NANUBHAI DESAI & CO.

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INCOME TAX

DOMESTIC TAXATION

Circulars

Streamlining procedure for scrutiny of income-tax returns
Central Board of Direct Taxes (CBDT) has reviewed its scrutiny selection procedure. CBDT has notified that during the financial year 2011-12, cases of senior citizens and small taxpayers who are filing income-tax returns in ITR-1 and ITR-2 will be subjected to scrutiny only where the Income Tax department is in possession of credible information.

For this purpose, it has been further notified that Senior citizens would be those individual taxpayers who are 60 years of age or more and small taxpayers would be those individual and HUF whose gross total income, before availing deductions under Chapter VIA, does not exceed Rupees Ten lakh.

Certificate for deduction at lower rates or no deduction of tax from income other than dividends
CBDT has made certain amendments in the Income-Tax Rules,1962 pertaining to the issuance of certificate by Assessing Officer for deduction at lower rates or no deduction of tax from income other than dividends. The CBDT has substituted following rules:

- Where the Assessing Officer, on an application made by a person under sub-rule (1) of rule 28 is satisfied that existing and estimated tax liability of a person justifies the deduction of tax at lower rate or no deduction of tax, as the case may be, the Assessing Officer shall issue a certificate in accordance with the provisions of sub-section (1) of section 197 for deduction of tax at such lower rate or no deduction of tax.
- The existing and estimated liability shall be determined by the Assessing Officer after taking into consideration the following:
  - tax payable on estimated income of the previous year relevant to the assessment year;
  - tax payable on the assessed or returned income, as the case may be, of the last three previous years;
  - existing liability under the Income-tax Act,1961 and Wealth-tax Act,1957;
  - advance tax payment for the assessment year relevant to the previous year till the date of making application under sub-rule (1) of rule 28;

  - tax deducted at source for the assessment year relevant to the previous year till the date of making application under sub-rule (1) of rule 28; and
  - tax collected at source for the assessment year relevant to the previous year till the date of making application under sub-rule (1) of rule 28.
- The certificate shall be valid for such period of the previous year as may be specified in the certificate, unless it is cancelled by the Assessing Officer at any time before the expiry of the specified period.
- The certificate shall be valid only with regard to the person responsible for deducting the tax and named therein.
- The certificate shall be issued directly to the person responsible for deducting the tax under advice to the person who has made an application for issue of such certificate.

New Income Tax Return Forms for Assessment Year 2011-12

CBDT has notified New Income Tax Return Forms for the Assessment Year 2011-2012. CBDT has also notified new return forms SAHAJ and SUGAM. It has issued has issued the list of specifications for printing of the SAHAJ and SUGAM forms.

CBDT Circular on Procedure for refund of excess TDS deducted/ paid

In supersession of the circular No. 285, dated 21-10-1980, the CBDT vide its circular dated 27 April 2011 has prescribed the procedure for regulating refund of amount paid in excess of tax deducted and/or deductible in respect of TDS on residents covered under sections 192 to 194LA of the Income-tax Act, 1961.

- The excess payment to be refunded would be the difference between:
  (i) the actual payment made by the deductor to the credit of the Central Government and
  (ii) the tax deductible at source.
- In case such excess payment is discovered by the deductor during the financial year concerned, the present system permits credit of the excess payment in the quarterly statement of TDS of the next quarter during the financial year.
- In case, the detection of such excess amount is made beyond the financial year concerned, such claim can be made to the Assessing Officer (TDS) concerned. However, no claim of refund can be made after two years from the end of financial year in which tax was deductible at source.

Safeguards to be exercised by Assessing Officer :

- To avoid double claim of TDS by the deductor as well as by the deductee, the Assessing Officer should examine such claim by exercising certain safeguards.

- The applicant deductor shall establish before the Assessing Officer that:
  - (i) it is a case of genuine error and that the error had occurred inadvertently;
  - (i) that the TDS certificate for the refund amount requested has not been issued to the deductee(s); and
  - (ii) that the credit for the excess amount has not been claimed by the deductee(s) in the return of income or the deductee(s) undertakes not to claim such credit.
- Prior administrative approval of the Additional Commissioner or the Commissioner (TDS) concerned shall be obtained, depending upon the quantum of refund claimed in excess of Rupees One Lakh and Rupees Ten Lakh respectively. After meeting any existing tax liability of the deductor, the balance amount may be refunded to the deductor.

This circular will not be applicable to TDS on non-residents falling under sections 192, 194E and 195 which are covered by circular No. 7/2007 issued by CBDT.

Case laws

Hoshang D Nanavati v ACIT (Mumbai Tribunal)
Section 14A - Disallowances

In case of Hoshang D Nanavati v. ACIT, the Mumbai Tribunal held that section 14A permits disallowance of “expenditure incurred by the assessee” and not of “allowance admissible” to him. There is a distinction between “expenditure” and “allowance”. The expression “expenditure” does not include allowances such as depreciation allowance. Accordingly, depreciation cannot be the subject matter of disallowance under section 14A.

Yatish Trading Co. Pvt. Ltd. v ACIT (Mumbai Tribunal)
Section 14A - Disallowances

In case of Yatish Trading Co. Pvt. Ltd. v. ACIT, the assessee, engaged in trading and investment of shares, received tax-free dividend income. The Assessing Officer (‘AO’) invoked Section 14A and disallowed the interest on borrowings on proportionate basis. The Mumbai Tribunal held that:

- The business of the assessee predominantly was trading in shares though it also had investments in shares. The AO has not disputed the assessee’s claim that the dividend had been received on shares purchased for trading purposes. Interest on borrowed funds used for trading activity is allowable under section 36(1)(iii) and it cannot be treated as expenditure for earning dividend income which is incidental to the trading activity. If the real purpose was to use borrowed funds for trading purposes and incidentally

there is tax-free dividend, it cannot be said that the interest has been incurred for earning the dividend income

- Although the expenditure incurred for an indivisible purpose has to be apportioned, when it is possible to determine the actual expenditure "in relation to" the exempt income or where no expenditure is incurred "in relation to" the exempt income, the principle of apportionment embedded in s 14A has no application.

Logitronics Pvt. Ltd. v CIT (Delhi High Court)
Section 28(iv) – Waiver of Loan:

In case of Logitronics Pvt. Ltd. v. CIT, the assessee, engaged in manufacture of electronic products, took a loan from SBI. Owing to its inability to repay the amounts due, the assessee entered into a settlement with SBI where under a part of the principal amount of the loan was agreed to be repaid. The balance portion of the principal amount and the whole of the interest was waived. The assessee offered the amount of interest waived to tax though it claimed that the principal sum waived was a capital receipt. The Delhi High Court held that the answer to the question whether the waiver of a loan is taxable as income or not depends on the purpose for which the loan was taken. If the loan was taken for acquiring a capital asset, the waiver thereof would not amount to any income exigible to tax under section 28(iv) or 41(1). On the other hand, if the loan was taken for a trading purpose and was treated as such from the very beginning in the books of account, its waiver would result in income.

CIT v M/s. Sai Metal Works (Punjab & Haryana High Court)
Section 40A(3) – Disallowance even when gross profit rate taken on adhoc basis:

In case of CIT v. M/s. Sai Metal Works 2011-TIOL-164, it was held by the Punjab & Haryana High Court that though the provisions of block assessment are special; the argument that they are a complete Code and the other provisions cannot apply is not acceptable and Section 40A(3) would also apply to block proceedings. It further held that the argument that if income is assessed by estimation on Gross profit rate, no other disallowance can be made cannot be universally applied. If expenditure which is legally not permissible has been taken into account that can certainly be disallowed even where income is estimated.

Cauvery Spinning & Weaving Mills Ltd. (In Liquidation) v DCIT (Madras High Court)
Section 45 – Capital gains vis-a-vis Other sources
In case of Cauvery Spinning & Weaving Mills Ltd. (In Liquidation) v DCIT 238 CTR 55, the Madras High Court held that where Company Court orders payment of sale consideration of Company's Mills in instalments together with interest, interest becomes part of sale consideration liable for Capital Gains. It is not taxable as income from other sources.

