

# TECHNICAL UPDATE

March 2010

Volume III /2010/CCI

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

## CONTENTS AT A GLANCE

### DIRECT TAX

#### Amendments, Notifications & Court Rulings

- Mere Disallowance of Expenditure Not a Sufficient Ground for Levy of Penalty
- Investments Through Mauritius Eligible for Benefits Under Indo-Mauritius DTAA
- Technical Know-how Must be 'Made Available' to Qualify as Fee for Technical Services
- Procurement Support Services by Non Residents to be Taxable in India
- Tax on Payments to Non Residents to be Withheld When Income Chargeable to Tax

### INDIRECT TAX

#### Amendments, Notifications & Court Rulings

- Procedure for electronic filing of Central Excise and Service Tax Returns and for electronic payment of Excise Duty and Service Tax.
- Rebate under Rule 18 on clearance made to SEZ by DTA units
- Recovery of duty drawback where export proceeds have not been realised

### FEMA & OTHER LAW

#### Amendments, Notifications & Court Rulings

- ECB Policy- Definition of Infrastructure Sector
- IFC – To comply with conditions under ECB policy

- Additional Disclosures by all commercial banks in the notes to accounts
- LAF – Repo and Reverse Repo rates
- Standing Liquidity Facilities for banks & primary dealers
- Accounting of Repo/Reverse Repo transactions
- ECB Policy- Structured Obligations
- FIPB Approval - An Update

### DIRECT TAX

#### 1. Mere Disallowance of Expenditure Not a Sufficient Ground for Levy of Penalty

In a landmark judgment, the Apex Court has held that the disallowance of expenditure claimed by the assessee, in itself, does not tantamount to furnishing inaccurate particulars of income. The assessee claimed interest expenditure on money borrowed for investment in shares from which no income was earned during the year. The revenue authorities disallowed interest under section 14A of the Income Tax Act, 1961 ('the Act') and contended that by making incorrect claim for expenditure, the assessee had furnished inaccurate particulars of his income and therefore penalty under section 271(1)(c) of the Act was leviable. The Apex Court observed that the details of income and expenditure filed by the assessee were not found to be inaccurate. Claim for expenditure which was not accepted by the revenue authorities in itself does not amount to furnishing inaccurate particulars of income and therefore does not attract the penal provisions.

#### 2. Investments Through Mauritius Eligible for Benefits Under Indo-Mauritius DTAA

The Applicant, a tax resident of Mauritius and a subsidiary of US company invested into shares of an Indian company. These shares were subsequently sold

to another Mauritius based company. The Applicant contended that as per the provisions of the Indo-Mauritius Double Taxation Avoidance Agreement ('DTAA'), capital gains arising out of such transfer were not taxable in India. The Indian revenue authorities contended that the Mauritian company being a conduit, was a mere device to avoid taxes and that the parent company in US was the beneficial owner of these shares and therefore, the transaction is not eligible for relief under Indo-Mauritius DTAA. The Authority for Advance Rulings ('AAR'), relying upon the landmark judgment of the apex court in UOI vs Azadi Bachao Andolan (263 ITR 706) held that if benefits are derived by a resident of a third country, by utilizing the beneficial provisions under treaties between other countries through a conduit entity, the legal transactions entered into by that conduit entity cannot be declared invalid. Accordingly, capital gains earned by the Mauritius company were taxable in Mauritius per provisions of the DTAA.

globally. It proposed to establish an office in India for rendering procurement support services to its group companies in relation to goods to be procured by such companies. The services included assistance in collection and dissemination of market intelligence, providing opinion on reasonability of prices, social audit of suppliers and supplier checks. The Applicant contended that there is a specific tax exemption available under the Act in respect of the activities confined to purchase and export of goods from India and therefore its activities are exempt from tax. However, the AAR held that the benefit of exemption is available to only those entities who act for or on behalf of the non resident for purchase of goods/merchandise from India. Based on this understanding, the AAR clarified that entities engaged in providing only support services to non-residents in connection with purchases made by them are outside the purview of such exemption. Accordingly, the activities carried on by the Applicant in India are chargeable to tax in India.

