Nanubhai Desai & Co.

April 2010
Part II

the RECKONER

keeping you AHEAD

Contents

INCOME TAX

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Zero coupon bonds specified

The Central Government has specified the Ten years Deep Discount Bond with the following particulars as zero coupon bond for the purposes of the clause (48) of section 2 of the Act

Name of the bond	Ten year Deep Discount Bond (Zero Coupon Bond) of Rural Electrification Corporation Limited (REC)
Period of life of the bond	10 years
Time schedule of the issue of bond	To be issued on or before the 31st day of March, 2011
Amount to be paid on maturity or redemption of the bond	Rs 30,000 for each bond
Number of bonds to be issued	2,500,000

It is also notified that income from such bonds will be taxed only as capital gains on transfer or redemption or maturity.

New Income Tax Return form SARAL II (ITR 1) and ITR V for Assessment Year 2010-11 has been notified by CBDT

CBDT has notified New Income Tax Return (Form SARAL II (ITR 1)) for Assessment Year 2010-11 for Individuals having income from Salary/Pension/ Income from One House Property (Excluding loss brought forward from previous years) / Income from Other Sources (Excluding winning from Lottery and Income from Race Horses). CBDT has also notified Income Tax Return Verification Form ITR-V for Assessment Year 2010-11 for SARAL II (ITR-1) ITR-2, ITR-3, ITR-4, ITR-5, ITR-6 & ITR-8 transmitted electronically without digital signature.

GENERAL

Valuation Rules Announced by CBDT

CBDT has announced valuation guidelines on April 8, 2010 ("Valuation Rules") specifying the methodology for calculation of value of shares of a company. While the Valuation Rules appear to be quite simple, however, it may raise certain issues for taxpayers in the future.

As per the Valuation Rules,

- The fair market value of listed shares traded on the stock exchange shall be equal to the value as recorded in the stock exchange.

- The value of listed shares traded off the stock exchange shall be equal to the lowest price of such shares on the valuation date. If there is no trading on the valuation date, the date immediately preceding the valuation date shall be considered to determine the price.

- The formula for calculation of the value of unlisted shares appears to be geared towards using the net asset value methodology based on the difference between assets and liabilities as appearing on the face of the Balance Sheet.

  While no formal report is required to be obtained from a merchant banker / accountant with respect to such valuation, the rules require reliance to be placed on the value of assets as per the balance sheet – without specifying whether the balance sheet is required to be audited. Considering that tax authorities may question the manner in which valuation has been done in the event it is based on unaudited results, this rule may result in requirement of additional audit for the company at the time of investment, thus increasing the cost and time of the transaction.

- The value of unlisted shares and securities, other than equity shares in an unlisted company, shall be estimated as per a report from a merchant banker / accountant. This rule would cover preference shares, debentures and other securities. This may add on to the cost of making the investment.

The valuation date is the date of receipt of property (including shares). It is also important to note that the Finance Act 2009 had already introduced an amendment to section 56 relating to investments by individuals at lower than fair market value. The Valuation Rules are also applicable with respect to such investments made by individuals. It is also relevant to note that while these Valuation Rules were not in place last year, tax could not be paid by individuals due to the methodology of valuation not been prescribed. The Government has however not come out with a clarification exempting such individuals from interest penalties for late payments of taxes due.

What next?

With the introduction of the Valuation Rules, the next brick has been put in place for implementation of the proposed amendment of section 56. However, the proposed amendment read along with the Valuation Rules, still leave some open items which will increase the cost of doing business in India. Investors can only wait and watch and hope that the broad nature of the section 56 amendment will be addressed to factor in the pricing benefits provided under alternative regimes. It does not make sense after all, that the Indian investment regime should give with one hand and take away with the other.

