R. N. Marwah & Company
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INSIDE THIS ISSUE

Dear Readers,

We have all by now got back to work in full earnest in 2008 and have taken the challenge of making this year a bigger success than the last. The biggest IPO of India has been a resounding success but the impact of the sub-prime crisis in the US is being felt by our markets back home.

We are pleased to inform our readers that RNM was in the news recently and an interview of Mr. Raghu Marwah, Partner on REIT's was featured in the Economic Times issue dated January 13, 2008. We are also in the process of updating the Company website and should have some interesting additions therein before our next issue.

The season of big discussions and changes is upon us with the Budget about 40 days away. We as part of CII and other Chambers of Commerce look forward to your Budget expectations and views to enable us to present the same before the 'Powers that Be' in the increasingly consultative approach to Budget formation.

We are also extremely pleased by your response to our first issue of the **RNM ALERT** and look forward to your continued support and feedback to improve constantly.

We wish all our readers a Happy Republic Day.

U.N. Marwah
Senior Partner
On behalf of the **RNM Alert** Editorial Team.

Denial Of CENVAT Credit On Renting Of Immovable Property

While the dismayed landlords of commercial rented premises have been eagerly waiting for the verdict of the various courts of law regarding validity of imposition of service tax on renting of immovable property, in an act to rub salt to their wounds, the Tax Research Unit of Department of Revenue issued a Circular No.98/1/2008-ST on 4th January, 2008 for clarifying whether commercial or industrial construction service or works contract service used for construction of an immovable property could be treated as input service for the output service namely renting of immovable property service under the CENVAT Credit Rules, 2004.

Clarification regarding this issue was given as follow:
"Right to use immovable property is leviable to service tax under renting of immovable property service.

Commercial or industrial construction service or works contract service is an input service for the output namely immovable property. Immovable property is neither subjected to central excise duty nor to service tax.
Input credit of service tax can be taken only if the output is a 'service' liable to service tax or a 'goods' liable to excise duty. Since immovable property is neither 'service' or 'goods' as referred to above, input credit cannot be taken."

Through this circular CENVAT Credit in respect of service tax paid to contractors by the landlords for the construction of immovable property developed for putting on lease has been out rightly denied. But this mandate raises some questions to be answered like, whether giving right to use is not providing service? If right to use is not a service then can service tax be imposed on providing right to use? And many more. It is note worthy that ever since the existence of service tax in India, many decisions of the Government in this regard was challenged in the Courts of Law for their constitutional validity. This circular is also likely to meet the same fate.

In the meantime, it is likely to impact the prices of realty which have been spiraling already, since real estate developers who have been increasingly adopting the Lease Model for the various commercial developments shall now factor in the denial of input credit in the lease rent.

Double Tax Avoidance Agreement

ITAT Ruling- **DTAA**-The appellant is a company incorporated in UK supplying aero-engines and spare parts to Indian Customers.

- The appellant's UK incorporated subsidiary was having its offices in India.
- The marketing and sale of goods to Indian customers were carried out by the appellant through the Indian offices of its subsidiary. AO was of the view that these Indian offices constituted appellant's business connection in India u/s 9 of the Act as well as permanent establishment under article 5 of the DTAA between India and UK.
- The AO invoked rule 10 of the Income-tax Rules, 1962 and attributed 100% of the profits arising from sale of goods to Indian customers in India.
- The ITAT observed that
  a) 50% of the profits is attributable towards manufacturing activity which cannot be taxed in India as no such manufacturing activity is carried out in India.
  b) The assessee has also carried out research and development activity outside India which is as important as manufacture. 15% of the total profits could be attributed to such R&D activities.
  c) Balance of the profit can be attributable to the marketing activities which are in India. Though contracts are signed outside India yet the negotiations and other discussions are in India and hence, all other profits can be said to accrue or arise into directly or indirectly through the operations of Permanent Establishment (PE) in India.

  The ITAT directed the AO to adopt 35% of the profit as against 75% of the global profits in respect of sales effected in India as chargeable to tax in India.

