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Editorial:

Dear Esteemed Readers,

We are pleased to share with you our latest newsletter covering tax and regulatory updates in India for the period June-July 2015.

"One'll never find a rainbow if one is looking down."

The present day government is surely looking skywards these days. For the Indian Met department has just retained its forecast for this year's monsoon rains at 88 percent of the long-period average, raising fears of the first drought in six years. Rainfall below 90 percent is considered to be drought. God forbid drought were to happen, one could expect food inflation to spiral upwards especially from the third quarter of current fiscal and will curb RBI's intent to loosen the interest string. All these could elongate our wait for the 'acche din'.

Though drought will impact agriculture which contributes 15% to the Indian economy, yet it retains the potential to affect the lives of more than two-thirds of Indians which causes concerns. And that could upset Government's plans and sincere efforts to usher in financial inclusion.

Talking of the monetary affairs, the RBI has in its just released, third Bi-monthly Monetary Policy Statement for 2015, not made any changes to the repo rates. However, what is worrisome is the data which shows that the gross non-performing assets of scheduled commercial banks in India stood at 4.6% of their total advances, as on March 31, 2015. The number had stood at 4% as on March 31, 2014. Also worrying is the fact that as on March 31, 2014, the stressed advances stood at 9.8% of the total advances. A year later this had jumped to 11.1% with the public sector banks faring badly on this count with stressed advances jumping from 11.7% of advances to 13.5%, between March 2014 and March 2015. All these inputs point out to certain fundamental structural impetus which needs to be planned by the Government as part of the course corrections required to literally jump start an economy in damp spirits.

Government's pursuit for rollout of the GST, India Financial Code, reining in of black money and injecting liquidity in the banking system through talk of planned capitalization, are some of the steps announced in June and July 2015, for driving its growth agenda.

Tax and Regulatory updates

Featuring in this edition of the Newsletter is our take on how to make taxation work where we first analyze some of the reasons for non-compliances and provide some suggestions on how to improve compliance. In another article, we have presented our thoughts on retrospective taxation and have put forth our view that restraint, more than retrospective legislative action, is a much better strategy, for building up faith in the tax system and encouraging voluntary compliance with the law.

In our 'Tax Controversy' series, this time, we take a closer look at whether the position of withholding tax requirement on car hire charges has been settled or has it been 'unsettled' by an innocuous controversial judgement.

In the RBI section, we have discussed the Master Circular on Corporate Governance requirements for NBFCs and certain other Master Circulars issued by the RBI.

Amongst income-tax cases, the Karnataka High Court has held that once DSIR has certified the scientific research expenditure u/s 35(2AB) of the Act, it is deemed that assessee has compiled with the conditions and the jurisdictional AO would be out of bounds to examine the correctness of the said certificate. The Delhi High Court has held that the number of days spent by an individual, involuntarily because of impounding of passport pursuant to Court order shall be excluded for deciding residential status of the assessee under the Act.

The Ahmedabad ITAT has held that the CUP method cannot be applied to benchmark an international transaction by placing reliance on prices in database. The ITAT in this case reasoned that the TPO erred in not taking into account comparability factors such as quality, quantity, transportation costs etc. and should have allowed adjustment for such differences so as to make the controlled and uncontrolled transactions comparable.

The Mumbai ITAT has held that the AO's mistake of not forwarding the draft assessment order within the prescribed time limit cannot be rectified by way of a subsequent corrigendum and hence was null and void and unenforceable.

The Delhi ITAT has held that only international transactions which lead to the generation of any income chargeable to tax, are required to be arm's length price. The provisions of Chapter X are not applicable to the international transaction of issue of equity shares which does not lead to any taxable income. In yet another transfer pricing judgement, the Delhi ITAT has held that where an adjustment on account of working capital has already been considered by the assessee in its transfer pricing analysis, a separate adjustment on account of notional interest on outstanding receivables is unwarranted.

In the TDS domain, the Jaipur ITAT has held that roaming charges by cellular companies cannot be considered as fees for technical services, subject to TDS u/s 194J of the Act.

The CBDT has issued clarifications on the rollback provisions for advance pricing agreement schemes. It has also prescribed the nature of business relationship which debars a Chartered Accountant from being an authorized representative.

The digestion of key decisions rendered by various appellate authorities and the summary of circulars issued by CBDT, RBI & SEBI have been compiled and presented for understanding, in the usual manner.

We hope you find this of interest. As always, we look forward to your feedback and comments which would enable us to further enhance the content of the newsletter.

Happy Reading!

Yours Sincerely,

Knowledgeware Team

B. K. Khare & Co.

Commented [DJ1]: Changes made in the editorial

Articles:

How to make taxation work

A tigress, says the *Mahabharata* lifts its cubs with its teeth yet does not harm them. So too should the ruler levy taxes on his subjects without causing them distress. (Mb.12.88.5). Raising taxes should be as unobtrusive as that

In comparison, in India the Government has always attempted to tackle the problem of black money through coercive measures. The recently enacted Undisclosed Foreign Income and Assets (Imposition of Tax) Act (UFIA), for instance, lays down *inter alia* that undisclosed foreign incomes and assets of Indian residents will be taxed at a flat rate of 30% without any exemptions, deductions or set off of losses of earlier years. The penalty for failure to disclose such income or assets would be up to three times the market value of the undisclosed assets (s.41); both the tax and penalty will be calculated on not only on the realized but also the unrealized profit from the foreign asset.

How effective are these draconian measures likely to be? Basically, they reflect the adversarial approach of our tax administration, based upon mistrust of the taxpayer that we have been seeing now for decades. Tax laws in India are on paper already pretty stiff. The tax administration has traditionally sought to counter evasion and avoidance through such coercive measures as monetary penalties, prosecutions, searches and surveys at the premises of suspected evaders, tough tax scrutinies and other coercive measures. Experience the world over, however, appears to suggest such policies yield only limited results. Within the frame work of this coercive model, probability of detection and swiftness and certainty of punishment do create some deterrence. Stringent punishments on paper, on the other hand, by themselves hardly affect hard core evaders, especially if they feel that that they can game the system. In India, the limitations of this current approach are apparent: some estimates indicate that more than half of our GDP consists of unaccounted incomes.

Time has therefore come to try alternative approaches. This is not to suggest that the existing coercive policies should be given up altogether, but their weight in the policies that the department implements should perhaps be reduced-except in the case of a few recalcitrant taxpayers.

We need instead to find out what drives non –compliance? Causes for evasion are innumerable: sometimes people do not pay tax because they cannot find the fiscal link between what they pay and the benefits they get from the state in return. Voluntary compliance improves dramatically when taxpayers can see what the state does for them when they grow old or are unemployed; or when they see they see good infrastructure- good roads, hospitals and schools. People do not like to pay taxes when they have negative feelings towards the government, the bureaucracy or the tax administration. These may very well be the result of an earlier experience of harassment, or of having been treated in a high- handed or unfair manner. Such feelings of inequity also arise when a person finds equally placed persons paying less or not doing so at all. The affected person then asks as why she is being singled out and being penalized. Many people feel it is better to remain outside the system because tax laws are far too complicated and difficult to comply with. They find that becoming a taxpayer involves not only paying tax but also penalties, interest and at times, unaffordable professional fees. Also, the department is very prompt in collecting demands, but extremely slow in giving effect to appellate orders, issuing refunds or carrying out rectifications. This again leads to complaints of unfairness and drives people away from voluntary compliance. Similar too is the case when laws are hastily introduced without considering the increase in the compliance cost of taxpayers. Finally, massive evasion tax could also be the result of a certain morality which regards petty theft to be more serious crime than not paying tax.

Drivers of noncompliance can thus be many; different taxpayers may have different reasons for failing to comply with the law. But it is always important for a tax administration to know why people pay taxes and why they do not. When confronted with the problem of massive non-compliance, it is important to work with the people and find out why they feel aggrieved. In India, this should not be difficult to accomplish, because we already have large tax administration with well-defined jurisdictions. Rather than focusing exclusively on desk scrutinies, officials should be encouraged to learn more about the behaviour of taxpayers in their areas, the problems they experience in meeting the requirements of the department and the difficulties they experience in paying taxes.

This approach has yielded excellent results in a number of OECD countries: tax collections in the U.S from day care providers increased when the IRS simplified forms and devised less burdensome procedures for them. They now use standardized rates for calculating deductions due to them for providing meals to the children they look after. In the U.K., the tax administration made concrete efforts to reach out to very small businesses who could not afford representation. They sent them letters, along with brochures, indicating answers to frequently asked questions and the persons they could contact to get their difficulties removed. The administrators then compared the results of this initiative to a control group who were not addressed at all. On the whole the traders who received communications offered six hundred pounds higher income per taxpayer than the members of the control group. Considering that we have hardly experimented with any such approach,there appears to be plenty of scope for taking such initiatives in our country.

A lot of hard work is thus needed to work with communities and convince taxpayers that it is always in their best interests to pay taxes honestly. They get, for example, easier access to the country’s financial system and loans from banks. Results from such campaigns emerge slowly but are much more enduring than coercive methods, for paying tax is a matter of habit; and good habits once formed tend to persist.

Cynical tax administrators who seem to think that nothing other than wielding the big stick works in this country need to look at the behaviour of the Indian diaspora settled in the west. In their new adopted homelands, the same people, who are considered to be incorrigible in India are widely admired for being law abiding and honest. People do respond to incentives and disincentives; when these change, so does behaviour: often half the battle is won when a tax officer is fair and reasonable.

The present dispensation is fond of quoting from ancient Indian classics. Here is one occasion they could take advice from *the Mahabharta*, without raising anyone's heckles. A bumble bee sucks nectar from a flower but leaves it unharmed. Taxation, says the *Mahabharata*, should be like that.

Whose GST is it anyway?

With the latest log jam in the Indian Parliament delaying further the voting on the Bill to amend the Constitution for facilitating the smooth passage of the legislation on Goods & Services Tax (GST), one really wonders how much more time needs to be invested in speculating about the final contours and structures of the GST that will ultimately see the light of the day in due course.

Millions of reams of paper, countless sound bytes,umpteen discussion papers and reports have gone down the drain over the last 8 years or so since the then Union Finance Minister (FM) announced that we Indians will finally herald a new era in indirect taxation by implementing the ubiquitous GST. Yet, nobody, not even the present day FM himself, can categorically assert with conviction as to when we are going to see GST implemented in India and what would be its final structure.

This piece is an attempt to analyze how far we have come today from the GST that we aspired to put in place a decade back. The objective of this paper is to give an idea to the reader about how GST has become more of a compromise on so many fundamental aspects, that in some respects, the existing indirect tax regime appears to be more beneficial to the business community as well as for the people.

To begin with, we aspired for a Single Unified GST…

The genesis of a single, unified GST across the country is found in the report of the Kelkar Task Force on implementation of the FRBM Act, 2003 which had suggested the reform based on the principle of value added taxation (VAT).Shri P. Chidambaram, the then Union Finance Minister, while announcing the ambitious plan to introduce GST from 1st April, 2010 had also indicated in his budgetspeech in February 2007that it would most likely to be a single, unified levy across the Country.

It was then envisaged that in the single GST, the cascading effects of both, central and state indirect tax levies will be eliminated by allowing the set-off of input stage GST, and a continuous chain of set-off from the original producer's point and service provider's point upto the retailer's level leading to a fall in the burden of tax on the end-consumer, under GST.

Then, we agreed for a dual GST and an IGST …

The Empowered Committee of State Finance Ministers (EC) set up a Joint Working Group in May 2007 and unanimously proposed a State level GST, distinct from the GST levied by the centre, on all goods and services which would be brought into the GST fold. The following were the justifications provided by the EC for imposition of a State GST –

(a) additional power of levy of taxation of services for the States,
(b) system of comprehensive set-off relief,including set-off for cascading burden of CENVAT and service taxes,
(c) subsuming of several levies such as Entertainment Tax and GST and
(d) removal of burden of CST.

Keeping in view the report of the Joint Working Group, the views received from the States and the Government of India, a dual GSTstructure with defined functions and responsibilities of the Centre and the States was ultimately agreed.

It was very clear at that point in time that GST shall have two components: one levied by the Centre (Central GST), and the other levied by the States (State GST). This however, introduced a new constraint in the GST model - Cross utilization of ITC between the Central GST and the State GST would not be allowed. This was the first breach of the fundamental pillar of elimination of cascading effect of taxes in the GST regime.

The EC also suggested an IGST model for taxation of inter-State transactions of Goods and Services. However, it was proposed that Centre would levy IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and services. The inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on his purchases. The Exporting State will transfer to the Centre the credit of SGST used in payment of IGST. The Importing dealer will claim credit of IGST while discharging his output tax liability in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information will also be submitted to the designated Central Agency which will act as a clearing house, verify the claims and inform the respective state governments to transfer the funds.

The major advantages of IGST Model were touted as:

a) Maintenance of uninterrupted ITC chain on inter-State transactions.
b) No upfront payment of tax or substantial blockage of funds for the inter-State seller or buyer.
c) No refund claim in exporting State, as ITC is used up while paying the tax.
d) It is a self-monitoring model.
e) Level of computerization is limited to inter-State dealers and Central and State Governments should be able to computerize their processes expeditiously.
f) As all inter-State dealers will be e-registered and correspondence with them will be by e-mail, the compliance level will improve substantially.
g) Model can take ‘Business to Business’ as well as ‘Business to Consumer’ transactions into account.

It was also proposed that revenues collected by the Union on account of IGST will be apportioned between States and Union as per the law providing for the mechanism for apportionment of such revenue by the GST Council.

At this point in time, reports and discussion papers doing the rounds pegged the revenue neutral rate (RNR) at 11 percent and GST rate was proposed at 1 -2 percent above the RNR. Thus a 12% CGST and 12% SGST was on the cards and industry as well as the public too were happy with these rates.

Then, we decided to keep a few goods and levies out of GST …

The States, through the EC, vehemently opposed any and every attempt by the Centre to include alcoholic beverages, petroleum products (including natural gas) and stamp duty in the GST fold. They steadfastly held on to their stand that Sales Tax/VAT could be continued to be levied on alcoholic beverages and petroleum goods as per the existing practice.

Eventually, we decided to have two rates with in-built compensation for States . . .

With the Centre and the States going back and forth on the floor rates, it was agreed that GST for goods will have a two-rate structure –a lower rate for necessary items and items of basic importance and a standard rate for goods in general. There will also be a special rate for precious metals and a list of exempted items. However, the standard rate was now being proposed at 16% instead of the earlier 12%, to compensate the States for any losses that they might suffer on account of introduction of GST.

For taxation of services however, a single rate, around 16% was proposed for both CGST and SGST.

Finally, we have 2 GSTs, an IGST, a two-rate GST strucutre, many goods and levies out of the GST fold, an additional 1% tax on interstate supplies of goods, compensation to States, …

Interestingly, the Constitution (122nd Amendment) Bill, introduced in the Parliament in December 2014, not only reflects the palpable mistrust between the States and the Centre, so far as collection and distribution of revenues in the GST regime are concerned, inspite of the general agreement between them on the floor rate to be pegged at 16%, both of these Constitutional Bodies continue to bicker over the overall authority to decide on tax rates, revenue sharing, turnover threshold, etc.A constitutional Body called the GST council was to be constituted by the President of India within 60 days from the passing of the Constitution (122nd Amendment) Act, 2014. This mistrust is also witnessed from the amendments carried out to the Constitution Bill so as to dilute the authority of GST Council by vesting the final veto power in the Centre and the States for deciding on:

(a) the taxes, cesses and surcharges levied by the Union, the States and the local bodies which may be subsumed in the GST;
(b) the goods and services that may be subjected to, or exempted from the GST;
(c) model GST laws, principles of levy, apportionment of IGST and the principles that govern the place of supply;
(d) the threshold limit of turnover below which goods and services may be exempted from GST;
(e) the rates, including the floor rates with bands of GST
(f) any special rate or rates for a specified period, to raise additional resources during any natural calamity or disaster;

(g) the date on which the GST is to be levied on specified petroleum products and natural gas

GST will now come with a plethora of following additional taxes –

- *Additional levy of excise duty* - Specified petroleum products, natural gas, tobacco and tobacco products will continue to attract excise duty in addition to the GST on such goods;
- *Additional levy of VAT* - Intra-State sale of Select petroleum products and alcoholic beverages will continue to attract VAT in addition to the GST levied on such goods;
- *Additional levy of Additional Tax* - There will be an additional one percent tax levied on inter-state supply of goods for the first two years and such tax shall be collected by the State where the supply originates. This additional levy will be similar to the Central Sales Tax presently levied on inter-state supply of goods and will be administered in a pretty much similar way.

  Only the Central Government will be empowered to exempt any class of goods from such additional tax.

And we are still not sure when GST will finally come and in what form!

In order to ensure that the Constitution Bill is passed by the Rajya Sabha (upper house of the Indian Parliament) with a two-third majority, a select panel was appointed by the Central Government at the instance of the major opposition parties in the parliament. Government has accepted all the recommendations of this select panel, primarily being –

- Full, five-year, constitutionally guaranteed compensation to states for any revenue loss from adopting GST; and
- Retention of the 1% additional tax on inter-state supply of goods

However, the select committee did not accept the proposal for raising states' voting right to three-fourth (75% of all the votes) in the GST council, up from two third proposed in the Constitution Bill. The present voting structure already provides for decision making at the Council with three-fourth (75%) of weighted votes of the members present and voting, thus making it practically impossible for either the Centre with one third weighted votes or the states with two third weighted votes to pass resolutions without the other's support. Insistence by the opposition parties therefore, for an even greater say for states at the Council doesn't make much sense.

The 1% origin based tax on inter-state trade distorts the GST design considerably, and eventhough it is proposed to last early for initial two years of GST regime, it is almost certain to cause heartburn for trade and consumers.

Thus, in spite of a passage of almost a decade since the first announcement of our intent to introduce GST, we still do not find any clarity in direction or vision of any stake holder in finalizing the GST framework. Nobody is still certain on whether we have heard the last word on the basic GST structure or there is more to be unfolded in the days to come. With complexities introduced in the landmark tax reform to appease all the stake holders, the GST that is ultimately going to see the light of the day is going to be a far cry from the one which was initially the aspiration and dream of every Indian. When the D day finally arrives, we are bound to ask each other, "whose GST is this anyway?"

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Tax Controversy - TDS on Car Hire Charges

If you thought that the question of tax-deduction at-source ('TDS') on car hire charges for corporate executives was an easy one to answer and that you were safe by deducting u/s 194C i.e. contractual payments, think again!

In what would qualify as a useful guide, the Mumbai ITAT has, in a recent judgement, outlined its thoughts on this subject. In the case of ITO Vs. BSNL [reported at **2014**-TIOL-203-ITAT-Mum], the ITAT has held that car hire charges would be covered under the ambit of 'equipment rentals' leading it to suffer TDS u/s 194I of the Act. Significantly, the ITAT has conceded deduction for cost of fuel and chauffeur, holding that these amounts ought to be exigible for TDS u/s 194C of the Act.

Interestingly, the ITAT has observed in this judgement that when the arrangement would include making available services of a chauffeur as well as meeting the fuel cost of transportation, then the portion referable to services of chauffer as well as fuel cost cannot be seen as towards car rental.

Alternate View

In these circumstances, it may be worthwhile to consider the view adopted by the Mumbai ITAT in the case of TATA AIG General Insurance Co Ltd Vs ITO [reported at **2010**-TIOL-811-ITAT-Mum]. In this case, on similar facts, the Mumbai ITAT had held that where the assessee had not made any payment for use of a particular car but the payment was made for transportation of its employees/guests as per the requirement, it was only the arrangement for providing cars of a particular category to facilitate transportation of the employees and guests of the assessee from one place to another, the tax at source from the payment of car hire charges was required to be made by the assessee as per the provisions of section 194C, read with Explanation (iv)(c) thereto.

Our Comments

The moot point to be evaluated in the context of car hire, is what does the transaction with its features convey – does it show the characteristics of rent or contractual obligation? No doubt, one could postulate that the element of a contractual obligation in case of rental payments is innate. However, appropriate characterization becomes imperative especially where the TDS rates differ.

If the car is hired (with or without driver) for a **period of time** say one day or one month, the consideration is more likely to answer the description of rent. In this case there is no obligation on the vehicle owner to do any specific work.

On the other hand, if the car is hired for **specific tasks** such as airport pick up and/or drop or on the basis of rates per kilometer and payment is made on the basis of actual mileage travelled – which involves carrying on of work of transportation - it is more likely to answer the description of work.

With due respect, application of the BSNL judgement (as above), in our humble view, is fraught with practical difficulties. For instance, service providers usually provide a consolidated bill for the car hire and do not itemize the invoice for the cost of fuel, chauffeur and car hire per-se and so on. So the question arises how to apportion these costs and then the facet of "reasonable deduction" for these costs remains subjective and susceptible to avoidable litigation.

Though the Revenue would try and argue that the BSNL judgement, being delivered at a later point in time, propounds the correct position on this subject, yet with humble regards, in our considered view, it is submitted that the TATA AIG judgement seems to be practicable, reflects the intention of the parties involved more closely and consequently, seems to be the better interpretation of the situation. In any case, in view of a conflict of views between two benches of coordinate strength, the matter ought to have been decided by a larger (Special) bench. Of course, at the moment, there is no rate disparity as the TDS rates applicable under sections 194I and 194C for car hire charges would be same i.e. 2%. But the controversy would have an impact for the period before 1.10.2009 where the TDS rate for equipment hire was 10%.

So next time, you believe the TDS position on car hire charges was a no-brainer, do consider the discussion above. The jury is still out on this one, though!

The relevant excerpts are reproduced below, with emphasis supplied by us, for understanding.

Quote

The arrangement in the present case is to make available a car (vehicle) for a designated person or class of persons, for a particular time/user, of course coupled with other facilities. The vehicle is decidedly at the disposal of the user. Stipulations as to distance and time is only toward regulating the said availability and, besides, have a direct implication on the charge/s (to be) raised as well in-as-much as payments for user beyond defined user parameters, viz. as to time (say, 8 or 12 hrs. a day, or from 9 a.m. to 6 p.m.) or mileage (as, say, 1500 kms per month), etc., would attract a higher charge. Why, even **where a hire is on a regular basis, the same would assume the nature of 'rent', as clarified by the CBDT per its Circular No. 715** (supra), relied upon by the assessee, with reference to the hire of a hotel room (refer Q. No. 20 and answer thereto). **A vehicle would only stand to be covered by the definition of 'plant' or 'machinery', which are both generic terms of wide amplitude**, even as, admittedly, the specific definition thereof u/ss. 43, 44BB, etc. may not be applicable for the purposes of s.194-I.

In our clear view, therefore, the arrangement is not toward the provision of carriage services, as understood by the first appellate authority, but for making available cars for the assessee's personnel. At the same time, clearly, the arrangement also includes making available services of a chauffeur as well as meeting the fuel cost of transportation. The same cannot by any means be considered as toward car rental. Subject to a reasonable deduction in respect of charges in its respect, based on the materials and/or information led by the assessee, which would though stand to be considered as toward contractual services covered by section 194-C, the balance amount would fall to be governed by u/s.194-I. Our decision, being based on finding/s of fact, the assessee's reliance on case law would be of no moment, though in fact none was specifically referred to.

Unquote

The nature and limits of retrospective taxation

The wish list of a taxpayer is very limited: she wants to see certainty and predictability in the system and credibility from the Government in its promises. When she enters into a transaction, she wants to know what its tax consequences will be. In India, these salutary principles of fiscal governance have of late been repeatedly jolted: first, the last Government overruled the Supreme Court judgment in *Vodafone International Holdings B.V. v. Union of India & Anr. (2012) 6 SCC 613* and retrospectively amended the law relating to the taxation of capital gains from 1st April, 1962, sixty years back in time when many of the present day actors in the saga had not even been born. The cause for this elaborate exercise was an international transaction which took place abroad and involved two foreign companies, none of whom was resident in India! Secondly, even more recently, the present Government, shortly after coming to power, seized upon a judgment coming from the Authority from Advance Rulings Authority in the case of *Castleton Investments Limited (A.A.R. 999 of 2010)(TS-607-AAR-2012)*and began issuing notices for the levy of minimum alternate tax (MAT) on incomes alleged to have escaped assessment in earlier years. These two separate developments have made both Indian and foreign taxpayers alike ask if there any limits at all on the powers of the Government to shift the goal posts and change tax laws with retrospective effect. Fortunately three Supreme Court judgments have shed considerable light on such powers. But when it comes to the crunch, we have to accept that such powers are vast; and constraints that do exist are mostly judge made. Even if the present Government is sincere in its assurances that it will not misuse these powers, they are potentially quite capable of being misused.

In *CIT v. Vatika Township Pvt. Ltd 2014-TIOL-77-SC*, the Court ruled on the date from which a certain surcharge on search assessments was to took effect. . The surcharge was introduced with effect from 1st June 2002, but was applicable to the assessment year relevant to the previous year (that is the financial year) in which the search took place. The Revenue argued that the provision was only clarificatory and desired that it should apply to all pending assessments; that is the assessment year starting on 1st April, 2002 (assessment year2002-03) and earlier assessment years if need be. The court did not accept this plea and held instead that the law would apply only to searches which took place on or after the above date. It pointed out that the nature of, and the extent to which, legislative power can be exercised retrospectively has never really been codified, and most of the principles have to be gleaned from judge made law. When such law is enacted, the courts will insist that the intention to effect a retrospective amendment should be explicit and unambiguous. The normal presumption is that the law enacted will take prospective effect. The rules of legal interpretation in India respect the Latin maxim *lex prospicit,non respicit* The law looks forward and not backward. When it does look backward, it should not seek to change the character of a transaction that has already occurred; impose fresh obligation or modify an accrued right, unless the legislature has specifically intended otherwise.

The vast powers vested in the Government to legislate with retrospective effect were reiterated in March this year in the case of *Netley 'B' Estate (civil appeal nos. 8617-8635 of 2003)*. In this case, The Karnataka Government tried to remove the lacuna in its Agricultural Income-tax Act by amending section 26(4). The amended new provision stipulated that even though the firm was actually no longer in existence, it was by a legal fiction still deemed to be alive for tax purposes and persons who constituted it would still have pay tax on such income even after it had been dissolved. This law was made in 1997 but was made effective from 1st April, 1975, twenty two years earlier. The amendment specifically sought to change the conditions in which the Supreme Court's own judgment in *L.P. Cardoza and others v. Agricultural Income-tax Officer and others [(1997) 227 ITR 421* was rendered. While upholding this amendment, the Supreme Court ruled that the Legislature is competent to amend law retrospectively so as to remove the lacuna pointed out by the Court and render an earlier decision of the Court ineffective. The legislature cannot, however, directly enact a law with the express object of overriding or revising the judgment of the Court or nullifying its directions to the parties. Also, the amendment must fall within the framework of the Constitution and pass the test of reasonability. The Court agreed with its earlier decisions to the effect that a liability cannot be created retrospectively for the first time; nor can a vested statutory right or relief be withdrawn from a back date, unless there are strong and exceptional circumstances for doing so (*Tata Motors Ltd. v. State of Maharashtra and others (2004) 5 SCC 783).* Halsbury further points out that retrospective effect will be given, when not to do so will do violence to the language of the enactment (Halsbury in volume 36 of the *Laws of England -3rd edition*).

These principles were applied by the Supreme Court in the case of *Sarkar Builders TS-279-SC-2015*: certain commercial area restrictions were introduced as a condition precedent for claiming a tax concession applicable to certain industrial undertakings and housing projects under section 80-IB of the Income -tax Act. These restrictions took effect from 1st April 2005. Ordinarily, this new law would have been applicable to the assessment year 2005-06, because direct taxation in India is based on the principle that the law applicable is the law as it stood on the first day of the assessment year. This is what the Revenue pleaded for. The Court held otherwise because following this principle, even though time honoured, would have been extremely unfair to assessees who had obtained approvals for their projects from local authorities on the basis of the unamended law in force prior 1st, April 2005. The assessees concerned could not have anticipated the change in law, and could not be expected to demolish buildings already constructed, so as to bring the project specifications within the ambit of the new law. It therefore ruled that the amendment would apply only to cases where local authority approvals had been obtained on or after 1st, April 2005, after the amendment to the section had already been announced.

