

Tax & Corporate law Bulletin

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FEBRUARY 2014

From the Editor's Desk...

Dear Reader,

Greetings for the season.

We are glad to put this FDI special edition for are esteemed readers, comprising the current updates on FDI as ... Review of the existing policy on FDI in the Pharmaceuticals Sector, Government clarifies policy on FDI in insurance, FDI in railways gets approval and many more...

We eagerly await your feedback on the bulletin.

Yours truly,

Rajput Jain & Associates

Chartered Accountants



Your partners
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For further details,
Please contact....

CA. Swatantra Singh

Singh.swatantra@carajput.com

CA. Sushil Singh

Sks_978@carajput.com

CA. Navneet Gupta

info@carajput.com

CA. Manoj Kumar Singh

support@carajput.com

Corporate office: P-6/90, Connaught circus, Connaught Place, New Delhi-110001.

Phone No: - 011- 23343333, 011-43520194, 9811322785, 9871857333

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GLOSSARY

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DIRECT TAX

Notifications and Circulars

➤ **Notification No. 5/2014 [F.No.142/32/2013-TPL], dated January 15th 2014**

In exercise of the powers conferred by Section 295 of Income Tax Act, 1961, the Central Board of Direct Taxes, has made the following rules further to amend the Income tax rules, 1962 namely:-

- These rules may be called the Income Tax (First Amendment) Rules, 2014. They shall come to force on the date of the publication in their Official Gazette.
- In Income Tax Rules, 1962, in Rule 44CA,-
 - a) In sub rule (1), for the bracket and words (other than the annexure and statements) the bracket and words (including the annexure and statements) shall be substituted.
 - b) For sub rule (2), the following sub rules shall be substituted, namely: - “Where an application has not been declared invalid under sub section (2C) of section 245D or an application has been allowed to be further proceeded under sub section (2D) of that section, all the material and other information produced by the assessee before the Settlement Commission shall be sent to the Commissioner to enable him to furnish the report under sub section (3) of section 245D”.
- Where the proceeding before the settlement commission abates, the commission shall send, all the material and other information produced by the assesses before the commission and the results of any enquiry held or evidence recorded in the course of proceeding before it, to the commissioner.
- Procedure for PAN allotment process will undergo a change

RECENT JUDGEMENTS

- **Section 254(2A): The Tribunal has no power to extend stay of demand beyond 365 days even if the assessee is not at fault. If dept seeks an adjournment, ITAT may either refuse it or dept should undertake not to recover the demand**

The Tribunal {probably following the Special Bench judgment in Tata Communications 138 TTJ (Mum) 257)} extended the stay beyond 365 days as the assessee was not responsible for the delay in disposal of the appeal. The department challenged the decision of the Tribunal by way of a Writ Petition to the High Court on the ground that after the insertion of the third Proviso to s. 254(2A), the Tribunal had no power to extend stay beyond 365 days even if the assessee was not at fault. HELD by the High Court allowing the Petition:

- In view of the third proviso to s. 254(2A) of the Act substituted by Finance Act, 2008 with effect from 1st October, 2008, the Tribunal cannot extend stay beyond the period of 365 days from the date of first order of stay;
- In case default and delay is due to lapse on the part of the Revenue, the Tribunal is at liberty to conclude hearing and decide the appeal, if there is likelihood that the third proviso to Section 254 (2A) would come into operation;
- The third proviso to Section 254 (2A) does not bar or prohibit the Revenue or departmental representative from making a statement that they would not take coercive steps to recover the impugned demand and on such statement being made, it will be open to the Tribunal to adjourn the matter at the request of the Revenue;
- An assessee can file a writ petition in the High Court pleading and asking for stay and the High Court has power and jurisdiction to grant stay and issue directions to the Tribunal as may be required;

- Section 254(2A) does not prohibit/bar the High Court from issuing appropriate directions, including granting stay of recovery;
- The constitutional validity of the provisos to Section 254 (2A) of the Act has not been examined and the issue is left open.

CIT vs. Maruti Suzuki (India) Limited (Delhi High Court) dated 26th Feb. 2014

➤ **Section- 276CC Prosecution (Supreme Court Judgment)**

Section 276CC applies to situations where an assessee has failed to file a return of income as required under Section 139(1) of the Act or in response to notices issued to the assessee under Section 142 or Section 148 of the Act. The proviso to Section 276CC gives some relief to genuine assessee. The proviso to Section 276CC gives further time till the end of the assessment year to furnish return to avoid prosecution. However the proviso would not apply after detection of the failure to file the return and after a notice under Section 142(1) (i) or 148 of the Act is issued calling for filing of the return of income. Prosecution proceedings could not be held till the culmination of assessment proceedings. The declaration or statement made in the individual returns by partners that the accounts of the firm are not finalized, hence no return has been filed by the firm, will not absolve the firm in filing the 'statutory return under Section 139(1) of the Act. *Sasi Enterprises vs. ACIT [2014] 41 taxmann.com 500 (SC).*

➤ **Section-4 Anti-Avoidance, genuineness of transaction (High Court Judgment)**

Assessing Officer submitted that it appears that all the companies who profited from the sale of the shares of 'I' resorted to the practice of entering into the transaction of buying and selling of shares of 'H' and, therefore, this is a pointer that these transactions were deliberately entered into for the purpose of reducing the liability to pay capital gain tax. It was observed that on the basis of a suspicion howsoever strong it is not possible to record any finding of fact. As a matter of fact, suspicion can never take the

place of proof. Accordingly, it was held that transactions of purchase and sale of shares was not a colorable device.

CIT vs. Lakshmanarh Estate & Trading Co. Ltd. [2013] 40 taxmann.com 438 (Kolkata).

