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NANUBHAI DESAI & CO.

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From,

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INCOME TAX

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GENERAL

Applicability of provisions under Section 194J of Income Tax Act 1961 in the case of transactions by the Third Party Administrators (TPAs) with Hospitals, etc.

The Central Board of Direct Taxes ('CBDT') has issued circular no. 8 dated 24th November 2009 on Applicability of provisions under section 194J of Income Tax Act 1961 in the case of transactions by the Third Party Administrators (TPAs) with Hospitals, etc.

As per Explanation (a) to 194J "professional services" means, services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession, etc.

The CBDT has issued the circular in the context of the following background:

- The services rendered by hospitals to various patients are primarily medical services and, therefore, provisions of 194J are applicable on payments made by TPAs to hospitals, etc.
- Further for invoking provisions of section 194J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to hospital. Therefore, TPAs who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes, including cashless schemes, are liable to deduct tax at source under section 194J on all such payments to hospitals, etc.
- In view of this, all such past transactions between TPAs and hospitals fall within provisions of section 194J and consequence of failure to deduct tax or after deducting tax, failure to pay on all such transactions, would make the deductor (TPAs) deemed to be an assessee in default in respect of such tax and also liable for charging of interest under section 201 (1A) and penalty under section 271C.
- A number of representations have been received by the CBDT on applicability of provisions under section 194 J of the Act on payments made by TPAs to hospitals on behalf of insurance companies for settling medical/insurance claims, etc. with the hospitals.

The CBDT has examined the number of representations made by TPAs, insurance companies and Hospitals. On its findings, the CBDT has issued the circular clarifying that

- no proceedings u/s 201 may be initiated after the expiry of six years from the end of financial year in which such payment have been made without deducting tax at source etc. by the TPAs.
- tax demand arising out of section 201 (1) in situations arising above, may not be enforced if the deductor (TPA) satisfies the officer in charge of TDS that the relevant taxes have been paid by the deductee assessee (hospitals etc.). A certificate from the auditor of the deductee assessee stating that the tax and interest due from deductee assessee has been paid for the assessment year concerned would be sufficient compliance for the above purpose. However, this will not alter the liability to charge interest under section 201 (1A) of the Income Tax Act, till payment of taxes by the deductee assessee or liability for penalty under section 271C of the Income Tax Act, as the case may be.

Dispute Resolution Panel Rules notified by Central Board of Direct Taxes

Recently, the CBDT has notified the rules to regulate the procedure of the Dispute Resolution Panel (DRP). This is a very important step in understanding how the DRP would function. One hopes that the constitution of the DRP too would be notified very soon. This will go a long way in guiding tax payers on the way forward in respect of draft orders already received in those cases where the Transfer Pricing Officers have passed orders.

The CBDT will constitute Dispute Resolution Panel (DRP) at the following places:

1. Delhi
2. Mumbai
3. Kolkata
4. Ahmedabad
5. Chennai
6. Hyderabad
7. Bangalore and
8. Pune

The CBDT has notified various key rules to regulate the procedure of the Dispute Resolution Panel. The CBDT has notified rules for Procedure for filing objections, Notice for hearing, call for records, Hearing of objections, No abatement of proceedings, Power to call for or permit additional evidence, Issue of directions, Directions to be communicated to parties, Passing of Assessment Order, Rectification of mistake or error and Appeal against Assessment Order.

New Perquisite Rules

Recently the Government of India has notified the new rules for valuation of taxable perquisites in the hands of employees.

These new rules come into effect retrospectively from 1st April, 2009 and apply to the current year also. The needs to notify the new rules arose on account of the abolition of Fringe Benefit Tax (FBT) vide the last Budget. The new rules are virtually a repetition of the old rules as they stood prior to the introduction of FBT. With the notification of these rules, the uncertainty prevailing regarding taxation of various perquisites in the hands of employees has ended.

The new perquisite rules have replaced the old perquisite rules contained in Rule 3 of the Income tax Rules, 1962, (Rules) with retrospective effect from 1st April, 2009. The summarized new perquisite rules and a comparison with the old rules are as under:-

Sr. No.	**Name of the Expenses/payment**	**Taxation under new regime as per new Rules w. e. f. 01.04.2009**
1	Unfurnished Residential accommodation owned by the employer (other than the Govt.)	This is taxable as a perquisite in the hands of the employee at following rates: • 15% of salary in cities having population exceeding 25 lakhs as per 2001 census • 10% of salary in cities having population exceeding 10 lakhs but not exceeding 25 lakhs as per 2001 census • 7.5% of salary in other areas As reduced by the amount, if any, recovered from the employee.
2	Unfurnished Residential accommodation taken on lease or rent by the employer (other than	This is taxable as a perquisite in the hands of the employee at the actual amount of rent paid by the

Sr. No.	Name of the Expenses/payment	Taxation under new regime as per new Rules w. e. f. 01.04.2009
	the Govt.)	employer or 15% of the salary, whichever is lower, as reduced by the rent, if any borne by the employee.
3	Furnished Residential accommodation owned by the employer (other than the Govt.)	Taxable as perquisite in the hands of the employee at the value as determined in respect of unfurnished accommodation as increased by 10% of the cost of the furnishings. If the furniture is hired by the employer, the perquisite value of the furnishing would be actual hire charges as reduced by the amount, if any recovered from employee.
4	Hotel accommodation provided by the employer to an employee for not more than 15 days in the aggregate on his transfer from one place to another	Not taxable as a perquisite in the hands of the employee.
5	Hotel accommodation provided by the employer to an employee for a period exceeding 15 days in the aggregate on his transfer from one place to another.	Taxable as perquisite in the hands of the employee @ 24% of the salary or the actual hotel charges paid, whichever is lower, as reduced by any amount recovered from the employee.
6	Motor car owned or hired by the employer or is owned by the employee and running and maintenance expenses are borne by the employer and the car is used only for business purposes.	Not a taxable perquisite provided that certain specified documents are maintained by the employer.
7	Where the motor car is owned or hired by the employer and is used exclusively for the private or personal purposes of the employee or any member of his household and the expenses are met/reimbursed by the employer.	Taxable as perquisite in the hands of the employee at actual amount of expenditure incurred by the employer on the running and maintenance of motor car, driver's salary, depreciation on motor car (@ 10% of cost) less any amount recovered from the employee.

