Monthly Newsletter Volume No. 8/2007

SNK

CONTENTS	PAGE NO.
1. Direct Taxes	1 – 4
2. Other Laws	4 – 5
3. For your Information	6
4. Important Due Dates	6

DIRECT TAXES

Judicial Pronouncements

Berg Trading Ltd. v. ACIT (2007) 14 SOT 455 (MUM.)

Method of Accounting - Foreign exchange fluctuation loss arising directly on account of raw material imported had to be considered as part of value of closing stock for purpose of its valuation.

R.& B. Falcon (A) Pty. Ltd (2007) 289 ITR 369 (AAR)

Fringe Benefit Tax - Hon`ble Authority has held that section 115WB(2), clauses (F) and (Q) cover traveling and conveyance expenses including foreign travel other than incurred for private journeys within the ambit of fringe benefits deemed to have been provided to the employees by the employer. As the expenditure incurred on transportation of offshore employees from their residence abroad to the work place and return journey back to their residence abroad is for business purpose the same would amount to fringe benefit u/s 115WB(2) clause (F) & (Q) and would attract fringe benefit tax.

CIT v. Dhir and Co. Colonisers Pvt. Ltd. (2007) 288 ITR 561 (P&H)

Once the possession is transferred and transferee has done construction over it the risks pertaining to the property have passed on to the transferee. Thus the receipt of deposit without transfer of the property is to be treated as revenue receipt and correspondingly the property shall not be treated as stock in trade.

ACIT v. Ronald Nardi (2007) 14 SOT 24 (MUM.)

It is not permissible u/s. 234B(3) to charge interest from first day of A.Y. till date of reassessment or re-computation u/s. 147 where income has been determined u/s. 143(1) & allowed to become final.

Santosh Kumar v. DCIT (2007) 161 TAXMAN 99 (JP) (TRIB.)

In absence of any specific direction of section under which interest is chargeable by assessing officer, no interest can be charged.

ACIT v. Modicon Network (P.) Ltd. (2007) 14 SOT 204 (DELHI)

Reimbursement of expenses cannot be considered as having an income element embedded therein so as to attract section 195(1).

Reimbursement of expenses done by Non-Resident/ Non-corporate to assessee, then such reimbursement cannot be considered as income. Further, the expenses what assessee wanted to remit abroad to non-corporate/ non-resident was only by way of reimbursement. Therefore, the assessee was not liable to deduct tax at source from payment made to Non-Resident/ Non-corporate.

Master Capital Services Ltd. v. DCIT (ITA NO. 364 OF 2006, Decided On 26-02-2007) (CHD.)

Fines/ penalties paid by NSE broker for violation of trading exposure limit, for delay in submission of margin certificates, and for non-delivery of shares deficiencies in documents in deliveries of shares (bad deliver) are in normal course of business and not for infraction of law and, hence, allowable.

ITO v. Kalyan Gupta (2007) 107 ITD 34 (Mum.)

Chapter XII-D, read with sections 2(22), 10(33) and 115-O of the IT Act

Distributed profits of domestic companies

By virtue of the Explanation deemed dividend referred to in section 2(22)(e) has been excluded from the ambit of Chapter XII-D; which means, under the said chapter, tax is not levied on the company with regard to deemed dividend. Consequently, the exemption provided u/s 10(33) is not applicable to 'deemed dividend' referred to in section 2(22)(e).

DIT (IT), Mumbai v. Morgan Stanley & Co., INC (Civil Appeal No. 2914 of 2007) (SC)

DTAA between India and US

Morgan Stanley and Company (MSCo.), a multi national enterprise & Morgan Stanley Advantages Services Pvt. Ltd. (MSAS), an Indian Company

The Supreme Court held

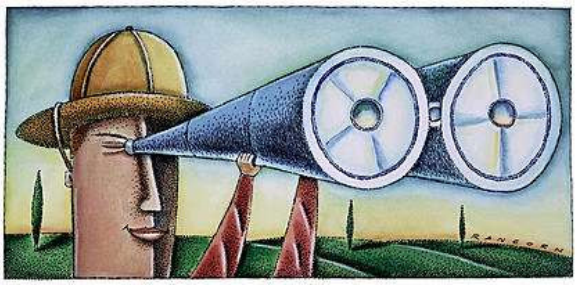
The AAR was right in ruling that MSAS would be a Service PE in India under Article 5(2)(1), though only on account of the services to be performed by the deputationists deployed by MSCo and not on account of stewardship activities.

