February 2009

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INCOME TAX

DOMESTIC TAXATION

General

Presentation of an Interim Budget

The Acting Finance Minsiter, Mr PranabMukherjee, presented iterim budget for year 2009-10 at the Parliament on 16 February 2009. For highlights of the same, you may refer to our separate publication titled 'Interim Budget – 2009 -10'.

PAN is not required for savings account & insurance premium below Rs 1 lakh

A year after declaring that PAN (permanent account number) would be made mandatory for all financial transactions, it has been recently decided by the Ministry of Finance to make it mandatory to quote PAN for just insurance products that have an investment element of more than Rs 1 lakh per annum.

At the same time, the Government has decided that quotation of PAN shall be mandatory for opening a current account and not for a savings account.

Sources in the Ministry's Department of Financial Services said that they had written to Insurance Regulatory & Development Authority, Life Insurance Corp and General Insurers' (Public) Sector Association to ensure compliance of the above norms on PAN for insurance products.

Besides an individual, banks, credit card companies, etc. are required to quote PAN of its clients in select financial transactions so that the data could be matched with the tax returns of the individual to check if he or she is evading taxes.

Every person has to quote his PAN or General Index Register Number in documents pertaining to the following transactions:

1) Sale/purchase of any immovable property valued at Rs 5 lakh or more.

2) Sale/purchase of motor vehicle which requires registration.

3) A time deposit exceeding Rs 50,000 with a banking company.

4) A deposit exceeding Rs 50,000 in any account with Post Office Saving Bank.

5) A contract of a value exceeding Rs 10 lakh for sale or purchase of securities.

6) Opening an account with a banking company to which the Banking Regulation Act, 1949 applies.

7) Applying for installation of a telephone, including cellular telephone.

8) Payment to hotels and restaurants against bills for an amount exceeding Rs 25,000 at any one time.

CASE LAWS

1. Mayawati vs. CIT (Delhi High Court)

Reopening notice even if served after limitation period is valid

The assessing officer had issued a notice under section 147 of the Income Tax Act 1961. He tried to serve the notice on the assessee within the limitation period of six years. The assessee claimed that same was served only after the expiry of the limitation period and hence the notice was not valid.

The AO had passed an order on 24.3.2008 stating that he had reason to believe that the assessee had not declared full and true particulars of her income. On 25.3.2008, the CIT recorded the approval to this proposal for initiation of proceedings and issuance of notice under Section 148 of the Income Tax Act. Accordingly, the AO has issued a Notice dated 25.3.2008 under Sections 147/148 of the IT Act to the assessee at her Delhi address. The assessee had refused to accept the notice at addresses belonging to her stating that she had shifted her residence. The assessee prayed for quashing the notice issued u/s 148 & 142(1).

Decision of Delhi High Court:

The Delhi High Court has passed the order dismissing the writ petition of assessee and held that:

1. Section 149, which imposes the limitation period, requires the notice to be "issued" but not "served" within the limitation period. Once a notice is issued within the period of limitation, jurisdiction becomes

vested in the AO to proceed to reassess. Service is not a condition precedent to conferment of jurisdiction but it is a condition precedent to the making of the order of assessment;

2. Section 27 of the General Clauses Act, 1897 creates a rebuttable presumption of due service or proper service if the document sought to be served is sent by properly addressing, prepaying and posting by registered post to the addressee and such presumption is raised irrespective of whether any acknowledgment due is received from the addressee or not. This means that the addressee to whom the communication is sent must be taken to have known the contents of the document sought to be served upon him without anything more. Similar presumption is raised under illustration (f) to S. 114 of the Indian Evidence Act where under it is stated that the Court may presume that the common course of business has been followed in a particular case, that is to say, when a letter is sent by post by pre-paying and properly addressing it the same has been received by the addressee. These presumptions are rebuttable but in the absence of proof to the contrary the presumption of proper service or effective service on the addressee would arise.

2. CIT vs. Reliance Utilities (Bombay High Court)

Advances to sister concerns must be presumed to have come out of own funds and not borrowed funds

The assessee had invested Rs.389.60 crores in Reliance Gas Limited and Rs.1.01 crore in Reliance Strategic Investments Limited. The Assessee was in the business of generation of power. The companies, in which the investments were made, were in the energy sector. Investments were made mainly during January, 2000 to March, 2000. The assessee had earned regular business income from distribution of power and investments made were in the companies in energy sector and were with a view to build long term business prospects. The assessee submitted that Investments were in the regular course of business and accordingly no part of interest can be disallowed when the fund is utilized for the purpose of business.

The Assessing Officer had recorded a finding that the sum of Rs.213 crores were invested out of their own funds and Rs.147 crores were invested out of borrowed funds. Accordingly, had disallowed interest amounting to Rs.4.40 crores calculated @ 12% per annum for three months from January, 2000 to March, 2000.

An analysis of funds generated through operation and funds raised through borrowings and capital infusion were given to AO and the higher authority.

The assessee preferred an appeal to the CIT (Appeals). The C.I.T. (Appeals) held that it agreed with the contention advanced by the assessee that they had enough interest free fund at its disposal for investment and accordingly CIT (Appeals) deleted the addition of Rs.4.40 crores made by the AO and directed him to allow the same under Section 36(1)(iii) of the Income Tax Act.

The revenue preferred an appeal to the Tribunal. From the facts on record the learned Tribunal upheld the order of CIT (Appeals).

Agrrived by the order of Tribunal, the revenue preferred an appeal before High Court.

Decision of Bombay High Court:

The Bombay High Court passed the order dismissing the appeal of the Revenue and held that the assessee had his own funds as well as borrowed funds, a presumption could be made that the advances for non-business purposes have been made out of the own funds and that the borrowed funds have not been used for this purpose. Accordingly, the disallowance of the interest on the borrowed funds was held to be not justified.

3. Snowcem vs. DCIT (Bombay High Court)

Section 115JA assessment is not liable for advance tax interest u/s 234B and 234C

The assessee submitted that in a case of computation of income under the provisions of Section 115JA of the Income Tax Act, the provisions of Section 234B and 234C are not applicable. The assessee had a book profit of Rs.6,31,77,987/- as against the computed income of Rs.45,16,690/-. Assessment was made u/s 115JA of the Income Tax Act. Since the assessee had paid short advance tax interest was charged for short fall of advance tax.

Decision of Bombay High Court:

The Bombay High Court held that interest under Section 234B and 234C should not be leviable in case of tax being determined on the basis of computation of income under the provisions of Section 115JA of the Income Tax Act.

