Volume 3
SEPTEMBER 2012

gFLASH

With Knowledge ....

.... you cannot NOT Grow

G.P. AGRAWAL & CO.
CHARTERED ACCOUNTANTS
www.gpaco.net

EDITOR'S note

Yet another month, yet another issue….

The support of our readers have encouraged us to expand the scope of **G FLASH.** We introduce our **Finance** segment from the current issue.

Your response on the same will be appreciated.

I extend my heartfelt thanks to all our readers and our writers for making this a success.

As each month passes by, the circumference of our scope expands as we continuously strive to keep it growing.

As the magnitude of Indian and International laws grow, so does the need for regular updations.

I, along with the entire team of **G Flash,** strive to provide a ready platform for such purpose.

contents

The West Bengal Value Added Tax Act, 2003

Relief to traders

Manoj Agrawal

The West Bengal Value Added Tax Act, 2003, u/s 16(3), provides that a specified Class of Dealers, namely traders, may pay Vat on a compounded rate of 1% on their Turnover.

The conditions for eligibility for the relief are -

1. The Gross Sales do not exceed Rs. 50,00,000 in a financial year;
2. Rate of Tax shall be flat @1% on the entire sales up to Rs. 50,00,000;
3. The dealer must be a registered dealer;
4. The Dealer shall not be entitled to issue Tax Invoices; and
5. In the event of the Turnover exceeding Rs. 50, 00, 000 in a Year, the dealer's eligibility for the relief shall end and he shall be required from the very next month to pay Vat as the normal dealer has to pay.

The following classes of dealers are not covered under the said section:

o An Importer o A manufacturer o A dealer engaged in works contract o A dealer dealing in Tea purchased and or sold through auctions o A dealers engaged in transfer of goods otherwise than by way of sale within or outside the state o A dealer who sells interstate o A dealer engaged in import or export of goods o A dealer selling goods received under Branch Transfers.

from the desk of our chairman and founder partner

Greetings to all readers.

This issue of G Flash is aimed to provide an insight into the current revolutions in the ever dynamic corporate sector of India.

Starting from the previous year, the corporate sector of Indian economy has commenced its stride towards globalisation which is evident from enactment of various statutory provisions aiming towards this goal.

Our team has put together articles which may be of relevance to our readers in understanding these changing dynamics.

G.P. Agrawal
Founder Partner
G.P. Agrawal & Co.

G.P. AGRAWAL & CO.

CHARTERED ACCOUNTANTS

www.gpaco.net
mail@gpaco.net

KOLKATA

7A, KIRAN SHANKAR RAY ROAD
JEETENDRA CHAMBERS
2ND FLOOR
KOLKATA 700001

PH: (033) 22483941/8338
FAX: (033) 22486814
Mail: mail@gpaco.net

MUMBAI

245, KUBER COMPLEX
NEW LINK ROAD
ANDHERI (W)
MUMBAI 400053

PH: (022) 26730167
(022) 40107907
Mail: mumbai@gpaco.net

NEW DELHI

252A, VIJAY TOWERS
SHAHPUR JAT
NEW DELHI 110049

PH: (011) 26491374
FAX: (011) 26496932
Mail: maildel@gpaco.net

RELATIONSHIPS THAT DRIVE THE MARKET

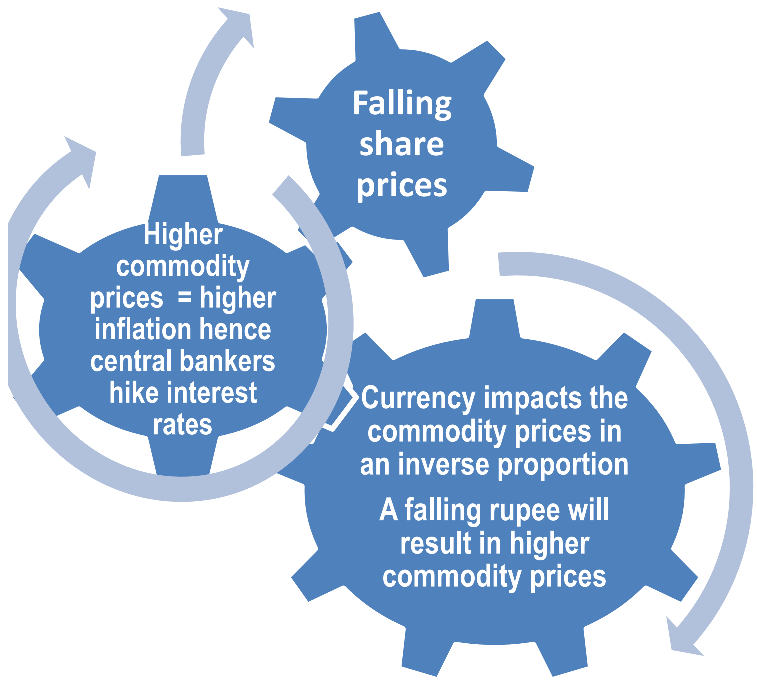
MANISH PAREEK

Relationships matter in every walk of life, and when it comes to the world of finance they become precious. We often hear people talking about the impact of growing inflation or falling interest rates on the stock market. Some of these key market relationships have caught my attention. These relationships are not just applicable today but have been applicable throughout. They have a well documented performance history of over 200 years. This article concentrates upon such relations and their applications in deriving returns.
There are four important asset classes i.e.

- Stocks,
- Bonds,
- Commodity, and
- Currency.