These three rulings of the Supreme Court appear to indicate that even with judicial constraints, the power to legislate retrospectively on tax matters is wide, almost draconian in nature. But merely because a power exists, does not mean that it has to be exercised. Restraint, more than retrospective legislative action, is a much better strategy, for building up faith in the tax system and encouraging voluntary compliance with the law. Government must realize that taxpayers have often to spend large sums of money on unproductive tax litigation. For the most part the issues involved in such litigation seldom require a court judgment, and should ordinarily be settled at a lower level. A taxpayer understandably feels doubly frustrated, when, after having spent large sums of money to vindicate her stand, she finds the Government stepping in to amend the law from a back date. To take an analogy from games, the Government must decide whether we are playing hockey, cricket or football. If we are playing cricket, don’t change the rules from a back date to say the batsman is not out when he is caught leg before. That is not sporting!

Supreme Court:

While an amendment to overrule a judgment is not valid, it is permissible to retrospectively alter the character of the levy so as to save it from illegality

FACTS:

The present case is concerned with the assessment of agricultural income received by a firm after it was dissolved. The income of the firm pertained to actual cash receipts after received after dissolution but the the income related to the period before dissolution. *Sub-section 4 was insertedto Section 26 of the Karnataka Agricultural Income-Tax Act ('**KAIT**') by way of an amendment in 1987* .This was the subject matter of the present appeal. It envisages that any sum received after discontinuance of business by a firm is deemed to be the income of the recipient and charged to tax accordingly and taxed as if such income was received before such discontinuance.

Section 27 Of the aforesaid act which is alsoinvolved in the present case lays down that tax on income of a firm, which is dissolved, as opposed to a firm whose business has been discontinued, shall be liable to paid by every person who was at the time of discontinuation or dissolution a partner/member of such firm and every such person shall be jointly and/or severally liable to pay such tax, penalty, etc.

Ratio and Decision

The SC made reference to the case of **L. P. Cardoza and others Vs. Agricultural Income-tax Office and Others (1997) 227 ITR 421 (Karnataka HC)**, where the question posed was whether a dissolved firm could be assessed to Income-tax after the date of its dissolution in respect of income received for supply of goods madeprior to dissolution. This question involved the same sections i.e. S. 26(4) and 27 but as they stood in 1987. The prayer of the appellant was answered by the following observations:

"There is nothing in this provision to indicate that where the firm is dissolved and some income is received after the dissolution in respect of agricultural produce supplied by the firm before its dissolution, the firm itself could be assessed in the year of receipt of income notwithstanding its dissolution."

Two principles were made clear, namely:

1. A firm after dissolution has no existence in the eyes of the law and cannot for that reason be an assessee u/s 27 of KAIT.

2. Section 26(4) would not help for the same reason and also becausethis provision only referred to a case of discontinuance of the business of a firm as opposed to dissolution of a firm.

The Court also held that nothing in the above sections indicated for assessment of income in the hands of the erstwhile firm, in respect of activities carried out pre-dissolution but where such income related to a datepost-dissolution.

After the above decision of the HC the legislature amended the S. 26(4) of KAIT w.e.f. April 01, 1975, by adding an explanation to the section. In the original provision, no express reference was made to companies or associations of persons, and no reference whatsoever was made to a dissolved firm which both have now been added in the amended provision. In the new explanation, the purpose of which is for the removal doubts, the Legislature has declared that when payments are not received pre-dissolution, and that income is received post-dissolution then, notwithstanding the dissolution, the said income will be **deemed** to be the income of the firm in the year it is received and the firm shall be deemed to be in existence. With this amendment, the basis of law as per Cardoza's judgment is changed, which stipulated that there was no deeming provision to make a dissolved firm an assessee where income was earned pre-dissolution but received post-dissolution. The effect of the said amendment is that instead of income taxed in the hands of the recipient it is now taxable in the hands of the dissolved firm.

The said amendment was then challenged before a division bench of the Karnataka High Court. Following the judgment in ***D. Cawasji and Co., Mysore Vs State of Mysore and another [Supp.] SCC 490,*** it was held that the amendment in the particular case suffered from the vice that it interfered directly with the judgment of the High Court and therefore had to be struck down as unconstitutional as the objects and reasons for the amendment was to undo the judgment of the High Court of Karnataka in Cardoza's case.

Counsel for revenue vehemently argued that the factual situation Cawasji's case was completely different from the situation in this case and the same being distinguishable could not be followed. To sum up, it was argued that in the present case the legislature changed the basis of the law of assessment of firms regarding income received after they were dissolved, being something within the competency of the legislature.

Counsel for the assessee relied on the judgment and it was argued that since there was no lacuna to be cured the legislative exercise of amending the section was bad in law, the same being unnecessary. It was also argued that an explanation cannot defeat the substantive provision to which it was attached and hence it is bad in law.

Cawasji's case was considered where the question related to a retrospective amendment made to the Mysore Sales Tax Act, 1957 which retrospectively raised the rate of sales tax from 6.5% to 45%. Even though the collection of sales tax was struck down,. The operative ratio of the judgment stipulated that the legislature instead of remedying the defect or removing any lacuna has by the impugned amendment sought to raise the rate of tax to avoid the liability of refunding the excess amount collected and has further purported to nullify the judgment and order passed by the High Court directing the refund of excess amount collected. The court struck down the amendment on two reasons. The first reason cited was retrospective enhancement of rate of tax from 6.5% to 45%; this was held to be arbitrary and unreasonable. The second reason was the defect / lacuna found by the high court was not sought to be remedied and the only justification provided for such steep rise in tax rate was to nullify the judgment of the High Court.

The Hon'ble Supreme Court held that this judgment was distinguishable from the facts of the current case because in the present case only the basis of taxation was changed by creating a legal fiction to bring to tax dissolved firms for incomes received post-dissolution relating to transactions carried out pre-dissolution. The legislature in the present case did not go to directly nullify the ratio in Cardoza's case but the legal foundation in Cardoza's case was retrospectively removed. This amendment is well within the competency of the Legislature.

The Hon'ble Supreme Court considered the case of ***Sri Ranga Match Industries and others Vs Union of India and others [1994] (Suppl.) 2 SCC 766*** where the court dealt a similar situation of a retrospective validation of a statute otherwise declared unconstitutional. Cawasji's case was relied upon in this case but was distinguished on the ground that *Cawasji's case cannot be read as laying down that in no event can the legislature seek to render the judgment of the Court ineffective and inoperative by amending or rectifying the defect or lacuna pointed out.* This is in the competency of the Legislature / Parliament which has been reiterated by various courts and judgments.

Case of ***Indian Aluminum Co and others Vs. State of Kerala and other (1996) 7 SCC 637*** was considered and even there Cawasji's case was relied upon. Judicial principles were laid down in this judgment which are as follows:

1. The adjudication of the rights of the parties is the essential judicial function. Legislature has to lay down the norms of conduct which govern parties / transactions and require the courts to give effect to.

2. Constitution delineated in a very delicate manner the powers between the Legislature, the Executives and the Judiciary.

3. Legislature exercised its powers per Article 245, 246 and companion articles and respective lists in the seventh schedule which includes the power to amend the law.

4. Courts must preserve balance devised by the Constitution between the three Sovereign functionaries. All functionaries required free play and space in their joints so that social order remains unimpeded.

5. To maintain and safeguard the judicial power it is necessary to check that there is no incursion into judicial preserve of invalidation of a valid law competently made.

6. The court must therefore always scan the law to find out:

a. Whether the vice pointed out by the court and invalidity suffered by previous law is cured complying with legal and constitutional requirements.

b. Whether the legislature has competence to validate the law

c. Whether the validation is consistent with rights guaranteed in Part III of the Constitution of India.

7. Courts cannot validate an invalid law or legalise impost of tax illegally made and collected or to remove the norm of invalidation or provide a remedy. These are not judicial functions, but the exclusive province of the legislature. Therefore it cannot be said to be encroachment on judicial power.

8. By exercising legislative power, by mere declaration, the legislature cannot directly overrule or override a judicial decision. It can only render a judicial decision invalid by effecting a valid law on the topic within its legislative field fundamentally altering or changing its character retrospectively.

9. The consistent rule that is constantly iterated by all Courts is that legislature cannot directly overrule the decision or make a direction as not binding on it but has power to make the decision ineffective by removing the base on which the decision was rendered, consistent with the law of the Constitution, and the legislature must have competence to do the same.

The legislature in this case has not directly overruled the decision of any court but has only rendered the decision ineffective by removing the basis on which the decision was arrived at.

The Supreme Court also cited that ***Panchi Devi Vs. State of Rajasthan and Other (2009) 2 SCC 589*** could not be applied as in the present case because there was no right or liability created for the first time; the only thing done in the present case is that a firm is that by legal fiction a firm is continued for certain purposes of assessment even after its dissolution***, Tata Motors Ltd. vs. State of Maharashtra and others (2004) 5 SCC 783*** could not be applied as there was no withdrawal of any right which has become a vested statutory right which deprives the assessee of anything in the present case. The judgment of ***Hardev Motor Transport Vs. State of Madhya Pradesh (2006) 8 SCC 613*** could not be applied as the main provision was expanded to include dissolved firms and the explanation creates a legal fiction in furtherance of the main provision to include a dissolved firm to be in existence for certain assessment purposes.

Looking at the non-encroachment upon the judicial function and the sole ideal being that there is creation of expanse to the main provision and not a specific nullification of the judgment the appeals of the revenue were allowed.

Comments:

The Courts have held that wherever there is an encroachment of the executive and the legislature into the functions of the judiciary, the principles of jurisprudence enshrined by the Constitution stand violated. Where any amendment -whether retrospective or prospective- is enacted to specifically nullify the judgment of a High Court it would be violative of the Constitution of India.

Our Parliament and state legislatures have in the past many timesenacted retrospective amendments . The Vodafone Ruling of the Hon'ble Supreme Court of India is an example. But it is seen that when Parliament has done so, it has treaded that very thin line of bifurcation between the Legislature, the Executive and the Judiciary with caution and has through its amendments, often changed the basis of levying tax without directly nullifying any court order.

Citation: **ACIT (Agr. IT) vs. Netley 'B' Estate (Supreme Court) TS-141-SC-2015(SC.)**

High Court

Mere filing of an appeal against the order of AO doesn't stay recovery proceedings

Facts and issue: Assessment u/s 153A was made vide assessment order passed in March 2015 and tax demand was raised. The assessee filed an appeal before CIT(A) against the said order. The assessee also made application u/s 220(6) to AO to keep the recovery proceedings in abeyance till the disposal of appeal filed. AO denied the request to keep the demand in abeyance till disposal of appeal against which the assessee filed writ with the High Court.

Decision: HC noted that the Revenue had rejected stay application since the request cannot be conceded merely on the ground that appeal before CIT(A) was pending. The assessee will have to make out a case by furnishing details such as (i) Assessment history of the case (ii) His conduct and cooperation with the Department (iii) Points raised in Appeal (iv) chances of recovery in the event of dismissal of Appeal (v) the hardship that would be caused by persistent demand of Department. The power u/s 220(6) of the IT Act was not a power to grant stay against the recovery of disputed demand but in fact it only bestows discretion on the Revenue to not treat the assessee in default subject to such conditions as are deemed fit to impose and thus save the assessee from the consequences of interest liability u/s 220(2) and penalty u/s 221of the IT Act. HC observed that the assessee had failed to substantiate its contention that order denying stay suffers from any infirmity. Accordingly, HC held that mere filing of appeal does not suo motu stay the recovery proceedings and that the Revenue is empowered to exercise its discretion.

Citation: Jalan Jee Polytex Ltd, Allahabad High Court, Writ Tax No. 477 of 2015

Inaccurate particulars sufficient for penalty to be levied u/s 271(1)(c), deliberate concealment not a pre-requisite

Facts and issue: The assessment proceedings for AY 2004-05 were completed u/s 143(3) determining the taxable income under the provisions of section 115JB. Subsequent to the completion of its assessment proceedings u/s 143(3) for AY 2004-05, assessee filed revised return of income wherein a payment to U.P. Distiller's Association ('UPDA') of Rs 3.40 crore was disclosed and added back as a disallowable item under explanation to section 37(1) of the IT Act and accordingly book profit was also recomputed by adding Rs 3.40 crore. Since the assessment was completed u/s 143(3), the revised return was treated as an invalid return by the department. However, since the assessee had disclosed a sum of Rs. 3.40 crores as additional income, which required verification, the case was re-opened u/s 147 of the IT Act.

During reassessment proceedings, AO noted that the assessee had offered amount of Rs. 3.40 Cr. pursuant to search carried out on UPDA and therefore the declaration was after the search carried out on UPDA and the amount were detected in the said search. In response to notice u/s 271(1)(c) assessee submitted that it had filed revised return on its own volition to avoid protracted litigation and it did not controvert on the genuineness of the information gathered by the Department in the search on UPDA. The assessee submitted that it wished to put a quitous to the issue. Assessee also submitted that it never owned such payment and no concealment was detected in course of assessment proceedings. AO rejected the assessee's contention and levied penalty u/s 271(1)(c) towards concealment of income.

Tribunal held that since the assessee itself offered the additional income and the department has not brought anything positive on record to substantiate the conclusion that the assessee has mens rea of concealment of its true income or furnishing of inaccurate particulars, penalty u/s 271(1)(c) could not be levied.

Decision: HC on analysis of provisions of section 271(1)(c) observed that "if assessee furnishes inaccurate particulars coupled with absence of satisfactory explanation, that would per se make the assessee liable to pay penalty. Concealment of income shall be presumed if there is difference between the returned and assessed income and the initial burden is on the assessee to rebut the presumption by giving bona fide explanation about the expenditure in respect of which the addition or disallowance of any amount is made in the assessment. "
HC noted that summon was issued to assessee with regard to the payments made to UPDA. The assessee instead of appearing and producing the documents submitted that it would not like to make any comment about the genuineness of the information relating to payment to UPDA.

HC also noted that the assessee did not expressly own up the payment of Rs.3.40 crores to UPDA. However, the absence of cogent and bona fide explanation on the part of the assessee in regard to payment to UPDA would attract the presumption of concealment of income

When the return already filed by him for AY 2004-05 u/s 139 includes an expenditure disallowable it would automatically follow that inaccurate particulars had been furnished in the return originally filed. As per sec 271(1)(c) if the assessee furnished inaccurate particulars coupled with absence of satisfactory explanation that would per se make the assessee liable to penalty. Concealment in such a case would be presumed provided assessment leads to addition or disallowance of the amount. The assessee had admitted that the original return filed by him included expenditure disallowable.

Honorable Calcutta High Court has inter alia referred to the judgments of Honourable Supreme Court on the issue of concealment of income and levy of penalty rendered in the context of changed scenario after omission of the expression deliberately in sub clause (c) of Section 271 (1) by the Finance Act, 1964 and has quoted the observations as follows-in the case of Union of India vs. Dharmendra Textile Processors 2008 (13) SCC 369 Honourable Supreme Court had held that penalty u/s 271(1)(c) is a civil liability and wilful concealment is not an essential ingredient.

in case of MAK Data Pvt. Ltd. [TS-545-SC-2013] Honourable Supreme Court had held that explanation to Sec 271(1) raises a presumption of concealment when a discrepancy between return and assessed income is noticed by the AO and the burden is then on the assessee to show otherwise by submitting cogent and reliable evidence.

Further Honourable Calcutta High Court noted that there is no doubt that ITAT is the final fact finding authority and in the present case, ITAT was correct in observing that no independent evidence was adduced by the Revenue to prove that the alleged payments reflected in the seized papers were actually made by the assessee. But on this basis, it cannot be concluded that that there was no concealment of income arising out of furnishing of inaccurate particulars. HC noted that in Revenue matters there is no scope for equity but in the present case the charge of concealment of income arising out of furnishing inaccurate particulars has duly been proved.

Accordingly, HC upheld the action of AO in levying penalty.

Citation: Balarampur Chini Mills Limited, Calcutta High Court, ITA 176 and 678 of 2008

Once DSIR certifies Sec 35(2AB) scientific research expense, AO can only follow procedure laid down in section.

Facts and issue: Assessee was engaged in the business of software-development, manufacturing and trading of networking equipment. For AY 2009-10, assessee claimed weighted deduction u/s 35(2AB) of Rs. 89.35 crore in respect of research and development (R&D) expenditure pursuant to the certificate from prescribed authority (viz. DSIR).

The AO noted that expenditure in respect of which weighted deduction u/s 35(2AB) was claimed was expenditure towards acquisition of rights in or arising out of scientific research as indicated in clause (ii) of Sec 43(4) which was specifically excluded from deduction ambit, being falling out of 'scientific research' definition. AO accordingly disallowed claim u/s 35(2AB) to the extent of Rs 48.41 crore on the ground that where the express provisions of the Act exclude certain expenditure from the purview of Sec 35, such expenditure cannot be allowed. On appeal DRP confirming action of AO held that where the express provision of the Act excludes certain expenditure such expenditure cannot be allowed and the certificate issued by DSIR cannot overrule express provision of the Act.

Being aggrieved, assessee instead of filing appeal with Tribunal filed writ petition before Karnataka HC seeking quashing of the assessment order u/s 143(3) r.w.s. 144C(13).

Decision:

Maintainability of writ petition

Revenue contended that the petitioner did not avail alternate remedy of filing an appeal before ITAT u/s 253(4) of the Act and hence the writ petition was not maintainable. HC noted that it had discretion to entertain or not to entertain a writ petition. The availability of an alternate remedy would not act as a bar for the Court to exercise the extraordinary power except in the case where writ was in regard to i) for enforcement of fundamental rights, ii) violation of principles of natural justice, iii) where the order or proceedings under challenge is attacked or being vitiated on the ground of such authority acting without jurisdiction and iv) where constitutional validity of a provision in a statute is itself under challenge. The issue under consideration was issue of jurisdiction of AO and therefore HC held that the writ petition was maintainable.

Sec 35 deduction - scope of AO's powers

Assessee contended that DSIR was prescribed authority under Rule 6(1) empowered to issue certificate to assessee who claims allowance of expenditure u/s 35(2AB). Once certificate of expenditure is issued by DSIR it is deemed that assessee has compiled with the conditions and the jurisdictional AO would be out of bounds to examine the correctness of the said certificate.

Revenue contended that without going into the issue of the correctness of such certificate or its contents thereof, AO had power to disallow assessee's claim if the expenditure claimed was specifically excluded from the ambit of Sec 35.

HC noted that clause (b) of section 35(3) provides that in the event of any question arising before the AO u/s 35 as to whether amount certified by the prescribed authority is eligible for being allowed as expenditure and to what extent and whether such activity constitutes or constituted, or any asset is or was being used for scientific research, then AO has to request the Board to refer such question to the prescribed authority. Thus the controversy arising out of certificate issued by the prescribed authority has to be referred to the prescribed authority by the Board on such doubt being raised by AO.

The correctness or otherwise of the order passed by the prescribed authority would not be examined by the AO or by the Income Tax Authority. The exercise of certification of scientific Research & Development expenditure has been outsourced by the Income Tax Department and same is being done by the prescribed authority namely DSIR..

HC held that when DSIR had certified the extent of expenditure which would be allowable, then AO could not sit in judgment over the report of DSIR. AO would be exceeding his jurisdiction, if he were to undertake the exercise of examining as to whether the certificate issued by the prescribed authority is within the parameters of statutory provisions of the Act or otherwise. The AO can however raise the issue to the CBDT.

After considering the fact that such contingency may arise, Parliament has specifically incorporated sub-section (3) to Section 35 of the Act which clearly indicates that where the AO does not accept the claim of the assessee made under Section 35(2AB), he has to refer the matter to the Board, which in turn, will refer the question to the prescribed authority and the decision of the prescribed authority in such case would be final.

It is the prescribed authority alone which would be competent to take a decision with regard to correctness or otherwise of its order of approval granted in Form No.3CL as prescribed under Section 35(2AB) of the Act read with Rule 7A of the Rules. Neither AO nor Board would be competent to take decision on such report as it involves expert view or opinion.

HC held that the aforesaid view was also fortified by Gujarat HC ruling in DCIT vs. Mastek Ltd. [TS-678-HC-2012(GUJ)].

Accordingly HC held that since DSIR being the prescribed authority had approved such expenditure in the prescribed certificate, assessee would be entitled to claim weighted deduction. HC thus allowed assessee's writ and deleted the disallowance.

Citation:Tejas Networks Limited, Karnataka High Court, Writ Petition No 7004 / 2014

Number of days spent by an individual, involuntarily because of impounding of passport pursuant to court order shall be excluded for deciding residential status of the assessee

Facts and Issues: The assessee wasl iving and working in United Arab Emirates (UAE)and was non-resident during the period 1985-2006. His passport was impounded on October 10, 2006 during his visit to India which began from September 28, 2006 and was released only on September 21, 2011 pursuant to the court orders.

In view of the passport being impounded the assessee, was on Indian soil for 185 days during AY 2007-08 and throughout during AY 2008-09.The AO denied the assessee's claim to be treated as "non-resident" and based on his physical presence during the year treated the assessee as resident and assessed income. The action of AO was confirmed by CIT(A).

Proceeding before the Tribunal

The assessee contended that he was assessed as "non-resident" consistently since 1985.His stay in India during the AY 2007-08 and AY 2008-09 exceeded 182 days only because of reasons beyond his control. His passport had been impounded by the government agencies rendering him unable to travel from India. The Tribunal noted that the assessee made every legal effort to maintain his past status as "non-resident". Only wrongful impounding of passport prevented him from exercising his lawful right of travelling abroad. Accordingly Tribunal held that for calculation of the assessee's stay in India for the relevant years, the days of wrongful impounding of passport which constituted forced stay in India, should be excluded.

Decision of High Court

Interpretation of statutory provision

- High Court noted that a strict interpretation of the rule contained in section 6(1)(a) of the Act would render the assessee a resident of India. It was neither just, nor fair, nor in consonance with the intention of the legislature. The High Court relied on SC rulings in CIT vs. JH Gotla (156 ITR 323) and CWS (India) Ltd vs. CIT (208 ITR 649) which supports the view that it is permissible, even in the field of taxation, to prefer such construction as results in equity over such literal meaning as is unjust. It also referred to the established legal principle that where literal interpretation of a statutory provision produces unjust or unreasonable results, than it is permissible, to prefer such construction as results in equity over such literal meaning as is unjust. The assessee made repeated pleas not only for removal of all restraints against his movement, but more importantly, for release of his passport so that he could go abroad and retain the "non-resident" status, he had been enjoying all along.
- The Act leaves the choice with the citizen of India to be treated as a "resident" for purposes of taxation or be "non-resident". The option to be in India was a matter of the assessee's discretion and that conversely presence in India against the will or without the consent of the citizen must not be counted adverse to his chosen course or interest.

Ruling of the Court

High Court held that strict interpretation to section 6(1)(a) of the Act in the above case would result in unjust, unfair or absurd consequences. Involuntary stay during the period that followed till the passport was restored under the Court's directive must therefore be excluded for calculating the period under section 6(1)(a) of the Act.

The High Court specifically noted that it shall not be treated as a thumb rule that each period of involuntary stay must invariably be excluded for counting stay in India. To decide residential status vis-à-vis cases of involuntary stay, each case will have to be examined on its merits in the light of the facts and circumstances leading to involuntary stay, if any, in India.

Citation: **CIT vs Suresh Nanda (TS-321-HC-2015)(Del.)**

Liability to pay service tax arises only on actual receipt of consideration. In absence of statutory liability to pay service tax, no disallowance can be made under section 43B

Facts and Issue: The assessee filed return of income without making disallowance of unpaid service tax. The AO made disallowance under section 43B on account of unpaid service tax. The CIT(A) deleted the disallowance of service tax under section 43B, as the same was not payable as on March 31, 2007 as the amount on which service tax was payable had not been received from the parties to whom services were rendered.

Decision: Section 43B does not contemplate liability to pay the service tax before actual receipt of the funds in the account of the assessee. Liability to pay service tax into the treasury arises upon the assessee receiving the funds and not otherwise. When services are rendered, the liability to pay the service tax in respect of the consideration payable will arise only upon the receipt of such consideration and not otherwise.

Accordingly, it was held that in absence of statutory liability to pay service tax, no disallowance can be made under section 43B

Citation: CIT vs. Ovira Logistics Pvt. Ltd [(TS-215-HC-2015(BOM))] (Mum.)

International Tax & Transfer Pricing

Show -cause notice is must before rejecting uncontested comparable

Facts and Issues: Assessee, Financial Objects Software (India), engaged in the business of software development. Assessee reported international transactions entered into with the Associated Enterprise (AE). The TPO rejected the assessee's T.P. study for various reasons and embarked on a fresh search for comparable and selected a final list of 20 comparables and accordingly proposed adjustment of Rs. 1.23 crores. CIT (A) gave partial relief to assessee by excluding 12 comparables applying various filters such as turnover filter, related party transactions (RPT) filter and export revenue filter. However, CIT (A) did not accept any company proposed by the assessee. Aggrieved, assessee filed appeal before ITAT and apart from other grounds pleaded for inclusion of 2 companies out of the 12 companies excluded by CIT (A).

Decision:

ITAT observed that assessee had not raised any objections against inclusion of these two companies before TPO / CIT (A). ITAT held, "Though the CIT (A) has co-terminus power with that of AO and can enhance the assessment, however, since he has not issued any show cause notice for enhancement under Section 251(2) of the Act, he cannot reject these two companies from the set of comparables."

ITAT thus set aside order of CIT(A) to this extent and directed TPO to recompute ALP after including these 2 companies.

Citation: M/s Financial Objects Software (India) Pvt Ltd [TS-292-ITAT-2015] (ITAT Bangalore)

No portion of receipts from sale of equipment can be taxed in India since all the activities relating to designing, fabrication and manufacturing took place outside India and the sale of equipment also took place outside India on principal to principal basis.

Offshore supply of design / drawings for setting up plants not "royalty" absent commercial exploitation

Facts and issue:

Issue No 1: The assessee a tax resident of Germany was engaged in the business of providing innovative and environmentally sound solutions for a variety of customers in metals and minerals processing industries. During AY 2010-11 assessee supplied equipment to seven Indian companies on export sale basis wherein the title/ownership in the equipment was transferred outside India i.e. before the equipment reached India. Assessee submitted that since the sale contracts were concluded on a 'principal to principal' basis outside India and consideration was received abroad, nothing was taxable in India. AO noted that conclusion of sale was subjected to various acceptance tests to be carried out in India and certain percentage of the payment was also payable upon the successful completion of those tests. Accordingly, AO proposed that 10% of the profit be chargeable to tax from the sale of above equipment which proposition was also confirmed by the DRP.

Issue No 2: The assessee had also provided drawings, designs & engineering documents relating to steel industry in India to the customers for the operation and maintenance of the plant, which were in the nature of basic engineering. The work in respect of above was done primarily outside India and the consideration was also received outside India in foreign currency. Assessee contended that since the basic engineering packages sold by it were designed largely on the basis of standard technologies available with it, the consideration received towards the same was for the sale of a product which was embedded in the plant set up by the Indian customers. Accordingly assessee treated the income earned from the sale of designs and drawings at par with the consideration received from the sale of a product and thus, regarded it as business income. However AO and DRP rejected assessee's contention and held that 10% of the sales revenue was attributable to the Indian PE.

Decision:

Issue No 1: ITAT noted that customer's inspection of equipment and activities relating to designing, fabrication and manufacturing took place outside India. Further the majority of payments i.e. 80-85% for each and every part of shipment became payable upon delivery of equipment. The payments through irrevocable letter of credit makes it clear that even if the ship does not sail or deliver the goods to the destination, the assessee receives payment out of Letter of Credit guaranteed by bank upon FOB delivery. The equipment was directly sold by the assessee on export sale basis and the title/ownership in the equipment was transferred outside India i.e. before the equipment reached India. The buyers were Indian customers who were independent and unrelated parties. The consideration was also received outside India in foreign currency.

