RNM ALERT

Thinking Of The BottomLine- Think of Us

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Dear Readers,

India was impacted by one of its worst terror attacks ever in Mumbai where over 200 people have been declared dead by official figures. The attack has led to an increased security environment all over India leading to a fear psychosis, with India Inc. hoping that foreign investment into India does not dry up as a fall out of the terror attack. The Hospitality industry has been one of the victims of the terror attacks with large scale cancellations across major destinations and popular holiday destinations like, Goa not being able to draw the international charter business to the same extent as last year. Ordinary citizens have been mobilizing peace rallies to force the government to take necessary steps to provide a sense of security to all. In Delhi, Mr. Raghu Marwah, Partner also attended a candle march in Jantar Mantar, New Delhi as a show of solidarity to the families of the victims and in general to the people of Mumbai. We at RNM strongly condemn all such terror attacks on innocent civilians and on our way of life in India.

The recent judgement on the Writ Petition in the Mumbai High Court in the *Vodafone- Hutchison* matter has wide ranging fallout on international structuring and international taxation in India. The Revenue Department is attempting to subject to tax in India the capital gains arising on the transfer of shares overseas of holding companies of various Indian subsidiary companies. The said Writ Petition was filed in response to a Show Cause Notice by the Revenue Department to Vodafone where the tax at stake is of the tune of over a 1 billion USD. The Hon'ble High Court held that unless the show cause notice was totally non est in the eye of law for absolute want of jurisdiction of the authority to even investigate into facts a Show Cause Notice would not be struck down and since in the current case it was a mixed question of fact and law, the Court has dismissed the Writ. In other words, the assessee is in for a long and protracted legal battle where the Revenue Department would try and force the crucial Agreement entered outside India by two non- resident contracting parties to be placed on record to determine the ticklish issue of jurisdiction.

The current move of the Government to provide an incentive package to the automobile, real estate and export sector by way of reduction in excise duty, additional funds to Exim Bank and National Housing Bank and Repo and reverse Repo rate cut by 100 bps although a step in the right direction, would not prevent a further slide in growth rates in 2009.

We would like to take this opportunity to wish all readers and their families the best wishes for Christmas and the New Year and hope that 2009 would bring happiness, good health, wealth and world peace to all.

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

CONTENTS

DIRECT TAXES

➢ *Case Law*

Business Expenditure

Allowability of expenditure towards renovation of rented premises.

The cost of repairs incurred by an assessee-tenant in respect of rented premises would have to be allowed under section 30(a)(i); the question of disallowing such an expenditure and relegating the assessee to claim depreciation under section 32 does not arise - ***CIT v. Hi Line Pens Pvt. Ltd. [ITA NO. 1202/2006]***

Conditions precedent for claiming business expenditure.

The onus is on the assessee to prove that a particular expenditure has been laid out or expended wholly and exclusively for the purpose of business; mere filing some names and addresses of parties and making payment by itself would not entitle the assessee to deduction of expenditure under section 37(1) unless the same is proved to be paid for commercial consideration and commercial expediency - ***Fouress Engg. (India) Ltd. v. ITO [ITA NO. 3786/M/2003]***

Allowability of expenditure u/s 37(1)

Assessee had leased out its theatre building to another party treating the lease rent as business income - As per lease agreement, liability to pay electricity charges was on lessee and assessee was getting rent net of electricity charges - Assessee's case was that during relevant year, there was change in terms of agreement through correspondence between assessee and lessee whereunder assessee had agreed to reimburse electricity charges paid by lessee - Assessee originally returned entire rental income and later on, filed a revised return claiming deduction of an amount being reimbursement of electricity charges as business income - Tribunal rejected its claim holding that there was no acceptable evidence - Whether, if claim was bona fide, assessee could have produced documents in form of assessment order completed in name of lessee showing inclusion of amount being reimbursement received from assessee - *Held,* yes - Whether in absence of any clear evidence towards that, Tribunal was justified in assuming that original agreement providing for payment of electricity charges by lessee had continued to be operative - *Held,* yes - Whether, therefore, Tribunal had rightly rejected assessee's claim - *Held,* yes - ***United Film Exhibitors v. CIT (Ker.)***