Sr. No.	Name of the Expenses/payment	Taxation under new regime as per new Rules w. e. f. 01.04.2009
8	Where the motor car is owned or hired by the employer and is used partly for business purposes and partly for private or personal purposes and the expenses are met/reimbursed by the employer.	Taxable as perquisite in the hands of the employee at Rs.1,800/- per month in case of cars whose engines have up to 1.6 liters of cubic capacity and at Rs.2,400/- in case of other cars. If chauffeur is also provided by employer then, an additional amount of Rs. 900/- per month is added to the value of perquisite.
9	Motor car owned or hired by the employer and used by employee partly for business purposes and partly for private or personal purposes and the expenses for personal use are met by the employee.	Taxable as perquisite in the hands of the employee at Rs. 600/- per month in case of cars whose engines have up to 1.6 liters of cubic capacity and at Rs. 900/- in case of other cars. If chauffeur is also provided by employer then, an additional amount of Rs. 900/- per month is added to the value of perquisite irrespective of the size of the car.
10	Motor car owned by the employee and used partly for business purposes and partly for private or personal purposes and the running and maintenance expenses are met by the employer	Taxable as perquisite in the hands of the employee. The difference between the amount of expenses incurred and the limit given in Item No. 8 above will be considered as the perquisite value. However, if it can be proved that a higher portion of the expenditure is attributable for official purposes, the taxable perquisite will be reduced to that extent, subject to certain specified documents submitted by the employee and the same are maintained by the employer and a certificate is issued by the employer.
11	Automotive conveyance other than motor car owned by the employee and used partly for	Taxable as perquisite in the hands of the employee. The difference between the amount of expenses

Sr. No.	Name of the Expenses/payment	Taxation under new regime as per new Rules w. e. f. 01.04.2009
	business purposes and partly for private or personal purposes and the running and maintenance expenses are met by or reimbursed by the employer	incurred and Rs. 900 per month will be considered as the perquisite value. However, if it can be proved that a higher portion of the expenditure is attributable for official purposes, the taxable perquisite will be reduced to that extent provided prescribed records of the same are kept.
12	Salaries of personal attendants, including a sweeper, gardener and a watchman, whether paid/reimbursed or given as an allowance by the employer to the employee.	Taxable as perquisite in the hands of the employee at the actual cost to the employer as reduced by the amount, if any, recovered from the employee.
13	Utilities services like gas electricity or water, whether paid/reimbursed or given as an allowance by the employer to the employee.	Taxable as perquisite in the hands of the employee at the actual cost incurred by/cost of manufacture to the employer as reduced by the amount, if any, recovered from the employee.
14	Provision of free or concessional educational facilities for any member of the employee’s household	The value of benefit shall be determined as amount of expenditure incurred by the employer as reduced by the amount recovered from the employee.
15	Provision of interest free or concessional loans to the employee in excess of Rs. 20,000 in the aggregate.	Taxable as perquisite as per specified limit.
16	The expenditure on travelling and touring	If personal expenses of the employee are borne by the employer then the same would be considered as a taxable perk in the hands of the employee. The value of benefit shall be determined as amount of expenditure incurred by the employer as reduced by the amount recovered from the employee. If the expenditure is incurred on official purposes, then

Sr. No.	Name of the Expenses/payment	Taxation under new regime as per new Rules w. e. f. 01.04.2009
		the same would not be considered as a perk.
17	Free food and non alcoholic beverages provided by the employer.	Expenses in respect of food and beverages provided by the employer to the employees in office or factory during office hours will not be taxed as perquisites in the hands of the employees. Other expenses will be taxed as perquisites at cost as reduced by the amount, if any, recovered from the employee.
18	Meal coupons which are not transferable and which are usable only at eating joints or outlets.	These will be exempt in the hands of the employee if value of the coupons does not exceed Rs 50/- per meal.
19	Gifts, whether given on ceremonial occasions or otherwise.	This will be taxed as a perquisite in the hands of the employee and the value of any gift/ voucher aggregate of which is more than Rs 5,000/- in the year, shall be considered to be the value of the perk.
20	Credit Card expenses.	This will be taxed as a perquisite in the hands of the employee and the expenditure incurred by the employer as reduced by the amount, if any, recovered from the employee shall be the value of the perk. If the expenditure is incurred wholly and exclusively for official purposes and prescribed records of the same are kept, then the same will not be considered as a perk.
21	Use by an employee of any movable asset belonging to the employer or hired by the employer.	Taxable as perquisite in the hands of the employee @ 10% of the cost of such asset or the amount of rent or charge paid by the employer, as the case may be, as reduced by the amount, if any, recovered from the employee.

Sr. No.	Name of the Expenses/payment	Taxation under new regime as per new Rules w. e. f. 01.04.2009
22	Transfer to an employee of any movable asset belonging to the employer.	Taxable as perquisite in the hands of the employee at specified rates of the cost of such asset as reduced by the amount, if any, recovered from the employee. In the case of computers and electronic items, the normal wear and tear would be calculated at the rate of 50% and in the case of motor cars at the rate of 20% on reducing balance method. In respect of other assets, the perquisite will be valued at the rate of 10% of actual (original) cost.
23	Club membership fees.	If expenses are incurred wholly and exclusively for official purposes and for which the employer maintains certain specified documents/ details, there will be no perquisite taxable in the hands of the employee. In other cases, the amount of expenditure incurred by the employer (other than on initial fee for the membership in case of corporate membership) as reduced by the amount, if any, recovered from the employee.
24	Employee Stock Option Plan (ESOP) / Sweat equity.	This will be taxed as a perquisite in the hands of the employee and the difference between the fair market value and the amount, if any recovered from the employee will be considered as the value of the perk.
25	Contribution to Super Annuation Fund.	Amount contributed in excess of Rs. 100,000/- per annum per employee would be taxed as perquisite in the hands of such employee.
26	Expenditure like conference charges, employee welfare expenditure, expenditure on	In absence of any specific valuation mechanism, it appears that these are not taxable in the hands of the

Sr. No.	Name of the Expenses/payment	Taxation under new regime as per new Rules w. e. f. 01.04.2009
	festival celebrations.	employees as perquisites.
27	Perquisites other than those stated above (other than telephone expenses incurred by the employer on behalf of the employee)	The value of benefit was determined as amount of expenditure actually incurred by the employer, as reduced by the amount recovered from the employee.