In regard to acceptance tests, ITAT held that these were merely in the nature of warranty provisions (only 15% of the payment was receivable by the assessee on completion of various tests) which do not impact the transfer of title and therefore do not merit undue importance. These tests cannot be construed to mean that any portion from the sale of equipment can be taxed in India.

ITAT relying on SC decision in the case of Ishikawajima-Harima Heavy Industries Ltd [TS-30-SC-2007] and Hyundai Heavy Industries Co. Ltd [TS-29-SC-2007] held that no portion of receipts from sale of equipment can be taxed in India both under the provisions of the Act and DTAA since all the activities relating to designing, fabrication and manufacturing took place outside India and the sale of equipment also took place outside India on principal to principal basis.

ITAT relying on Delhi HC ruling in the case of Ericsson A.B. [TS- 769-HC-2011(DEL)], LG Cable Ltd. [TS-2-HC-2010(DEL)] held that in case of supervisory PE only the income arising on account of supervisory activities is taxable in India as the PE has been constituted merely on account of rendition of supervisory services under Article 5(2)(i) of the DTAA. ITAT noted that majority of the assessee's projects did not have a supervisory PE in India and in some, supervisory services had not commenced till the end of FY. The PE under the DTAA has to be determined separately for each of the project in accordance with Article 5(2)(i) of the DTAA. ITAT thus held that in absence of supervisory PE in India for the said projects, the question of any attribution being made for supply of equipment to the supervisory PE doesn't arise.

Issue No 2: Revenue contended that in a contract for erection and commissioning of plant, equipment is a part of the whole plant which consists of various designs, electrical and automated systems. Even though the contract was split into parts, the completeness of the contract was achieved only after the successful testing of the plant. Thus revenue submitted that it was not a case of sale of equipment simplicitor, but it involved a host of services employed at the site level to complete the whole plant. The ultimate ownership of the designs and drawings was never passed to the buyer, and only license to use was granted, the true nature of the receipts were Royalties under the Act as well as DTAA.

ITAT noted that as per the contract and sample copies of airway bill, entire work relating to designs and drawings was done outside India and even the sale was carried out outside India in foreign currency. ITAT relying on the decision of SC in case of Scientific Engg. House Pvt Ltd [TS-6-SC-1985] held that the designs and drawings for setting up plants in India, partake the character of a product and thus, to be assessed as business income.

The designs and drawings sold tantamount to the use of a ‘copyrighted article’ as against use of a ‘copyright’, since the design and drawings were used by the Indian customers for internal business purpose and not any commercial exploitation. ITAT relying on the decision of AAR ruling in the case of Dassault Systems K.K [TS-126-AAR-2010] and GeoQueste Systems B.V. [re., 327 ITR 1(AAR)] held that the restriction on intellectual property would not make any difference since the designs and drawings were used by the Indian customers for internal purpose of setting up plants and not for commercial exploitation. Accordingly, the character of the transaction does not change from the sale of the product to the use of licence/know-how. Retaining intellectual property in designs and drawings was similar to retaining of patented rights in any goods/machinery. Since the sale took place outside India and even the work was done abroad. Thus, such income cannot be taxed either under DTAA or the Act.

Key Takeaway: Hon’ble Tribunal has upheld the proposition that an integrated composite contract should be read as a whole for the purpose of determining the taxability of the amount of consideration payable by the Indian tax payer and should not be dissected into different components/parts though the consideration for each part is stated separately.

Citation: Qutotech GMBH, Kolkata Tribunal, ITA 431 /Kol/ 2014

Multiple year data for comparable is justified if the taxpayer's margin fluctuates over a period of time.

Facts and Issue

The assessee is engaged in the business of providing content related services such as data conversion, composition editorial services and indexing etc. During the year in question the assessee rendered services to its AE Innodata Asia Holdings Ltd., Bermuda which is held by ultimate parent company Innodata USA. The parent company sources the businesses from its customers and the same is then sub-contracted to the assessee. The assessee was compensated for its services based on price per transaction/transmission which in turn is determined as a percentage of the sales made to third parties by the AE. During the AY in question the assessee received, as its remuneration, 76% of the revenue realised by the AE from third parties and the AE retained the balance 24%. From the facts, as mentioned in the order, it is gathered that while the assessee executes the works, the marketing and R&D related to new processes/services is performed by the AE along with assuming credit risks, market risks, technological risks, price risk and service liability risk. The assessee justified the arm's length characteristic of international transaction following TNMM with PLI of OP/OC. The assessee computed the PLI of the 13 comparables, using the weighted average of three years data including the current year data to the extent available at the time of preparing TP Study, at 10.25% as against the OP/OC of the assessee at 6.63%, falling within +/-5% range of the average OP/OC of the comparables.

The TPO, while accepting the TNMM and the PLI selected by the assessee, considered only the current year data of the comparable and also rejected two of the comparables selected by the assessee, based on export filter, and computed the average OP/OC of 11 comparables with current year data only at 17.70% which resulted in TP addition of approximately Rs.3.00 Crores. Aggrieved by the order of the TPO/AO the assessee appealed before CIT (A). CIT(A) upheld the assessee's approach of using multiple year data in respect of comparable on the ground that volume of the business from the end customers fluctuates, the billing rate (price per transaction agreed between AE and its customers remains constant giving rise to fluctuation in profitability of the assessee. CIT (A) remarked that data of the taxpayer reveals facts which has an influence on the determination of the transfer price and such a situation is covered under proviso to Rule 10B(4) allowing for the use of multiple year data. The CIT(A) also did not agree with the rejection of comparable selected by the assessee on the ground of nil foreign exchange earnings as the TPO himself had selected companies which had negligible or nil foreign exchange earnings. CIT (A) also agreed with the arguments of the assessee that the AE is not merely a marketing arm of the assessee but performs R&D functions and assumes significant risks, viz, price risk, technology risks, credit risks, market risks, service liability risks. CIT (A) observed that inspite of broader spectrum of functions and risks assumed by the AE, it retained only 3.38% of its revenue as profit while the taxpayer earned a mark up of 6.63% on its operating cost. Based on this the CIT(A) deleted the TP addition made by the AO/TPO.

Decision

Aggrieved by the order of the CIT (A), the revenue appealed before the ITAT. Agreeing with the reasoning of CIT(A) in respect of use of multiple year data and also on the facts that in the prior year the TPO himself had agreed to the use of multiple year data, the ITAT upheld the application of multiple year data in respect of the comparables. The ITAT also did not agree with the rejection of comparable selected by the assessee on the ground of nil foreign exchange earnings as the TPO himself had selected companies which had negligible or nil foreign exchange earnings. In conclusion, the ITAT upheld the decision of CIT(A) deleting the TP additions made by the TPO/AO.

Comments

In respect of use of multiple year data of comparables, the operative part of the Tribunal order merely mentions that since the revenue itself had adopted multiple year data in the preceding year and no cogent reasons have been given by the TPO to deviate from the same and form a different view, it was arbitrary to use single year data. However, the CIT(A)'s order, which the ITAT has heavily relied upon, raises several questions. First, the CIT(A)'s reasoning for justifying the application of multiple year data for the comparable does not seem to fall within four corners of the proviso to Rule 10B(4). The CIT(A) mentions that fluctuating profitability of the assessee is a situation where data of the assessee reveals facts which has an influence on the determination of the transfer price. However, the proviso to Rule 10B(4), however ambiguous as it may be, unambiguously mentions that in order to use the multiple year data, the data of the uncontrolled comparable should reveal facts which has influence on the determination of the transfer price. Although the way of framing a remuneration model is the prerogative of the businessman as long as the remuneration received by the service provider is commensurate with the functions performed, assets deployed and risks assumed it is assumed to be at Arms' length. Under the facts and circumstances of the case it is clear that the assessee is providing services only to its group company. However, the remuneration model of the assessee is based on percentage of sales made by the AE to third party there by exposing the assessee to market risk, price risk, volume risks and it is not clear whether the assessee assume credit risk or not. If the assessee does not have any say in determination of price and assessee cannot go out and bring business on its own then contractual allocation of market risks, price risks, volume risk etc does not align with arm's length principle because a third party may not be willing to assume those risks on which it does not have any control.

Citation: Innodata Isogen India Pvt. Ltd. [ITA No 1528/Delhi/2011] (ITAT Delhi)

ALP of interest on foreign currency loan should be benchmarked following LIBOR

Facts and Issue

The assessee is engaged in rendering pharma services. During the AY in .question, the assessee advanced loan to its AEs in USA @ 10% p.a. The TPO determined the arm's length interest rate by benchmarking the same against BB rated corporate bonds in India on the premise that loan advanced by the assessee to its AEs are riskier than the government bond. The TPO determined interest rate of 17.26% of BB rated corporate bonds in India and equated the same with the loan advanced by the assessee to its AEs and, accordingly made a TP addition. The assessee, relying on the Chennai Bench judgement in the case of Siva Industries and Holdings Ltd, argued before the TPO that LIBOR based rate should be used to benchmark for loan advanced in foreign currency. The assessee, on a without prejudice basis, also argued that even if at all rate for corporate bond is used then the same should be of the countries where the borrower is situated.

The DRP did not agree with the arguments placed by the assessee and confirmed the TP addition.

Decision

Aggrieved by the order of the AO/TPO/DRP, the assessee filed an appeal before the ITAT. The ITAT, following Chennai Bench ruling in the case of Siva Industries Holdings Ltd, held that LIBOR based rate is internationally recognised interest rate for benchmarking loan in foreign currency. As the interest rate charged by the assessee was not lower than the LIBOR based interest rate, the TP addition made by the AO/TPO/DRP was deleted.

Comment:

There have been a series of judgments on benchmarking of interest on foreign currency denominated loans and the judicial view seems to have settled in favour of adopting LIBOR based interest rate for the purpose of benchmarking the foreign currency loan. Delhi HC, in the case of Cotton Naturals (I) Pvt. Ltd., has also upheld the LIBOR based interest rate for benchmarking the interest on foreign currency loan. In a very recent decision Hon'ble Bombay High Court has in the case of Tata Autocomp Systems Ltd. upheld the use of Euribor rate for benchmarking interest on loan denominated in Euros (TS-45-Bom-HC TP)

Citation: Indegene Lifesystems Pvt. Ltd. [ITA No 1504/Bang/2012] (ITAT Bangalore)

CUP method cannot be applied to benchmark an international transaction by placing reliance on prices in database

Facts and Issue

The assessee is engaged in the business of manufacturing of chemicals. During the AY in question, it entered into international transaction of sales of chemicals to AEs in Germany. The assessee applied TNMM as the most appropriate method to benchmark these transactions. However, TPO rejected TNMM and adopted CUP method on the basis of uncontrolled prices available in database and made a transfer pricing addition. CIT(A) deleted the addition made by the TPO/AO. Aggrieved by the order of the CIT(A), revenue filed an appeal before ITAT.

Decision

The ITAT, relying on ITAT rulings in assessee's own case for AY 2002-03 and AY 2004-05, rejected the application of CUP and upheld the application of TNMM on the facts and circumstances of the case. The ITAT observed that the TPO erred in comparing the price charged in relation to meagre quantity sold to unrelated party locally with the price charged to AE particularly when the quantity of sales to AE was much higher than the sales to Non AE and the geographical location of markets of the AE is different from the Non AE market. The ITAT further observed that the TPO merely relied on the price given in the database without pointing out any comparable transaction. The ITAT, relying on Special Bench Ruling in the case of Aztech Software and Technology Services Limited, wherein it was held that industry average is not a comparable uncontrolled transaction. The ITAT also reasoned that the TPO erred in not taking into account comparability factors such as quality, quantity, transportation costs etc. and should have allowed adjustment for such differences so as to make the controlled and uncontrolled transactions comparable. It was also observed by the ITAT that the assessee's operating margin of 17.13% was much higher than the industry average of 12.87%. In view of these observations, the ITAT upheld the order of CIT(A) deleting the TP adjustment.

Citation: Schutz Dishman Bio-Tech Pvt. Ltd. [ITA No 2060/Ahd/2009] (ITAT Ahmedabad)

AO's mistake of not forwarding the draft assessment order within the prescribed time limit cannot be rectified by way of a subsequent corrigendum.

Facts and Issue: The assessee company was engaged in the business of design, development and export of computer software, software solutions and providing information technology enabled services and related services. The chronology of assessment proceedings for AY 2007-08, in brief, was as under –

Date	**Stage of Proceedings**
17.10.2011	Final assessment order under section 144C r.w.s 143(3) considering the directions issued by DRP
25.01.2012	Order of the Tribunal setting aside the matter to the AO. Specific observation that DRP has not given any reason and/or commented upon the objections of the assessee in the order while agreeing with the adjustments proposed by TPO.
Set aside proceedings -	
12.03.2014	Assessment order passed under section 143(3) r.w.s 254
16.04.2014	Corrigendum stating that the order dated 12.3.2014 was not assessment order but was a 'Draft assessment order'
09.01.2015	Final assessment order considering the directions of the DRP

Thus the AO had passed an assessment order on 12.3.2014 under section 143(3) r.w. 254 of the Act. The AO had issued the notice of demand and also the penalty notice under section 271(1)(C) of the Act along with that order. Further, as per the mandate of section 144C(1) of the Act, the AO should have forwarded a copy of the draft order to the assessee. However, he failed to do so. A subsequently issued corrigendum dated 16.4.2014 stated that the order dated 12.3.2014 was only a ‘Draft assessment order’

Against the order passed by the assessing officer dated 12.03.2014 and the corrigendum treating it as draft assessment order, the assessee filed objections before the DRP and the DRP issued directions dated 5.12.2014 under section 144C(5) of the Act. The assessing officer thereafter passed the assessment order dated 9.1.2015. The assessee filed the present appeal challenging the assessment order dated 09.01.2015.

The issue before the Tribunal was whether issuing a corrigendum stating assessment order dated 12-03-2014 should be read as “Draft assessment order” will make good the mistake committed by the assessing officer?

Decision:

The Tribunal, in its earlier order dated 25.1.2012, had made a specific observation that the DRP had not passed a reasoned order and hence the matter was resorted to the file of the AO. Hence in the set aside proceedings, the AO was required to forward a copy of the draft order as per section 144C(1) of the Act. By passing the assessment order dated 12.3.2014, the AO had failed to follow the directions given by the Tribunal in its order dated 25.1.2012. The Tribunal also considered the issue of notice of demand at the time of passing the order dated 12.3.2014 which indicated that the AO had rushed to complete the assessment.

Provisions of section 144C(13) override the provisions of section 153 only for the limited purpose of completing the assessment in conformity with the directions issued by the DRP under section 144C(5) of the Act. The extended time limit as prescribed under section 144C(13) would have been available only if the AO had completed the process of forwarding the draft assessment order within the time limit prescribed under section 153(2A) of the Act i.e., by 31.3.2014. In the instant case, the draft order was not forwarded to the assessee within the prescribed time. Even the corrigendum dated 16.4.2014 was issued after the prescribed time limit. The Tribunal relied on the decision of Vijay Television Private Ltd. Vs. DRP (2014) (46 Taxmann 100) [Mad High Court] and held that defect cannot be cured by the corrigendum issued subsequently after the expiry of limitation period.

As the AO had failed to follow the mandate of provisions of section 144C of the Act and further failed to comply with the time limit prescribed under section 153(2A) of the Act, the impugned order was the one without jurisdiction, null and void and unenforceable.

Citation: Lionbridge Technologies Pvt. Ltd. [ITA No. 1041/Mum/2015](Mumbai Tribunal)

Foreign exchange gain to be treated as part of operating revenue for computing operating margin of the company and its comparables

Facts and issues:

The assessee is a company engaged in the business of manufacture of aluminium radiator and air-conditioners for cars and multi-utility vehicles. The assessee during AY 2010-11 entered into international transactions with its AE and adopted TNMM as most appropriate method and operating profits to total revenue as profit level indicator. The AO refused to accept the assessee's claim that foreign exchange gain should be treated as part of operating revenue for the purpose of computing operating margin of the assessee and the comparable companies. The CIT(A) referred to co-ordinate bench decision in the case of SAP Labs India Pvt. Ltd. v. ACIT (2011) (44 SOT 156), wherein it was held that foreign exchange fluctuation gain is nothing but integral part of the sale proceeds of the assessee carrying on export business and that the same should be treated as operating income. Following the said decision, the CIT(A) directed AO to compute margin of the assessee and comparable companies by treating foreign exchange gain/loss as operating in nature.

The issue for consideration before the ITAT was whether foreign exchange gain received by assessee as a result of exchange rate fluctuation at the time of realization of sale proceeds should be considered as part of operating revenue while computing ALP

Decision:

The stand taken by the Income tax department was unsustainable when it was not disputed that the foreign exchange fluctuation and the resulting gain to the assessee was in respect of the sale proceeds Foreign exchange gain on realization of sale proceeds should be treated as part of operating revenue for computing operating margin of assessee and comparables.

Citation: Denso Kirloskar Industries Pvt Ltd [TS-284-ITAT-2015(Bang)-TP]

Only international transactions which leads to the generation of any income chargeable to tax, are required to be arm's length price. The provisions of Chapter X are not applicable to the international transaction of issue of equity shares which does not lead to any taxable income.

Facts and Issues: The assessee is a 100% Indian subsidiary of a Germany company (hereinafter referred to as AE). It is engaged in the business of providing loans to retail customers for the construction or purchase of residential properties in India. During the year under consideration, the assessee had issued additional share capital to the AE. The book value of shares of the assessee at the beginning of the year was Rs. 13.70. The assessee had issued shares to its AE at Rs. 10 per share.

The TPO held it as a transaction of `transfer of assets of the company' to its AE in the guise of issue of share capital. Such under-charging of the price of shares was treated as deemed loan given by the assessee to its AEs without any consideration. The TPO held that the assessee ought to have been compensated for such deemed loan with suitable interest. Applying this benchmark as ALP of the share capital, the TPO treated the differential amount of Rs.47,40,42,150/- as deemed loan given by the assessee to its AE. The TPO further held that the assessee ought to have charged interest on such loan of Rs. 47.40 crore from its AEs. By applying the benchmark interest rate of 14% on such deemed loan, the TPO worked out the arm's length value of interest received at Rs. 6,63,65,901/-. Since no interest was charged by the assessee on such deemed loan, the TPO proposed transfer pricing adjustment of Rs. 6.63 crore.

The question before ITAT was whether any addition can be made towards transfer pricing adjustment on account of interest on deemed loan.

Decision:

Whether international transaction?

Definition of 'international transaction' refers to transaction that has bearing on the assets. As the issue of shares by a company has direct bearing, inter alia, on its assets in terms of receipt of consideration, such transaction would be an international transaction.

Whether income chargeable to tax?

A bare perusal of the transfer pricing provisions divulges that, firstly, there should be an international transaction and secondly, such international transaction should result into income chargeable to tax. When both these conditions are satisfied then only the income so arising from an international transaction is required to be computed at ALP.

It is only when some income chargeable to tax arises from an international transaction, the same is required to be substituted with the income determined at ALP. If an international transaction with its determined ALP does not lead to the generation of any income chargeable to tax, then the provisions of section 92(1) i.e. computation of income from international transaction at ALP, are not triggered.

Applicability of section 56(2)(viib)

Section 56(2)(viib) of the Act is attracted only when the share capital is issued to any person being a resident. The provision had no application on the assessee as the year under consideration is AY 2007-08, whereas section 56(2)(viib) was inserted w.e.f. AY 2013-14 without any indication that it has a retrospective operation. The assessee has issued shares to its non-resident AE, whereas section 56(2)(viib) applies only when shareholder is resident. Further, the assessee has issued shares at a price less than the fair market value, whereas this provision is applicable only when a company issues shares at a price above the fair market value.

Considering the above, the addition of Rs. 6.63 crore on account of interest on the deemed loan due to under-receipt of share premium was accordingly deleted.

Citation: First Blue Home Finance Ltd. vs. ACIT (TS-258-ITAT-2015(Del)-TP)(Del.)

Transaction between an Indian company and its overseas branch office is not an 'International transaction' and therefore, need not be benchmarked at ALP.

Facts and Issues: The assessee, an Indian company was a wholly owned subsidiary of a company incorporated in USA. The assessee was engaged in development of computer software. During the year under consideration, the assessee reported several transactions in Form 3CEB and benchmarked these transactions following Transactional Net Margin Method (TNMM). The assessee, apart from having head office in India has also a branch office in Canada which was providing software development services to its AE in the USA. The assessee also paid for certain consulting services rendered by its Associated Enterprise (AE) to its Canada branch.

The TPO altered some of the comparables chosen by the assessee and computed the arm's length margin of his final set of comparables at 23.56% of operating cost.

Decision:

Whether transactions between India head office and its branch international transaction?

The assessee had inadvertently reported the transactions between the head office in India and the branch office in Canada, as a matter of abundant caution. A bare perusal of the definition, brings to light that for treating any transaction as an "international transaction", it is sine qua non that there should be two or more separate AEs. On the principle of mutuality, since no person can transact with self, one cannot earn any profit or suffer loss from self. On the aggregation of the accounts of the head office and branch office, such income of the head office would be set off with the equal amount of expense of the branch office, leaving thereby no separately identifiable income on account of this transaction. It is the merged figures of both the head office and branch office taken together as one unit, that have been taken into consideration for all practical purposes including the computation of total income and the transfer pricing analysis.

Since the office in Canada was only a branch office and not a separate legal entity distinct from the assessee, the transactions between the head office in India and branch office in Canada could not be considered as international transaction. Accordingly, the TPO was not justified in determining ALP of the international transaction of 'Software Product Development/Software Consultancy Services' by applying the average operating profit margin of the comparables to the cost base of transactions with its AE, which also included transactions with the branch office in Canada.

Comments: It would be interesting to see the applicability of transfer pricing in reverse situation i.e. transaction between the non-resident Indian branch office and its head office outside India as per the DTAA.

Citation: Aithent Technologies Pvt. Ltd. vs DCIT (TS-261-ITAT-2015)(Del)-TP)(Del.)

Interest on overdue payment from AE – Debtors needs to be benchmarked at LIBOR+ rate and not as per domestic lending rate

Facts and Issues: The assessee, an Indian company was a wholly owned subsidiary of a company incorporated in USA. The assessee was engaged in development of computer software. The TPO required the assessee to furnish the details in respect of realization of the sale proceeds from AEs and third parties. The TPO examined the details and noted that there was substantial delay in receipt of payments from AEs as against dues from third parties. The weighted average number of days' delays in respect of AEs was 39 and in relation to non- AEs was 25.

The assessee had applied TNNM method in holding that its international transactions were at arm's length price, whereas the TPO computed the ALP on the basis of CUP method by comparing the transactions of the assessee with the AEs vis-a-vis non-AEs. Thereafter, the TPO applied LIBOR plus rates and the cost of guarantee cost while determing the arm's length price of the interest in respect of excess credit period allowed to the AEs. The CIT(A) on the other hand, applied the Indian Prime Lending rates in order to compute the arm's length price for interest.

Decision: Once the transaction between the assessee and its AEs was in foreign currency, then the same part takes the nature of international transaction and the said transactions have to be looked upon by applying the commercial principles with regard to an international transaction. If that is so, then the domestic lending rates cannot be applied in order to benchmark the transaction of the assessee with its AEs and the international rates fixed by LIBOR would come into play.

There was substantial delay in receipt of payment from AEs and substantial amount stood unrecovered from the AEs beyond the stipulated periods. The assessee initially did not charge interest from the AEs and subsequently, charged interest from AEs at American Federal Rate @ 2.98%. This amount was in the nature of loan or borrowing after the stipulated credit period, thus, such recovery of dues in the international transaction with its AEs is to be benchmarked by applying CUP method of international bank rates. LIBOR plus rates should be applied to amounts due from the AEs beyond the period of 25 days. Interest is to be charged on the balance number of days of delay by applying LIBOR plus rates.

Citation: iGATE Computer Systems Ltd. vs. ADIT (TS-250-ITAT-2015(PUN)

Suzlon Energy Limited functionally incomparable to Enercon India Limited though both are engaged in supply & installation of wind mills

Facts and issue: The assessee company was engaged in the business of manufacturing of wind turbine generators and installation of wind mills. During AY 2005-06, it recorded certain international transactions viz. imports – goods, components and spares, exports – manufactured blades, imports – capital goods, reimbursement of guarantee charges and sale of computers. In its transfer pricing study, it benchmarked its international transaction in respect of import of goods, components and spares from its group entity for its manufacturing activities by adopting the TNMM as most appropriate method and selected 11 comparable companies. The assessee arrived at the mean margin of comparables at 7.16% in comparison to its operating margin at 11.57%. Accordingly, the assessee claimed that its international transactions were at arm's length. The TPO rejected the comparables selected by the assessee and asked the assessee to furnish the TNMM analysis after considering the companies engaged in wind generation especially Suzlon Energy Ltd. Overruling the assessee's objections, the TPO proceeded to take 3 companies (viz. Suzlon Energy Ltd, NEPC India Ltd and Vestas RRB India Ltd) as comparable, arrived at a mean margin of 13.39% and made an adjustment of Rs. 16.07 crores. Aggrieved by this, the assessee filed an appeal before the CIT(A) who provided relief by reversing the TP adjustment. The Department then preferred an appeal against this order to the ITAT.

Arguments and contentions: The assessee challenged the action of the TPO on the following two key points:

a) He contended that the profit margin of Suzlon Energy Ltd. was wrongly taken by the Transfer Pricing Officer before depreciation & interest.
b) The assessee pointed out that Suzlon Energy Ltd. was not carrying out the various activities for installation and commissioning of wind mills and therefore, was not functionally comparable with the assessee. The assessee submitted that Suzlon Energy Ltd. operated under three different legal entities / companies to carry out various activities i.e. of supplying of wind mill (Suzlon Energy Limited), installation & commissioning (Suzlon Infrastructures Ltd.) and land purchase and development of site (Sarjan Realities Ltd). If this company is to be treated as a comparable, then the combined mean operating margin for all the three related companies needs to be

considered which worked out to 11.21% which was almost same as that of the assessee i.e 11.5% and therefore, ought to be treated as at arm's length.

The DR submitted that the CIT(A) should have provided an opportunity to the TPO to verify the recalculation of operating margin for the 3 Suzlon group companies. He further contended that there was no provision of combining the results of more than one company as accepted by the CIT(A). Based on these arguments, the DR submitted that the action of CIT(A) was not sustainable.

ITAT's decision:
The ITAT noted that the department had not disputed the assessee's contention that the activities of Suzlon Energy Limited on a stand-alone basis were not comparable with the ones carried out by the assessee. The ITAT further observed that between mean margin of 13.39% as worked out by the TPO and 11.5% as disclosed by the assessee, the benefit of tolerance range of +/- 5% ought to be given to the assessee. On both the above counts, the ITAT deleted the adjustment made by the TPO.
Our comments: This decision continues the trend emanating from well-reasoned decisions of various Tribunals emphasizing the importance of functionally comparable entities in the FAR analysis.

Citation: DCIT, Mumbai Vs. Enercon India Ltd. [ITA Nos. 8373/Mum/2010] (Mumbai ITAT)

An Adjustment on account of working capital is considered to be factored in in case the assessees's margins are significantly higher than that of its comparable companies. A separate adjustment on account of notional interest is unwarranted

Facts and issue: The assessee, Kusum Healthcare, is a company, in the manufacture and marketing of pharmaceutical products for its overseas Associated Enterprise ("AE") as well as for third parties. The assessee, during AY 2010-11, had exported pharmaceutical products to its AE. The said transaction was benchmarked using Transaction Net Margin Method (TNMM) as the Most Appropriate Method. The profitability of the assessee from its manufacturing and trading segment was compared with margin earned by comparable companies engaged in performing similar manufacturing and trading functions respectively. Since the operating profit margin of the assessee in both the segments was higher than the comparable companies considered in respective segment, the international transactions were considered to be at arm's length price.

During the course of assessment proceedings, the above international transactions of the assessee were accepted by the TPO as at arm's length price. The TPO, however, noticed that the assessee had receivables outstanding beyond the stipulated period of 180 days. The TPO computed notional interest based on SBI Prime Lending rate +300 basis points (resulting in interest rate of 14.88%), with regards to receivable for a period exceeding 180 days. And accordingly proposed a transfer pricing adjustment of Rs. 1.57 crores.