➤ **Section- 37(1) Explanation Expenditure on secret commission and free distribution of books**

Any secret transaction/payment that is made to secure an unfair advantage would necessarily be repugnant to law. Transaction which is not transparent, offends normal business practice, must suffer scrutiny. Such unexplained and untouched expenditure, if allowed, is likely to encourage illegal payments, evasion of tax and unscrupulous practices ushering in at both ends.

The expenditure incurred on secret commissions would necessarily fall within the mischief of the Explanation added to Section 37 of the Act. High Court remitted the case back to the Tribunal for deciding the question of allow-ability of deduction on secret commissions as also expenditure allegedly made on distribution of free books in the light of Explanation introduced and appended to Section 37(1) of the Act while evaluating and probing evidence of incurring of expenses on both the counts so as to give a finding with regard to reasonableness of such expenditure.

CIT vs. Dhanpat Rai & Sons ITA No. 51 of 1999, Order dated 10-01-2014 (Punjab & Haryana).

➤ **Section- 69 Bogus purchases**

In case conclusion arrived is that parties from whom purchases were allegedly made were bogus, not the entire amount covered under such purchase, but the profit element embedded therein would be subject to tax.

CIT vs. Bholanath Poly Fab (P.) Ltd. [2013] 40 taxmann.com 494 (Gujarat).

➤ **Section- 272B Penalty for non-quoting of PAN**

In case, the PAN Numbers are not furnished by the deductee, the respondent-assessee cannot be

penalized under Section 272B. Section 139A also imposes the obligation on the deductee to furnish PAN Number to the deductor. The Board in the letter dated August 5th, 2008 vide No. 275/24/2007-IT(B) has clarified that penalty of 10,000/- under Section 272B is linked to the linked to the person, i.e., the deductor who is responsible to deduct TDS, and not to the number of defaults regarding the PAN quoted in the TDS return.

Therefore, regardless of the number of defaults in each return, maximum penalty of Rs. 10,000/- can be imposed on the deductor. Penalty cannot be imposed by calculating the number of defective entries in each return and by multiplying them with Rs. 10,000/-. This also appears to be a legislative intent, as in many cases, the TDS amount may be small or insignificant fraction of Rs. 10,000/-.

Commissioner of Income Tax –TDS versus DHTC Logistics Ltd. (ITA 314/2013).

INDIRECT TAX

Central Excise

➤ **Change in rates of duty levied on the basis of production capacity in case of pan masala with and without tobacco and change in duty ratio:**

In respect of certain specified goods, the duty is levied on the basis of production capacity. Accordingly, (i) pan masala falling under tariff heading 21069020. of the First Schedule to the Central Excise Tariff Act, 1985 except the pan masala containing not more than 15% betel nut and (ii) pan masala containing tobacco, commonly known as gutkha, falling under tariff heading 24039990 manufactured with the aid of packing machine, are leviable to duty based on packing machines vide Notification No.42/2008-CE dated 1st July 2008. The Notification is amended to increase the rates of duty. **(Notification No. 1/2014-CE dated January 24th 2014).**

➤ **Increase in the quantity deemed to be produced by each operating packing machine**

in respect of Pan Masala and Pan Masala containing tobacco, Commonly known as gutkha and change in duty ratio:-

Pan masala falling under tariff heading 21069020 except the pan masala containing not more than 15% betel nut and pan masala containing tobacco, commonly known as gutkha, falling under tariff heading 24039990, manufactured with the aid of packing machine and packed in pouches, are leviable to Excise Duty on the basis of production capacity. In this regard, Pan Masala Packing Machines (Capacity Determination and Collection of Duty) Rules, 2008 were introduced. These rules are amended vide this notification as under:-

- The quantity deemed to be produced by each operating packing machine is increased as specified in the given Notification.
- Since the increase in production capacity is notified in-between the month i.e. on 24th January, 2014, calculation method for such transitional period is provided. Accordingly, for the period from 24th January, 2014 till 31st January, 2014, the annual capacity of production shall be calculated on pro rata basis for the total number of days in January, 2014 and number of days remaining in the month starting from and including 24th January, 2014.
- Further, the assessee is required to make monthly payment of duties and intimate Jurisdictional Superintendent of Central Excise in Form 2. (Notification No. 3/2014-CE (NT) dated January 1st, 2014).

Service Tax

- **The Central Government vide Notification No. 1/2014-ST dated 10th January, 2014** has amended the said entry to extend the exemption to sponsorship of those sporting events where the participating teams or individuals represent any country.
- **The CBEC vide Circular No. 175/01/2014-ST dated January 10th, 2014,** has clarified on

various issues related to the scope of the exemption granted to Resident Welfare Associations (RWAs) under the negative list approach as provided under Entry No. 28(c) of Mega Exemption Notification No. 25/2012-ST dated June 20th, 2012.

- If per month contribution of any member of a RWA exceeds Rs.5, 000/- the entire contribution of such member would be ineligible for the exemption under the said notification.
- Threshold exemption of Rs. 10 Lakh under Notification No. 33/2012-ST is applicable to a RWA, subject to conditions prescribed in the notification. As per Explanation B of the notification, the definition of “aggregate value” does not include the value of services which are exempt from service tax.
- Where the payment for an electricity bill raised by an electricity transmission or distribution utility in the name of the owner of an apartment is collected and paid by the RWA to the utility, without charging any commission or a consideration by any other name, the RWA is acting as a pure agent and hence exclusion from the value of taxable service would be available.
- However, in the case of electricity bills issued in the name of RWA, in respect of electricity consumed for common use of lifts, motor pumps for water supply, lights in common area, etc., since there is no agent involved in these transactions, the exclusion from the value of taxable service would not be available.
- RWA may avail CENVAT credit and use the same for payment of service tax, in accordance with the CENVAT Credit Rules.