INTERNATIONAL TAXATION

International Taxation

Case laws

1. UAE EXCHANGE CENTRAL LIMITED (DELHI HIGH COURT)

Facts

- The assessee is a limited liability company incorporated in UAE. The head office of the assessee is situated at Abu Dhabi. The assessee offers remittance services to NRIs in UAE. In pursuance to the contracts in this regard entered into between the assessee and the NRI, funds are received from such NRI client at UAE by the assessee and funds so collected are remitted to the beneficiaries of the NRI in India. The assessee levies one time fee to the NRI client for the same. The funds collected from the NRI client are either remitted to the bank account in India of the beneficiary by telegraphic transfer or are remitted by issuing cheques on banks in India. The cheques so drawn are issued to the beneficiary by taking assistance of the liaison offices established by the assessee in India. The liaison offices are established by the assessee after obtaining necessary prior approval of the Reserve Bank of India. As per the said approval of Reserve Bank of India, certain restrictions and guidelines were provided with regard to the activities which the liaison offices would carry out in India. Reserve Bank of India specifically prohibited the liaison offices from charging any commission or fees or from receiving or earning any remittances from any activity given by it. As per the norms of the Reserve Bank of India in this regard, the expenses of the liaison offices in India were also required to be met exclusively out of the funds received from outside of India. The returns of income of the liaison office were filed by the assessee inter alia declaring nil income. The basis of the same was that the assessee contended that no income accrued or deemed to have accrued in India in the hands of the liaison offices having regard to the provisions of the act as well as the Tax Treaty entered between India & UAE. In response to an application filed by the assessee before the Authority for Advance Ruling (AAR), it was ruled that the income earned in UAE by the assessee, by virtue of business activity carried out at UAE, had a real and intimate relationship with the activities carried out by the liaison offices in India and consequently, ruled that liaison offices would be subject to tax in India.

Aggrieved by the said ruling, the assessee filed a writ petition before Delhi High Court.

Contentions of the Assessee

- The assessee held that the Court would act within its powers to consider the writ petition filed by the assessee, having regard to the framework of the Constitution of India as well as certain judicial precedents available to this effect. The assessee also made an elaborate submissions on the nature of activities performed for the NRI client by the assessee at UAE as well as auxiliary activities carried out in India by the liaison offices. The assessee also contended that even if it was assumed that the income was deemed to arise or accrue to the assessee in India under the provisions of the Act, the business profits to the extent attributable to the permanent establishment of the assessee in India would be liable to tax. The assessee further contended that having regard to the meaning of the term PE provided under article 5 as well as per the provisions of article 7, no income could be taxed in India in the hands of the assessee. The assessee also brought out certain erroneous inferences and conclusions made by AAR while issuing the ruling.

Contentions of the Revenue

- The Revenue challenged the jurisdiction of the Court to entertain the petition. The Revenue contended that the Court could not interfer to the ruling provided by AAR. As regard to the subject matter, the Revenue contended that the activities undertaken by the liaison offices in India established a real and intimate connection between the business activity of the assessee in UAE and therefore it would fall within the purview of section 9(1)(i) r.w.s. 5 (2) (b). The Revenue further contended that having regard to the activities of the liaison offices, the same would constitute PE of the assessee in India in as much as the activities carried on by the liaison offices could not be termed as an activities of an auxiliary character.

Decision of the Court

- The Court analysed the provisions of Chapter XIXB of the Act dealing with scope and powers of AAR. The Court also referred to the framework of the Constitution of India and held that it would be appropriate for the Court to consider the ruling of AAR. Thereafter, the Court analysed the relevant provisions of the Act as well as of the Tax Treaty and also referred to the decision of the Supreme Court in the case of Azadi Bachao Andolan. The Court also considered the activities carried on by the assessee at UAE as well as by the liaison offices in

India. As regard to the interpretation of the nature of activity of an auxiliary character, the Court also referred to the decision of the Supreme Court in the case of Morgan Stanley. The Court thereafter held that activities carried on by the liaison offices in India did not contribute directly or indirectly to the earnings of the assessee in UAE. The Court quashed ruling of the authority.

2. DAIMLER CHRYSLER INDIA PRIVATE LIMITED (ITAT PUNE)

Facts

- The assessee is a Company incorporated in India. In view of the shareholdings pattern of the assessee, it was not a 'Company in which public are substantially interested'. The erstwhile parent company of the assessee company is incorporated and registered at Germany (hereinafter referred to as 'the erstwhile German Company'). In view of a global merger of the erstwhile German Company with its other business entity, a new parent company was formed in Germany (hereinafter referred to as 'the new parent company'). The assets and liabilities of the erstwhile German Company, on account of merger which took place outside of India, were transferred. In view of the transfer of such assets and liabilities of the erstwhile German Company in favour of the new parent company, the shareholding pattern of the assessee (Indian Company) got altered in as much as the shareholder of the assessee (Indian Company) got substituted, from the erstwhile German Company to new parent company. Since these shares were more than 51% of the total shares of the assessee, the assessing office invoked the provisions of section 79 and consequently denied the assessee the benefits of carry forward & set off of the unabsorbed losses. During the appellate proceedings before CIT (A), the contentions of the assessee were rejected and CIT (A) confirmed the stand taken by the assessing officer. Aggrieved, by the same, the assessee preferred an appeal before ITAT Pune. The assessee raised an additional ground before ITAT whereby relieves were sought by invoking article 24 (4) of the Tax Treaty signed between India and Germany.

Contentions of the Assessee

- The assessee contended that the change in its shareholding was due to global merger of the erstwhile German Company, resulting into establishment of new parent company. The assessee contended that such global merger could not be stated to be a tax avoidance practice. The assessee also invited attention to the amendment made to section 79 with effect from 1st April, 2000 which now provides for exception to the

provisions of section 79. As regard to the additional ground filed before the ITAT Pune, the assessee stated that the said was purely legal in nature and should be admitted to advance the cause of substantial justice.