FBT has been abolished w. e. f. 1-4-2009 and the concept of taxing the various benefits in the hands of the employee has also been reinstated w. e. f. 1-4-2009. However, the rules to enable this provision have been notified only now in December, 2009. This implies that every employer will have to rework the taxable salary for its employees for the months for which salary has already been paid (April 09 to November 09) and consequent increase, if any, in the tax to be deducted at source will have to be recovered and paid immediately to avoid interest payments.

CASE LAWS

1. ITAT V/s Om Shanti Cooperative Society (ITAT Mumbai)

Income received by society & its member is chargeable to tax as long term capital gain

The assessee, a registered cooperative society, is not engaged in any business activity. Prime Property Developers Pvt Ltd (PPDPL) approaches the society to seek permission to construct two floors & 8 flat on the existing building. In return PPDPL offered Rs. 26 Lakh to the assessee and Rs.5.50 Lakh to each members of the society since they have to bear with the disturbance caused due to further construction and also certain modification.

The Assessing Officer observed that assessee society having entered into an agreement with PPDPL for construction of additional floor on existing structure, there was a part performance of the assessee also which can be equated to transfer by way of ***Relinquishment of Right*** and on such transfer of right by an assessee, the consideration has to be offered to tax under the head of "Long Term Capital Gain". Since there is no cost of acquisition, the entire consideration received was brought to tax as Long Term Capital Gain. CIT (A) has confirmed the order of the Assessing Officer and further he was of the view that the amount receivable by the each member of the society is also assessable to tax in the hand of society in the event of transfer of right. Thus, The CIT (A) has enhanced the assessment and directed the Assessing officer to bring to tax total consideration of Rs.92 Lakh given to the assessee society and its members.

Decision of the Tribunal

According to the Tribunal, it is not in dispute that the assessee society and its member were not having any right to construct additional floor on existing building since they have already exhausted the right available with it while constructing the existing 12 flats. It is not the case of the revenue that the Transferable Development Right (TDR) was obtained by the assessee and sold to the third party. In the absence of any cost at the time of granting permission to the developer to construct additional floor, the computation under provision of section 45 fails. Therefore, the Tribunal held that the amount received by the assessee and its members is not assessable to tax under the head "Long Term Capital Gain".

2. <u>ITO vs. Arihant Tiles & Marbles (Supreme Court)</u>

Cutting & polishing marble blocks is "production" for s. 80-IA

The assessee, during the relevant Assessment Year 2001-2002, was engaged in the business of manufacture / production of polished slabs and tiles which the assessee exported (partly). The prime condition for allowing deduction under Section 80IA was that industrial undertakings should manufacture or produce any article or thing, not being any article or thing specified in the list in Eleventh Schedule of the Income Tax Act, 1961('the Act'). Thus the question under consideration was, that whether the activities undertaken by the assessee amounts to "manufacture or production of article or thing" for the purposes of deduction u/s 80IA.

The assessee has been consistently regarded as a manufacturer / producer by various Government Departments and Agencies. The processes undertaken by the assessee have been treated as manufacture under the Excise Act and allied tax laws.

It has been consistently held in numerous judgments that the word "production" is wider in its scope as compared to the word "manufacture". Manufacture means & includes an object converts into new & different form, character& with new existence. ***Manufacture simply means the***

change in the foundation or base of an object. Mere extraction of stones may not constitute manufacture .

The Authorities below rejected the contention of the assessee(s) that its activities of polishing slabs and making of tiles from marble blocks constituted "manufacture" or "production" under Section 80IA of the Act. There was difference of opinion in this connection between the Members of the ITAT.

As per the High Court, the original block does not remain the marble block; it becomes a slab or tile. In the circumstances, not only there is manufacture but also an activity which is something beyond manufacture and which brings a new product into existence. Accordingly, the Rajasthan High Court has accepted the contention of the assessee holding that polished slabs and tiles stood manufactured / produced from the marble blocks and, consequently, the assessee was entitled to the benefit of deduction under Section 80IA.

Decision of Supreme Court

Aggrieved by the order of High Court, the Department has filed Civil Appeals before Supreme Court. Supreme Court affirmed with the decision of the High Court stating that blocks converted into polished slabs and tiles after undergoing the process indicated by the assessee certainly results in emergence of a new and distinct commodity. The original block does not remain the marble block but it becomes a slab or tile. Thus, not only there is manufacture but also an activity which is something beyond manufacture and which brings a new product into existence and, therefore the activity undertaken by the assessee did constitute manufacture or production in terms of Section 80IA of the Act.

Supreme Court further pointed out, that if the contention of the Department that the activity undertaken by the assessee is not manufacture and if the said contention has been accepted then there would be serious and disastrous revenue consequences because the assessee would plead that they were not liable to pay excise duty, sales tax, etc. in the absence of the activity which did not constitute manufacture.

3. CIT vs. Bharat Aluminium (Delhi High Court)

Under "block of assets", user of individual assets is not required

The assessee purchased machinery which was **not** put to use during the year though it formed a part of the "block of assets". The Assessing Officer (AO) had disallowed the depreciation on the non-operating plant and machinery. According to the AO, plant and machinery was not put to use during the relevant assessment year and therefore, depreciation thereon was not allowable.

The Tribunal had allowed the claim of depreciation. The Tribunal held that once an asset merges into the block of assets, it loses its identity. Thus, the user of individual asset is not required and relevant factor would be the use of block asset. The individual working of the machinery also is not necessitated as the new asset falling within the block gets added to the written down value.

