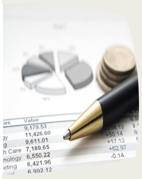
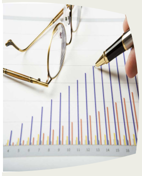




Issue 02 | February 2010

SNK Newsletter

DIRECT TAXES

Judicial pronouncements

BUDGET 2010 – DATES TO NOTE

Type of Budget	*Date*
General Economic Survey	22nd February, 2010
Union Budget 2010-11	26th February, 2010

Cherukuri Ramesh v. ACIT (ITA No. 491/Vizag/2008)

Income from even an isolated transaction of sale of land can be considered as business income of an assessee though not carrying on real estate business

If attendant circumstances of the case, the process of purchase of land, conversion thereof and sale, compel to come to the conclusion that the purchase of land, in itself, was with an intention to sell at a profit in the form of an 'adventure in the nature of trade' and hence though it is an isolated' transaction the income thereon can still be considered as business income.

Mrs. Bakhtawar B. Dubash v. DCIT, Mumbai (ITA No. 403 1/Mum/03) and Mrs. Sudha D. Dubash v. DCIT, Mumbai (ITA No. 4032/Mum/03)

Expenses disallowed in the hands of the Company cannot be added in the taxable income of the Director of the Company

Mrs Bakhtawar & Mrs Sudha, directors of M/s Trans Impex Pvt Ltd ('Company'), had traveled outside India. The travel expenditure on the said foreign tours were partly incurred by the Company and partly by a division of the Company. Issue before the Tribunal was whether expenses on the said foreign tours disallowed in the hands of the Company as non business expenditure for want of evidence to prove genuineness of expenditure incurred as wholly and exclusively for business purpose, can be considered as a taxable benefit in the hands of the taxpayer?

The Mumbai ITAT has held that an amount disallowed in the hands of the Company for corporate tax purposes, should not be taxed again in the hands of its Director as the same amount cannot be taxed twice.

CIT v. Industrial Finance Corporation of India (2010-TIOL-42-HC-DEL-IT)

Difference between forward rate and exchange rate prevailing on the date of entering into forward contracts is fully allowable as deduction

Facts of the case

- The Taxpayer, a financial corporation, is engaged in the business of making loans and advances to various industrial concerns. The Taxpayer raises foreign currency borrowings for the purpose of meeting lending requirements. In order to safeguard loss on account of foreign exchange fluctuation, the Taxpayer enters into forward contracts with banks for the purchase of foreign currency.

- During the tax year 1994-95, the loss of INR 817 million was reckoned based on the difference between the forward rate and the exchange rate prevailing on the date of entering into the forward contracts. In terms of the relevant Accounting Standard issued by

- The Institute of Chartered Accountants of India, the Taxpayer amortized the loss over the life of the forward contracts and recognized INR 146 million as exchange loss in its books of account in tax year 1994-95 and carried forward the balance INR 671 million to be recognized over the balance life of the forward contracts. However, for tax purposes, the Taxpayer claimed deduction for the full amount of INR 817 million.

- The Tax Authority restricted the deduction to INR 146 million and disallowed the balance INR 671 million on the ground that the same pertained to future years.

- Aggrieved by the action of the Tax Authority, the Taxpayer appealed to the first appellate authority who upheld the Tax Authority's order. The Taxpayer appealed further to the Tribunal which ruled in favor of the Taxpayer and allowed deduction for the full amount of INR 671 million. The Tax Authority appealed to the Delhi HC against the Tribunal's ruling.

Ruling of the HC

The HC ruled in favor of the Taxpayer and held that the Taxpayer was entitled to deduction in the tax year 1994-95 for the full amount of INR 817 million on account of the following reasons:

- The Taxpayer entered into forward contracts to safeguard itself against the exchange fluctuation loss on the foreign currency borrowings made for meeting its lending requirements. The forward contracts represent legally binding, enforceable contracts for purchase offoreign currency on a future date at pre-determined rates. The date of purchase and the rate is fixed at the time of entering into the forward contracts itself. Hence, the difference between the forward rate and the exchange rate prevailing on the date of entering into the forward contracts has to be recognized as an expense, as a definite and ascertained liability exists in the year of entering into the forward contracts.

- The determination of the liability is possible at the time of execution of the forward contracts itself and, hence, the loss cannot be regarded as notional or contingent. In terms of the tests laid down in the SC rulings in Calcutta Co. Ltd. and Bharat Earth Movers, the liability was a debt owed by the appellant which accrued on the date of entering into the forward contract itself and, hence, the entire loss was allowable in the year under reference.

- The rulings in Madras Industrial Investment Corpn. Ltd. and Taparia Tools Ltd. are distinguishable since the benefit of the discount allowed on the debentures is obtained over the period of the debentures. The money secured by the issue of debentures is used over a number of years and, hence, there is a continuing benefit to the taxpayers' business over the entire period.

- Ordinarily, revenue expenditure incurred in a particular year should be allowed in the same year and the Tax Authority cannot deny the deduction if the taxpayer claims it in that year. However, in those cases where the taxpayer himself wants to spread the expenditure over a period of ensuing years, it can be allowed only if the principle of matching concept is satisfied, which, in the case of debentures, is fulfilled.