Bharat Bjilee Limited v ACIT (Mumbai Tribunal)
Section 50B - Slump sale:
In case of Bharat Bjilee Limited v. ACIT the assessee transferred its undertaking on a "going concern" basis pursuant to a scheme of arrangement under section 391 to 394 of the Companies Act. In consideration, the transferee allotted preference shares & bonds to the assessee. The assessee claimed that the transfer was not liable to tax on capital gains on the basis that there was no "cost of acquisition" of the undertaking. The AO held that the transaction was a "slump sale" as defined in section 2(42C) and that the gains had to be computed under section 50B. This was upheld by the CIT (A). On appeal by the assessee to the Mumbai Tribunal held that

- In order to constitute a "slump sale" under section 2(42C), the transfer must be as a result of a "sale" i.e. for a money consideration and not by way of an "Exchange". The presence of money consideration is an essential element in a transaction of sale. If the consideration is not money but some other valuable consideration it may be an exchange or barter but not a sale. On facts of the case, as the undertaking was transferred in consideration of shares & bonds, it was a case of "exchange" and not "sale" and so section 2(42C) and section 50B cannot be applied;
- Further, as regards taxability under section 45 & 48, the "capital asset" which was transferred was the "entire undertaking" and not individual assets and liabilities forming part of the undertaking. There was no basis for apportioning the consideration amongst the various assets comprised in the undertaking nor could the "cost of acquisition" of the undertaking be determined. In the absence of a cost/date of acquisition, the computation & charging provisions of section 45 fail and the transaction cannot be assessed to tax.

Kumarpal Amrutlal Doshi v DCIT (Mumbai Tribunal)
Section 54EC – Date of issue of cheque to be taken as date of investment:
The Mumbai ITAT ruled in case of Kumarpal Amrutlal Doshi v. DCIT that Section.54EC relief is available if cheque is issued within 6 months of transfer of long term capital asset even if cheque is cleared and bonds are issued after 6 months. When a payment is made by cheque, the 'date of payment' is the 'date of the cheque' even though the cheque may be encashed subsequently. The law

as it stood on the date of transfer of the capital asset has to be applied. The fact NABARD Bonds were “specified assets” as on the date of the transfer of capital assets but were no longer “specified assets” on the date of payment is no bar to claim the relief under section 54EC.

Midas Polymer Compounds (P) Ltd. v ACIT (Kerala High Court (Full Bench))

Section 80-IB – Production of an intermediate product also eligible for deduction:

In case of Midas Polymer Compounds (P) Ltd. v. ACIT 237 CTR 401, the Kerala High Court (Full Bench) held that the words "production of an article or thing" in section. 80-IB doesn't necessitate production of final product in itself. Deduction under section. 80IB can be claimed even if the new industrial unit is producing a material to be used in production of final product.

CIT v Interra Software India (P) Ltd. (Delhi High Court)

Section 10A and Section 80 HHE (5) - Claim of deduction under another section in a subsequent year:

In the case of CIT v. Interra Software India (P) Ltd. 238 CTR 23, the Delhi High Court held that sub-Section.(5) of Section 80HHE is no bar for claiming benefit of Section.10A simply because assessee has claimed deduction under section 80HHE in an earlier year, more so when it has been claiming exemption under section 10A in the preceding three assessment years which has been allowed by the AO.

CIT v Packworth Udyog (Kerala High Court (Full Bench))

Section 115JA/JB and Section 80HHC – Determination of amount deductible:

In case of CIT v. Packworth Udyog 331 ITR 416, the Kerala High Court (Full Bench) held that there is no such provision in SECTION.80HHC to determine export profit with reference to Profit & Loss A/c. Clause (iv) of SECTION. 115JB (2) provides that the “amount of profit eligible for deduction under section 80HHC as computed under section 80HHC (3)” has to be deducted in computing the book profits. Accordingly, only the deduction under section 80HHC, as computed, under the normal provisions is allowable.

Hind Syntex Ltd. v CIT (Madhya Pradesh High Court)

Section 147(a) – Disclosure in accounts:

It was ruled in the case of Hind Syntex Ltd. v. CIT 331 ITR 36 by the Madhya Pradesh High Court that in case of adequate disclosure by the assessee at various places in the final accounts regarding change in the method of depreciation from SLM to WDV, reopening of assessment beyond four years based on this information is not valid.

CIT v M/s. India Sea Food (Kerala High Court)
Section 154 and Section 147 – Simultaneous proceedings under both the section not valid:
In case of CIT v. M/s. India Sea Food, the Kerala High Court held that if an assessment happens to be an under-assessment or a mistaken order, the course open to the AO is either to rectify the mistake under section 154 or to make a reassessment under section 147. While, it is correct, as held in EID Parry 216 ITR 489(Mad.), that the AO has to choose between the two and cannot initiate both proceedings at the same time, the fact that the AO invoked section 154 and dropped it does not affect the validity of re-assessment under section 147.

Honeywell Automation India Ltd. v DCIT (Pune Tribunal)
Maintainability of stay application:
In case of Honeywell Automation India Ltd. v. DCIT, the assessee filed a stay application before the AO, ACIT & CIT but none of the authorities dealt with it. The assessee also filed a stay application before the Tribunal which was opposed by the Department on the ground that the application was not maintainable without there first being a rejection by the lower authorities. Dismissing the department's objection, the Pune Tribunal held as follows:

- It is settled law that a Direct Stay Application filed before the Tribunal is maintainable and it is not the requirement of the law that assessee should necessarily approach the CIT before approaching the Tribunal for grant of stay.
- Further, it does not make any difference whether the assessee filed any application before the Revenue and did not await their decisions before filing application before the Tribunal or directly approached the Tribunal without even filing the applications before the Revenue authorities, when there exists threat of coercive action by the AO.

ITO v United Marine Academy (Special Bench Mumbai Tribunal)
Section 50C - Computation of capital gain in case of depreciable assets
In case of ITO v. United Marine Academy it was held by Special Bench of the Mumbai Tribunal that there are two deeming fictions created in section 50 and section 50C for computing capital gains on building. While section 50 modifies the "cost of acquisition" for purposes of section 48, section 50C modifies the term "full value of the consideration received or accruing as a result of transfer of the capital asset". The two deeming fictions operate in different fields and there is no conflict between them. As section 50C was inserted to prevent assessee's indulging in under-valuation, there is no logic why it should not be applied to a depreciable building; It further held that the assessee itself had considered the entire block of buildings as having been sold/transferred during the year and the same was upheld by the CIT (A) hence, the assessee's alternate argument that as the AO had held that the block of asset had not ceased to exist in the year and was in existence, section 50 could not apply as held in Roger

Pereira Communications 34 SOT 64 is not acceptable. The assessee was not aggrieved by the finding and could not file an appeal nor was it permitted to raise it as a Respondent under Rule 27 of the Tribunal rules to raise the issue(Hukumchand Mills 63 ITR 232 (SC) and Mahalakshmi Textile Mills 66 ITR 710 (SC) distinguished).

Godrej Industries Ltd v DCIT (Mumbai Tribunal)

Section 14A disallowance of interest on borrowings on ground that assessee ought to have repaid borrowings instead of investing in tax-free investments invalid

In case of Godrej Industries Ltd v. DCIT, it was observed by the Mumbai Tribunal that as per the facts of the case, borrowed funds were utilized for business purposes and the investment in shares & units was made out of own funds. It held that the A.O's argument, relying on Abhishek Industries 286 ITR 1 (P&H), that the assessee could have utilized its surplus funds for repaying the borrowings instead of investing in shares and by not doing so, there was diversion of borrowed funds towards investment in shares to earn dividend income is not acceptable in view of CIT v. Hero Cycles Ltd 323 ITR 518 (P&H) where Abhishek Industries was distinguished. Hence, disallowance u/s 14A of interest on borrowed funds was not permissible if the investment in shares was made out of own fund.