Decision of High Court

The High Court, inclined to affirm the view taken by the Tribunal in the instant case. The High Court held that, once the various assets are clubbed together and become block of asset within the meaning of Section 2(11) of the Act, for the purpose of deprecation it is one asset. Every time, a new asset is acquired, it is to be thrown into the common hotchpotch, i.e., block of asset on meeting the requirement of depreciation allowable at the same rate. The value of the block of asset increases and the depreciation is to be claimed on the WDV of the existing block as increased by the value of newly added asses. Fusion of various assets into the block of asset gets disturbed only when eventuality contained in clause (iii) of Section 32 takes place, viz., when a particular asset is sold, discarded or destroyed in the previous year (other than the previous year in which first brought in use). Even in that event, the amount by which the moneys payable in respect of that particular building, machinery, etc. together with the amount of scrap value is to be deducted from total written down value of the 'block asset'.
Though as per section 32(1), the asset is to be owned and "used" for the purpose of business or profession, the expression "used for the purpose of business" when applied to block of asset would mean use of block of asset and not any specific items in the said block as individual assets have lost their identity after becoming inseparable part of the block asset. The fact that under the second proviso to section 32 assets acquired after 30th Sept shall be entitled to 50% depreciation of amount admissible does not mean requirement of user of individual asset remains intact. In the first year when the particular asset is acquired, user of the asset is required**.** In subsequent years, the user of individual assets is not required. Since it is not in dispute for the year in question and block of assets was used, the assessee was rightly given the benefit of deprecation in the years in question. The order of the revenue had been dismissed by the High Court.

4. CIT vs. Kohli Brothers Color Lab (Allahabad High Court)

Assessee has to prove "bad debt" even under new s. 36 (1) (vii)

The assessee is engaged in the business of developing and printing of photos. The assessee, had written off an amount as a bad debt in its accounts under the head " Amounts written off" and claimed a deduction u/s 36 (1) (vii). The Assessing Officer observed that merely stating that the amount has been written off would not suffice as the assessee failed to furnish the information, which may substantiate that the said debt is a bad debt. Therefore, the Assessing Officer held the expenditure claimed by the assessee under the head "Amounts written off" as disallowable as per the provisions of Section 36(1) (vii) of the Act. The disallowance was confirmed by the CIT (A).

Aggrieved with the order, the assessee preferred an appeal before the Tribunal. The Tribunal decided in favour of the assessee by relying on the decision of **Oman International Bank 100 ITD 285 (Mum) (SB)** where it had been held that after the amendment to Section 36(1)(vii) w.e.f. 1.4.1989, it was not obligatory on the part of the assessee to prove that the debt written of was indeed a bad debt.

Decision of the Allahabad High Court

On appeal by the Revenue, Allahabad High Court has allowed the appeal and has held that:

- The effect of the amendment to Section 36 (1) (vii) is that it is not necessary for the assessee to establish that the debt had become bad in the previous year and mere writing off the debt as irrecoverable is sufficient. However, on the strength of the aforementioned amendment, it cannot be said that an inquiry is not permissible under the provision of the Act to see and satisfy that there is some semblance of the genuineness in the entry, which had been made, same is not at all totally fake entry as assessee would be entitled for deduction only if its bad debt, or part thereof.
- Further, though standard of proof of proving the same is bad debt, is not required to be adopted and is to be decided on the wisdom of the assessee and not the assessing officer. Thus, assessee cannot be questioned and no demonstrative or infallible proof of bad debt having become bad is required. Commercial expediency is to be seen from the

point of view of assessee depending on the nature of transaction, capacity of debtor etc.

- Thus, section 143 (2) and section 36 (1) (vii), both would be harmonized to give purposeful meaning to both the statutory provisions, as one extends benefit to the assessee of deduction for their debt or part thereof becoming bad and other authorizes Assessing Officer to see that provision of the Act are not flouted by any means.
- As in the present case, no reply had been submitted to the query made as such by the Assessing Officer, the disallowance is justifiable. However, in case such reply is submitted by the assessee, then in that event Assessing Officer is directed to take fresh decision in accordance with law after affording opportunity of the assessee on the basis of the record produced.

5. Growth Avenue Securities vs. DCIT (ITAT Delhi)

Even exempt capital gains are includible in "book profits"

The assessee earned long-term capital gains of Rs 40, 57,000 which was **not chargeable** to tax u/s 54EC. As the said gains were credited to the Profit and Loss Account, the assessee excluded the gains whilst computing "book profits" u/s 115JB. The assessee had shown net profit in audited profit & loss account at Rs.77, 81,868/-. The assessee's total income computed under the normal provisions of Income Tax Act 1961 ('the Act') was determined by the Assessing Officer at nil. The Assessing Officer (AO), therefore, proceeded to compute book profit within the meaning of section 115JB of the Act with a view to charge tax on book profit. The AO computed the book profit/total income u/s 115JB as under:

Income u/s 115 JB

Net profit as per profit & loss account	-	77, 81,868
Dividend income u/s 10(33)	-	1, 34,770
		76, 47,098
Rounded Off:	-	76, 47,100

According to the AO, assessee's total income computed under the normal provisions of the Act was determined at nil. The AO, therefore, ordered to compute book profit within the meaning of section 115JB of the Act with a view to charge tax on book profit.

Against the AO's order, the assessee had preferred an appeal before the CIT(Appeal) by taking a ground that the net profit shown in the Profit & Loss Account at Rs.77,81,868/- includes a long term capital gain of Rs.40,57,545/- not liable to be taxed in the light of the provisions contained in section 54EC of the Act, and thus, the said amount of Rs.46,57,545/- is to be excluded from the net profit for the purpose of computing profit u/s 115 JB. The CIT(A) rejected the assessee's contention by observing that the book profit u/s 115 JB need to be determined as per the method of computation provided u/s 115 JB, which does not provide for excluding any long term capital gain exempted u/s 54 EC of the Act.

Decision of the Tribunal

The Tribunal noted that the assessee had shown the short term and long term capital gain on sale of shares. The assessee had made investment in the shares which are shown as stock in trade as well as investments. The gain has been disclosed under the head "long term capital gain" and as well as "short term capital gain". In the balance sheet, the assessee has shown unsecured loan taken. It is not clear whether the loan obtained by the assessee on which interest has been paid has been utilized for the purpose of acquiring shares held as stock in trade as well as investment. Therefore, it was decided by the Tribunal to restore the matter back to the file of the AO to examine the matter afresh and decide the same accordingly as per law after providing reasonable opportunity of being heard to the assessee. Further, in the fresh assessment, if any such disallowance is called for, that would invariably be restricted only to the extent of 15% of the dividend income as upheld by the CIT (A).