Mrs. Hami Aspi Balsara v. ACIT. [2009-TIOL-789-ITAT-MUM]

Effective date of transfer of shares for capital gains when agreement to transfer of shares is revocable

The Mumbai ITAT has held that where a transfer of shares is made conditional upon fulfillment of certain covenants by the parties, the transfer can be regarded as complete only upon the fulfillment of such covenants. In the facts of the present case where the Taxpayer entered into an agreement to sell the shares that were held, the ITAT held that the transfer by way of extinguishment of rights did not arise on mere execution of the agreement to sell. This was because the Taxpayer had the right to revoke the transaction on non-fulfillment of certain covenants by the buyer of the shares. The ITAT held that it was not relevant that the Taxpayer was restricted from exercising any rights over the shares, post the date of agreement to sell, and the transfer took place only when the sale became irrevocable from the Taxpayer's perspective.

Judicial pronouncements

This ITAT ruling provides guidance that for the purposes of taxation of capital gains under the ITL, the transaction should be completed in a manner that it becomes irrevocable on the part of the taxpayer. The stage of completion of sale is reckoned, having regard to statutory approvals, consents or procedures which are prerequisites for completion of the sale.

DLF Universal vs. DCIT (ITAT Delhi Special Bench)(ITA No. 4986/ Del/2003)

Even introduction of stock-in-trade as capital contribution into firm attracts s. 45(3)

The assessee was engaged in the business of real estate development. It held land as stock in trade with a book value of Rs. 4.4 crs. The said land was introduced at its market value of Rs. 11.50 crs as capital contribution into a new firm. The surplus of Rs. 6.01 crore was credited to the profit and loss account. Relying on Hind Construction 83 ITR 211 (SC), it was claimed that the surplus of Rs. 6.01 crs was not liable to tax as the introduction of an asset into a partnership was not a sale. It was also claimed that s. 45 (3) was applicable only to capital assets and not to stock-in-trade. The AO and the CIT (A) took a contrary view relying on Sunil Siddharthbhai 156 ITR 509 (SC) & McDowell 154 ITR 148 (SC). On appeal by the assessee, HELD by the majority, dismissing the appeal:

In Sunil Siddharthbhai it was held that when a partner introduces his asset into a firm as capital contribution, there is a “transfer” though the gains are not chargeable to tax as the consideration is not determinable. It was clarified that this principle did not apply if the partnership was non-genuine or sham or where the transaction of transferring the personal asset to the partnership firm was a device or ruse to convert personal assets into money while evading tax on capital gains;

Geetanjali Trading vs. ITO (ITAT Mumbai)(ITA No. 5428/Mum/2007)

Right to set-off loss is a “vested right” which is available despite amendment in year of set-off

In AY 2002-03, the assessee suffered a long-term capital loss. U/s 74(1) as it then stood, such loss could be carried forward and set off against all capital gains including short-term capital gains. S. 74 was amended in AY 2003-04 to provide that long-term capital loss could only be set-off against long-term capital gains and not against short-term-capital gain. When the assessee claimed a set-off in AY 2004-05 the question arose whether the amended law should apply or the unamended law. HELD deciding in favour of the assessee:

(i) In Govinddas 103 ITR 123 (SC) it was held that unless the terms of a statute expressly so provide or necessarily require it, retrospective operation should not be given to a statute so as to take away or impair an existing right or create a new obligation or impose a new liability otherwise than as regards matter of procedure. If the enactment is ambiguous in language, which is fairly capable of either interpretation, it ought to be considered as prospective only.

(ii) Applying this principle, the amended s. 74 is applicable to computation of loss under the head “Capital Gains” for AY 2003-04 and onwards. As regards loss of earlier years, the law as it then stood gave a vested right of set off the loss against all capital gains. There is nothing in the amendment which withdraws the said vested right. Consequently, the loss can be set off against short-term capital gains despite the amendment.

CIT vs. Gopal Purohit (Bombay High Court)(ITA No.1121 of 2009)

Shares activity treated as investment in earlier years cannot be treated as business in subsequent years if facts are the same

The assessee was engaged in two different activities of sale and purchase of shares. The first set of transactions involved investment in shares in which the assessee took delivery of the shares. The second set of transactions involved dealing in shares for business purposes. The assessee was accordingly an investor as well as a dealer. The income from investment activity was offered as capital gains while the income from dealing activity was offered as business income. This position was accepted by the AO in the earlier years. In AY 2005-06, the AO took a different view and held that even the shares held on investment account had to be assessed as business income. The Tribunal allowed the assessee’s appeal (see 122 TTJ (Mum) 87). On appeal by the Revenue, HELD dismissing the appeal:

(i) The Tribunal has correctly applied the principle of law in accepting the position that it is open to an assessee to maintain two separate portfolios, one relating to investment in shares and another relating to business activities involving dealing in shares. Delivery based transactions were rightly treated as being in the nature of investment transactions giving rise to capital gains.

(ii) The Tribunal correctly accepted the position that though the principle of res judicata is not attracted, there ought to be uniformity in treatment and consistency when the facts and circumstances are identical. The Tribunal has noted that the assessee has followed a consistent practice in regard to the nature of the activities, the manner of keeping records and the presentation of shares as investment at the end of the year in all the years and there is no justification for a different view being taken by the AO.

(iii) The Tribunal applied the correct principle in holding that while entries in the books of account alone are not conclusive in determining the nature of income, it does have a bearing.

