

Tax & Corporate News Bulletin

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VAISH ASSOCIATES ADVOCATES
Corporate, Tax and Business Advisory Law Firm

From the Editor's Desk...

Dear Reader,

It took a full blown crisis to realize that a global economy calls for global integration. World leaders are busy finding ways to pull the world back from the brink of financial collapse. Today, the economies are so much interlaced with each other that there would invariably be a cascading effect. In the process, India also seems to be caught in the slowdown spiral.

Amidst the liquidity crunch which appears to be creeping in the Indian financial markets, the Regulators have raised their guards to keep the financial adversities at bay or least, to minimize the impact of global economic meltdown. A flurry of measures have been taken to provide the requisite resilience to the financial system (particularly, the banking system). Some more measures are likely.

Infrastructure sector is being given utmost attention. A recent news report suggests that the Government is mulling over setting up of a special dedicated fund to the tune of INR 500-billion for infrastructure sector. Other significant measures include liberalization of the external commercial borrowing policy, expansion of the infrastructure sector, consideration of SEZs under 'infrastructure' category (except for purchase of land), revision of the all-in-cost ceiling for trade credits, etc.

It remains for the time to decide whether the efforts of the Regulators are apt and adequate to arrest the slowdown of the Indian economy.

Yours truly,



Hitender Mehta
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INCOME TAX

Transfer Pricing

Sony India (P) Ltd. v. DCIT: 114 ITD 448, ITAT (Del.)

The Delhi Bench of the Tribunal in the case of *Sony India (P) Ltd. v. DCIT: 114 ITD 448*, laid down certain important principles in relation to the transfer pricing legislation under the [Indian] Income-tax Act, 1961 ('the Act').



In this case, Sony India (P) Ltd., an Indian company, a wholly owned subsidiary of Sony Corporation, Japan, was engaged in the business of assembly and distribution of colour televisions and audio products. It also distributed high-end electronics goods (DVDs and Handy Cams), recordable media tapes, play stations, and projectors. Spare parts of these goods were imported from its associated enterprises (AEs). Sony India also rendered advisory services and software development services to its AEs.

Sony India had imported electronic components and color television from AEs during the financial year relevant to the assessment year 2002-03. The Transactional Net Margin Method (TNMM) was applied, which was also accepted by the Transfer Pricing Authority, for determining the arm's length price in relation to the aforesaid transactions with the AEs. Sony India was taken as the tested party and the operating profit margin on sale was considered as the profit level indicator for determining the arm's length price applying TNMM. However, disputes arose between the assessee and the Transfer Pricing Officer (TPO) regarding the manner of computation of operation profit and the selection of comparables. The Tribunal held as under:

❖ *Exclusion of reimbursement of advertisement expenses:*

Where the assessee had received monies towards reimbursement of advertisement expenses under an agreement with the AE and the genuineness of the same was not disputed, the TPO was not justified in treating the said funds as a windfall and bounty. The same had to be treated as a part of the normal operating profit of the assessee and could not be ignored in computing the comparable margins.

❖ *Exclusion of other amounts credited in P&L account:*

Other amounts received by way of reimbursement of cost, provision written back, balances written back, interest

received from customers and other miscellaneous revenue receipts also constitute part of the operating profit and could not be ignored in computing the operating profit.

- ❖ Statutory levies paid to the State Government had to be ignored in computing the operating profit of the taxpayer as other comparable enterprises taken into account by the TPO were not subjected to such levy.

❖ *Application of proviso to Section 92C(2)*

The proviso to section 92C (2) consists of two limbs. Under the first limb, where, if applying the Most Appropriate Method, more than one price is determined, the arithmetic mean of such price has to be taken to be the arm's length price in relation to the international transaction. The second limb gives "an option" to the taxpayer to take arm's length price which may vary from the arithmetic mean by an amount not exceeding 5% of such arithmetic mean.

This option provided in the proviso was held by the Tribunal to be applicable even in cases where the taxpayer intends to challenge the Arm's Length Price taken as arithmetic mean and determined through the Most Appropriate Method. The argument of the Department that where the difference is more than 5%, then the taxpayer cannot have the benefit of the said provision, particularly where the taxpayer has not accepted such arithmetic mean, was rejected by the Tribunal. Thus, the benefit of the second limb was held to be available to all tax payers irrespective of the fact that price of international taxation disclosed by them exceeds the margin provided in the provision.