The relationship that exists between these markets is known as the inter market relationship. **The basic principal of inter market analysis is that all markets are related and what happens in one market has an effect on another.**
Market participants have long understood these relationships but as a group they have largely confined themselves to an individual sector or segment of the market, especially the fundamental analyst who tracks an individual sector or industry. The flow of information in the market is so big that the only way out of this whirlpool is to focus sensibly on limited information.

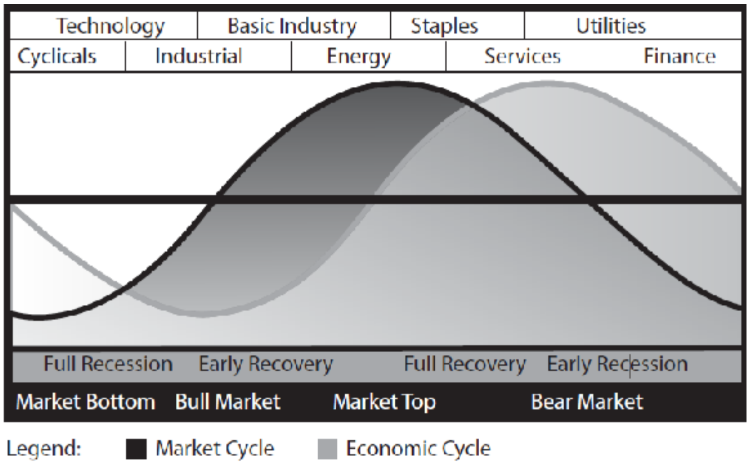
The easy way of understanding these relationships is to consider them as a cycle or a chain reaction. Rising interest rates have historically been bad for stocks and are affected by the direction of commodity prices. Rising commodity prices result in rising inflation, which puts upward pressure on interest rates. Commodity prices and interest rates are influenced by the direction of a country's currency. A falling rupee will result in higher commodity prices (as we observe these phenomena in Oil prices). This boost in commodity prices results in higher inflation that puts pressure on central bankers to raise interest rates, which has a negative impact on the share prices (Share prices are the present value of future cash flows, higher discount rate results in lower present value hence lower stock price).



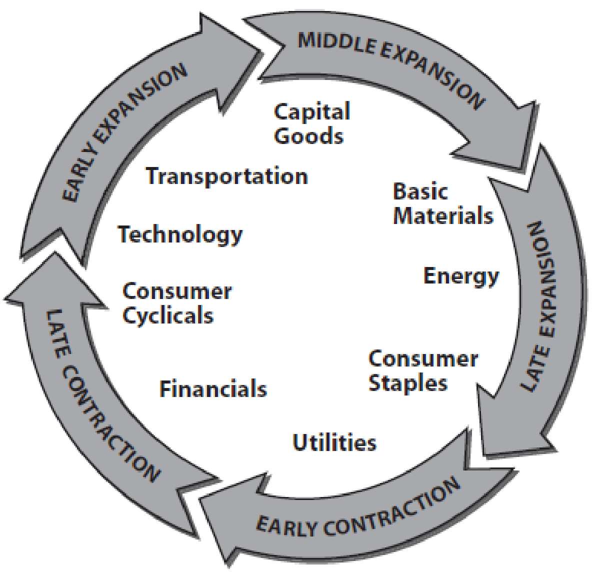
The given figure shows that stock market cycle is a leading indicator of the economic cycle. This is because the markets always anticipate in advance what is going to be the state of the economy in future. Stock markets in India peaked in the latter half of October, 2010 where as the GDP started declining from the second quarter of 2011.

STATE OF ECONOMIC CYCLE VIS. A VIS. ASSET CLASSES

Inter market analysis explains how different asset classes perform in different stages of the economic cycle thereby helping the investors to decide where exactly to invest their capital for optimum returns.

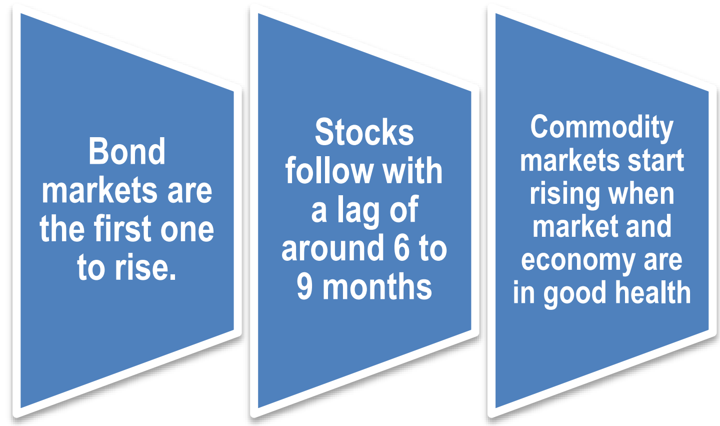


The figure below shows how the different sectors perform in different stages of the business cycle. In our analysis it can be seen that the Indian economy is in the stage of early expansion. As usual the technology companies performed really well in this stage and the capital goods sector are consolidating or forming the base to participate in the next phase of economic expansion.



ROLE OF DIVERSIFICATION

All this is acceptable but we are missing the golden word uttered by everyone in the market place i.e. Diversification. The inter market principles not only tell us which sector of the market should we invest but it also tells us which asset class we should invest in. The key lies in three letters **BSC** where B stands for Bonds, S for stock, and C for commodities.



In the market cycle, Bond markets are the first one to rise. Stocks follow with a lag of around 6 to 9 months. And only when everything is fine in the market and the economy is in good health, commodity market in general start rising and they continue to rise as we approach slowdown or even recession.