CIT vs. Emptee Poly-Yarn (Supreme Court)(Civil Appeal No.786 of 2010)

Twisting and texturising POY is "manufacture". Department must examine process. Opinion of expert must be considered

The assessee was engaged in twisting and texturising POY and the question arose whether this amounted to 'manufacture' for purposes of s. 80IA. The assessee provided an opinion from Mumbai University which stated that the activity was 'manufacture' and the same was not controverted by the revenue. HELD deciding in favour of the assessee:

(i) Though the Court has repeatedly asked the department to examine the process applicable to the product in question and not to go only by dictionary meanings, the recommendation is not being followed. Even when the assessee gives an opinion on a given process, the Department does not submit any counter opinion.

(ii) Applying the test laid down in Oracle Software India Ltd, as POY simplicitor is not fit for being used in the manufacture of a fabric and it becomes usable only after it undergoes the operation/process which is called as thermo mechanical process which converts POY into texturised yarn, the said process is "manufacture".

CIT vs. Oracle Software India (Supreme Court)(SLP(C) No. 4719/2008)

Copying software onto blank discs is "manufacture" for s. 80-IA

The assessee imported Master Media of software from Oracle Corporation which was duplicated on blank discs, packed and sold in the market. The question arose whether the activity of copying the discs amounted to manufacture or processing of goods for purposes of s. 80IA. HELD, deciding in favour of the assessee:

(i) In interpreting the expression "manufacture or processing of goods", one has to move with the times and bear in mind that technological advancement in computer science makes knowledge as of today obsolete tomorrow. Therefore where the issue arises for determination, the Department should study the actual process undertaken by the assessee to decide whether there is manufacture or processing.

(ii) The term "manufacture" implies a change, but, every change is not a manufacture, despite the fact that every change in an article is the result of a treatment of labour and manipulation. However, this test of manufacture needs to be seen in the context of the process adopted by the assessee for duplication of software. If an operation/ process renders a commodity or article fit for use for which it is otherwise not fit, the operation/ process falls within the meaning of the word "manufacture". Applying this test, as the assessee has undertaken an operation which renders a blank CD fit for use for which it was otherwise not fit, the duplicating process constitutes 'manufacture' u/s 80IA(12)(b).

(iii) The argument of the revenue that since the software on the Master Media and the software on the pre-recorded media is the same, there is no manufacture because the end product is not different from the original product is over-simplified and does not take into account the ground realities of business in modern times. In Tata

Consultancy Services v. State of AP 271 ITR 401 (SC) it was held that a software programme put in media for transferring or marketing is "goods". When one buys a software programme, one buys not the original but a copy. Accordingly, to say that the contents of the original and the copy are the same is not correct.

ACIT v. Shipra Estate Ltd. (ITA Nos. 4628 (Delhi) of 2003)

Deductions u/s 80-IA r.w.s. 80-IB Act - Profits and gains from industrial undertakings, etc., after certain dates/infrastructure undertaking

Assessee was a limited company engaged in buildings construction activities. During relevant assessment years, assessee-company in joint venture with Ghaziabad Development Authority was engaged in business of development and construction of houses of different categories. Assessee-company undertook commencement of construction of 'S' complex which was further sub-divided into six projects. Assessee's case was that develop-ment and construction of four projects of 'S' complex were commenced after 1-10-1998 and, therefore, it was entitled to benefit of tax holiday relief available under section 80-IA(4F)/80-IB(10).

Assessing Officer rejected assessee's claim on following grounds: assessee had purchased land on which proposed construction was to be done prior to 1-10-1998; development authority had sanctioned plan of construction prior to 1-10-1998; assessee had advertised for booking of flats prior to insertion of section 80-IA, i.e., 1-10-1998, and assessee had undertaken earth filling activity of land so purchased for undertaking construction of project prior to 1-10-1998.

It was held that purchase of land and approval of construction plan by development authority might not necessarily lead to inference that development and construction of projects had commenced prior to 1-10-1998. Further, merely getting booking money in advance in respect of housing project whose development and construction were started after 1-10-1998 would not disentitle assessee to benefit of deduction under section 80-IA(4F)/80-IB(10), insofar as crucial condition was commencement of develop-ment and construction of housing project and not receipt of booking amount in advance. Mere act of levelling earth does not amount to construction of housing project within meaning of section 80-IA (4F) and, therefore, said act of assessee could not snatch its deduction which was otherwise available to assessee. In view of aforesaid and having regard to other relevant facts, such as, written construction contracts were entered into by assessee with contractors after specified date, i.e., 1-10-1998 and work orders in case of all four projects were subsequent to 1-10-1998, there was no reason to assume that commencement of development and construction of housing project were prior to 1-10-1998 for purpose of declining claim of deduction under section 80-IA(4F)/80-IB(10). Therefore, Assessing Officer was not justified in rejecting assessee's claim.

Section 263 of the Income-tax Act, 1961 - Revision of orders prejudicial to interest of revenue

It was also held that where acting in accordance with law, Assessing Officer frames an assessment order, same cannot be branded as erroneous simply because according to Commissioner, order should be written more elaborately.

ACIT v. Hotel Blue Moon (Supreme Court) (Civil Appeal No. 1198 of 2010)

Issue of s. 143 (2) notice is mandatory for block assessment proceedings. Disclosed items cannot be assessed in block assessment. Circulars are binding on the revenue.