Transactional Net Margin Method was the appropriate method for determination of the arm's length price in respect of transaction between MSCo and MSAS.

The computation of the remuneration based on cost plus mark-up worked out at 29% on the operating costs of MSAS is accepted. This position is also accepted by the Assessing Officer and by the transfer pricing officer.

As regards attribution of further profits to the PE of MSCo where the transaction between the two are held to be at arm's length, the AAR ruling is correct in principle provided that an associated enterprise (that also constitutes a PE) is remunerated on arm's length basis taking into account all the risk-taking functions of the multinational enterprise. In such a case nothing further would be left to attribute to the PE. The entire exercise ultimately is to ascertain whether the service charges payable or paid to the service provider (MSAS in this case) fully represents the value of the profit attributable to his service.

- The Department has also to examine whether the PE has obtained services from the multinational enterprise at lower than the arm's length cost? Therefore, the Department has to determine income, expense or cost allocations having regard to arm's length prices to decide the applicability of the transfer pricing regulations.
- Economic nexus is an important aspect of the principle of Attribution of Profits.



Aztec Software & Technology Services Ltd. v. ACIT, Bangalore

Section 92C, r.w.s. 92CA of the Income-tax Act, 1961 - Transfer pricing - Computation of arm's length price

- It is not a legal requirement under provisions contained in Chapter X that Assessing officer should prima facie demonstrate that there is tax avoidance, before invoking relevant provisions
- Whether before a case is referred to Transfer Pricing Officer (TPO) under section 92CA(1) for computation of arm's length price (ALP) Assessing officer is not prima facie required to demonstrate that any one or more of circumstances set out in clauses (a), (b), (c) and/or (d) of section 92C(3) are satisfied.
- Assessing officer is not required to record his opinion/reason before seeking previous approval of Commissioner under section 92CA(1)
- Before making a reference to TPO under section 92CA(1), read with section 92C(3), it is not a necessary condition precedent that Assessing officer shall provide assessee an opportunity of being heard
- CBDT instruction No. 3 of 2003, dated 20-5-2003 on transfer pricing matters is not illegal and same is binding on departmental authority
- Prior to amendment brought with effect from 1-6-2007, though order of TPO issued under section 92CA(3) is not binding on Assessing Officer, Assessing Officer may take ALP

determined by TPO without making any change under section 92CA(3) for making assessment. (Issue of determination of quantum of ALP remanded)

ACIT v. Balarampur Chini Mills Ltd. (2007) 14 SOT 372 (Kol.)

Section 115JB of IT Act, 1961

AO made an addition of amount of deferred tax under Explanation (c) to section 115JB sub section (2) for purposes of computing book profit. Since deferred tax charge is not cover by any of clauses of explanation to section 115JB(2), such deferred tax charge is not required to be added back in computation book profit for purpose of section 115JB and therefore, addition made by AO was to be deleted.

Distribution of profit payable as per provision of section 115-O is of similar nature as fringe benefit tax payable under Chapter XII-H. Since by virtue of Circular No. 8 dtd. 29-8-2005 fringe benefit tax is an allowable deduction in computation of book profit u/s.115JB taxed on profit distributed as dividend u/s.115-O is also allowable as deduction in computation of book profit for purpose of section 115JB.

CIT v. Catapharma (India) (P.) Ltd. (SC)
Section 80HHC of the Income-tax Act, 1961 - Excise duty and sales tax does not form part of total turnover while computing deduction u/s 80HHC.

Western Union Financial Services Inc. v. ADIT (2007) 291 ITR (AT) 176 (Delhi)
Section 9 - Hon`ble Bench had held that wherever there is a DTAA between India and another country. Then the provisions of the DTAA will override those of the Income Tax Act, since there is no PE in India under article 5 of the Double Taxation Avoidance Agreement between India and USA, no profit can be attributed to the Indian operation of the assessee and taxed in India.

Udayan Mukharjee v. CIT (2007) 291 ITR 318 (Cal)

Penalty u/s 271(1) - Held by the Hon`ble Court that wrong calculation on the basis of mistaken indexation does not come in the purview

of section 271(1)(c) . Penalty could not be imposed.

CIT vs. Kay Aar Enterprises (Madras High Court)

A re-arrangement of share holdings in a company to avoid possible litigation among family members is not a "transfer" for purposes of capital gains.

Adidas India Marketing P.Ltd. v. CIT (2007) 288 ITR 379 (Delhi)
Penalty u/s 201

Held by the Hon`ble Court that the tax deducted by the assessee is the tax payable on the income of the deductee, since the deductee has paid the income-tax no penalty can be levied on the deductor.