Understanding the inter market relationship is important. Even the strongest advocate of diversification will accept that major markets throughout the world rise and fall together. This is what happened in 1987, 2001, and most recently in 2007. Hence in extreme environment when the global markets become more correlated, even international diversification is of little help. What we need is a strong understanding of how to switch between the asset classes.

These cues are always present in the market and help us spot when to shift from paper assets to real assets and back again. Now listening to what these principles are telling us about the Indian market, at the moment, we need to focus on the Bond yield and the stock market. The benchmark bond yield in India peaked on mid of November the previous year. As seen historically the stock markets should turn after six months since the bond yield peak. We saw the bottom of Nifty in the second week of June this year near 4800. The markets gave 12% return since then, which is good for a three month period. As we see the economic cycle turning, and the bond yield still falling it can be confidently said that the markets have miles to go before they sleep.

Binding nature of the decisions of the High Courts

(Refer Kanel Oil & exports Ind. Ltd. vs. JCIT (ITAT Ahmedabad Third Member)

CA. Neha Popat

The decision of the Hon'ble Supreme Court becomes the law of land under Article 144 of the Constitution of India. However, the binding nature of decision of the Hon'ble High Courts is little complex.

First and foremost, it may be noted that High Court is above the Tribunal in the judicial hierarchy and so the judgment of a High Court would prevail over that of the ITAT. However, conflicts may arise in situations where a contrary Special Bench decision exists.

Applicability of decisions of the High Courts including exceptions is discussed below:

Decision of the jurisdictional High Court

Article 227 of the Constitution of India states that the Jurisdictional High Court has superintendence over all the tribunals and officers in its jurisdiction. All the officers [A.O. CITs, CIT(A) etc.] are bound by the decisions pronounced by the Hon'ble High Court of the Jurisdiction. Thus, the order of the High Court prevails even if a contrary Special Bench Decision exists. If an officer does not follow the decision of the High Court before making addition in the hands of the assessee, then a WRIT may be filed against the officer for contempt of court.

Decision of the Non- Jurisdictional High Court vis-a-vis decision of the Special Bench

In case of the decision of a Non-jurisdictional High Court -

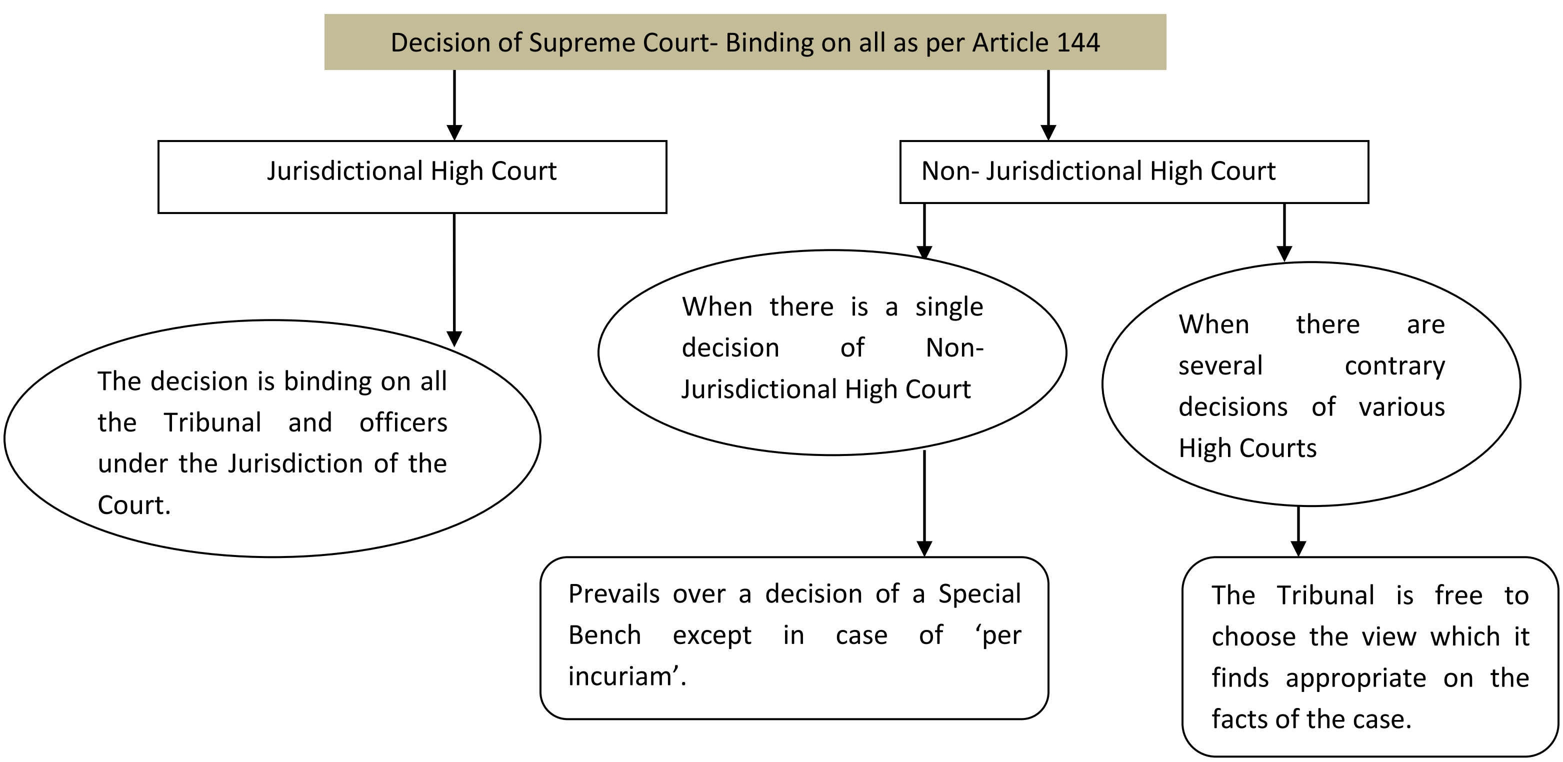
1. **Where there exists a single/lone decision of the Non-jurisdictional High Court and a contrary decision of the Special Bench**

