

# TECHNICAL UPDATE

February 2010

Volume II /2010/ASA

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

- Allowability of Bad Debts Written Off
- No Tax Liability on Foreign Company if Indian Agent Compensated at Arm's Length
- Transactions of Lending Money to Overseas Subsidiaries to be at Arm's Length
- Roll Over Charges Paid in Pursuance of a Forward Exchange Contract to be Capitalized Over the Cost of Asset
- New TDS Rules Notified

### INDIRECT TAX

#### Amendments, Notifications & Court Rulings

- Deposit of Excise Duty and filing of returns electronically from April 1, 2010
- Deposit of Service Tax and filing of returns electronically from April 1, 2010
- Haryana VAT rate increased from 4 to 5 per cent

### FEMA & OTHER LAW

#### Amendments, Notifications & Court Rulings

- Compliance with FDI norms-Half yearly certificate from Statutory Auditors of NBFCs

- Master Circular - Prudential Guidelines on Capital Adequacy and Market Discipline –NCAF
- External Commercial Borrowings (ECB) Policy - Liberalization
- Infrastructure Finance Companies
- Setting up of Cash Processing Centers
- Interest Rates on Export Credit in Foreign Currency

### DIRECT TAX

#### 1. Allowability of Bad Debts Written Off

The Apex Court in a landmark ruling has held that it is not necessary for the Assessee to establish that the debt has actually become irrecoverable. In other words, in order to claim the deduction on account of bad debts, it would be sufficient if the bad debts are written off in the books of accounts of the Assessee.

*Source TRF Ltd Vs CIT (Appeal No. 5293/2003, Supreme Court)*

#### 2. No Tax Liability on Foreign Company if Indian Agent Compensated at Arm's Length

A foreign company, resident of the United Kingdom ('UK') was engaged in the business of running news channel. The foreign company appointed its Indian subsidiary company as its agent to solicit orders for the sale of advertising airtime on its channel. The Indian tax authorities accepted that the Indian company was being remunerated at Arm's Length in consideration of services rendered by it. However, the tax authorities alleged that the Indian company constituted a Permanent Establishment ('PE') in terms of Article 5 of the Double Taxation Avoidance Agreement ('DTAA') between India and UK and therefore further profits should be attributed to the Indian operations. On an appeal preferred by the foreign company, the Income Tax Appellate Tribunal, Delhi ('ITAT') relied upon the previous judgments

of the Apex court and held that even if the Indian company constituted a PE of the foreign company, no further profits can be attributed, as it was already being remunerated at an Arm's Length Price.

*Source BBC Worldwide Limited Vs Dy. Director of Income Tax (ITA No. 1188(Del)06, Supreme Court)*

### 3. Transactions of Lending Money to Overseas Subsidiaries to be at Arm's Length

The Assessee, an Indian company granted interest free loan to its overseas subsidiaries located in Bermuda. The Transfer Pricing Officer ('TPO') held that the transaction was not carried out at Arm's Length Price ('ALP') since under an uncontrolled environment no person would have granted such loan without charging interest on the same. The Assessee contended that the loans were in the nature of quasi-equity instead of a pure loan and that the subsidiaries being in the start up stage were not in a position to pay interest. However, the TPO disregarded the contention of the Assessee and made an adjustment by applying the rate of interest prevailing under open market conditions. The ITAT held that there was nothing in the loan agreement to substantiate that the transaction was in the nature of quasi equity. Further, the ITAT held that the transaction of lending/borrowing money is squarely covered by the Indian Transfer Pricing provisions and therefore such transactions between Associated Enterprises needs to meet the Arm's Length standard. Consequently, the Tribunal upheld the adjustment made by the TPO.

*Source Perot Systems TSI (India) Limited vs Dy. CIT (ITA No. 2320/Del/2008, ITAT Delhi)*

### 4. Roll Over Charges Paid in Pursuance of a Forward Exchange Contract to be Capitalized Over the Cost of Asset

The Assessee, a manufacturing company, imported capital assets against borrowings in foreign currency. In order to hedge the risk on account of fluctuations in foreign exchange rates, the Assessee entered into a forward exchange contract with an authorized dealer. As per the prevalent regulations forward exchange contracts could be entered into only for a period of

six months, however since the tenure of borrowings was more than six months the contract was required to be rolled over after six months for which roll over charges were required to be paid to the Authorized Dealer ('AD'). The Assessee contended that such charges were in the nature of Interest and therefore allowable as revenue expenditure. However, the revenue authorities contended that such expenses were incurred in relation to purchase of capital assets and should have been capitalized in accordance with the provisions of Section 43A of the Act. The Apex court held that the roll over charges paid by the Assessee to mitigate the risk of exchange fluctuation which arose due to acquisition of capital assets. Therefore, such expenses were capital in nature to be capitalized along with the cost of fixed asset.