- **The CBEC vide Circular No. 176/02/2014-ST dated January 20th, 2014** has clarified that a declaration of VCES made u/s. 107 (1) of Finance Act, 2013 shall become conclusive only upon issuance of acknowledgement of discharge under Section 107 (7). Accordingly, CBEC has advised all the Chief Commissioners to ensure that the discharge certificate is issued promptly & not later than the stipulated period of 7 days from the date of furnishing the details of payment of the tax dues in full, along with interest, if any. CBEC further clarified that the eligibility of CENVAT credit of “tax dues paid” would be governed by the CENVAT Credit Rules, 2004.

CORPORATE LAWS

- **Report u/s. 394A of the Companies Act, 1956– Taking account of comments/ inputs from Income-tax Department and others.**

MCA General Circular No. 1/2014 dated January 15th, 2014

The MCA has directed that while responding to the notices on behalf of the Central Government under Section 394A, the Regional Director concerned shall invite specific comments from Income-tax Department within 15 days of receipt of notice before filing his response to Court. If no response from the Income-tax Department is forthcoming, it may be presumed that the Income-tax Department has no objection to the action proposed under Section 391 or 394 as the case may be. It is also emphasised that it is not for the Regional Director to decide the correctness or otherwise of the objections/ views of the Income tax Department or other Regulators. If there are compelling reasons for doubting the correctness of such views, the Regional Director must make a reference to this Ministry for taking up the matter with the Ministry concerned before filing

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the representation under Section 394A.

➤ **SEBI Notification No. LAD-NRO/GN/2013-14/43/207 dated January 31th, 2014 – Securities and Exchange Board of India (Issue and Listing of Debt Securities) (Amendment) Regulations, 2014**

SEBI has notified the aforesaid regulations w.e.f 31st January 2014. These amendments have been issued in light of the new provisions provided for in Companies Act, 2013 especially those dealing with filing of shelf prospectus in respect of public issue of debt securities. These regulations also list down the nature of entities that can file shelf prospectus under section 31 of Companies Act, 2013 for public issuance of their debt securities. Certain criteria have been prescribed for filing of information memorandum along with the shelf prospectus.

As per these regulations, SEBI's Investigating Officer would have to request the SEBI Chairman for Warrants of Authority for execution of search and seizure of a person, an enterprise, building, place, vessel, vehicle or aircraft. These warrants would need to be returned to SEBI Chairman after being executed fully along with the seizure memo, or even I not executed within the authorised time.

➤ **Notification No. LAD-NRO/GN/2013-14/37/50 dated January 9th, 2014 – Securities and Exchange Board of India (Settlement of Administrative and Civil Proceedings) Regulations, 2014**

SEBI has notified the aforesaid regulations w.e.f January 9th, 2014 to provide for the terms of settlement and the procedure of settlement and matters connected therewith or incidental thereto. These regulations provide for guiding factors for dealing with the settlement process, while serious offences such as insider trading are excluded from the scope of settlement. As against the earlier settlement provisions, the list of violations that cannot be settled have been expanded widely under the new norms, which also provide for the involved entity to file settlement plea within 60 days of the show cause notice served by SEBI.

➤ **SEBI notification No. LAD-NRO/GN/2013-14/40/52 dated January 10, 2014 – Securities and Exchange Board of India (Procedure for Search and Seizure) Regulations, 2014**

SEBI has notified the aforesaid regulations w.e.f 10th January 2014 to provide for search in the premises of certain entities and seizure of documents and records recovered during such search. These regulations *inter alia* provide for detailed procedures to be followed for issuance of warrants and execution of search and seizure orders. As per these regulations, SEBI's Investigating Officer would have to request the SEBI Chairman for Warrants of Authority for execution of search and seizure of a person, an enterprise, building, place, vessel, vehicle or aircraft. These warrants would need to be returned to SEBI Chairman after being executed fully along with the seizure memo, or even if not executed within the authorised time.

➤ **SEBI Notification No. LAD-NRO/GN/2013-14/39/51 dated 9th January 2014 – Securities and Exchange Board of India (Collective Investment Schemes) (Amendment) Regulations, 2014**

SEBI has notified the aforesaid regulations w.e.f 9th January, 2014 to provide for certain amendments to the collective investment scheme regulations of SEBI. These regulations provide for registration of Collective Investment Management Company and also certain provisions wherein existing schemes or arrangements deemed to be a collective investment scheme have to obtain provisional registration.

➤ **SEBI Notification No. LAD-NRO/GN/2013-14/38/49 dated January 9, 2014 – Securities and Exchange Board of India (Investor Protection and Education Fund) (Amendment) Regulations, 2014**

SEBI has notified the aforesaid regulations w.e.f January 9, 2014 to widen the scope of the IPEF. These regulations seek to help aggrieved investors by allowing it to utilize Investor Protection and Education Fund to refund their money in deserving cases. SEBI has stated that this would be done in certain cases it "deems fit" make "restitution to

eligible and identifiable investors who have suffered losses resulting from violation of securities laws.

➤ **SEBI Notification No. LAD-NRO/GN/2013-14/36/12 dated January 7th, 2014 – Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014**

SEBI has notified the aforesaid regulations w.e.f January 7, 2014 to put in place a framework for registration and procedures with regard to foreign investors who propose to make portfolio investment in India. These regulations also provide for categories of foreign portfolio investors into Category I, II and III based on certain parameters. They also seek to restrict the various avenues under which investments can be made by these foreign portfolio investors.