CASE LAWS

Vijaya Bank vs. CIT (Supreme Court)

For Section 36(1) (vii) - Bad Debts: Write off of individual debtor's account is not necessary

The assessee had made a provision for bad debts by debiting the Profit & Loss Account and crediting the Provision for Bad debts Account. Thereafter, the provision account was debited and the loans and advances account was credited. The Assessing Officer (AO) disallowed the claim for bad debts under section 36(1) (vii) on the ground that the individual account of the debtor had not been written off. According to the AO, the impugned bad debt supposedly written off by the assessee bank was a mere provision and the same could not be equated with the actual write off of the bad debt, as per the requirement of Section 36(1) (vii) of the Act. CIT (A) opined that it was not necessary for the purpose of writing off of bad debts to pass corresponding entries in the individual account of each and every debtor and that it would be sufficient, if the debit entries are made in the Profit and Loss Account and corresponding credit is made in the "Bad Debt Reserve Account".

Decision of Tribunal and High Court

Aggrieved by the order of CIT (A), the Department preferred an appeal to the Income Tax Appellate Tribunal. The Tribunal upheld the contention of the assessee on three grounds. Firstly, according to the Tribunal, the assessee had rightly made a provision for bad and doubtful debt by debiting the amount of bad debt to the Profit and Loss Account so as to reduce the profits of the year. Secondly, the provision account so created was debited and simultaneously the amount of loans and advances or debtors stood reduced and, consequently, the provision account stood obliterated. Lastly, according to the Tribunal, loans and advances or the sundry debtors of the assessee as at the end of the year lying in the Balance Sheet was shown as net of "provisions for doubtful debt" created by way of debit to the Profit and Loss Account of the year. Thus, the Tribunal concluded that deduction under Section 36(1) (vii) of the Act was allowable to the assessee.

On appeal to the High Court by the department, the High Court confirmed the disallowance made by the AO by setting aside the order of Tribunal.

Decision of Supreme Court

On appeal by the assessee, the Supreme Court had upheld the judgement of the Tribunal and set aside the impugned judgement of the High Court. Accordingly, the Supreme Court held that:

- Pursuant to the Explanation inserted w.e.f. 1.4.1989, a mere provision for bad debt is not entitled to deduction under section 36(1) (vii).

  However, in the case of the assessee, besides debiting the amount to Profit and Loss Account, the assessee had also obliterated the said provision by reducing the corresponding amount from the debtors account in the Balance Sheet. Consequently, the figure in the loans and advances in the Balance Sheet was shown net of the provision for bad debts

- The AO's contention that the individual account of the debtor should be written off was not acceptable on the following grounds:
  - that it was based on a mere apprehension that the assessee might claim deduction twice over and it was open to the AO to check whether the assessee was claiming double deduction,
  - that if the individual accounts were closed, the Debtor could, in the recovery suits, rely on the Bank statement and contend that no amount is due and payable to the assessee and
  - that as per Section 41(4) of the Act, the AO is empowered to tax the amount of bad debt which is subsequently recovered.

CIT vs. Glenmark Pharmaceuticals Ltd. (Bombay High Court)

Tests laid down to determine when contract manufacturing will amount to a contract of sale for Section 194C (TDS)

The assessee entered into an agreement with a third party for the manufacture of certain pharmaceutical products under which it provided the formulations and specifications and the manufacturer affixed the trademark of the assessee on the articles produced. The raw materials were purchased by the manufacturer and property in the goods passed to the assessee only on delivery. The agreement was on a principal to principal basis. The assessee contended that the contract was a contract of sale. The AO took the view that the contract was a contract of 'work' and tax was deductible at source under section 194C. The CIT (A) confirmed the order of the AO. On an appeal filed by the assessee, the Tribunal upheld that the agreements which were entered into by the assessee with manufacturers were not contracts for work within the meaning of Section 194C. The Tribunal upheld the contention of the assessee that the contract involved a sale.