*Source ACIT vs Elecon Engg. Co. Ltd. (Appeal No.2057 of 2010, Supreme Court)*

### 5. New TDS Rules Notified

The Central Board of Direct Taxes ('CBDT') has notified new TDS rules w.e.f. April 1, 2009. The TDS Rules were earlier amended vide Income Tax (Eight Amendment) Rules, 2009, wherein, amongst other requirements electronic income tax challan in form-17 and the concept of Unique Transaction Number ('UTN') were introduced. These rules were subsequently put in abeyance by the CBDT. However, the CBDT has now withdrawn these rules and reinstated the old TDS rules which existed prior to April 1, 2009. Consequently the requirement of electronically furnishing income tax challan in form-17 and quoting the UTN have been dispensed with.

*Source Income Tax (First Amendment) Rules, 2010, dated February 17, 2010*

## INDIRECT TAX

### 1. Deposit of Excise Duty and filing of returns electronically from April 1, 2010

The Central Excise Rules have been amended to provide for deposit of duty through internet banking, as well as to electronically file the monthly or quarterly return as the case may be. This amendment is applicable from April 1, 2010 in case

of any assessee who has paid a total duty of Rs 10 lakhs or more including the amount of duty paid by utilization of CENVAT credit in the preceding financial year.

Prior to the amendment, this limit was Rs 50 lakhs and excluded the amount of duty paid by utilization of CENVAT credit.

*Source: Notification No. 04/2010-Central Excise (N.T.), dated February 19, 2010*

## 2. Deposit of Service Tax and filing of returns electronically from April 1, 2010

The Service Tax Rules have been amended to provide for deposit of service tax through internet banking, as well as to electronically file the half-yearly return. This amendment is applicable from April 1, 2010 in case of any assessee who has paid a total service tax of Rs 10 lakhs or more including the amount of service tax paid by utilization of CENVAT credit in the preceding financial year.

Prior to the amendment, the requirement for electronic filing of return and deposit of service tax was applicable if the amount of service tax paid was Rs 50 lakhs or more in the preceding financial year or already paid to such extent during the current financial year.

*Source: Notification No. 01/2010-Service Tax, dated February 19, 2010*

## 3. Haryana VAT rate increased from 4 to 5 per cent

Haryana VAT rate on items of Schedule 'C' of the Act has been increased from 4 to 5 per cent with effect from February 15, 2010.

*Source: Notification No. S.O. /H.A.6/2003/S.7/2010, dated February 15, 2010*

## FEMA

### 1. Compliance with FDI norms-Half yearly certificate from Statutory Auditors of NBFCs

Reserve Bank of India ('RBI') has made it mandatory for Non Banking Financial Corporations ('NBFCs')

to submit a certificate from their Statutory Auditors on half yearly basis certifying compliance with the existing terms and conditions of Foreign Direct Investment within one month from the close of the half year.

*Source: RBI/2009-10/304 DNBS (PD) CC No 167/03.10.01 / 2009-10 dated February 04, 2010*

### 2. Master Circular - Prudential Guidelines on Capital Adequacy and Market Discipline – NCAF

RBI has issued Master Circular on Capital Adequacy and Market Discipline - New Capital Adequacy Framework.

*Source: RBI/2009-10/308 DBOD No BP BC 73 /21.06.001/ 2009-10 dated February 8, 2010*

### 3. External Commercial Borrowing (ECB) Policy - Liberalization

With a view to simplify the procedure of External Commercial Borrowing ('ECB'), RBI has delegated its powers to Authorized Category - I bank in relation to any kind of changes or modifications in the drawdown or repayment schedule of borrowing, changes in the currency of borrowing and any other changes of the Authorized Dealer bank.

*Source: RBI/2009-10/311 A. P. (DIR Series) Circular No.33 dated February 09, 2010*

### 4. Infrastructure Finance Companies

RBI has included a fourth category for Non Banking Finance Corporations ('NBFCs') as Infrastructure Finance Companies ('IFC') having minimum of 75 per cent of its total assets deployed in infrastructure loans, net owned funds of Rs. 3 billion or above, a minimum credit rating 'A' or equivalent of CRISIL, FITCH, CARE, ICRA or equivalent rating by any other accrediting rating agencies and a CRAR of 15 percent.

*Source: RBI/2009-10/316 DNBS.PD. CC No.168/03.02.089 / 2009-10 dated February 12, 2010*

### 5. Setting up of Cash Processing Centers

RBI has approved the recommendations of and asked banks to set up Cash Processing Centers ('CPCs') at

various key locations with enhanced processing and storage capacities.

*Source: RBI/2009-10/320 DCM (Plg) No G-18/10.01.03/2009-10 dated February 19, 2010*

#### 6. Interest Rates on Export Credit in Foreign Currency

RBI has reduced the ceiling rate on export credit in foreign currency by banks to LIBOR plus 200

basis points subject to the condition that the banks would not levy any other charges e.g. service charge, management charge etc except for recovery towards out of pocket expenses incurred.

*Source: RBI/2009-10/321 DBOD.DIR (Exp) No. 76/04.02.001/2009-10 dated February 19, 2010*

## **ASA & Associates** chartered accountants (A member firm of NIS Global)

#### Head Office

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

#### Mumbai Office

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

#### Bangalore Office

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