

RNM ALERT

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Dear Readers,

We wish to begin by wishing all of you the best of health, prosperity and good fortune in 2008.

In the rapidly growing Indian Economy all business and professions are reaching new heights. In the present scenario, legislative amendments and business changes are taking place at very fast pace. In order to take benefit from these amendments, everyone should be aware of these changes in a timely and accurate manner.

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International New Delhi
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The philosophy of RNM is to assist its clients in achieving business success through our professional advice and specialized services thereby creating long lasting relationships based on mutual respect, trust and confidentiality. Knowledge, principles, dignity, innovation and out of the box thinking are our hallmarks.

Our constant endeavor is to be committed to our clients needs through our personalized attention in a professional environment, striving for the pinnacles of perfection in all areas of service, employing the latest technological tools and industry best practices. In order to keep our clients up-to-date, we have now started an initiative, a fortnightly newsletter, the **RNM ALERT**. We hope this would be of immense help to all.

The **RNM ALERT** is dedicated to bring all information regarding changes made in provisions in laws regarding Auditing, Accounting, Direct Taxes, Indirect Taxes, Company Laws etc.

We would be pleased to receive your comments and suggestions to make this initiative even more profitable in the interest of all readers.

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On behalf of the **RNM Alert** Editorial Team.
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GGI WORLD CONFERENCE HOSTED IN NEW DELHI BY RNM & CO.



R.N. Marwah & Company were the hosts in New Delhi of the 2007 World Conference of the Geneva Group International from November 22nd to 24th 2007 at the Taj Mahal Hotel, New Delhi. During the three day event, over 150 delegates from a cross section of countries were able to learn first hand the richness of our land and network with their fellow members. The Conference was addressed by Mr. R.S. Mathoda, Member (Income Tax) of the Central Board of Direct Taxation as the Key Note Speaker who informed the gathering of the robust growth in Income tax collections during the year, as a sign of the growth momentum of the Indian economy.

Mrs. Ambika Soni, Hon'ble Union Minister of Tourism addressed the Conference on November 23, 2007 and gave an eloquent exposition on the tourism potential of our

country and the challenges faced by a developing country like ours in positioning ourselves in the fiercely competitive international tourism sector. Ayurveda, Yoga, naturepathy, luxury resorts, ski resorts and ease of communication are some of the factors that make India an upcoming star in the global tourism map.

In the evening the delegates enjoyed a cultural experience in a unique setting among vintage Rail engines at the National Rail Museum, New Delhi. The presence of Mr. Sheelbhadra Banerjee Secretary, Tourism, Government of India and the audio visual presentation made by him made the colourful evening even more enjoyable. The dancers from Punjab and the fire eaters, especially brought a spark to the nite with their vibrant and fun filled dances.

On the concluding day, delegates had fruitful discussions through various Workshops, including a workshop on Doing Business in India conducted by Mr. Raghu Marwah, Partner R.N. Marwah & Company.

The Gala Dinner at the Imperial Hotel was the perfect setting to mark the close of a successful Conference. The Chief Guest of the evening was the Hon'ble Ambassador of Switzerland, Excellency Mr. Dominique Dryer.

PROMULGATION OF UP VAT W.E.F. 01.01.2008

The Government of Uttar Pradesh vide Notification No.2643(2) / 79-V-I-07-2 (ka) 41/2007 LUCKNOW: DATED: December 20,2007 has promulgated the UTTAR PRADESH VALUE ADDED TAX ORDINANCE,2007 (U.P. ORDINANCE NO.37 OF 2007) to provide for introducing Value Added System of taxation for the levy and collection of tax on sale or purchase of goods in the State of Uttar Pradesh and for matters connected therewith and incidental thereto.

The whole of Uttar Pradesh is being put under VAT regime w.e.f. 01.01.2008.

Some features of the said ordinance are as follows:

1. **REGISTRATION:**

A dealer who is liable to pay tax under UP VAT ordinance shall apply to the registration authority within a period of thirty days from the date on which such dealer has become so liable, in the prescribed form and manner along with proof of deposit of registration fee. If a dealer is already registered under the erstwhile Act (the UTTAR PRADESH TRADE TAX ACT, 1948), he shall present registration certificate before the registration authority or the assessing authority, as the case may be, for necessary endorsement. The procedure for endorsement is similar to a new registration application.

2. **PAYMENT:**

Any amount of tax or fee or penalty or any other amount which a dealer or other person is liable to pay under this Ordinance, shall be deposited by the dealer or such other person in the prescribed manner and within prescribed time, failing which simple interest shall become due and be payable on unpaid amount.

3. **SUBMISSION OF RETURN:**

Every taxable dealer including a dealer from whom any amount of tax has been deducted at source, shall for prescribed tax period and within prescribed time, submit tax return.

If any dealer discovers any omission or other error in any tax return submitted by him, he may submit a revised tax return.

4. **STOCK DECLARATION:**

Under the VAT Ordinance registered traders are required to make a statement of stock on 01.01.2008. This declaration can be made only once. There is no provision of extension of time to make declaration.

IMPLICATIONS OF THE MORGAN STANLEY CASE ON THE PE ISSUE

The issue of Permanent Establishment (PE), resulting attribution of income to the PE and arm's length price are burning issues in the arena of international taxation. With the increasing globalization of India and cross border transactions becoming more common the issue of taxability in India of Multinational Enterprises (MNE) has become a hotbed of litigation, especially in the BPO sector. In this background the recent implications of the judgment on Morgan Stanley of the Hon'ble Supreme Court of India is worth noting.