Decision of Bombay High Court

The Bombay High Court dismissed the appeal filed by the department and accordingly held that:

- a contract for sale has to be distinguished from a contract of work. If a contract involves the sale of movable property as movable property, it would constitute a contract for sale. On the other hand, if the contract primarily involves carrying on of work involving labour and service and the use of materials is incidental to the execution of the work, the contract would constitute a contract of work and labour;

- the argument of the department that the restrictions imposed on the manufacturer to (a) utilize the formula provided by the assessee, (b) affix the trade-mark of the assessee, (c) manufacture as per specifications provided by the assessee and (d) deal exclusively with the assessee show that the contract is not one of sale is not acceptable because this has not been the understanding of the law at any point of time even by the CBDT and judicial precedents;

- though a product is manufactured to the specifications of a customer, the agreement would constitute a contract for sale, if (i) the property in the article passes to the customer upon delivery and (ii) the material that was required was not sourced from the customer / purchaser, but was independently obtained by the manufacturer from a third party;

- this position is now statutorily recognized in explanation (e) to Section 194C inserted by the Finance Act 2009 to provide that the expression 'work' shall not include manufacture or supply of a product according to the requirement or specification of a customer by using material which is purchased from a person other than such customer;

- on facts, as (i) the agreement was on a principal to principal basis, (ii) the manufacturer had his own establishment where the product was manufactured, (iii) the materials required in the manufacture of the article or thing was obtained by the manufacturer from a person other than the assessee and (iv) the property in the articles passes only upon the delivery of the product manufactured, the contract was one of "sale" and there was no obligation to deduct tax under section 194C.

Porrits & Spencer (Asia) Ltd. vs. CIT (P&H High Court)

Tax planning is valid.

The appellant is a Public Limited Company incorporated under the Companies Act, 1956. It is a subsidiary of Porritts & Spencer Ltd. U.K. and is engaged in manufacturing of engineered fabrics and industrial textiles. The registered as well as corporate office of the appellant is situated at Faridabad, where it has its factory also. At all material times, the appellant have been carrying on the business of manufacturing and selling machine clothing for different applications to a diverse range of industries in India and abroad. On May 21, 1990, the appellant had purchased 25 lacs units of 'US'64' of Unit Trust of India (UTI) at the then prevalent market rate of Rs. 15/- per unit, for a total consideration of Rs. 3,75,00,000/- from ANZ Grindlays Bank, New Delhi. The units were purchased on credit for the purposes of making investment. The units were duly transferred by the UTI to the appellant on May 30, 1990. On account of non-availability of surplus funds and cost of holding them on interest being unprofitable, the appellant sold the units on July 21, 1990 to ANZ Grindlays Bank, New Delhi, at the then prevailing market rate of Rs. 13.01 per unit, for a total consideration of Rs. 3,25,25,000/-, after deducting interest of Rs. 9,86,300/- at the rate of 16% on the total sale consideration of Rs. 3,75,00,000/- for a period of 60 days. It is apparent that the appellant incurred a loss of Rs. 51,61,875/- in this transaction. Accordingly, the appellant in its return of income for the Assessment Year 1991-92 claimed the loss as a short term capital loss and also claimed set-off against its income and offered dividend income of Rs. 45 lacs after the statutory deduction for tax.

The AO, however, did not allow deduction claimed for the short term capital loss of Rs. 51,61,875/-. The AO passed the order stating that the transactions of purchase and sale of units were not genuine transactions and was a device for tax avoidance. The AO further stated that the loss incurred on account of these transactions was of speculative business within the meaning of Explanation to Section 73 of the Act. As such, it was not allowable against the profits and gains of the business of the appellant. Accordingly, the AO taxed the entire dividend income of Rs. 45 lacs earned on these units as income from other sources. The AO, however, allowed deduction of Rs. 35,13,700/- for it under Section 80M of the Act.

Decision of CIT (A) and Tribunal

The CIT (A) upheld the view of the AO opining that the transaction concerning unit 'US-64' was speculative in nature. The CIT (A) affirmed the finding of the AO. The order of the CIT (A) was challenged by both, the appellant, as well as AO. It was held by the Tribunal that the appellant was not entitled to setoff of the said loss against its income from business, since the transactions were not bona fide because they were entered into with a motive to reduce the liability of tax which is not permissible in law.