Proceedings before the Dispute Resolution Panel (DRP)

The DRP concurred with the TPO and justified that the extension of credit to an AE is an international transaction and benchmarking it by applying CUP method was in order. The TPO, however, was directed to make adjustment at SBI rate plus 150 basis points. The DRP also directed TPO to make adjustment for relief foregone on outstanding receivable balances with non-AE/third parties.

Assessee's key submissions before the Tribunal

Before the Tribunal, the assessee's contentions were as under:

- A working capital adjustment takes into account the impact of outstanding receivables on the profitability.
- Aggregation of closely linked transactions.
- No interest has been charged on the overdue balances from unrelated third parties as is the case for outstanding receivables from AEs. The AE was the key customer of the assessee and the sales made by assessee to its AE amounts to 88% of the total turnover of the assessee.
- Re-characterization of outstanding receivables as unsecured loans advanced by the assessee to its AE is not permissible under the Act.
- Without prejudice to above contentions of the assessee, if interest is to be imputed, then LIBOR rate should be applied for imputing interest.

Decision: An uncontrolled entity will expect to earn a market rate of return on its working capital investment independent of the functions it performs or products it provides. However the amount of capital it requires to support these functions varies greatly, because the level of inventories, debtors and creditors varies. High levels of working capital create costs either in the form of incurred interest or in the form of opportunity costs. High levels accounts receivable and inventory tend to overstate the operating results while high levels of accounts payable tend to understate them thereby necessitating appropriate adjustment.

The assessee had undertaken a working capital adjustment for the comparable companies selected in its transfer pricing report. The Tribunal held that assessee's analysis demonstrates that differential impact of working capital is already factored in the pricing/profitability of the assessee which is more than the working capital adjusted margins of the comparable companies. Any further adjustment of the margins of the assessee on the pretext of outstanding receivables is unwarranted.

The Tribunal relied on the decision of *Micro Ink [TS-216-ITAT-2013) (Ahd) TP]* and deleted the adjustment on account of alleged excess credit period allowed to AE. The Tribunal also upheld the applicability of aggregation principal and concluded that the assessee had earned significantly higher margins than comparable companies, which is accepted by the TPO. These margins compensate for the credit period extended to the AEs.

Citation: Kusum Healthcare Pvt. Ltd. (ITA No. 6814/del/2014) [Delhi Tribunal]

Foreign exchange gain which has direct nexus with rendering of IT enabled services (ITES) cannot be excluded while computing 'operating revenues' for working out Profit Level Indicator (PLI)

Facts and Issue: The assessee, a subsidiary of US Company was engaged in the business of providing ITES to its Associated Enterprises (AEs). The assessee, during AY 2009-10 conducted its TP Study applying TNMM as the Most Appropriate Method (MAM). The assessee selected 8 comparables with average margin of 14.01% on cost. The TPO, after examining the assessee's TP Study Report rejected it and conducted a search for fresh comparables arriving at final list of 8 comparable companies with profit margin of 25.04%.

The CIT (A) confirmed the action of the TPO on selection of comparable companies with profit margin of 25.04%. The CIT(A), however allowed partial relief to the assessee by holding that foreign exchange loss / gain, should not be excluded while computing 'operating revenue'.

The Income Tax department contended that the CIT (A) erred in holding that foreign exchange loss / gain was to be included in operating revenues, without ascertaining the nexus between the forex gain/loss with the business activity of the assessee, without appreciating that this gain/loss is not derived from the operating activity of the assessee.

Decision: The foreign exchange gain has arisen as a consequence of the realization of the consideration for rendering ITES. Accordingly, the said gain has to be included in the operating revenues, for the purpose of calculating the PLI.

Citation: DCIT vs. Amba Research India Pvt. Ltd [(TS-194-ITAT-2015(Bang)-TP)] (Bang.)

Whether benchmarking of International transaction of granting of loan to be done on the basis of Prime Lending Rate prevailing in India or LIBOR

Facts and Issue: The assessee, an Indian company was engaged in the business of manufacture and exports of rider apparels. For the purpose of marketing and promoting their exports to USA, the assessee incorporated a subsidiary in USA, which was wholly owned by them and their two shareholders.

The assessee, as per Form 3CEB and Transfer Price documents had entered into the following international transactions with the AE:

Equestrian Apparel sold to JPC Equestrian Inc.	Rs. 2,44,38,153/-
Loan provided to JPC Equestrian Inc.	$ 10,50,000/-
Interest Received	Rs. 20,52,101/-

The assessee selected the Comparable Uncontrolled Price method (CUP) to benchmark sale of equestrian apparels and the interest received on the loan. The assessee had declared that the interest received at the rate of 4% was comparable with the export packing credit rate obtained from independent banks in India.

The TPO enumerated several reasons to hold that the arm's length interest rate should be taken as 14% p.a. He computed arm's length interest on the loan at Rs.71,82,354/-, in the place of interest received of Rs.20,52,101/-.

The question before the High Court was whether Prime Lending Rate of 14% p.a. has to be adopted for benchmarking the transaction or LIBOR to be adopted.

Decision: The High Court opined that the relevant interest rate should be the market determined interest rate applicable to the currency concerned in which the loan has to be repaid. Interest rates should not be computed on the basis of interest payable on the currency or legal tender of the place or the country of residence of either party. Interest rates applicable to loans and deposits in the national currency of the borrower or the lender would vary and are dependent upon the fiscal policy of the Central bank, mandate of the Government and several other parameters. Interest rates payable on currency specific loans/ deposits are significantly universal and globally applicable.

The currency in which the loan is to be re-paid normally determines the rate of return on the money lent i.e. the rate of interest. Accordingly, it was held that interest on loan granted to Overseas AEs should be benchmarked using LIBOR + rate. Prime Lending rate prevailing in India cannot be used for benchmarking of such loans to International AEs.

Comment: The assessee for benchmarking, interest income received on loan transaction with overseas AEs, using LIBOR basis point for determining Arms' Length Price. The TPO were not accepting the same and used to benchmark such interest using Prime Lending Rate prevailing in India. This is a welcome decision which has accepted LIBOR + basis points for benchmarking international transactions with the reasoning that interest rate has to ben benchmarked in the same currency in which loan is given and the country of lender is not a relevant factor.

Citation: CIT vs. Cotton Naturals (I) Pvt. Ltd [(TS-117-HC-2015(DEL)-TP)] (Del.)

Penalty under section 271(1)(c) on account of transfer pricing adjustment not leviable where proper disclosure has been made and the issue is debatable in nature

Facts and Issue: The assessee, during AY 2007-08 provided bank guarantee to its AE. This fact was disclosed in Form 3CEB. The TPO noticed that no fee was charged by the assessee from its AE for service of rendering guarantee and proposed a transfer pricing adjustment of Rs. 52 lakhs on this amount. This adjustment was confirmed by the CIT (A) as well by the ITAT.

The Finance Act, 2012 had amended section 92B of the Act, and an explanation was inserted with retrospective effect from April 1, 2002 to bring guarantee transactions within the purview of an 'International Transaction'. The assessee, during the course of hearing, had not disputed that the transactions falls within the definition of a "international transaction", which required evaluation of Arm's Length Price under Transfer Pricing provisions. It was also not denied that no amount had been charged by the assessee from its subsidiary on account of bank guarantee fees. The ITAT confirmed transfer pricing adjustment on guarantee fees as well as on actual expenditure incurred by the assessee for securing bank guarantee for the AE.

As the addition made attained finality, the AO levied penalty under section 271(1)(c) on transfer pricing addition at 100% of the tax sought to be evaded.

The assessee in Form 3CEB had disclosed the fact of giving bank guarantee as well as incurring the expenditure for providing the bank guarantee.

Decision: Penalty in the case of the assessee was sought to be levied in respect of the transfer pricing adjustment. The said transactions were duly disclosed by the assessee in the form No.3CEB. Even otherwise prior to the amendment to section 92B vide Finance Act, 2012 whereby the explanation has been inserted with retrospective effect from April 1, 2002 the claim of the assessee is based on good faith and due diligence and therefore it was not considered a fit case for levy of penalty under section 271(1)(c).

As regards adjustment on expenditure, this was a highly debatable issue as to whether it was a separate international transaction or was a part and parcel of the bank guarantee furnished by the assessee on behalf of the AE. It is only an expenditure incurred to effectuate the international transaction of bank guarantee and therefore, the belief of the assessee that it is not an international transaction by itself was bona-fide.

The penalty proceedings were **accordingly** dismissed

Citation: TechnocraftInd (India) Ltd vs. Addl. CIT [(TS-188-ITAT-2015(Mum)-TP)] (Mumbai)

Lower capacity utilization as compared to external uncontrolled comparables warrants appropriate economic adjustment and TP addition be made only in respect of international transactions

Facts and issue:

The assessee is engaged in the business of manufacturing, marketing and distributing ready to serve and ready to cook food products and food intermediaries. During the year under assessment, the assessee sold ready to serve (RTS) foods to both its AEs and non-AEs. The assessee had benchmarked the international transactions of sale of RTS foods following TNMM with OP/OC as Profit Level Indicator (PLI). The assessee computed its OP/OC at 6.25% and compared with the three years' average OP/OC of ADF Foods Ltd., company selected by the assessee as comparable, computed at 9.02%. Although, the TPO accepted the TNMM and also the comparable chosen by the assessee he re-computed the OP/OC of the comparable at 15.07% as against 9.02% and that of the assessee at 4.32% as against 6.25%. The TPO made a TP addition of Rs. 3.05 Crores. The assessee objected to the draft order of the AO before the DRP wherein the DRP directed the AO/TPO to re-compute the margin of ADF Foods limited by excluding the income of Rs. 4.54 Crores, arising from the sale of import license and proportionate share of unallocated expenses of Rs. 3.49 Crores. This resulted in OP/OC of ADF Foods Ltd. being 8.32% and TP addition was reduced to Rs. 1.14 Crores. The TPO did not allow the benefit of bearing the tolerance range of +/-5% as mandated under proviso to Section 92C(2) on the ground that there was only one ALP as the assessee chose only one company as comparable.

Aggrieved by the final order of the AO, the assessee agitated the TP addition made by the AO/TPO before the ITAT wherein it pressed for two grounds, viz. utilization of capacity by it at only15.40% as compared to capacity being utilized at 53.3% by ADF Foods Ltd and inappropriate calculation of TP addition where the addition was made on total sales which comprised non-AE sales as well.

Decision:

The Pune ITAT, following Mumbai ITAT rulings in the case of Fiat India Limited and Pune ITAT ruling in the case of Ariston Thermo India Ltd., agreed, in principle, with the assessee that difference in capacity utilization between assessee and comparable needs to be ironed out to make the two comparable. Further, the ITAT, following Coordinate Bench ruling, in the case of Demag Cranes & Components (India) Pvt. Limited and Mumbai ITAT ruling in the case of Emerson Process Management India Pvt. Ltd. ,agreed, in principle, with the assessee's argument that the transfer pricing adjustment can be made only in respect of international transactions. The ITAT restored both the issues raised by the assessee to the file of the AO/TPO to verify the computational aspect and make the adjustment, if any, on the basis of directions given by the ITAT in the order.

Comments:
The Pune ITAT decision has been in line with the several other decisions of ITATs including Pune ITAT. In so far as the issue relating to the capacity utilization is concerned, the ITAT has not mentioned whether the adjustment be made on the tested party or on the comparable. The mandate of Rule 10 B is however required to be kept in mind in so far as the adjustment to assessee's profit margin is concerned.

Citation: Tasty Bites Eatables Ltd. [ITA No. 1682/PN/2011] (ITAT Pune)

No need to impute interest from overdue receipts from AEs as debts are intrinsic to international transaction of sales and working capital adjustment takes care of difference in the level of working capital between tested party and comparable.

Facts and issue:

The assessee is engaged in providing software development and allied services to its group companies. Under the terms of the contract with the AEs, the assessee allowed a credit period of 60 days to its AEs. However, during the AY in question the TPO observed that the assessee allowed to the AEs credit period exceeding 60 days without charging interest. The TPO considered interest accrued, computed on the basis of SBI PLR, for the credit period exceeding 60 days as international transaction and accordingly made a TP addition of Rs. 10.87 lakhs.

CIT (A) confirmed the TP addition but directed the TPO/AO to compute the interest based on LIBOR based rate.

Aggrieved by the order of the CIT(A), the revenue and the assessee both filed an appeal and cross appeals respectively before the ITAT. In their respective appeal, the revenue objected to the application of LIBOR and the assessee raised the issue of separate benchmarking of interest on overdue receipts from the AEs.

Decision:

In so far as the cross appeal of the assessee is concerned, the ITAT relied on Mumbai ITAT ruling in the case of Goldstar Jewellery Ltd. and Delhi ITAT ruling in the case of Kusum Healthcare Pvt Ltd. and held that interest on credit period allowed to AE is not a separate transaction but closely linked with primary international transaction of sales to AEs. Further the Tribunal also held that any difference in credit period allowed by the tested party and the comparable should be taken care of by the adjustment in the operating margin of the comparables by way working capital adjustment. In respect of appeal filed by the revenue, the ITAT merely mentioned that there is no illegality in application of LIBOR based rate by CIT(A) in respect of computation of interest on overdue receipts from AEs. The ITAT set aside both the issues to the file of the AO/TPO for reworking of ALP in light of the directions given.

Comment

The logic of the ruling is well recognized in the TP guidelines of the OECD & UN which provides that if the "tested party" has a higher level of debtors as compared to the comparable companies then the "tested party" would need a higher profit margin to fund the incremental working capital and vice versa. The difference in the level of working capital/debtors between comparable and the tested party is ironed out by way of a proper working capital adjustment to the profit margins of the comparable companies. Treating, a normal overdue balance separately from sales transaction tantamounts to re-characterization of international transactions which is permitted only under exceptional circumstances, viz, where substance of the transaction differs from the form. For example, if the receivable remains outstanding for a very long period say for two to three years or even more then the working capital adjustment may not be the right approach as the result may lead to an absurd profit ratio. Such a situation may call for separate benchmarking analysis to impute the interest for overdue debtors considering this as a financing arrangement in the garb of sales.

Citation: M/s Information Systems Resources Centre Pvt. Ltd. [ITA No.7757/Mum/2012] (ITAT Mumbai)

Earning of high profit cannot be sole factor for rejection of comparable and voice based companies cannot be compared with non-voice based companies though both the categories fall within broad ITeS segment.

Facts and Issue

The assessee is a subsidiary of Acclairs Inc. and is a captive non-voice based Back Office Processing (BPO) services provider to clients of Acclaris Inc. During AY 2007-08, the assessee provided BPO services to its AE and justified the arm's length characteristic of the international transaction of provision of BPO service by TNMM wherein it compared its OP/OC of 15.02% vis-à-vis average OP/OC of 14 comparables computed at 11.28%. The TPO rejected the assessee's comparables and chose companies having OP/OC within a range of 10% to 50%. The TPO selected 5 companies with an average OP/OC of 29.12% and made a TP adjustment of Rs. 1.32 Crores. TPO's peer set included Maple E- Solutions Ltd. and Indusind Information Technologies Ltd which the assessee objected to on functional differences. The assessee also objected to the inclusion of Galaxy commercial Ltd. and ICRA Online Ltd. on the basis of these companies earning super profit.

Decision

ITAT agreed with the arguments of the assessee that functional profile of voice based company is different from a non-voice based company. ITAT relied on Delhi ITAT ruling in the case of CRM Services India Pvt. Ltd. and Panji ITAT ruling in the case of Pentair Water India (P) Ltd. The ITAT also noted that Maple E-Solutions was involved in fraud and its reputation was severely compromised. ITAT held that Maple E-Solutions Ltd. be rejected from the peer set for comparability. In regard to Indusind Information Technologies Limited, the ITAT agreed with the arguments of the assessee that a company providing software development cannot be compared with a BPO service provider. Relying on several precedents, the ITAT held that functions performed and risks assumed by a company engaged in BPO services is different from a company providing software development services and therefore IndusInd Information Technologies Limited should be rejected. In respect of Galaxy commercial Ltd. and ICRA Online Ltd., the ITAT held that a company cannot be rejected for comparability just because it has earned high profit. The ITAT observed that high profit or loss only invites further scrutiny as to the specific and particular reason demonstrating abnormality in the profit/loss. On the TPO's approach of selecting companies having OP/OC within a range of 10% to 50%, the ITAT held that the TPO's approach was arbitrary and had no legal sanction under Indian TP regulation. The ITAT restored the matter to the file of the AO for making a fresh search of comparables

Comment

The ITAT has once again affirmed the principle that while selecting comparables for benchmarking under TNMM, functional similarity should be ensured. Further, in line with several other rulings, the ITAT also held that high profit/loss cannot be a criterion to reject a company.

Citation: M/s Acclairs Business Solutions Pvt. Ltd. [ITA No 695/Kol/2011] (ITAT Kolkata)

Economic adjustment cannot be made in the operating margin of the tested party to account for the difference in the functional profile of the tested party vis-à-vis the comparable

Facts and Issue

The assessee is engaged in the business of manufacturing components of earth moving machines. During the AY in question the assessee entered into international transactions which, inter alia, included export of finished goods and import of raw materials. The assessee justified the arm's length characteristics of these two transactions on an aggregated basis following TNMM on an entity level with the Profit Level Indicator (PLI) of OP/OC for export and OP/Sales for import of raw materials. The assessee had adjusted its PLI to 10.79% as against the unadjusted OP/OC of (-) 45.23%. The assessee had made the adjustment in its operating cost base to account for the inefficiency, wastage, lower volume of output etc. as its was in start-up phase and the AY in question was not even the first full year of operation. The TPO agreed with the TNMM and also the approach of aggregation for benchmarking the international transactions of export of finished goods and import of raw materials but he rejected two of the ten comparables selected by the assessee, viz, Ahmedabad Steelcraft Ltd. with OP/TC at(-)16.71% and Shiv Agrico Implements Ltd. (Seg.) with OP/TC at (-)50.79%. Arithmetical mean of the remaining 8 comparable companies was computed by the TPO at 13.47%. The TPO did not accept the adjustment in the PLI of the tested party and made TP addition amounting to Rs. 21.75 Crores applying average OP/OC of 8 companies at 13.74% on unadjusted operating cost of the assessee and the same was confirmed by the DRP.

Decision

ITAT remarked that the mandate of Rule 10B(1)(e)(i) does not provide for any adjustment to the PLI of the tested party. If at all there is any need of adjustment to account for the difference in the functional profile or difference in the economic conditions between the tested party and the comparable then the same should be performed on the comparables. Further, first year of operation, per say, does not entitle adjustment unless and until it can be demonstrated with specific example of cost that was incurred only during start up phase. ITAT thus held in assessee's case that the methodology adopted by the assessee was "simply devoid of any statutory sanction, totally unacceptable and a glaring example of travesty of the transfer pricing provisions", as assessee had failed to specifically show how some of the first year of operation specific expenses were absent in the case of comparables, requiring adjustment in the profit margin of the comparables.

In respect of Ahmedabad Steelcraft Ltd. (an external uncontrolled comparable), the ITAT observed that this company was using its own wind mill as against the assessee using generator set. Further, the turnover of this company had reduced due to Government policy change and also there was retrenchment of employees during the year in question. The ITAT held that these extraordinary and abnormal differences make this company incomparable with the assessee, and upheld TPO's exclusion from list of comparables. In respect of Shiv Agrico Implements Ltd (seg) ITAT disagreed with TPO's arguments and held that when the goods move from one segment to another, their profitability is accordingly taken into consideration under the respective segment. Since the TPO had not demonstrated how Engineering and Fabrication segment was dissimilar with that of the assessee, ITAT directed inclusion of this company on segmental basis. In conclusion, ITAT set aside TPO / DRP order and remitted the matter to AO / TPO for fresh computation of ALP on the basis of directions given by the ITAT.

Comments

This ruling emphasises on the fact that in order to make economic adjustment the taxpayer should be specific in pointing out the cause of difference and should be in a position to demonstrate as to how the specific factor/s affected the profit/price as compared to the comparable and adjustment, if at all required should be made to comparable margin/price. In the past, ITATs have agreed on the economic adjustment in the PLI of the tested party as well. For example, Mumbai ITAT in Fiat India Private limited accepted the adjustment in the PLI of the tested party though the view expressed by Delhi ITAT in JCB India Limited seems to be an outcome of interpretation placed on Rule 10B (1) (e) (iii) of the Income Tax Rules. In the earlier decisions co ordinate benches of the Hon'ble Appellate Tribunal had taken contrary view that the differences which are likely to materially affect the price, cost charged or paid, or the profit in the open market are to be taken into consideration with the idea to make reasonable and accurate adjustments to the margins of the tested party in order to eliminate the differences and such an adjustment was not otiose to transfer pricing mechanism.

Citation: M/s JCB India Ltd. (formerly known as JCB Manufacturing Ltd.) [ITA No 1456/Pune/2010] (ITAT Delhi)

Commented [DJ3]: New additions to the file

Tribunal

TDS not applicable on payment of factoring charges

Facts and issue: The assessee company was engaged in the business of manufacturing and trading in gold, diamond jewellery and bullion. The assessee availed factoring facilities from Global Trade Finance Limited ('GTF') (a subsidiary of State Bank of India) and did not deduct TDS from payments to GTF as it did not treat the same as interest payments. The AO did not accept this contention and made an addition of Rs. 93,68,870/- on account of payment of factoring charges by invoking the provisions of section 40(a)(ia) of the Act as no tax at-source was deducted on the same.

Aggrieved by this, the assessee filed an appeal before the CIT(A) who confirmed the AO's actions. The assessee filed a second appeal to the ITAT.

Arguments and contentions: Quoting from the assessment order, the DR argued that the impugned payments were in the nature of interest owing to the following key arguments:

- The whole concept of factoring charges showed that they are in the nature of specialized services rendered by the financial institutions.
- The concept of factoring also showed that the prepayments made, against the invoices, was nothing but a short-term financing facility provided by the financial Institution (factor), on which the client is under a legal obligation to pay interest at a fixed rate along with the factoring charges.
- Even though the assessee called these as 'discounting charges', effectively, they were interest payments exigible to TDS provisions.
- Factoring services rendered by GTF were in the nature of 'recourse factoring' (where assessee became liable to GTF in the wake of default by debtor) and the facility was

secured by obtaining tangible collateral property and personal guarantee of the Directors of the assessee.

- The terms ‘interest’ as defined under section 2(28A) of the Act covered money paid in respect of amount borrowed or debt incurred in any manner and included service fees or other charges in respect thereof.
- Furthermore, the assessee was not able to substantiate its claim that no TDS was required to be made on the payments to GTF because of its being a subsidiary of SBI.
- The fact that no other person making a payment to GTF or the assessee itself did not deduct tax in the earlier years could not absolve the assessee from discharging its legal obligation.

The AR, on the other hand, relied extensively on the judicial precedents on this subject.

ITAT’s decision: The ITAT took notice of the fact that that the Hon’ble Calcutta High Court in the case of CIT vs. M/s. MKJ Enterprises Limited (GA No.1927 of 2014) had specifically considered whether factoring charges were tantamount to interest and whether the tax was to be deducted at-source on the same. The Hon’ble High Court held that factoring charges were not interest and as such, provisions of TDS were not applicable. Applying the ratio of this judgement to the facts of the present case, the ITAT disposed the matter in favor of the assessee and held that TDS was not applicable on payment of factoring charges to GTF.

Our comments: Though the ITAT has not discussed on the merits of the case and has pronounced its verdict by solely relying on the Kolkata High Court decision on the same subject, yet with humble regard to this judgement, it needs to be kept in mind that the Kolkata High Court decision was rendered in the context of a del-credere agent and to that extent, the facts could be distinguished. This decision will prove handy to the entities providing factoring services in as much as this judgement could be canvassed in support of their request to their constituents not the deduct tax at-source from their payments, alleviating the cash flow significantly.

Citation: M. Sons Gems N Jewellery Pvt Ltd Vs. Addl. CIT, New Delhi [ITA No. 5419/Del/2012] (Delhi ITAT)

Principles & primacy of judicial discipline reaffirmed by the ITAT

Facts and Issue: The assessee undertook construction of a housing project at Panchkula and claimed profits from this project as deduction under section 80(IB)(10) of the Act. During the course of assessment proceedings for AY 2007-08, the AO examined the genuineness of the deduction claimed by the assessee and recorded the following two findings:

i) The project was granted approval on 15 February 1996 i.e. much before the date of 1 October 1998, provided (at that time) in the Act for claiming deduction under section 80IB(10) of the Act; and

ii) The assessee had also not furnished completion certificate of the local authority that the project was completed by 31 March 2008.

The Assessing Officer accordingly rejected assessee's claim of deduction under section 80IB(10) of the Act .

Being aggrieved, the assessee filed appeal before the learned CIT (A). The assessee during course of appellate proceedings filed some letters from the Director, Town and Country Planning, Chandigarh based on which the CIT(A), after seeking a report from the AO on these documents, inferred that the completion certificate was issued by the competent local authority. The deduction claimed under section 80IB(10) of the Act was accordingly allowed. It may be noted here that the CIT(A) did not adjudicate whether the approval for the project was granted by the competent authority after 1 October 1998 which was a *sine qua non* for claiming the aforesaid deduction.

The Revenue filed an appeal before the ITAT which noted the abovementioned omission on the part of the CIT(A) to adjudicate on the project approval date and set aside the impugned order passed by the CIT(A) as being bad in law. Accordingly, the ITAT remanded the matter back to the CIT(A) to adjudicate on this issue.

It appears that in the interim, there was a transfer in the CIT(A)'s chair. In view of the directions of the Hon'ble ITAT, the incumbent CIT(A) after examining the facts before him, concluded that the project was indeed approved by the competent authority after 1 October 1998. He did not rest there. He further quipped that in the absence of any fresh evidence before him, he could not sit in judgement over the view taken by his predecessor and in any case, the view taken by his predecessor was a correct one indeed. Accordingly, he accepted the assessee's contentions and allowed the claim of deduction u/s 80(IB)(10) of the Act.

Arguments and contentions: The DR argued that the CIT(A) acted in defiance of the ITAT directions by relying upon his predecessor's order which the ITAT had set aside and held to be bad in law. He argued that the order passed by the CIT(A) (after directions from the ITAT) was a mere reliance on the order passed by his predecessor and hence not on the basis of merits. The AR, on the other hand, canvassed the order passed by the CIT(A).

ITAT's Observations: The ITAT observed that through its action of setting aside the order passed by the earlier CIT(A), that order had ceased to exist in the eyes of law. It could not be taken into consideration for any purpose and any order relying on the same was not an order in the eyes of law either.

The Revenue contended before the ITAT that the project was granted approval on 15 February 1996 i.e. much before the date of 1 October 1998. The ITAT noted that the CIT(A), instead of following the ITAT's directions and without giving his independent opinion on the matter in issue which he was directed to, had preferred to follow the views of his predecessor in allowing the appeal of the assessee. The ITAT inferred that the CIT(A) failed to note that when earlier order of his predecessor was subject matter in departmental appeal before the ITAT and the order of his predecessor had been set aside and the matter in issue was remanded to his file for passing the order afresh, there was no question of treating the order of his predecessor to be an order in accordance with law. The ITAT took exception to the CIT(A)'s remarks that the views adopted by his predecessor were right indeed whereas such order was non-existent in the eyes of law by virtue of it having been set aside.

Accordingly, it concluded that the CIT(A) had shown disobedience to the earlier remand order of the ITAT and hence remanded the matter back for his adjudication afresh within 2 months from the receipt of the order, after giving the assessee an opportunity of being heard. Taking a lenient view, the ITAT refrained from initiating contempt proceedings against the CIT(A) in view of this being the first such instance of disobedience, but let him off with a stern warning.