❖ *Selection and rejection of Comparables:*

For the purposes of determining what parties should be considered for purposes of comparison under rule 10B(3), what is to be judged is the impact of the related party transaction vis-à-vis sales and not just profit (since profit of an enterprise is influenced by large number of other factors). The facts and circumstances surrounding the company in question should determine its status as a comparable and not its financial result. The cumulative effect of all factors has to be considered.

It was observed, that an entity can be taken as uncontrolled, for the purpose of being considered as a comparable, if its related party transactions do not exceed 10 to 15% of the total revenue.

The aforesaid decision is expected to help evolution of transfer pricing jurisprudence.

Disallowance of Expenses relating to Exempted Income

ITO v. Daga Capital Management (P) Ltd. [(ITA No. 8057/Mum/03)]

The Special Bench of the Income-tax Appellate Tribunal ('ITAT') in the case of *ITO v. Daga Capital Management (P) Ltd. [(ITA No. 8057/Mum/03)]* held that the provisions of section 14A of the Act apply even in relation to shares held as stock-in-trade.

In the above case, the assessee company was engaged in the business of dealing in shares. It earned certain dividend income which was tax exempt under section 10(33) of the Act. The assessing officer was of the view that deduction in respect of interest paid on borrowed capital for buying equity shares was not allowable in view of the provisions of section 14A of the Act since the dividend income receivable on such shares was exempt from tax under section 10(33) of the Act. The assessee contended that it had acquired the shares for selling it at a profit in future and not for earning dividend. According to the assessee, the dividend income was only incidental to such acquisition of shares. Consequently, no disallowance could be made under section 14A of the Act.

The Special Bench, by a majority view (2:1), observed that the intention of the legislature is clearly to disallow all expenditure incurred in relation to income not forming part of total income and, therefore, expenditure in relation to exempted income from shares, even if the same are held as stock-in-trade, has to be disallowed. The Special Bench did not accept the proposition that if the dominant purpose of acquiring shares is to profit by dealing in them and not earning dividend income (which is only incidental), section 14A would have no application.

The Special Bench further held that scope of sub-sections (2) and (3) of section 14A of the Act which empowers the assessing officer to compute the disallowance under section 14A, was procedural and that the said sub-sections, inserted, w.e.f. April 1, 2007 had retrospective operations.

The method of computing disallowance under section 14A is provided under rule 8D which is notified recently. The said rule would axiomatically apply retrospectively.

The aforesaid decision of the Special Bench has far reaching consequences. It is therefore advised to suo motu compute the

disallowance under section 14A on a reasonable basis lest the assessing authority invokes sub-sections (2) and (3) of that section and computes disallowance as per the formula given in Rule 8D of the Income-tax Rules.

Capital Gains on Sale of Undertaking

PNB Finance Ltd. V. CIT [Civil Appeal No. 3721 of 2002]



In a landmark ruling, the Supreme Court in the case of *PNB Finance Ltd. V. CIT [Civil Appeal No. 3721 of 2002]*, held that where the cost of acquisition of the undertaking cannot be computed, no capital gains tax was leviable.

In this case, the question before the apex Court was whether transfer of banking undertaking in the facts and circumstances of the case gave rise to taxable capital gains under section 45 of the Act. As a sub-part to deciding this question the Court also had to decide whether section 41(2) of the Act, which deals with the sale of depreciable assets applied in this case.

It may however to be noted that the aforesaid ruling would have no application in relation to assessment year 2000-01 and onwards, in view of the insertion of section 50B in the Act, w.e.f. April 1, 2000 containing specific provisions for taxation on slump sale of undertaking.

FEMA/ RBI

External Commercial Borrowing (ECB) Policy Liberalization



RBI has further modified some of the aspects of the ECB Policy which are given below:

- ✧ ECB up to USD 500 million per borrower per financial year would be permitted for rupee expenditure and/ or foreign currency expenditure for

permissible end - uses under the automatic route.

Accordingly, the requirement of minimum average maturity period of seven years for ECB more than USD 100 million for rupee capital expenditure by the borrowers in the infrastructure sector has been dispensed with.