### 3. Technical Know-how Must be 'Made Available' to Qualify as Fee for Technical Services

The Applicant, an Indian consulting company obtained Management & Technical Services ('Services') from its overseas group company in the United Kingdom ('UK'). The question before the AAR was classification of such services as Fee for Technical Services ('FTS') under Article 13 of the DTAA between India and UK, which requires that technical knowledge should be 'made available' to the recipient of services. The AAR observed that the applicant (recipient of services) was provided with the information on various business and commercial matters, guidelines, templates, best practices and strategies wherein no transfer of technical know-how/technology was involved and held that the technical knowledge was not 'made available' to the Applicant. Accordingly, the AAR held that the fee paid in consideration of the above services cannot be classified as FTS and hence not taxable in India.

### 4. Procurement Support Services by Non Residents to be Taxable in India

The Applicant, a Netherlands company was engaged in providing support services to its group companies

### 5. Tax on Payments to Non Residents to be Withheld When Income Chargeable to Tax

The assessee, an Indian company, reimbursed certain expenses to its non-resident parent company. Such payment was accepted by the Indian revenue authorities to be non-taxable in India. The revenue authorities subsequently contended that per provisions of section 195 of the Act, the assessee was liable to deduct tax at source on such payment. The Income Tax Appellate Tribunal ('ITAT') upheld the view taken by revenue authorities and held that tax at source is required to be withheld, irrespective of the fact that the sum being paid is not chargeable to tax in India. On further appeal by the assessee, the Delhi High Court held that the obligation to deduct tax at source arises only when the sum being paid is chargeable to tax under the provisions of the Act in the hands of such non-resident. Where the payer is of the view that whole of such sum is not chargeable to tax, an application must be made before the revenue authorities for determination of appropriate amount chargeable to tax. More importantly, the court held that the

- a) decision of the revenue authorities is binding and that the assessee cannot plead non-compliance to such directions during assessment proceedings.

- b) once the sum has been assessed as non-taxable in hands of recipient, the payer cannot be treated in default for non-withholding of tax at source

## INDIRECT TAX

### 1. Procedure for electronic filing of Central Excise and Service Tax Returns and for electronic payment of Excise Duty and Service Tax.

Comprehensive instructions have now been issued outlining the procedure for mandatory electronic filing of excise and service tax returns and electronic payment of taxes in respect of assesseees who have paid central excise duty or service tax of Rs 10 lakhs or more, including payment by utilization of Cenvat credit, in the previous financial year.

### 2. Rebate under Rule 18 on clearance made to SEZ by DTA units

It has been clarified that the rebate of duty paid on excisable goods or on materials used in the manufacture of processing of such goods under Rule 18 of Central Excise Rules, 2002 is also admissible when supplies are made from Domestic Tariff Area (DTA) units to Special Economic Zone (SEZ) units. The procedure and the documentation is also now laid down for effecting supply of goods from DTA to SEZ.

### 3. Recovery of duty drawback where export proceeds have not been realised

It has been clarified that exporters will not be entitled for duty drawback where export proceeds have not been realised in accordance with the provisions of the Foreign Exchange Management Act, 1999 even if the claim has been settled by ECGC or realisation waived by Reserve Bank of India.

## FEMA

### 1. ECB Policy- Definition of Infrastructure Sector

Reserve Bank of India ('RBI') has expanded the definition of infrastructure sector, for the purpose

of availing of External Commercial Borrowing ('ECB'), to include, 'cold room facility, including for farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat'. The infrastructure sector so far only included (i) power (ii) telecommunication (iii) railways (iv) road including bridges (v) sea port and airport, (vi) industrial park (vii) urban infrastructure (water supply, sanitation and sewage projects) (viii) mining, exploration and refining and (ix) cold storage or cold room facility.

