

TECHNICAL UPDATE

February 2009

Volume II/2009/ASA

The amendments introduced in statutes, policies and procedures in respect of Direct Tax, Indirect Tax, Company Law & Accounting Standards, FEMA / EXIM Policy & SEBI related matters are summarized hereunder

CONTENTS AT A GLANCE

DIRECT TAX

Amendments, Notifications & Court Rulings

- Determination of Income from sale of flats during development of a Project by a Developer
- Taxability of an American Company having no PE in India for providing services to various Indian Hotels
- Taxability of reimbursements made in consonance of 'Secondment Agreement' with a Korean Company
- Taxability of Income earned by a Non-Resident Company on Offshore Supply of Equipment
- Taxability of a Non-Resident Assessee for making purchases from India through its Indian Liaison Office
- Entitlement to carry forward & set-off accumulated losses on change in Shareholding Pattern
- Proof of travel not required for claiming LTA
- Taxability of reimbursement of salary to Parent Company

INDIRECT TAX

Amendments, Notifications & Court Rulings

- Credit of duty paid on inputs used in manufacturing of branded products
- Applicability of the provisions of the Export of Services Rules, 2005 in certain situations
- Reduction in rate of Service Tax

CORPORATE LAW

Amendments, Notifications & Court Rulings

- Formats for Disclosure of pledged shares

FEMA & OTHER LAW

Amendments, Notifications & Court Rulings

- Ratings of NBFCs
- Interest Rates on Export Credit in Foreign Currency
- Lending under Consortium Arrangement / Multiple Banking Arrangements
- Calculation of total Foreign Investment
- Transfer of ownership of Indian Companies in sectors with caps
- Clarification on downstream investment by Indian Companies

DIRECT TAX

1. Determination of income from sale of flats during Development of a Project by a Developer

The Hon'ble Bench of Delhi Income Tax Appellate Tribunal ('ITAT') held that the developer's profit is related to that part of the development of the project which has been completed; it is not necessary that all the flats should be first sold and then the project can be said to have been completed. ITAT further held that each and every flat or unit is to be treated as an independent project and the profit on that part which has been completed by handing over the possession to the buyer cannot be postponed beyond the date on which the possession was handed over by the developer to the buyer

Source – Growth Techno Projects Ltd Vs CIT (2009) Delhi – ITAT [ITA No. 563/Del/2005]

2. Taxability of an American Company having no PE in India for providing services to various Indian Hotels

The Delhi High Court held that the payments received by the non-resident assessee for provision of advertisement, publicity and sale promotion service to its Indian clients (i.e. hotels), were neither in the nature of royalty or fee for technical services within the meaning of the section 9 of Income-tax Act nor taxable under Article 12 of the Indo-American DTAA. It further held that the payments received were in the nature of 'business income' and since the assessee did not have a PE under Article 7 of the DTAA, such business income received by the assessee could not be brought to tax in India.

Source - Director of Income-tax Vs Sheraton International (2009) High Court of Delhi [ITA Nos. 921, 922 & 924 etc. of 2007]

3. Taxability of reimbursements made in consonance of 'Secondment Agreement' with a Korean Company

The Authority for Advance Rulings ('AAR') held that the reimbursement made by Applicant-Indian Company to a Korean company for providing the services of a technical person in terms of the secondment agreement, cannot be treated as fee for technical services within the meaning section 9 of the Income-tax Act or Article 13 of the Indo-Korean Tax Treaty. Therefore, no tax is liable to be deducted at source by the Indian company in respect of the payments made to such Korean company under the terms of the Secondment Agreement.

Source - Cholamandalam MS General Insurance Co. Ltd., (2009) In re [AAR No. 752 of 2007]

4. Taxability of income earned by a Non-Resident Company on Offshore Supply of Equipment

The Madras High Court held that if a contract is a composite contract in spite of the apparent demarcation into separate parts, the mere fact that for offshore supply the title passed outside India alone will not decide taxability of the profits of contract. It therefore held that there are situations where profits from offshore supply of machinery cannot be totally excluded from tax.