Decision of P&H High Court

On Appeal by the Appellant, the High Court allowed the appeal by dismissing the order of Tribunal. It was held by the High Court that:

- In the case of Azadi Bachao Andolan (Decision of bench consisting of 2 judges), it was held by the Hon'ble Supreme Court that once the transaction is genuine, merely because it has been entered into with a motive to avoid tax, it would not become a colourable devise and earn any disqualification. Applying the principles of the decision of Hon'ble Supreme Court in the case of Azadi Bachao Andolan, as the transaction of purchase of units has been held to be genuine by the Tribunal and the basic object of purchasing the units was to earn dividends, which are tax free under section 80 M and to sell the units by suffering losses, it cannot be concluded by any stretch of imagination that the assessee used any colourable devise, particularly when Parliament has incorporated section 94 (7) w.e.f. 1.4.2002 to recognize and regulate the purchase and sale of units and the dividends/income received from such units;

- The argument of the department based on the decision of Hon'ble Supreme Court in the case of McDowell & Co (Decision of bench consisting of 5 judges) cannot be accepted because the judgement rendered therein has been explained in detail by the later judgement in the decision of Hon'ble Supreme Court in the case of Azadi Bachao Andolan. It is well settled that if a smaller Bench of the Supreme Court has later explained its earlier larger Bench, then the later judgement is binding on the High Court. Accordingly, the view expressed in case of Azadi Bachao Andolan has to be accepted as binding and it cannot be said that the principle of law laid down by the House of Lords in Duke of Westminster as applied in the case Azadi Bachao Andolan is no longer applicable.

INTERNATIONAL TAXATION

CIRCULARS

Areas outside India notified as 'specified territory'

Section 90 of the Act was amended by the Finance Act 2009 to enable the Central Government to enter into an agreement with any specified territory outside India, in addition to the already existing provision of agreement with the Government of any country. Explanation 2 provides for notification of such specified territories.

In exercise of the powers conferred by Explanation 2 to section 90 of the Income Tax Act, 1961 ("The Act"), the Central Government notified following areas outside India as the 'specified territory' for the purposes of the said section:

Name of the Country	Territory
Bermuda	a British Overseas Territory
British Virgin Islands	a British Overseas Territory
Cayman Islands	a British Overseas Territory
Gibraltar	a British Overseas Territory
Guernsey	a British Crown Dependency
Isle of Man	a British Crown Dependency
Jersey	a British Crown Dependency
Netherlands Antilles	an Autonomous Part of the Kingdom of Netherlands
Macau	a Special Administrative Region of The People's Republic of China

The Central Government has approved notification of the above mentioned areas as 'specified territory' for the purpose of Explanation 2 to Section 90 of the Act.

As a result of this notification, the Central Government can initiate and negotiate agreements for exchange of information (i.e. tax information exchange agreements (TIEA)) for the prevention of evasion or avoidance of income tax and assistance in collection of income tax with these nine specified territories. Even double tax avoidance agreements an also be entered with these countries.

The Central Government also notified "Hong Kong Special Administrative Region of the People's Republic of China" as specified territory for the purpose of said section of the Act.

Earlier, in December 2009, the Central Government had notified following as specified territory and specified association, respectively, for the purpose of the said section:

(a) the territory in which the taxation law administered by the Ministry of Finance in Taipei is applied;

(b) the India-Taipei Association in Taipei and the Taipei Economic and Cultural Centre in New Delhi.

CASE LAWS

ITO vs. Prasad Production Ltd (ITAT Chennai Special Bench)

S. 195 (1) - TDS obligation does not arise if the payment is not chargeable to tax. Ratio propagated by decision of Karnataka HC in the case of Samsung Electronics not followed

The assessee had entered into an agreement with IMAX Ltd., Canada for purchase of equipment, maintenance and installation to establish IMAX theatre at Hyderabad as per the contract awarded by the Tourism Department of Government of Andhra Pradesh. As per the agreement with IMAX Ltd., the total consideration was to be USD 13,65,000 for purchase of system and USD 9,50,000 as technology transfer fee. During the year under consideration, the assessee remitted USD 9,02,500 to IMAX Ltd, Canada towards technology transfer fee without deducting tax at source (TDS).