Chapter XIV-B provides that where a search u/s 132 is conducted, the AO shall determine the undisclosed income for the block period. S. 158 BC (b) provides that in making the block assessment the provisions of s. 143 (2) shall "*so far as may be, apply*". The Supreme Court had to consider whether a block assessment order passed without service of notice on the assessee u/s 143(2) within the prescribed period of time was valid. HELD, deciding in favour of the assessee:

(i) While notice u/s 143 (2) is not necessary if the AO accepts the return as filed, the notice within the prescribed time is mandatory if the AO proposes to make an assessment u/s 158BC r.w.s143 (3). Omission to issue notice u/s 143(2) is not a procedural irregularity and the same is not curable and, the requirement of notice u/s 143(2) cannot be dispensed with. If the intention of the legislature was to exclude the provisions of s. 143 (2), the legislature would have indicated that.

(ii) In Circular No.717 dated 14.8.1995 the CBDT has directed that the AO "*shall proceed to determine the undisclosed income of the block period and the provisions of s. 142, sub-s (2) and (3) of s. 143 and s. 144 shall apply accordingly*". This circular clarifies the requirement of law in respect of service of notice u/s 143 (2). The circular is binding on the department though not on the Court.

(iii) A search is the sine qua non for a block assessment under Ch. XIV-B. A block assessment is in addition to regular assessments proceedings and not in substitution thereof. The scope and ambit of a block assessment is limited to materials unearthed during search and can only be done on the basis of evidence found as a result of search or requisition.

Bhavesh Developers vs. AO (Bombay High Court)(Writ Petition No.2508 of 2009)

Reopening u/s 147 not valid if there is no finding regarding failure to disclose material facts

In AY 2002-2003, the assessee claimed deduction u/s 80-IB (10) of Rs. 3.85 crs which was allowed by the AO vide s. 143 (3) order. The assessment was reopened u/s 147 after the expiry of four years from the end of the assessment year on the ground that the claim for deduction u/s 80IB (10) included ineligible items of other income such 'society deposit', 'stilt parking' and sundry credit balances and that income had thereby escaped assessment. The assessee filed a writ petition to challenge the s. 148 notice. HELD upholding the challenge:

(i) Under the proviso to s. 147, an assessment made u/s 143 (3) can be reopened after the expiry of 4 years from the end of the assessment year only if there is a failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment;

(ii) On facts, the assessee had furnished details of the claim u/s 80IB (10) including the break up of the other income. Even the recorded reasons showed that the inference that the income has escaped assessment was based on the disclosure made by the assessee itself. Further, there was no finding in the recorded reasons that that there was a failure to disclose necessary facts;

(iii) Accordingly, the condition precedent to a valid exercise of the power to reopen the assessment was absent. An exceptional power has been conferred upon the Revenue to reopen an assessment after a lapse of four years and the conditions prescribed by the statute for the exercise of such a power must be strictly fulfilled and in their absence, the exercise of power would not be sustainable in law.

CIT vs. Kelvinator of India (Supreme Court)(Civil Appeal Nos.2009-2011 of 2003)

AO deemed to have applied his mind if facts are on record and reopening u/s 147 on change of opinion is not permissible even within 4 years

In CIT vs. Kelvinator of India Ltd. 256 ITR 1 the Full Bench of the Delhi High Court was considering a case of reopening u/s 147 within 4 years from the end of the assessment year. The Court held that when a regular order of assessment is passed in terms of section 143 (3) of the Act, a presumption can be raised that such an order has been passed on application of mind. It was held that if it be held that an order which has been passed purportedly without application of mind would itself confer jurisdiction upon the Assessing Officer to reopen the proceeding without anything further, the same would amount to giving premium to an authority exercising quasi-judicial function to take benefit of its own wrong. It was held that section 147 of the Act does not postulate conferment of power upon the Assessing Officer to initiate reassessment proceedings upon a mere change of opinion. On appeal by the department to the Supreme Court, HELD dismissing the appeal:

Though the power to reopen under the amended s. 147 is much wider, one needs to give a schematic interpretation to the words "reason to believe" failing which s. 147 would give arbitrary powers to the AO to re-open assessments on the basis of "mere change of opinion", which cannot be per se reason to re-open. One must also keep in mind the conceptual difference between power to review and power to re-assess. The AO has no power to review; he has the power to re-assess. But re-assessment has to be based on fulfillment of certain pre-condition and if the concept of "change of opinion" is removed, as contended on behalf of the Department, then, in the garb of re-opening the assessment, review would take place. One must treat the concept of "change of opinion" as an in-built test to check abuse of power by the AO.

Hence, after 1.4.1989, the AO has power to re-open, provided there is "tangible material" to come to the conclusion that there is escapement of income from assessment. Reasons must have a live link with the formation of the belief. This is supported by Circular No.549 dated 31.10.1989 which clarified that the words "reason to believe" did not mean a change of opinion.

Anil Kumar Bhatia v. ACIT (ITA No. 2660 to 2665/Del/2009)

S.153A does not authorize de novo assessment. Non-pending assessments do not abate. Additions must be confined to search material

S. 153A provides that where a search is initiated u/s 132 the AO shall "assess or reassess the total income of six assessment years immediately preceding the assessment year" relevant to the previous year in which the search is conducted or requisition is made. The 1st Proviso states that the AO shall "assess or reassess the total income in respect of each assessment year falling within such six assessment years" while the 2nd Proviso states that the assessment or reassessment relating to the said six assessment years "*pending*" on the date of initiation of the search under section 132 shall "*abate*". In the assessee's case, search action was initiated and assessments under s. 153A were framed for six assessment years making various additions. The assessee claimed that the additions were not tenable as regular returns had been filed where the particulars relating to the additions had been disclosed and the same had been accepted u/s 143 (1) and also that no material had been found during the search to justify the additions. The revenue claimed that *the effect of the Provisos to s. 153A was that all assessments abate and there had to be a de novo assessment in which the AO was not confined to the material found during the search*. HELD rejecting the claim of the Revenue:

(i) S. 153A does not authorize the making of a de novo assessment. While under the 1st Proviso, the AO is empowered to frame assessment for six years, under the 2nd Proviso, only the assessments which are *pending* on the date of initiation of search *abate*. The effect is that completed assessments do not abate. There can be two assessments for the same assessment year. Assessments which are not pending before the AO on the date of search but are pending before an appellate authority will survive.