### 2. IFC – To comply with conditions under ECB policy

Infrastructure Finance Company ('IFC') being a new category under Non Banking Financial Companies ('NBFC') has been permitted to avail of ECB under the approval route in compliance with the norms prescribed for on-lending to infrastructure sector subject to compliance with the following conditions

- (i) hedging of the currency risk in full; and
- (ii) the total outstanding ECBs including the proposed ECB not exceeding 50 per cent of the Owned Funds.

### 3. Additional Disclosures by all commercial banks in the notes to accounts

RBI has decided to prescribe following disclosures in the "Notes to accounts" in the banks' balance sheets, from the year ending March 2010:

- (i) Sector-wise Non Performing Assets ('NPAs')
- (ii) Movement of NPAs
- (iii) Overseas Assets, NPAs and revenues
- (iv) Concentration of Deposits, Advances, Exposures
- (v) Off-balance sheet Special Purpose Vehicle sponsored by banks

### 4. LAF – Repo and Reverse Repo rates

RBI has decided to raise the repo rate under the Liquidity Adjustment Facility ('LAF') by 25 basis

points from 4.75 per cent to 5.00 per cent and the reverse repo rate under the LAF by 25 basis points from 3.25 per cent to 3.50 per cent with immediate effect.

## 5. Standing Liquidity Facilities for banks & primary dealers

Standing liquidity facilities provided to banks (export credit refinance) and Primary Dealers (collateralized liquidity support) from the RBI would be available at the revised repo rate, i.e., at 5.0 per cent with effect from March 20, 2010.

## 6. Accounting of Repo/Reverse Repo transactions

RBI has announced the revised Guidelines for Accounting of Repo / Reverse Repo Transactions for uniform accounting of Repo/Reverse Repo transactions. The guidelines apply to market repo transactions in government securities and corporate debt securities and not to repo/reverse repo transactions conducted under the Liquidity Adjustment Facility with RBI. Under the guidelines market participants can undertake repos from any of the three categories of investments, viz., Held for Trading, Available for Sale and Held To Maturity.

## 7. ECB Policy- Structured Obligations

RBI has placed a comprehensive policy framework eligible for non-resident entities by extending the

credit enhancement facility to domestic debt, raised through issue of capital market instrument, such as debentures and bonds by Indian Companies engaged exclusively in the development infrastructure and by the Infrastructure Finance Companies subject to certain conditions.

## 8. FIPB Approval - An Update

The government of India has reviewed the extant policy with immediate effect for approval involving FDI and has decided that following entities shall not be requiring fresh prior approval of the Government for bringing in additional foreign investment in the same entity:

- (i) Entities whose activities had earlier required prior approval of FIPB/ CCFI/CCEA and who had accordingly obtained approval for their initial foreign investment but subsequently such activities/sectors have been placed under automatic route;
- (ii) Entities whose activities had sectoral caps earlier and who had accordingly obtained such approval for their initial foreign investment but subsequently such caps were removed/ increased and the activities were placed under automatic route; provided such additional investment along with the original investment does not exceed the sectoral caps;
- (iii) Entities who had earlier obtained prior approval of FIPB/CCFI/CCEA prior approval of the Government under the FDI policy due to certain requirements for bringing in additional foreign investment in the same entity.

## CORPORATE CATALYST INDIA PVT LTD

### Head Office

KS House 118 Shahpur Jat  
New Delhi 110 049 INDIA  
Tel : +91 11 4100 9999  
Fax : +91 11 4100 9990

### Mumbai Office

Navbharat Estate 'East Wing' 2nd Floor  
Zakaria Bunder Road Sewri (W)  
Mumbai 400 015 INDIA  
Tel : +91 22 2410 4000  
Telefax : +91 22 2410 6263

### Bangalore Office

A-2 Ground Floor  
Akruti Antara Apartment  
No 11/1 Haudin Road  
Bangalore 560 042 INDIA  
Tel : +91 80 4151 0751  
Fax : +91 80 4113 5109