Source - Ansaldo Energia SPA Vs ITAT (2009) High Court of Madras [Tax Case No. 1303 of 2007]

5. Taxability of a Non-Resident Assessee for making purchases from India through its Indian Liaison Office

The Hon'ble Bench of Bangalore Income Tax Appellate Tribunal ('ITAT') held that when the activities of the non-resident assessee are confined to purchase of goods though not for itself, but for its affiliates and it ends by export of the same from India, all the services that is rendered by the non-resident company through its Liaison Office is for purchase for export, and hence, no income is earned in India as per Explanation I(b) to section 9(1)(i) of Income-tax Act, 1961.

Source - Nike Inc. Vs ACIT - Bangalore ITAT [ITA Nos. 60 to 63/ Bang./2007]

6. Entitlement to carry forward & set-off accumulated losses on change in Shareholding Pattern

The Hon'ble Bench of Pune Income Tax Appellate Tribunal ('ITAT') held that there is no rational basis for differentiation in treatment of an Indian subsidiary of an Indian parent company *vis-à-vis* an Indian subsidiary of a German parent company for the purpose of section 79 of the Income-tax Act ('Act') and in view of the provisions of Article 24(4) of the Indo-German Tax Treaty, which prohibits such a discrimination. ITAT further held that the disability on carry forward and set off of accumulated losses on account of change in shareholding pattern, under section 79 read with section 2(18), cannot be extended to the Indian subsidiaries of German parent companies as long as German parent companies are listed on a German stock exchange recognized under their domestic laws.

Source - Daimler Chrysler India (P) Ltd Vs DCIT (2009) Pune ITAT [ITA No. 968/PN/03]

7. Proof of travel not required for claiming LTA

The Apex Court of India held that the employers, while assessing the conveyance and Leave & Travel Allowance (LTA) claims of their staff, are under no statutory obligation to collect supporting evidence and furnish them to tax authorities. The Court held that assessee employers are under no statutory obligation to collect bills and details to prove that the employees had utilised the amounts obtained against these claims on travel and related expenses.

Source - CIT Vs ITI Ltd (2009) Supreme Court (221 CTR 619) & CIT and Anr. Vs Larsen and Toubro Ltd. (2009) Supreme Court (221 CTR 620)

8. Taxability of reimbursement of salary to Parent Company

The Hon'ble Bench of Bangalore Income Tax Appellate Tribunal ('ITAT') held that once it is decided that the Indian assessee company is the economic employer of the seconded employee and reimburse the parent company for the salary paid to the seconded employee. Under no circumstances, it can be treated as fee for technical services and no TDS is to be deducted on such a sum. It is also noted by the Hon'ble ITAT that the TDS was duly deducted at source and paid to the income tax authorities by the seconded employee in his personal capacity.

Source - IDS Software Solutions (India) Pvt Ltd Vs ITO (2009) ITAT - Bangalore (ITA No 87/Bang/2008)

INDIRECT TAX

1. Credit of duty paid on inputs used in manufacturing of branded products

Exemption to Small Scale Industries from the duty of excise is not available in respect of goods bearing a brand name of another person. Now, the CBEC has issued a notification, clarifying that input credit to the extent of inputs used in the manufacture of branded final product which are in-eligible for the exemption shall be allowed to be taken.

Source: Notification No. 2/2009 - Central Excise dated February 11, 2009

2. Applicability of the provisions of the Export of Services Rules, 2005 in certain situations

The benefits of provisions of 'Export of Services Rules, 2005' was being denied in the following cases, on the ground that these services do not satisfy the condition of 'used outside India'

- i Call centers attending calls from outside India.
- ii Medical transcription where the case history of a patient as dictated by the doctor abroad is typed out in India and forwarded back to him.
- iii Indian agents who undertake marketing in India of goods of a foreign seller.
- iv Foreign financial institution desiring transfer of remittances to India, engaging an Indian organization to dispatch such remittances to the receiver in India.

It has now been clarified that the phrase 'used outside India' has to be interpreted to mean that the benefits of the services accrue outside India. Since the benefits

in the above cases accrue outside India, the benefits of the provisions relating to Export of Services shall be allowed in such cases.

Source: Circular No. 111/05/2009-ST dated February 24, 2009

3. Reduction in rate of Service Tax

The CBEC has issued a notification, whereby the rate of service tax has been reduced from 12 percent to 10 percent (technically, the notification exempts the tax payable in excess of 10 percent). The effective rate therefore comes down from 12.36 percent to 10.30 percent.