Renu Hingorani v ACIT (Mumbai Tribunal)

Section 271(1)(C) - Failure to voluntarily apply section 50c does not attract penalty under section 271(1)(C)

In case of Renu Hingorani v. ACIT it was held by Mumbai Tribunal that in the given case, A.O. had not questioned the actual consideration received by the assessee but the addition was made purely on the basis of the deeming provisions of section 50C. The A.O. had not doubted the agreement or given any finding that the actual sale consideration was more than the sale consideration stated in the sale agreement. The fact that the assessee agreed to the addition is not conclusive proof that the sale consideration as per agreement was incorrect and wrong. Accordingly, there was no concealment of income or furnishing inaccurate particulars of income.

Ruchi Strips & Alloys Ltd v DCIT (Mumbai Tribunal)

Section 271(1)(C) - Penalty under section 271(1)(C) even if Section 115JB book profit assessed

In case of Ruchi Strips & Alloys Ltd v DCIT it was ruled by Mumbai Tribunal that the concealment of income had its repercussions only when the assessment was done under the normal procedure. If the assessment as per the normal procedure was not acted upon and it was the deemed income assessed u/s 115JB which became the basis of assessment, the concealment had no role to play and was totally irrelevant. The concealment did not lead to tax evasion at all.

CIT v Bharat R. Ruia (Bombay High Court)
Section 43(5) - Derivatives loss is "speculation" loss- Section 43(5)(d) is not retrospective

In case of CIT v. Bharat R. Ruia it was ruled by the Bombay High Court that Section. 43(5) defines the expression 'speculative transaction' to mean a transaction in which a contract for the purchase or sale of any "commodity" including stocks and shares is periodically or ultimately settled otherwise than by the actual delivery or transfer of the "commodity" or scrips. The expression 'commodity' is not defined and so has to be given the meaning as understood in common parlance i.e. an article of trade or commerce which is tangible in nature. As futures contracts are articles of trade and commerce which are legally permitted to be traded on the stock exchange, transactions in futures are transactions in a "commodity" as contemplated by section 43(5). Transactions in futures contracts like transactions in stocks & shares if settled otherwise than by actual delivery would be speculative transactions u/s. 43(5). It was further observed that The argument that section 43(5) refers to contracts which are capable of settlement by actual delivery whereas the transactions in futures are incapable of settlement and therefore, transactions in futures fall outside the scope of section 43(5) is not acceptable because the very object of section 43(5) is to treat transactions which are settled otherwise than by actual delivery as speculative transactions. It is only those derivative transactions which are covered under clause (d) are taken outside the purview of section 43(5) and the rest of the transactions in derivatives continue to be covered by section 43(5).

Nayan Builders & Developers Pvt. Ltd. v ITO (Mumbai Tribunal)
Section 271(1)(c)- Mere admission of appeal by high court sufficient to disbar section 271(1)(C) penalty

In case of Nayan Builders & Developers Pvt. Ltd. v. ITO in quantum proceedings, the Tribunal upheld the addition of three items of income, appeal against which was filed to the High Court was admitted. The A.O. levied penalty under section 271(1)(c) in respect of the said three items. It was held by the Hon'ble ITAT, Mumbai that when the High Court admits substantial question of law on an addition, it becomes apparent that the addition is certainly debatable. In such circumstances penalty cannot be levied u/s 271(1) (c). The admission of substantial question of law by the High Court lends credence to the bona fides of the assessee in claiming deduction. Once it turns out that the claim of the assessee could have been considered for deduction as per a person properly instructed in law and is not completely debarred at all, the mere fact of confirmation of disallowance would not per se lead to the imposition of penalty.

CIT v Cadbury India Ltd (Delhi High Court)
Section 271(1)(c)- no penalty for TDS breach if no "mala fide intention" or "deliberate defiance" of law

In case of CIT v. Cadbury India Ltd it was ruled by Delhi High Court that the assessee has not disputed the quantum is not a good ground for imposition of penalty since the findings in the assessment proceedings are not conclusive. It was further decided that to levy the penalty it is required by revenue authority to bring on record that the assessee has deliberately defied the provision of the law (Anwar Ali 76 ITR 696 (SC) referred) and levy of penalty u/s 271(1)(c) is not automatic. Before levying penalty, the AO is required to determine whether the failure was without reasonable cause.

On facts, there is no reason to disbelieve the assessee that the deduction u/s 194C was being done on the misconceived professional advice given by the CA No malafide intention of any kind can be attributed to the assessee for deducting tax under one provision of law than the other. This was neither the case of malafide intention nor that of negligent intention or want of bonafide, but a case of misconceived belief of applicability of one provision of law.

CIT v Gujarat Power Corporation Ltd (Gujarat High Court)
Section 14A disallowance of interest on borrowings on ground that assessee ought not to have used own funds for tax-free investments invalid

In case of CIT v. Gujarat Power Corporation Ltd it was ruled by Gujarat High Court that if the assessee has sufficiently explained that a majority of the investment in the tax-free security was made before the borrowing. The assessee had demonstrated that it had other sources of investment and that no part of the borrowed fund could be stated to have been diverted to earn tax free income. As borrowed funds were not used for earning tax-free income, applying section 14A was not justified.

M/s Durga Dass Devki Nandan v ITO (HP High Court)
CBDT Circular which specifies that for section. 40(b)(v), the partnership deed should specify the remuneration, is invalid.

In case of M/s Durga Dass Devki Nandan v. ITO it was ruled by HP High Court that a partnership deed which provides that the remuneration would be as per the provisions of the Act meaning thereby that the remuneration would not exceed the maximum remuneration provided in the Act is valid and deduction is admissible under section 40b(v). Section. 40(b)(v) does not lay-down any condition that the partnership deed should fix the remuneration or the method of quantifying remuneration. Accordingly, CBDT circular No. 739 dated 25.3.1996 which requires that either the amount of remuneration payable to each individual should be fixed in the agreement or the partnership agreement deed should lay down the manner of quantifying such remuneration. The CBDT cannot issue a circular which goes against the provisions of the Act. The CBDT

can only clarify issues but cannot insert terms and conditions which are not part of the main statute.

Raj Ratan Palace Co-op Hsg Soc v DCIT (Mumbai Tribunal)
Granting permission for development not "transfer" & consideration not assessable in society's hands

In case of Raj Ratan Palace Co-op Hsg Soc v. DCIT it was ruled by Hon'ble ITAT, Mumbai that the assessee-society had merely given permission to the developer to construct on the society's land. No part of the land was ever transferred by the society. The Society continued to be the owner of the land and no change in ownership of land had taken place. Mere grant of consent will not amount to transfer of land/or any rights therein. Hence, the amount received by the members (on which some of them had paid tax) was not assessable in the assessee's hands either u/s 2(24) or as capital gains.

Ramesh Babu Rao v ACIT (Mumbai Tribunal)
Large volume in shares not deciding factor to hold assessee trader

In case of Ramesh Babu Rao v. ACIT, it was ruled by ITAT Mumbai that the assessee, a retired professor, offered gains from sale of shares as short-term capital gains (STCG). The AO assessed the gains as business profits. The Hon'ble ITAT, Mumbai held that the assessee was an investor and the gains are assessable as capital gains on the following criteria:

- The assessee was a good timer of purchase and sale of shares thereby substantially increasing his gains in the stock market;
- The large turnover was because of bulk purchases and sales in scrip. There were very few transactions of purchase and sale, as the assessee was purchasing in block of a particular share in large volume. Accordingly, large volume cannot be a deciding factor to hold as a trader;
- The assessee was not a broker or sub-broker and did not have any office establishment;
- The assessee did not do any speculative activity nor indulge in any sales without delivery;
- The shares were shown as capital assets in the books of account;
- The assessee had not pledged any shares with any financial institutions, nor borrowed any funds.

