational bases in India thus, creating more demand for corporate space.

## INVESTMENTS

As per study report, Construction development sector (including townships, housing, built-up infrastructure & construction-development projects) has attracted a cumulative FDI worth US$ 21,765.55 million from April 2000 to November 2012. According to the Department of Industrial Policy and Promotion (DIPP), FDI flows into the construction sector for the period April-October 2012-13 stood at US$ 691 million,

India needs to invest a huge amount to modernize urban infrastructure and keep pace with shift towards and expansion of cities.

## GOVERNMENT INITIATIVES

The Government of India has allowed FDI up to 100 per cent under the automatic route in townships, housing, built-up infrastructure and construction development projects to increase investment, generate economic activity, create new employment opportunities and add to the available housing stock and built-up infrastructure

## ROAD AHEAD

The year 2012 has seen maximum number of steps taken by the Government to boost real estate sector. As a result, developers believe that 2013 would be a positive year for the sector. The real estate market in India is yet in a promising stage. The sector happens to be the second largest employer after agriculture and is expected to grow at the rate of 30 per cent over the next decade.

Emergence of nuclear families and growing urbanization has given rise to several townships that are developed to take care of the elderly. With a number of senior citizen housing projects been planned, the segment is expected to grow significantly in the future.

## DIRECT TAX PROPOSALS

- Proposal to increase surcharge from 5 % to 10% on domestic companies where their taxable income exceeds Rs. 10 Crores.
- Increase in withholding tax rate on royalties and fees for technical services paid to non residents increased to 25% from 10% may impact big real estate developer companies using foreign construction designs and technologies.
- Allowance of additional deduction of interest upto Rs.1 lac for a person taking first home loan up to Rs.25 lacs during the FY 2013-14.

## INDIRECT TAX PROPOSALS

- Abatement available for construction of a complex, building, civil structures etc is reduced from 75% to 70% in case of construction of premises having carpet area of more than 2,000 sq.fts. or where the Value is more than Rs.1 crore.
- Increase in excise duty on Marbles from Rs.30/- per Sq. Mtr to Rs.60/- per Sq.Mtr. will increase cost of construction.

# TELECOM SECTOR

The Indian Telecom sector has come a long way since liberalization started with New Telecom Policy. Telecom sector has witnessed exponential growth especially in the wireless segment in the last few years. Telecom has evolved as a basic infrastructure like electricity, roads, water etc. and has also emerged as one of the critical components of economic growth required for overall socio economic development of the country. The telecom sector is one of the major drivers of the growth of the Indian economy. It is the fastest growing telecom sector in the world with more than 16 million subscribers being added every month.

The telecom industry witnessed significant in subscriber base over the last decade, with increasing network coverage and competition induced decline in tariff acting as catalysts for the growth in subscriber base. The growth story and potential have also served to attract newer players in the industry, with the result that the intensity of competetion has kept increasing.

## CURRENT STATUS

The sector is growing at a speed of 45% during the recent years. This rapid growth is possible due to various proactive and positive decisions of the Government and contribution of both by the public and the private sectors. The rapid strides in the telecom sector have been facilitated by liberal policies of the Government that provides easy market access for telecom equipment and a fair regulatory framework for offering telecom services to the Indian consumers at affordable prices. Presently, all the telecom services have been opened for private participation.

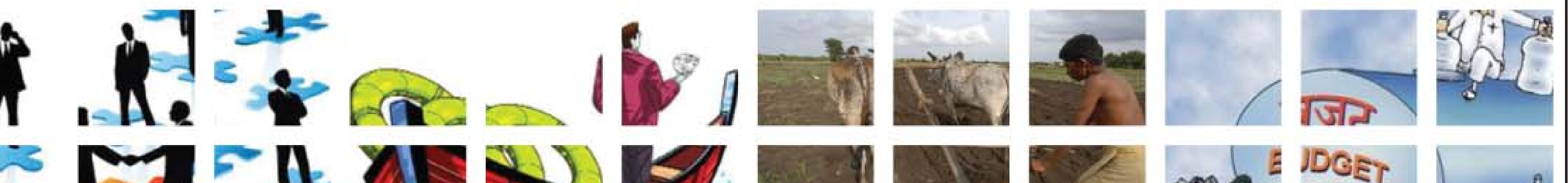
## MARKET SHARE

Private operators hold 87.83% of the wireless market share (based on subscriber base) where as BSNL and MTNL, the two PSU operators hold only 12.17% market share. The graphical presentations of market shares and shares in net additions of all the service providers during the month of December, 2012 are given below:

## INDUSTRY EXPECTATIONS

- Considerable amount of investments are being made for telecom infrastructure, for which input credit is unavailable. The sector requires recovery of its input costs against taxes paid.
- The definition of the term 'royalty' has been amended to include all revenue streams of telecom operators, which necessitates tax withholding retrospectively.
- When it comes to withholding taxes, amending provisions retrospectively will hurt the players, and it is hoped that the Budget will bring positive changes with respect to this.
- Earlier during the year, the Government had granted infrastructure status to telecom tower companies. Tax holiday benefits under Sec 80 IA are also available. It is desired that





this status should be given to all telecom players, and extend tax holiday benefits to all companies in the sector.

- The players in the telecom sector provide a variety of services to consumers, which include providing games, wallpapers, ringtones, etc as well. These services are categorized as entertainment and requirement of entertainment tax. This will result in double tax for the players as service tax is also being paid.
- The telecom sector has seen a huge erosion of investor confidence as a result of several issues in the past. Easing FDI norms for the telecom sector and minimizing obstacles is a way to boost foreign investor's confidence in the sector.

## DIRECT TAX PROPOSALS

- Increase in surcharge from 5% to 10% on domestic companies whose taxable income exceeds Rs. 10 crores. Additional surcharges to be in force for only one year.
- Investment allowance at the rate of 15% of actual cost of new asset acquired to manufacturing companies that invest more than Rs. 100 crore in Plant & Machinery during the period 01/04/2013 to 31/03/2015
- The surcharge applicable on Dividend distribution tax u/s 115-O is increased from 5% to 10%.
- Concessional rate of tax of 15% on dividend received by an Indian Company from its foreign subsidiary proposed to continue for 1 more year.
- TDS at the rate of 1% on the value of the transfer immovable properties where consideration exceeds Rs. 50 Lakhs. Agricultural land to be exempted.
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