Our Comments: A plain reading of this order shows the anguish of the ITAT owing to the judicial indiscipline displayed by the CIT(A) in this case. This judgement should serve as a reminder to those departmental officers who take their responsibility in a casual and injudicious manner. The issue of judicial discipline has been discussed by various Courts from time to time, with the Apex Court's landmark decision in the case of Union of India Vs. Kamlakshi Finance Corporation (AIR 1992 SC 711) setting the tone at the top. One would wish that the views of the Hon'ble Apex Court in the Kamlakshi case (supra) were taken seriously in order to prevent chaos in administration in the various tax laws.

Citation: DCIT, Chandigarh Vs. Sham Sunder Sharma [ITA No. 966/Chd/2014] (Chandigarh ITAT)

Commented [DJ4]: Few editing changes in these two articles

Loss of transfer of long term shares can be set-off against long term losses

Facts and issue:

The assessee is engaged in manufacturing and sale of pharmaceuticals. The assessee in the computation of income had set off long term capital loss on sale of shares (in respect of which securities transaction tax was deducted) against long term capital gains arising from sale of land. The AO held that the long term capital loss on sales of shares cannot be set-off since long term capital gain on sale of shares is exempt u/s. 10(38) of the Act.
The learned CIT(A) confirmed the action of the AO stating that it is settled law that the concept of income includes loss as well.

Decision:

Section 10(38) provides exemption of 'income' from transfer of long term equity shares subject to certain conditions.

As per the section, the 'income' contemplated as exempt under section 10(38) refers to only a stream / portion out of the total capital gains on shares. Thus, only a limited portion of source is treated as exempt and not the entire capital gain (on sale of shares).

If a stream / portion of the source is exempt by virtue of particular "provision" of the Act for providing benefit to the assessee, then it cannot be held that the entire source will not enter into computation of total income. The concept of income to include loss will apply only when the entire source is exempt and not in the cases where only one particular stream of income under a particular source is falling within exempt provisions.

Thus, long term capital loss on sale of shares (income if any exempt u/s 10(38)) would be allowed to be set-off against long term capital gain on sale of land.

Comments: Considering the issue under consideration, the above decision of Mumbai ITAT has led to clarity and can be considered as a welcome judgment.

Citation: Raptakos Brett & Co Ltd [TS-326-ITAT-2015] (ITAT Mumbai)

Surrender of tenancy right being capital asset chargeable to tax under capital gains

Facts and Issues:

- M/s. Modern Textiles and Silk Mills Private Limited (tenant of the subject premises) entered into an agreement dated 13th June, 1972 with the assessee to grant use of the 'premises' incidental to its use of looms and machinery in its capacity only as Licensee. It was also provided in the agreement that the arrangement cannot in any manner be construed as a sublease of the subject premises.

- Subsequently in AY 2009-10, the assessee surrendered the occupation of the 'premises' and offered the consideration received therefrom as Capital Gains and claimed exemption under section 54EC of the Act.
- The AO held that the assessee cannot be held as 'tenant' of the premises and accordingly the income therefrom should be taxable as Income from other sources and not as capital gains. On appeal, CIT(A) upheld the order of the AO.

Decision:

Tribunal concluded that surrender of occupation was surrender of tenancy and the amount received was taxable under the head Capital Gains placing reliance upon the definition of the tenant under Sections 5(11) and 15A of the Bombay Rent Control Act which provides that a person in occupation of the premise on 01^{st} February 1973 shall be **deemed** to have become the tenant of the landlord in respect of the premises in his occupation. As the assessee has entered into the agreement prior to 1 February 1973 it would be construed as the 'deemed tenant' of the premises. Further, tenancy right would qualify as capital asset as per Section 2(14) of the Act and accordingly, income from surrendering tenancy rights would qualify as capital gains.

Comments: The ITAT has followed the principle laid down by Supreme Court in the case of *CIT v/s. D. P. Sandu Bros. Chembur 273 ITR 1* that tenancy right is a capital asset whose surrender would attract Section 45 of the Act.

Citation: CIT v. Kewal Silk Mills [TS-343-HC-2015] (ITAT Mumbai)

Apportions depreciation based on utilization of asset; Rejects allocation based on turnover

Facts and issue:

- The assessee was engaged in the business of software development and provisions of software services.
- The assessee claimed exemption u/s. 10A in respect of STP unit post reallocation of expenses between STP unit and Non-STP unit.
- The depreciation on vehicles had been allocated by the assessee on the basis of turnover of STP and Non-STP unit, since the vehicles were used for the entire business of the assessee.
- The Assessing Officer was of the view that depreciation on vehicles can be allowed on the basis of use of vehicles by the respective unit employees.

Decision:

- Depreciation on the asset utilized for a particular unit has to be allocated to that unit alone.
- Depreciation on vehicles has to be allocated on the basis of the 'use of vehicles' for the specific unit as vehicles allocated to the staff of the STP and Non-STP unit can be identified.

Citation: M/s Tata Technologies Limited [TS-340-ITAT-2015] (ITAT Pune)

MD was a non-resident and salary was received by him outside India for services rendered outside India, no TDS was required to be deducted and no disallowance could be made under section 40(a)(i) for salary payment

Facts and issue:

- The assessee was engaged in the business of shipping industry as freight forwarding agent.
- During the year, the assessee paid salary to the MD on which no TDS had been deducted.
- The Assessing Officer disallowed the said payment by invoking the provisions of section 40(a)(i) and made addition.

Decision:

- The Tribunal held that the salary in question was paid to MD of the assessee in US. The MD was rendering services in relation to the USA branch of the assessee.
- The US branch was separately assessed as a PE of the assessee and assessee was claiming exemption under the provisions of Chapter-IX in respect of the tax paid in US which has been allowed by the department.

- Further, the assessee also produced the passport and visa of the MD to show that he was a non-resident Indian during the year under consideration and therefore, the salary received by him outside India for the services rendered outside India are not taxable in India.
- As the fact that the MD of the assessee is a non-resident during the year has not been disputed by the revenue, therefore, the salary paid outside India for the services rendered in US would not be taxable in India as per the provisions of section 9 of the Income-tax Act, 1961.

Citation: Swift Freight India Ltd [2015] 58 taxmann.com 105 (ITAT Mumbai)

Assessee eligible for deduction u/s 80-IC even though manual return of income is filed before due date instead of electronic return

Facts and issue: The assessee company had filed manual return of income on 9th September 2010 for AY 2010-11 and claimed deduction under section 80-IC. Subsequently the return of income in electronic mode (e-mode) was filed on 25th January 2011. AO noted that the assessee had filed manual return of income and in fact had failed to file return of income in e-mode within due date as specified under section 139(1). According to section 80AC, the assessee is eligible for deduction u/s 80-IC only if the returns are furnished on or before due date as specified u/s 139(1). Accordingly AO held that since the return of income was not filed in electronic mode, the assessee was not eligible to claim deduction u/s 80-IC. CIT(A) held that the fault was only a technical fault and was beyond the control of assessee and accordingly allowed the deduction.

Decision: Assessee contended that the accountants were not aware that the return was required to be filed in e-mode and AY 2010-11 was in fact the first year in which the return was statutorily required to be filed in electronic mode. Further when it came to the knowledge of the assessee, the compliance was made by filing the return in e-mode. Tribunal noted that the tax consultants had given an affidavit that they were not fully aware of the fact that the return had to be filed in e-mode. The assessee had complied with the substantive provisions of the Act by filing manual return before due date. Tribunal held that assessee was entitled to deduction u/s 80-IC. However, since AO had not examined the claim of deduction on merits, the matter was restored to the file of AO with a direction to verify and allow claim of assessee if the conditions as specified u/s 80-IC are complied with.

Key Takeaway: The decision of the Hon’ble Tribunal upholds the proposition that a procedural provision, ordinarily, should not be construed as mandatory, if the defect can be cured by permitting the appropriate rectification to be carried out at a subsequent stage. Procedural laws are devised and enacted for the purpose of advancing justice.

Citation: Sucram Pharmaceuticals Private Limited, Chennai Tribunal, ITA No 804/MDS/2014

No TDS under section 194H is required to be deducted on discount paid to sim card distributors. Roaming charges cannot be considered as fees for technical services, subject to deduction of TDS under section 194J

Facts and issues:

The assessee, a telecommunications service provider is engaged in the business of providing cellular mobile telephone services under the brand name "Airtel". It has been marketing its products through the distributor network. It sells its products to distributors in bulk against prior payments such as prepaid start up packs and recharge coupon vouchers which have "right to use airtime" embedded in it. These are sold to various distributors on principal to principal basis at a discounted price as compared to MRP. There are different distributors who in turn sell on out right basis to retailers. The assessee also provided GSM mobile services to its subscribers whereby the subscribers could avail of telecommunication facility, when they were not in the area being covered by the assessee, through other mobile operators. To avail such services, the assessee was making payments to other mobile operators as roaming charges.

The AO noted that there was principal agent relationship between the assessee and the sim-card distributors. The assessee was paying fixed commission to these distributors in garb of discount. The AO thus held that the assessee was liable to deduct TDS under section 194H of the Act on commission paid to the sim card distributors. The AO further held that the roaming charges paid by assessee fall under the definition of fees for technical services and thus liable to TDS under section 194J of the Act.

Decision:

Discount paid to sim card distributors

The relationship between assessee and its distributors qua the sale of impugned products is on principal to principal basis. The consideration received by assessee is sale price simpliciter.

There is no relationship of Principal and agent between assessee and distributors. The transaction being one of sale & purchase of sim card and relationship being of principal to principal the discount paid does not amount to commission in terms of section 194H. Accordingly, the assessee was not required to deduct any TDS on discount paid to sim card distributors.

Roaming charges paid to other mobile operators

The assessee makes payment to other mobile operators, which is called 'roaming charges'. Entire roaming facility is based on IMSI which consists of MNC (Mobile Network Code a unique code allotted to assessee) and SIM which is also issued by the assessee. Roaming services is a highly technical service which is possible with the use of equipment such as MSC, VLR, Radio Network, Tower, BTS, BSS and highly advanced technology. It is a technical arrangement between the two telecom service providers to connect their equipment, network and services to enable their customers to have access of telecom network wherever they move.

On the issue of roaming charges, for installation, setting up, repairing, servicing and maintenance capacity augmentation of equipment used in providing roaming services, it requires human intervention. After completing this process, mere interconnection between the operators is automatic and does not require any human intervention. The SC in the case of Bharti Cellular Ltd. and the Pune tribunal in the case of i-GATE Computer System Ltd. has held that data link transfer does not require any human intervention and charges received or paid on account of this, is not fees for technical services as envisaged in section 194J read with section 9(1)(vii) read with Explanation 2 of the Act. Accordingly, roaming charges would not be in the nature of fees for technical services, subject to TDS under section 194J of the Act.

Citation: Bharti Hexacom Limited [TS-333-ITAT-2015(JPR)]

Indexation benefit while computing long term capital gain not available for computation of book profit under section 115JB

Facts and issues:

The assessee was engaged in the business of investments, leasing and broking. In the return of income filed for AY 2009-10 the assessee had paid taxes as per book profit computed under section 115JB of the Act. The assessee added long term capital gains ('LTCG') after indexation for the purpose of computing the tax liability under section 115JB. as per the proviso to section 10(38), which requires that LTCG shall be taken into account for computing book profit and tax payable under section 115JB. The amount of LTCG was arrived at after taking into account indexed cost of acquisition of shares as required under section 48 of the Act. The AO however rejected assessee's methodology of arriving at the book profit and held that LTCG after indexation and deduction of STT paid cannot be accepted for the purpose of computing book profit and held that entire sale consideration should be taken.

Decision:

The ITAT observed that for the purpose of MAT computation it is mandatory for every assessee to prepare its profit & loss account in accordance with part II & III of Schedule VI of the Companies Act, 1956, according to which net gain / loss should be disclosed in case of sale of investments without bifurcating the same between long term or short term capital gains.

As per the amendments by Finance Act 2006, the amount of book profit is to be increased by the amount of expenditure relatable to any exempt income under section 10 with specific exclusion for income under section 10(38). Also a corresponding amendment had been brought to provide that book profits shall be reduced by the amount of exempt income with specific exclusion to section 10(38). Thus, from the harmonious reading of the relevant provisions, ITAT observed that book profit shall be reduced by the amount of exempt income, however, income under section 10(38) will not be reduced. Thus, the income arising from transfer of long term capital asset shall be included in the book profit. Therefore, while computing the book profit, income under section 10(38) will not be reduced and this income referred to here would mean income credited to the profit & loss account.

Once, Explanation to section 115JB provides that the amount of income which is to be reduced or not, which inter alia means any such amount which is credited to the profit & loss account then only such amount credited in the profit & loss account shall alone be taken into consideration for computing the book profit. The concept of indexation while computing the LTCG cannot be imported to the computation of book profit under section 115JB as per the expressed provisions of the said section itself which is a complete code in itself.

Our comments: Section 115JB of the Act is non obstante provision and a complete code by itself. For computing the profit and the taxability under section 115JB of the Act, it is mandatory for the taxpayer to compute profit as per the profit & loss account in accordance with the Companies Act, 1956. As per the Companies Act 1956, difference between sale consideration and cost of acquisition is considered as net gain / loss on sale of investments, which is required to be disclosed without bifurcating it further into long term or short term capital gains. Considering the said provision, it was held that the concept of indexation while computing the LTCG cannot be imported to the computation of book profit under section 115JB of the Act.

Citation: Dharmayug Investments Ltd [TS-347-ITAT-2015(Mum)]

There is no legal requirement in section 10A of the Act of having certain percentage of new employees in the new unit. Nevertheless, as transferred employees to new SEZ units were within the parameters laid down by CBDT circular, it was not a case of splitting up or re-construction of existing business

Facts and Issues: The assessee was engaged in the business of software development both on-site and off-shore. During the year i.e. AY 2005-06, the assessee had 14 units in respect of which it had claimed deduction under section 10A of the Act. The first unit i.e. BPO undertaking, in the past was held to be eligible for deduction under section 10A of the Act. The assessee thereafter, established various independent units, which started operating in different years as new units and were claiming deduction under section 10A of the Act.

The assessee upto AY 2004-05 had established 12 undertakings. During the AY 2005-06, the assessee established two more undertakings. First unit was set up at Bangalore, which was approved by the STPI and had commenced business from August, 2004. Another unit was set up at Mumbai with separate STPI license, separate Plant & Machinery, Skilled Staff, premises and infrastructure.

<u>Proceedings before the AO</u>

The AO observed that manpower was the main yardstick to ascertain the independence of units. In the assessee’s line of business, software engineers were the main capital which were highly mobile and transferrable. Even the work they did was transferrable from one place to other.

Accordingly, the AO made enquiries as to whether in the new unit, substantially same persons were carrying on the same business or not.

Bangalore unit

In Bangalore unit about 28% of the software engineers were old employees of the company, working in various existing units and had been transferred / shifted from such old units, during the first year of operation. The new unit as such, was carrying on the same business of software development. As per the AO, the unit was clearly formed by splitting and reconstruction of the existing business, as provided in section 10A(2)(ii) of the Act. The assessee had not given any details of the work order or clients of the new unit to show that the unit was given any fresh work order or otherwise carrying on any business different from the existing business. Accordingly, it was held that Bangalore unit was not an independent unit and therefore, not eligible for deduction under section 10A of the Act.

Mumbai unit

In respect of Mumbai unit, the AO noted that the unit was basically a system hub, a server unit providing support to business operations of other units. The AO observed that the assessee had two old software units in close proximity to the new one. The ratio of desktop computers to the engineers deployed was low. There was actually no software engineer employed in this unit suggesting that this unit was not a separate unit for software development, but only providing logistical support to the existing units and their businesses. The assessee had not given any details of the work order or the clients of the new unit to show that the unit was given any fresh work order or otherwise carrying on any business different from the existing business carried out by other units. The AO therefore, held that the Mumbai unit was not eligible for deduction under section 10A.

Decision: Section 10A(2)(iii) of the Act prohibits formation of new units by way of transfer of previously used plant & machinery to the new unit. The explanatory memorandum to the said section does not express additional objective of employment generation. There is no legal requirement in section 10A of the Act of having certain percentage of new employees in the new unit. The CBDT vide Circular No.14/2014, dated October 10, 2014 has clarified that transfer or re-deployment of technical manpower, from the existing units to the new units located at SEZ, in the first year of commencement of business, shall not be construed as splitting up or reconstruction of the existing business, provided the number of technical manpower so transferred at the end of the financial year does not exceed 50% of the total technical manpower actually engaged in the development of software or IT enabled projects in the new unit.

Shifting of existing manpower to new unit

As per details furnished by the assessee, in the new unit at Bangalore, the new employees employed were 289 and the transferred employees were 112 i.e. total employees 401. The percentage of transferred employees to the total employees was 27.93%.

In Mumbai unit, the new employees totaled to 65 along with transferred employee of 6, resulting in total employees of 71 and the percentage of transferred employees to the total employees was 8.45%. Thus, percentage of transferred employees was within the parameters laid down by the CBDT vide Circular No. 2014 and hence transfer of old employees to the new units could not be construed as splitting up or re-construction of existing business.

Mumbai unit a system hub

Another objection raised by the AO in respect of Mumbai unit was that it was a system hub. The plea of the assessee was that it was engaged in providing remote infrastructure management through technology software and equipment and with the said software, the assessee could directly access from India the software and systems at client’s location and carry out necessary de-bugging, patch-work and also providing software support. The unit was engaged in the development and maintenance of the systems software. The conclusion of the CIT(A) was that the system was engaged in different line of software business and was not a system hub or server unit providing support to the business operations by other units. The said finding of the CIT(A) had not been controverted by the Income tax department. The assessee had also furnished on record the details of investment made in plant & machinery in both the undertakings which shows that both the units have complied with the conditions prescribed under section 10A of the Act and are independent and separate undertakings working from different locations with new plant & machinery, having adequate skilled staff to carry out its operations and are independently viable undertakings earning profits / losses, which are attributable to the business carried on by the assessee in the separate units. The said units were therefore eligible for claim of deduction under section 10A of the Act since the same were not formed by the splitting up or reconstruction of a business, already in existence.

The ITAT accordingly held that the assessee was eligible for deduction under section 10A of the Act.

Citation: iGATE Computer Systems Ltd. vs. ADIT (TS-317-ITAT-2015(PUN)

Department Representative seeking adjournment on flimsy ground draws flak from an irked ITAT

Facts and Issue: A matter was listed before the 'D' bench of the Mumbai ITAT, having the Hon'ble Vice-President and an Accountant Member as its constituted members. The Department Representative (DR) requested for adjournment in all the cases listed for hearing before this Bench on the ground that regular DR was on leave and several details were required to be submitted for effective representation of the cases. The DR further stated that she had got the intimation on a Friday that she has to appear before the aforesaid Bench but due to intervening holidays, she could not prepare the cases.

The technical issue involved related to non-deduction of income-tax at-source by the assessee on 'access charges' paid to its parent company for use of their telecom network. Though the AO treated the assessee as 'in default' for failure to deduct tax at-source, the CIT(A) provided relief to the assessee by accepting both the contentions of the assessee, i.e. payment of access charges cannot be said to be payment towards 'fees for technical services' or 'rent' and hence the payment need not be subject to TDS under section 194-J or 194-I of the Act. The CIT(A) found that the 'access charges' were considered as income in its audited books of account of the deductee company and offered to income-tax and that the AO had passed a rectification order u/s 154 r.w.s 201(1) of the Act exonerating the assessee from his 'assessee in default' status. Thus, the CIT(A) found that there was no tax impact involved in the appeals in the light of circular of the CBDT dated 29.01.1997 and the decision of the Apex Court in the case of Hindustan Coca Cola Beverage (P) Ltd. vs. CIT 293 ITR 226.

ITAT's Observations: Apropos the adjournment sought by the DR, the ITAT refused to accede thereto, with a direction to the DR to be ready to present the case on the part of the department. However, by the time the cases were called upon for hearing, the DR left the court room without informing anybody. She was hardly present in the court for about 30 minutes, i.e. from 10.30 a.m. to 11.00 a.m. only to seek adjournments in all the cases assigned to her on the ground that though she had got the intimation on Friday itself that she has to appear before 'D' Bench but due to intervening holidays, she could not prepare the cases. Passing the following strictures, the ITAT observed that this cannot be a valid reason for seeking adjournment. The DR is duty bound to prepare the cases and only in exceptional circumstances could seek adjournment. It is for the Chief Commissioner to engage some experienced Department Representatives who are aware of the court procedures. The ITAT remarked that in the recent past, it was noticed that some of the DRs had never had exposure to the functions of the Tribunal except the formal court observation as part of their training programme, which sometimes result in not supporting the stand of the Revenue effectively and in turn may affect a genuine case of the Revenue for want of proper prosecution. The ITAT suggested that any official, on being assigned the duty of DR, should be made to sit in the court room for observation at least for 15 days so that their services can be used effectively at a later stage. In the instant case, they noted that it appeared that on a temporary basis, the DRs were posted; only in the previous week the fact of non-availability of DR could be made known to the CCIT who had to make an alternative arrangement and then it is for the nominated DR, who is a 24 hour government servant, to collect the files from the office and go through the records properly to make an effective representation on Monday morning. Here is the situation where the CIT-DR sought adjournment in all the cases assigned to her on the ground that she was asked to represent the matters on Monday, only by sending intimation on Friday. It is for the Revenue to take appropriate steps in this regard for effective representation of the cases and it is not necessary for the tribunal to discuss more on this aspect. The ITAT then went on dispose the matter ex-parte, in favor of the assessee, by observing that none appeared on behalf of the Revenue.

Our Comments: This is a welcome judgement aimed at improving the speed and quality of departmental representation before the ITAT matters. While several attempts have been and continue to be made in this regard, in our humble view, unless the issue is addressed holistically, it may not yield desired results. It is a fact that the DR's are overworked with insufficient research material and inadequate people resources at their disposal, often with bureaucratic delays in obtaining case records, leading to low motivation and poor morale to pursue the matters with zeal and positive vigour. Perhaps tapping the prodigious talent available in the Private sector especially Chartered Accountants, Advocates and other competent professionals, and seeking their assistance in clearing the ginormous backlog before various tax Courts is an idea whose time has arrived.

On a parallel note, it is noted that often, the issues involved could make or mar the prospects of filling Government's exiguous coffers by having value 'res judicata'. It may seem utopian but it could be worthwhile for the Finance Minister to incorporate data pertaining to tax impact involved in cases where the Revenue has lost, in a statement similar to or in the 'Taxes Foregone' statement of the Union Budget.

Even after having the benefit of referring to various decisions from the judicial fora, the same issue is litigated again and again either by differentiating the earlier decisions on flimsy grounds, which does not behove a responsible litigant. The least the Government could do is to proactively settle uncomplicated controversies by issuing clarificatory circulars (issue of pre-April 2015 MAT on FIIs being a case in point) or by amending the law. Amending the law is to be attempted with due caution else the very design of the legislation could become extremely complicated and offer enormous latitude as well as discretion for the AOs and scope for interpretation to the assessees, which in turn breeds corruption and avoidable/needless litigation.

One hopes from the Government of this day to usher in a wave of reforms aimed at making India a better place to do business in and the tax litigation reforms, some of which have been discussed above, could be a good beginning.

Citation: DCIT (TDS), Mumbai Vs. Reliance Communications Infrastructure Ltd. [ITA Nos. 4010 to 4013/Mum/2011] (Mumbai ITAT)

Date of inauguration is immaterial – depreciation is allowable

Facts and issue: The assessee company was engaged in the business of newspaper publication. For AY 2008-09, the assessment was completed under section 143(3) of the Act and order passed under section 143(3) of the Act on December 6, 2010 determining the loss at Rs.1,47,12,817. Subsequently, during the audit scrutiny, it was found that as per the Director's report, the assessee had commenced its business on October 27, 2007. It was observed that the assessee had claimed depreciation at full, normal rate on opening block of plant and machinery and electrical equipment blocks; on all other assets, the assessee had claimed depreciation @

50% of normal rate of depreciation as they were was used for less than 180 days. From the aforesaid facts, the AO was of the opinion that the assessee having commenced its business only on October 27, 2007, it could not have used its assets before that date. Hence, assessee's claim of full, normal rate of depreciation @ 15% was denied and instead 50% of normal rate of depreciation on opening WDV of plant and machinery and electrical equipment totaling to Rs. 38,43,674 was allowed vide order passed in reassessment proceedings u/s 147 of the Act.
Aggrieved by this order, the assessee took the matter before the CIT(A) who sustained the action of the AO.

Arguments and contentions: The assessee challenged the action of the AO on the following three key points:

a) The date of inauguration of the newspaper on October 27, 2007 has no relation with the actual date of commencement of assessee's business. Assets were ready to put to use even earlier.
b) Without disturbing the WDV of block of assets for previous AY i.e. AY 2007-08, it was not possible for the AO to change the WDV of those blocks for the subsequent year.
c) No depreciation was claimed in the block of plant and machinery and electrical equipment in the previous AY i.e. AY 2007-08.

The Department felt that when the formal inauguration of newspaper took place on October 27, 2007, the logical conclusion would be that the assessee's business commenced with formal inauguration. Having said this, it appears that the Department did not bring on record any finding that the assessee had not put to use the assets during the impugned AY 2008-09.
Based on these arguments, the DR submitted that the actions of the AO and CIT(A) were sustainable.

ITAT's decision: The ITAT examined the second proviso to section 32(1) which prescribes that if an asset is acquired by the assessee during the previous year **and** is put to use for the purpose of business or profession for a period of less than 180 days in that previous year, deduction under section 32(1) in respect of such asset shall be restricted to 50% of the amount calculated at the percentage prescribed for that asset. Thus, to qualify for full amount of depreciation, two conditions have to be satisfied as per second proviso to section 32(1). Firstly, the asset on which depreciation is claimed, must have been acquired by the assessee during the previous year and secondly, it must have been put to use for the purpose of business or profession for a period of more than 180 days. The ITAT applied the aforesaid statutory provisions to the facts of the present case and noted that the assets on which the assessee had claimed depreciation at the full rate i.e. 15% were acquired during the previous year relevant to the AY 2007-2008 and had been shown as opening WDV as on April 1, 2007. The ITAT observed that there was no dispute to the aforesaid factual position as the Department had accepted the opening WDV shown by the assessee. Therefore, the other condition which remained to be satisfied by the assessee for claiming full depreciation was, whether the assessee had put to use such assets for the purpose of his business or profession for more than 180 days in the relevant previous year.

The ITAT discerned that the AO merely relied upon the Director’s Report wherein it was mentioned that inauguration of newspaper happened on October 22, 2007 to conclude that business of assessee had commenced on October 22, 2007. There was no other material brought on record by the AO to conclusively prove the fact that the plant and machinery as well as electrical equipment were not put to use for the purpose of assessee’s business prior to October 22, 2007. In this context, the ITAT pointed out that the words used in section 32(1) were for the ‘purpose of business’ or ‘put to use’ for the purpose of business. The provision does not use the expression ‘commencement of business’.

The ITAT concluded that the principle of law which emerged from the various judicial precedents it examined on this issue, is to the effect that the term ‘used’ as employed in section 32(1) had to be given a wider meaning and would include passive user of the asset. It had been held consistently by various Courts that if the machinery or plant was ready for use but it was not actually used, still the assessee would be eligible for depreciation. The ITAT applied these principles to the facts of the present case and concluded that the plant and machinery as well as electrical installation were ready for use in the impugned assessment year.

Therefore, considering the totality of the facts and circumstances of the case, the ITAT held the disallowance of 50% out of the total depreciation as claimed by the assessee on the opening WDV was without any reasonable basis and deleted the addition made on that account.

Citation: SPR Publications P. Ltd. Vs ACIT, Hyderabad [ITA Nos. 351/Hyd/2015] (Hyderabad ITAT)

Levy of fees u/s 234E for period prior to June 01, 2015 cannot be sustained as enabling provision was absent for such period.

Facts of the case:

Assessee filed TDS statement (commonly known as 'TDS return') for the Quarter 3 of FY 2012-13 belatedly. While processing the TDS return, the AO raised a demand for levy of fees u/s 234E of the Act for default in furnishing the TDS return in a timely manner. This demand was raised by an adjustment vide intimation u/s 200A of the Act. Assessee was of the view that there was no scope for adjustment for levy of fees u/s 234E of the Act in the intimation u/s 200A of the Act. So the assessee preferred an appeal before the CIT(A) who sustained the AO's action.