INTERNATIONAL TAXATION

Case laws

GVK Industries Ltd v ITO (Supreme Court)
Parliament's powers to make laws with extra-territorial effect and section 9(1)(vii)

The assessee challenged the constitutional validity of S. 9(1)(vii)(b). On appeal to Supreme Court, the matter was referred to the Constitutional Bench to determine the extent to which laws enacted by Parliament can have extra-territorial effect under Article 245 of the Constitution of India. The Constitutional Bench held that

- The Parliament is constitutionally restricted from enacting legislation with respect to extra-territorial aspects or causes that do not have, nor expected to have any, direct or indirect, tangible or intangible impact(s) on or effect(s) in or consequences for: (a) the territory of India, or any part of India; or (b) the interests of, welfare of, well-being of, or security of inhabitants of India, and Indians. In all other respects, Parliament may enact legislation with extra-territorial effect. This power is not subject to tests of "sufficiency" or "significance" or in any other manner requiring a pre-determined degree of strength. All that is required is that the connection to India be real or expected to be real, and not illusory or fanciful.
- However, Parliament does not have the power to legislate "for" any territory, other than the territory of India or any part of it. Parliament can only make laws for India and any law which has no impact on or nexus with India would be ultra-vires.
- The constitutional validity of section 9(1)(vii)(b) by relying the judgment of Electronics Corporation of India Ltd.

ABN Amro Bank NV v CIT (Calcutta High Court)
Interest paid by a branch of a Foreign Bank to its Head Office is deductible in the hands of the branch. Such interest is not taxable in the Head Office's hands.
The assessee, a Netherlands Bank, carried on banking business through a PE in India. The PE borrowed funds from its HO on which interest was paid. The assessee claimed that in the computation of profits of the PE under Article 7(3)(b) of the India-Netherlands DTAA, the interest paid to the HO was deductible. The AO & CIT (A) held that while the interest was deductible in principle in the hands of the PE, it was taxable in the hands of the HO and as there was no TDS u/s 195, the interest had to be disallowed u/s 40(a)(i). Thus

the interest paid by the PE to the HO was disallowed in the hands of the PE while being assessed in the hands of the HO. On appeal, it was held that the PE and the HO were the same person and the interest paid was neither deductible in the hands of the PE nor assessable in the hands of the HO. On appeal by the assessee, held that:

- As regards deductibility of the interest in the hands of the PE, though a branch and the HO are the "same person" in general law, Articles 5 & 7 of the DTAA provide that the PE shall be assessable as a separate entity. Under Article 7(3)(b) payment of interest by a bank's PE to its HO is allowed as a deduction. The result is that the interest paid by the PE to the HO is deductible in computing the PE's profits.
- As regards taxability in the hands of the HO & obligation for TDS u/s 195, in accordance with the principles of apportionment of profits between the PE & the HO as laid down in Hyundai Heavy Industries (SC) & Morgan Stanley (SC), only the PE is to be taken as the assessee and not the HO. As the interest was not chargeable to tax in the hands of the HO, the PE was under no obligation to deduct tax u/s 195 and consequently no disallowance u/s 40(a)(i) can be made in the hands of the branch.

CIT v Swaraj Mazda Ltd (P&H High Court)
Payment of out of pocket expense not subject to TDS u/s 195 and if certificate u/s 195(2) not withdrawn, assessee not in default u/s 201 for non deduction of TDS

The assessee made payment of "daily allowance" to a Japanese company on account of the stay of Japanese engineers without deduction of tax at source. The AO held that the payment was assessable to tax as "fees for technical services" and that the assessee was liable u/s 201 for failure to deduct tax at source. The assessee argued that it was not liable to deduct tax at source as the AO had issued a 'No Objection Certificate" u/s 195(2). The Tribunal accepted the assessee's plea. On appeal by the department the Hon'ble High Court held that:

- The payment for out of pocket expenses is not covered under S 9(1)(vii) and was not taxable as FTS.
- The AO had issued a certificate u/s 195(2) authorizing the remittance without deduction of tax at source. As this certificate was not cancelled u/s 195(4), the assessee was not required to deduct tax at source and could not be treated as assessee in default. The issue whether the payments were taxable or not need not be gone into.

Pankaj Extrusion Ltd v ACIT (Gujarat High Court)
S. 144C order cannot be passed if no transfer pricing adjustments made by TPO

The TPO passed an order u/s 92CA (3) stating that the transactions with affiliated enterprises were at arms' length and no transfer pricing adjustments were to be made. Pursuant to that the AO passed a draft assessment order u/s 144C. The assessee filed a Writ Petition to challenge the draft assessment order. The Hon'ble High Court held:

- U/s 144C(1) the AO has to pass a draft assessment order in the case of an "eligible assessee" which is defined in s. 144C(15)(i) to mean any person in whose case the variation from returned income arises as a consequence of the order of the TPO u/s 92CA(3).
- **As no transfer pricing adjustments had been made by the TPO, the assessee was not an "eligible assessee" and the AO had no jurisdiction to pass the draft assessment order.**

VNU International B.V. v DIT (AAR)
Even when no tax is payable in India, a tax return is required to be filed in India

The Applicant, VNU International B.V. a tax resident of Netherlands, transferred 50% shares of ORG-IMS Research Pvt. Ltd. ("ORG-IMS"), an Indian company to IMS-AG & Interstatistik AG ("IMS-AG"), a company incorporated in Switzerland.

One of the issues raised by the Applicant from the above sale of shares to IMS-AG was if gains on sale of above shares are not taxable in India, whether the Applicant has to file a return under Section 139 of the Act.

Regarding filing of return of income, the applicant is of the view that as the income is not taxable in India, it is not under any obligation to file the return of income under section 139(1) of the Act. The Authority rejected the contention that when the resulting income is nil, there is no obligation to file return of income, and emphasized that as per the third proviso to Section 139(1) of the Act, every company is required to file its return of income, whether it has an income or a loss and due consideration should be given to the fact that the legislature in its wisdom has not provided any exception to this rule in case of companies unlike other categories of taxpayers u/s 115AC(4) and also as Section 139(1) would extend to the Applicant, a foreign company, which is covered within the definition of a 'company' under Section 2(17) of the Act.

The Authority highlighted that the Applicant has accepted that the income arising from the sale of shares is liable to be taxed in India by virtue of Section 5(2) of the Act, although the same is not payable in India due to the application of the Treaty. The Authority concluded that instead of causing inconvenience to

the Applicant, the process of filing of return would only facilitate the Applicant in all future interactions with the Income tax department.

D.B. Zwirn Mauritius Trading No. 3 Ltd v DIT (AAR)

Gains derived by a Mauritius company from sale of shares of Indian company not subjected to tax in India

The Applicant, a company incorporated in Mauritius and holding a tax residency certificate obtained from Mauritius Revenue Authorities entered into an agreement to sell shares of an Indian company to another Mauritius company. Question arose as to the taxability of gains derived by the Mauritius company from the sale of shares of Indian company in India.

The Authority held that under the Tax Treaty between India and Mauritius, gains derived by a Mauritius company are taxable in Mauritius. The decision upholds the sanctity of Circular No. 789 dated 13.04.2000 and Circular No. 682 dated 30.03.1994 and various precedent judicial pronouncements in case of E*Trade Mauritius and Azadi Bachao Andolan.

Shri Rajeev Sureshbhai Gajwani v ACIT (Special Bench of Ahmedabad Tribunal)

Non-Resident can invoke non-discrimination clause of tax treaty to avail the benefit of tax holiday

The taxpayer, a sole proprietor and a US tax resident, carrying on the business of exports of software through its Permanent Establishment (PE) in India. Taxpayer claimed deduction in respect of profit earned from export of computer software under section 80HHE of the Income-tax Act by invoking provisions of Article 26(2) of India-USA Double Taxation Avoidance Agreement ("tax treaty"). Taxpayer claim for deduction under section 80HHE was based on the fact that he should not be treated as less favorably than a person resident in India and the deduction under section 80HHE should be allowed to him in view of Article 26(2) of India-USA tax treaty. AO and CIT(A) disallowed the claim of the taxpayer and were of opinion that benefit of section 80HHE is available to person resident in India, taxpayer being non-resident is not entitle for the benefit of section 80HHE. On appeal, allowing the claim of the taxpayer, the Special Bench of Ahmedabad Tribunal observed that under Article 26(2) of the India- US tax treaty taxation of PE of an enterprise of a contracting state in other contracting state shall not be less favorable in that other contracting state than the taxation of an enterprise of that other contracting state carrying on the same activities. In other words, exemption and deductions available to Indian enterprises would also be granted to US enterprise if they are carrying on the same activity.