Contentions of the Revenue

- At the outset, the Revenue challenged the additional ground of appeal filed by the assessee before ITAT, Mumbai. The Revenue contended that it would be necessary to examine the matter further to investigate the facts for admission of the new ground and the same should not be admitted at this stage. The Revenue further stated that the assessee, who is resident in India, cannot seek to claim treaty override benefits by invoking article 24 (4) of the Tax Treaty between India and Germany since the Tax Treaty and the article 24 (4) can be invoked by the Non-Resident. The Revenue was of the view that merely because shareholders of the assessee were resident of Germany, benefits to the Tax Treaty cannot be claimed by the assessee. The Revenue also argued that if the treaty benefits were allowed to the assessee merely because the shareholders of the assessee were resident of Germany, it would defeat the scheme of Tax Treaty protection.

Decision of the Tribunal

- The Tribunal referred to several judicial precedents and observed that admission of a legal plea could not be declined by the Tribunal, as along as the relevant facts were available on record. The Tribunal referred to the decision of Apex Court in this regard. The Tribunal observed that if the treaty benefits were not invoked by the assessee at the time of assessment proceedings and at the time of first appellate proceedings, the assessee can be permitted from seeking treaty protection before the Tribunal. After carefully considering the relevant provisions, the Tribunal admitted the additional ground of appeal filed by the assessee. The Tribunal thereafter proceeded to examine the scope of section 90 and purpose of entering into Tax Treaty by India. The Tribunal also referred to the International commentaries on the subject of interpretation of Tax Treaty. The Tribunal then elaborated on the scheme of the prohibition of the discrimination set out under article 24 of the Tax Treaty. The Tribunal also referred to the wordings on non-discrimination in the Tax Treaty between India and Canada. In absence of any direct judicial precedents available from judicial forums of India on the issue before the Tribunal, few judgments by foreign judicial forums in this matter were considered. The Tribunal also made out a strong case for referring and relying on judicial precedents of foreign judicial forums. After considering decision of several foreign courts on

interpretation of treaty override provisions, the Tribunal opined that for the purposes of non discrimination prohibition under Article 24(4) in the present context, what was to be examined was whether Indian subsidiary of a German company was any worse off vis-à-vis an Indian subsidiary of an Indian company. Before reaching its decision, the Tribunal also distinguished a precedent in the form of decision of House of Lords that could support the contentions of the Revenue with regard to entitlement of the assessee to claim benefit of treaty override. To reach to the said conclusion, the Tribunal also examined the OECD commentary as well as view of learned professor Late Vogel & Kees van Raad on the subject at a great length. The Tribunal opined that for the purpose of examining whether or not there was indeed a discrimination against an Indian subsidiary of a German company, it would appropriate to compare the same with an Indian subsidiary of an Indian company. The Tribunal held that the disability on carry forward and set off of accumulated losses on account of change in shareholding pattern, under Section 79 r.w.s 2(18), cannot be extended to the Indian subsidiaries of German parent companies as long as German parent companies are listed on a German stock exchange recognized under its domestic laws. To this extent, the rigour of Section 79 must stand relaxed due to treaty override.

Our Comments

- This is going to be a significantly important decision not only for the purposes of interpreting the scope and applicability of article 24 of the Tax Treaty but also for providing a road map on method and manner of interpreting the provisions of the law while dealing with issues of international taxation. The Tribunal rightly emphasised on the importance of adopting harmonious interpretation & for meeting the said end appropriateness of using foreign judgments. The Tribunal provided an important principle to be adopted by the judiciary in as much as it was opined by the Tribunal that the treaty partner state must try to give a harmonious interpretation. The Tribunal further stated that it was a desirable practice to follow, as far as possible, that the interpretation assigned to the expressions found in the bilateral tax treaties should be such that it would be in harmony with the judicial opinion abroad and, where there was a divergence of judicial opinion abroad, it should at least be in harmony with the judicial opinion in the treaty partner country. We strongly believe that this decision would be referred by many forums while dealing with intricate issues of international taxation.

3. *CHOLAMANDALAM MS GENERAL INSURANCE COMPANY LIMITED (AUTHORITY FOR ADVANCE RULINGS)*

Facts

The Applicant is an Indian Company engaged in the business of Non-life Insurance. A company incorporated at Korea (hereinafter referred to as Korean Company) entered into a Secondment Agreement with the applicant. Under the agreement, a senior employee of the Korean Company was seconded to the applicant for a period of two years in order to assist the applicant in matters relating to insurance business. The applicant entered into this agreement for its business requirements. The Korean Company was not in the business of supply of manpower. The seconded employee was engaged to perform certain specific activities under the supervision and control of the applicant. However, the seconded employee had no right or authority to conclude any contract on behalf of the applicant. The Korean Company made payment of salary to the seconded employee from time to time. The Korean Company deducted appropriate amount of income tax from such salary payment and deposited the same with the income tax department in India. Out of the total payments made to the seconded employee by the Korean Company, part of such salary and other benefits amount, as provided for in the relevant agreement, was charged to the applicant. The applicant was required to pay such part amount of salary and other benefits to the Korean Company. The applicant raised several questions for consideration by the authority particularly with regard to the obligation of the applicant to withhold tax while reimbursing the part salary and other benefits to the Korean Company.

Contentions of the Applicant

- The applicant contended that the payment under consideration to the Korean Company was in the nature of reimbursement. No income arises in favour of the Korean Company in India on account of such reimbursement. The Korean Company did not have a PE in India having regard to the Tax Treaty signed between India and Korea. The applicant was therefore not required to withhold any tax at source. The applicant also contented that since day to day working of the seconded employee was supervised and controlled by the applicant, the real and economic employer of the seconded employee should be the applicant and not the Korean Company.

Contentions of the Revenue

- The Revenue contended that the payment under consideration was towards services of a technical personnel availed by the applicant. Such payment shall be regarded as 'fees for technical services' under the provisions of the act as well as the Tax Treaty. The Revenue also contended that the seconded employee would be regarded as an agent of the Korean Company in India. This would result into an establishment of an Agency PE in India by the Korean Company.

Rulings of the Authority

- The Authority considered the business activities of the applicant as well as of the Korean Company. The Authority also elaborately and exhaustively perused the terms of the Secondment agreement entered between the applicant and the Korean Company. The Authority thereafter referred to the definition of fees of technical services provided under the Act. It was noted by the authority that the definition of the term 'fees for technical services' shall not include consideration which would be the income of the recipient chargeable under the head salary. The Authority also observed that merely because the seconded employee performed certain services of technical nature would not automatically characterize the payments under consideration by the applicant to the Korean Company as fees for technical services. The Authority also observed that the essence or substance of the arrangement was not for deriving income by way of charging a fee for the services. After examining general judicial precedents, especially to the decision of Calcutta High Court in the case of Dunlop Rubber Company Limited and of the Authority in the case of AT&S India Limited, the Authority concluded that the payment under consideration is towards reimbursement of salary paid by the Korean Company for the seconded employee. The Authority also distinguished its earlier rulings in case of Danfoss Industries Limited. The Authority thereafter ruled that the applicant was not liable to deduct any tax at source in respect of the reimbursement of the part salary and expenses of the seconded employee.