Aggrieved by this, the assessee filed an appeal before the ITAT.

The question posed to the ITAT was whether or not fees u/ 234E in respect of defaults in furnishing TDS statements could be levied by way of an intimations u/s 200 of the Act, for period prior to June 01, 2015.

Arguments:

The assessee relied on the decisions of the Kerela High Court in the case of Narath Mapila LP School Vs Union of India, Karnataka High Court in the case of Adithya Bizor P Solutions Vs Union of India, Bombay High Court in the case of Rashmikant Kundalia Vs Union of India, etc. granting stay on the demands in respect of fees levied u/s 234E.

The DR, on the other hand, relied on the orders of the CIT(A) and the AO.

The ITAT proceeded to decide on the matter as there were no order from the High Courts restraining the ITAT from adjudicating on the merits of the issue involved in this matter.

Decision:

After examining the provisions of sections 200A and 234E of the Act, the ITAT concluded that the adjustment to include fees u/s 234E vide the intimation u/s 200A of the Act was beyond the scope of permissible adjustments. It held that there was no enabling provision u/s 200A to make such adjustment for interest u/s 234E of the Act. As the intimation u/s 200A was an appealable order, the first appellate authority should have examined the legality of adjustments made. Accordingly, it struck down the order of the AO and upheld the assessee's plea.

Our Comments:

The Finance Act, 2015 has now enabled the computation of fee payable under section 234E of the Act at the time of processing of TDS statement under section 200A of the Act w.e.f June 1, 2015. This decision of the ITAT (a welcome one at that) is based on the premise that there cannot be retrospective application of the amendment.

The levy of fee under section 234E of the Act was intended to be an effective tool in improving the compliance in respect of timely submission of TDS/TCS statements by the deductor or collector. The issue considered by the ITAT, in our view, puts the spotlight on a bigger issue – the role of draftsmen applying care and caution while drafting tax legislations. In this case, while inserting a section, it appears there was an omission to consider whether it could be operationalized. If due care and caution is not exercised, one could expect such amendments to be struck down by the honorable Courts, needless to add the defeat of the intended purpose and giving rise to avoidable litigation.

CITATION: **Sibia Healthcare Private Limited Vs. Dy. Commissioner of Income-tax (TDS) [ITA no. 90/ASR/2015 (A.Y. 2013-14)]**

CBDT Notification/ Circular

Procedure for Response to Arrear Demand by Taxpayer and Correction of Demand by AO and CPC, Bangalore

The CBDT vide Instruction No. 4 of 2014 dated April 7, 2014 had earlier prescribed Standard Operating Procedure for verification and correction of income tax demand uploaded by AOs in CPC Demand Portal. The facility was made available to taxpayers on the e-filing website (www.incometaxindiaefiling.gov.in) to provide online responses to such demands.

The actions to be performed by the taxpayer and the AO are being consolidated in this Circular. This Circular lists down the detailed steps to be followed by the Taxpayers where they disagree with the income tax demand.

The AO or CPC Bangalore has been directed to reduce/ remove/ confirm the demand in appropriate cases and are directed to verify demand on priority basis for cases, where tax demand has been paid, demand is arising due to mismatch and where demand is already reduced but action is pending on CPC website.

Income Tax Circular: CBDT Circular No. 8/2015 dated May 14, 2015

Dividend declaration by foreign companies would not get covered by Explanation 5 to section 9(1)(i) of the Act dealing with indirect transfer of capital asset situated in India and would not be taxable in India

Section 9 of the Act provides for income which are deemed to accrue or arise in India. As per section 9(1) of the Act, all income accruing or arising, whether directly or indirectly, from any asset or through the transfer of a capital asset situated in India, shall be deemed to accrue or arise in India.

The Finance Act, 2012 had inserted Explanation 5 to section 9(1)(i) which clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest, directly or indirectly, substantially derives its value from the assets located in India.

A number of representations were received by the CBDT stating that the purpose of introduction of Explanation 5 was to clarify the legislative intent regarding the taxation of income accruing or arising through transfer of a capital asset situated in India. Apprehensions were expressed about the applicability of the Explanation to the transactions not resulting in any transfer, directly or indirectly of assets situated in India. It was pointed out that such an extended application of the Explanation may result in taxation in India of the dividend declared by a foreign company, outside India. This may cause unintended double taxation and would be contrary to the generally accepted principles of source rule as well as the object and purpose of the amendment made.

The Shome Committee in its draft report on Retrospective Amendments Relating to Indirect Transfer had raised this issue and had suggested removal of the phrase “any asset or” from the section 9(1)(i) of the Act. The Shome Committee had also recommended that the CBDT should come out with a clarification that dividend paid by a foreign company shall not be deemed to accrue or arise in India under section 9(1)(i) read with Explanation 5.
The Finance Minister in his Budget speech at the time of presenting the Finance Bill 2015 had clarified that the CBDT would issue a necessary circular to ensure that the provisions relating to indirect transfers do not lead to dividends being paid by foreign companies being taxed in India.

The CBDT vide the above Circular has clarified that dividends declared and paid by a foreign company outside India, in respect of shares which derive their value substantially from assets situated in India, would not be deemed to be income accruing or arising in India. The Circular further clarifies that declaration of dividend by a foreign company outside India does not have the effect of transfer of any underlying assets located in India and therefore, such dividend declared by foreign company would not be taxable in India.The above Circular clarifies the position that Explanation 5 to section 9(1)(i) would apply only in a situation where there is indirect transfer of a capital asset situated in India.

Our comments

The above Circular is a welcome move by the CBDT. This clarification is in line with the recommendations made by the expert committee chaired by Mr. Shome and the Finance Minister speech on retrospective amendments relating to the taxation of indirect transfer of assets. This clarification reiterates the commitment of the Government to provide a non-adversarial tax regime in India to gain the investor’s confidence.

Income Tax Circular: CBDT Circular No. 4/2015 dated March 26, 2015

The nature of business relationship which debars a Chartered Accountant from being an authorized representative, has now been prescribed.

Section 288 of the Act deals with appearance by the Authorized Representative before any Income Tax Authority or the Appellate Tribunal. A Chartered Accountant who holds a valid COP can be an authorized representative for the purpose of this section. As per Explanation to section 288, a person who whether directly or indirectly has business relationship with the assessee of such nature as may be prescribed, was debarred from being an authorized representative. The nature of business relationship has now been prescribed as per the Notification.

All business relationship of commercial nature with the assessee would debar the Chartered Accountant from being an authorized representative, except in the following situations:

(i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;

(ii) commercial transactions which are in the ordinary course of business of the company at arm's length price – like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses."

Income Tax Notification No.: CBDT Notification 50/2015 dated June 24, 2015

CBDT issues guidelines on condonation of delay in filing claim for refund/carry forward of losses

The Ministry of Finance, Government of India, has put forth, through a Circular issued on 9 June 2015, criteria and guidelines for the condonation of a delay in filing claim for refund/ carry forward of losses.

The CBDT has come up with a comprehensive circular, superseding all earlier circulars/ instructions/ orders in this regard. The key highlights of this Circular are set out below:

- The power to condone a delay has been delegated to various authorities as follows:

Amount of claim (refund / loss) for any one assessment year	**Authority**
Upto INR 10 Lakhs	Principal CIT/ CIT
More than INR 10 Lakhs and upto INR 50 Lakhs	Principal CCIT/ CCIT
More than INR 50 Lakhs	CBDT

- Application is to be made within six years from the end of the relevant assessment year.Such an application will be examined for acceptance/ rejection by the authority, based on the following criteria:
  a) The claim is correct and genuine;
  b) There is a case of genuine hardship on merits;
  c) Income is not assessable in the hands of any other person under the Act
  d) The refund has arisen as a result of excess tax deducted or tax collected at source, advance tax or self-assessment tax.
- The Authorities have been empowered to direct the jurisdictional AO to make necessary inquiry or scrutiny to ascertain the correctness of the claim.Taxpayers can claim an additional refund even after completion of the assessment.No interest would be admissible in case of belated claim of refunds.
- The application should be ideally disposed of by the authorities within six months from the end of the month in which the application was received.
- A guideline has been prescribed for cases involving refund claim pursuant to a Court Order. The time limit of six years to exclude the period for which the proceedings were pending before any Court of Law. In such a case, the condonation application should be filed within six months from the end of the month in which Court order was issued or the end of financial year, whichever being later.
- Time limit of six years does not apply in the case of tax deducted at source by banks on interest in relation to 8% Savings (Taxable) Bonds, 2003 at the time of maturity,

resulting in mismatch between the year of recognition of income by the taxpayer (on mercantile basis, if any) and tax deducted at source.

- The Circular also provides coverage in respect of applications/ claims pending as on the date of issuance of the Circular.

Income Tax Circular: CBDT Circular No. 9/2015 dated May14, 2015

Clarifications on Rollback Provisions of Advance Pricing Agreement Scheme

The Advance Pricing Agreement (APA) program was introduced in the Indian Income-tax Act, 1961 (the Act) with effect from 1st July, 2012, vide Finance Act, 2012. Provisions for a Rollback Mechanism were brought into the Act vide Finance Act (No.2), 2014 with effect from 1st October, 2014. Detailed Rules for the same and the procedure for giving effect to them (the Rules) were announced by the Central Board of Direct Taxes (CBDT) on 14th March, 2015.

Subsequent to the Rules being notified, the CBDT received several requests for clarifications regarding certain matters. To address these, the CBDT has now issued the following clarifications:

1. **Return of Income:**
   Rollback provisions will be available even in case of revised return of income (ROI or return) filed under section 139(5) of the Act, because the revised return replaces the original return. However, rollback provisions will not be available for a return filed under section 139(4) of the Act, because it is a return not filed within the specified due date.

2. **Same International Transaction:**
   As per the Rules, rollback provisions were to apply to the "same" international transaction to which the APA applies. It has been clarified that "same" implies same nature of transaction, and undertaken with the same associated enterprise(s) (AEs), as proposed to be undertaken in the future years and in respect of which APA has been reached. Also, the underlying FAR (functions, assets and risks) of the transaction should not be "materially" different, i.e., there should not be a material change in underlying facts and circumstances which could have resulted in an APA with significantly different terms and conditions.

3. **Rollback Years:**
   The applicant does not have the option to choose any specific year(s) for rollback. He has to either apply for a rollback for all the 4 years or not apply at all, except when:
   i. The relevant international transaction(s) was not undertaken in any of the four years; or
   ii. If the covered international transaction(s) fails the prescribed rollback conditions in any of the 4 years, rollback benefit for that year will be denied.

In the above cases, the Applicant can still apply for rollback for other rollback years.

4. **Appeal Before the Tax Authorities:**
   Rollback provisions would not be applicable for the international transaction for which a Tribunal has passed an order disposing of an appeal, since the Tribunal is the final fact finding authority and hence, on factual issues, the matter would be assumed to have reached finality in that year. However, if the matter has been set aside by the Tribunal for fresh consideration by lower authorities with "full discretion" at their disposal, the matter shall not be treated as one having reached finality and hence rollback provisions would still be applicable.

5. **Reduction in Total Income or Increase in Loss:**
   Rollback provisions would be available where the application of rollback is effected in a manner such that the returned income or loss does not reduce or increase, respectively, i.e., the rollback benefit would be limited to the extent of declared income, and not beyond. For example, if the returned income is INR 100, the income after transfer pricing adjustment is INR 120, and the application of the rollback provisions results in reducing the income to INR 90, then the rollback for that year would be determined in a manner that the declared income INR 100 would be treated as the final income for that year.

6. **Cancellation of APA:**
   The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out the stipulated activities, then the entire APA agreement would stand cancelled.

7. **Mutual Agreement Procedure (MAP) Applications:**
   If MAP has been concluded for any rollback year for a particular international transaction, then rollback provisions would not be available for that particular international transaction in that particular year, subject to fulfillment of conditions specified in Rules 10MA and 10RA. However, if MAP is pending for any rollback year, then, at the option of the applicant, either MAP or rollback application can be proceeded with for that year.

8. **Determination of Arm's Length Price (ALP):**
   ALP could be different for different years – however, the manner of determining ALP (including choice of Method, comparability analysis and Tested Party) as per the rollback provision would need to be the same as that agreed in the APA.

9. **Compliance Audit for Rollback:**
   ALP for rollback years would be agreed after full examination of facts, including validating critical assumptions. Accordingly, compliance audit for rollback years would be required to check if the agreed price or methodology has been applied in the modified return of income.

10. **Withdrawal of Rollback Application:**
An applicant can withdraw its rollback application, and still maintain the APA application for future years. However, it cannot accept the rollback results without accepting the APA for future years. In case of withdrawal, the fee for filing rollback application shall not be refunded.

11. **Revision of APAs:**
As per second proviso to Rule 10MA(5), already concluded APAs (i.e., finalised before 14 March 2015) may be revised to include rollback provisions.

12. **Time- limit for Filing Modified Return for Rollback Years:**
For already concluded APAs, the time to file the modified return of income for all rollback years shall start from the date of signing the revised APA incorporating the rollback provisions.

13. **Eligibility of Rollback when One or More Merging Companies are APA Applicants:**
Only the entity which has applied for an APA, or entered into one, would be eligible for rollback provisions. For example:
    i. If A, B and C merge to form C and C is the APA applicant, then only C would be eligible for rollback provisions – while A and B would not be.
    ii. If A and B merge to form new company C, and C files an APA application, then neither A nor B would be eligible for rollback provisions.

14. **Eligibility of Rollback in case of Demerger of an APA Applicant:**
Same Principle as above i.e. the person (company) who makes an APA application or enters into an APA would only be entitled for rollback provisions. For example:
If A has applied for or entered into an APA, and subsequently demerges into A and B, then only A will be eligible for rollback provisions, as B was not in existence during the rollback years.

Citation: CBDT Circular F.No. 500/7/2015/-APA-II

India and USA signs an Inter-Governmental Agreement (IGA) to implement Foreign Account Tax Compliance Act (FATCA) and share reciprocal information to fight black money menace

FATCA

The FATCA was enacted by the US Government on 18 March 2010. FATCA is aimed at combating possible tax evasion by US persons having income outside USA. FATCA requires US persons including those living overseas, to report their financial accounts held outside USA. It also requires non-US financial institutions to report details of their USA clients to the Internal Revenue Service (IRS).

FATCA imposes 30% withholding tax on US source income of the foreign financial institution (FFI), unless it registers itself with the IRS and reports details of its US customers. The consequence of non-registration of FFI with the IRS is that the US sourced income of FFI (and not of US person) would be subject to 30% withholding tax.

What is Foreign Financial Institution?

FATCA defines FFIs as depository institutions viz. Banks, custodial institutions viz. mutual funds and brokers, investment entities viz. hedge funds or private equity funds, interests in foreign partnerships and insurance companies that have cash value products or annuities. Domestic mutual funds investing in foreign stocks and securities, foreign real estate directly held and personal property directly held are not subject to reporting under FATCA.

Specified US person

Under FATCA, a US person is defined as a citizen or resident of the USA (including a green card holder), a US incorporated entity (including partnerships and trusts), or a non-US incorporated entity having shareholding of 10 percent or more held by a US citizen, US resident, individual with a US mailing address or US incorporated entity.

How does FATCA works?

FATCA has two reporting requirements - one for individuals and one for FFIs.

Reporting requirement for individuals

For individuals, specified US persons holding financial assets outside USA must report those assets to the IRS in Form 8938 i.e. Statement of Specified Foreign Financial Assets.

Reporting requirement for Indian Financial Institution

For Indian Financial Institutions, FATCA requires that each institution report the names, address, tax identification numbers, account numbers and account balances of each account holder that is a specified US person.

For FFIs in countries that have not entered into a FATCA agreement with USA, reporting is required to be done directly to the IRS. For FFIs which have an agreement with USA, FFIs report this information to their respective government, who would in-turn pass on this information to IRS.

Exemptions from reporting requirements

The following FFI are specifically exempt from any reporting under FATCA:

- Most governmental entities;
- Most non-profit organizations;
- Certain small, local financial institutions;
- Certain retirement entities.

In addition to above exemption, FFIs are not required to report details of US persons where amount is less than US $50,000 per individual US customer.

The specified US persons with foreign financial assets less than US $50,000 for individuals residing in USA, and US $200,000 for individuals residing overseas do not need to be reported on Form 8938.

CBDT letter to Tax Officers on filing of appeals on merits

The CBDT took note of the fact that despite several instructions to the Tax Officers to file appeals before the ITAT/ High Court/ Supreme Court (‘the Courts’), only after considering merits of the case, necessary due diligence and caution is not exercised by the Tax Officer. The CBDT also took note of several court decisions which have taken an adverse view against the Income Tax Department filing appeal on frivolous matters.The Courts are taking a stern and inclement view as far as Income-tax Department's actions in litigation matters is concerned.

The CBDT in the letter addressed to the Tax Officer observed that the significance of filing appeal and pursuing litigation only in deserving cases, cannot be over-emphasized, more so in the backdrop of the fact that Income-tax Department is facing shortage of officers at all levels. Senior Tax Officers are directed to ensure that appeals are filed only on the merits thereof and not merely on the tax effect involved.

Income Tax Circular: CBDT Letter Ref. No. 279/M-88/2014-ITJ dated 3 July 2015

The Black Money Act

- **Tax Compliance under the Black Money Act;**
- **CBDT prescribes Rules for valuation of undisclosed foreign assets;**
- **Clarification on tax compliance for undisclosed foreign income and assets by way of FAQ's**

Tax Compliance under the Black Money Act

The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (The Black Money Act) was enacted on May 26, 2015. The Black Money Act has been introduced to deal with the menace of black money stashed away abroad. It levies tax on undisclosed assets held abroad by a person who is a resident in India and ordinarily resident in India at the rate of 30% of the value of such assets. It also provides for a penalty equal to 90 % of the value of such asset and also provides for rigorous imprisonment of three to ten years for wilful attempt to evade tax in relation to undisclosed foreign income or assets. The Black Money Act is therefore not applicable to a non-resident and resident but not ordinarily resident in India.

Considering the stringent nature of the penalty and prosecution prescribed as per the Black Money Act, the CBDT has provided for a one-time compliance opportunity for a limited period to persons who have such undisclosed foreign assets. Under this facility, once the taxpayer pays tax at 30% on the value of undisclosed foreign assets and amount equal to the penalty he would be immune from the provision of Black Money Act and thereby avoid rigorous imprisonment.

Scope of compliance window

A person who is a resident and ordinarily resident in India fulfilling the below mentioned conditions can make a declaration in respect of undisclosed foreign assets located outside India and acquired from income chargeable to tax under the Income-tax Act for any AY prior to AY 2016-17 where:

- he either failed to furnish a return under section 139 of the Income Tax Act, or
- failed to disclose such income in a return furnished before the date of commencement of the Black Money Act, or
- such income had escaped assessment by reason of omission or failure on the part of such person to make a return under the Act or to disclose fully and truly all material facts necessary for the assessment or otherwise.

Declaration not eligible in certain cases

The benefit of one-time compliance window is not available in the following cases:

- A notice in respect of any undisclosed asset acquired from income chargeable to tax under the Act has been issued in respect of such AY and the proceeding is pending before the AO and the notice in reference to above has been served on or before June 30, 2015.
- A search has been conducted/requisition has been made/survey has been carried out, time for issuance of a notice of initiation of assessment has not expired.
- Any information has been received by the competent authority under the Tax Treaty in respect of undisclosed asset before June 30, 2015.

Prosecution proceedings have been initiated against the taxpayer under Indian Penal Code or Unlawful Activities (Prevention) Act or the Prevention of Corruption Act.

Rate of tax and penalty

The person making the declaration will be liable to pay tax at the rate of 30% of the value of such undisclosed assets. He would in addition to tax of 30%, be liable to pay a penalty at the rate of 100% of such tax. This special rate of tax and penalty specified in the compliance provisions will override any rate or rates specified under the provisions of the Act or the annual Finance Acts.

Time limits for declaration and making payment

One time compliance window has been effective from 1 July 2015. The declaration may be made at any time before 30 September 2015. The designated Principal CIT/CIT will issue intimation to the declarant by 31 October 2015. Where any such information had been received by the designated Principal CIT/CIT under the Tax Treaty, the declarant is allowed to file a revised declaration excluding such assets. The declarant shall not be liable for any consequences under the Black Money Act in respect of, any asset which has been duly declared but has been found ineligible for declaration as the Central Government had prior information on such asset. However, such information may be used under the provisions of the Act. The revised declaration shall be filed within 15 days of receipt of intimation from the designated Principal CIT/CIT.

The declarant is required to pay the requisite tax and penalty on the assets eligible for declaration by 31 December 2015. After the intimation of payment by the declarant, the designated Principal CIT/CIT will issue an acknowledgement of the accepted declaration within 15 days of such intimation of payment by the declarant.

Circumstances where declaration shall be void

The declaration shall be void if:

- The declarant fails to pay the entire amount of tax and penalty before December 31, 2015
- The declaration has been made by misrepresentation or suppression of facts or information.

Any tax or penalty paid in pursuance of the declaration will not be refundable under any circumstances.

Effect of valid declaration

The filing of valid declaration would have the following consequences for the declarant:

- The amount of undisclosed investment in the asset declared shall not be included in the total income of the declarant under the Act for any AY;
- Declaration shall not be admissible as evidence against the declarant in any penalty or prosecution proceedings under the Income Tax Act, the Wealth Tax Act, the FEMA, the Companies Act or the Customs Act;
- The value of the asset stated in the declaration shall not be chargeable to wealth tax for any AYs;
- Declaration of an undisclosed foreign asset will not affect the finality of completed assessments. Therefore, the declarant will not be entitled to claim re-assessment of any earlier year or revision of any order or any benefit or set off or relief in any appeal or proceedings under the Black Money Act or under the Income Tax Act in respect of declared undisclosed asset located outside India or any tax paid thereon.

CBDT prescribes Rules for valuation of undisclosed foreign assets

The CBDT has issued the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Rules, 2015 (the Black Money Rules) under the provisions of Black Money Act.

Rule 3 of the Black Money Rules prescribes the manner of determination of fair market value (FMV) for the following assets as under:

Sr	**Nature of asset**	**Valuation**

No		
1	Bullion, jewellery or precious stone	Higher of cost of acquisition and price that the bullion, jewellery or precious stones shall ordinarily fetch if sold in the open market on the valuation date.
2	Archaeological collections, drawings, paintings, sculptures or any work of art	Higher of cost of acquisition and price that the artistic work shall ordinarily fetch if sold in the open market on the valuation date.
3	Quoted shares and securities	Higher of cost of acquisition and average of the lowest and highest price of such shares and securities on the valuation date. Where on the valuation date there is no trading in such shares and securities, take average of the lowest and highest price of such shares and securities on any established securities market on a date immediately preceding the valuation date when such shares and securities were traded.
	Unquoted shares and securities	Higher of cost of acquisition and value, on the valuation date, of such equity shares as determined in the following manner: (A+B–L) x (PV)/(PE) A = Book value of all the assets (other than bullion, jewellery, precious stones, artistic work, shares, securities and immovable property) as reduced by – (i) any amount of income tax paid, if any, less the amount of income tax refund claimed, if any, and (ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset B= Fair market value of bullion, jewellery, precious stones, artistic work, shares, securities and immovable property as determined in the

		manner provided in the Rule L= Book value of liabilities, excluding specified Liabilities as specified in the rules PE= Total amount of paid up equity share capital as shown in the balance-sheet PV= The paid up value of such equity shares
	Other than equity shares and securities – unquoted	Higher of cost of acquisition and price that the share or security shall ordinarily fetch if sold in the open market on the valuation date.
4	Immovable property	Higher of cost of acquisition and price that the property shall ordinarily fetch if sold in the open market on the valuation date.
5	Overseas bank account	• The sum of all the deposits made in the account with the bank since the date of opening of the account. It does not include the deposits that are withdrawn earlier from the account. • Where a declaration of such account has been made and value of the account (as computed) has been charged to tax and penalty, the sum of all deposits made in the account with the bank since the date of such declaration.
6	Interest of a person in a partnership firm or in an association of persons or a limited liability partnership of which he is member	Total of • Net assets of the firm/Association of Person/Limited Liability Partnership to the extent represented by amount of capital to be apportioned amongst the partner/member in capital ratio and • Residue net assets to be apportioned in accordance with agreement for distribution in the event of dissolution and in absence of such agreement, in the profit sharing ratio Net assets of the firm = A+B-L in a manner provided in Sr. No. 3(ii)

7	Any other assets	Higher of cost of acquisition and price that the asset would fetch if sold in the open market on the valuation date in an arm's-length transaction.

The Black Money Rules has prescribed the procedure for declaration of an undisclosed asset outside India, procedure for an appeal to CIT as well as ITAT. The following Forms has been prescribed as per the Black Money Rules:

a. Form 1 – Notice of demand
b. Form 2 – Appeal to the CIT(A)
c. Form 3 – Appeal to the ITAT
d. Form 4 – Form of Memorandum of cross objections to the ITAT
e. Form 5 – Certificate under section 31 or 33 of the Black Money Act
f. Form 6 – Form of undisclosed asset located outside India under section 59 of the Black Money Act
g. Form 7 – Acknowledgement of declaration of the undisclosed foreign asset under Chapter VI of the Black Money Act

The declaration is to be made in Form 6. The declaration may be filed with the Commissioner of Income Tax, Delhi. The declaration may also be filed online on the website of the Income tax department using the digital signature of the declarant.

Clarification on tax compliance for undisclosed foreign income and assets by way of FAQ's

After the prescription of the Black Money Rules, various queries were received from the public about the scope of Rules and the procedure to be followed. The CBDT considered the same and decided to clarify the points raised by issue of a Circular in the form of questions and answers. The key FAQs are summarized as under:

Sr No	**Issue**	**Response**
1	Partner filing declaration in respect of undisclosed foreign assets of a firm	The declaration can be made by the firm which has to be signed by the partner. The partner in his individual name cannot make a declaration for undisclosed assets of the firm.

2	Can a company file a declaration? If yes, then whether immunity would be granted to Directors of the company?	Yes, the company can file a declaration under the Black Money Act. The directors of the company would be granted immunity under the following Acts viz, the Income Tax Act, Wealth Tax Act, FEMA, Companies Act and the Customs Act, in respect of declaration made in the name of the company.
3	Where an undisclosed foreign asset is declared under Black Money Act and tax & penalty is paid on its FMV, will the declarant be liable for capital gains on sale of such asset in the future? If yes, then how will the capital gains in such case be computed?	Yes, the declarant will be liable for capital gains under the Income Tax Act on sale of such asset in future. As per the current provisions of the Income Tax Act, the capital gains is computed by deducting cost of acquisition from the sale price. As the asset will be taxed at its FMV, the cost of acquisition for the purpose of capital gains shall be the said FMV and the period of holding shall start from the date of declaration of such asset under of the Black Money Act.
4	Where a notice under various provisions of the Income-tax Act has been issued to a person for an AY will he be ineligible from voluntary declaration under section 59 of the Black Money Act?	Where a search, scrutiny and reassessment notice under various provisions of the Income-tax Act is issued to a person, he will be ineligible from declaration of those foreign assets which have been acquired during the year. However, he is free to declare other foreign assets that have been acquired during other years for which no notice has been issued.
5	Where an undisclosed foreign asset has been acquired partly during a previous year relevant to the AY which is pending for assessment and partly during other years not pending for assessment then whether such asset is eligible for declaration under the Black Money Act?	Where an undisclosed foreign asset has been acquired partly during a previous year for which a notice under various provisions is issued on or before June 30, 2015 and partly in a year in which no notice is served, the declarant is eligible to make declaration in respect of such assets. For computing the amount of declaration, the investment made in the asset during the previous year relevant to AY for which such notice is issued, needs to be deducted from the FMV of the asset.