In the course of show cause notice issued by the Department under section 201 of the Act for non-deduction of tax, the assessee had filed relevant schedule of agreement for maintenance, installation, testing and training services. The assessee could not provide the information for break-up of the amount remitted. The AO found that the payment made by the assessee is for provision of a variety of services to be provided by the personnel of IMAX Canada in India. The AO was of the view that the amount remitted by the assessee was for provision of technical services by IMAX Canada which falls under section 9 (1) (vii). The AO concluded that since the assessee had not obtained any order under section 195 (2), 195 (3) or under section 197, the gross amount remitted by the assessee was liable to tax under section 195 of the Act. Accordingly, the AO raised a demand on assessee and also levied interest under section 201 (1A) of the Act.

Aggrieved by the order of the AO, the assessee had preferred an appeal before CIT (A). CIT (A) observed that though the agreement provides for installation and training in the beginning, the amount of remittance represents a part of sale consideration of the equipment. Accordingly, the CIT (A) held that there is no ambiguity in regard to the portion which is taxable and the portion which is not taxable. Accordingly, the CIT (A) passed the order stating that the entire sum is not chargeable to tax at all and therefore, the decision of Hon'ble Supreme Court in the case of Transmission Corporation of AP Ltd was not applicable.

Decision of Special Bench of Chennai Tribunal

On appeal by the department, the question as to whether a person responsible for making payment to a non-resident was liable to deduct tax at source under section 195 (1), if he did not apply to the AO under section 195 (2) for permission to remit without deduction at source, was referred to the Special Bench of Tribunal. Special Bench had dismissed the appeal of the department and accordingly held that:

- The effect of the decisions of the Hon'ble Supreme Court in the cases of Transmission Corporation and Eli Lilly is that Section 195 (1) applies only if the payment made to the non-resident is chargeable to tax. If the payer has a bona fide belief that no part of the payment has income character, Section 195 (1) will not apply and it is not necessary to apply to the AO under section 195 (2);

- In the case of Samsung Electronics, Karnataka HC held that Section 195 / 201 liabilities cannot be avoided on ground of non-taxability of recipient. A judgement of a non-jurisdictional High Court need not be followed where there are conflicting High Court judgements or where the judgement is rendered perincuriam (Kanel Oil 121 ITD 596 (Ahd)) or where the correct legal position was not brought to the notice of the High Court (Lalsons Enterprises (Del) 89 ITD 25 (Del) (SB)). Apart from the judicial conflict, the alternative TDS procedure as per the CBDT Circulars was not brought to the attention of the High Court. Consequently, the judgement of the Special Bench in Mahindra & Mahindra (AT) 313 ITR 263 (AT) (Mum), which held that Section 195 (1) did not apply if the payment was not chargeable to tax, has to be followed in preference to that of Samsung Electronics;

- On merits, as the services rendered by the payee were auxiliary to the sale of equipment, the consideration was not chargeable to tax in India.

ACCOUNTS, AUDIT & INVESTMENT

ACCOUNTS AND AUDIT

Standard on Auditing (SA) 200 (Revised) "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"

Recently the Institute of Chartered Accountants of India (ICAI) has come out with a Standard on Auditing (SA) 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"

Scope of this SA

This Standard on Auditing (SA) establishes the independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with SAs. Specifically, it sets out the overall objectives of the independent auditor, and explains the nature and scope of an audit designed to enable the independent auditor to meet those objectives. It also explains the scope, authority and structure of the SAs, and includes requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the SAs. The independent auditor is referred to as "the auditor" hereafter.

SAs are written in the context of an audit of financial statements by an auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information.

Overall Objectives of the Auditor

In conducting an audit of financial statements, the overall objectives of the auditor are:

a. To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
b. To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the SAs require that the auditor disclaim an opinion or withdraw from the engagement, where withdrawal is legally permitted.

Effective Date

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010.