Note: this decision brings out the fact that Article 26(2) of the tax treaty has precedence over Article 7 of the tax treaty to the extent deduction are of general nature.

Areva T&D v ADIT (Delhi High Court)

Despite view taken for grant of certificate under section 195(2)/197 order, reopening under section 147 valid

The assessee was awarded contracts for on-shore supply, on-shore services and off-shore supply by Power Grid Corporation of India Ltd (PGCIL). PGCIL filed an application u/s 195(2) and obtained an order from the AO that tax had to be deducted at 10% on certain payments and at Nil rate on other payments. The assessee obtained s. 197 certificates to the same effect. Subsequently, the AO revised the s. 197 order and directed that tax be deducted at a higher rate even in respect of payments received in earlier assessment years for which Nil rate had been prescribed. This was challenged by the assessee and it was held by the High Court that the revision in TDS rates would apply prospectively. Subsequently, the AO issued notice u/s 148 alleging that income had escaped assessment. This was challenged by the assessee on the ground that as the s. 195/197 orders had been passed after full application of mind, the reopening was based on a “change of opinion”.

The High Court held that

- It is well settled that orders passed u/s 195(2) and 197 are provisional and tentative. These orders do not bind the AO in regular assessment proceedings and do not pre-empt the Department from passing appropriate orders of assessment.
- Under Explanation 2 (a) to s. 147, a case where no return is filed is deemed to be a case where income has escaped assessment. On a combined reading of s. 195 and 197, if any opinion is expressed at the time of grant of certificate it is tentative or provisional or interim in nature and does not debar the AO from initiating proceeding u/s 147 on the ground that there has been a change of opinion.

Note: In CIT v/s Swaraj Mazda Ltd (P&H High Court) it was held that Assessee not in default u/s 201(1) if it follows the certificate issued u/s 195(2) of the Act.

M/s Richter Holding Limited v ADIT (Karnataka High Court)

Lifting of Corporate veil in case of sale of shares between two non residents

Richter Holding Limited (“taxpayer”), a Cypriot Company, entered into an agreement to purchase and acquire 60% of the shares of a UK Company Finsider International Company Limited (“Finsider”) from another UK Company Early Guard Limited (“Early Guard”) in the year 2007. Finsider in turn held 51% of the shares of an Indian Company Sesa Goa Limited (“Sesa Goa”). There was also an offer by the taxpayer to buy additional 15% shares of M/s Sesa Goa Ltd. The Revenue Authorities issued a show cause notice notice to the taxpayer since in their view the taxpayer had failed to deduct tax on the payments made by it to Early Guard for purchase of shares of Finsider since in their view the sale of Finsider shares had led to an indirect acquisition of 51% of

shares in Sesa Goa was a taxable event as as per the provisions of inter alia Section 9, the shares of Sesa Goa being constituting a capital asset in terms of Section 2(14) of Income Tax Act ("ITA"). Aggrieved by the show cause notice issued by the Revenue Authorities, the taxpayer filed a Writ Petition before the Karnataka High Court ("the High Court") challenging the legality of such notice.

The taxpayer contended that the transfer in question was that of the shares of a UK company between two non residents. The taxpayer contended that such transfer did not tantamount to acquisition of immovable property or controlling the management of an Indian company and it was only an incident of ownership of shares pursuant to holding of the shares. Thus, the question of treating the same as capital gains and obligation to withhold tax on the same did not arise.

The High court has directed the taxpayer to urge all contentions before the respondent authority pursuant to such show cause notice issued to contend that the purchase of 51% shares does not amount to transfer of capital asset. The High Court has asked the authorities to ascertain whether taxpayer as a majority shareholder enjoys the power by way of interest and capital gains in the assets of the company and whether transfer of shares in the case on hand includes indirect transfer of assets and interest in the company. The High Court observed that "it may be necessary for the fact finding authority to lift the corporate veil to look into the real nature of transaction to ascertain virtual facts", and thus seemingly gave a implicit approval to the principal of form over substance.

Transworld Garnet Company Ltd (AAR)

Denial of the benefit of the second proviso to s. 48 to a non-resident would not amount to discriminatory treatment in terms of art. 24 of the DTAA with Canada

The applicant was a company registered under the laws of Canada. It held 74 per cent of the equity share capital in Transworld Garnet India (P) Ltd. (TGI). The applicant entered into a share purchase agreement on 10th June, 2008 with V.V. Minerals, a partnership firm registered in India for transfer of its shareholding in TGI. The question posed before the AAR was whether the denial of indexation benefit to a non-resident tantamount to discriminatory tax treatment under Art. 24 of the India-Canada DTAA?

While examining the provisions of Art. 24 of India-Canada DTAA, AAR observed that Article 24 aims at ensuring equality of treatment to the nationals of the Contracting States so that they are not subjected to any taxation requirement which is more burdensome to the nationals of one State as compared to the nationals of the other State in the same circumstances and that different treatment does not constitute discrimination unless it is arbitrary. It further observed that Article 24 seeks to prevent differentiation solely on the

ground of nationality. A comparison cannot be made between a resident and a national of one State and a national of another State to contend that they must be taxed in the same way. A State is not obliged to extend the same privileges to non-residents which it accords to its own residents. Therefore, discrimination on account of nationality other than residence may be prohibited. It further explained that a situation may arise wherein a foreign national may be resident and an Indian national may be non-resident or that both the nationals may be non-residents. But being of different nationalities and being non-residents, the nationals cannot be said to be discriminated in terms of Art. 24 of the DTAA.

Therefore, it came to the conclusion that the denial of the benefit of the second proviso to s. 48 to a non-resident assessee while computing capital gains arising from the sale of shares would not amount to discriminatory treatment in terms of Art. 24 of the DTAA with Canada.

3i Infotech Ltd v DCIT (ITAT)

Deputation of personnel to foreign subsidiary without consideration falls within the definition of "international transaction" in S. 92B(1) of ITA. ALP to be determined in such cases if there is erosion of tax base in India. (b) Jurisdiction of TPO is restricted to the transactions referred to him by the AO under S. 92CA(1) of ITA

The assessee had deputed three of its employees to its subsidiary in US. Since it did not consider to the transaction to be covered within the definition of “international transaction” as given in S.92B(1) of ITA, it did not report the same in Form 3CEB. The question before the Tribunal was whether the aforesaid transaction would be considered as “international transaction” and if affirmative, whether ALP was required to be determined in such a case. Further, since the AO had not referred the transaction to the TPO, whether TPO was empowered to determine the ALP in such a transaction.

The Tribunal held that Definition of "international transaction" in S. 92B(1) was wide enough to include any arrangement between two AEs for allocation of cost in connection with a benefit, service or facility provided. Therefore, the act of deputation of three employees by the assessee to its US subsidiary was covered by the said definition. The fact that no consideration was paid for such transfer could not take the transaction out of the purview of S. 92 of ITA.

It further held that the deciding factor as to whether ALP has to be determined in such cases will be to see if the Indian tax base is eroded. If there is likely to be erosion of Indian tax base then the AO will be well within his powers to determine income arising out of such international transaction. Therefore the AO was well within his powers to examine the transaction with a view to determine the ALP of this transaction and determine income which the assessee ought to have earned on the transaction.

With regard to the question of jurisdiction of TPO, Relying on CBDT Instruction No. 3 of 2003 dated 20th May 2003, the Tribunal held that TPO cannot determine the ALP in relation to an international transaction not referred to him by the AO under s. 92CA(1) and that, if during the course of proceedings before him, it was found that there are certain other transactions which have not been referred to him by the AO, he would have to take up the matter with the AO so that a fresh reference is received in regard to such transactions.

(It is to be noted that an amendment was brought in Sec 92CA vide Finance Act 2011 to take effect from 1st June 2011 to annul the effect of CBDT Instruction No. 3 of 2003. The amendment states that Transfer Pricing Officer shall have the jurisdiction to determine the arms length price of the transaction which is noticed by him also in the course of proceedings before him in addition to the transactions already referred to the TPO by the Assessing Officer.)