(ii) An assessment can be said to be "pending" only if the AO is statutorily required to do something further. If a s. 143 (2) notice has been issued, the assessment is pending. However, the assessment in respect of a return processed u/s 143 (1) is not "pending" because the AO is not required to do anything further about such a return.

(iii) The power given by the 1st Proviso to "assess" income for six assessment years has to be confined to the undisclosed income unearthed during search and cannot include items which are disclosed in the original assessment proceedings.

(iv) On facts, as the returns had been processed u/s 143 (1), the assessments were not "pending" and as no material was found during the search, the additions could not be sustained.

Judicial Pronouncements - International Taxation

Schefenacker Motherson Ltd v. ITO (ITA No. 4459 & 4460/Del/07)

Use of Cash Profit/Sales and Cash Profit/Cost emphasized as an appropriate PLI for use of TNMM

The Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal), held that cash profit on sales "CP/Sales" or cash profit on total cost excluding depreciation "CP/TCdep" can be adopted as an appropriate profit level indicator (PLI) under Transactional Net Margin Method (TNMM),to adjust for material differences in the assets utilized between tested party and comparable companies and thereby enable better comparability analysis.

Global Vantedge Pvt. Ltd. [2010-TIOL-24-ITAT-DEL]

The Delhi Tribunal has held that the total amount of adjustment made, along with the arms length price (ALP) already reported by the Taxpayer, cannot exceed the total amount of revenues earned by the Taxpayer and its associated enterprise (AE) from dealing with third party clients. Further, the Tribunal observed that in undertaking a TP analysis the least complex entity should be selected as the tested party. However, selecting an overseas entity as the tested party may not be appropriate because it is difficult to obtain all relevant facts and data required for undertaking a proper analysis of functions, assets and risks (FAR) and making the requisite adjustments.

Quark Systems Pvt. Ltd. [2010-TIOL-31-ITAT-CHD¬SB]

The SB of the Tribunal has adjudicated on issues regarding the selection of comparable companies. The SB held that if comparable companies did not satisfy the very basic requirements of the FAR analysis then they need to be rejected. The SB observed that if on an analysis of a plain function of services rendered by the comparable party shows that these functions are neither compatible with those of the Taxpayer nor do they belong to the genus to which functions performed by the Taxpayer belong, it would be futile to suggest that merely because the Taxpayer and the comparable company are grouped under the same head in a database, comparability is established.

Perot System TSI (India) Ltd. *v.* DCIT (ITA Nos. 2320 to 2322/ Del/2008)

Notional interest on interest-free loans can be assessed under transfer pricing law

The assessee, an Indian company, advanced interest-free loans to its 100% foreign subsidiaries. The subsidiaries used those funds to make investments in other step-down subsidiaries. On the question whether notional interest on the said loans could be assessed in the hands of the assessee under the transfer pricing provisions of Chapter X, the assessee argued that the said "loans" were in fact "quasi-equity" and made out of commercial expediency. It was also argued that notional income could not be assessed to tax. HELD rejecting both arguments:

(i) The argument that the loans were in reality not loans but were quasi-capital cannot be accepted because the agreements show them to be loans and there is no special feature in the contract to treat them otherwise. There is also no reason why the loans were not contributed as capital if they were actually meant to be a capital contribution;

(ii) The argument that the loans were

given on interest-free terms out of commercial expediency is not acceptable because this was not a case of an ordinary business transaction but was an international transaction between associated enterprises. One had to see whether the transaction was at arms length under the transfer pricing provisions;

(iii) The argument that notional interest income cannot be assessed is not acceptable in the context of transfer pricing. S 92(1) provides that any income arising from an international transaction has to be computed having regard to the arm's length price. S. 92B (1) defines an "international transaction" to mean "a transaction between two or more associated enterprises … in the nature of … lending or borrowing money …" In considering the "arms length" price of a loan, the rate of interest has to be considered and income on account of interest can be attributed;

(iv) The result of the transaction was that the income of the assessee in India would reduce while that of the assessee in Bermuda, a tax haven, would increase. This was a classic case of violation of transfer pricing norms where profits were shifted to tax havens to bring down the aggregate tax incidence of a multi national group;

(v) The Proviso to s. 92C (2) which allows a variation of 5% from the arms length price applies only when "more than one price is determined" and an arithmetic mean is adopted. The TPO had adopted the LIBOR rate of 2.39 and added the arithmetic mean of 'average basis point' charged by other companies which came to 1.64 and worked out the arms length price at LIBOR + 1.64%. As only one LIBOR rate has been applied which has been adjusted for some basis points, it cannot be said that "more one price" has been used so as to attract the Proviso.

RBI's approval does not put a seal of approval on true character of a transaction from perspective of transfer pricing regulation

Lending or borrowing money between two associated enterprises come within the ambit of international transaction and whether the same is at arms length price has to be considered.