Chargeability of income

Agricultural Income: Sale genuine even if purchaser not traceable

Assessment year 1999-2000 - Assessing Officer made impugned addition by treating agricultural income shown by assessee-company on account of sale of trees as 'income from other sources' on ground that assessee could not furnish correct address of purchaser of trees - Whether when sale consideration was received through account-payee cheques which were deposited in regular bank account of assessee and assessee had also furnished bill *vide* which trees were sold to purchaser, merely because after three or four years purchaser of trees had left place of his business and assessee could not furnish his correct address, it could be said that transaction of sale was not genuine one - *Held,* no - Whether on facts, Tribunal was right, in law, in deleting addition and in holding that genuineness of transaction regarding agricultural income stood proved - *Held,* yes –

CIT v. S.R.M. Cotton & Oil Mills (Punj. & Har.)

Search Matters

Block assessment in search cases.

Where amounts in question were received through cheques and same were duly credited to bank accounts of assessee and were reflected in his regular books of account prior to date of search, such amounts could not be treated as undisclosed and, thus, could not be subjected to assessment under section 158BC –

Commissioner of Income-tax v. Arman Sheikh[2008] 174 Taxman 179 (Gau.)

Deductions

Export Benefit u/s 80HHC (3)

Section 80HHC (3) fixes quantum of deduction on basis of a proportion of business profits under head 'profits and gains of business or profession', irrespective of what could strictly be described as profits derived from export of goods out of India; therefore, an assessee carrying on composite trading business of domestic and export sales would be entitled to deduction under section 80HHC even if it had not derived profits from export business.

Mysodet (P.) Ltd. v. Commissioner of Income-tax - [2008] 174 Taxman 221 (SC)

Duty drawback treatment for deduction u/s 80 IB

Assessment year 2003-04 - During course of assessment, Assessing Officer excluded amount received by assessee as duty drawback from business profits while working out deduction under section 80-IB holding that said amount could not be treated as profits derived from industrial undertakings - Commissioner (Appeals) affirmed view taken by Assessing Officer relying, *inter alia*, upon judgment of Supreme Court in *CIT* v. *Sterling Foods* [1999] 237 ITR 597- Whether since Division Bench of Court had decided issue against assessee on basis of judgment of Supreme Court in *Sterling Foods'* case (*supra*), no substantial question of law arose in instant appeal and, consequently, it was to be dismissed - *Held,* yes –

***Raj Oversease* v. *CIT* (Punj. & Har)**

International Taxation

Transfer of controlling interest thru Offshore Company Sale: Taxable in India

The moot point in the high profile Vodafone case was whether thru the sale of shares of M/s CGP Investments (Holdings) Ltd., a Cayman Island registered Company the transfer of interests, tangible and intangible, in Indian companies of the Hutch Group in favour of the Petitioner is taxable in India u/s 9 of the Income Tax Act, 1961 as deemed income or capital gains of Hutchison Telecom India Ltd. (HTIL).

The High court held that Shares in themselves may be an asset but in some cases like the present one, shares may be merely a mode or a vehicle to transfer some other asset(s). In the instant case, the subject matter of transfer as contracted between the parties is not actually the shares of a Cayman Island Company, but the assets (as stated supra) situated in India. The choice of the Petitioner in selecting a particular mode of transfer of these right enumerated above will not alter or determine the nature or character of the asset.

The Court further placed reliance on the American principle of "Effects Doctrine" which is as follows:

"Any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state represents." In International Law 4th Edition by Malcolm N.Shaw at pages 483 to 490 and also Page 456, which reads as follows:

"International law accepts that a state may levy taxes against persons nor within the territory of that state, so long as there is some kind of real link between the state and the proposed taxpayer, whether it be, for example, nationality or domicile."