CIT v. Dewan Kraft Systems (P) Ltd. (2007)

In computing, deduction under Section 80 IA, profits of units eligible for deduction cannot be reduced by losses of other units not eligible for deduction.

Where the assessee was running its business in units situated at a notified backward area and also from other business units which was not in notified backward areas and it had profits from the first unit and losses from other, it was held that in view of sub-section (7) of Section 80-IA, the unit situated at a notified backward area being the only unit of the assessee eligible for the deduction u/s 80-IA was to be treated as an independent unit, and the

same was to be treated as the only source of income for the assessee for the purpose of computing the total deduction u/s 80-IA of the Act. The Assessing Officer, thus, mixed the profits of both the units and thus, he erroneously restricted the deduction to the extent of the business income arrived after setting of the losses against the profits.

Circulars / Notifications

Notification No. 214/2007, Dated 3-8-2007

Notified Cost Inflation Index for financial year 2007-08

In exercise of the powers conferred by clause (v) of the Explanation to section 48 of the Income-tax Act, 1961 (43 of 1961), the Central Government, having regard to seventy-five per cent of the average rise in the Consumer Price Index for the financial year commencing from the 1st day of April, 2006 and ending on the 31st day of March, 2007 for the urban non-manual employees, hereby specifies the Cost Inflation Index for the financial year commencing from the 1st day of April, 2007 and ending on the 31st day of March, 2008 and for that purpose further makes the following amendment in the notification of the Government of India in the Ministry of Finance (Department of Revenue), Central Board of Direct Taxes, Number S.O. 709(E), dated the 20th August, 1998, namely:

In the said notification, in the Table, after serial number 26 and the entries relating thereto, the following serial number and the entries relating thereto shall be added, namely:

'27	2007-08	551'

OTHER LAWS

Circulars / Notifications

RBI/2007-2008/100 A. P. (DIR Series) Circular No. 03, Dtd. 19-07-2007

Remittances to non-residents - Deduction of tax at source

Attention of Authorised Dealer Category - I (AD Category - I) banks and authorised banks is invited to A. P. (DIR Series) Circular No.56 dated November 26, 2002 enclosing a copy of Central Board of Direct Taxes (CBDT) Circular No.10/2002 dated October 9, 2002 (F.No.500/152/96-FTD) regarding revision in the format of the undertaking and the certificate to be submitted by the remitter at the time of making remittances to non-residents.

2. We have been receiving queries from authorised dealers whether such undertaking and certificate should be obtained in all cases of remittances in foreign currency to non-residents including remittances for trade payments. On the basis of the communication received from CBDT, Department of Revenue, Ministry of Finance, Government of India, it is clarified that under Section 195 of the Income Tax Act read with Rule 29B of the IT Rules, any person responsible for making payment to a non-resident or to a foreign company, any interest or any other sum chargeable under the IT Act, shall at the time of payment or credit of the amount deduct Income Tax thereon at the rate in force. Section 195 of the IT Act is not limited to interest income and it takes into account business income also. Further, points 7 and 8 of the Chartered Accountant's certificate deals with remittances for supply of articles or things (plant, machinery, equipment, etc.) or computer software and business income, respectively.

3. Accordingly, a remitter of foreign exchange is required to submit to the authorised dealer, an undertaking and Chartered Accountant's certificate in the format prescribed by CBDT vide circular No. 10/2002 dated October 9, 2002 at the time of making the remittance in foreign exchange to non-residents including remittances which are in the nature of trade transactions such as import payments.

4. AD Category - I banks and authorised banks may bring the contents of this circular to the notice of their customers and constituents concerned.

5. The directions contained in this circular have been issued under Section 10 (4) and Section 11 (1) of the Foreign Exchange Management Act, 1999 (42 of 1999) and is without prejudice to permissions / approvals, if any, required under any other law.

A. P. (DIR SERIES) Circular No. 4, Dtd. 7-8-2007

Review of External Commercial Borrowings (ECB) Policy

Attention of Authorised Dealer Category - I (AD Category – I) banks is invited to A.P. (DIR Series) Circular No. 5 dated August 1, 2005 and A.P. (DIR Series) Circular No. 60 dated May 21, 2007 relating to External Commercial Borrowings (ECB). A review of the ECB guidelines has been undertaken keeping in view the current macroeconomic situation and the experience gained so far by the Reserve Bank in administering the ECB policy.

