

TECHNICAL UPDATE

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

CONTENTS AT A GLANCE

DIRECT TAX

Amendments, Notifications & Court Rulings

- No Permanent Establishment Despite Stock Held in India
- Profits of Permanent Establishment Not Taxable as Fee for Technical Services
- Transfer Pricing Study Cannot be Summarily Rejected
- Revised Discussion Draft on Direct Tax Code Released

INDIRECT TAX

Amendments, Notifications & Court Rulings

- Clean Energy Cess Rules, 2010
- Amendment of the Customs, Central Excise & Service Tax Drawback Rules, 1995 and the Re-Export of Imported Goods (Drawback of Customs Duties) Rules, 1995
- Determination of value under Section 14 of the Customs Act, 1962 in respect of sale of warehoused goods
- Service Tax Amendments

CORPORATE LAW

Amendments, Notifications & Court Rulings

- Introduction of Company Law Settlement Scheme, 2010
- Introduction of Easy Exit Scheme, 2010

FEMA & OTHER LAW

Amendments, Notifications & Court Rulings

- Shortfall in maintenance of Statutory Liquidity Ratio
- Issue of Non Convertible debentures
- Enhancement of security features in Cheque Forms

DIRECT TAX

1. No Permanent Establishment Despite Stock Held in India

The Assessee, a UK company, was engaged in the business of repairing & overhauling of aircraft components and providing replacement spares. The stock of such spares was maintained by the Assessee with the customer airlines in India. The Assessing Officer ('AO') contended that such stock held by customer airlines constituted a fixed place Permanent Establishment ('PE') as well as an agency PE of the Assessee. On appeal, the tribunal observed that in order to constitute a fixed place PE, the enterprise should have a physical place at its disposal through which its business is carried on. In respect of this transaction, the tribunal observed that the Assessee did not have any place at its disposal from which it could carry on its business and accordingly held that no fixed place PE could be constituted. Regarding the agency PE, the tribunal observed that since the consignment stock with the airlines was the final step (and not an intermediate step) to get the business, an airline customer cannot be construed to be the agent of the Assessee. The tribunal further observed that even if such relationship tantamounts to agency, it is not a dependent agency relationship as is necessary to constitute a PE.

Source: Airlines Rotables Limited, UK vs Joint Director of Income Tax (ITA No 3254/MUM/06, ITAT Mumbai)

2. Profits of Permanent Establishment Not Taxable as Fee for Technical Services

The Assessee, an Australian company, rendered technical services through a PE and offered to tax the profits so earned in accordance with Article 7 of Double Taxation Avoidance Agreement ('DTAA'). The AO contended that the provisions of Article 7 were neither applicable to technical services nor any rate of tax in respect of such services was provided in Article 7. Accordingly, the tax was levied in accordance with the provisions of Section 115A of the Income Tax Act, 1961 ('the Act'). On appeal, the tribunal observed that since the Assessee constituted a PE in India, it was subject to taxation on "net income" basis in accordance with Article 7 of the DTAA.

Source: Rio Tinto Technical Services vs DCIT (ITA No 3399/DEL/2002, ITAT Delhi)

3. Transfer Pricing Study Cannot be Summarily Rejected

The Assessee was engaged in the business of manufacturing and export of jewellery. During the relevant financial year the Assessee exported jewellery to its Associated Enterprises (AEs). The pricing for such exports was documented through a detailed Transfer Pricing study wherein operating margins of 3.56% earned by the Assessee, were benchmarked against the operating margin of 3.27% earned by uncontrolled comparables. The Transfer Pricing Officer ('TPO') rejected the Transfer Pricing study and conducted fresh benchmarking whereby an Arm's Length margin of 7.25% was computed. Accordingly, an adjustment was made to the price charged by Assessee. On appeal, the Tribunal observed that the Assessee had selected comparables from external database and a detailed search process in accordance with the Indian Transfer Pricing regulation was followed. The Tribunal therefore held that the Transfer Pricing study and the Arm's Length Price determined on the basis of such an analysis, cannot be rejected without any cogent reason by the TPO.