It observed that the above "Effects Doctrine" has been upheld and followed by our Hon'ble Supreme Court in the case of Shyama Charan Agarwala & Sons Vs. Union of India (2002) 6 SCC 201

The Hon'ble Supreme Court has held that where the question involved is as to the nature of the transaction depending on the construction of documents, the same is a mixed question of facts and law and it is for the fact finding authorities to go into the same, particularly when the law prescribes a particular procedure for ascertaining those facts and the same cannot be subject matter of a Writ Petition. Accordingly the Writ was dismissed.

Vodafone International Holdings B.V. v. Union of India (Bom) HC

Relief may come to multi-national banks with eased taxes

The Delhi bench of the Income Tax Appellate Tribunal (ITAT) has ruled that there will be no tax liability in India on fees charged by foreign banks for transactions in India, but carried out through international credit cards issued

by their overseas branches. The landmark ruling comes in response to an appeal filed by Standard Chartered Grindlays Bank against the income tax department's claim for payment of taxes. The court's verdict effectively implies Grindlays will not have to pay tax on transaction in India by a credit card issued by its branch abroad to a customer outside the country.

AAR on FBT liability of a foreign entity earning no income from India but paying fringe benefits to its employees in India

A foreign entity not earning any income in India, but having employees in this country is liable to FBT, if it pays fringe benefits to those employees - ***Singapore Tourism Board, In re [AAR NO. 775 OF 2008]***

Overseas firms' income from brand names taxable

Foreign firms may now be wary of letting Indian companies use their brand names as the income from providing technical solutions under overseas companies' brands could invite tax liability, according to a recent tribunal ruling. The Income Tax Appellate Tribunal (ITAT) has, in a recent ruling, said the Indian arm of German company Hutarew and Partner is liable to pay tax deducted at source (TDS) on the license fee paid to the parent company for technical services. "If services have been used by the assessee within India, then it is immaterial whether the non-resident has a residence or place of business or business connection in India as the sum paid to the non-resident would be included in the income, which will be deemed to have accrued to the non-resident, and it will be subject to TDS provisions," the tribunal ruled.

Non applicability of Interest u/s 234B(1) where TDS is Deductible

The assessee was a non-resident French company, which had engaged employees of an associate company for providing technical services in connection with offshore drilling in India. Tax was not deducted at source. The AO noticed that these employees drew salaries exceeding the exemption limit and, therefore, passed an order under Section 163(1), read with Section 143(3), treating the French company as agent of the technicians and made assessments on it on income from salary and perquisites received by these technicians. Since no tax was deducted at source from the salaries paid and no advance tax was paid for such employees, the AO charged interest under Section 234B (1) of the Act also. On appeal, the CIT(A) observed that the entire income of the foreign technicians was liable to TDS and, therefore, as per Section 209(1)(d) the tax payable for the purpose of advance tax was required to be reduced by the tax 'deductible at source'. ***DCIT vs Pride Foramer SAS (2008 24(II) ITCL 259) (Del-ITAT)***

Other Issue

Change in method of valuation of closing stock under section 145A of Income-tax Act, 1961 –

When on account of application of section 145A a change is *per se* forced upon the assessee in the valuation of its closing stock, a corresponding adjustment in opening stock has to be carried out for consistency –
DCIT v. Beck India Ltd. [ITA NO. 483/Mum/2005]

Capital asset

Mere inclusion of land in industrial zone without any infrastructure development thereupon or without establishing and proving that land was put into use for non-agricultural purposes does not and cannot convert agricultural land into non-agricultural land - ***Haresh V. Milani v. Joint Commissioner of Income-tax - [2008] 114 ITD 428 (Pune) [It Appeal No. 192 (Pune) of 2003]***

Undisclosed Income

Assessment year 1998-99 - Assessing Officer found certain amounts deposited in assessee's books - On being asked, assessee contended that those deposits were made against booking of flat/plot in scheme of assessee, but were later on cancelled by parties - Assessing Officer found that assessee had received all payments in cash, even though most of persons had bank accounts but they did not enter into said transactions through their bank accounts - He held that said transactions had been done only to evade tax and, therefore, he made addition under section 68 - Whether on facts, Assessing Officer was justified in doing so - *Held,* yes - ***Indus Valley Promoters Ltd.* v. *CIT* (Delhi)**

➢ *Latest Notifications/ News*

DTAA between India and Tajikistan.