6	Where a search/ survey operation was conducted and the assessment has been completed but the undisclosed foreign asset was not taxed, then whether such asset can be declared under the Black Money Act?	Yes, declaration can be made under the Black Money Act for such undisclosed asset
7	Whether a person is barred from voluntary declaration under the Black Money Act if any information has been received by the Government under DTAA?	The person cannot make a declaration of an undisclosed foreign asset where the Central Government has received information in respect of such asset under the DTAA. The person is entitled for voluntary declaration in respect of other undisclosed foreign assets for which no information has been received.
8	What are the consequences if no declaration under the Black Money Act is made in respect of undisclosed foreign assets acquired prior to the commencement of the Act?	Where any asset has been acquired prior to the commencement of the Black Money Act and no declaration under Black Money Act is made then such asset shall be deemed to have been acquired in the year in which it comes to the notice of the AO and the provisions of the Black Money Act shall apply accordingly.
9	A person has some undisclosed foreign assets. If he declares those assets in the Tax Return for AY 2015-16 or say 2014-15 (in belated return) then should he need to declare those assets in the voluntary tax compliance under the Black Money Act?	Since an asset reported in Schedule FA does not form part of computation of total income in the Income-tax Return and consequently does not get taxed, mere reporting of a foreign asset in Schedule FA of the Return does not mean that the source of investment in the asset has been explained. Therefore, declaration should be made under the Black Money Act in respect of all those foreign assets which are unaccounted/ the source of investment in such asset is not fully explainable.
10	A person holds certain foreign assets which are fully explained and acquired out of tax paid income. However, he has	Since, these assets are fully explained they are not treated as undisclosed foreign assets and should not be declared under Black Money Act. However, if these assets are not reported in Schedule FA of the Tax Return for AY 2016-17 or any subsequent AY by a person, being a resident

	not reported these assets in Schedule FA of the Tax Return in the past. Should he declare such assets under the Black Money Act?	(other than not ordinarily resident), then he shall be liable for penalty of Rs. 10 lakhs. The penalty is, however, not applicable in respect of an asset being one or more foreign bank accounts having an aggregate balance not exceeding an amount equivalent to Rs. 5 lakhs, at any time during the previous year.
11	A person has a foreign bank account in which undisclosed income has been deposited over several years. He has spent the money in the account over these years and now it has a balance of only $500. Does he need to pay tax on this $500 under the declaration?	Tax and penalty needs to be paid on FMV, which is the sum of all the deposits made in the account computed in accordance with Rule 3(1)(e) and not on the balance as on date.
12	A person held a foreign bank account for a limited period between 1994-95 and 1997-98 which was unexplained. Since such account was closed in 1997-98 does he need to declare the same under the Black Money Act?	Section 59 of the Black Money Act provides that the declaration may be made of any undisclosed foreign asset which has been acquired from income which has not been charged to tax under the Income Tax Act. Since the investment in the bank account was unexplained and was from untaxed income the same may be declared under the Black Money Act.
13	A person inherited a house property in 2003-04 from his father who is no more. Such property was acquired from unexplained sources of investment. The property was sold by the person in 2011-12. Does he need to declare such property under the Black Money Act and if yes then, what will be the FMV of such property for the purpose of declaration?	Since the property was from unexplained sources of investment the same may be declared under the Black Money Act. However, the declaration in this case needs be made by the person who inherited the property in the capacity of legal representative of his father. The FMV of the property in his case shall be higher of its cost of acquisition and the sale price as per Rule 3(2) of the Rules.

14	A person acquired a house property in a foreign country during the year 2000-01 from unexplained sources of income. The property was sold in 2007-08 and the proceeds were deposited in a foreign bank account. Does he need to declare both the assets under the Black MoneyAct and pay tax on both the assets?	The declaration may be made in respect of both the house property and the bank account at their FMV. The FMV of the house property shall be higher of its cost and the sale price, less amount deposited in bank account. If the cost price of the house property is higher the declarant will be required to pay tax and penalty on (cost price – sale price) of the house. If the sale price of the house property is higher the FMV of the house property shall be nil as full amount was deposited in the bank account. The FMV of the bank account shall be as determined under Rule 3(1)(e) and tax and penalty shall be paid on this amount. (Please also refer to the illustration under Rule 3(3) for computation of FMV). Further, it is advisable to declare all the undisclosed foreign assets even if the FMV as computed in accordance with Rule 3 comes to nil. This may avoid initiation of any inquiry under the Act in the future in case such asset comes to the notice of the AO.
15	A person is a non-resident. However, he was a resident of India earlier and had acquired foreign assets out of income chargeable to tax in India which was not declared in the return of income or no return was filed in respect of that income. Can that person file a declaration under the Black Money Act?	Section 59 provides that a declaration may be made by any person of an undisclosed foreign asset acquired from income chargeable to tax under the Income-tax Act for any AY prior to AY 2016-17. Since the person was a resident in the year in which he had acquired foreign assets (which were undisclosed) out of income chargeable to tax in India, he is eligible to file a declaration under section 59 in respect of those assets under the Black Money Act.
16	A person is a resident now. However, he was a non-resident earlier when he had acquired foreign assets (which he continues to hold now) out of income which was not chargeable to tax in India. Does the person need to file a declaration in	No. Those assets do not fall under the definition of undisclosed assets under the Black Money Act.

	respect of those assets under the Black Money Act?	
17	If a person has 3 undisclosed foreign assets and declares only 2 of those under the Black Money Act, then will he get immunity from the Black Money Act in respect of the 2 assets declared?	It is expected that one should declare all his undisclosed foreign assets. However, in such a case the person will get immunity under the provisions of the Act in respect of the two assets declared under the Black Money Act and no immunity will be available in respect of the third asset which is not declared.
18	A resident earned income outside India which has been deposited in his foreign bank account. The income was charged to tax in the foreign country when it was earned but the same was not declared in the return of income in India and consequently not taxed in India. Does he need to disclose such income under the Black Money Act? Will he get credit of foreign tax paid?	Declaration under the Black Money Act is to be made of an undisclosed foreign asset. In this case, the person being a resident of India, the foreign bank account needs to be declared under the Black Money Act as it is an undisclosed asset and acquired from income chargeable to tax in India. The FMV of the bank account shall be determined as per Rule 3(1)(e). No credit of foreign taxes paid shall be allowable in India as section 84 of the Black Money Act. Further, section 73 of the Black Money Act does not allow agreement with foreign country for the purpose of granting relief in respect of tax chargeable under the Black Money Act.
19	Can a person declare under Chapter VI his undisclosed foreign assets which have been acquired from money earned through corruption?	No. As per section 71(b) of the Black Money Act, Chapter VI shall not apply, *inter-alia*, in relation to prosecution of any offence punishable under the Prevention of Corruption Act, 1988. Therefore, declaration of such asset cannot be made under Chapter VI. However, if such a declaration is made and in an event it is found that the asset represented money earned through corruption it would amount to misrepresentation of facts and the declaration shall be void under section 68 of the Act. If a declaration is held as void, the provisions of the Act shall apply in respect of such asset as they apply in relation to any other undisclosed foreign asset.

20	If a foreign asset has been acquired partly out of undisclosed income chargeable to tax and partly out of disclosed income/exempt income (tax paid income) then whether that foreign asset will be treated as undisclosed? Whether declaration under Black Money Act needs to be made in respect of such asset? If yes, what amount should be disclosed?	As per section 5 of the Black Money Act, in computing the value of an undisclosed foreign asset any income which has been assessed to tax under the Income-tax Act from which that asset is acquired shall be reduced from the value of the undisclosed foreign asset. Only part of the investment is such foreign asset is undisclosed (unexplained) hence declaration of such foreign asset may be made under the Black Money Act. The amount of declaration shall be the FMV of such asset as on 1st July, 2015 as reduced by the amount computed in accordance with section 5 of the Black Money Act.
21	Whether for the purpose of declaration, the undisclosed foreign asset should be held by the declarant on the date of declaration?	No, there is no such requirement. The declaration may be made if the foreign asset was acquired out of undisclosed income even if the same has been disposed off and is not held by the declarant on the date of declaration.

Source: Circular 12 of 2015 dated 2 July 2015, 13 of 2015 dated 6 July 2015 and Notification No. 56, 57 & 58/2015 [F.No. 133/33/2015-TPL] / GSR 529 dated 2 July 2015

Commented [DJ5]: New Addition to the file

Inter Governmental Agreement (IGA)

FATCA requires signing of an IGA between USA and other countries to promote transparency between the two nations on tax matters. Over 110 countries have already signed the IGA with USA.

India and USA, on 9 July 2015 signed the IGA to implement FATCA. As per the IGA, FFIs in India will be required to report tax information about US account holders directly to the Indian Government which will, in turn, relay that information to the IRS. The IRS will provide similar information about Indian account holders in USA. This automatic exchange of information is scheduled to begin from 30 September 2015.

By signing the IGA, the Indian government has ensured that Indian financial institutions would not face US withholding taxes for failing to disclose the dealings of US citizens and entities. The fear of US withholding, and the burden of compliance, has caused several Indian mutual funds to bar US residents and US-based Non-Resident Indians (NRIs) from investing in their funds. With signing of the IGA, Indian financial institutions are not required to directly register with the IRS.

The information shared under FATCA will be treated as confidential and will be used only for tax purposes. All the information exchanged shall be subject to the confidentiality and other protections provided for in the Convention, including the provisions limiting the use of the information exchanged.

Our Comments

This development puts onerous responsibilities on the banks and other players in this sector and hence may not be well received by them.

Income-tax Press Release: CBDT Press Release dated 9 July 2015

Reserve Bank of India (RBI)

Simplification of procedure - Reserve Bank of India (RBI) dispenses requirement of declaring export of Goods /Software in Statutory Declaration Form (SDF)

Regulation 3 of Foreign Exchange Management (Export of Goods and Services) Regulations, 2000, as amended from time to time, requires every exporter of goods or software in physical form or through any other form, either directly or indirectly, to any place outside India, other than Nepal and Bhutan, to furnish to the specified authority, a declaration in one of the forms, containing true and correct material particulars. In case such exports are taking place through Electronic Data Interchange (EDI) ports, exporters have to declare such details in SDF and submit it to the Commissioner of Customs. After duly verifying and authenticating the SDF, the Commissioner of Customs shall forward the original declaration form/data to the nearest office of the Reserve Bank and hand over the duplicate form to the exporter for being submitted to the authorised dealer.

In order to simplify the procedure, the Reserve of Bank of India has dispensed with the requirement of declaring the export of Goods /Software in the SDF, as the mandatory statutory requirements contained in the SDF have been incorporated in the Shipping Bill format.

Our comments: This simplification is yet another positive step towards 'ease of doing business in India' and will provide relief to the exporters as it will reduce paperwork.

RBI Circular reference: RBI//2014-15/599/A.P. (DIR Series) Circular No.101 dated 14 May 2015

'Ease of doing business' in India facilitated - Reserve Bank of India (RBI) permits recognised non-resident lenders providing External Commercial Borrowings (ECB) denominated in Indian Rupees to enter into swap transactions with their overseas bank

In terms of Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 dated May 3, 2000, as amended from time to time, the RBI has allowed the recognised non-resident lenders to hedge their currency risk in respect of ECBs denominated in INR, with authorised dealer banks in India. Non-resident lenders may use the following products for hedging purposes:

a) Forward foreign exchange contracts with INR as one of the currencies;

b) Foreign currency - INR options; or

c) Foreign currency - INR swaps

The RBI has now permitted such lenders to enter into swap transactions with their overseas bank which shall, in turn, enter into a back-to-back transaction with any AD Category-I bank in India.

Our comments: While helping leverage on the comfort the lender enjoys with his banker abroad, this shall enable the foreign lender to shield against the interest rate and currency exposure by reducing the uncertainty of future cash flows. This is yet another step towards facilitating the 'ease of doing business' in India.

RBI circular reference: RBI/2014-15/608/A. P. (DIR Series) Circular No. 103 dated May 21, 2015

Line of Credit of USD 100 million to Vietnam

In furtherance of "Make in India" program, Exim Bank has made available line of credit to Vietnam amounting to USD 100 million for financing supply of High Speed Patrol Vessel to that friendly nation, salient features of the agreement being :.

1) Eligibility of exports as per the foreign trade policy of GOI.
2) Out of the total credit by Exim Bank goods and services of the value of at least 75% of the contract price shall be supplied by the seller from India and the remaining 25% goods and services (other than consultancy services) may be procured by the seller for the purpose of the eligible contract from outside India.
3) The last date for opening of letters of credit and disbursement will be 48 months from the scheduled completion date of contract in the case of project exports and September 14, 2020 (72 months from the execution date of the Credit Agreement) in the case of other supply contracts.
4) Shipments under the LOC will have to be declared on EDF/ SDF Forms as per instructions issued by the Reserve Bank from time to time.
5) Agency commission is not payable under the above LOC. However, if required, the exporter may use his own resources or utilize balances in his Exchange Earners' Foreign Currency Account for payment of commission in free foreign exchange.

Refer to RBI/2014-15/644/ A.P. (DIR Series) Circular No.111 dated June 18 2015 for details

Submission of Long Form Audit Report (LFAR) to the Chairman of PSB's

All PSBs are advised that LFAR in respect of a branch should be addressed by the branch auditors to the Chairman of the bank with a copy thereof to the Central Statutory Auditors. The Guidelines for Appointment of Statutory Auditors in Public Sector Banks (PSBs) states that statutory branch audit of PSBs may be carried out for all branches with advances of Rs. 20 crore

& above and 1/5th of the remaining branches covering a representative cross section of rural/semi-urban/urban and metropolitan branches, predominantly including branches which are not subjected to concurrent audit, so as to cover 90% of advances of a bank. The said guideline also states that in respect of branches below cut-off limit i.e. branches having advances below Rs. 20 Crore, which are subject to concurrent audit by chartered accountants, henceforth, LFARs and other certifications done earlier by Statutory Branch Auditors will be submitted by the concurrent auditors and such branches may not generally be subject to statutory audit.. The banks in turn will have to consolidate/compile all such LFARs submitted by the Concurrent Auditors and submit to Statutory Central Auditor as an internal document of the bank.

Refer to RBI/2014-15/626 DBS.CO.ARS.BC.8/08.91.001/2014-15 dated June 4, 2015 for details

AD Category-I banks permitted to borrow from international / multilateral financial institutions without approaching Reserve Bank for a case by case approval subject to certain conditions.

With a view to providing greater flexibility in seeking access to overseas funds, AD Cat-I banks are now permitted to borrow from international / multilateral financial institutions without approaching Reserve Bank for a case by case approval. The limit for such borrowing is hundred per cent of their unimpaired Tier I capital as at the close of the previous quarter or USD 10 million (or its equivalent), whichever is higher, subject to such conditions as the Reserve Bank may direct. The institutions from which such borrowing can be made include International / Multilateral Financial Institutions of which Government of India is a shareholding member or which have been established by more than one Government or have shareholding by more than one Government and other international organizations. Such borrowings should be for the purpose of general banking business and not for capital augmentation and shall be subject to the applicable prudential conditions stipulated in the A.P. (DIR Series) Circular no. 40, 2013 dated September 10, 2013.

Refer circular RBI/2014-15/644/ A.P. (DIR Series) Circular No.111 dated June 18 2015 for details

Reserve Bank of India (RBI) introduces a more robust framework by proposing to change the ownership structure in the companies with distressed assets Strategic Debt Restructuring (SDR) Scheme

An earlier circular on "Framework for Revitalising Distressed Assets in the Economy – Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP)"stated that, a change of management is an effective step as a part of restructuring of stressed assets. The premise is that the shareholders should bear the 'first' loss rather than the debt holders. With this principle in view, JLF/Corporate Debt Restructuring Cell (CDR) following are the options when a loan is restructured:

- Possibility of transferring equity of the company by promoters to the lenders to compensate for their sacrifices;

- Promoters infusing more equity into their companies;
- Transfer of the promoters' holdings to a security trustee or an escrow arrangement till turnaround of company. This will enable a change in management control, should lenders favor it.

In many cases of restructuring of accounts, borrower companies do not come out of stress due to operational/ managerial inefficiencies despite substantial sacrifices made by the lending banks. In such cases, change of ownership will be a preferred option. Therefore, through this circular, it was decided that, the Joint Lenders' Forum (JLF) should actively consider such change in ownership with the implementation of SDR scheme.

Following are the key features:

1. Conversion of loan into shares should be supported by necessary approvals/ authorizations (including special resolution by the shareholders) from a borrower company.
2. Provisions of the SDR would also be applicable to the accounts which have been restructured before the date of this circular.
3. The decision on invoking the SDR by converting the whole or part of the loan into equity shares should be taken by the JLF within 30 days from the above review of the account.
4. Post the conversion, all lenders under the JLF must collectively hold 51% or more of the equity shares issued by the company
5. Banks should include necessary covenants in all loan agreements, including restructuring, supported by necessary approvals/authorisations (including special resolution by the shareholders) from the borrower company.
6. The JLF must approve the SDR conversion package within 90 days from the date of deciding to undertake SDR
7. Banks should ensure compliance with the provisions of Section 6 of Banking Regulation Act and JLF should closely monitor the performance of the company and consider appointing suitable professional management to run the affairs of the company
8. <u>Conversion process/value:</u>

The conversion price of the equity shall be determined as mentioned in the guidelines i.e. value of outstanding debt (principal as well as unpaid interest) into equity instruments measured be at a 'Fair Value' inter-alia based on Market value and Break-up value and subject to the floor of 'Face Value' (restriction under section 53 of the Companies Act, 2013)

9. <u>Asset classification for SDR:</u>

On completion of conversion of debt to equity as approved under SDR, the existing asset classification of the account will continue for a period of 18 months from the reference date. Thereafter, the asset classification will be as per the extant IRAC norms, assuming the aforesaid 'stand-still' in asset classification had not been given.

10. <u>Divestment of JLF lenders' equity and related asset classification norms:</u>

JLF and lenders should divest their holdings in the equity of the company as soon as possible. On divestment of banks' holding in favor of a 'new promoter', the asset classification of the account may be upgraded to 'Standard'. However, the quantum of provision held by the bank against the said account as on the date of divestment, which shall not be less than what was held as at the 'reference date', shall not be reversed. At the time of divestment of their holdings to a 'new promoter', banks may refinance the existing debt of the company considering the changed risk profile of the company without treating the exercise as 'restructuring' subject to banks making provision for any diminution in fair value of the existing debt on account of the refinance.

With the introduction of this circular, the RBI has provided a superior option to the joint lenders for accessing/controlling the ownership powers and to ensure more 'skin in the game' for the borrower-promoters.

Circular Reference

RBI/2014-15/627 DBR.BP.BC.No.101/21.04.132/2014-15

RBI issues Master Circular – "Non-Banking Financial Companies –Corporate Governance (Reserve Bank) Directions, 2015"

Corporate governance is a requirement of clause 49 of the SEBI listing agreement. However, with a view to strengthen the governance framework of unlisted NBFCs*, RBI has issued the said corporate governance directions.

Highlights:

These directions mainly address the following issues :

a. 'Fit and Proper' criteria for appointing a director
b. Rotation of partners of the Statutory Auditors Audit Firm
c. Framing of internal guidelines for corporate governance
d. Constitution of certain committees of the Board of directors (Board) and
e. Certain disclosures and transparency requirements

The Directions have listed out the process of due diligence that a Board of NBFC should undertake before appointment of a director as well as what are the general criteria which should be satisfied by a nominee to be called 'Fit and Proper' for appointment. The directions also give the draft of the undertaking that a director should submit to the NBFC before appointment.

NBFCs are directed to rotate the partner/s of the Statutory Auditor firm every three years. However, a partner so rotated will be eligible for conducting the audit of the NBFC after the next rotation of partners.

The Directions demand constitution of Audit Committee, Nomination Committee and Risk Management Committee beside the Asset Liability Management Committee by the NBFCs. The formation of these committees is in line with the respective provisions of Companies Act, 2013.

Further, subject to the Board's approval, the NBFCs should formulate internal guidelines on corporate governance.

The NBFCs are directed to put up before the Board the progress made by the NBFC in risk management systems etc. Further standard disclosure requirements in the annual report of the NBFCs are also given in the Directions.

Circular Reference: RBI/2014-15/632 DNBR (PD) CC No.040/03.01.001/2014-15

**Applicable to all deposit taking NBFCs and Non deposit taking NBFCs with asset size of Rs. 500 Crores or more. Not applicable to Systemically Important Core Investment Company within the meaning of Core Investment Companies (Reserve Bank) Directions, 2011.*

RBI prescribes submission of BEF statement by AD category – I banks under XBRL route.

RBI has prescribed that all AD category – I banks should submit their BEF returns in XBRL format and the same should be uploaded online.

The AD category – I banks are required to monitor outward remittances for imports and submit to RBI a periodic return of the same in BEF report, which was being done manually. The same contains details such as remittances beyond a prescribed limit for which the required documents are not submitted beyond 6 months.

Under the new instructions, the filing will be done centrally for every bank i.e. no branch-wise submission. Further, the same will be prepared under the eXtensible Business Reporting Language (XBRL) system and uploaded online.

The reporting will be done every June and December for *remittances beyond USD 100,000 for which the required documents are not submitted beyond 6 months.*

Circular Reference: **RBI/2014-15/643 A.P.(DIR Series) Circular No. 110**

RBI issues Guidelines on Compensation of Non-Executive Directors of Private Sector Banks

The Reserve Bank of India (RBI) by way of notification dated June 1, 2015; has issued Guidelines on Compensation of Non-Executive Directors of Private Sector Banks.To enable banks to attract and retain professional directors, it is essential that such directors are appropriately compensated. At present, banks in private sector pay only sitting fees to non-executive directors, and no other remuneration is paid to them. The Part-time Chairman however, is being paid a fixed remuneration with the approval of RBI. The Board of Directors, in consultation with its Remuneration Committee shall adopt a compensation policy which shall comply with the relevant provisions of the Companies Act, 2013.However, the compensation and remuneration of part time chairman shall be subject to the provisions of Banking Regulation Act, 1949. The compensation policy shall be subject to review under the Basel II framework.

Circular Reference: RBI/2014-15/617 DBR.No.BC.97/29.67.001/2014-15\

RBI allows appointment of Non-Deposit Accepting NBFCs as sub- agents under Money Transfer Service Schemes (MTSS)

The Reserve Bank of India (RBI) by way of a notification dated August 12, 2014 allowed appointment of non-deposit accepting NBFCs as sub agents under Money Transfer Service Schemes (MTSS) with the prior approval and subject to certain conditions.

MTSS is a quick and easy way of transferring personal remittances from abroad to beneficiaries in India. Only inward personal remittances into India such as remittances towards family maintenance and remittances favoring foreign tourists visiting India are permissible. No outward remittance from India is permissible under MTSS.

The aforementioned scheme has been suppressed by a new notification dated June 25, 2015. Under the new notification, RBI has allowed all non-deposit taking NBFCs to act as sub agents under the MTSS without any prior approval.

Circular Reference: RBI/2014-15/648 DNBR.CC.PD.No.041/03.10.01/2014-15

RBI issues Master Circular – "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015"

The Reserve Bank of India (RBI) by way of notification dated June 11, 2015; has issued "Master Circular – Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015" (hereinafter referred to as "the Directions"). The Directions deal with the updated notifications on the captioned subject till March 27, 2015.

The said Directions are applicable to all NBFCs (not accepting or holding deposits) having an asset size of Rs. 500 crore or more as per last audited balance sheet. Certain carve outs are prescribed by the Directions for government owned NBFCs, Systemically important core investment companies and NBFC – Micro Finance Institutions.

The Directions deal with a vast array of topics. Right from the asset classification, provisioning requirements and income recognition criteria for the said classes of NBFCs to the opening of branches, safety measures to be followed while opening new branches etc.

Circular Reference: RBI/2014-15/629 DNBR (PD) CC No. 037/03.01.001/2014-15

Prior approval of RBI required in cases of acquisition or transfer of control of Non-Banking Financial Companies (NBFCs)

Further to it's circular(DNBS (PD) CC.No.376/03.10.001/2013-14 and Notification No. DNBS(PD) 275/GM(AM)-2014 dated May 26, 2014 which required the NBFCs to take prior approval of RBI in case of any acquisition, takeovers or any amalgamation of NBFCs RBI has added certain new dimensions to the conditions subject to which approval of RBI is required.

This notification includes requirement of prior approval of RBI for :

(a) any takeover of an NBFC even if it does not result in a change of management
(b) any change in shareholding including gradual change in shareholding resulting in a total shareholding beyond 26% (not in case of buy back)
(c) Retirement and reappointment of non rotational Director if such action affects 30% of whole time directors.

Procedure for applying for approval is as per para 4 of the notification, subsequent to which, public notice is required to be given for the changes.

Circular Reference: RBI/2015-16/122 DNBR (PD) CC.No. 065/03.10.001/2015-16

RBI prescribes new 'Annual Return' formats for non deposit taking NBFCs below asset size of Rs. 500 Crore

In terms of the new regulatory framework for NBFCs, all non-deposit taking NBFCs (NBFCs-ND), with assets less than Rs. 500 Crore are required to submit an Annual Return.

Two new Return Formats have been created to capture important financial parameters of the respective category of NBFCs. The returns are to be filed within 30 days of end of financial year. For NBFCs which have not filed the returns for the year ended 31st March 2015 the due date is extended to 30th September 2015. For NBFCs which have already submitted their annual return (which was not required to be filed) requirement for filing the return in new format is waived.

The new return formats which have been prescribed provide clarity for the smaller NBFCs and relax certain criteria considering the size of the NBFC.

Circular Reference: RBI/2014-15/643 A.P.(DIR Series) Circular No. 110

RBI issues master circular - "Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2008."

Statutory auditors of a NBFC have to submit an audit report to the Board of Directors of the NBFC from the year 2008. There is no change in these directions in the master circular of 2015.

For brevity, the Report asks the auditor to report to the Board certain specific matters such as, eligibility of the Company to continue to hold the certificate of registration given by RBI based on the asset and income pattern for the year under consideration, whether the NBFC is a micro finance institution (NBFC – MFI) etc. Further, specific matters with respect to NBFC accepting deposit from the public at large are mentioned in the regulation, which need to be certified by the Statutory Auditors.

The master circular gives a ready reference to the Auditor's of the NBFC as to the specific requirements enumerated in the standalone notification. This would also provide guidance to auditors to plan specific audit procedures to certify matters in the report if not already covered under the audit procedures.

Circular Reference: RBI/2015-16/11 DNBR (PD) CC.No.057/03.10.119/2015-16

RBI issues master circular - "Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007"

On 1st July of every year, the Reserve Bank of India (RBI) issues a compilation of all circulars and notifications issued during the previous year as a master circular for ease of reference and use. Accordingly, RBI has issued the captioned master circular.

The major changes which have been highlighted in the master circular are the changes brought in by the revised regulatory framework issued in November 2014. The new framework has given a roadmap for NBFCs for the next 3 years covering various aspects such as asset classification, provisioning requirements etc.
Some of the major changes are highlighted below:

<table>
<tr><th>Sr No</th><th>Heading</th><th>Key Provision</th></tr>
<tr><td>I</td><td colspan="2">Changes in Asset classification and NPA recognitions timelines.</td></tr>
<tr><td></td><td>NPA recognition stages:</td><td>Previously: 6 months outstanding
For March 31, 2016: 5 months outstanding
For March 31, 2017: 4 months outstanding
For March 31, 2018: 3 months outstanding</td></tr>
<tr><td></td><td>Doubtful Assets recognition:</td><td>Previously: 18 months outstanding
For March 31, 2016: 16 months outstanding
For March 31, 2017: 14 months outstanding
For March 31, 2018: 12 months outstanding</td></tr>
<tr><td>II</td><td>Standard Asset provisioning</td><td>Provision on standard assets shall be made @<table><tr><th>Rate</th><th>Period</th></tr><tr><td>0.25%</td><td>Previously</td></tr><tr><td>0.30%</td><td>End of March 2016</td></tr><tr><td>0.35%</td><td>End of March</td></tr></table></td></tr>
</table>

			2017	
		0.40%	End of March 2018	

Circular Reference: RBI/2015-16/22 DNBR (PD) CC.No.045/03.10.119/2015-16

A step to bring consistency in information assimilation: Reserve bank of India (RBI) issues a format for furnishing of credit information to Credit Information Companies (CIC) and other regulatory measures

Credit information on counterparties is a critical component of financial infrastructure. An efficient system of credit information sharing along with the quality and consistency built in, reduces cost of intermediation. Effectively, it allows banks to price, target and monitor loans and thereby enhance the competition in the credit market.