Source: DCIT vs Indo American Jewellery Limited, ITA No 6194/Mum/2008, (ITAT Mumbai)

4. Revised Discussion Draft on Direct Tax Code Released

The Ministry of Finance has issued a revised discussion paper addressing the following major issues

- i) **Minimum Alternate Tax ('MAT')** – MAT to be computed with reference to Book Profits and not Gross Assets.
- ii) **Tax Treatment of Savings** – Exempt Exempt Exempt ('EEE') regime of taxation has been retained in place of Exempt Exempt Tax ('EET') proposed earlier
- iii) **Income from Employment** – Perquisite value of Rent free Accommodation to be computed as per existing norms which is linked to rent paid and not market value.
- iv) **Taxation of Income from House Property** – Proposed scheme of computing gross rent at 6% shelved.
- v) **Taxation of Capital Gains** – Different modes of taxation in respect of assets held for more than one year and those held for less than one year. Listed securities held for more than one year to be taxed after allowing deductions at rates to be specified later. In respect of other assets held for more than one year capital gains to be computed after allowing indexation benefits. Income earned by FIIs to be deemed as Income from Capital Gains and not as business income.
- vi) **Taxation of Special Economic Zones ('SEZ') Units** – Profit linked deduction to units already operating in SEZs to continue till the unexpired period.
- vii) **Residential status of Foreign Companies** – Concept of Effective Place of Management to determine residency of a foreign company has been introduced. Effective place has been referred to the place where Board of Directors make their decisions or approve the commercial and strategic decisions made by the Executive Directors.
- viii) **General Anti Avoidance Rules ('GAAR')** – GAAR provisions have been diluted to a certain extent. CBDT to issue guidelines specifying circumstances and threshold limits when GAAR can be invoked. The DRP option has been made available to matters wherein GAAR has been invoked.
- ix) **Controlled Foreign Corporation ('CFC')** – A concept of CFCs has been introduced wherein the accumulated passive income earned by foreign companies, controlled directly or indirectly by Indian residents shall be deemed to have been distributed and consequently taxable in the hands of resident shareholders as dividend income.

Source: Revised Discussion Paper on Direct Tax Code

- x) **Treaty vs Domestic Law** – The Act will prevail over tax treaties when

- General Anti Avoidance Rules ('GAAR') are invoked
- Controlled Foreign Corporation Rules are applicable
- Branch Profit Tax is levied

Source Ashapura Minichem Limited vs ADIT (ITA No. 2508/Mum/08, ITAT Mumbai)

INDIRECT TAX

1. Clean Energy Cess Rules, 2010

The Finance Act, 2010 has introduced Clean Energy Cess Rules, 2010. These Rules extend to whole of India and shall be effective from July 01, 2010. They specify the various provisions relating to registration, assessment, manner of payment of cess, maintenance of records, filing of return and penal provisions. The Central Board of Excise and Customs will regulate the implementation of the Clean Energy Cess Rules, 2010.

Certain provisions of the Central Excise Act, 1944 have been made applicable in respect of the cess imposed. The cess is to be computed on an amount calculated at the rate of Rs 50/- per tonne.

Source: Notification No. 06/2010, 02/201 and 03/2010, dated June 22, 2010

2. Amendment of the Customs, Central Excise & Service Tax Drawback Rules, 1995 and the Re-Export of Imported Goods (Drawback of Customs Duties) Rules, 1995

The amended Rules have made the time limits prescribed for making various applications/claims of drawback, exporters friendly. It aims to liberalize the provisions relating to granting of extensions in case of delays and to delegate greater powers to the field officers, at the level of the Assistant/Deputy Commissioner of Customs. The objective is to facilitate trade and commerce.

Source: Notification No 48/2010 and 49/2010- Custom (NT) dated June 17, 2010 and FNo 609/51/2010 DBK dated June 24, 2010

3. Determination of value under Section 14 of the Customs Act, 1962 in respect of sale of warehoused goods

The Central Board of Excise and Customs has clarified that where imported goods have been sold after warehousing, but before home consumption, the assessable value of such goods will not be the sale/transaction value.