India entered into a Double Taxation Avoidance Agreement with Tajikistan on November 20, 2008. The said DTAA follows the Permanent Establishment concept for taxability of business income and prescribes a withholding rates for taxation of dividends in the source State to a maximum of 5 % of the gross amount of dividends if the beneficial owner of the dividends is a company which holds directly at least 25% of the share capital of the company paying the dividends and 10% of the dividends in all other cases. Withholding rates for taxation of interest and royalties in the source State have been restricted to a maximum of 10% of the gross amount of interest and royalties respectively.

The DTAA provides for source state taxation of capital gains from alienation of shares. However, capital gains arising from alienation of shares of a company deriving its value principally from immovable property will be taxed in the state where the company is resident and not where the immovable property is situated.

Accountants Report u/s 80-IB (11C) notified

Sub-Section 11C of Section 80-IB deals with the deduction for the undertaking which derives profit from operating and maintaining a hospital located anywhere in India, other than the excluded area (the area comprising an urban agglomeration). These undertaking are entitled for 100% deduction of the profit derived from such business for a period of five consecutive assessment years, beginning with the initial assessment year.
Certain prescribed conditions are as under:

1. The hospital has at least 100 beds for patients.
2. The assessee furnishes along with the Return of Income a report of audit (i.e. form no. 10CCBD) which is duly sighed & verified by a Charted Accountant. The format of audit report is notified now. [***NOTIFICATION NO. 98/2008 [F.No. 142/12/2008-TPL], DATED 22-10-2008.]***

INDIRECT TAXES

➢ *CENTRAL EXCISE & SERVICE TAX*

➢ *Latest Notifications/ News*

Reversal of Cenvat Credit in Case of Trade Discount

Issue

Whether proportionate credit should be reversed in cases where a manufacturer avails credit of the amount of duty paid by supplier as reflected in the excise invoice, but subsequently the supplier allows some trade discount or reduces the price, without reducing the duty paid by him.

Clarification

In view of above, it is clarified that in such cases, the entire amount of duty paid by the manufacturer, as shown in the invoice would be available as credit irrespective of the fact that subsequent to clearance of the goods, the price is reduced by way of discount or otherwise. However, if the duty paid is also reduced, along with the reduction in price, the reduced excise duty would only be available as credit. It may however be confirmed that the supplier, who has paid duty, has not filed/claimed the refund on account of reduction in price.

[Circular No. 877/15/2008-CX dated 17th November 2008.]

➢ *Leading Case Law*

Transfer of technology against a consideration is not covered under service tax

The Commissioner (Appeals) held that under the agreement respondent has not received any service falling under the ambit of 'Consulting Engineer' as the agreement is for transfer of technology.

The Tribunal found that the agreement is for transfer of technology and a consolidated

amount is the consideration for transfer of technology and not for technical assistance. In these circumstances the Tribunal held that service tax is liable in respect of technical assistance and not for the transfer of technology.

[CCE, Indore Vs M/S Indore Composite Pvt Ltd, 2008-Tiol-1949-Cesat-Del]

➢ *CUSTOM DUTY*

- *Latest Amendments*

FTA between India and Turkey on the Anvil

India and Turkey have decided to start talks for a free trade accord, double bilateral trade to six billion dollars by 2010 and deepen cooperation in counterterrorism. The two sides decided to launch the negotiations for FTA during the visit of the Prime Minister of Turkey Mr. Recep Tayyip Erdogan to India during the third week of November 2008. India and Turkey decided to begin negotiations on a Free Trade Agreement and to "proactively encourage" two-way investment flows.

