

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. NPA Provisions Created By NBFCs are Not Deductible

The Assessee, a Non Banking Financial Company ('NBFC'), created provision towards Non Performing Assets ('NPA') in accordance with RBI directions and consequently claimed deduction u/s 36(1) (vii). The Assessee contended that since the provision has been created in order to comply with the statutory obligation casted upon it by RBI directions, the same shall be allowed while computing the taxable income. The Apex Court held that provisions of section 36(1)(vii) allows deduction in respect of doubtful debts actually written off in the books of accounts and specifically disallows any provisions made towards provision of such doubtful debts. Further, the court held that RBI directions are not intended to interfere with the tax regulations and both legislations operate in an independent manner.

Source Southern Technologies Ltd Vs JCIT (Appeal No. 1337/2003, Supreme Court)

2. Under a block of assets even a close unit is eligible for depreciation

The Assessee conducted its business through two divisions, one located at Dombivili and the other at Surat ('Dormant Unit'). The Assessing Officer disallowed the claim of depreciation relating to the Surat division on the ground that such assets were not used for the business during the relevant previous year. The Tribunal held that the use of an asset has to be seen in relation to the block of assets as a whole. The use of individual asset for the purpose of business is to be examined only in the first year when the asset is purchased. The mere existence of assets in the block itself amounts to their use for the purpose of

business. Accordingly, the tribunal held that the assets of the Surat division were part of block of assets and therefore entitled to claim of depreciation.

Source: Swati Synthetics Vs ITO (ITAT Mumbai, ITA No. 1165/M/2006)

3. Change of Opinion Not a Sufficient Reason to Reopen Past Assessments

The Apex Court in a landmark judgment has held that the Assessing Officer cannot reopen past assessments merely on the basis of change in opinion. It is necessary that the Assessing Officer should possess tangible material on record which corroborate the fact that income has escaped assessment.

Source: CIT vs. Kelvinator of India Ltd. (Appeal No 2009-2011 of 2003, Supreme Court)

4. Allowability of Specific Expenditure

The assessee incurred expenditure towards fee for technical services during AY 2002-03, which were neither debited to the profit and loss account nor any tax was deducted at source. During the subsequent assessment year, the assessee debited the same to the profit and loss account as a prior period item and also deducted the requisite withholding taxes on the same and claimed the same in its return of income. The Assessing Officer disallowed claim of the assessee on the ground that the expenditure represented prior period expenditure and therefore not allowable during assessment year 2003-04. The hon'ble High Court held that the deduction is to be allowed in accordance with the provisions of section 40(a)(i), in the year when withholding tax has been deducted and paid. The fact that the assessee did not record the same in its books of accounts will not deny such claim.

Source: CIT vs SMCC Construction India Formerly Mitsui Kensetsu India Ltd (Delhi High Court)

5. Revision to Double Taxation Avoidance Agreement (DTAA) Between India & Finland

A revised Agreement and Protocol between India and Finland for the avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income has been signed. As per the revised agreement, withholding tax rates have been reduced on dividends from 15 percent to 10 percent, and on royalties and fees for technical services the rates have been reduced from 15/10 percent to a uniform rate of 10 percent. The concept of 'Service Permanent

Establishment' ('PE') has been incorporated in the DTAA and also the time test for Independent Personal Services has been extended from 90 days to 183 days. Recourse to Mutual Agreement Procedures ('MAP') has also been provided.

Source: Press Release dated January 15, 2010

6. Dispute Resolution Panel ('DRP') is Optional

The Central Board of Direct Taxes ('CBDT') has clarified that recourse to the Dispute Resolution Panel ('DRP') is an optional remedy available to the assessee. The introduction of the DRP does not preclude the assessee from approaching the Commissioner of Income Tax ('Appeals') against the order of the assessing officer. The assessee therefore has a choice to either approach the DRP or the CIT(A) against the draft assessment order/order passed by the assessing officer.

Source: Notification no. F.No. 142/22/2009-TPL (Pt. II) dated January 20, 2010

INDIRECT TAX

1. Irregular Availment of Cenvat Credit on certain activities not amounting to manufacture

It has been clarified that where the process undertaken by an assessee indisputably does not amount to manufacture, the department should inform the assessee about the correct legal position and advise him not to pay duty and not to avail credit on inputs. In case the assessee has already paid duty, and in a situation where there is no manufacture as held by the Courts subsequently, and facts of the case are covered by the provisions of Section 5B of the Central Excise Act, 1944, the assessee is at liberty to approach the Central Government for issue of appropriate notification for regularization of the Cenvat credit availed.

Source: Central Excise Circular No. 911-01-2010-CX dated 14th January 2010

2. Increase in DVAT Rate

Amendment has been made in Section 4 of the Delhi Value Added Tax Act, 2004, in respect of goods specified in the Third Schedule of the Delhi Value Added Tax Act, increasing the VAT rate on such goods to five from four per cent, except declared goods as defined from time to time.