The decision of the High shall prevail subject to 'per incuriam' i.e. when a decision is rendered by the High Court without having been informed about certain statutory provisions or binding precedents that are directly relevant, such decision of the non – jurisdictional High Court shall not prevail upon the decision of the Special Bench.

2. **In cases where exists a large number of contrary views of non-jurisdictional High Courts**

The Tribunal is free to choose that view which it finds appropriate on the facts of the case and in certain circumstances the view which is favorable to the taxpayer may be adopted.

To summarize:



INPUT SERVICE DISTRIBUTOR – A COMPLETE REFERENCER

A manufacturer or a service provider may have offices at various place(s) and the services received in these offices eventually will be directly/indirectly used for manufacture of final product or provision of output service.
Following this logic, CENVAT credit of input services so received and paid for, at these offices can be availed. For the purpose of availing such CENVAT Credit, such offices have to get registered as **'Input Service Distributor'**. If such registration is obtained, the registered offices can issue invoices on the manufacturer or producer or service provider.

An **'Input Service Distributor'**, as per Rule 2(m) of the CENVAT Credit Rules, 2004, means

(a) An office of the manufacturer or producer of final products or provider of output service,
(b) Such office receives invoices issued under Rule 4A of the Service Tax Rules, 1994 towards purchases of input services, and
(c) Such office issues invoice, bill or, as the case may be, Challan for the purposes of distributing the credit of service tax paid on the said services to such manufacturer or producer or provider, as the case may be.

A point to be noted here is that if a manufacturer / service provider has a head office and only one manufacturing unit / service providing unit, he can't get registered as an input service distributor. Thus, to be eligible to get registered as in input service distributor, the manufacturer / service provider must have more than 1 manufacturing unit / service providing unit.

Distribution of credit on inputs by an office or other premises of an output service provider:

As per Rule 7A of the CENVAT Credit Rules, 2004, credit on inputs or capital goods received is allowed to an output service provider, on the basis on an invoice, bill or Challan, issued by an office or premises of the said output service provider, receiving invoices issued in terms of Central Excise Rules, 2002, towards purchase of the said inputs or capital goods.

Manner of Distribution of Credit:

Till 31st March, 2012, Rule 7 of the said rules provided the following manner to be adopted by the input service distributor for the purpose of distribution of CENVAT credit in respect of the service tax paid on the input service to its manufacturing units or units providing output service.

(a) As per Rule 7(a) of the said rules, the amount of credit distributed by the distributor could not be more than the service tax paid i.e. if Input Service Distributor X has paid service tax amounting to Rs. 10,000/-, it can distribute credit up to a maximum of Rs. 10,000/-.
(b) As per Rule 7(b) of the said rules, if an input service is attributable to service used in a unit exclusively engaged in manufacture of exempted goods or provision of exempted services, credit in respect of service tax paid on such service shall not be distributed.

Till the said date, distribution of credit could be made in any ratio as there was no provision for distribution on proportionate basis under the said Rule 7. The distributor could at his discretion, distribute entire credit to only one of its units even though the services were used for two or more units. This position was confirmed by the Tribunal, M/s. TVS Motor Company Ltd. v. CCE, Chennai (2011), ECOF Industries Pvt. Ltd. v. CCE, Bangalore (2009) CESTAT-Bang. and referred in the case of M/s. Asian Paints Ltd. vs. CCE, Pondicherry (2010).

Effective from 1st April, 2012, the erstwhile Rule 7 of the CENVAT Credit Rules, 2004, providing the manner of distribution of credit by input service distributor, has been substituted by a new Rule 7, vide Ntfn. No. 18/2012-CX(NT) dated 17-03-2012 to insert the following two additional conditions, in addition to those aforementioned –

(a) The credit of service tax attributable to service used wholly in a unit has to be distributed only to that unit; and
(b) The credit of service tax attributable to service used in more than one unit shall be distributed prorata on the basis of the **turnover during the relevant period** of the concerned unit to the sum total of the turnover of all the units to which the service relates during the same period i.e. based on following formula –

$$\frac{\text{Turnover of the Concerned Unit} \quad \text{X} \quad \text{Credit of Service Tax (as aforesaid)}}{\text{Sum Total of the Turnover of all the Units to which the service relates}}$$

Relevant Period shall be the month previous to the month during which the CENVAT credit is distributed. However, in case if any of its unit pays tax or duty on quarterly basis as provided in Rule 6 of Service Tax Rules, 1994 or Rule 8 of Central Excise Rules, 2002 then the relevant period shall be the quarter previous to the quarter during which the CENVAT credit is distributed.