INTERNATIONAL TAXATION

CASE LAWS

1. <u>In re Geofizyka Torun Sp.zo.o (AAR)</u>

Fees for services falling within Section 44BB are not taxable u/s 9 (1) (vii) r.w.s. 44DA

The applicant is a Company incorporated in Poland and a 'tax resident' of Poland. The applicant provides geophysical services to international oil and gas industry. The Applicant was engaged in conducting seismic surveys and providing seismic data to oil companies in connection with it's oil exploration and drilling activities. The applicant conducts seismic surveys and provides on-shore seismic data acquisition and other associated services such as processing and interpretation of such data to global and oil companies.

Seismic surveys can paint the picture of the sub-surface in order to better target oil and gas reserves. The results would help assessing the potential for tapping oil and gas at the particular spot. The seismic surveys are conducted to gather data to understand the size and location of oil fields so that the risks involved in exploratory drilling could be reduced. The applicant states that the main objective of seismic data acquisition is "to gather good quality seismic data in the block area so as to obtain meaningful geological sub-surface information and to indicate any direct (bright spot) or indirect evidence for the occurrence of hydrocarbons".

Per Petroleum Tax Guide, published by the Govt. of India, investigations relating to the sub-surface geology are part of "exploration operations". Hence, the applicant submits that for any oil and gas exploration activity, seismic survey is the first and important step. The applicant states that it has been providing the seismic data acquisition, processing and interpretation services to various oil and gas exploration and production companies in India.

It is, therefore, the contention of the applicant that the activities/services related to seismic data acquisition clearly fall within the ambit of Section 44BB of the Income Tax Act, 1961 ('the Act') and therefore the computation of income should be done in terms of that Section.

Advance ruling was sought on the question that:

"Whether income derived by the applicant in India is covered under the provisions of Section 44BB of the Income Tax Act, 1961?

The Advanced Authority Ruling (AAR) has answered the question in favour of the applicant by stating that the income has to be computed in terms of Section 44BB. The AAR has given its decision on the basis of following findings:

- Section 44BB applies to an assessee engaged in the business of providing services or facilities including in connection with the prospecting of mineral oils. On the other hand, Explanation 2 to Section 9 (1) (vii) defines "fees for technical services" to mean consideration for the rendering of technical services but not including consideration for mining or like project undertaken by the recipient.
- The Applicant's case falls within Section 44BB because the words in connection with therein have an expansive meaning. The services provided by the Applicant have a real, intimate and proximate nexus with the prospecting for or extraction of mineral oils. The seismic survey and data acquisition is a prelude and critical component of the oil and gas exploration activity.

Without seismic data acquisition and interpretation, it is impracticable to carry out the activity of prospecting which is a step in aid to exploration.

- There is no compelling reason to assign a narrow and restricted meaning to the expression 'services' and confine it to services other than technical, consultancy or managerial services. The argument of the Revenue that the term 'services' in Section 44BB are other than the services covered by Explanation 2 to section 9(1)(vii) is not acceptable.
- The argument of the Revenue that the exclusion with regard to mining projects in Explanation 2 to section 9(1)(vii) is applicable only to those who have taken up main project but not to those who rendered services to the enterprise promoting the main project is also not acceptable in view of binding Instruction No. 1862 issued by the CBDT on 22.10.1990 wherein it was held that the term 'mining project' in Explanation 2 to section 9(1)(vii) covers the rendering of services.
- Even on first principles, Section 44BB is a special provision dealing with the computation of profits of non-residents engaged in providing services in prospecting of mineral oils and will prevail over Section 9 (1) (vii), which is a general provision for charging fees for technical services to tax.

2. In Re Dana Corporation (AAR)

No capital gains in a business reorganization if consideration not determinable. Transfer pricing law does not apply if there is no income

The applicant, Dana Corporation, was incorporated in the USA. DHC (Dana Holding Corporation) and Dana Companies LLC (DCLLC) are the companies established as part of reorganization of DC.

As part of its extensive worldwide operations, DC owned shares in three Indian companies, all of which were its subsidiaries. In 2007, Dana Corporation filed for reorganization under Chapter 11 of the Bankruptcy Code of the United States. Under the scheme approved by the Bankruptcy Court, a new holding company was created Dana Holding Companies (DHC), to which Dana Corporation was required to transfer the shares it held in the three Indian companies. This transfer was effected whereby Dana Corporation transferred its holding in the Indian companies to another group company called Dana World Trade Corporation, which was controlled by DHC. Subsequently, Dana Corporation merged with DCLLC, and ceased to exist as an independent entity.

DHC is 100% holding company of DCLLC. Thus, DC through its successor company, DCLLC, has applied to the Advance Authority Ruling (AAR).

The applicant desires to have a ruling on the question whether the transfer of shares of Indian companies by DC to Dana World Trade Corporation (Dana WTC) and Dana Global Products, Inc. (Dana Global) is taxable in India.

<u>Applicant's Contentions</u>
The applicant contends that the transfer of shares is without consideration, as specifically stated in the Transfer Agreement. Also, the transfer is only a part of the overall restructuring / reorganization of DC under Chapter 1I of US Bankruptcy Code, no consideration can at all be attributed to the transfer of shares. This transfer was not for consideration, since its object was merely to comply with the requirements of the bankruptcy reorganization scheme.
The applicable provision in the Income Tax Act, 1961, is section 45 which is the charging provision on capital gains. To charge a transaction to capital gains, it is necessary to establish "profits and gains" that "arise from the transfer of a capital asset". The computation provision is section 48. In the absence of consideration or in determinability of full value of consideration, the computation provision in section 48 fails and as a result, the charging provision under section 45 cannot be invoked by the Revenue to charge the capital gains tax on this transfer.

The transfer pricing provisions of the Income Tax Act (viz. Section 92 and other) cannot be made applicable to the case of the applicant as there is no chargeable income under the Act.

<u>Contentions of the Revenue Department</u>
The Revenue has contended that there is consideration for the transfer of shares as a part of reorganization scheme as directed. The Revenue argued that the expression transfer, defined in section 2(47) of the Act, includes transfers by operation of law and transfers under the order of a court. The taking over of the liabilities by DHC can be legitimately construed as the consideration for the transfer of shares in the present case. Once it is concluded that there was a transfer, income from such transfer has to be calculated as per the provisions of section 45 read with section 48.