4. M/S. IDS SOFTWARE SOLUTIONS (INDIA) PRIVATE LIMITED (ITAT BANGALORE)

- This decision of the ITAT Bangalore has considered the issues similarly to the issues as considered by the Authority for Advance Ruling in the case of Cholamandalam MS General Insurance Company Limited. The facts before ITAT Bangalore were similar in as much as the Indian

Company had entered into a Secondment Agreement and with its parent company at USA. In pursuance to the said agreement, US Company seconded a Senior Vice President to Indian Company to perform and carry out duties and responsibilities as that of Managing Director of the Indian Company. The ITAT Bangalore has considered the terms of the Seconded Agreement in great details as well as referred to the relevant provisions of the Act and Tax Treaty signed between India and USA. The ITAT Bangalore also referred to various judicial precedents and held that the seconded employee was employee of the Indian Company for the Secondment period and amount payable to the US Company by way of reimbursement shall not be subject to TDS. The ITAT Bangalore also observed that requisite amount of income tax which was due on the salary and other entitlements of the seconded employee in India were deducted and paid with the Revenue Authorities in India. The ITAT Bangalore held that the payment to US Company did not represent 'fees for technical services'. The ITAT Bangalore concluded that the assessee was not liable to deduct tax while remitting the amount representing the amount of reimbursement of the salary paid by US Company to the seconded employee.

5. NICHOLAS APPLEGATE SOUTH EAST ASIA FUND LTD (ITAT MUMBAI)

- This decision of the ITAT Mumbai has dealt with an issue of a Fund resident of Mauritius that was by and large on the principle of 'substance over form'. In this matter, the assessee (Fund resident of Mauritius) was a protected cell company (PCC) and there were 4 cells during the relevant assessment year. Separate returns for each cell were filed by the assessee with the Revenue Authorities within the prescribed due date of filing of return. The assessee thereafter realised that a consolidated return for the assessee should have been filed and not separate returns for each cell. The consolidated return was filed beyond the time prescribed under section 139 (1). The Assessing Officer therefore disallowed the claim of carry forward of unabsorbed losses. When the matter reached before the Tribunal, the Hon'ble Members had differing views on the matter and hence the matter was referred to Third Member. After detailed analysis of the relevant provisions of the Act, the Tribunal reversed the order of the Assessing officer and held that the assessee was eligible to carry forward its unabsorbed losses.

6. KRUPP UHDE GMBH (ITAT MUMBAI)

- This decision of the ITAT Mumbai has dealt with an issue of a company registered and incorporated at Germany. The assessee was engaged in providing technical know-how / licence, basic engineering services and

supervisory activities in connection with construction or installation of specified machineries / assembly provisions. Several projects were undertaken by the assessee in India where such services were provided to Indian company. The assessee had offered tax on such income @ 10% as per Article 12 and Article 11 of the Tax Treaty between India and Germany. One of the important issues that was raised before the Tribunal was with regard to the method and manner of computing the number of days for the purposes of determination of the existence of PE of the assessee in India on account of executing multiple projects in India. The Tribunal ruled that in the absence of any geographical or commercial coherence, there was no requirement under the Tax Treaty to aggregate the number of days for which supervisory services were rendered by one entity under different projects. It was further held by the Tribunal that the period of stay in respect of other sites could not be taken into consideration while determining the existence of a PE in India. There were some other connected issues that were also examined by the Tribunal and the decision establishes several important principles on the matter of determination of existence of PE in India.

7. MITSUI & CO LTD (ITAT DELHI)

- This decision of the ITAT Mumbai has dealt with the issue of taxability of liaision office of a foreign company. As held by the Tribunal in earlier years in the assessee's own case, it was held by the Tribunal that having regard to the activities of the liaision office in India, there was no PE in India and consequently, there could be no question of attribution of any profit in favour of the liaision office. It is heartening to observe that it has been now held by various appellate authorities that there could be no question of attributing any profit to the liaision office of a foreign company in India, especially on account of the nature of activities performed by it in India having regard to the framework of the regulations promulgated under Foreign Exchange Management Act.

INDIRECT TAX

SERVICE TAX

General

Cut in the Service Tax Rate

Vide notification dated 24 February 2009, the Government has reduced the service tax rates from 12 percent to 10 percent in order to give relief to the industry facing the impact of slowdown and recession. The effective service tax rate with education cess shall be 10.30 percent. The new rate has become effective with effect from 24 February 2009.

EXCISE

General

Cut in the Excise Duty Rate

Vide notification dated 24 February 2009, the Government has reduced the Excise Duty rates from 10 percent to 8 percent in order to give relief to the industry facing the impact of slowdown and recession. The effective Excise Duty with education cess shall be 8.24 percent. This new rate became effective from 24 February 2009.

REGULATIONS GOVERNING INVESTMENTS

FOREIGN EXCHANGE MANAGEMENT ACT (FEMA)

Guidelines for calculation of total foreign direct and indirect investment in Indian Companies

Recently the Government of India has issued a Guideline for calculating total foreign direct and indirect investment in an Indian Company. Investment in Indian companies can be made both by non-resident as well as resident Indian entities. Any non-resident investment in an Indian company is direct foreign investment. Investment by resident Indian entities could again comprise of both resident and non-resident investment. Thus, such an Indian company would have indirect foreign investment if the Indian investing company has foreign investment in it. The indirect investment can be a cascading investment i.e. through multi-layered structure also.

Recognizing the need to bring in clarity, uniformity, consistency and homogeneity into the exact methodology of calculation across sectors/activities for all direct and indirect foreign investment in Indian companies, Government of India has issued the guidelines for calculation of direct and indirect foreign investment.

To illustrate, if the indirect foreign investment is being calculated for Company A which has investment through an investing Company B having foreign investment, the following would be the method of calculation:

(i) where Company B has foreign investment less than 50% Company A would not be taken as having any indirect foreign investment through Company B.