SERVICE TAX

Circulars and notifications

Amendment in Point of Taxation Rules

Following services have been specified as Continuous Service for the purpose of POT (point of taxation Rules, 2011)

- Commercial or Industrial Construction Service,
- Construction of Complex Service,
- Telecommunication Service,
- Internet Telephony Service and
- Works contract Service

Finance Act, 2011 brought into force with effect from 1 May 2011

The new taxable services and amendments to existing taxable services defined under section 65 of Finance Act, 1994 (the Act) will be brought into effect from 1 May 2011.

Services provided by clinical establishments or doctors exempt from whole of service tax

The services provided by a clinical establishment or by a doctor providing services from any clinical establishment would be exempt from the whole of service tax.

Accommodation services provided by hotel, inn, guest house etc. below tariff of INR 1000 exempt from service tax

Taxable service provided by a hotel, inn, guest house, etc where the declared tariff is less than INR 1000 has been exempt from the whole of service tax.
Declared tariff has been defined to include charges for all amenities in the accommodation unit, like furniture, air-conditioner, refrigerators etc but does not include discounts offered on published charges.

Representation by CA, CS or CWA before statutory authority liable to service tax

Representation services provided before any statutory authority by a practicing Chartered Accountant or Cost Accountant or Company Secretary which were exempt from the payment of service tax are now taxable services and liable to service tax w.e.f 01/05/2011.

Pre-school coaching and training exempt from service tax

The services of pre-school training or coaching or any coaching or training leading to a grant of certificate or diploma or degree or any educational

qualification which is recognised by law for the time being in force when provided by a commercial coaching or training centre has been exempt from whole of service tax from 01/05/2011.

Abatement from service tax to services of restaurant and hotel

Service tax would be payable on 30% of the gross amount charged for the taxable service provided by a restaurant, having air-conditioning and which has license to serve alcoholic beverages

Service tax would be payable on 50% of the gross amount charged for the taxable service provided by a hotel, inn, guest house etc in relation to provision of accommodation for a continuous period of less than three months

Composition scheme for Life insurance Companies

W.e.f. from 01/05/2011 an option has been given to a life insurance company to pay service tax either

- on the gross premium charged to a policy holder after deducting the amount allocated for investment or savings on behalf of the policy holder, if such amount has been intimated to the policy holder; or
- 1.5 % of the gross premium charged by the life insurance company to the policy holder

The above two options will not be available where the entire premium paid by the policy holder to the life insurance company is towards only risk cover in life insurance.

Amendments to Export Rules

The taxable service provided by a restaurant having facility of air-conditioning and has license to serve alcoholic beverages and accommodation services provided by a hotel, inn, guest house etc, shall be treated as export in case such restaurant or hotel is situated outside India.

Amendment to Import Rules

The taxable service provided by a restaurant having facility of air-conditioning and has license to serve alcoholic beverages and accommodation services provided by a hotel, inn, guest house etc, shall be treated as received in India in case the restaurant or hotel is situated in India.

REGULATIONS GOVERNING INVESTMENTS

RBI

FDI and FII related developments

Consolidated FDI Policy

The Government has announced First Foreign Direct Investment (FDI) consolidated policy on 1st April 2010 & decided to review the same every six months. The Government has announced third updated edition on 31st March, 2011 which is effective from April 1, 2011. The following major changes have been announced in the said poilicy:

- **Pricing Guidelines**
  In case of convertible instruments company will now have the option of prescribing a conversion formula which would help the recipient companies to obtain performance linked valuation. However, such conversion price would be subject to minimum fair value worked out at the time of issuances of such instruments in accordance with FEMA/ SEBI Regulation i.e. Discounted Cash flow Method of valuation for the unlisted companies and valuation in terms of SEBI (ICDR) Regulations, for the listed companies.
- **Issue of Equity Shares against Non-cash consideration**
  In addition to conversion of External Commercial Borrowing [ECB] / lump-sum fee / royalty into equity shares / fully compulsorily and mandatorily convertible preference shares, permission has now been granted to allow issue of equity shares to persons resident outside India, in following cases, subject to specific conditions, under the Government Route:
  - Import of capital goods / machinery / equipment (including second hand machinery); and
  - Pre-operative / pre-incorporation expenses (including payment of rent etc.) – payments made directly to the Indian company by the foreign investor.
- **Removal of the condition or prior approval in case of existing joint ventures/ technical collaboration in the same field**
  Government approval through FIPB was required by a person resident outside India having an existing joint ventures / technology transfer / trademark agreement in India, as on January 12, 2005, for new proposal in the same field for investment / technology transfer / technology collaboration / trademark agreement. This requirement has been

removed. This would facilitate easy entry and coupled with fresh investments and technology inflows into the country. It will also reduce Government intervention in doing business in India.

- **Guidelines related to down-stream investments**
  The Government has now simplified and rationalized the categories of companies and now there is only two categories existing; one is companies owned or controlled by foreign investors, the other is companies owned and controlled by Indian residents.
- **Development of Seeds**
  In the agriculture and animal husbandry sector, 100% FDI under the automatic route is allowed in the development and production of seeds and planting material without complying with the under controlled conditions.

Annual reporting by Indian companies on foreign liabilities and assets

Every Indian Company which has either received or made Foreign Investment is currently required to submit Part B to Form FC - GPR ("Part B") detailing the outstanding position of foreign direct investments, portfolio investments, overseas direct investments ("ODI"), etc on June 30 every year. The RBI has replaced the existing Part B with an Annual Return on Foreign Liabilities and Assets ("ARF"). This form is to be filed by July 15th every year.

The ARF proposes to capture more data as compared to the Part B and has been introduced with an aim to align with international best practices. We have summarized the key features of the ARF and the differences with Part B

Structural Changes

The ARF is divided into three sections. Section I pertains to the identification particulars which includes the credentials of the company, the sector and industry to which it belongs, paid-up capital and free reserves and surplus.

Section II on Foreign Liabilities deals with investments by non-residents into Indian companies under the FDI route as well as the portfolio investment scheme route, and other liabilities in the form of Financial Derivatives, Trade credits, etc. The disclosure is to be now split into investments where there is 10% or more equity participation and less than 10% equity participation. With respect to portfolio and other investments, while the existing Part B was silent on the scope of investments covered by the Form, the ARF clarifies that only position with unrelated parties has to be reported. However, the circular does not define the term 'unrelated parties'.

The disclosure with respect to Equity and Other Capital under the FDI section is now split into two:

- Claims on Direct Investor – Represents investments by the Indian Company in the Direct Investor, also referred as reverse investment
- Liabilities to Direct Investor – Represents Equity participation by the Direct Investor

With respect to financial derivatives, the Indian Companies are now required to disclose even the mark to market values. Section III on Foreign Assets pertains to direct Investments made overseas under the ODI scheme as well as the outstanding investments other than those made under ODI scheme. The changes in this section are similar to the ones introduced in the section on Foreign Liabilities, including the bifurcation of Equity and Other Capital, Split of investments between enterprises where the Indian Company holds 10% or more and less than 10%, etc. The ARF has also introduced a detailed section on Equity Capital, Free Reserves and Surplus of Direct Investment Enterprise Abroad and Contingent Liabilities. These disclosures are required to be made in Foreign Currency. Additionally the ARF also requires the Indian Company to provide details of its subsidiaries in India.

Methodology for valuation of foreign liabilities and foreign assets

The existing Part B does not specify any valuation methodology to be adopted for the purpose of disclosures. The ARF, however, prescribes the following valuation methodology:

- In case of listed companies, the share price on the closing date of the reporting period should be used for valuation of equity.
- In case of unlisted companies, the concept of Own Funds at Book Value ("OFBV") has been prescribed for valuation of equity. OFBV has been defined as the sum of paid up capital including share premium, all types of reserves identified as equity in the company's balance sheet and cumulated reinvested earnings which would take in account changes for consumption of fixed capital.
- Debt securities are to be valued at market price, while all other types of debts viz., loan, trade credit, deposits, other accounts payable / receivable are to be valued at nominal value. The corresponding end-March/ end-December market price/exchange rate is to be used for the valuation of outstanding investments.

