

TECHNICAL UPDATE

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The key amendments introduced in statutes, policies and procedures in respect of Direct Tax, Indirect Tax, Corporate Laws & Accounting Standards, Foreign Exchange Management Act / Export Import Policy & Securities and Exchange Board of India related matters are summarized hereunder

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DIRECT TAX

1. Gains Arising from Transfer of Shares of Foreign Company to another Foreign Company is Not Taxable in India

The SC delivered a landmark ruling in the case of Vodafone International Holdings B.V. ('Vodafone') putting an end to the controversy surrounding taxation of offshore transfer of shares in India. In the instant case, Vodafone, a foreign company, purchased 100% shares of another foreign company namely CGP Investments (Holdings) Limited ('CGP') from Hutchison Telecommunications International (Cayman) Holdings Ltd. ('HTIL'), which resulted in acquiring control over CGP and its subsidiaries, including an Indian company namely Hutchison Essar Limited ('HEL'). The tax authorities argued that sale of shares of CGP by HTIL result into indirect transfer of shares of HEL and thus taxability arises in India. Accordingly, Vodafone was required to withhold tax at source on payments made to HTIL. Setting aside the decision of Bombay HC, the SC has held that gain arising from offshore transfer of shares is not taxable in India and hence, there was no obligation on Vodafone to withhold tax at source. The SC has held that

- Tax planning is not illegal. The onus is on the revenue authorities to identify whether transaction undertaken is a colourable device.
- Chargeability under section 9(1)(i) of the Act requires transfer, existence and situation of capital asset in India and thus cannot be extended to cover indirect transfer of capital assets situated in India.
- Test to examine the genuineness of a transaction is the timing test i.e. timing of incorporation of entities, transfer of shares etc.

- Controlling interest is an incident of ownership of shares of company and is not an identifiable distinct capital asset. Situs of shares is where the company is incorporated.
- Where transaction involves alienation of shares, it cannot be broken into individual components, assets or rights.
- Withholding tax provisions applies to payment from a resident to non-resident and not between non-residents situated outside India.

Source: Vodafone International Holding B.V. (SLP (C) No 26529 of 2010, Supreme Court)

2. Interest is Chargeable Since Inception of Demand

The AO raised a demand of Rs 2.12mn under scrutiny assessment. The tax payer, besides filing an appeal before CIT (A), requested for stay of demand before the AO, who instructed the tax payer to pay Rs 1.05mn and stayed the balance demand. The CIT (A) allowed the appeal and the tax payer was granted refund. Subsequently, the ITAT reversed the order of CIT (A). The AO, giving effect to the order of ITAT, also charged interest on tax demand from the date of original demand notice till the date of order of ITAT which was challenged by the tax payer through a writ petition before Delhi HC. It was stated that no interest was payable for the period when the order of CIT (A) was operative since no demand was due from the tax payer during that period. The HC observed that demand kept in abeyance revives from inception once the assessment gets finally confirmed applying the doctrine of merger. Hence, it was held that the interest is chargeable from the date of unpaid amount and any variation in demand caused due to order of appellate authorities has no effect on the liability of the tax payer to pay interest.

Source: Girnar Investment (17 Taxmann. com 69)

3. Adjustment on Account of Working Capital Should be Allowed in Determining Arm's Length Margin

The tax payer is engaged in manufacturing of material handling equipments viz. industrial cranes, process cranes, jib cranes and KBK cranes. The TPO made transfer pricing adjustments to manufacturing as well as trading segment of the taxpayer. While proposing the said adjustment, the TPO denied benefit of working capital adjustment

to the taxpayer. The DRP upheld view of the TPO. Aggrieved, the tax payer filed an appeal before the Tribunal. The Tribunal observed that the issue of working capital adjustment was not discussed by the DRP. It was held that if the working capital constitutes a difference between the international transactions and the comparable uncontrolled transactions and the said difference could materially affect the amount of net profit margin of the relevant transaction in the open market, then difference on account of working capital adjustment should be allowed while determining the arm's length operating margins of the comparables.

Source: Demag Cranes & Components (India) Pvt. Ltd. v DCIT (ITA No. 120/PN/2011)

Legends

Act - Income-tax Act, 1961

uls - Under section

AO - Assessing Officer

TPO - Transfer Pricing Officer

DRP - Dispute Resolution Panel

CIT (A) - Commissioner of Income Tax (Appeals)

ITAT - Income Tax Appellate Tribunal

HC - High Court

SC - Supreme Court

INDIRECT TAX

1 Exemption from Service Tax

The Central Government has extended the exemption from service tax on following till April 01, 2012:

- Transport of specified goods by rail
- Service provided in relation to transport of goods by rail

Source: Notification No. 49/2011 and 50/2011 - Service Tax, Dated December 30, 2011

2 Refund of specified taxable services received by an exporter of goods

From January 03, 2012, the following services are also eligible for refund of service tax paid, if used by exporter for export of goods:

- Service received in relation to transport of goods through national waterway, inland water and coastal shipping.
- Service received from airports authority or any other person in any airport.