For example, take the case of X Ltd. having 2 manufacturing units and registered as an input service distributor. It is liable to pay service tax on monthly basis in terms of the said Rule 6. Assuming it is eligible to claim small scale industries exemption, it is liable to pay excise duty on quarterly basis under Rule 8 of Central Excise Rules, 2002. Thus, for X Ltd relevant period shall be the quarter previous to the quarter during which the CENVAT credit is distributed.
Further, in case of an assessee who does not have any total turnover in the said period, the input service distributor shall distribute any credit only after the end of such relevant period wherein the total turnover of its units is available.
Thus, taking the case of Y Ltd. which is liable to pay service tax on monthly basis, if for distribution of credit during the month of December' 2012 it is found that there was no turnover in November' 2012, the credit can't be distributed during December' 2012 and shall be distributed only after the end of the month wherein the total turnover of its units is available.

As per Explanations to the said rule, for the purposes of this rule -

i) **"Unit"** includes the premises of a provider of output service and the premises of a manufacturer including the factory, whether registered or otherwise.
ii) **"Total turnover"** means sum total of the value of –
  (a) All excisable goods cleared during the relevant period including exempted goods, dutiable goods and excisable goods exported;
  (b) Export turnover of services and the value of all other services, during the relevant period; and
  (c) All inputs removed as such under Rule 3(5) of the CENVAT Credit Rules, 2004 against an invoice, during the period for which the claim is filed.

Returns:

As per Rule 9(10) of the CENVAT Credit Rules, 2004, an input service distributor is required to submit half yearly returns in prescribed form, within last day of the month following the half year to which it relates. As per Rule 9(11), the said return may be revised to correct a mistake or omission within 60 days from the date of submission of original return.

Document required for distribution and availment of Credit:

As per Rule 9(1)(g) of the said rules, for the purpose of availment of credit distributed by an input service distributor, invoice, bill or Challan issued by such input service distributor under Rule 4A of the Service Tax Rules, 1994 is an eligible document. The requirements of rule 4A (2) of the Service Tax Rules, 1994 are as follows:

a) The document should be serially numbered.
b) It shall be signed by the distributor or a person authorized by him in this regard.
c) Separate documents should be issued for each recipient of credit distributed.
d) Invoice should contain the following details:
   i) Name and address of the input service distributor,
   ii) Name and address of the recipient of credit distributed,
   iii) Name, address and registration number of the person providing input services,
   iv) Serial number and date of invoice, bill or Challan issued by service provider under rule 4A(1). □□

ESTABLISHMENT OF LIAISON/ PROJECT/ BRANCH OFFICE IN INDIA BY FOREIGN ENTITIES

CA. Pradeep Samal

In the present global economy, India continues to be a large player along with other BRICS countries owing to availability of intellectual capital along with the low cost of labour. From the time the East India Company established its business in India, it remains an attractive destination and will continue to be so in the near future. A lot of foreign companies have their business interest in India for which they open **branch/liaison/project offices** in India to protect their interest in India and/or to monitor their projects.

In this, article we will be discussing the regulatory requirements for opening a **branch/liaison/project office** in India by foreign entities which is regulated in terms of **Section 6(6) of Foreign Exchange Management Act, 1999 (FEMA) read with Notification No. FEMA 22/ 2000-RB dated May 3, 2000** as amended from time to time.

A. Application/Permission:

A foreign company desirous of opening a **Branch Office (BO) or Project office (PO)** in India, is required to take permission from the RBI under the provisions of FEMA, 1999.

They have to apply to RBI in Form FNC through a designated AD Category-1 bank and will be considered by the RBI under the following two routes:

- **Reserve Bank Route** — Where principal business of the foreign entity falls under sectors where 100 per cent (FDI) is permissible under the automatic route.

- **Government Route** — Where principal business of the foreign entity falls under the sectors where 100 per cent FDI is not permissible under the automatic route.

Applications from entities falling under this category and those from Non - Government Organisations / Non - Profit Organisations / Government Bodies / Departments are considered by the Reserve Bank in consultation with the Ministry of Finance, Government of India.

B. Documents Required:

1) Form FNC - 1
2) Copy of letter of award of the contract
3) English version of Certificate of incorporation , MOA , AOA duly attested by Indian Embassy/ notary public of the parent company
4) Audited accounts for last three years duly notarized by notary public of the country of the parent company
5) Banks report of the company from the host country / country of residence showing number of years the applicant has had banking relationship with that bank, with bank's phone no.
6) Name and address of the company
7) Capital structure of the company , - authorised and paid up
8) Free reserve, Intangible assets.
9) Main object of the company
10) Address of any other project office, if any
11) Indian project details , amount , project period
12) Expected number of employee and how many are foreigners along with any other document as may be prescribed from time to time.

Applicants who do not satisfy the eligibility criteria and are subsidiaries of other companies can submit a Letter of Comfort from their parent company subject to the condition that the parent company satisfies the eligibility criteria as prescribed above.

The BO/Liaison Office(LO) will be allotted a Unique Identification Number(UIN) after approval and they shall have to obtain PAN from the IT Authorities in India for the BO/LO.

C. Liaison Office(LO)

A LO (also known as Representative Office) can only undertake liaison activities, i.e. it can act as a channel of communication between Head Office abroad and parties in India. They are not permitted to undertake any business activity and cannot earn any income in India. Permission to set up such offices is initially granted for a period of 3 years and this may be extended from time to time by an AD Category I bank. Expenses of such offices are to be met entirely through inward remittances of foreign exchange from the Head Office outside India.

A Liaison Office can undertake the following activities in India:

i. Representing in India the parent company / group companies.
ii. Promoting export / import from / to India.
iii. Promoting technical/financial collaborations between parent/group companies and companies in India.
iv. Acting as a communication channel between the parent company and Indian companies.

D. Liaison Office of Foreign Insurance Companies/ Banks:

Foreign Insurance companies can establish Liaison Offices in India only after obtaining approval from the Insurance Regulatory and Development Authority (IRDA).