- ✧ In order to further develop the telecom sector in the country, payment for obtaining license/ permit for 3G Spectrum will be considered an eligible end use for the purpose of ECB.
- ✧ At present, ECB proceeds are required to be parked overseas until actual requirement in India and such proceeds can be invested in the following liquid assets (a) deposits or certificate of deposit offered by banks rated not less than AA (-) by Standard and Poor/ Fitch IBCA or Aa3 by Moody's; (b) deposits with overseas branch of an AD bank in India; and (c) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above. It has now been decided that henceforth the borrowers will be extended the flexibility to either keep these funds off-shore as above or keep it with the overseas branches/ subsidiaries of Indian banks abroad or to remit these funds to India for credit to their Rupee accounts with AD Category I banks in India, pending utilization for permissible end-uses. However, the rupee funds will not be permitted to be used for investment in capital markets, real estate or for inter-corporate lending.
- ✧ In view of the tight liquidity conditions in the international financial markets, it has been decided to rationalize and enhance the all-in-cost ceilings as under:

Average Maturity Period	All-in-Cost ceilings over 6 months LIBOR*	
	Existing	Revised
Three years and up to five years	200 bps	300 bps
More than five years and up to seven years	350 bps	500 bps
More than seven years	450 bps	

* for the respective currency of borrowing or applicable benchmark.

- ✧ Keeping in view the risks associated with unhedged foreign exchange exposures of SMEs, a system of monitoring such unhedged exposures by the banks on a regular basis is being put in place.

The amendments to the ECB guidelines will come into force with immediate effect. All other aspects of ECB policy such as USD 500 million limit per company per financial year under the

automatic route, eligible borrower, recognized lender, end-use, average maturity period, prepayment, refinancing of existing ECB and reporting arrangements remain unchanged.

[Source: RBI/2008-09/ 245 A.P. (DIR Series) Circular No. 26 dated October 22, 2008]

ECB Policy- Expansion of infrastructure sector



ECB Policy has been liberalized by the RBI by making amendments in the definition of infrastructure sector in the existing Policy w.e.f. October 8, 2008.

As per the extant ECB Policy, Infrastructure sector is defined as

- (i) power; (ii) telecommunication;
- (iii) railways; (iv) road including bridges; (v) sea port and airport;
- (vi) industrial parks; and (vii) urban infrastructure (water supply, sanitation and sewage projects).

On a review of the ECB Policy and to promote the development of the mining, exploration and refinery sectors in the country, it has been decided to expand the definition of Infrastructure sector for the purpose of availing of ECB by adding (i) mining, exploration and mining, in the definition.

[Source: RBI/2008-09/210 A.P. (DIR Series) Circular No. 20 dated October 08, 2008]

Review of all-in-cost ceiling- Trade Credits for Imports into India

RBI has w.e.f. October 27, 2008 revised the all-in-cost ceiling for Trade Credits as under:

Maturity Period	All-in-Cost ceilings over 6 months LIBOR*	
	Existing	Revised
Up to One year	75 bps	200 bps
More than one year and up to three years	125 bps	

* for the respective currency of credit or applicable benchmark

[Source: RBI/2008-09/ 251 A. P. (DIR Series) Circular No. 27 dated October 27, 2008]

Allocation of FII Investment between debt and equity

RBI has decided to dispense with the restriction on allocation of FII investment between equity and debt in the ratio of 70:30. Earlier, FIIs were allowed to purchase shares, fully convertible debentures, warrants, commercial papers etc. subject to various conditions, including restriction on the allocation in equity and debt in the ratio of 70:30 only.



Necessary amendments have been made to the Para I Schedule 5 of *Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations 2000*. This will provide greater flexibility to FIIs to allocate their investments across equity and debt.

Earlier, SEBI has in consultation with Government of India also issued a Circular No. IMD/FII & C/33/2007 dated October 16, 2008 dispensing with the condition provided in 15(2) of Securities and Exchange Board of India (Foreign Institutional Investor) Regulation, 1995 pertaining to restrictions of 70:30 ratio of investment in equity and debt, respectively.

[Source: RBI/2008-09/240 A. P. (DIR Series) Circular No. 25 dated October 17, 2008]

SPECIAL ECONOMIC ZONES

Important issues relating to SEZs

The Empowered Group of Ministers (EGOM) in its meetings held on October 24, 2008 and October 30, 2008 took certain important decisions, followed by notifications, if any, by the concerned Departments:

i) Removal of export duty on supply of steel product to SEZs

Ministry of Finance has issued Customs Notification No. 115 dated October 31, 2008 whereby export duty on steel, which was imposed by Notification no. 66/2008-Customs dated May 10, 2008, has been removed on all items except Ferrous waste and scrap, re-melting scrap ingots of iron or steel.

ii) Availability of Cenvat credit to domestic manufacturers on inputs used in finished goods supplied to a Developer in SEZ.

EGOM has agreed that Cenvat credit rules would be amended and the facility of Cenvat credit would be extended to the domestic manufacturer even for supply of goods to SEZ developers.

iii) Classifying SEZs as an infrastructure project

EGOM has agreed that a recommendation would be made to RBI for treating SEZs, excepting for purchase of land, as infrastructure instead of treating SEZs as Real Estate.