Standard on Auditing (SA) 220(Revised) "Quality Control for an Audit of Financial Statements"

Recently the Institute of Chartered Accountants of India (ICAI) has come out with a Standard on Auditing (SA) 220 "Quality Control for an Audit of Financial Statements"

Scope of this SA

This Standard on Auditing (SA) deals with the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. It also addresses, where applicable, the responsibilities of the engagement quality control reviewer. This SA is to be read in conjunction with relevant ethical requirements.

System of Quality Control and Role of Engagement Teams

Quality control systems, policies and procedures are the responsibility of the audit firm. Under SQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

a. The firm and its personnel comply with professional standards and regulatory and legal requirements; and
b. The reports issued by the firm or engagement partners are appropriate in the circumstances.

This SA is premised on the basis that the firm is subject to SQC 1.

Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise.

Objective

The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

c. The audit complies with professional standards and regulatory and legal requirements; and
d. The auditor's report issued is appropriate in the circumstances.

Effective Date

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010.

Standard on Auditing (SA) 501 (Revised) "Audit Evidence—Specific Considerations for Selected Items"

Recently the Institute of Chartered Accountants of India (ICAI) has come out with a Standard on Auditing (SA) 501 "Audit Evidence—Specific Considerations for Selected Items"

Scope of this SA

This Standard on Auditing (SA) deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence in accordance with SA 3302, SA 500 (Revised) and other relevant SAs, with respect to certain aspects of inventory, litigation and claims involving the entity, and segment information in an audit of financial statements.

Objective

The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:

c. Existence and condition of inventory;
d. Completeness of litigation and claims involving the entity; and
e. Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

Effective Date

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010.

Financial sector firms may get more time to adapt to IFRS

In a move that would help the financial sector fully prepare for its convergence with international accounting standards, it has been proposed by a sub-group of the Corporate Affairs Ministry that all commercial banks and urban co-operative banks having a net worth of more than Rs 300 crore be allowed to prepare their balance sheet as per international standards from April 1, 2013.

Insurance companies have been given a timeline of April 1, 2012 for converting their opening balance sheet in compliance with accounting standards that have been converged with International Financial Reporting Standard (IFRS).

In a roadmap laid down by the sub-group for banking, insurance and non-banking finance companies, it has been proposed that the convergence would happen in a phased manner. In the first phase, commercial banks and urban co-operative banks having a net worth of more than Rs 300 crore would be required to prepare accounts as per the international standards from April 1, 2013.

Earlier, it was decided that all listed and unlisted companies with a net worth of over Rs 1,000 crore would have to prepare their balance sheet as per international accounting standards beginning April 1, 2011.

The convergence is expected to increase the credibility of Indian companies globally. The financial sector has been given extra time "keeping in mind their level of preparedness by the sector and also because International Accounting Standard Board (IASB) has not finalized its standard on financial instruments. That will happen only by December 2010.

In phase II, the urban co-operative banks having a net worth of more than Rs 200 crore but less than Rs 300 crore would be required to prepare their accounts as per IFRS from financial year April 1, 2014. However, urban co-operative banks and regional rural banks having net worth less than Rs 200 crore have been exempt from the compliance.

The government asked Chartered Accountants, Cost Accountants and Company Secretaries to report all suspicious fund transfers

The government has asked Chartered Accountants, Cost Accountants and Company Secretaries to directly report to the Home Ministry cases of suspicious fund movements in an out of companies, as it looks to crack down on money laundering and terror funding.

The Home Ministry, through the Ministry of Corporate Affairs, has asked the Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries of India (ICSI) and the Institute of Cost and Works Accountants of India (ICWAI) to ensure that their members report any instances of diversion of funds directly without any procedural formalities.

If any suspicious fund movements come to the notice of the above mentioned professionals, details of it along with full particulars of its clients should be reported within 24 hours. Incidences should be reported directly to a designated e-mail as also be conveyed through fax to the Home Ministry, requesting anonymity. Such cases will be handled by a senior Home Ministry official.