Important Concepts and Definitions

The ARF has introduced the concept of residence, which is to be used while completing the Form. An enterprise is said to have a center of economic interest and to be a resident unit of a country (economic territory) when the enterprise is

engaged in a significant amount of production of goods and/or services there or when it owns land or buildings located there. The enterprise must maintain at least one production establishment in the country and plan to operate the establishment indefinitely or over a long period of time. While the details of the country of the non-resident investor and the direct investment enterprise is required to be provided in Section II as well as Section III, the concept of residence is relevant in the case of investments by Indian companies abroad. With respect to foreign investments into India, the ARF separately clarifies that, if the investor is a company, then the country is the country of incorporation. This clarification is absent in the case of foreign investments by Indian enterprises. Apart from the above, the circular provides definition of certain important terms used in the Form. We have listed certain key definitions as detailed in the Circular:

General Definitions

Free Reserves and Surplus – Free Reserves and Surplus has been defined to include all unencumbered reserves. Free reserves should exclude tax and other provisions like provision for deferred taxation, tax equalization reserve, unutilized investment allowance and revaluation reserve.

- **Definitions specific to Direct Investments**
    - Direct Investment – Direct investment is a category of international investment in which a resident entity in one economy (Direct Investor ("DI")) acquires a lasting interest in an enterprise resident in another economy (Direct Investment Enterprise ("DIE")). It consists of two components, viz., Equity capital and Other Capital.
    - Equity Capital under Direct Investment – This has been defined to covers Equity in branches and all shares (except non-participating preferred shares) in subsidiaries and associates; Contributions such as the provision of machinery, land & buildings by a direct investor to a DIE by equity participation; Acquisition by a DIE of shares in its direct investor, termed as Reserve investment (ie claims on DI).
    - Reverse Investment – If the reporting Indian company also holds the equity shares in its DI company abroad and if its share is less than 10 per cent of equity capital of DI company, then it is called as reverse investment. Likewise, if the non-resident DIE also holds the equity shares in Indian reporting company (DI) and if its share is less than 10 per cent of equity capital of reporting company, then it is called as reverse investment.
    - Other Capital under Direct Investment – Other capital (inter-company debt transactions) component of direct investment covers the outstanding liabilities or claims arising due to borrowing and lending of funds, investment in debt securities

including non-participating preference shares, trade credits, financial leasing, share application money, between direct investors and DIEs and between two DIEs that share the same Direct Investor.

- **Definitions specific to Portfolio and other investments**
  - Portfolio Investment – It has been defined to cover external claims by or liabilities to reporting Indian company in equity and debt securities other than those included in direct investment. Debt securities include long-term bonds and notes, short-term money market instruments.
  - Other Investments – This is a residual category that includes all financial outstanding not considered as direct investment or portfolio investment such as trade credits, loans, other liabilities and assets, long term and short term investments.
  - Long-term and Short-term Investments – Long-term investment is defined as investment with an original contractual maturity of more than one year. Short-term investment includes currency, investment payable on demand or with an original contractual maturity of one year or less.
  - Equity Securities – Equity securities are instruments acknowledging the holders' claim to the residual income of the issuing enterprise after the claims of all creditors have been met. These include ordinary shares, stocks, participating preference shares, depository receipts (ADRs/GDRs) denoting ownership of equity securities issued to non-residents, shares/units in mutual funds & investment trusts, equity securities that are sold under repurchase agreement, equity securities that are sold under securities lending arrangement.
  - Debt Securities – These include bonds and notes, money market instruments.
  - Bonds and Notes – This category includes debt securities with original contractual maturities of more than one year (long-term). It includes the long-term securities such as debentures, non-participating preference shares, convertible bonds, negotiable certificates of deposit, perpetual bonds, collateralized mortgage obligations, dual currency, zero coupon and other deep discounted bonds, floating rate bonds and index-linked bonds.
  - Money Market Instruments – These short-term instruments include treasury bills, commercial paper, bankers’ acceptances, short-term negotiable certificates of deposit and short-term notes issued under note issuance facilities. It may be noted that the instruments that share the characteristics of money market instruments but are issued with maturities of more than one year are to be classified as Bonds and Notes.

- **Financial Derivatives**
  - Financial derivatives are linked to a specific financial instrument, indicator, or commodity and through which specific financial risks can be traded in the financial markets in their own right. Derivative instruments include futures, interest and cross currency swaps, forward rate agreements, forward foreign exchange contracts, credit derivatives and various types of options.
- **Contingent Liabilities**
  - Contingent liabilities are defined as obligations that arise from a particular discrete event, which may or may not occur. Contingent liabilities are further defined to include (i) explicit contingent liabilities – arise from a legal or contractual arrangement (Loan & other payment guarantees, credit guarantees, Contingent credit availability guarantees, exchange rate guarantees, etc) and (ii) implicit contingent liabilities – do not arise from a legal or contractual source, but recognized after a condition or event is realized.

Other requirements

In case of group companies, a consolidated return covering all the branches/offices in India is to be furnished Balance sheet for the reporting year of the entity is to be enclosed along with the return. In case the balance sheet is not audited, the information may be submitted based on the un-audited balance sheet and the audited balance sheet is required to be submitted in due course In case there are major differences in the reported/returned figures, a revised return may be submitted along with a copy of the balance sheet. The time limit for filing a revised return is, however, not prescribed. The amounts are to be disclosed as on March 31 of the previous year, December 31 of the current year and March 31 of the current year.

Foreign investments in India by SEBI registered FIIs in other securities

RBI has enhanced the FII investment limit in listed non-convertible debentures / bonds (with a residual maturity of five years and above, and issued by Indian companies in the infrastructure sector (where ‘infrastructure’ is defined in terms of the extant ECB guidelines) from USD 5 billion to USD 25 billion.

With this, the total limit available to FIIs for investment in listed non convertible debentures / bonds would be USD 40 billion with a sub limit of USD 25 billion for investment in listed non-convertible debentures / bonds issued by corporates in the infrastructure sector.

Further, such investment by FIIs in listed non-convertible debentures / bonds would have a minimum lock-in period of three years. However, FIIs are allowed to trade amongst themselves during the lock-in period.

It has also been decided to allow SEBI registered FIIs to invest in unlisted non-convertible debentures / bonds issued by corporates in the infrastructure sector. The same conditions as applicable to investments in listed non-convertible debentures would apply.

Other important recent developments

- RBI enhanced the period of realization and repatriation to India of the amount representing the full export value of goods or software exported, from six months to twelve months from the date of export. This relaxation was from March 31, 2011 to September 30, 2011.

- Banks are required to obtain an unconditional, irrevocable standby Letter of Credit (LC) or a guarantee from an international bank of repute situated outside India or a guarantee of an AD Category – I bank in India (if such a guarantee is issued against the counter guarantee of an international bank of repute situated outside India) for an advance remittance exceeding USD 100,000 or its equivalent. RBI has now liberalized the above limit of USD 100,000 to USD 200,000.

- Custodian banks have been allowed to issue Irrevocable Payment Commitments (IPCs) in favour of the Stock Exchanges / Clearing Corporations of the Stock Exchanges, on behalf of their FII clients for purchase of shares under the PIS.

SEBI

Listing Agreement for Securitized Debt Instruments

Securities Exchange Board of India (SEBI) (Public offer and Listing of Securitised Debt Instruments) Regulations, 2008 provided for issuance and listing of securitised debt instruments by a special purpose distinct entity (SPDE). Securitisation involves pooling of financial assets and the issuance of securities that are re-paid from the cash flows generated by these assets. Draft listing agreement for securitized debt instruments for public comments/ suggestions was issued by SEBI in the month of October 2010. SEBI came out with the final listing agreement for securitized debt instruments on March 16, 2011, which would help improve the secondary market liquidity for such instruments.

The listing agreement provides for disclosure of pool level, tranche level and select loan level information. The listing agreement comes into force with immediate effect for all securitised debt instruments as defined under regulation 2(1)(s) of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008, seeking listing on the stock exchange. Common assets for securitisation include credit cards, mortgages, auto and consumer loans, student loans, corporate debt, export receivable and offshore remittances.