New Rate of Exchange for Valuation of Goods under Customs.

The Central Board of Excise and Customs has notified the new rates of exchange and the significant currency exchanges are as follows:-

Australian Dollar :32.40/31.40,
Canadian Dollar:40.60/39.70,
EURO 64.65/63.25,
Hong Kong Dollar: 6.50/6.35,
Pound Sterling: 76.10/74.35,
US Dollar: 50.25/1; and
100 Japanese Yen: 52.35/51.05

[Notification No.130/ 2008-Customs (N.T.) Dated 25th November, 2008]

Anti-Dumping Duty on Acrylic Fiber

The Central Government has imposed on Acrylic Fibre imported from Thailand and Korea RP falling under Chapter 55 of the First Schedule to the said Customs Tariff Act anti dumping duty.

The anti-dumping duty imposed under this notification shall be effective for a period of five years (unless revoked, superseded or amended earlier) from 20th November, 2008 and shall be paid in Indian currency.

[Notification No.123/2008-Customs dated 20th November, 2008]

Anti-Dumping Duty on Compact Fluorescent Lamps (CLF).

The Central Government has imposed anti dumping duty on import of Compact Fluorescent Lamps (CFL), falling under heading 8539 of the First Schedule to the Customs Tariff Act, 1975 (51 of 1975) originating in, or exported from China PR, Sri Lanka and Vietnam.

[Notification No. 126 /2008-CUSTOMS dated 21st November, 2008]

Computation of Assessable Value u/s 14 for Levy of Export Duty

After the imposition of export duty on steel at ad valorem rates in May 2008, a doubt has been raised regarding the manner of calculation of export duty i.e whether the export duty should be charged simply as a percentage of FOB price or whether the FOB price should be taken as the 'cum-duty price' for determination of assessable value and duty due thereon.

Normally it is calculated on the basis of FOB price declared as cum duty price as per the instruction issued by the Board. However, the practice of computation of export duty will be changed from 01.01.2009. it is proposed that for the purposes of calculation of export duty, the transaction value, that is to say the price actually paid or payable for the good for delivery at the time and the place of exportation u/s 14 of the Customs Act, 1962 shall be the FOB price of such goods at the time and place of exportation.

[Circular No. 18/2008-Cus dated 10th November, 2008]

Clarification on setting up Duty Free Shops approved by FIPB

The duty free shops at airport/ports are being considered by the Foreign Investment Promotion Board (FIPB). The recommendation of FIPB in respect of these proposals is only for foreign financial and technical collaboration. Foreign investors will, however, need to take other prescribed clearances separately. The FIPB's approval is only for the purpose of permitting foreign investment. CBEC has laid down instructions, conditions and guidelines for setting up private bonded warehouse from time-to-time, notably under circulars Nos. 68/95 dated 15.6.95, 99/95 dated 20.9.95, 28/96-Cus dated 14.5.96 and 18/2007-Cus dated 24.04.2007. At present, duty free shops can only be set up in the Customs areas. *[Circular No.: 19 /2008-Customs 14th November, 2008]*

New compounding amount in relation to customs offences.

The Central Government has amended Rule 5 of the Customs (Compounding of Offences) Rules, 2005, regarding fixation of the compounding amount and the new compounding amounts for the following offences shall be as follow:

1. False declaration, false documents, etc.
2. Obstruction of officer of customs.
3. Refusal to be X-rayed

Compounding amount: Rs. 50000

4. Misdeclaration of value, any fraudulent evasion, attempt at evasion of any duty etc.)
5. Export of any goods which are liable to confiscation
6. Fraudulently availment of or attempts to avail of drawback or any exemption from duty

Compounding amount: Up to ten per cent of the amount of market value of the goods, subject to a minimum of Rs. 100,000

7. Carrying, removing, depositing, harboring, keeping, concealing, selling or purchasing or in any other manner dealing with any goods which is liable to confiscation,):
8. Preparation to export any goods in contravention

Compounding amount: up to five per cent of the amount of market value of the goods, subject to a minimum of Rs.100000

[Notification No.118/ 2008-Customs (N.T.) dated 12th November, 2008]

New Tariff Value of Specified Goods Under Customs.