It further argued that the consideration for such transactions is the agreement of the holding company to participate in the reorganization scheme. As the transfer of shares is for fair consideration (irrespective of whether the applicant has identified the consideration for transfer of shares or not), it cannot be said that there is no income in the hands of the applicant. Even if the consideration for transfer of shares is not determinable, the arm's length price can be arrived at by taking resort to the provisions of section 92 which is dealing with transfer pricing (as this transaction is an international transaction between two or more related entities). Consequently, the Revenue contended that consideration could be determined through transfer pricing provisions, and particularly by resorting to the arm's length price mechanism prescribed in section 92 of the Act.

Decision of AAR

Two issues formulated by the Authority

"Whether any profit or gain arose to DC as a result of transferring its holding in the Indian companies to DWTC,"

"Whether any "amount" was received by or accrued to DC as a result of the transfer."

The Authority rejected the Revenue's contentions on both the questions. In doing so, the Authority referred to what is known as the "real income principle", and observed "***the profits or gains under the Income Tax Act must be understood in the sense of real profits or gains, on the basis of ordinary commercial principles on which the actual profits are computed"***. Applying this principle, the Authority held that section 45 does not apply unless the profit or gain is a ***"distinctly and clearly identifiable component of the transaction"*, and that *"there must be a causal nexus between the transfer of capital asset and the profit or gain…".*** The Authority also held that the transferor receives "no profit or gain" because the reorganization plan is ***"in the overall interests of its business and that there is a certain business advantage to the applicant has no bearing on the point whether any consideration has in fact been received or accrued on the transfer of shares".***

The contention of the Revenue, that income has to be computed on arm's length basis regardless of whether there is consideration, has also been rightly rejected by the Authority. The Authority noted that section 92 begins with the words "<u>any income</u> arising from an international transaction shall be computed having regard to arm's length price". This clearly implies that income must arise in the first place. The income in the present case, if at all, is traceable to 'Capital gains' which is one of the heads of income. If by application of the provisions of section 45 read with section 48 which are integrally connected with each other, the income cannot be said to arise as per the provisions of section 92 of the Act even though it is an international transaction. The expression 'income' in section 92 is not used in a sense wider than or different from its scope and connotation elsewhere in the Act. Section 92 obviously is not intended to bring in a new head of income or to charge the tax on income which is not otherwise chargeable under the Act.

The Authority rightly noted that section 92 cannot be used to levy capital gains on a transaction that does not satisfy the ingredients of section 45 in the first place. Thus, the argument of the Revenue that the transfer pricing provisions will apply even if there is no income is not acceptable.

ACCOUNTS, AUDIT & INVESTMENT

1. Companies will have to disclose cost of climate change effort soon

Soon, Indian companies will have to compulsorily follow a cost-accounting standard on climate change.

The Corporate Affairs Ministry has asked the Institute of Cost and Works Accountants of India (ICWAI) to prepare such a Standard — the first of its kind even globally. This means companies will have to work out costs involved in adopting environment-friendly measures and disclose them.

The Government can use this data while taking policy decisions and for climate change talks.

The Ministries of Corporate Affairs and Environment will shortly hold discussions on this. The new cost-accounting Standard on environment-friendly measures will be high, but achievable by Indian companies. The Standard will be on costs incurred for reducing pollution, re-planting forests or restoring mined areas.

The ICWAI would seek International Federation of Accountants' inputs. The Standard on climate change could be stand-alone or part of other new cost accounting Standards.

2. Foreign Direct Investment (FDI) in Real Estate May Get Rid of Three Year Lock-in Period

Rid of Three Year Lock-in Period Foreign investment in the real estate sector may potentially no longer be subject to the statutory three-year lock-in period. It is believed that the department of industrial policy & promotion, ministry of commerce & industry, recently circulated a draft note for consideration of the Cabinet Committee on Economic Affairs, where it has proposed to remove the condition of minimum period for repatriation of the original foreign investment.

Under present FDI policy, 100% foreign investment, without government approval (automatic route), is permitted in townships, housing, built-up infrastructure and construction-development projects. Regulated by Press

Note 2 (2005), these investments are subject to certain minimum capitalization norms and conditions prescribing the minimum area to be developed. Press Note 2 also stipulates that the original investment cannot be repatriated before a period of three years from completion of the minimum capitalization, except with prior government approval. It is pertinent to highlight that investments in SEZs, hotels and hospitals are exempt from all, including inter alia, the investment conditions, as stipulated in Press Note 2.

The instant recommendation appears to be in keeping with the government's ongoing process to liberalize the FDI regime in India. The original restrictions on repatriation must have been a cautionary measure, intended to prevent speculative investments in the real estate sector. However, this sector has, for some time now, been feeling the pressures of the global economic crisis and has desperately been in need of greater capital and liquidity to fund its existing projects and growth. Thus, the change, if it were approved and eventually implemented, will undoubtedly be a positive development for the realty sector. But what should also be noted is that, greater foreign investments in this sector will also enhance overall employment opportunities and generate greater domestic economic activity.

3. Foreign Direct Investment Guidelines

The Government has put in place a simple and transparent policy for Foreign Direct Investment (FDI) wherein most of the sectors are open to FDI under the automatic route. FDI policy is reviewed on an ongoing basis through inter-Ministerial consultations with a view to attract FDI in more industries and sectors.

As per Government's policy on FDI in Micro and Small Enterprises (MSE) sector as contained in Press Note 6 (2009) on 04.09.2009, FDI in MSE is allowed subject only to the sectoral equity caps, entry routes and other relevant sectoral regulations. Any industrial undertaking, with or without FDI, which is not a MSE, manufacturing items reserved for manufacture in the MSE sector (presently 21 items) as per the Industrial Policy, would require an Industrial License under the Industries (Development & Regulation) Act, 1951, for such manufacture. Such an industrial undertaking would also require prior approval of the Government (FIPB) where foreign investment is more than 24% in the equity capital. It is expected that these guidelines would boost FDI in MSE.