ACIT v. IIC Systems (P) Ltd. (ITA Nos. 394 & 395/Hyd/2007)

Agreement between India and USA - Fees for technical service vis-a-vis payment for supply of personnel

Assessee, an Indian subsidiary of a US company, and IBM entered into a contract for providing software personnel for the projects of IBM worldwide. Assessee, in turn, entered into a contract with ACSC of USA for procuring software personnel in USA for the projects of IBM. As per the said arrangement, ACSC procured the required personnel and deployed them on the projects of IBM in USA as and when assessee issued a work order/purchase order on it. Admittedly, the agreement between the assessee and ACSC is only for supply of manpower or technical personnel. Fact that provision of services may require technical input by a person providing the service does not per se mean that technical knowledge or skill is made available to the person purchasing the service. Neither the assessee company nor ACSC is engaged in computer programming activity. Even the developed work did not belong to the assessee company or ACSC. Therefore, payments made to ACSC cannot be treated as 'fees for included service' within the meaning of art. 12(4)(b) of DTAA. Since payments have been made only for supply of manpower for certain number of hours and no technology, skill, experience, technical plan, design, etc. is made available, the payments are not chargeable to tax in India under art. 12(4)(h). Even if the payments constitute fees for technical services under s. 9(I)(vii), assessee company has the option to be governed by the provisions of the DTAA in view of s. 90(2) and thus, the payments made to ACSC are not chargeable to tax in India. When no tax is liable to be paid by the recipient, the provisions of s. 195 are not attracted and the assessee has no obligation to deduct tax at source.

Circulars / Notifications

Circular No. 2/2010, dated 29-1-2010

Section 115WM of the Income-tax Act, 1961 – Income-tax on fringe benefits – Chapter XII-H not to apply after a certain date – Adjustment of advance tax in respect of fringe benefits for assessment year 2010-11 against advance tax

The Finance Act, 2005 introduced a levy namely Fringe Benefit Tax (FBT) on the value of certain fringe benefits as contained in Chapter XII H (Section 115W to 115WI) of Income Tax Act, 1961. By the Finance (No. 2) Act, 2009 a new Section 115WM was inserted to abolish the FBT with effect from Assessment Year (A.Y.) 2010-11. Consequently, benefits given to employees are taxed as perquisites in the hands of employees in terms of amendment to Clause 2 of Section 17 of Income Tax Act. 1961. However, during the current Financial Year 2009-10 some assessees have paid advance tax in respect of fringe benefits for Assessment Year 2010-11. In such cases the Board has decided that any installment of advance tax paid in respect of fringe benefit for A.Y. 2010-11 shall be treated as Advance Tax paid by assessee concerned for A.Y. 2010-11. The assessee can adjust such sum against its advance tax obligation in respect of income for A.Y. 2010-11 or in case of loss to claim such payment as refund as advance tax paid in A.Y. 2010-11.

Press Release No. BSC/BY/GN-16/10 dated January 27, 2010 (Ministry of Finance)

Date for filing ITR-V Form Extended

Central Board of Direct Taxes has decided to extend the time limit for filing ITR-V form relating to income-tax returns filed electronically (without digital signature) on or after 1st April 2009, up to 31st March 2010 or within a period of 120 days from the date of uploading of the electronic return data, whichever is later. The ITR-V form should continue to be sent by ordinary post to Post Bag No.1, Electronic City Post Office, Bengaluru – 560100 (Karnataka). However, in cases where email acknowledgement for ITR-V form is not received by the taxpayer from the CPC Bengaluru, the taxpayer may send another duly signed ITR-V form by speed post to Centralized Processing Centre, Electronic City Post Office, Bengaluru, Karnataka – 560100.

This has been done in relaxation of the stipulation in Circular No. 3/2009 dated 21.05.2009 which allows taxpayers who file their income tax returns in electronic form without digital signature to submit their ITR-V form duly verified and signed, within a period of 30 days thereafter to Post Bag No.1, Electronic City Post Office, Bengaluru, Karnataka-560100, by ordinary post.

The relaxation has been made following requests from taxpayers that, as a one-time measure, the time limit for filing of ITR-V form may be extended to 31st March 2010 and that alternative modes of submission of ITR-V form may also be provided in cases where an ITR-V form has not been received at CPC, Bengaluru by ordinary post.

INDIRECT TAXES

Circulars / Notifications

Circular No. 120/01/2010-ST dated 19th January, 2010

Circular is issued by CBEC with regard to Problems faced by exporters in availing refund of excess credit. Please click on the following link to view the contents of the circular.

http://www.servicetax.gov.in/st-cirmainpg.htm

OTHER LAWS

OTHERS

Mandatory application of Cost Accounting Standards, w.e.f. 1st April 2010

The Council of the ICWAI at its 251st Meeting held on 12-13 February 2009 and 258th Meeting held on 14th December 2009 decided as below:

Mandatory application of Cost Accounting Standards

"RESOLVED THAT the following Cost Accounting Standards

CAS 1: Classifications of Costs

CAS 2: Capacity Determination

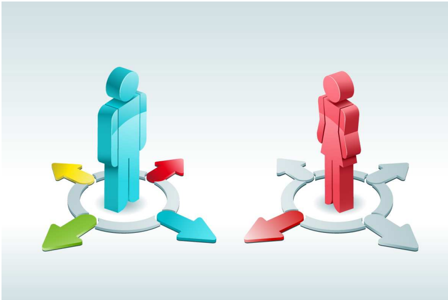
CAS 3: Overheads

CAS 4: Cost of Production for Captive Consumption

CAS 5: Determination of Average (Equalized) Cost of Transportation

CAS 6: Material Cost

In case the cost accountant is of the opinion that the aforesaid standards have not been complied with for the preparation of the Cost Statements, it shall be his duty to make a suitable disclosure/qualification in his audit report/ certificate".