FEMA

➤ **Overseas Direct Investments – Rollover of Guarantees**

A.P. (DIR Series) Circular No. 83, dated January 3rd, 2014

RBI has decided not to treat/reckon the renewal/rollover of an existing/ original guarantee, which is a part of the total financial commitment of the Indian party in terms of Regulation 6 of the Foreign Exchange Management (Transfer or Issue of any Foreign Security) (Amendment) Regulations, 2004, as a fresh financial commitment, provided that:-

- There is no change in the end use of the guarantee, i.e. the facilities availed by the JV/WOS/Step Down Subsidiary;
- There is no change in any of the terms & conditions, including the amount of the guarantee except the validity period;
- The reporting of the rolled over guarantee would be done as a fresh financial commitment in Part II of Form ODI, as hitherto; and
- If the Indian party is under investigation by any investigation/ enforcement agency or regulatory

body, the concerned agency/ body shall be kept informed about the same.

➤ **Foreign Direct Investment (FDI) Clarifications on Issue of Non-convertible/redeemable bonus preference shares or debentures**

The RBI vide Notification No. FEMA. 291/2013-RB, dated October 4th, 2013 and A.P. (DIR Series) Circular No. 84 dated January 6th, 2014, has provided clarification on issue of Non convertible/ redeemable bonus preference shares and debentures. The RBI in order to rationalize and simplify the procedure has permitted the Indian companies to issue non-convertible redeemable preference shares or debentures to non-resident shareholders, including the depositories that act as trustees for the ADR/GDR holders, by way of distribution as bonus from its general reserves under a Scheme of Arrangement approved by a Court in India under the provisions of the Companies Act, as applicable, subject to no-objection from the Income-tax Authorities.

➤ **Pricing Guidelines for FDI instruments with optionality clauses**

(i) **Notification No. FEMA. 294/2013-RB dated November 12th, 2013**

(ii) **Press release No. 2013-2014/1388 dated January 9th, 2014**

(iii) **A.P. (DIR Series) Circular No. 86 dated January 9th, 2014**

As per the extant regulations, only equity shares or convertible preference shares/debentures without optionality clause are eligible instruments to be issued to person resident outside India under the FDI policy. On a review, RBI has decided that optionality clauses (but without any option/right to exit at an assured price) may henceforth be allowed in equity shares and compulsorily and mandatorily convertible preference shares/debentures to be issued to a person resident outside India under the FDI Scheme.

The optionality clause shall oblige the buy-back of securities from the investor at the price prevailing/value determined at the time of exercise of

the optionality so as to enable the investor to exit without any assured return subject to the following conditions:

- Such instruments shall be locked-in period of one year or a minimum lock-in period as prescribed under FDI Regulations, whichever is higher
- After the lock-in period, as applicable above, the non-resident investor exercising option/right shall be eligible to exit without any assured return.

➤ **Review of the existing policy on FDI in the Pharmaceuticals Sector**

Press Note No. 1 (2014 Series), dated January 8th, 2014 issued by the Department of Industrial Policy & Promotion

The Government of India (GOI) has reviewed the position of FDI in the pharmaceuticals sector and has decided that the existing policy relating to FDI in the pharmaceuticals sector as given in paragraph 6.2.18 of 'Consolidated FDI Policy - Circular 1 of 2013' would continue with the condition that 'non-compete' clause would not be allowed except in special circumstances with the approval of the Foreign Investment Promotion Board. This decision shall take immediate effect.

➤ **External Commercial Borrowings (ECB) Policy – Liberalization of definition of Infrastructure Sector**

The RBI vide A.P. (DIR Series) Circular No. 85 dated January 6th, 2014, corrigendum to modification in Notification No. FEMA.281/2013-RB dated July 19th, 2013, has decided that for the purpose of ECB, 'Maintenance, Repairs and Overhaul' (MRO) will also be treated as a part of airport infrastructure. Consequently, MRO, as distinct from the related services which are other than infrastructure, will be considered as part of the sub-sector of Airport in the Transport Sector of Infrastructure.

➤ **Clarifications on Conversion of ECB and Lump sum Fee/Royalty into Equity**

A.P. (DIR Series) Circular No. 94, dated January 16th, 2014

Under the extant regulations, an Indian company can issue equity shares against ECB subject to certain conditions and pricing guidelines as prescribed by the RBI from time to time regarding value of equity shares to be issued. On queries being raised as to how the rupee amount against which equity shares are to be issued shall be arrived at i.e. what rate of exchange shall be applied to the amount in foreign currency borrowed or owed by the resident entity from/to the non-resident entity, the RBI has clarified that where the liability sought to be converted by the company is denominated in foreign currency as in case of ECB, import of capital goods, etc.

➤ **Liberalization of regulations relating to Resident Bank accounts maintained by residents in India with relative Non-resident Indians (NRIs) as Joint holders**

A.P. (DIR Series) Circular No. 87, dated January 9th, 2014

Presently, individuals resident in India are permitted to include RBI close relative(s) (relatives as defined in Section 6 of the Companies Act, 1956) as a joint holder(s) in their resident savings bank accounts on "former or survivor" basis. Such NRI close relatives are, however, not eligible to operate the account during the life time of the resident account holder in terms of said instructions. In view of the representations received by RBI, RBI has allowed to include NRI close relative (relatives as defined in Section 6 of the Companies Act, 1956) as joint holder with the resident account holder on "Either or Survivor" basis subject to certain conditions.