The aforesaid judgment has wide implications on the taxability of MNC's operating in India through representative/ liaison offices which are carrying on marketing activities on behalf of the parent company. The fact that negotiations and discussions were held in India through such representative office formed the basis of such office constituting a PE. These factors therefore need careful consideration while structuring any India operation.

Accounting Standards On Financial Instruments

Corporates houses, banks and financial institutions have got just 18 months to begin the changeover to a new set of transparency inducing accounting standards that will have a major impact on their financial statements. The new norms to classify, value and disclose the complex financial instruments they trade in is expected to change the way exposure to many instruments are reported now, besides capturing many unreported exposures.

The Institute of Chartered Accountants of India (ICAI) has introduced two new standards AS 30 and AS 31 —recognition and measurement of financial instruments — from April 1, 2009. "All business entities are recommended to adopt them from April 1, 2009 and it will be mandatory for them to follow these standards from 2011.

The new norms will bring more clarity in the nature of instruments that bear more than one property. Convertible debentures, for example, have the characteristics of both loan and equity. As per international practice, they have to be split into equity and debt components as the equity value of the company reduces the interest rate payable. The standards will cover all financial instruments, including equity, debt, derivatives, convertible debentures and their combinations.

There are some areas in the new standards, AS 30 and AS 31 that are in conflict with the company law and Sebi norms. During the 18 months before the norms are introduced, ICAI will work with the government and Sebi to bridge this gap.

Under the new standards, financial instruments have to be classified under four main categories — financial assets and financial liabilities at fair value through profit and loss; held to maturity investments; loan and receivables; and available-for-sale financial assets.

Apex Court Upholds Accounting Standard 22

The Supreme Court has upheld the revised accounting standards AS 22 'Accounting for Taxes on Income' issued by the Institute of Chartered Accountants of India. Dismissing the appeals of a large number of companies that opposed the new policy, the Court held that AS 22 sought to arrive at the true accounting income.

The main challenge of the companies was the new concept of deferred tax accounting. They argued that it was inconsistent with the provisions of the Companies Act, the Income Tax Act and the Constitution.

Rejecting this contention, the Court said that deferred tax was nothing but accrual of tax due to the divergence between accounting profit and tax profit.

Recent Amendments Pertaining To Company Law:

Amendment to Rule 4A of Companies (Central Government's) General Rules and Forms, 1956:
As per the Amendment effective 19th of November 2007 a system of **resubmission** has been introduced for application of availability of alternative name in case the application for originally proposed name is rejected. The resubmission of application is permitted upto

two times against the fee paid for the original application. After the name is approved, the same is to be adopted by the company within a period of sixty days from the date the name is allowed. If the name so allowed is not adopted within the period of sixty days, the applicant may apply for extension for a further period of thirty days on payment of Rs. 250/-.

Company Master Data and Charge Documents

The facility of correction of Company Master Data and Charge Documents has been made available without any charge. However, this facility, without any charges, would be available only for a limited period of time (up to **31 March 2008**).

Procedure For Refund Of Tax Deducted At Source U/S 195

The circular No. 7/2007 dated 23.10.2007 has been issued laying down the procedure for refund of tax deducted under section 195, in following situations to the person deducting the tax at source from the payment to the non-resident.

a) the contract is cancelled and no remittance is made to the non-resident;

b) the remittance is duly made to the non-resident, but the contract is cancelled. In such cases, the remitted amount has been returned to the person responsible for deducting tax at source;

c) the contract is cancelled after partial execution and no remittance is made to the non-resident for the non-executed part;

d) the contract is cancelled after partial execution and remittance related to non-executed part is made to the non-resident. In such cases, the remitted amount has been returned to the person responsible for deducting the tax at source or no remittance is made but tax was deducted and deposited when the amount was credited to the account of the non-resident;

e) there occurs exemption of the remitted amount from tax either by amendment in law *or* by notification under the provisions of Income-tax Act, 1961;

f) an order is passed under section 154 or 248 or 264 of the Income-tax Act, 1961 reducing the tax deduction liability of a deductor under section 195;

g) there occurs deduction of tax twice from the same income by mistake;

h) there occurs payment of tax on account of grossing up which was not required under the provisions of the Income-tax Act, 1961;

i) there occurs payment of tax at a higher rate under the domestic law while a lower rate is prescribed in the relevant double taxation avoidance treaty entered into by India.