Source: Delhi VAT Notification No. F.14 (16)-LA-2009-LJ-10-LC LAW-1 dated 6th January 2010

3. Tax credit not to exceed the tax payable on sale

Amendment has been made in Section 10 of the Delhi Value Added Tax Act, 2004, to provide for tax credit on purchases to be reduced proportionately where the sales are made at a price lower than at which it was purchased by the dealer

Source: Delhi VAT Notification No. F.14 (16)-LA-2009-LJ-10-LC LAW-1 dated 6th January 2010

4. Refund of Input Credit to exporters of services

The department has clarified there cannot be different yardsticks establishing the nexus between input/input service to output service for taking of credit and refund of credit, even if different phrases are used in different rules of CENVAT Credit Rules, and they have to be construed in a harmonious manner. The test to be used to determine sufficient nexus can be if the absence of such input/input service adversely impacts the quality and efficiency of the provision of service exported, it should be considered as eligible input or input service.

Source: Service Tax Circular No. 120/01/2010-ST dated 19th January 2010

FEMA

1. Branch /Liaison Office in India - Change in Regulatory Compliances

The Reserve Bank of India ('RBI'), has simplified processes pertaining to Branch Office ('BO')/ Liaison Offices ('LO') in India. The new guidelines are effective from February 1, 2010.

- (i) **Setting-up a BO/LO In India:** Henceforth, applications to set-up a BO/LO in India are to be submitted with the Authorized Dealer Bank ('AD'), which shall verify, recommend and forward to the RBI.
- (ii) **Extension of LO:** LO which are initially allowed for a period of 3 years, can henceforth seek an extension for another 3 years by applying to the AD. The AD can directly permit an extension.
- (iii) **Closure of LO/BO:** Shall be directly handled by the AD Bank. If necessary documentation is in place, AD will then permit repatriation of funds lying in the bank account.

(iv) **Activity Report:** The Annual Activity Certificate, till now submitted with the RBI will henceforth be submitted with the AD and with the Directorate General of Income Tax (International Taxation).

Source: RBI/2009-2010/279 A. P. (DIR Series) Circular No.24 dated December 30, 2009

2. Disclosure in Balance Sheet – Bancassurance Business

RBI has clarified that banks should disclose in the 'Notes to Accounts', from the year ending March 31, 2010, the details of fees/remuneration received in respect of the bancassurance business undertaken by them.

Source: RBI/2009-10/283 DBOD No FSD BC 67/24.01.001/2009-10 dated January 7, 2010

3. Purchase of Immovable Property in India – Amendment of the definition of PIO

The definition of a Person of Indian Origin ('PIO') has been clarified as an individual (not being a citizen of Pakistan or Bangladesh or Sri Lanka or Afghanistan or China or Iran or Nepal or Bhutan) who (i) at any time, held an Indian Passport or (ii) who or either of whose Father or Mother or whose Grandfather or Grandmother was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955).

Source: RBI/2009-10/286 A.P. (DIR Series) Circular No.25 dated January 13, 2010

4. Remittance of Salary - Relaxation

The Government of India has liberalized certain guidelines regarding operation of Foreign Currency Account by a person resident in India as follows:

- (i) A foreign citizen resident in India or a citizen of India, employed by a foreign company and deputed to the office /branch /subsidiary /joint venture in India have been permitted to open, hold and maintain a foreign currency account with a bank outside India and receive the whole salary payable to him outside India, provided income-tax chargeable under the Income Tax Act 1961 is paid on the entire salary as accrued in India.
- (ii) A foreign citizen resident in India being in employment with an Indian company has been permitted to open, hold and maintain a foreign currency account with a bank outside India and remit

the whole salary received in India in Indian Rupees, to such account, provided that income-tax chargeable under the Income Tax Act 1961 is paid on the entire salary accrued in India.

Source: RBI/2009-10/288 A.P. (DIR Series) Circular No.26 dated January 14, 2010

5. ECB Policy – Relaxation in end-use conditions

As per the existing policy, in the telecommunication sector, External Commercial Borrowings ('ECB') for the purpose of payment for spectrum allocation is permitted under the automatic route. Keeping in view the large outlay of funds required to be paid directly to the Government within a limited period of time, RBI has announced a one-time relaxation in the end-use conditions of the ECB policy by permitting successful bidders to make the initial payment out of Rupee resources to be refinanced with a long-term ECB, under the approval route,

subject to the following conditions:

- (i) ECB be raised within 12 months from the date of payment of the final installment;
- (ii) The AD should monitor the end-use of funds;
- (iii) Banks in India will not be permitted to provide any form of guarantees; and
- (iv) All other conditions of ECB, such as eligible borrower, recognized lender, all-in-cost, average maturity, etc, should be complied with.

Eligible borrowers in the telecommunications sector proposing to fund the payment for Spectrum allocation directly out of the proceeds of the ECBs may continue to avail of the ECBs under the automatic route as per the existing policy.

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