(ii) where Company B has foreign investment of say 75% and:

a. invests 26% in Company A, the entire 26% investment by Company B would be treated as indirect foreign investment in Company A;

b. Invests 80% in Company A, the indirect foreign investment in Company A would be taken as 80%

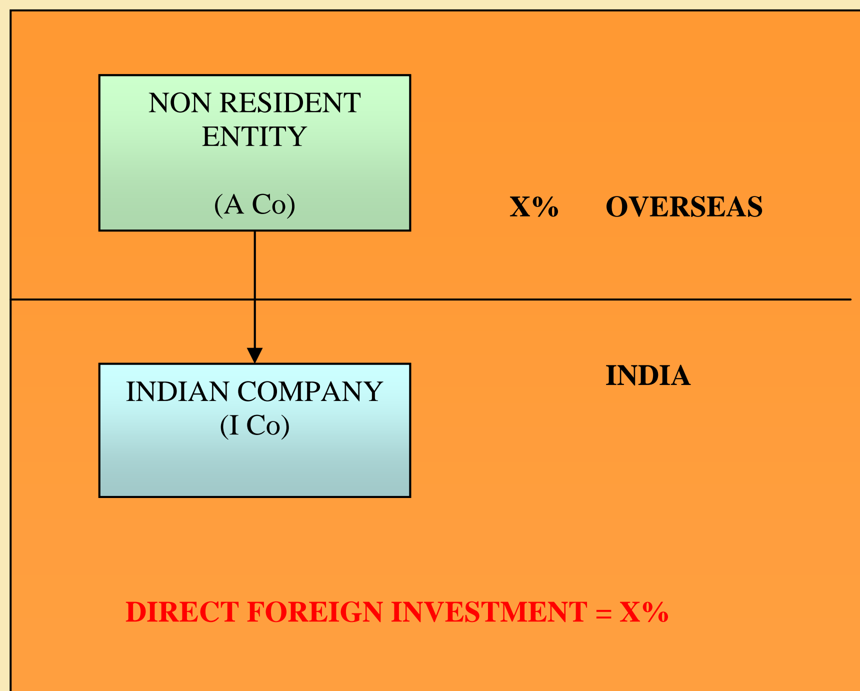
c. where Company A is a wholly owned subsidiary of Company B (i.e. Company B owns 100% shares of Company A), then only 75% would be treated as indirect foreign equity and the balance 25% would be treated as resident held equity. The indirect

foreign equity in Company A would be computed in the ratio of 75: 25 in the total investment of Company B in Company A.

The total foreign investment would be the sum total of direct and indirect foreign investment. The above methodology of calculation would apply at every stage of investment in Indian Companies and thus to each and every Indian Company. Several conditions are also prescribed to ensure adequate compliance of the Regulation by the parties.

The Press Note, amongst other announcements / clarifi cations, also prescribes a detailed policy for downstream investment by investing companies.
This has been explained with the Diagrams shown below:

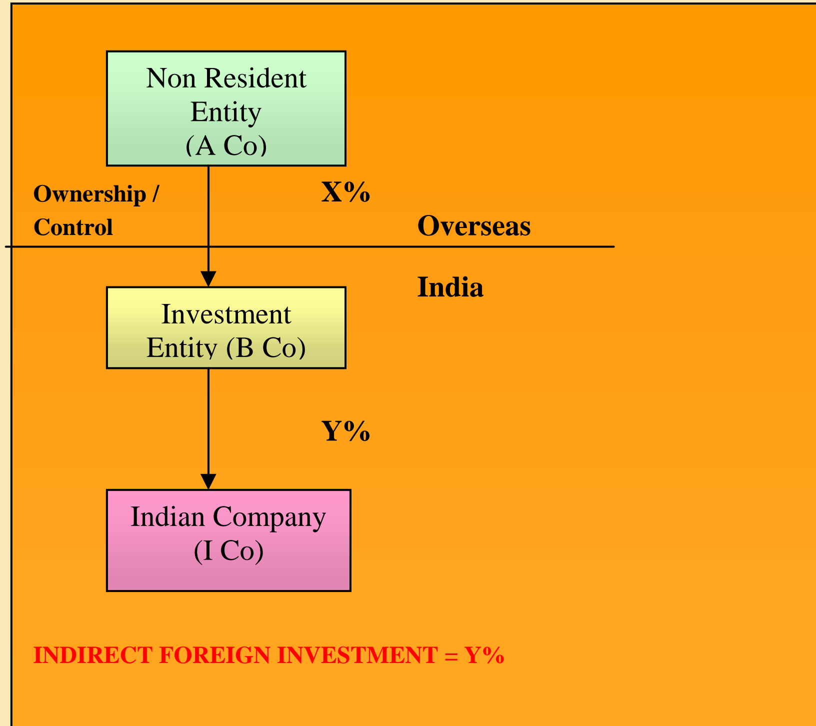
DIRECT FOREIGN INVESTMENT



Only Investment directly made by a non-resident entity (A Co) into an Indian company (I Co) would be characterized as direct foreign investment in I Co