Discontinuance of Reporting on Short Positions of ODIs by FIIs

FIIs have been submitting weekly reports of information pertaining to securities lent to entities abroad i.e. report of security wise positions of the quantity lent to entities other than in the Indian Securities Market by them, i.e. where the Overseas Derivative Instruments (ODIs) are issued- which has the effect of a short sale in the Indian security/ synthetic shorts. SEBI has, after reviewing such reports, decided that the FIIs are no longer required to file these reports as there were no outstanding short positions as on March 04, 2011.

FII Investment in corporate bonds infra long term category

- **Increase in overall limits:** The existing limit of USD 5 billion for investment by foreign Institutional investors (FIIs) in corporate bonds issued by companies in the infrastructure sector with a residual maturity of over five years has been increased by an additional limit of USD 20 billion taking the total limit to USD 25 billion. These investments are now permissible in unlisted instruments.

- **Investments in unlisted bonds:** FIIs shall now be eligible to invest in unlisted bonds issued by companies in the infrastructure sector that are generally organised in the form of special purpose vehicles.
- **Lock-in period for investments subject to inter FII trading:** Investments in such bonds shall have a minimum lock-in period of three years. However, during the lock-in period, FIIs will be allowed to trade amongst themselves. During the lock-in period, the investments cannot however, be sold to domestic investors.
- **Manner of allocation:** FII/sub-accounts can now avail of these limits without obtaining SEBI approval till the overall FII investments reaches 90% (ninety percent) i.e. USD 22.5 billion. After which the process mentioned in circular dated November 26, 2010 shall be initiated for allocation of remaining limits.
- **Special window at exchanges:** To facilitate to the FIIs during the lock-in period as mentioned above, a special trading window for FIIs will be provided by Exchanges on the same lines as is available for equities in companies where the overall FII investment has touched the maximum limit.

ACCOUNTS, AUDIT & INVESTMENT

ACCOUNTS AND AUDIT

Filing of Balance sheet and Profit and Loss a/c in XRBL (eXtensible Business Reporting Language) mode vide General Circular No. 09/2011 17/70/2011 – CL.V

It has been decided by the Ministry of Corporate Affairs to mandate following class of companies to file balance sheets and profit and loss account for the financial year 2010-11 onwards by using XBRL taxonomy:-

- All listed companies in India and their subsidiaries, including overseas subsidiaries
- All companies having a paid up capital of Rs. 5 crore and above or a Turnover of Rs. 100 crore or above

All companies falling in above phase are permitted to file upto 30-09-2011 without any additional filing fee.

The Frequently Asked Questions (FAQs) about XBRL have been framed by the Ministry and they are being annexed as Annexure I with this circular for the information and easy understanding of the stakeholders on website of the Ministry at www.mca.gov.in.

Revision of Schedule VI of the Companies Act, 1956

The Ministry of Corporate Affairs has issued revised Schedule VI, which prescribes the format of financial statements and disclosure requirements for corporate entities.

Schedule VI of the Companies Act, 1956, prescribes the format of financial statements and disclosure requirements for corporate entities in India. Considering the economic and regulatory changes that have taken place globally, and being an old Act (1956), Schedule VI had completely outlived its utility. Therefore, it is essential to harmonize and synchronize the general disclosure requirements under Schedule VI with those prescribed in the Accounting Standards.

Revised Schedule VI has been framed as per the existing non-converged Indian Accounting Standards notified under the Companies (Accounting Standards), Rules, 2006. **This will apply to all the companies uniformly for the financial statements to be prepared for the financial year commencing on or after 1.4.2011.**

Comparison between Old Schedule VI & Revised Schedule VI as per Companies Act:

Sr. No.	Particulars	Old Schedule VI	Revised Schedule VI
1	Rounding off of Figures appearing in financial statement	Turnover of less than Rs. 100 Crs - R/off to the nearest Hundreds, thousands or decimal thereof	Turnover of less than Rs. 100 Crs - R/off to the nearest Hundreds, thousands, lakhs or millions or decimal thereof
		Turnover of Rs. 100 Crs or more but less than Rs. 500 Crs - R/off to the nearest Hundreds, thousands, lakhs or millions or decimal thereof	Turnover of Rs. 100 Crs or more - R/off to the nearest lakhs, millions or crores, or decimal thereof
		Turnover of Rs. 500 Crs or more - R/off to the nearest Hundreds, thousands, lakhs, millions or crores, or decimal thereof	
2	Net Working Capital	Current assets & Liabilities are shown together under application of funds. The net working capital appears on balance sheet.	Assets & Liabilities are to be bifurcated in to current & Non-current and to be shown separately. Hence, net working capital will not be appearing in Balance sheet.
3	Fixed Assets	There was no bifurcation required in to tangible & intangible assets.	Fixed assets to be shown under non-current assets and it has to be bifurcated in to Tangible & intangible assets.
4	Borrowings	Short term & long term borrowings are grouped together under the head Loan funds sub-head Secured / Unsecured	Long term borrowings to be shown under non-current liabilities and short term borrowings to be shown under current liabilities with separate disclosure of secured / unsecured loans.
			Period and amount of continuing default as on the balance sheet date in repayment of loans and

			interest to be separately specified
5	Finance lease obligation	Finance lease obligations are included in current liabilities	Finance lease obligations are to be grouped under the head non-current liabilities
6	Deposits	Lease deposits are part of loans & advances	Lease deposits to be disclosed as long term loans & advances under the head non-current assets
7	Investments	Both current & non-current investments to be disclosed under the head investments	Current and non-current investments are to be discosed separately under current assets & non-current assets respectively.
8	Loans & Advances	Loans & Advance are disclosed alongwith current assets	Loans & Advances to be broken up in long term & short term and to be disclosed under non-current & current assets respectively.
		Loans & Advance to subsidiaries & others to be disclosed separately.	Loans & Advance from related parties & others to be disclosed separately.
9	Deffered Tax Assets / Liabilities	Deferred Tax assets / liabilities to be disclosed separately	Deferred Tax assets/ liabilities to be disclosed under non-current assets / liabilities as the case may be
10	Cash & Bank Balances	Bank balance to be bifurcated in scheduled banks & others	Bank balances in relation to ermarked balances, held as margin money against borrowings, deposits with more than 12 months maturity, each of these to be shown separately.
11	Profit & Loss (Dr Balance)	P&L debit balance to be shown under the head Miscellaneous expenditure & losses.	Debit balance of Profit and Loss Account to be shown as negative figure under the head Surplus. Therefore, reserve & surplus balance can be negative.

12	Sundry Creditors	Creditors to be broken up in to micro & small suppliers and other creditors.	It is named as Trade payables and there is no mention of micro & small enterprise disclosure
13	Other current liabilities	No specific mention for separate disclosure of Current maturities of long term debt	Current maturities of long term debt to be disclosed under other current liabilities.
		No specific mention for separate disclosure of Current maturities of finance lease obligation	Current maturities of finance lease obligation to be disclosed.
14	Separate line item Disclosure criteria	any item under which expense exceeds one per cent of the total revenue of the company or Rs. 5,000 whichever is higher; shall be disclosed separately	any item of income / expense which exceeds one per cent of the revenue from operations or Rs. 1,00,000, whichever is higher; to be disclosed separately
15	Expense classification	Function wise & nature wise	Expenses in Statement of Profit and Loss to be classified based on nature of expenses
16	Finance Cost	Finance cost to be classified in fixed loans & other loans	Finance cost shall be classified as interest expense, other borrowing costs & Gain / Loss on foreign currency transaction & translation.
17	Foreign exchange gain / loss	Gain / Loss on foreign currency transaction to be shown under finance cost	Gain / Loss on foreign currency transaction to be separated into finance costs and other expenses
18	Purchases	The purchase made and the opening & closing stock, giving break up in respect of each class of goods traded in by the company and indicating the quantities thereof.	Goods traded in by the company to be disclosed in broad heads in notes. Disclosure of quantitative details of goods is diluted.

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