Government has also announced a number of measures to accelerate the demand in the economy, which would enable India to continue as an attractive investment destination. Under the liberalized economic environment, investment decisions of investors are based on the macro-economic policy framework, investment climate in the state, investment policies of the transnational corporations and other commercial considerations. The Government of India continues to make efforts to increase economic cooperation with the developing as well as developed countries through different fora such as Joint Commissions/Joint Committees, other bilateral channels like interaction with the delegations visiting the country and organizing visits abroad for discussions on issues of mutual interest and business/ investment meets between Indian and foreign entrepreneurs to stimulate foreign investment into India. The Department of Industrial Policy and Promotion also participates in discussions covering industrial cooperation organized by other Ministries and Departments of Government of India and the Joint Business Council meetings. The Government has announced the setting up of 'Invest India', a joint venture company between the Department of Industrial Policy & Promotion and FICCI, as a not-for-profit, single window facilitator, for prospective overseas investors and to act as a structured mechanism to attract investment

The Government of India also undertakes investment promotion activities by organizing events such as 'Destination India' and 'Invest India' in various countries with FDI potential to create awareness about the investment climate and opportunities in India, as well as to provide support to potential investors.

The Government of India, in partnership with various State Government and Business Associations, is making concerted efforts to make regulations conducive for business. In addition, the Government has initiated to implement e-Biz Project, a Mission Mode Project, a Mission Mode Project under the National e-Governance Project, to provide online registration, filing payment services to investors and business houses

As per Press Note 2 (2009), calculation of direct and indirect foreign investment in Indian companies will be made as per the guidelines issued there under. These guidelines would be applicable for determining the total foreign investment in all sectors, excepting in sectors such as insurance, where such calculation is governed specifically under any statutes or rules there under.

4. The International Auditing and Assurance Standards Board (IAASB) Issues New Assurance Standard on Controls at Service Organizations

Recognizing the widespread international use of outsourcing, the International Auditing and Assurance Standards Board (IAASB) has recently released International Standard on Assurance Engagements (ISAE) 3402, Assurance Reports on Controls at a Service Organization. This new standard addresses reports on the description, design, and operating effectiveness of controls relating to the broad range of services that today's service organizations provide. Such services can range from assisting with processing transactions to performing one or more business functions.

A single service provided by a service organization can have direct relevance to the quality of financial reports prepared by entities around the globe. Effective controls for delivering the service are therefore essential. This new standard sets a global benchmark for reporting on controls at a service organization, thereby helping to fulfill the needs of those who use such services and their auditors under International Standards on Auditing (ISAs).

ISAE 3402 is the first new assurance standard, other than the ISAs, developed under the IAASB's International Framework for Assurance Engagements. Therefore, the IAASB will be interested in the experiences of service auditors and others with its implementation and has decided to actively seek feedback in 2013 on implementation of the standard.

ISAE 3402 is effective for service auditors' reports covering periods ending on or after June 15, 2011. An overview of this new standard is available in the IAASB section of the new Publications and Resources site.

5. International Public Sector Accounting Standards Board (IPSASB) Issues Standard on Agriculture as Part of its Global Convergence Program

The International Public Sector Accounting Standards Board (IPSASB) has taken a further step in its global convergence program with International Financial Reporting Standards (IFRSs), scheduled for completion by December 31, 2009, by issuing International Public Sector Accounting Standard (IPSAS) 27, Agriculture. IPSAS 27 provides requirements for accounting for agricultural activity.

IPSAS 27 is primarily drawn from the International Accounting Standards Board's International Accounting Standard 41, Agriculture, with limited changes dealing with public sector-specific issues. This IPSAS provides financial reporting requirements that enhance accountability for such activity and are a further step towards our convergence target.

IPSAS 27 is available to download free of charge from the IFAC website (www.ifac.org/Store). The IPSASB encourages IFAC members, associates, regional accountancy bodies, and firms to use these materials and to promote their availability to members and employees.

6. No case to extend Financial Reporting Standards, says Government

India will stick to its earlier announced deadline for convergence with the International Financial Reporting Standards (IFRS) by April 2011 Government said recently.

Government said that India is a signatory to accept IFRS. The Government also clarified that accept means convergence to IFRS by April 2011 and not adoption. There is no reason to change that date or extend the time, Government said recently. The entire exercise of convergence would have to be in the interest of the country and also that of the growth of the corporate sector.

As regards the companies that should do the convergence first, the Government said that listed companies should go ahead with early adoption of IFRS if they feel that this would help their business and give them more credibility in the foreign markets.

The Government also asked industry to submit views on the kind of legislative changes that need to be undertaken for smooth transition to IFRS. India Inc has also been asked to submit views on whether the IASB developed document of “IFRS for SMEs” should be entirely accepted by India.

7. PAN to be linked with Unique Id Number

Banking heavily on the use of biometrics, the ten-digit Permanent Account Number (PAN) and the 16-digit Unique Identification (UID) Number are set to be linked up.

The government has decided to link the plan for biometric PAN cards with the UID project. The finance ministry has already begun talking to the Unique Identification Authority of India (UIDAI) in this regard.

The move comes at a time when both the income tax department and the UIDAI propose to use biometrics to verify the identity of citizens and avoid duplication of cards. More importantly, it would help the UIDAI get easy access to the nearly 70 million PAN cardholders.

Under the proposal, the PAN card infrastructure will be used by the UIDAI for data collection and enrollment of citizens. Further, the UID number will be embedded in new PAN cards, while earlier PAN cardholders will be sent a letter with their UID number.

For the Biometric Permanent Account Number (PAN) cards, tax authorities were planning to capture the fingerprints of four fingers of an individual—two from each hand; along with the face (with the eyes fully visible), the UIDAI is expected to use only fingerprints.

While the Central Board of Direct Taxes has been planning to launch biometric PAN cards for over three years, it was just this year that it actually floated a tender for it.

In the initial years, the department plans to issue biometric PAN cards to new applicants and those seeking a re-issue. It would be extended to existing cardholders later.

8. The Government says no proposal to withdraw stimulus this year

The government recently said it would not withdraw the fiscal stimulus, provided in the last one year to help the economy deal with the global slowdown, in the current financial year. It has been indicated, at present, there is no proposal for the withdrawal of stimulus measures in 2009-10

The fiscal measures announced by the government and the monetary measures by the Reserve Bank of India were aimed at mitigating the effects of the economic downturn.