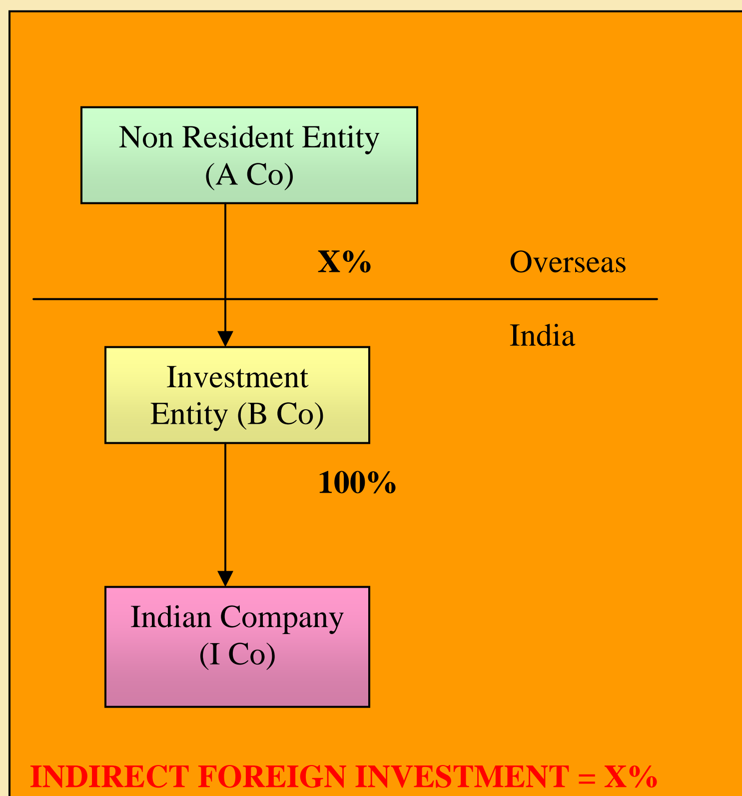
INDIRECT FOREIGN INVESTMENT

Scenario 1



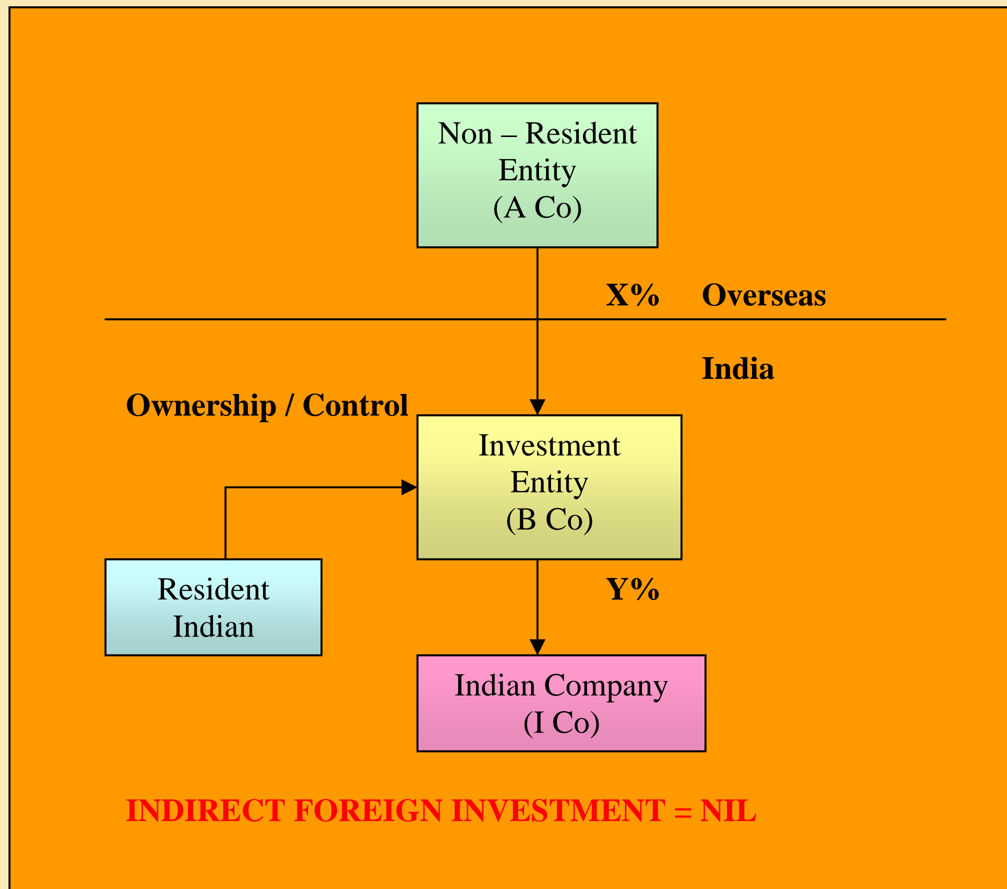
- Investment made by a non-resident entity (A Co) into an Indian Investment company (B Co) which is also owned / controlled by A Co.
- In this scenario investment made by B co into another Indian company (I Co) would be characterized as indirect direct foreign investment in I Co.

Scenario 2 (exception to Scenario 1)



- Investment made by a non-resident entity (A Co) into an Indian investment company (B Co)
- B Co makes a downstream investment in a Wholly Owned Subsidiary (I Co).
- The foreign investment would be limited to the investment made by A Co into B Co.
- In this scenario, the investment made by B Co in I Co would be disregarded for computation of indirect foreign investment.

Scenario 3



- Investment made by a non-resident entity (A Co) into an Indian investment company (B Co) which is owned / controlled resident Indians.

- In this scenario, investment made by B Co into another Indian company (I Co) would not be characterized as indirect direct foreign investment in I Co.

Guidelines for transfer of ownership or control of Indian Companies in sectors with caps from resident Indian citizens to non-resident entities

Recently the Government of India has issued a Press Note issuing guideline for transfer of ownership or control of Indian companies in sectors with caps from resident Indian citizens to non-resident entities. At present, the transfer of shares from residents to non-residents, including acquisition of shares in an existing company, is on the automatic route, subject to the sectoral policy on FDI. Concerns have been raised on recent acquisitions of certain Indian companies by non-resident entities in sectors with caps.

Vide the Press Note, it has been clarified that prior approval of Foreign Investment Promotion Board (FIPB) / Government of India would not be required in all cases of transfer of ownership or control of Indian Companies which are operating in Sectors where FDI upto 100 per cent is allowed under automatic route. As regard to certain specifi ed sectors, prior approval of the FIPB would be required under specifi ed circumstances.

SECURITY EXCHANGE BOARD OF INDIA (SEBI)

Companies not filing full disclosures with stock exchange and SEBI will face fine

Companies delaying or not filing full disclosures with stock exchanges and with market regulator, the Security Exchange Board of India (SEBI), as mandated, will have to face a penalty of up to Rs 1 crore.

Under certain categories, companies which acquire shares beyond a certain percentage, as stipulated under the regulations, are required to make disclosures under the SEBI Act. Offenders are liable for a maximum penalty of up to of Rs 1 crore for not filing disclosures.

Quarterly disclosure of pledged shares

SEBI has asked all the listed companies to make disclosure of pledged shares by promoters every quarter from the current quarter onwards. Previously, SEBI had also amended regulations that required all listed companies to disclose any pledging of promoter shares within seven days of the event.

The latest change to the rules is aimed at bringing more transparency in the shareholding pattern of promoters and thus protecting the interest of stock market investors.

The companies would have to make such disclosure if the aggregate number of pledged shares by promoters, taken together with shares already pledged during that quarter, exceeds 25,000 or one per cent of total shareholding or voting rights, whichever is lower.

Under the new rules, the promoters would also have to disclose within seven working days from the date of invocation of pledging, the details of such invocation.