[Source: EPCES Circular No. 37 dated November 3, 2008]

Online filing facility for SEZ proposals



The Ministry of Commerce and Industry, Department of Commerce has introduced online filing of SEZ proposals. A software has been developed for filing and processing of applications for setting up of SEZs, computerizing Board of Approval ('BoA') processes and creation of

databases for SEZs. There are no charges for using the software. This is a trial run of the software. Any feedback relating to the software may be given to the nodal officer at sectionofficersez@gmail.com.

It is proposed to make the following services available through the online facility:

- Filing of application (Form A) for setting up SEZ.
- Filing of other requests viz. Application for authorized operations, addition of co-developer, application for conversion of in-principle approval to formal approval, application for validity extension of approvals, change in developing entity, change in sector, change in area/ location, land details.
- Inbuilt e-mail box for each developer/ co-developer to enable it to communicate with the Department.
- Online status of requests.

To be able to avail the online facility, the developer/ co-developer would have to register and obtain a login Id and password and thereupon the developer/ co-developer can communicate and track the applications using the login Id. Details available at <http://www.sezindia.nic.in/>

[Source: Cir. F. No. D.12/13/2008- SEZ dt. October 21, 2008]

SEBI/ CORPORATE LAWS

Corporate Governance in Listed Companies Clause 49 of the Listing Agreement

As per Circular dated April 8, 2008, SEBI amended Clause 49 of the Listing Agreement to the effect that if the non-executive Chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, then at least one-half of the board of the company should consist of independent directors.

In order to bring clarity, the term 'related to any promoter' shall mean (a) if the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees and (b) if the promoter is an unlisted entity, then its directors, its employees or its nominees, shall be deemed to be related to it.

The existing listed entities which are required to comply with clause 49 are required to implement the same before March 31, 2009 and for entities seeking listing for the first time, it shall be applicable at the time of seeking in-principle approval for such listing.

[Source: Circular SEBI/CFD/DIL/CG/2/2008/23/10 dated October 23, 2008]

Consolidation of holdings under Takeover Regulations

With a view to boost market sentiments and promote consolidation of promoter shareholding, SEBI has decided to allow consolidation through



creeping acquisition upto 5% to persons holding 55% and above but below 75% in listed entities, provided that such acquisition can only be via open market purchases in the normal segment, and no consolidation via bulk/ block/ negotiated deal or through preferential allotment would be permitted. Further, it has been decided to automatically exempt the increase in the holding of promoters/ consolidation upto 5% per annum as a result of buy back by a company, for which it was earlier mandatory to seek exemption under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. However, one would require waiting for necessary amendments to SEBI Regulations.

[Source: Press Release No. PR No. 239/2008 dated October 27, 2008]

FII investments in Debt Securities

Under the ECB policy, the cumulative debt investment limit has been increased from US \$3 billion to US \$6 billion for FII investments in Corporate Debt. Accordingly, the enhanced limit for investment in corporate debt shall be allocated among the FIIs on a 'first come first served' basis in terms of the Circular dated January 31, 2008, subject to a ceiling of US \$300 million per registered entity. Further, in order to afford more flexibility to the FIIs for allocating investments across equity and debt, it has been decided to do away with the conditions provided in regulation 15(2) of SEBI FII regulations pertaining to restrictions of 70:30 ratio of investment in equity and debt respectively, with immediate effect.

[Source: Cir. IMD/FII & C/ 33 /2007 dated October 16, 2008]

Internal Audit of Stock Brokers/ trading members/ clearing members

It has now been decided by SEBI that stock brokers/ trading members/ clearing members shall carry out complete internal audit on a half yearly basis by chartered accountants, company secretaries or cost and management accountants who are in practice and who do not have any conflict of interest.

[Source: Circular No. MRD/DMS/Cir-29/2008 dated October 21, 2008]

Foreign investments in infrastructure companies in securities markets

In terms of Circular No. MRD/DSA/SE/Dep/Cust/Cir-23/06 dated December 22, 2006, foreign investments in the infrastructure companies in securities markets were allowed and investments by FIIs were allowed only through purchases in the secondary market. It has now been clarified that the term 'secondary market' shall mean "In respect of exchanges that are not listed, purchase of shares of such exchanges by a FII can be through transactions outside of the exchange provided it is not an initial allotment. However, if the exchange is listed, transactions by FIIs should be done through the exchange".