Source: Notification No. 52/2011 - Service Tax, Dated December 30, 2011

FEMA & OTHER LAWS

1. External Commercial Borrowings ('ECB')

Non-residents have been permitted to hedge their currency in respect of ECBs denominated in India Rupees, with Authorized Dealer category - I banks in India.

Source: RBI/2011-12/326 A.P. (DIR Series) Circular No.63 dated December 29, 2011

Limits of average maturity period under the automatic route have been enhanced

USD 20 million or equivalent	Minimum average maturity of 3 years
USD 20 million and up to USD 750 million	Minimum average maturity of 5 years

Source: RBI/2011-12/340 A.P. (DIR Series) Circular No.64 dated January 05, 2012

Eligible borrowers under the automatic route can raise Foreign Currency Convertible Bonds ('FCCBs') up to USD 750 million or equivalent per financial year and Corporate in service sectors like hotel, hospital and software can raise FCCBs up to USD 200 million or equivalent for permissible end uses.

Source: RBI/2011-12/340 A.P. (DIR Series) Circular No.64 dated January 05, 2012

2. Foreign investment in Single-Brand Retail Trading

RBI has allowed 100 per cent Foreign Direct Investments ('FDI') in single-brand product retail trading under the Government Approval route. Following additional conditions needs to be satisfied if FDI is beyond 51 per cent:

- (i) The foreign investor should be the owner of the brand
 - (ii) Any addition to product categories to be sold under 'Single Brand' would require fresh approval from the government.
 - (iii) Sourcing of at least 30 per cent of the value of products sold would have to be done from small Industries, village and cottage industries, artisans and craftsman in India.
- Small industries means 'industries that have a total investment in plant and machinery not exceeding

USD 1 Million at the time of installation, without providing for depreciation, provided that if at any point in time, this valuation (of plant and machinery) is exceeded, the industry shall not qualify as a small industry for this purpose.

- The compliance of this condition will be ensured through self-certification by the company, to be subsequently checked by Statutory Auditors of the Company.

Source: RBI/2011-12/348 A.P. (DIR Series) Circular No.67 dated January 13, 2012

3. Scheme for Investment by Qualified Foreign Investors in Equity shares

RBI has allowed Qualified Foreign Investors ('QFIs') to purchase equity shares of listed Indian companies through Securities and Exchange Board of India ('SEBI') registered Depository Participants ('DP') and recognized brokers on recognized stock exchanges in India as well as in equity shares of Indian companies which are offered to public in India on repatriation basis. The individual and aggregate investment limits for the QFIs shall be 5 per cent and 10 per cent respectively of the paid up capital of an Indian company. These limits shall be over and above the Foreign Institutional Investment and Non Resident Indian investment ceilings prescribed under the Portfolio Investment Scheme.

Source: RBI/2011-12/347 A.P. (DIR Series) Circular No.66 dated January 13, 2012

4. Investment by QFIs in Rupee Denominated Units of Domestic Mutual Funds

RBI has modified the time period for which funds and dividend payments on mutual funds can be kept in the single rupee pool bank account of the DP to 5 (five) working days including the day of credit of funds through normal banking channels from QFIs as well as by way of credit of redemption proceeds of the units of domestic mutual funds. In these 5 days dividend payment can be utilized for fresh purchase of units of domestic mutual funds.

Source: RBI/2011-12/347 A.P. (DIR Series) Circular No.66 dated January 13, 2012

5. Commodity Hedging

RBI has authorized Authorised Dealer Category - I Banks to grant permission to hedge the price risk of permitted commodities in the international commodity exchanges/markets to

- (i) The listed companies on a recognized stock exchange (in respect of any commodity except gold, silver, platinum);
- (ii) Domestic companies engaged in refining crude oil to hedge the price risk on crude oil imports on the basis of past performance;
- (iii) Domestic producers/users of aluminium, copper, lead, nickel and zinc listed on a recognized stock exchange;
- (iv) Actual domestic users of Aviation Turbine Fuel ('ATF') to hedge economic exposures in respect of ATF based on domestic purchases;

- (v) Domestic crude oil refining companies to hedge commodity price risk on domestic purchases of crude oil and domestic sales of petroleum products, which are linked to international prices; and
- (vi) Domestic oil marketing and refining companies to hedge commodity price risk on Inventory subject to guidelines as prescribed by the RBI.

Authorised Dealer Category - I Banks can also grant permission to unlisted companies to hedge price risk on import/export in respect of any commodity (except gold, silver, platinum) subject to the guidelines.

Source: RBI/2011-12/353 A.P. (DIR Series) Circular No. 68 dated January 17, 2012



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