Press Release No. KKP/ska dated January 22, 2010 (Press Information Bureau, Government of India)

Two separate sets of accounting standards u/s 211(3c) of the Companies Act agreed upon by the core group for convergence of Indian Accounting Standards with IFRS

For Banking and Insurance Companies there will be separate roadmap

The Core Group, constituted by the Ministry of Corporate Affairs for convergence of Indian Accounting Standards with International Financial Reporting Standards (IFRS) from April, 2011, that held its meeting on 11th January 2010 agreed that in view of the roadmap for achieving convergence, there will be two separate sets of Accounting Standards u/s Section 211(3C) of the Companies Act, 1956.

First set would comprise of the Indian Accounting Standards which are converged with the IFRSs which shall be applicable to the specified class of companies. The second set would comprise of the existing Indian Accounting Standards and would be applicable to other companies, including Small and Medium Companies (SMCs).

The first set of Accounting Standards (i.e. converged accounting standards) will be applied to specified class of companies in phases:

(a) **Phase-I**:- The following categories of companies will convert their opening balance sheets as at 1st April, 2011, if the financial year commences on or after 1st April, 2011 in compliance with the notified accounting standards which are convergent with IFRS. These companies are:-

- Companies which are part of NSE – Nifty 50
- Companies which are part of BSE - Sensex 30
- Companies whose shares or other securities are listed on stock exchanges outside India
- Companies, whether listed or not, which have a net worth in excess of Rs.1,000 crores.

(b) **Phase-II** :- The companies, whether listed or not, having a net worth exceeding Rs. 500 crores but not exceeding Rs. 1,000 crores will convert their opening balance sheet as at 1st April, 2013, if the financial year commences on or after 1st April, 2013 in compliance with the notified accounting standards which are convergent with IFRS.

(c) **Phase-III** :- Listed companies which have a net worth of Rs. 500 crores or less will convert their opening balance sheet as at 1st April, 2014, if the financial year commences on or after 1st April, 2014, whichever is later, in compliance with the notified accounting standards which are convergent with IFRS.

When the accounting year ends on a date other than 31st March, the conversion of the opening Balance Sheet will be made in relation to the first Balance Sheet which is made on a date after 31st March.

Companies which fall in the following categories will not be required to follow the notified accounting standards which are converged with the IFRS (though they may voluntarily opt to do so) but need to follow only the notified accounting standards which are not converged with the IFRS. These companies are: -

(a) Non-listed companies which have a net worth of Rs. 500 crores or less and whose shares or other securities are not listed on Stock Exchanges outside India.

(b) Small and Medium Companies (SMCs).

Separate roadmap for banking and insurance companies will be submitted by the Sub-Group I in consultation with the concerned regulators by 28th February, 2010.

The draft of the Companies (Amendment) Bill, proposing for changes to the Companies Act, 1956 will be prepared by February, 2010 incorporating the recommendation of Sub-Group 1 Report.

Revised Schedule VI to the Companies Act, 1956 according to the converged Accounting Standards has been submitted by the ICAI to NACAS which, after review, will submit to the Ministry by 31st January, 2010. Amendments to Schedule XIV will also be made in a time bound manner.

In respect of the converged Accounting Standards, the Chairman of the Accounting Standards Board of ICAI will submit the converged version of Accounting Standards to NACAS from time to time for recommendations and onward submission to Ministry. However, convergence of all the accounting standards will be completed by ICAI by 31st March, 2010and NACAS will submit its recommendations to the Ministry by 30th April 2010.

Press Release No. BY/GN-6/10 Dated January 15, 2010 (Press Information Bureau, Government of India)

Government signs revised DTAA with Finland

A revised Agreement and Protocol between India and Finland for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (DTAA) was signed by Sh. S.S.N.Moorthy, Chairman, CBDT on behalf of Government of India and Ms Terhi Hakala, the Ambassador of Finland to India, on behalf of Government of Finland, here today.

As per the revised Agreement, withholding tax rates have been reduced on dividends from 15 percent to 10 percent, and on royalties and fees for technical services from 15 or 10 percent to a uniform rate of 10 percent. Lowering of withholding tax will promote greater investments, flow of technology and technical services between the two countries.

The revised Agreement also expands the ambit of Article concerning Exchange of Information to provide effective exchange of information in line with current international standards. The Article inter-alia provides that a Contracting State shall not deny furnishing of the requested information solely on the ground that it does not have any domestic interest in that information or such information is held by a bank etc. An Article for Limitation of Benefits to the residents of the contracting countries has also been included to prevent misuse of the DTAA.

Other features of the revised Agreement are:-

(a) Provisions regarding Service PE has been included in the Article concerning PE.

(b) Paragraph 2 to Article 9 has been included to increase the scope for relieving double taxation through recourse to Mutual Agreement Procedure (MAP).

(c) A new Article on assistance in collection of taxes has been added to ensure assistance in collection of taxes when such taxes are due under the domestic laws and regulation.

(d) The time test for Independent Personal Service has been extended from 90 days or more in the relevant fiscal year to 183 days or more in any period of 12 months commencing or ending in the fiscal year concerned.