While extending this facility the AD bank should satisfy itself about the actual need for such a facility and also obtain the declaration duly signed by the non-resident account holder in the prescribed format. For detailed conditions, please refer circular available on RBI website at:

➤ **Clarifications on Provisions under section 6(4) of Foreign Exchange Management Act, (FEMA) 1999**

A.P. (DIR Series) Circular No. 90, dated January 9th, 2014

In terms of Section 6 (4) of FEMA, 1999, a person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security Western India Chartered Accountants Newsletter or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

In this regard, RBI has clarified that the following transactions shall be covered under section 6(4) of FEMA, 1999:

- Foreign currency accounts opened and maintained by such a person when he was resident outside India;
- Income earned through employment or business or vocation outside India taken up or commenced while such person was resident outside India, or from investments made while such person was resident outside India, or from gift or inheritance received while such a person was resident outside India;
- Foreign exchange including any income arising there from, and conversion or replacement or accrual to the same, held outside India by a person resident in India acquired by way of inheritance from a person resident outside India;
- A person resident in India may freely utilize all their eligible assets abroad as well as income on such assets or sale proceeds thereof received after their return to India for making any payments or to make any fresh investments abroad without approval of RBI.

➤ **Invitation of comments/views on Discussion paper on e-commerce in India**

DIPP has prepared a Discussion Paper on e-commerce in India on the following aspects:-

- Introduction
- Status of the global e-commerce industry
- E-commerce in emerging economies
- Status of e-commerce in India
- Existing regulations on e-commerce in the country
- FDI in B2C e-commerce
- Advantages and disadvantages of FDI in B2C e-commerce
- Conclusion and recommendations.

The Discussion Paper is available on DIPP's website. DIPP has invited comments/views/suggestions on the above discussion paper by January 30th, 2014. The comments may be sent to the Director, DIPP

➤ **Risk Management and Inter Bank Dealings**

A.P. (DIR Series) Circular No. 92, dated January 13th, 2014

Under the extant regulations, the facility of cancellation and rebooking is not permitted for forward contracts, involving Rupee as one of the currencies, booked by residents to hedge current and capital account transactions. However, exporters are allowed to cancel and rebook forward contracts to the extent of 50% of the contracts booked in a financial year for hedging their contracted export exposures and importers are allowed to cancel and rebook forward contracts to the extent of 25% of the contracts booked in a financial year for hedging their contracted import exposures.

On a review of the evolving market conditions and with a view to providing operational flexibility in respect of current and capital account transactions, RBI has allowed, in case of contracted exposures, forward contracts in respect of all current account transactions as well as capital account transactions

with a residual maturity of one year or less to be freely cancelled and rebooked.

➤ **Clarifications on establishment of Liaison Office/ Branch Office/ Project Office in India by Foreign Entities – General Permission**

Notification No. FEMA. 293/2013-RB, dated November 12th, 2013 and A.P. (DIR Series) Circular No. 93, dated January 15th, 2014

In terms of Regulation 4 of Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations, 2000, no entity or person, being a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran or China shall establish in India, a branch office or a liaison office or a project office or any other place of business by whatever name called, without the prior permission of RBI. RBI has now clarified that the provisions of the said Regulation 4 shall, ibid along with their specified conditions apply for entities from Hong Kong and Macau also.

Accordingly, applications from entities registered in/resident of Hong Kong and Macau, for establishment of Liaison/ Branch/Project Offices or any other place of business by whatever name called shall require prior approval from RBI. Consequently, Regulation 4 of Notification No. FEMA 22/2000–RB is amended vide Notification No. FEMA 293/2013–RB dated November 12th, 2013 effective from December 6th, 2013.

➤ **Clarifications on Facilities for Persons Resident outside India**

A.P. (DIR Series) Circular No. 96, dated January 20th, 2014

Presently, Foreign Institutional Investors (FIIs) are allowed to approach any AD Category-I bank for hedging their currency risk on the market value of entire investment in equity and/or debt in India as on a particular date subject to certain conditions specified by RBI. However, RBI has been receiving references from market participants as to whether, along similar lines, it is possible for FIIs and other foreign investors to effect remittances on cash /TOM

/spot basis to a bank other than the designated AD Category-I custodian bank.

In this connection, RBI has clarified that a foreign investor is free to remit funds through any bank of its choice for any transaction permitted under FEMA, 1999 or the Regulations / Directions framed there under. The funds thus remitted can be transferred to the designated AD Category-I custodian bank through the banking channel. Note should, however, be taken that KYC in respect of the remitter, wherever required, is a joint responsibility of the bank that has received the remittance as well as the bank that ultimately receives the proceeds of the remittance. Besides, the remittance receiving bank is required to issue FIRC to the bank receiving the proceeds to establish the fact the funds had been remitted in foreign currency.

INTERNATIONAL TAXATION



➤ **ITO vs. Device Driven (India) Pvt. Ltd. (ITA No. 282/Coch/2013) (Kochi ITAT)**

Facts of the case

The taxpayer was engaged in development and sale of software. During the year under consideration, the taxpayer paid export commission to its non-resident director, acting as a commission agent, without deduction of tax. The taxpayer claimed export commission as a deduction while computing its taxable income. He was not having any Permanent Establishment (PE) in India. The nonresident director was a qualified architect and has got vast experience in the technical field, especially in mobile

communication. The terms of the commission agency agreement entered into between the taxpayer and commission agent are as follows:

- The commission agent will facilitate marketing of the taxpayer's services in the territory and will provide support as well as sales expertise for projects to be executed at the customer site or at the taxpayer's centre in India.
- The commission agent shall be responsible for generating leads and initiating interaction with end customers in the relevant competency areas of the taxpayer.
- The commission agent shall if required, provide support to taxpayer in evaluation from a business perspective, in the light of his relationships with the proposed clients and local expertise.

He will also provide support to the taxpayer for presentations and other collateral proposals and contracts.