SEBI has amended clauses 35 and 41 of the listing agreement to provide for furnishing of the details of shares pledged by the promoter and promoter group entities. The reporting under the revised formats should start from the quarter ending March 31, 2009. The regulator has also asked the bourses to revert on the status of implementation in its next monthly development report.

Security Exchange Board of India (SEBI) hikes custodial fee for companies from April, 2009

SEBI has increased the annual custodial fees payable by companies to depositories; NSDL and CDSL, which maintains the databases for all the securities listed in the domestic equities market, effective from the next fiscal.

The fees payable at various slabs (set according to value of securities) have been increased by at least 50 per cent.

With effect from April 1, the issuers have to pay Rs 8 for a folio (ISIN position) against the Rs 5 paid earlier to the respective depositories, subject to a minimum amount for the nominal value of admitted securities, said a SEBI circular.

A folio represents a lot of shares held by one shareholder; each folio is assigned a specific ISIN number.

FEE SLABS

In terms of nominal value of admitted securities, an issuer will now have to pay Rs 50,000 as against Rs 30,000 paid earlier for nominal securities of more than Rs 20 crore in value.

Corporates having issued securities of nominal value above Rs 10 crore and up to Rs 20 crore will now pay Rs 30,000 instead of Rs 20,000.

For securities of nominal value above Rs 5 crore and up to Rs 10 crore, the fees will now be Rs 15,000 as against Rs 10,000; and for securities of up to Rs 5 crore, the fee will be Rs 6,000 as against Rs 4,000.

OTHER REGULATIONS AND ANNOUNCEMENTS

Commerce ministry mulls 3-yr extension of Export Oriented Unit (EoU) tax breaks

The commerce ministry has proposed a three-year extension of tax benefits given to Export-oriented Units (EoUs) in an attempt to encourage export industries at a time when global demand is expected to slump further.

The move will benefit more than 2,700 companies operating within the EoUs. Under Section 10(B) of the Income Tax Act, EoUs do not pay tax on profits provided it fulfill some conditions, including exporting not less than 50 per cent of its total production. This benefit is to expire at the end of next fiscal 2009-10.

Exports by these EoUs stood at Rs 154,428 crore in 2007-08, about 24.7 per cent of the total exports (in rupee terms). Chemical and pharmaceutical units account for about 18 per cent of the exports from the EoUs, followed by engineering companies at about 10 per cent.

The EoU scheme, introduced in December, 1980, allows manufacturing units in the zones to enjoy 100 per cent income tax exemption on profits from overseas sale and also exemption from payment of import duty to import raw materials.

EoUs differ from Special Economic Zones (SEZs) in terms of the level and time-period of tax breaks to which they are entitled. SEZs get income-tax breaks for 15 years. SEZs are also exempt from sales tax and excise, among other local imposts. SEZs are governed by the SEZ Act of 2005.

EoUs are governed by the Foreign Trade Policy, which is supervised by the Commerce Ministry. Existing factories can be converted to EoUs, but not into SEZs.

Easier risk norms for Asset Finance Companies on cards

The Government may push the Reserve Bank of India to ease prudential norms for Asset Finance Companies (AFCs) to help them lend more to finance the

purchases of commercial vehicles, and construction and material handling equipments.

The Finance Ministry has recommended to the RBI to reduce risk weights for assets financed by these non-banking finance companies by 50% and the central bank is expected to take a decision in a few weeks. The move will reduce capital adequacy need for lenders, allowing them to lend a larger portion of their funds.

Currently, assets financed by NBFCs carry a uniform risk weight of 100%, regardless of whether the credit is secured or not. Each bank or NBFC has to make a provisioning according to the risk involved in the credit they extend. A 100% risk means the institution will have to make a provisioning of the mandated proportion of loan, called the capital adequacy ratio, in its books.

ACCOUNTS & AUDIT

Revised Standards on Auditing (SA) 230 (Revised) "Audit Documentation" and (SA) 560 (Revised) "Subsequent Events"

Recently, the Institute of Chartered Accountants of India (ICAI) has come out with revised Standards on Auditing (SA) 230 (Revised) "Audit Documentation" and (SA) 560 (Revised) "Subsequent Events"

Revised Standard on Auditing (SA) 230 (Revised) "Audit Documentation"

This Standard on Auditing (SA) deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. It is to be adapted as necessary in the circumstances when applied to audits of other historical financial information. The specific documentation requirements of other SAs do not limit the application of this SA. Laws or regulations may establish additional documentation requirements.

Audit documentation that meets the requirements of this SA and the specific documentation requirements of other relevant SAs provides:

a) Evidence of the auditor's basis for a conclusion about the achievement of the Overall objective of the auditor; and

b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Audit documentation serves a number of additional purposes, including the following:

- Assisting the engagement team to plan and perform the audit.
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with Proposed SA 220 (Revised).
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.

- Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.

- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Revised Standard on Auditing (SA) 560 (Revised) "Subsequent Events"

This Standard on Auditing (SA) deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements.

Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks2 specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:

1) Those that provide evidence of conditions that existed at the date of the financial statements; and
2) Those that provide evidence of conditions that arose after the date of the financial statements.

Effective Date

These SAs are effective for audits of financial statements for periods beginning on or after April 1, 2009.

Standards on Internal Audit (SIA) 9 "Communication with Management" and (SIA) 11 "Consideration of fraud in an internal audit"

Recently the Institute of Chartered Accountants of India (ICAI) has come out with Standards on Internal Audit (SIA) 9, Communication with Management and

Standards on Internal Audit (SIA) 9 "Communication with Management"

This Standard on Internal Audit provides a framework for the internal auditor's communication with management and identifies some specific matters to be communicated with the management as described in the terms of the engagement.

The internal auditor while performing audit should:

a) Communicate clearly the responsibilities of the internal auditor, and an overview of the planned scope and timing of the audit with the management;

b) Obtain information relevant to the internal audit from the management;

c) Provide timely observations arising from the internal audit that are significant and relevant to their responsibility as described in the scope of the engagement to the management; and

d) Promote effective two way communication between the internal auditor and the management.

Standards on Internal Audit (SIA) 11 "Consideration of fraud in an internal audit"

This Standard shall become mandatory from such date as may be notified by the Council in this regard.

Fraud is defined as an intentional act by one or more individuals among management, those charged with governance, or third parties, involving the use of deception to obtain unjust or illegal advantage. A fraud could take form of misstatement of an information (financial or otherwise) or misappropriation of the assets of the entity.

The primary responsibility for prevention and detection of frauds rests with management and those charged with governance. They achieve this by designing, establishing and ensuring continuous operation of an effective system of internal controls.