[Source: Circular MRD/DSA/SE/Dep/Cust/CIR-30/08 dated October 23, 2008]

LABOUR LAWS

Expatriates working in India obliged to contribute to [Indian] Social Security Schemes [Provident Funds & Pension Schemes]

Effective from November 1, 2008, the Government of India [Ministry of Labour and Employment] has extended the applicability of the EPF Scheme and the EPS Scheme to the International Workers through Notification of the *New Schemes for International Workers*.

- ✧ Expatriates working in India will now be covered under the *New Schemes for International Workers* irrespective of whether their basic pay in India is more than Rs. 6500 per month. However, in case of expatriates are from such countries with which India has entered into Social Security Agreement and they are making contributions towards social security in their home countries, such expatriates would be excluded from the purview of the *New Schemes for International Workers*.
- ✧ Expatriates working in India will now be required to contribute 12 per cent of their salary which includes basic pay, dearness allowance, retaining allowance and cash value of food concessions under the Provident Fund Schemes.

[Source : Notification No. G.S.R. 705(E) dt. October 1, 2008]

IMPORTANT DATES WITH REGULATOR (S)

COMPLIANCE CHECKLIST

December, 2008 - January, 2009

Sr. No	PARTICULARS	Sections/ Rules Clauses, etc	Acts/Regulations, etc.	Compliance Due Date	To whom to be submitted
A. INCOME TAX					
1	TDS from Salaries for the previous month	Section 192	Income-tax Act, 1961	December 7/ January 7	Income-tax Authorities
2	TDS on Contractor's Bill/ Advertising/ Professional service Bills TDS collected in the previous month	Section 194-C Section 194-J	Income-tax Act, 1961	December 7/ January 7	Income-tax Authorities
3	TDS on Rent	Section 194-I	Income-tax Act, 1961	December 7/ January 7	Income-tax Authorities
4	Advance tax (up to 75% of advance tax payable in case of companies)	Section 208	Income-tax Act, 1961	December 15	Income-tax Authorities
B. CENTRAL EXCISE & SERVICE TAX					
5	Pay Service Tax in Form TR-6 collected during the previous month (for companies)	Rule 6	Service Tax Rules, 1994	December 5/ December 6 (e-payment) January 5 / January 6 (e-payment)	Service Tax Authorities
6	Submission of CENVAT Return	Rule 9(7)	CENVAT Credit Rules, 2004	December 10/ January 10	Excise Authorities
7	Pay monthly Central Excise duty on goods by assessee other than SSI Units	Rule 8	Central Excise Rules, 2002	December 5/ December 6 (e-payment) January 5 / January 6 (e-payment)	Excise Authorities
C. LABOUR LAWS					
8	Monthly payment of Provident Fund dues	Paragraph 38	The Employees' Provident Funds Scheme, 1952	December 15/ January 15	PF Authorities
9	Monthly return of Provident Fund for the previous month w.r.t. international workers	Paragraph 36	The Employees' Provident Funds Scheme, 1952	December 15/ January 15	PF Authorities
10	Monthly return of Provident Fund for the previous month	Paragraph 38	The Employees' Provident Funds Scheme, 1952	December 25/ January 25	PF Authorities
11	Remittance of ESI contribution for the previous month (Form S-III cash challans & S-IV cheque challans)	Regulation 31	Employees' State Insurance (Gen) Regulations, 1950	December 21	ESIC Authorities

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PHDCCI “International Tax Conference: Recent Developments”

Ajay Vohra Chaired the Technical Session(s) and *Rupesh Jain* was a Panel Speaker (On the topic: Taxation of Payments for Software) at the PHDCCI International Tax Conference held on October 17-18,

2008 at New Delhi. In addition, the following articles were contributed from the chamber for the Conference backgrounder:

- (i) Article titled **“Special Economic Zones - Income-tax Issues”** authored by **Hitender Mehta**.
- (ii) Article titled **“Arm's Length Price Determination with reference to Far Analysis”** authored by **Neeraj Jain**.
- (iii) Article titled **“Issues to be considered for characterization of Income as Fees for Technical Services”** authored by **Sachit Jolly**.

ICSI-NIRC & ASSOCHAM Joint Seminar on “Resolving Tax Complexities through Practical Cases: Service Tax/ WCT/VAT”

Article titled **“Special Economic Zones Service Tax(ing!) Issues”** co-authored by **Hitender Mehta & Deepti Rustagi** was published in the ICSI-NIRC & ASSOCHAM joint seminar held on October 18, 2008 at New Delhi.



Disclaimer:

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