Most credit institutions furnish data on retail and commercial borrowers in the format used by Credit information bureau of India Limited (CIBIL). Similarly, there is a different format for Micro finance institution (MFI) reporting. In nutshell, different CICs are using different formats for capturing data on corporate borrowers.

The differing and inconsistent formats delays reporting, increases reporting costs resulting in mismatch in reporting. To avoid such inconsistencies, the Committee recommends using formats used by CIBIL for consumer and commercial bureau reporting, and the MFI Common Data Format for MFI reporting. This Report of the Committee was placed on RBI's website on March 22, 2014 inviting comments on the recommendations of the Committee.

RBI through its notification dated June 27, 2014 did update the data formats after incorporating few of the comments/suggestions received.

Vide the notification dated July 9, 2015, RBI has decided to create a new status viz. 'Restructured due to Natural calamity' for the fields 'written off and settled status' in the consumer bureau/sector and 'Major reasons for restructuring' in the commercial bureau/sector. This modification is intended to:

- enabling banks/FIs to report restructured/scheduled agricultural loans on account of any declared natural calamities and
- helping banks to know if any earlier loans availed by the farmers were restructured due to natural calamities.

In order to give time to Banks /FIs for updating their systems, RBI has made above reporting to **commence from September 30, 2015**.

Along with an intention to reduce the information asymmetry between lenders and borrowers, RBI is now accumulating relevant additional information to take advantage of a common sharing platform. Considering the likelihood of a drought like situation in India and a current exposure of financial sector to agriculture and allied activities, such initiatives will provide a fillip to growth of credit especially among disadvantaged sections of society and foster financial inclusion and inclusive growth after adhering to higher standards of financial disciplines/disclosures.

RBI circular reference

RBI/2015-16/120DBR.No.CID.BC.28 /20.16.056/2015-16 dated July 9, 2015

Good news to consumers: Reserve bank of India (RBI) annexures a new category of semi-closed prepaid payment instruments (PPI) with defined features therein

Prepaid payment instruments are those which facilitate purchase of goods and services against the value stored on such instruments. The value stored on such instruments represents the value paid for by the holder, by cash, by debit to a bank account, or by credit card. For eg. smart cards, internet accounts and online wallets etc.

RBI through its notification dated July 1, 2014 has issued a master circular providing all prevailing instructions on PPI updated till date. RBI has issued various categories of prepaid payment instruments.

Semi-closed system payment instrument was the latest entrant i.e. an instrument which can be **used for purchase of goods and services, including financial services at a group of clearly identified** merchant locations/ establishments which have a specific contract with the issuer to accept the payment instruments. These instruments **do not permit cash withdrawal or redemption** by the holder.

A new category of semi closed PPI for mass transit system (MTS) has now been introduced. The PPI for MTS **will enhance commuter convenience and will also facilitate the migration to electronic payments in line with the country's vision of moving to a cashless society**. The instrument will come with features like in-built mechanism of automated fare collection application, transfer of funds by travellers-card holders with a cap of Rs. 2000, validity of six months etc.

The above guidelines have come into effect from the date of issue of circular i.e. July 9, 2015.

In simpler terms, this means the operators of mass transport systems such as Mumbai Metro, Delhi Metro, Indian Railways and even local road transport services can now issue the 'pre-paid cards'. And even travelers can now electronically transfer an amount to these cards, which can be swiped through designated machines.

RBI circular reference

RBI/2015-16/123 DPSS.CO.PD.No. 58/02.14.006/2015-16 dated July 9, 2015

RBI revises Concentration of Credit / Investment Norms of NBFCs (both Deposit Accepting and Non-Deposit Accepting); excludes investments in shares of subsidiaries or companies in the same group

In terms of section 45IA(7)(I) of the Reserve Bank of India Act, 1934, loans given or investments made in companies in the same group or in subsidiaries by NBFCs, in excess of 10% of the Net Owned Fund (NOF) are to be reduced in calculation of capital adequacy. Such exposures are also subject to the Concentration of Credit/ Investment norms prescribed in Para 24 of "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015" and Para 20 of Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007. To enable RBI to regulate the credit system to the advantage of the country as also in public interest, RBI has amended these directions. As per the amended directions, the ceiling specified in para 24 and 20 will not be applicable in following cases:

(A) investments of NBFCs in shares of (i) its subsidiaries; (ii) companies in the same group, to the extent they have been reduced from Owned Funds for the calculation of Net Owned Funds (NFO) and

(B) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with,(i) subsidiaries of the NBFC; and (ii) companies in the same group, to the extent they have been reduced from Owned Funds for the calculation of Net Owned Funds".

Refer to RBI/2015-16/114 DNBR (PD) CC.No. 064/03.10.001/2015-16 dated June 02 2015 for details

Opening of Branch/Subsidiary/Joint Venture/ Representative office or Undertaking Investment Abroad by Non Banking Financial Companies (NBFCs)

RBI has not made any changes in the master circular of July 2014 with respect to opening of Branch/Subsidiary/Joint Venture/ Representative office or Undertaking Investment Abroad by NBFCs. To re-iterate, salient features of the circular are as follows:

1) NBFCs desirous of making any overseas investment to obtain 'No Objection' (NoC) of the Department of Non-Banking Supervision (DNBS) of RBI before making such investment, from the Regional Office in whose jurisdiction the head office of the company is registered.
2) Investment in non-financial service sectors is not permitted.
3) Direct investment in activities prohibited under FEMA or in sectoral funds is not permitted.
4) Investments are permitted only in those entities having their core activity regulated by a financial sector regulator in the host jurisdiction.
5) The aggregate overseas investment should not exceed 100% of the NoF. The overseas investment in a single entity, including its step down subsidiaries, by way of equity or fund based commitment shall not be more than 15% of the NBFC's owned funds.
6) The NBFC shall comply with the regulations issued under FEMA, 1999 from time to time

7) The NBFC shall comply with the KYC norms.
8) A quarterly return shall be submitted by the NBFC to the Regional Office of DNBS and also Department of Statistics and Information Management (DSIM).

Refer to RBI/2015-16/24 DNBR (PD) CC. No. 060/03.10.119/2015-16 dated July 01 2015 for details

Reserve Bank of India (RBI) introduced cash settled interest rate futures (IRFs) with range of maturities

Background

Initially RBI through its circular dated Aug 28, 2009, had permitted interest rate future (IRF) contracts on 10-year notional coupon bearing government of India security. Subsequently IRF with 2 to 5 years were also permitted in December 30, 2011.
In order to consolidate and revise existing instructions, Interest Rate Futures (Reserve Bank) Directions, 2013 were issued on December 5, 2013. **Eligible instruments** defined under such directions were: “The Interest Rate Futures deriving value from the following underlying are permitted on the recognized stock exchanges

- 91-day Treasury Bills
- 2-year, 5-year and 10-year coupon bearing notional Government of India security, and
- Coupon bearing Government of India security”

Cash settled IRF contract on 10-Year Government of India (GoI) Security has received an encouraging response. RBI has decided to increase the flexibility and has hence permitted introduction of cash settled IRF on 4-8 years and 11-15 years Government of India Securities

Amendment

RBI has specified IRFs can be issued on coupon bearing government of India securities with range of residual maturities. Further, RBI has extended option of issuing two more cash settled interest rate future contracts. Previously 10-year cash settled IRF were allowed, now 6-year and 13-year contracts can also be introduced after this amendment.

RBI has provided two options for each class of cash settled IRFs which are reproduced below:

Duration of IRFs	**Option A**	**Option B**
6-year	Coupon bearing GoI security with FV Rs. 100 and Residual maturity between 4 and 8 years on expiry of future contract	Notional 6-year GoI security with FV of Rs. 100 For each contract, there shall be basket of GoI securities, with residual maturity between 4 and 8 years on the day of expiry of future contract, with appropriate weights assigned to each security in the basket.

10-year	Coupon bearing GoI security with FV Rs. 100 and Residual maturity between 8 and 11 years on expiry of future contract	Notional 10-year GoI security with FV of Rs. 100 For each contract, there shall be basket of GoI securities, with residual maturity between 8 and 11 years on the day of expiry of future contract, with appropriate weights assigned to each security in the basket.
13-year	Coupon bearing GoI security with FV Rs. 100 and Residual maturity between 11 and 15 years on expiry of future contract	Notional 13-year GoI security with FV of Rs. 100 For each contract, there shall be basket of GoI securities, with residual maturity between 11 and 15 years on the day of expiry of future contract, with appropriate weights assigned to each security in the basket.

Other requirements for cash settled 6-year, 10-year and 13-year interest rate future contracts are:
For Option A:

- Underlying security shall be decided by stock exchange in consultation with Fixed Income Money market derivatives association (FIMMDA)
- The contract shall be cash-settled in Indian rupees
- The final settlement price shall be arrived by calculating the volume weighted average price of the underlying security based on prices during the last two hours of the trading on Negotiated dealing system-order matching system (NDS-OM system)

However, if less than 5 trades are executed in the security during the last two hours of trading, FIMMDA price shall be used

For Option B

- The underlying security have a coupon with semi-annual compounding
- Exchange disclose criteria for including securities in the basket and determining their weights
- The contract shall be cash settled in Indian rupees
- The final settlement price shall be based on average settlement yield which shall be volume weighted average of the yields of securities in the underlying basket. (For each security in the basket, yield shall be calculated by determining weighted average yield of the security based on last two hours of the trading in NDS-OM system).

If less than 5 trades are executed in the security during the last two hours of trading, then FIMMDA price shall be used for determining the yields of individual securities in the basket.

Our comments

Market participants can deal in IRF with Coupon bearing Government of India Security with residual maturity between 4 - 8 Years, 8 - 11 years and 11 - 15 years. They can also deal in a 6-Year, 10-Year and a 13-Year cash-settled Interest Rate Future Contracts. . This would provide market participants greater choice and flexibility to hedge their interest rate risk across different tenors.

RBI circular reference

RBI/2014-15/640 FMRD.DIRD.10/14.03.01/2014-15 dated June 12, 2015

Investment in India by Foreign Portfolio Investors (FPIs): Reserve Bank of India (RBI) provides a relaxation for specific investment avenue

RBI, through its notification dated May 3, 2000, issued terms and conditions for investment by a Non-resident or overseas body corporate or registered FII. Subsequently through a circular issued in July 14, RBI imposed a condition regarding investment **in government bond** stating that such bonds should have a minimum residual maturity of **three years.**

Condition of investment with a minimum residual maturity of three years was also extended to investment in **corporate bonds** vide RBI circular dated Feb 3, 2015. In the same circular, restriction was laid down on any further investment by FPI in **liquid and money market mutual fund** schemes. Further**,** FPIs are not allowed to make an investment in **Commercial papers** and **debt instruments** with option clause exercisable within three years. They are permitted to invest in **amortized debt instruments** provided the duration of the instrument is three years and above.

RBI, in this circular, has now also clarified that the restriction on investment with less than three year residual maturity will not be applicable to Security Receipts issued by Asset reconstruction /Securitisation companies (ARCs).

The primary goal of ARCs is to manage the distressed assets portfolio bought from Banks/NBFCs against the issuance of Security receipts. Considering the dynamics involved in such type of distressed underlying assets, a concept of maturity period either may not be applicable (in case of sale of assets) or would be applicable for a period less than three years. Therefore, this is a welcome step by RBI which will ultimately ease the liquidity available for fresh funding.

RBI circular reference: RBI/2015-16/131 A.P. (DIR Series) Circular No.6 dated July 16, 2015

Amendments to the Framework for revitalising distressed assets in the economy - made applicable to NBFCs by RBI

Keeping in mind the growing NPAs in banks, RBI had issued a framework in January 2014 with a view to arrest this growth and help banks in identifying distressed assets and take remedial actions. By a notification in March 2014, the said framework was also made applicable to NBFCs. In view of industry responses the framework was amended thrice and is now notified, salient features being :

(a) Allowing conversion of debt liability into equity of the company along with the guidelines for computing the conversion price
(b) Review of the Corrective Action Plan (CAP) of 'Joint Lender Forum' (JLF) by Independent Evaluation Committee (IEC)
(c) To effect any changes in the management of the company under consideration if the JLF or CDR is of the opinion that it is causing hindrances in the performance of the company; relaxations in the 'Special Mention Accounts' (SMA) reporting; certain special asset classification benefits to NBFCs etc.

Circular Reference: **RBI/2015-16/137 DNBR.CC.PD.No.066/03.10.01/2015-16**
To view the text of the notification, follow this link.

RBI Revises it's guidelines on Concurrent Audit System in Banks

RBI had vide its circular dated August 14, 1996 issued guidelines on 'Concurrent Audit system in commercial banks'. By way of a notification dated July 16, 2015 RBI has amended the guidelines.

The change is proposed mainly due to the transition of the structure of the commercial banks from 1996 to now. Hence the changes which are brought in by the notification are to ensure that the reason behind conducting concurrent audit is not defeated by a change in structure. Few instances of changes are:

- specific inclusion of branches which are dedicated to processing of data in audit coverage
- A specific guidance for coverage of 50% of the advances and deposits in a branch is introduced in the revised guidelines
- Guidelines for familiarisation of auditors as well as the bank's own staff with the data and other factors involved in the process of concurrent audit

Circular Reference: **RBI/2015-16/133 DBS.CO.ARS.No. BC. 2/08.91.021/2015-16**

RBI issues notification on priority sector lending for all scheduled commercial banks as an addendum to the master circular on the said subject

RBI has issued the 'Master Circular on Priority Sector Lending – Targets and Classification' on July 1, 2015. The said master circular gives targets to all scheduled banks (the Banks) for financial years 2015-16 and 2016-17 for priority sector lending. However, due to the recent weather-related difficulties faced by the agriculture sector government has expressed concerns.

In light of this, RBI has asked the Banks to maintain the overall direct lending to non-corporate farmers in line with the system wide average of the last three years. The number of the three year average is yet to be notified by RBI. The said lending also has certain exclusions which are enumerated in the Master Circular.

Circular Reference: **RBI/2015-16/132 FIDD.CO.Plan.BC.08/04.09.01/2015-16**

RBI amends the Prudential Norms on Asset Classification and Provisioning pertaining to Advances – Credit Card Accounts

The prudential norms which were issued on the captioned subject gave the asset classification and provisioning requirements for credit cards accounts. However, certain terminologies in the prudential norms were open ended. The amendment which has been circulated on July 16, 2015 is in regards with clarification and streamlining of business practices with the interpretation of the terms.

The said circular clarifies when a credit card account can be called as 'Past Due'. It further, clarifies that the banks should follow a uniform practice of recognition of past due accounts. The circular also specifies that a credit card issuer shall report the account to the Credit Information Companies (CICs) or levy charges only when it remains past due for more than 3 days.

Circular Reference: **RBI/2015-16/126 DBR.No.BP.BC.30/21.04.048/2015-16**

RBI issues Master Circular – "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015"

The Reserve Bank of India (RBI) by way of notification dated June 11, 2015; has issued "Master Circular – Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015" (hereinafter referred to as "the Directions"). The Directions deal with the updated notifications on the captioned subject till March 27, 2015.

The said Directions are applicable to all NBFCs (not accepting or holding deposits) having an asset size of Rs. 500 crore or more as per last audited balance sheet. Certain carve outs are prescribed by the Directions for government owned NBFCs, Systemically important core investment companies and NBFC – Micro Finance Institutions.

The key highlights of the changes brought about by the Directions are tabulated below:

<table>
<tr><th>Sr No</th><th>Heading</th><th>Key Provision</th></tr>
<tr><td>I</td><td colspan="2">Changes in Asset classification and NPA recognitions timelines.</td></tr>
<tr><td></td><td>NPA recognition stages:</td><td>Previously: 6 months outstanding
For March 31, 2016: 5 months outstanding
For March 31, 2017: 4 months outstanding
For March 31, 2018: 3 months outstanding</td></tr>
<tr><td></td><td>Doubtful Assets recognition:</td><td>Previously: 18 months outstanding
For March 31, 2016: 16 months outstanding
For March 31, 2017: 14 months outstanding
For March 31, 2018: 12 months outstanding</td></tr>
<tr><td>II</td><td>Standard Asset provisioning</td><td>Provision on standard assets shall be made @
<table>
<tr><th>Rate</th><th>Period</th></tr>
<tr><td>0.25%</td><td>Previously</td></tr>
<tr><td>0.30%</td><td>End of March 2016</td></tr>
<tr><td>0.35%</td><td>End of March 2017</td></tr>
<tr><td>0.40%</td><td>End of March 2018</td></tr>
</table></td></tr>
</table>

The Directions deal with a vast array of topics. Right from the asset classification, provisioning requirements and income recognition criteria for the said classes of NBFCs to the opening of branches, safety measures to be followed while opening new branches etc.

Circular Reference:

RBI/2014-15/629 DNBR (PD) CC No. 037/03.01.001/2014-15

Guidelines on 'Sale of Financial Assets to Securitisation Company (SC)/ Reconstruction Company (RC) and Related Issues by Banks', now extended to All India Financial Institutions (AIFIs)

As per the earlier circular (DBOD.BP.BC.No.98/21.04.132/2013-14) on the captioned subject, for Non-performing assets (NPAs) sold on or after February 26, 2014 to SCs/RCs, **banks** can reverse the excess provision on sale of NPAs, if the sale value is for a value higher than the net book value (NBV i.e. book value minus accumulated provision held). This was aimed towards incentivizing banks for de-stressing their balance sheets, and also providing a continuous stream of cash flows which can be used for fresh lending.

RBI, through this circular, has now extended this **benefit to AIFIs** i.e. allowed reversal of excess provision arising out of sale of NPAs when the cash received (by way of initial consideration and/or redemption of security receipts/pass through certificates) is higher than the NBV of the NPAs sold to SCs/RCs.

The quantum of excess provision reversed to the profit and loss account on account of sale of NPAs shall be disclosed in the financial statements of the bank under 'Notes to Accounts' with an appropriate disclosure per the following format:

(In Rs. Crore)

Particulars	**Backed by NPAs sold by the AIFI as underlying**		**Backed by NPAs sold by banks / other financial institutions / non-banking financial companies as underlying**		**Total**	
	Previous Year	**Current Year**	**Previous Year**	**Current Year**	**Previous Year**	**Current Year**
Book value of investments in security receipts						

The banking regulator has tried to put AIFIs at par with banks. Considering the sizable amount of stressed portfolio sold to SCs/RCs from AIFIs, this inclusion is expected to create a positive impact on the balance sheets of beneficial companies. It will also benefit AIFI's in terms of quick realisation of funds which can be used for onward lending.

Refer circular: RBI/2014-15/634 DBR.No.FID.5/01.02.00/2014-15

Commented [DJ6]: New Additions to the file

Securities and Exchange Board of India (SEBI)

SEBI (Share Based Employee Benefits) Regulations, 2014 – process and disclosure requirements

Securities and Exchange Board of India (SEBI) had earlier notified SEBI (Share Based Employee Benefits) Regulations, 2014 (revised Regulations, 2014) which were effective from October 28, 2014 and which repealed the erstwhile ESOP Guidelines, 1999 (erstwhile guidelines, 1999). As per the revised Regulations, 2014, certain process and disclosure requirements were to be specified subsequently by SEBI, which have now been issued through circular dated 16 June 2015 (the Circular, 2015). The revised Regulations, 2014 had widened scope of the erstwhile guidelines, 1999 to specifically include Stock appreciation rights schemes; General Employee Benefits Schemes and Retirement benefit schemes as compared to the erstwhile guidelines, 1999 which only covered Employee Stock Options and Employee Stock Purchase Schemes. Accordingly, the Circular, 2015 also covers such benefit schemes.

The Circular, 2015 provides detailed guidance on:

- Provisions that need to be incorporated by companies when drafting Share based Employee Benefit schemes *("Share Based Schemes")* including for Trusts managing/administering such schemes and;
- Disclosures that are required to be made by companies and the Board of Directors to shareholders' and Stock Exchanges. A key change is requirement for detailed disclosure of terms of Share Based Schemes on the websites of respective companies with a link to be provided in the Directors report to the website.

A. <u>Provisions that are to be incorporated in Share Based Schemes</u>

Regulation 3 (3) Trust Deeds

- Minimum provisions to be included in Trust Deeds in case of Trusts managing Share Based Schemes have been specified. Further, Trust Deeds are required to state that it would be the duty of the trustees to act in the interest of employees (beneficiaries of the trust) and no provisions can be included in the trust deed that would be detrimental to the interests of the beneficiaries.
- Powers and duties of Trustees have been defined. The duties of Trustee include framing of rules for administration of Share Based Schemes and maintenance of books of account per law.

Regulation 5 (3) - Terms and Conditions of schemes to be formulated by Compensation Committee

- Minimum provisions that need to be included in Share Based Schemes have been specified – the same are substantially the same as the provisions of the erstwhile ESOP Guidelines, 1999.

B. <u>Disclosure requirements</u>

Regulation 6 (2) - The Circular, 2015 requires following additional disclosures compared to the erstwhile guidelines, 1999 to be included the Explanatory statement to the notice and resolution for shareholders meeting:

- maximum quantum of benefits to be provided per employee under a scheme;
- whether scheme is implemented and administered directly by the company / trust;
- whether scheme involves new issue of shares by the company or secondary acquisition by the trust or both;
- Amount of loan to be provided for implementation of the scheme by the company to the trust, its tenure, utilization, repayment terms, etc.;
- maximum percentage of secondary acquisition that can be made by the trust for the purposes of the scheme;
- Statement to effect that the company shall conform to the accounting policies specified in regulation 15 i.e. ICAI guidance note on accounting for share based payments and other Accounting Standards that may be prescribed.

Regulation 10 (b) Stock Exchange filings and Regulation 10 (c) Issue of shares – The format per erstwhile guidelines, 1999 for details of shares proposed to be issued by the Company under Share based Schemes and information and documents that need to be included in the Statement to be filed with stock exchanges has been continued.

Regulation 14 – Disclosures by Board of Directors – Disclosures to be made by Board of Directors per erstwhile guidelines, 1999 have been continued. In addition, certain details as follows are to be included on companies websites with a weblink to be included in Directors report:

➢ Relevant disclosures as per ICAI guidance note on accounting for employee share-based payments. The ICAI guidance note requires disclosure of Method adopted for accounting and impact on the net results and EPS if intrinsic value instead of fair value method is adopted, description of each scheme, modifications in the existing plans and effect of employee share-based payment plans on the net profit and on its financial position

➢ Diluted EPS on issue of shares pursuant to all the schemes covered under the regulations shall be disclosed in accordance with 'Accounting Standard 20 - Earnings Per Share' issued by ICAI.

Regulations 16(2) and 23(3) **- Disclosure Document to grantees**

The Circular, 2015 continues disclosures required by erstwhile Regulations, 1999 to be made to the grantee of Share Based Schemes comprising, Statement of risks, Financial information about the Company and Salient features of the Scheme.

Circular reference: CIR/CFD/POLICY CELL/2/2015 June 16, 2015

SEBI allows Stock Exchange to introduce Cash Settled Interest Rate Futures (IRF) on 6 year and 13 year Government of India (GoI) securities (earlier only 10 year security was permitted)

With a view to enable entities to manage risk due to volatility in the currency market, SEBI, in consultation with RBI had permitted Stock Exchanges to introduce cash settled IRF on 10 year GoI security vide CIR/MRD/DRMNP/35/2013 dated December 5, 2013.

With this circular, SEBI has permitted Stock Exchange to introduce cash settled IRFs on 6 year and 13 year GOI securities subject to:

- Stock Exchange/Clearing Corporations to submit proposal to SEBI for approval before launch of the product.
- Product specifications, position limits and risk management framework specified in the circular. Key parameters thereof are:
  - *Contract size:* Each futures contract shall represent 2,000 underlying bonds of total face value of INR 2,00,000
  - Coupon: Same are underlying bond or to be decided by the Stock Exchange.
  - *Tenure:* Three serial monthly contracts followed by maximum three additional quarterly contracts of March/June/September/December cycle may be made available by Stock Exchanges.

SEBI had prescribed monitoring mechanism for IRFs positions of Foreign Portfolio Investors (FPIs) vide circular CIR/MRD/DRMNP/2/2014 dated January 20, 2014. This circular would also apply to cash settled IRF on 6 year and 13 year GoI Security.

The permission for cash settled IRFs on 6 year and 13 year GoI security in a short span of time, i.e. one and half year from launch of cash settled IRFs on 10 year GoI security, is another step towards up gradation of Indian foreign market with internationals standards.

Circular reference: CIR/MRD/DRMNP/11/2015 dated June 12, 2015

Encouraging Retail Investor to participate in the Offer for Sale (OFS) of shares

To facilitate promoters of listed companies to dilute/offload their holding in listed companies in a transparent manner with wider participation, the Securities and Exchange Board of India (SEBI) by circulars dated July 18, 2012 and January 25, 2013 permitted the Stock Exchanges to provide a separate window for offer for sale of shares through stock exchange mechanism.

In order to enhance more retail participation in the OFS process and to simplify the bidding process for retail investors, SEBI has:

- Specified that OFS notice that is to be given latest by 5 pm on T-2 days, shall be reckoned from banking days instead of trading days.
- Mandated sellers to provide option to retail investor to place their bids at cut off price in addition to placing price bids - earlier this was recommendatory in nature.

Circular reference: CIR/MRD/DP/12/2015 dated June 26, 2015

Other Regulators – Competition Commission, Ministry of Company Affairs

Competition Commission of India (CCI) amends its Combination Regulations

The CCI by way of a press release date July 3, 2015; has amended the Combination Regulations. CCI has amended the erstwhile Competition Commission of India (Procedure in regards to the transaction of business relating to combinations) Regulations, 2011.

Earlier regulations were subject to certain ambiguity as well as debate as to interpretation of the text.

Certain key changes done by the said amendment are:

a. Allowing any person duly authorised by the Board of Directors to sign the notice of combination instead of the Company Secretary, duly authorised by the board of directors.
b. As well as the number of copies of the notice have also been reduced (from 2 to 1).
c. The term 'other documents' has been defined which was not defined earlier.
d. Form – I (notice of combination) has been amended to include industry suggestions, as well as notes to the forms will be published to provide guidance to the notifying parties regarding the information that is required to be filed in a notice.

Circular Reference: F. No. CCI/CD/Amend/Comb.Regl./2015

Ministry of Corporate affairs has clarified on repayment of deposits by companies before commencement of the Companies Act, 2013 ("the Act") under section 74 of the said Act

Background

MCA has introduced Companies Act, 2013 with stricter provisions in respect of accepting deposits from public. In order to give effect to the provisions of Companies Act, 2013, a period of one year was given to all companies under section 74. During this period, all companies were supposed to repay deposits accepted from public under the Companies Act, 1956.

As per sub-section 4 of section 73 of the Act, a depositor can apply to National Company Law Tribunal (NCLT) for an order directing the company to pay the due amount.

Through sub-section 2 of section 74 of the Act, the NCLT was assigned with powers to provide extension of time for repayment of deposits. Such extension of time was allowed only on receiving application from the company. However, NCLT has not been constituted.

MCA has received representations seeking clarification regarding processing of deposits related complaints received from investors in respect of default under section 74.

Amendment

MCA has issued circular to empower the Company law Board (CLB) to exercise the powers of NCLT in respect of default in repayment of deposit u/s 73(4). Thus, the depositors can file an application with NCLT in case of default by the company u/s 73(4). It further clarifies that Companies can file application for extension of time u/s 74(2) with CLB. These powers are exercisable by Company Law Board till constitution of NCLT.

MCA has also clarified that Registrar of Companies can also file prosecution against a company for default in repayment.

Our comments

MCA has assigned powers of CLT to CLB till the time Company law tribunal will be constituted by Government of India.

MCA circular reference

General Circular No.9/2015 dated June 18, 2015