The internal auditor should exercise due professional care, competence and diligence expected of him while carrying out the internal audit. Due professional care signifies that the internal auditor exercises due professional care in carrying out the work entrusted to him in terms of deciding on aspects such as the extent of work required to achieve the objectives of the engagement, relative complexity and materiality of the matters subjected to internal audit, assessment of risk management, control and governance processes and cost benefit analysis. Due professional care, however, neither implies nor guarantees infallibility, nor does it require the internal auditor to travel beyond the scope of his engagement.

Companies may have to reveal details of auditors to their banks

The Government and the Reserve Bank of India (RBI) are planning to ask companies to disclose the name and the email address of their statutory auditors on a yearly basis to the banks where they hold accounts. The banks, in turn, would be asked to generate and directly send automated status reports of these accounts to the auditors at the end of every quarter or financial year.

This is a simple solution under consideration to remove the most glaring systemic weakness at the heart of India's biggest corporate scandal — the failure of statutory auditors to independently verify the inflated bank balance of Satyam Computer Services. The proposal is being considered by PMO and RBI. If approved, the measure, which would not cost an extra rupee, would prevent auditors from failing in independently verifying the bank balances of their clients. Many auditors confirmed that it is impossible to independently verify all the bank statements and other invoices that companies provide to auditors while completing the audit of large corporations within a fortnight. Auditors approach their work with an unbiased mind, unlike that of a detective, who presumes that a fraud has already taken place. They independently verify only a sample of the thousands of documents as a full-fledged investigation by them is not feasible.

New Companies Bill likely to see stronger auditing regulations

In the wake of the Satyam's accounting fraud, the ministry of corporate affairs has woken up to the need of stronger auditing standards and feels that the new Companies Bill would provide a stronger regulatory platform since the Centre would notify the same as part of the bill. Currently, there is no provision for auditing standards and it is up to the Institute of Chartered Accountants of India (ICAI) to decide on the implementation of both the accounting and auditing standards.

The Joint Secretary, Ministry of Corporate Affairs announced that as per the new Companies Bill, 2008, there is a provision that the auditing standards will be prepared by the Centre. This would be quite relevant considering the fact that the Satyam fraud has raised questions about auditing standards and the role of auditors.

The new Companies Bill, currently before the Parliamentary standing committee on finance, specifically provides for a clause, which states, "The Centre may, after consultation with the National Advisory Committee on Accounting and Auditing Standards, by notification, lay down auditing standards. Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards. The Centre may, after consultation with the advisory committee, by general or special order, direct, in

respect of such class or description of companies, as may be specified in the order, that the auditors' report shall also include a statement on such matters as may be specified therein".

The Public Company Accounting Oversight Board (PCAOB) Offers Guidance on Auditing Small Companies

The Public Company Accounting Oversight Board (PCAOB) has published guidance to help auditors apply Auditing Standard No. 5 to audits of internal controls at smaller public companies.

"Staff Views - An Audit of Internal Control Over Financial Reporting That Is Integrated with an Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies" offers advice on how to scale the audit to the size and complexity of the company. Some of the advice centers around evaluating the effectiveness of the CFO's review process, including examples involving experienced CFOs who conduct reviews of payroll processing and bank reconciliations.

The guidance also notes that upper management needs to be watched carefully at smaller companies.

International Federation of Accountants (IFAC's) Accounting Education Standards Board Proposes New Framework to Enhance Clarity and Relevancy of Standards

The International Accounting Education Standards Board (IAESB), an independent standard-setting board within the International Federation of Accountants (IFAC), has undertaken a new initiative to enhance the relevancy, clarity and consistency of its standards as well as their applicability to IFAC members and associates. It is proposing a revised Framework for International Education Standards, which sets out the concepts that underlie the IAESB's International Education Standards.

The proposed framework consists of two parts:

1. Part One explains the educational concepts of competence, initial professional development, continuing professional development, and measurement of the effectiveness of learning and development, which will be used by the IAESB when developing the IESs; and

2. Part Two describes the nature of the IESs as well as the related IAESB pronouncements and IFAC member body obligations.

The framework is targeted primarily to IFAC member bodies that have direct or indirect responsibility for the learning and development of their members and students. It is, however, also relevant to a wide range of stakeholders, including accounting faculties at universities, employers of professional accountants, professional accountants, prospective professional accountants, and others interested in the work of the IAESB.

How to Comment:

Comments on the exposure draft (ED) of the proposed revised framework are requested by April 30, 2009. The ED can be viewed by going to http://www.ifac.org/EDs.

Comments may be submitted by email to edcomments@ifac.org. They can also be faxed to the attention of the IAESB Technical Manager at +1 (212) 286-9570 or mailed to IFAC, 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. All comments will be considered a matter of public record and will ultimately be posted on IFAC's website.

New IFAC Guidance on Corporate Governance Addresses Risks and Organizational Accountability

As part of its ongoing commitment to support professional accountants in business and their organizations in enhancing governance and in improving organizational performance, the Professional Accountants in Business (PAIB) Committee of the International Federation of Accountants (IFAC) has released a new International Good Practice Guidance document entitled Evaluating and Improving Governance in Organizations. The new guidance to professional accountants in business includes a framework, a series of fundamental principles, supporting guidance, and references on how they can contribute to evaluating and improving governance in organizations.

This International Good Practice Guidance brings together globally recognized and applicable good practice principles on effective governance into an international benchmark for the accountancy profession and it will help PAIBs and their organizations to further improve their governance structures and processes - something critical to ensuring an organizations viability and accountability.

This guidance is designed to complement existing governance codes, such as the OECD Principles of Corporate Governance (2004), issued by the Organization for Economic Co-operation and Development (OECD), by encouraging organizations to achieve a balance between conformance with rules and regulations and driving organizational performance. It also focuses on how

to create sustainable stakeholder value in the form of good products or services, economic profitability, job security, safety, or other social or economical responsibilities.

A separate document, Preface to IFAC's International Good Practice Guidance, sets out the scope, purpose, and due process of the committee's International Good Practice Guidance series to which this guidance paper on governance belongs.

Both Evaluating and Improving Governance in Organizations and the Preface to IFAC's International Good Practice Guidance can be downloaded free-of-charge from the PAIB section of the IFAC online bookstore at http://www.ifac.org/store. The PAIB Committee welcomes all feedback, which can be emailed to paib@ifac.org.

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