Facts Of The Case

- Agreement dated 14-4-05 for outsourcing of the following services by MSCo, a US company to MSAS, an Indian company:
 - a) IT support services.
 - b) Account reconciliation.
 - c) Equity research.
 - d) Maintaining industry database
 - e) Sending of staff from MSCo. on deputation without shifting payroll of deputed employees.
 - f) Sending of staff from MS Co. on stewardship activities.
- The issue before the Supreme Court by way of SLP was
 - A. whether MSCo. has any fixed place PE and agency PE in India under Article 5 of Indo-US DTAA.
 - B. Whether MSCo. has any service PE under the stewardship and deputation arrangement

- C. Whether there should be any additional attribution of income to MSAS beyond the ALP
- D. Whether appropriate transfer pricing method was used and the adequacy of the mark up

Conclusion:-

1. Fixed Place 'PE' issue- The SC held that since MSAS was performing 'back office' operations supportive to 'front office' operations of MSCo, MSCo is not carrying on any business in India through a fixed place PE.
2. Agency PE issue- the SC held that since MSAS did not have the authority to enter into/ conclude contracts in India and that all contracts were entered and concluded in USA no Agency PE of MSCo. arose in India
3. Service PE issue- The SC held that a service PE arises when the following twin conditions are met:-
 - a. MNE furnishes services within India; and
 - b. That service is rendered through its employees

In respect of stewardship activities, SC held that MSCo was merely protecting its interest by ensuring quality and confidentiality of MSAS support services and therefore service PE did not arise qua stewardship. However, qua the deputation arrangement, SC noted that since the deputationist continues to remain on the payroll of the MNE a service PE emerges.



4. 'Attribution beyond ALP' issue- the SC has affirmed that once an Indian entity is remunerated at the ALP covering all the functions and risks undertaken by it, then no further attribution of income may be made to 'PE' of MNE in India. Further, the SC in its judgment has highlighted that 'TP' analysis should be wholesome and reflect all risks and functions undertaken by Indian entity in order to avoid any additional attribution.
5. Adequacy of Mark up- 29% cost plus mark up offered by MSCo to MSAS for 'outsourced services' was held to be correct as per the Transaction Net Margin Method (TNMM) of TP. It seems that same is restricted to facts of MSCo and MSAS and may get changed from year to year on the basis of respective 'TP' study.

Broadly speaking this is a landmark judgment which has dealt with many concepts for the first time, especially in the outsourcing and captive BPO space.

Recent judgments, including that of Galileo International Inc. recently decided on November 30, 2007 before the Delhi ITAT would be greatly influenced by this judgment.

RBI CIRCULAR REGARDING SHARE APPLICATION MONEY

The RBI vide AP (DIR Series) Circular No. 20, dated 14.12.2007 has made an amendment to Notification No. FEMA 20/2000-RB dated 3rd May 2000 with effect from November 13, 2007, as per which a Company which receives moneys from overseas as Share Application money is required to issue shares or convertible debentures within 180 days from date of receipt of the inward remittance or date of receipt of funds from NRE/ FCNR (B) account. The RBI may on an application made to it and for sufficient reason permit the refund of the said money after the said period of 180 days.

The RBI vide the aforesaid Circular is attempting to clamp down on borrowing by companies under the garb of Share Application money. Prior to this notification there was no restrictive time limit within which share application money was to be disposed off, neither under the Companies Act, 1956 nor under the Foreign Exchange Management Act, 1999. Promoters and investors would therefore need to plan their business structure much more carefully now prior to getting funds into India.

REIT'S & ITS IMPACT

The Securities and Exchange Board of India (SEBI) has published a draft for public comment of the much awaited Real Estate Investment Trusts Regulations, 2008 for regulating the conduct and formation of Real Estate Investment Trusts (REIT's).

REIT's is an investment vehicle, similar to a Mutual fund, which is formed by way of a Trust structure registered under the Indian Trusts Act, 1882 and approved by the SEBI. It is a unique instrument by way of which retail investor can be part of the real estate boom in India today by investing in units of REIT's. The REIT's shall be managed by a professional real estate investment management company and shall be appointed so by the Trustee's. Few of the chief eligibility criterions of the Trust as well as the investment management company for obtaining approval under the draft regulations are as under:-

- minimum net worth, for the time being stated as Rs. 5 crore. To begin with a networth of Rs. 3 crore is permitted provided it is increased to Rs. 5 crore within three years
- At least 50% of the trustees, directors shall be independent and not directly or indirectly associated with the persons in control of the Trust or the Management company
- The trustees, directors shall have adequate professional experience in related field and be fit and proper and their appointment shall be made with the prior approval of the Board

The draft Regulation prohibits providing any guaranteed or assured returns as part of the scheme. Further, every scheme shall appoint an independent property valuer who shall have a minimum net worth of Rs. 5 crore.

The Board has proposed certain investment and dividend limitations which are worth noting:-

- No real estate investment trust shall under all its schemes have exposure to more than 15% of a single real estate project
- No real estate investment trust shall under all its schemes have exposure to more than 25% of all the real estate projects developed, marketed, owned or financed by a Group of companies.
- Real estate shall generally be income generating and the scheme is prohibited from investing in vacant land or participating in property development activity
- The aggregate borrowing of a scheme shall not exceed 20% of the value of the total gross assets of the scheme
- Dividend of not less than 90% of its annual net income after tax shall be distributed to unit holders at the end of each year

REIT's shall provide a big fillip to the organized development of the real estate sector by providing access to funds to the medium size developers. Such developers have so far only been getting funds from overseas Private Equity (PE) players whose return expectations are generally in excess of 22%. With the tightening of bank debt by the RBI many projects were getting delayed due to the shortage of fund availability. By broadbasing this rally and including the retail investor, we are expecting a lot more liquidity to enter the real estate sector in the times to come.

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