The Assessing Officer (AO) held that the terms of the agreement are beyond the scope of normal commission agency agreement, and the technical skills of the director have been utilized by the taxpayer.

Accordingly, the payment made to a commission agent was accruing and arising in India and liable for deduction of tax. However, since the taxpayer did not deduct tax, the AO disallowed the payment under Section 40(a) (i) of the Act. The Commissioner of Income-tax (Appeals) [CIT (A)] upheld the order of the AO

Held

In the present case, the commission agent has vast technical knowledge and experience. Further, he is also one of the directors of the taxpayer. He is able to secure orders only because of his vast technical knowledge and experience.

As per the clauses of the agreement, the commission agent is responsible in securing orders and for that purpose he has to assist the taxpayer in all respects

including identifying markets, making introductory contacts, arranging meeting with prospective clients, assisting in preparation of presentations for target clients. Western India Chartered Accountants Newsletter filing of return of income, and notice under Section 143(2) of the Act was issued after the AAR application. Following the ruling of Hyosung Corporation it has been held that the question raised by the applicant in the present case is not already pending before the income-tax authorities and therefore, the application is admitted.

➤ ACIT vs. Sivagami Holdings Pvt. Ltd. (2014-TII-01-ITAT-Chennai-INTL)

Facts of the case

Sivagami Holdings Pvt. Ltd. is an investment company having its branch in Malaysia. The foreign investments are managed by the assessee's Malaysian branch through its duly appointed agent. The assessee acquired immovable property at Malaysia from which it received rental income. In its return of income, the assessee admitted the fact of having foreign income from its Malaysian branch, however, claimed exemption on the income so earned in view of the India-Malaysia Double Taxation Avoidance Agreement ('DTAA'). The relevant Assessment Years ('AYs') in question are 2006-07, 2008-09 and 2009-10. The Assessing Officer, in the subject AYs, held that the income of assessee's branch in Malaysia was taxable in India. The AO further held that although the assessee may be maintaining a fixed place of business in Malaysia by forming a company under Malaysian Laws, the Malaysian Branch was not a permanent establishment of the assessee.

Issue before the Tribunal

Whether the Malaysian branch of the assessee-company forms a permanent establishment and the income arising there from is taxable in India?

Held

ITAT followed the order of the co-ordinate bench of the Tribunal for the assessee's own case in earlier assessments years. It noted that the co-ordinate bench of the ITAT, while passing its order for AYs 2000-01

to 2005-06, had also observed that the situs of the branch company was in Malaysia i.e. outside India, it was dealing in the affairs of the foreign investments of the assessee company and the branch office has been established as an independent legal entity in accordance with the Malaysian laws.

In such circumstances and in the absence of any record to deny the branch a permanent establishment status, it was held that the Malaysian branch formed a permanent establishment of the assessee in Malaysia and the income arising is not taxable in India in view of the Double Taxation Avoidance Agreement between India and Malaysia.”

➤ Pricing Guidelines for FDI instruments with optionality clauses

(i) Notification No. FEMA. 294/2013-RB dated November 12th, 2013

(ii) Press release No. 2013-2014/1388 dated January 9th, 2014

(iii) A.P. (DIR Series) Circular No. 86 dated January 9th, 2014.

As per the extant regulations, only equity shares or convertible preference shares/debentures without optionality clause are eligible instruments to be issued to person resident outside India under the FDI policy.

On a review, RBI has decided that optionality clauses (but without any option/right to exit at an assured price) may henceforth be allowed in equity shares and compulsorily and mandatorily convertible preference shares/debentures to be issued to a person resident outside India under the FDI Scheme. The optionality clause shall oblige the buy-back of securities from the investor at the price prevailing/value determined at the time of exercise of the optionality so as to enable the investor to exit without any assured return subject to the following conditions:

- Such instruments shall be locked-in period of one year or a minimum lock-in period as

prescribed under FDI Regulations, whichever is higher (e.g. defence and construction development sector where the lock-in period of three years has been prescribed).

- The lock-in period shall be effective from the date of allotment of such shares or convertible debentures or as prescribed for defence and construction development sectors, etc. in Annex. B to Schedule 1 of Notification No. FEMA. 20 as amended from time-to time;
- After the lock-in period, as applicable above, the non-resident investor exercising option/right shall be eligible to exit without any assured return

➤ Review of the existing policy on FDI in the Pharmaceuticals Sector

Press Note No. 1 (2014 Series), dated January 8th, 2014 issued by the Department of Industrial Policy & Promotion

The Government of India (GOI) has reviewed the position of FDI in the pharmaceuticals sector and has decided that the existing policy relating to FDI in the pharmaceuticals sector as given in paragraph 6.2.18 of ‘Consolidated FDI Policy - Circular 1 of 2013’ would continue with the condition that ‘non-compete’ clause would not be allowed except in special circumstances with the approval of the Foreign Investment Promotion Board. This decision shall take immediate effect.

➤ External Commercial Borrowing (ECB) Liberalization of definition of Infrastructure Sector

A.P. (DIR Series) Circular No. 85 dated January 6th, 2014

The definition of infrastructure sector for the purpose of raising ECB was expanded vides Notification No. FEMA.281/2013-RB dated July 19th, 2013 effective from September 12, 2013 A.P. (DIR Series) Circular No. 48 dated September 18th, 2013 taking into account the Harmonized Master List of Infrastructure sub-sectors and Institutional Mechanism for its

update approved by Government of India vide Notification F.No.13/06/2009-INF dated March 27, 2012.

RBI has now decided that, for the purpose of ECB, 'Maintenance, Repairs and Overhaul' (MRO) shall also be treated as a part of airport infrastructure. Accordingly, MRO, as distinct from the related services which are other than infrastructure, will be considered as part of the sub-sector of Airport in the Transport Sector of Infrastructure.