The move is aimed at sensitising professionals of their responsibilities under Section 51A of the Unlawful Activities (Prevention) Act, which aims at preventing routing of terror funds through domestic firms.

Suspicious activities include cases where a dubious individual or entity approaching them for investing into financial instruments or immovable property or arrange for incorporating a company as a director, shareholder or partner.

The move assumes significance at a time when Indian Companies passes through the annual audit season, which involves professionals such as CAs and Company Secretaries to audit the financials of companies and vet their management affairs. The Government wants that the professionals act in a more responsible manner to report cases of corporate malafides as soon as they come to their notice.

SEBI

Additional instructions for an application to secure registration as FII with SEBI

SEBI has issued new guidelines on 7th April, 2010 that prescribes filing of additional information while making an application for securing registration as FII (vide Form A) and Sub Account registration (vide Form AA)

As per the new guideline issued by SEBI, in addition to the general instructions that are in force with regard to the filing of an application to secure registration as FII (vide Form A) and registration as sub account (vide Form AA), on or after April 7, 2010, the below mentioned additional declaration and undertaking shall be required to be enclosed to the application form.

1. Declaration:

The applicants are required to provide the following declaration on its letter head:

(a) that it is not a Protected Cell Company (PCC) or Segregated Portfolio Company (SPC) and does not have an equivalent structure by whatever nomenclature.

(b) that it is not a Multi Class Share Vehicle (MCV) by constitution and does not have an equivalent structure by whatever nomenclature. It contains only single class of share.

(c) that it is a MCV by constitution and has more than one class of shares or has an equivalent structure and that a common portfolio is maintained for all classes of shares and satisfies broad based criteria.

OR

(c) A segregated portfolio is maintained for separate classes of shares wherein each such class of shares are in turn broad based.

2. Undertaking:

In case the applicant is/ proposed to be a MCV or an equivalent structure and have more than one class of shares, it shall undertake the following on its letter head:

(a) Common portfolios shall be allocated across various share classes and it shall be broad based;

OR

(a) If portfolios are segregated for each distinct share class, then each such share class shall satisfy the broad based criteria;

(b) In case of change in structure/ constitution/ addition of classes of shares, prior approval of SEBI shall be taken;

(c) In case of any addition of share classes, it shall follow the criteria at (a) above

For all new applications to be filed with SEBI to secure registering as FII/Sub Account on or after April 7, 2010, the above mentioned declaration and undertaking are required to be enclosed. In case, the same is not provided, the forms shall be treated as incomplete.

All other instructions (viz. for Selecting Categories, for Signatures and Filling and for Filing of the Applications etc..) remain unchanged.

Prohibition on Protected Cell Companies (PCC) and Segregated Portfolio Companies (SPC) Extended to Existing Entities

On April 7, 2010 SEBI had issued new guidelines for filing of additional information while making an application for securing registration as FII (vide Form A) and Sub Account registration (vide Form AA) and instructed FII to furnish a declaration that they are not structured as PCCs/ SPCs at any level. Also, collective investment schemes set-up as Multi Class Vehicles were eligible for registration as FII/ sub-account only if certain stringent restrictions were complied with.

We understand that SEBI has subsequently sent a communication to the Domestic Custodians of existing sub-accounts and FIIs, requesting to obtain similar declarations from their clients on or before September 30, 2010.

This is an obvious indicator that SEBI is suspicious that the very structure of the Foreign Institutional Investors could be misused for round-tripping, whereas earlier the regulator's concentration was on misuse of P-note issuances by FIIs.

SEBI cuts IPO listing time to 12 days

In a move that could make the existing public issue process more efficient and reduce pre-listing manipulation, the SEBI has decided to reduce the time between public issue closure and listing to 12 days from existing period of up to 22 days. This will be applicable to public issues opening on or after May 1, 2010. The new process would require syndicate members to capture all data relevant for the purposes of finalizing the basis of allotment while uploading bid data in the electronic bidding system of the stock exchanges. To ensure that the data so captured is accurate, syndicate members would be permitted an additional day to modify some of the data fields entered by them in the electronic bidding system. As per the SEBI Registrar to the issue is required to validate the bids and finalize the basis of allotment only on the basis of the final electronic bid file provided by the stock exchanges.