The revised DTAA will enter into force after completion of internal processes in both the countries.

NBFC not under the purview of the Money Laundering Act: Gujarat HC

An attempt by the state government to regulate non-banking financial companies (NBFCs) operating in the state failed when justice Jayant Patel of the Gujarat high court ruled that NBFCs can't be put under the purview of the Money laundering act (ML Act).

The judgment is significant in the present scenario as scores of NBFCs in the state and thousands of people are getting advances through such companies regularly. The NBFCs were irked when the registrars of the co-operative department had issued them notices in 2009.

The registrars, by issuing notices, called upon the NBFCs to produce the accounts and documents for verification so that they could check whether the provisions of the ML Act were being complied with, failing which fines and the other punishment could were initiated against them under the act.

Four companies, Sundaram Finance, Indiabulls financial services limited, GE Money financial services limited and Bussan Auto finance India limited, had challenged the notices before the high court. The ML Act was passed by the state government in 1967 essentially for the purpose of regulating transaction of money lending. It enables the state government to control the rate of interest.

The companies contended that the ML act, which is state law, cannot be imposed on them as they are directly governed by the rules stipulated by the Reserve Bank of India (RBI). The notice by the state government overlaps the jurisdiction of central laws under which the RBI framed laws for the NBFs.

However, the state government said, RBI has not issued any instruction to control the chargeability of rate of interest in the transaction of loan by NBFCs, whereas the state under ML Act, has for all moneylenders prescribed the rate of interest.

If this court holds that the provisions of the ML Act would not apply to companies like NBFC, they would be at liberty to charge exorbitant rates of interest.

Shivshahi Punarvasan Prakalp vs. UOI (Bombay High Court)(Writ Petition No.2270 of 2009)

State Govt. PSUs do not need COD approval

The assessee is a State Govt. undertaking. Its appeal was dismissed by the Tribunal on the ground that the approval of the Committee on Disputes ("COD") had not been obtained. In a writ petition filed by the assessee, the Additional Solicitor General appearing for the revenue stated that it was not the contention of the revenue that COD approval was required for appeals before the Tribunal in Income-tax matters. It was pointed out that though in ONGC vs. CIDCO 2007 (7) SCC 39, the Supreme Court had directed the formation of a Committee to sort out differences between the Central Government and State Government entities, and a Committee would be constituted by the UOI to look into disputes on a case to case, this was not necessary in income-tax matters. Accordingly, the order of the Tribunal was set-aside for a decision on the merits.

Southern Technologies Ltd vs. JCIT (Supreme Court)(Civil Appeal No. 1337/2003)

Provisions for NPA as per RBI Norms by NBFCs is not deductible

The assessee, a NBFC, made a 'Provision for NPA' in terms of the RBI Directions 1998. It claimed a deduction for the said provision u/s 36 (1)(vii) on the ground that as it was debited to the P&L Account and reduced the profits, it was a 'write off'. In the alternative, it was claimed that there was a diminution in the value of its assets for which a deduction u/s 37 as a trading loss was eligible. It was also claimed that the RBI Directions overrode the I. T. Act. The Tribunal allowed the claim but the High Court rejected it. On appeal, HELD dismissing the claim:

(i) The RBI Directions issued u/s 45JA of the RBI Act provide that anticipated losses must be taken into account but expected income need not be taken note of. This is for ensuring that NBFCs state true and correct profits without projecting inflated profits. These are prudential norms or disclosure norms but have nothing to do with the computation or taxability of the provisions for NPA under the IT Act. Further though the RBI Directions deviate from the accounting practice as provided in the Companies Act, they do not override the provisions of the IT Act. The RBI Directions 1998 and the IT Act operate in different fields.

(ii) The "Provision for NPA" made in terms of the RBI Directions does not constitute expense for purposes of s. 36(1)(vii). The said Provision is for presentation purposes and in that sense it is notional.

(iv) The argument that a provision for NPA under commercial accounting is not "income" hence on the basis of "Real Income Theory" it cannot be added back has no merit. Though profits have to be computed on commercial principles and on real income basis, this is subject to the provisions of the Act. A provision for NPA is only a notional expense. Further, under the Expl to s. 36(1)(vii) a provision for doubtful debt is not allowable. For the same reason, deduction can also not be claimed u/s 37 (1).

(v) The argument of the NBFCs that the non-grant of benefits u/ss 36 (1)(viia) & 43D to NBFCs and confining such benefits to banks, SFCs, HFCs violates Articles 14 & 19 of the Constitution has no merit. As regards Art 14, the business operations of NBFCs and banks are quite different and they satisfy the test of "rational and intelligible differentia" having nexus with the object sought to be achieved. As regards Art 19 (1), keeping in mind the important role assigned to banks in the economy and the fact that NBFCs are vulnerable to economic and financial uncertainties, the restriction placed on NBFC by not giving them the benefit of deduction satisfies the principle of "reasonable justification". Further, laws relating to economic activities should be viewed with greater latitude than other laws.

Due Dates of key compliances pertaining to the month of February 2010:

5th Feb.	***Payment of Service Tax & Excise duty for January***
6th Feb.	***Payment of Excise duty paid electronically through internet banking***
7th Feb.	***TDS/TCS Payment for January***
10th Feb.	***Excise Return ER1 / ER2 /ER6***
15th Feb,	***PF Contribution for January, Excise payment by SSI***
21st Feb.	***ESIC Payment for January***