➤ **Clarifications on Conversion of ECB and Lump sum Fee/Royalty into Equity**

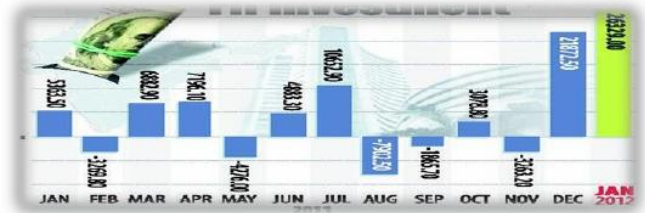
A.P. (DIR Series) Circular No. 94, dated January 16, 2014

Under the extant regulations, an Indian company can issue equity shares against ECB subject to certain conditions and pricing guidelines as prescribed by the RBI from time to time regarding value of equity shares to be issued. On queries being raised as to how the rupee amount against which equity shares are to be issued shall be arrived at i.e. what rate of exchange shall be applied to the amount in foreign currency borrowed or owed by the resident entity from/to the non-resident entity, the RBI has clarified that where the liability sought to be converted by the company is denominated in foreign currency as in case of ECB, import of capital goods, etc. it will be in order to apply the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion.

RBI has further clarified that the principle of calculation of INR equivalent for a liability denominated in foreign currency as mentioned above shall apply, mutatis mutandis, to all cases where any payables/liability by an Indian company such as, lump sum fees/royalties, etc. are permitted to be converted to equity shares or other securities to be issued to a non-resident subject to the conditions stipulated under the respective Regulations.

POLICY WATCH

➤ **FII's invest USD 3.05 billion in debt market till January 2014**



The Foreign Institutional Investors (FIIs) invested over USD 3.05 billion in the Indian debt market till January 2014. FII inflows into the debt market are increasing on back of stability observed in foreign exchange and interest rates. FIIs were gross buyers of debt securities worth USD 4.87 billion and sellers of bonds to the tune of USD 1.84 billion till January 24, 2014, resulting in a net inflow of USD 3.03 billion. FIIs also infused USD 0.56 billion into the equity market during this period, taking their total investment in debt and stocks to about USD 3.58 billion.

➤ **FDI in railways gets approval**

The Ministry of Home Affairs has finally given its green signal to the proposal of allowing Foreign Direct Investment (FDI) in railways. India will allow foreign players to invest only in construction and maintenance of railway projects, not in operations. The railways ministry is keen in getting FDI, especially in Public-Private Partnership (PPP) projects. This is because domestic private players have shown little interest in this segment. The move will also help the railways achieve its revenue target of USD 9.65 billion through projects like construction of factories to manufacture locomotives and coaches.

➤ **RBI lays out framework for banks to limit bad loans**

The Reserve Bank of India (RBI) has laid out a road map to deal with an increase in bad loans in India. The framework outlines a corrective action plan that will offer incentives for early identification of stressed assets by banks, timely revamp of accounts considered to be unviable and prompt steps for

recovery or sale of assets in the case of loans at the risk of turning bad.

➤ **Government clarifies policy on FDI in insurance**

Government has clarified that the 26% cap on foreign investments in the insurance sector also applies to intermediaries such as brokers, third party administrators, and surveyors. In the case of insurance companies, the 26% cap will include Foreign Direct Investment (FDI), Foreign Institutional Investments (FIIs), and investments from Non-Resident Indians (NRIs). India's insurance regulator has set up a committee to study the option of allowing 100 percent FDI in insurance intermediaries, third-party administrators, surveyor, and loss assessors.



➤ **Government and the World Bank signs USD 500 million loan pact**

Government has signed a 500 million loan agreement with the World Bank to improve the piped water supply and sanitation services, through decentralized delivery systems in the states of Assam, Bihar, Jharkhand and Uttar Pradesh.

The project will be implemented over a six-year period and will support the design and implementation of a dedicated Rural Water Supply and Sanitation Program for low income states under the ongoing National Rural Drinking Water Program in the Ministry of Drinking Water and Sanitation. This project is expected to directly benefit about 7.8 million rural people in these states.

INDUSTRY WATCH & CORPORATE HIGHLIGHT

➤ **India & Zimbabwe to enhance ties in pharmaceuticals, infrastructure, & health sectors**

India & Zimbabwe have decided to enhance cooperation in sectors such as pharmaceuticals, infrastructure, and health to boost trade and investment between the countries. Also, various projects have been executed under the India-Africa Forum Summit Programme. India is also in the process of setting up Rural Training Park and a Vocational Training Centre. India is willing to provide assistance under the Buyers' Credit Programme.





➤ **RBI eases third party payment norms for export/import**

The Reserve Bank of India (RBI) has liberalized the third party payment norms for the import of goods by removing the ceiling of USD 100,000. Earlier, the amount of an import transaction for third party payment could not exceed USD 100,000. The central bank also simplified certain documentation norms related with third party payments for export and import transactions.



➤ **Spectrum auction to boost consolidation in telecom industry**

The recent spectrum auction will help in consolidation in the telecom industry and the number of players in the country could come down to six-seven with smaller operators likely to be acquired by the larger ones. The consolidation will improve operating profitability and cash flow, and return pricing power to the larger operators in the medium term.