Source: F.No 456/06/2010 Custom, dated June 03, 2010

4. Service Tax Amendments

Air Travel Services

Finance Act, 2010 had extended the scope of such services to include Economy Class Travel but with these exemptions-

- In case of a person coming from abroad and who is in transit through India.
- Any person employed by the aircraft operator on board the aircraft in any capacity.

Source: Notification No. 25/2010-Service Tax, dated June 22, 2010

- In excess of, 10% of the gross value of the ticket, or Rs 100/-, whichever is less, for passengers travelling in any class within India.
- In excess of 10% of the gross value of the ticket or Rs 500/-, whichever is less, for passengers travelling abroad.

No input credit is permitted where such inputs have been used for providing the taxable service.

Source: Notification No. 26/2010-Service Tax, dated June 22, 2010

- For passengers embarking on a journey originating/terminating in an airport located in the North Eastern States of India.

Source: Notification No. 27/2010-Service Tax, dated June 22, 2010

Sponsorship Services

Finance Act, 2010 had extended the scope of services to sports events but exempts services provided for tournaments organized by any of the National Sports Federations, Indian Universities, Central Civil Services Cultural and Sports Board and Indian Olympic Association.

Source: Notification No. 30/2010-Service Tax, dated June 22, 2010

Airport/Port Services

Finance Act, 2010 had extended the scope of service, to services performed within the airport/port, but has exempted the service of repair of ships, supply of water electricity and services undertaken by fire service and pollution control agencies.

Source: Notification No. 31/2010-Service Tax, dated June 22, 2010

CORPORATE & OTHER LAWS

1. Introduction of Company Law Settlement Scheme, 2010

The Ministry of Corporate Affairs has introduced the following scheme w.e.f 30-5-2010.

Company Law Settlement Scheme, 2010 “CLSS” has been introduced by Ministry of Corporate Affairs to enable the defaulting companies to file belated documents with Registrar of Companies. Under this scheme the delay in filing belated documents with the Registrar would be condoned, immunity would be granted from prosecution and additional fee of 25 percent of actual additional fee payable for filing belated documents would be charged.

CLSS would be applicable from May 30, 2010 to August 31, 2010.

Source: Company Affairs General Circular No. 1/2010 dated 26 May 2010

2. **Introduction of Easy Exit Scheme, 2010 “EES”** has been introduced by Ministry of Corporate Affairs giving opportunity to the defunct companies to get their names struck off from the register under Section 560 of the Companies Act, 1956. This scheme is applicable to defunct companies which do not carry any business or operation on or after April 1, 2008. EES would be applicable from May 30, 2010 to August 31, 2010.

Source: Company Affairs General Circular No. 2/2010 dated 26 May 2010

FEMA

1. **Shortfall in maintenance of Statutory Liquidity Ratio**

Reserve Bank of India (‘RBI’) has decided to allow the scheduled commercial banks to avail additional

liquidity support under the Liquidity Adjustment facility (‘LAF’) to the extent of up to 0.5 percent of their net demand and time liabilities. The additional liquidity support will be available with effect from the LAF auctions of May 28, 2010 and up to July 2, 2010.

Source: RBI/2009-10/477 Ref. DBOD.No.Ret.BC.103/12.02.001/2009-10 dated May 26, 2010

2. **Issue of Non Convertible Debentures**

RBI has finalized the draft guidelines for “Issuance of Non Convertible Debentures “(NCDs)” of original or initial maturity up to one year which shall come in force with effect from August 02, 2010. The guideline brings into light the Eligibility norms, Rating requirement and procedure for issuance of the NCDs.

Source: RBI/2009-10/505 IDMD.DOD.10 /11.01.01(A)/2009-10 dated June 23, 2010

3. **Enhancement of security features in Cheque Forms**

RBI has introduced Standardized and Enhanced security measures prescribing ‘prohibition on the alterations/correction of cheques to curtail cheque frauds. The security prescription will be effective from December 01, 2010 and it would be applicable only for cheques cleared under the image based Cheque Truncation System (CTS).

Source: RBI/2009-10/503 DPSS.COCHD.NO. 2806/04.07.05/2009-10 dated June 23, 2010

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