Source: Notification No. 8/2009 - ST dated February 24, 2009

CORPORATE & OTHER LAWS

1. Formats for Disclosure of pledged shares

SEBI has issued a circular to stock exchanges informing them about the formats for making the disclosures under Regulation 8A of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. SEBI has also issued another circular about the amendments to be made in formats under Clause 35 and Clause 41 of the listing agreement for reporting of "pledged shares" by listed companies to stock exchanges. The above formats have been prescribed pursuant to amendment to SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 vide gazette notification dated January 28, 2009 inserting a new Regulation 8A under Chapter II (pertaining to disclosures of shareholding and control in a listed company).

Source: PR No.:76/2009

FEMA

1. Ratings of NBFCs

Reserve Bank of India ('RBI') has directed Non Banking Finance Companies (deposit taking and non-deposit taking) with asset size of INR 1 billion and more to furnish within 15 days, information about change in assigned rating of its financial products, to respective Regional Office of RBI.

Source: RBI/2008-09/372 DNBS (PD) CC. No.134/03.10.001 / 2008-2009 February 04, 2009

2. Interest Rates on Export Credit in Foreign Currency

RBI has decided to raise the ceiling rate on export credit in foreign currency which is offered by banks

to Libor plus 350 basis points from the present ceiling rate of Libor plus 100 basis points subject to certain conditions. Further, the ceiling interest rate on the lines of credit with overseas banks has also been increased from six months Libor/Euro Libor/Euribor plus 75 basis points to six months Libor/EuroLibor/Euribor plus 150 basis points with immediate effect.

Source: RBI/2008-09/374 DBOD.DIR.(Exp).No.107/04.02.001/2008-09 February 5, 2009

3. Lending under Consortium Arrangement / Multiple Banking Arrangements

In order to strengthen the information sharing system among banks in respect of the borrowers taking credit facilities from multiple banks, banks have been permitted to accept certification by a Chartered Accountants & Cost Accountants, in addition to Company Secretaries, regarding compliance of various statutory prescriptions

Source: RBI/2008-2009/379 DBOD. No. BP.BC.110/08.12.001/2008-09 dated February 10, 2009

4. Calculation of total Foreign Investment

Government of India has notified guidelines for calculation of total foreign investment (direct and indirect) in an Indian Company at each stage of investment including downstream investment to determine total foreign investment in Indian Companies. To summarize:-

- i Investment by a non-resident entity in Indian Operating Company to be treated as Foreign Direct Investment ('FDI').
- ii In case of Indian Companies which are owned and controlled by resident Indian citizens Foreign

Investment through an Indian Investing Company will not be treated as Indirect Foreign Investment.

- iii If the Indian Investing Company is owned or controlled by Non-Resident entities the entire investment by the Indian Investing Company in the Indian company will be considered as indirect Foreign Investment.
- iv If the Indian Investing Company has 100 per cent ownership of the downstream company, FDI in downstream company will be equal to proportion of FDI in the Indian Investing company

Source: Press Note 2 of 2009 dated February 13, 2009

5. Transfer of ownership of Indian Companies in sectors with caps

In sectors with FDI caps or those which require FIPB approval, any transfer of ownership or control of Indian Companies to foreign entities or to Indian entity with foreign investment and ownership/control of non-resident entities, would require FIPB approval.

Source: Press Note 3 of 2009 dated February 13, 2009

6. Clarification on downstream investment by Indian Companies

Downstream investments by Indian companies have been subjected to compliance with the foreign investment norms on entry route, besides the sectoral caps. Further, the downstream investments have been categorized as (a) Only Operating Companies; (b) Operating Cum Investment Company; (c) Only Investing Company. Foreign investment in all operating-cum-investing companies will now comply with sectoral capitals, whereas, foreign investment in all non-operating investing companies requires FIPB approval.

Source: Press Note 4 of 2009 dated February 25, 2009

ASA & Associates

chartered accountants (formerly Ajay Sethi & Associates)

Head Office

K S House 118 Shahpur Jat
New Delhi 110 049 INDIA
Tel : +91 11 4100 9999
Fax : +91 11 4100 9990
Email : info@asa.in

Mumbai Office

B2 Manoj Premises
G D Ambekar Road Wadala
Mumbai 400 031 INDIA
Tel : +91 22 2410 4000
Telefax : +91 22 2410 6263
Email : infomumbai@asa.in

www.asa.in

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
Email : infobangalore@asa.in