Statutory compliance calendar for the month of February, 2014			
Due date	Statutory compliance under Act	particulars	Governing Authority
			
06/02/2014	Service Tax	Payment of monthly service tax for the month of January by all tax payers electronically	Central Board of Excise and Custom
	Central Excise	Payment of monthly central excise duty for the month of January on goods by assesses other than SSI units electronically	Central Board of Excise and Custom
07/02/2014	Income Tax	Deposit of Income Tax TCS and TDS deducted in January	Central Board of Direct Tax.
	NBFC-D	Monthly return of exposure to capital markets in form NBS-6 by NBFC having total assets of 100 crore and above	Reserve Bank of India.
	NBFC-ND-SI	Monthly return of source and application of funds, profit and loss account, asset classification	Reserve Bank of India.
10/02/2014	Central Excise	Monthly central excise return in form ER-1/ER-2 by other than SSI	Central Board of Excise and Custom
	Central Excise	Monthly return of receipts and consumption of Principal Inputs by specified manufacturers of excisable goods in form ER-6	Central Board of Excise and Custom
	NBFC-ND-SI	Monthly statement of short term dynamic liquidity in form NBS-ALM I	Reserve Bank of India.
15/02/2014	Provident Fund	(a) Payment of monthly dues of Provident Fund for the month of January (b) Monthly return in form 5 for employees joining Provident Fund during January along with declaration in form 2 furnished by the employees (c) Monthly return of Provident Fund in form 10 of employees leaving the service during January	The Central Board of Trustees, The Employees' Provident Fund Scheme, 1952
21/02/2014	ESIC	Payment of ESIC contribution for the month of January	The employees' state insurance Act-1948. Ministry of labour and employment.
25/02/2014	Provident Fund	Monthly contribution statement (abstract) in form 12A, along with copy of receipted challans regarding payment of contribution.	The Central Board of Trustees, The Employees' Provident Fund Scheme, 1952

Glossary

AAR	Authority of Advance Rulings
ADR	American Depository Receipt
ALP	Arm's Length Price
AO	Assessing Officer
AP	Association of Persons
APA	Advance Pricing Agreement
ATM	Automated Teller Machine
AY	Assessment Year
BCD	Basic Customs Duty
BI	Body of Individuals
BP	Balance of Payments
CA	Chartered accountant
CAD	Current Account Deficit
CBDT	Central Board of Direct Taxes
CBEC	Central Board of Excise & Customs
CENVAT	Central Value Added Tax
Customs Act	Customs Act, 1962
CIT	Commissioner of Income Tax
CPI	Consumer Price Index
CSR	Corporate Social Responsibility
CD	Countervailing Duty
DDT	Dividend Distribution Tax
DTA	Domestic Tariff Area
ECB	External Commercial Borrowings
ESI	Employee's state insurance
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act
FERA	Foreign Exchange Regulation Act
FII	Foreign Institutional Investors
FIPB	Foreign Investment Promotion Board
FPI	Foreign Portfolio Investment
FTS	Fees for Technical Services
FY	Financial Year
GDP	Gross Domestic Product
GDR	Global Depository Receipt
GI	Government of India
GST	Goods and Services Tax
HUF	Hindu Undivided Family
ICAI	Institute of chartered accountant
IFRS	International Financial Reporting Standard
IDR	Indian Depository Receipt
IIP	Index of Industrial Production
IRDA	Insurance Regulatory Development Authority
ITR	Income tax return

LCD	Liquid-crystal Display
MP	Madhya Pradesh
MP	Market price
MF	Mutual fund
MSME	Micro Small and Medium Enterprises
NBFC	Non Banking Finance Company
NHAI	National Highway Authority of India
NPS	National Pension Scheme
NRI	Nonresident in India
NABARD	National Bank for Agriculture and Rural Development
OEM	Original Equipment Manufacturer
OET Act	Odessa Entry Tax Act, 1999
PSU	Public Service Undertakings
P&L	Profit & loss
PF	Provident fund
POTR	Point of Taxation Rules
QE	Quantitative Easing
QFI	Qualified Foreign Investor
RBI	Reserve Bank of India
REF	Renewable Energy Fund
REIT	Real Estate Investment Trust
Rules	Income-tax Rules, 1962
SA	Standard on Auditing
SAD	Special Additional Duty
SC	Scheduled Caste
SC	Supreme Court
SEBI	Securities and Exchange Board of India
SEZ	Special Economic Zone
ST	Scheduled Tribes
ST	Service Tax
STP	Software Technology Park
STR	Service Tax Rules
STCG	Short Term Capital Gain
TIN	Transaction identification number
TNNM	Transactional Net Margin Method
Tribunal	Income tax Appellate Tribunal
TDS	Tax Deducted at Source
TPO	Transfer Pricing Officer
TED	Terminal Excise Duty
VAT	Value Added Tax
VCC	Venture Capital Companies
VCF	Venture Capital Fund
WPI	Wholesale Price Index
WT	Wealth tax

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Our Clientele

BRANCHES / AFFILIATES:-

The headquarter of **Rajput Jain & associates** Chartered Accountants is located in Delhi, India. Beside this **Rajput Jain & associates** has presence all over India, with Nepal, and United States of America, Australia, through its associates / affiliates.

CORPORATE OFFICE

P-6/90, Connaught Place, Connaught
Circus, New Delhi-110001, India.

Phone No: - +91-9811322785;

011-23343333.

DELHI BRANCH

204, Prakash Chamber, 6 Netaji Subhash
Marg, Main Road Daryaganj, New Delhi-
110002, India.

Phone No: - +91-9871857333; 011-
43520194.

UTTAR PRADESH BRANCH

B-2, Shanchar Vihar, ITI Mankapur,
District Ghonda, Uttar Pradesh,
271308241, India.

Phone No: - +91-9811322785.

NEPAL BRANCH

Building No:-65, Ward No: - 10, Lakhe
Chaur Marg, Kathmandu Metropolitan
Kathmandu, Nepal.

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