SEBI said lead managers or their agents would be responsible for the accuracy of data entry and for resolving investor grievances. Further, the ASBA process would also undergo suitable modification to make it consistent with these timelines.

The SEBI move will reduce instances of manipulation in the pre-listing period. Several IPOs had created havoc before and after listing due to big grey market plays. Market operators manipulate the IPO process using the long gap in the listing process. On the other hand, investors' money wouldn't be blocked for a longer period. The SEBI move has come at a time when the primary market is on the revival path with many IPOs slated to hit the market in the coming months. SEBI's plan is to bring down the listing time to seven days.

SEBI trims individual FIIs purchase limit for bonds

Recently SEBI slashed the purchase limit for corporate bonds to Rs 2,000 crore and for Government papers to Rs 200 crore by individual FIIs, as demand for these debt instruments are on the rise.

While the SEBI reduced the limit for a single entity to Rs 200 crore from Rs 300 crore in case of Government papers, the limit for corporate bonds was curtailed to Rs 2,000 crore from the existing Rs 10,000 crore.

No single entity shall be allocated more than Rs 200 crore of the Government debt investment limit and no single entity shall be allocated more than Rs 2,000 crore of the corporate debt investment limit, said SEBI in a circular.

Earlier the regulator had raised the limit for a single FII after the overall limit for these institutions were raised to 15 billion dollars (about Rs 67,500 crore) in case of corporate bonds and five billion dollars (about Rs 22,500 crore).

FEMA

CCI Valuation scrapped - DCF valuation introduced for foreign investments in India

RBI has issued a Notification no. FEMA 205/2010-RB dated 7th April, 2010 that replaces the prevailing Valuation Methodology prescribed under FDI Scheme with regard to issue and transfer of shares to a non-resident. Consequently, the erstwhile methodology as prescribed, vide erstwhile Controller of Capital Issues guidelines (CCI guidelines), stands replaced with the new Discounted Free Cash Flow (DCF) method.

As per the said Notification issued by RBI, price of shares to be issued to persons resident outside India under Schedule I, shall not be less than-

(a) the price worked out in accordance with the SEBI guidelines, as applicable, where the shares of the company is listed on any recognized stock exchange in India;

(b) the fair valuation of shares done by a SEBI registered Category-I Merchant Banker or a Chartered Accountant **as per the discount cash flow method**, where the shares of the company is not listed on any recognized stock exchange in India; and

(c) the price as applicable to transfer of shares from resident to non-resident as per the pricing guidelines laid down by the Reserve Bank from time to time, where the issue of shares is on preferential allotment"

Thus, in the case of a company whose shares are not listed on any recognized stock exchange in India, the fair value of the shares to be issued to the person resident outside India shall be the valuation done by a SEBI registered Category-I Merchant Banker or a Chartered Accountant as per the Discount Cash Flow (DCF) method.

Amendments/Clarifications on report to RBI of Foreign Investments

Indian companies are required to report to RBI (vide Form FC-GPR) requisite information/particulars of Foreign Investments. The Indian companies are required to submit Part B of Form FC-GPR by 31st of July every year. Part B prescribes particulars and forms of report of outstanding position as at end-March of the current (reporting) year in respect all investments by way of direct investments/ portfolio investments/ re-invested earnings/ others in the Indian company made by non-residents. The information on overseas investments made by the Indian company may also be reported in this FC-GPR Part B.

Some of the changes made in FC-GPR Part B are as under:

(i) Retained profit has been changed to Retained Profit (+)/(-) retained Loss of the year, which is in proportion to FDI holdings in the company and not the complete retained profit/loss of company,

(ii) Financial Derivatives at item 8 to be reported at Mark to Market Value,

(iii) Face Value per share at item 10 of return.

All are advised to use the revised format while reporting FC-GPR Part B for the year 2009-10

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