ESOP Valuation Rules For FBT

The Central Board of Direct Taxes has made the following rules vide notification no. 264/2007, dt. 23-10-2007, which have come into force with effect from the 1st day of April, 2008, i.e. from AY 2008-09 and provide the method of valuation of specified security or sweat equity share being a share in the company.

The fair market value of any specified security or sweat equity share, being an equity share in a company, on the date on which the option vests with the employee, shall be:

- The average of the opening price and closing price of the share on the recognized stock if the share of the company is listed on a recognized stock exchange,
- The average of opening price and closing price of the share on the recognized stock exchange which records the highest volume of trading in the share, in case the shares are listed on more than recognized stock exchanges.
- The fair market value shall be such value of the share in the company as determined by a merchant banker on the specified date, in case the shares of the company are not listed. Where the "specified date" means,

  (i) the date of vesting of the option; or

  (ii) any date earlier than the date of the vesting of the option, not being a date which is more than 180 days earlier than the date of the vesting;

Deduction u/s 80 HHC

The assessee has taken the figure of book profit in place of the profits of business for the purpose of computing the deduction u/s.80HHC and which was reduced as per clause (viii) to section 115JA(2) of the Act.

Respectfully following the decision of the **Special Bench of ITAT, Mumbai in the case of Syncome Formulations (I) Ltd., the Chennai Tribunal held that for computing the deductions u/s.80HHC for the purpose of computation of the book profit u/s.115JA, the adjusted book profit is to be adopted and not the profit computed under the normal provisions of the Income-tax Act.**

Loan Advanced Not Allowable as Bad Debt

The assessee claimed a deduction in respect of bad debts regarding loan advanced to M/s. Bangur Finance Ltd. (in short BFL). The total amount due from BFL was Rs.8,91,82,466/.

The AO disallowed the entire claim of bad debts on the grounds that the assessee is engaged in the manufacture of heavy vehicles and money lending and banking are not the principal activities of the assessee. The loan

was given out of the surplus funds available with the assessee for earning interest and as the assessee could not recover the principal, the same is written off as irrecoverable. The AO noted that the advances are transactions on capital account and, therefore, the loss suffered by the assessee is capital loss which is neither admissible u/s.36(1)(vii) nor u/s.37(1) of the Act.

The Tribunal concurred with the view of the assessing officer that the assessee utilized the surplus funds for advancing loans to BFL; as such it was not into the business of money lending. **The said investment therefore would be capital in nature, so the loss sustained by the assessee in respect of the loan advanced to BFL is in the nature of capital loss and is not allowable u/s.28 of the Act also.**

Alteration in Form of Balance Sheet

As per GSR No. 719(E) dated 16.11.2007 the following alterations in Schedule VI to the Companies Act have been made with effect from 16.11.07 in respect of the Micro, Small and Medium Enterprises Development Act, 2006 (MSME) which replaced the Small Scale Industries Act.

1. The following shall be disclosed under notes to Accounts :-

(a) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier as at the end of each accounting year.

(b) The amount of interest paid by the buyer in terms of section 16 of the MSME, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year.

(c) The amount of interest due and payable for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under the MSME;

(d) The amount of interest accrued and remaining unpaid at the end of each accounting Year ; and

(e) the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues as above are actually paid to the small enterprises, for the purpose of disallowance as a deductible expenditure under section 23 of the MSME.

2. The following information is required to be disclosed in respect of Sundry Creditors:

(a) total outstanding dues of micro enterprises and small enterprises instead of small scale industrial undertakings ; and

(b) total outstanding dues of creditors other than micro enterprises and small enterprises.

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