The GDP growth, which was 7.7 per cent in the second quarter of 2008-09, decelerated to 5.8 per cent in the third quarter of 2008-09 and recovered to 6.1 per cent in the first quarter of this financial year. The economy recorded a robust 7.9 per cent growth in the second quarter.

The expansionary fiscal stance at present is a short-term measure to address demand slowdown in the economy and minimize the impact of the global financial crisis.

The government's intention to resume the process of fiscal consolidation has been indicated, which envisages a fiscal deficit of 5.5 per cent of GDP in 2010-11 and 4 per cent in 2011-12.

9. The Institute of Chartered Accountants of India (ICAI) revises internal audit guidelines

The Institute of Chartered Accountants of India (ICAI) has recently revised its internal audit standards to strengthen internal audit practices in the country.

The current revision, approved recently by the ICAI council, addresses issues such as effects of laws and regulations in conducting internal audit, responsibility of management for compliance with laws and regulations, responsibility of internal auditor and internal audit procedures.

The new system — the Standard on Internal Audit (SIA) 17 — distinguishes the internal auditor's responsibilities in relation to compliance with two different categories of laws and regulations, one that have direct effect on financial statements and other that have significant impact on the functioning of the entity, an ICAI statement said.

With the issuance of the new standard, the tally of SIAs issued by the Institute now stands at 17. In addition to providing performance benchmarks to the internal auditors, these SIAs aim to bring in greater consistency, standardization and independence in the internal audit activity.

Since SIA codifies best practices in the field, the Institute, through its Internal Audit Standards Board (IASB), has devoted a lot of attention and resources on the development and propagation of these standards.

Further, in order to enhance awareness about SIA, the ICAI Council has also approved to host the complete text of the SIAs on the institute's website for free download.

10. The ministry of corporate affairs plans to bring in a new reporting tool - Extensible Business Reporting Language (XBRL)

The ministry of corporate affairs is planning to introduce Extensible Business Reporting Language (XBRL) for its MCA 21 portal, which is the database for 9 lakh companies in India. This means that the companies will also have to file their documents in the XBRL format, which would in turn increase their compliance cost.

At present, XBRL is being followed in many countries including the US, where after a period of voluntary compliance with XBRL, they are now moving towards mandatory XBRL filings for the domestic companies.

The XBRL is an electronic format for communication of business and financial data that allows the users of financial information to electronically retrieve data with greater assurance of accuracy. According to experts, while XBRL would involve some initial conversion costs for companies, the long-term benefits for investors and the capital markets would be significant.

XBRL filings would ensure that financial data is filed in a standard format and is retrievable electronically. This would also facilitate detailed analysis of the underlying data using standard data analysis tools. This would only involve initial conversion cost but keeping in mind the long term benefits. The ministry would be working with the accounting regulator, Institute of Chartered Accountants of India for the application of the reporting language to the MCA 21 database.

Seeing the rising importance of XBRL as an effective means of communicating financial information, ICAI constituted the XBRL group in 2007 for undertaking the development and promotion of XBRL in India. With the use of XBRL, the software can also immediately confirm the financial data, highlighting errors and gaps which can immediately be addressed. It also helps the user in selecting and processing the data for re-use. At present, MCA 21 is only able to provide the information of one company at a time and the data filed in the scanned PDF format cannot be collated. In case of XBRL language, the user would be able to obtain information of a number of companies that can be collated, analyzed and retrieved at the same time. This will be of a great help to the stakeholders as it would become easier for them to gather information about many companies.

The usage of XBRL in MCA 21 would make filing of documents much easier for companies, and at the same time the stakeholders would be able to receive the financial data in a customized manner. They would also come to know the profitability of a particular industry segment.

XBRL would be beneficial for those who collect business data including governments, regulators, economic agencies, stock exchanges, financial information companies and the like and those who produce or use it, including accountants, auditors, company managers, financial analysts, investors and creditors.

11. Draft press note no. (2010) on FDI regulatory framework

Recently, the Department of Industrial Policy and Promotion Ministry of Commerce and Industry, Government of India has issued a draft press note no. (2010) on Foreign Direct Investment (FDI) regulatory framework

This Press Note consolidates into one document all the prior regulations on FDI and reflects the current 'regulatory framework' on FDI. It is clarified that this is a consolidation/compilation and comprehensive listing of most matters on FDI and is not intended to make changes in the extant regulations. While attempt has been made to deal with the subject comprehensively, if some aspect(s) has been left out then that will continue to be dealt in the current way where it is listed.

This Press Note contains five chapters for various subjects which are summarized as follows:

Chapter 1:

Chapter 1 contains various definitions of terms used in this draft press note (2010).

Chapter 2:

Chapter 2 deals with;

- source of investment in India,
- types of instrument,
- eligibility of investments in resident entities,
- conditions on issue/transfer of shares and
- issue/transfer of investment.

Chapter 3:

Chapter 3 deals with;

- calculation of total foreign investment i.e. direct and indirect foreign investment in Indian companies,

- entry routes for investment,
- caps on investments,
- entry conditions on investment,
- other conditions on investment besides entry conditions,
- downstream investment by Indian companies,
- guidelines for consideration of FDI proposals by FIPB and
- constitution of FIPB.

Chapter 4:

Chapter 4 deals with;

- policy on route which includes prohibition on investment in India,
- other caps on investment and
- conditions for FDI.

Chapter 5:

Chapter 5 deals with;

- remittance and repatriation,
- reporting of FDI,
- acquisition/transfer/sale of immovable property and repatriation of sale proceeds thereof and
- adherence to guidelines/orders and consequences of violation

This Press Note will have a sunset clause of six months and will automatically lapse on 30th September, 2010. A new press Note on Regulatory Framework would be issued every six months which will incorporate and reflect all the changes in the regulations during the last intervening period of six months. Thus the Government will issue Press Note on FDI Regulatory Framework twice a year in April and October which would be the current regulatory framework on that date.

All earlier Press Notes on FDI issued by Department of Industrial Policy and Promotion, Government of India will stand rescinded.

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