The Central Board of Excise & Customs has amended the Tariff value of the following specified goods in US $ term for metric tonne:-

Brass Scrap (all grades): 3525; Poppy seeds: 5206

COMPANY LAW

➢ *Latest News*

Proposal for amendment of Schedule VI of the Companies Act

The Ministry of Corporate Affairs proposes to revise existing Schedule VI to the Companies Act, 1956 which provides for the manner in which every company is required to prepare its Balance sheet and Profit & Loss Account. It is also proposed to introduce a new Saral Schedule VI for the Small and Medium Companies (SMCs).

FOREIGN EXCHANGE MANAGEMENT ACT

➢ *Latest Notifications/ News*

Guidelines for Foreign investment in Commodity Exchanges.

Government of India had laid the guidelines vide Press Note 2 (2008) for foreign investment in Commodity Exchanges. As per the guidelines, a composite ceiling for foreign investment of 49% was allowed with prior Government approval subject to the condition that investment under the Portfolio Investment Scheme will be limited to 23% and that under the FDI Scheme will be limited to 26%. Further no foreign investor/entity including persons acting in concert will hold more than 5% of the equity in these companies.

Since some of the existing Commodity Exchanges had foreign investment above the permitted level as on the date of issue of the said Press Note, it has been decided to allow a transition/ correction time to the existing Commodity Exchanges who are required to divest the foreign equity in excess of the prescribed limits by 30.06.2009.

All Commodity Exchanges shall furnish a compliance report informing the foreign investment in the Commodity Exchange as on 30.6.2009, along with details of equity structure, to the Department of Industrial Policy & Promotion, Department of Consumer Affairs, Foreign Investment Promotion Board, the Forward Market Commission and SEBI.

[Press Note No. 8 (2008) dated 19.08.2008- Department of Industrial Policy & Promotion]

Buyback / Prepayment of Foreign Currency Convertible Bonds (FCCBs)

The existing policy on the premature buyback of FCCBs has been reviewed by the RBI and it has been decided to liberalise the procedure and consider applications for buyback of FCCBs by Indian companies, both under the automatic and approval routes, as detailed hereunder:

A. Automatic Route:

The designated AD Category - I banks may allow Indian companies to prematurely buyback FCCBs, subject to compliance with the terms and conditions set out hereunder:

i) the buyback value of the FCCB shall be at a minimum discount of 15 per cent on the book value;

ii) the funds used for the buyback shall be out of existing foreign currency funds held either in India or abroad and / or out of fresh ECB raised in conformity with the current ECB norms; and

iii) where the fresh ECB is co-terminus with the outstanding maturity of the original FCCB and is for less than three years, the all-in-cost ceiling should not exceed 6 months Libor plus 200 bps, as applicable to short term borrowings. In other cases, the all-in-cost for the relevant maturity of the ECB, as laid down in A. P. (DIR Series) No.26 dated October 22, 2008 shall apply.

B. Approval Route:

The Reserve Bank will consider proposals from Indian companies for buyback of FCCBs under the approval route, subject to compliance with the following conditions:

i) The buyback value of the FCCB shall be at a minimum discount of 25 per cent on the book value;

ii) the funds used for the buyback shall be out of internal accruals, to be evidenced by Statutory Auditor and designated AD Category – I bank's certificate; and

iii) the total amount of buyback shall not exceed USD 50 million of the redemption value, per company.

[A.P. (DIR Series) Circular No. 39 dated 08.12.2008]

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