Foreign banks can establish Liaison Offices in India only after obtaining approval from the Department of Banking Operations and Development (DBOD), Reserve Bank of India (RBI).

E. Branch Office:

Permissible Activities:

Companies incorporated outside India and engaged in manufacturing or trading activities are allowed to set up Branch Offices in India with specific approval of the RBI. Such Branch Offices are permitted to represent the parent / group companies and undertake the following activities in India:

i. Export / Import of goods.
ii. Rendering professional or consultancy services.
iii. Carrying out research work, in areas in which the parent company is engaged.
iv. Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
v. Representing the parent company in India and acting as buying / selling agent in India.
vi. Rendering services in information technology and development of software in India.
vii. Rendering technical support to the products supplied by parent/group companies.
viii. Foreign airline / shipping company.

Normally, the Branch Office should be engaged in the activity in which the parent company is engaged. Retail trading activities of any nature is not allowed for a Branch Office in India. A Branch Office is not allowed to carry out manufacturing or processing activities in India, directly or indirectly. Profits earned by the Branch Offices are freely remittable from India, subject to payment of applicable taxes.

F. Branch Office in Special Economic Zones (SEZs)

RBI has given general permission to foreign companies for establishing branch/unit in Special Economic Zones (SEZs) to undertake manufacturing and service activities subject to the following conditions:

i. Such units are functioning in those sectors where 100 per cent FDI is permitted.
ii. Such units comply with part XI of the Companies Act,1956 (Section 592 to 602).
iii. Such units function on a stand-alone basis.

In the event of winding-up of business and for remittance of winding-up proceeds, the branch shall approach an Authorized Dealer Category-I Bank with the documents as mentioned in "Closure of Office" except for the copy of RBI approval.

G. Branch of a Foreign Bank:

A foreign bank which intends to open branches in India need to obtain approval under the Banking Regulation Act, 1949. They are not required to take separate approval under FEMA for opening branches.

Additional Activities: Additional activities may be permitted by the RBI to the existing BO/LO of the foreign company. Requests for undertaking activities in addition to what has been permitted initially by the RBI may be submitted through the designated AD Category -I bank to the Chief General Manager-in-Charge, Reserve Bank of India, Foreign Exchange Department, Foreign Investment Division, Central Office, Mumbai, justifying the need with comments of the designated AD Category - I bank.

Annual Activity Certificates by Branch/Liaison Offices:

Branch Offices / Liaison Offices have to file Annual Activity Certificates (AAC) (Annex 3) from Chartered Accountants, at the end of March 31, along with the audited Balance Sheet on or before September 30 of that year. In case the annual accounts of the LO/ BO are finalized with reference to a date other than March 31, the AAC along with the audited Balance Sheet may be submitted within six months from the due date of the Balance Sheet to the designated AD Category I bank and a copy to the Directorate General of Income Tax (International Taxation), New Delhi.

H. Project Office (PO):

Reserve Bank has granted general permission to foreign companies to establish Project Offices in India, provided they have secured a contract form an Indian company to execute a project in India, and

i. The project is funded directly by inward remittance from abroad; or
ii. The project is funded by bilateral or multilateral International Financing Agency; or
iii. The project has been cleared by an appropriate authority; or
iv. A company or entity in India awarding the the project is funded by a bilateral or multilateral International Financing.

However, if the above criteria are not met, the foreign entity has to approach the Reserve Bank of India, Central Office, for approval.

I. Opening of Foreign Currency Account;

AD Category – I banks can open **non-interest** bearing Foreign Currency Account for Project Offices in India subject to the following:

i. The Project Office has been established in India, with the general / specific permission of RBI, having the requisite approval from the concerned Project Sanctioning Authority.
ii. The contract, under which the project has been sanctioned, specifically provides for payment in foreign currency.
iii. Each Project Office can open **two Foreign Currency Accounts**, usually one denominated in USD and other in home currency, provided both are maintained with the same AD category– I bank.

iv. The permissible debits to the account shall be payment of project related expenditure and credits shall be foreign currency receipts from the Project Sanctioning Authority, and remittances from parent/group company abroad or bilateral / multilateral international financing agency.
v. The responsibility of ensuring that only the approved debits and credits are allowed in the Foreign Currency Account shall rest solely with the branch concerned of the AD. Further, the Accounts shall be subject to 100 per cent scrutiny by the Concurrent Auditor of the respective AD banks.
vi. The Foreign Currency accounts have to be closed at the completion of the Project.

J. Intermittent Remittances by Project Offices in India:

AD Category – I bank can permit intermittent remittances by Project Offices pending winding up / completion of the project provided they are satisfied with the bonafides of the transaction, subject to the following:

i. The Project Office submits an Auditors' /Chartered Accountants' Certificate to the effect that sufficient provisions have been made to meet the liabilities in India including Income Tax, etc.
ii. An undertaking from the Project Office that the remittance will not, in any way, affect the completion of the Project in India and that any shortfall of funds for meeting any liability in India will be met by inward remittance from abroad.

Inter-Project transfer of funds requires prior permission of the RBI Regional Office concerned under whose jurisdiction the Project Office is situated.

K. Reporting requirement

The foreign company establishing a Project Office in India is to furnish report through the concerned AD branch, to the concerned Regional Office of Reserve Bank of India under whose jurisdiction the Project Office is set up, incorporating the required details. The Project Office shall also submit to the AD branch on an annual basis, a Certificate from a Chartered Accountant showing the Project Status and certifying that the accounts of the Project Office has been audited and the activities undertaken are in conformity with the General / Specific permission given by the RBI.