2. Based on the review, it has been decided to modify the ECB policy until further review as indicated below:

(i) Henceforth, ECB more than USD 20 million per borrower company per financial year would be permitted only for foreign currency expenditure for permissible end-uses of ECB. Accordingly, borrowers raising ECB more than USD 20 million shall park the ECB proceeds overseas for use as foreign currency expenditures for permissible end-uses and shall not remit the funds to India. The above modifications would be applicable to ECB exceeding USD 20 million per financial year both under the Automatic Route and under the Approval Route.

(ii) ECB up to USD 20 million per borrowing company per financial year would be permitted for foreign currency expenditures for permissible end-uses under the Automatic Route and these funds shall be parked overseas and not be remitted to India. Borrowers proposing to avail ECB up to USD 20 million for Rupee expenditure for permissible end-uses would require prior approval of the Reserve Bank under the Approval Route. However, such funds shall be continued to be parked overseas until actual requirement in India.

(iii) All other aspects of ECB policy such as eligible borrower, USD 500 million limit per borrower company per financial year under the Automatic route, recognised lender, average maturity period, all-in-cost-ceiling, prepayment, refinancing of existing ECB and reporting arrangements remain unchanged.

(iv) These conditions will not apply to borrowers who have already entered into loan agreement and obtained loan registration numbers from the Reserve Bank. Borrowers who have taken verifiable and effective steps wherein the loan agreement has been entered into to avail of ECB under the previous dispensation, and not obtained the loan registration number, may apply to the Reserve Bank through their Authorised Dealer.

3. The above changes will come into force with immediate effect.

4. Necessary amendments to the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000 dated May 3, 2000 are being issued separately.

5. AD Category - I banks may bring the contents of this circular to the notice of their constituents and customers concerned.

6. The directions contained in this circular have been issued under sections 10(4) and 11(1) of the Foreign Exchange Management Act, 1999 (42 of 1999) and is without prejudice to permissions / approvals, if any, required under any other law.

FOR YOUR INFORMATION

Announcements

Withdrawal of the Announcement issued by the Council on 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956

Deleted:

In this context, it may be noted that Schedule VI to the Companies Act, 1956, provides, inter alia, that where the original cost and additions and deductions thereto, relate to any fixed asset which has been acquired from a country outside India, and in consequence of a change in the rate of exchange at any time after the acquisition of such asset, there has been an increase or reduction in the liability of the company, as expressed in Indian currency, for making payment towards the whole or a part of the cost of the asset or for repayment of the whole or a part of moneys borrowed by the company from any person, directly or indirectly, in any foreign currency specifically for the purpose of acquiring the assets (being in either case the liability existing immediately before the date on which the change in the rate of exchange takes effect), the amount by which the liability is so increased or reduced during the year, shall be added to, or, as the case may be, deducted from the cost, and the amount arrived at after such addition or deduction shall be taken to be the cost of the fixed asset

Inserted:

1. The Council of the Institute of Chartered Accountants of India had issued an Announcement on 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956', which was published in the November 2003 issue of 'The Chartered Accountant'

2. Subsequent to the issuance of the above Announcement, the Ministry of Company Affairs (now known as the Ministry of Corporate Affairs) issued the Companies (Accounting Standards) Rules, 2006, by way of Notification in the Official Gazette dated 7th December, 2006. As per Rule 3(2) of the said Rules, the Accounting Standards shall come into effect in respect of accounting periods commencing on or after the publication of these accounting standards under the said Notification.

3. AS 11, as published in the above Government Notification, carries a footnote that "it may be noted that the accounting treatment of exchange differences contained in this Standard is required to be followed irrespective of the relevant provisions of Schedule VI to the Companies Act, 1956".

4. In view of the above footnote to AS 11, the Council of the Institute of Chartered Accountants of India has decided at its 269th meeting held on July 18, 2007, to withdraw the Announcement on 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956', published in 'The Chartered Accountant' of November 2003. Accordingly, the accounting treatment of exchange differences contained in AS 11 notified as above is applicable and not the requirements of Schedule VI to the Act, in respect of accounting periods commencing on or after 7th December, 2006.

Due Dates of key compliances pertaining to the month of August-07:

5th Aug.	**Payment of Service Tax & Excise for June**
7th Aug.	**TDS/TCS Payment for June**
10th Aug.	**Excise Return ER1 / ER2 /ER6**
16th Aug.	**PF Contribution for May, Excise payment by SSI**
21st Aug.	**ESIC Payment for June**