L. Other General Conditions Applicable to BO/LO/PO in India:

i. Without prior permission of the RBI, no person being a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran or China can establish in India, a Branch or a Liaison Office or a Project Office or any other place of business. Entities from Nepal are allowed to establish only Liaison Offices in India.
ii. Branch/Project Offices of a foreign entity are permitted to acquire immovable property by way of purchase **for their own use** and to carry out permitted/incidental activities. However, entities from Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran, Bhutan or China are not allowed to acquire immovable property in India for a Branch / Project Office without prior RBI approval. All Branch / Project Offices including Liaison Offices, have general permission to carry out permitted / incidental activities from **lease** property subject to lease period not exceeding five years.
iii. Branch / Liaison / Project Offices are allowed to open non-interest bearing INR current accounts in India. Such Offices are required to approach their Authorised Dealers for opening the accounts.
iv. Transfer of assets of Liaison / Branch Office to subsidiaries or other Liaison/Branch Offices or any other entity is allowed with specific approval of the Central Office of the Reserve Bank.
v. Branch Offices are permitted to remit outside India profit of the branch net of applicable Indian taxes, on production of the following

documents to the satisfaction of the Authorised Dealer through whom the remittance is effected –

a. A Certified copy of the audited Balance Sheet and Profit and Loss account for the relevant year,
b. A Chartered Accountant's certificate certifying:

    1. The manner of arriving at the remittable profit,
    2. hat the entire remittable profit has been earned by undertaking the permitted activities, and
    3. That the profit does not include any profit on revaluation of the assets of the branch.

vi. Authorised Dealers can allow term deposit account for a period not exceeding 6 months in favor of a branch/office of a person resident outside India provided the bank is satisfied that the term deposit is out of temporary surplus funds and the branch / office furnishes an undertaking that the maturity proceeds of the term deposit will be utilised for their business in India within 3 months of maturity. However, such facility may not be extended to shipping/airline companies.

M. CLOSURE OF BRANCH/LIAISON OFFICES:

At the time of winding up of Branch/Liaison office the company has to approach the designated AD Category - I bank with the following documents:

i. Copy of the Reserve Bank's permission/ approval from the sectoral regulator(s) for establishing the BO / LO.
ii. Auditor's certificate- i) indicating the manner in which the remittable amount has been arrived at and supported by a statement of assets and liabilities of the applicant, and indicating the manner of disposal of assets; ii) confirming that all liabilities in India including arrears of gratuity and other benefits to employees, etc., of the Office have been either fully met or adequately provided for; and confirming that no income accruing from sources outside India (including proceeds of exports) has remained un-repatriated to India.
iii. No-objection / Tax Clearance Certificate from Income-Tax authority for the remittance/s.
iv. Confirmation from the applicant/parent company that no legal proceedings in any Court in India are pending and there is no legal impediment to the remittance.
v. A report from the Registrar of Companies regarding compliance with the provisions of the Companies Act, 1956, in case of winding up of the Office in India.
vi. Any other document/s, specified by the RBI while granting approval.

The designated AD Category - I bank has to ensure that the BO / LO had filed their respective Annual Activity Certificates with the Reserve Bank for the previous years, in respect of the existing Branch/Liaison Office. Confirmation about the same can be obtained from the Central Office of the RBI in the case of BOs and from the Regional Office concerned in the case of LOs.

Closure of such BO / LO has to be reported by the designated AD Category - I bank to the RBI (the Regional Office concerned for LOs and Central Office for BOs), along with a declaration stating that all the necessary documents submitted by the BO / LO have been scrutinized and found to be in order. If the documents are not found in order or cases are not covered under delegated powers, the AD Category - I bank may forward the application to the RBI, with their observations, for necessary action. All the documents relating to the BO / LO operations may be retained by the AD Category - I bank for verification by the internal auditors of the AD / inspecting officers of the RBI. □ □

INCOME TAX – SOME IMPORTANT RECENT DECISIONS

Arisudana Spinning Mills Ltd vs. CIT (Supreme Court) [CIVIL APPEAL NO.1466 OF 2008 dated 05/09/2012]

Sub: **Section 80IA- Deduction from profits of Eligible Business**

Section 80IA requires that separate books of account be maintained for eligible business i.e. if the assesse is engaged in more than one business and one of the businesses is eligible for deduction u/s 80IA of the Act then separate accounts should be prepared for computing the profits from the eligible business. However, in cases where separate accounts are not prepared, the A.O. may bifurcate the expenses etc. and compute the profit from eligible business.

ACIT vs. Ashok Raj Nath (ITAT Delhi) [ITA No.2970/Del/2012 dated 31/08/2012}

Sub: **271(1)(c) Penalty for concealment**

The assesse may file a Revised Return of Income declaring additional income, even after issuance of notice u/s 143 (2) of the Act. Additional income would not be liable for penalty u/s 271(1) (c), since issuance of notice does not amount to detection of concealed income.

CIT vs. Smifs Securities Ltd (Supreme Court) [CIVIL APPEAL NO.5961 OF 2012 dated 22/08/2012]

Sub: **Depreciation u/s 32**

In case of amalgamation, excess of consideration paid over net value is treated as 'Goodwill' paid in the books of the amalgamated company. Such 'goodwill' is an intangible asset and should be included in the meaning of the term "asset" under Explanation 3 to s. 32.

The said Explanation states that "asset" shall mean an intangible asset, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature. The words "*any other business or commercial rights of similar nature*" in clause (b) of Explanation 3 indicates that **goodwill would fall under the expression "*any other business or commercial right of a similar nature*"**. The principle of **ejusdem generis** would strictly apply while interpreting the said expression which finds place in Explanation 3(b). Consequently, **"Goodwill" is an asset** under Explanation 3(b) to s. 32(1) & eligible for depreciation. Further, the assesse pays the difference between the **cost of an asset** and the **amount paid** as 'goodwill', hence it is eligible for claiming depreciation u/s 32 of the Act.

Inductotherm (India) Pvt. Ltd vs. DCIT (Gujarat High Court) [SPECIAL CIVIL APPLICATION No. 858 of 2006 dated 06/08/2012]

Sub: **Reopening of intimation u/s 143(1)**

In the said case, based on audit objection the A.O. sought to reopen the case for which intimation u/s 143(1) accepting the return had been issued to the assesse. Four issues were noted by the A.O. as reasons for reopening the case. In two reasons it was stated that the reopening was for the purpose of "verifying" the expenditure.

The High Court held that even in a case where only a s. 143(1) Intimation is passed, the power to reopen can be exercised only where there is "reason to believe that income has escaped assessment" and **not** merely to "scrutinize" the return or "verify" the expenditure. Even in case of reopening of an assessment which was previously accepted u/s 143(1) i.e. without scrutiny, the AO would have power to reopen the assessment only if he had tangible material on the basis of which he could form a reason to believe that income chargeable to tax had escaped assessment.

The A.O. cannot reopen the case only to verify the claims raised in the Return of Income.

It may be noted that the above case was reopened because the other two issues could justify the reopening.

Commissioner of Income-tax vs. Ahmedabad Stamp Vendors Association (Supreme Court) [CIVIL APPEAL NO.10270 OF 2003 dated 06/09/2012]

Sub: **Section 194 H- TDS on Commission/ brokerage**

Cash discount for bulk purchase cannot be treated as Commission/Brokerage for the purpose of deduction of TDS u/s 194H of the Act. Stamp vendors, make bulk purchase of stamps and receive discount. The nature of this discount should be treated as cash discount on purchase and not as commission /brokerage liable for TDS yu/s 194H.

Esquire Pvt. Ltd vs. DCIT (ITAT Mumbai))[ITA No. 5688/Mum/2011 dated 29/08/2012]

Sub: **Section 14A- Dividend on Stock-in-trade**

The Hon'ble Tribunal held that the A.O. should determine whether the dividend income is incidental to trading activity or to investing activity. If it is a result of trading activity then, following the principles laid down by the Hon'ble Karnataka High Court in the case of CCI Ltd vs. JCIT 206 Taxman 563, the expenditure incurred in acquiring shares cannot be apportioned to the dividend for making disallowance under section 14A. As held by the Hon'ble High Court of Kerala in the case of CIT vs. Smt. Leena Chandran 339 ITR 296 (Ker.) interest paid on funds borrowed for acquisition of shares in the form of investment would only attract disallowance under section 14A.

CIT vs. Sureshchandra Durgaprasad Khatod (HUF) (Gujarat High Court) [TAX APPEAL No. 1404 of 2010 dated 24/08/2012]

Sub: **Tax Effect Circular-retrospective**

Instruction No. 3 of 2011 dated 9.2.2011 as issued by CBDT laying down the minimum tax effects for appeals is retrospective in nature and applies to all pending appeals.

Ramakrishna Vedanta Math vs. ITO (ITAT Kolkata) [I.T.A. No.: 477,478 and 479/Kol/2012 dated 31/07/2012]

Sub: **Section 201**

Section 201 provides for collection of tax from the payer in case TDS has not been affected by him and the recipient has also not paid the tax dues. Thus, the non-payment of taxes by the recipient is a condition precedent to invoking s. 201(1) & the onus is on the AO to demonstrate that the condition is satisfied. The assesses has to submit all such information about the recipient as he is obliged to maintain under the law. Once this information is submitted, it is for the AO to ascertain whether or not the taxes have been paid by the recipient of income. Only after the A.O. has proved that the recipient has not paid then taxes, he can recover the same from the payer.

Sardar Sarovar Narmada Nigam Ltd. vs. ACIT (ITAT Ahmadabad, SB)

Profits and Gains from Business/ Profession can only be computed after commencement of business. For this purpose 'date of commencement' should be construed as the date on which one of the categories of its business activities is started. It is not necessary that all categories of its business activities must start either simultaneously or the last stage must start before it can be said that the business was set up. Further, absence of flow of revenue is irrelevant for deciding whether a business has been set up.

The Mutual Fund Industry in India

An update

CA. Pradeep Samal

In our last issue of G-Flash, we had discussed the Mutual Funds Industry in India and the need of the hour to make the Industry achieve the required goal of inclusive growth.

In their recent Board meeting on 16th August, 2012, the SEBI board has taken some positive steps which have the potential to boost the Mutual Fund Industry in this otherwise gloomy economic scenario. The good thing is that SEBI has recognised the problem of lack of penetration of mutual fund products, inadequate distribution network, need for greater alignment of the interest of various stakeholders, regulation of distributors and issues concerning investor protection and has decided to develop a long term policy including financial inclusion and tax issues for mutual funds to deal with the objectives of achieving sustainable growth of the mutual fund industry and mobilisation of household savings for the growth of the economy.

The following initiatives were taken to re-energise the Mutual Fund Industry:

a) Increase in penetration of mutual fund products and energising distribution network:

- To accord flexibility and bring cost effectiveness, fungibility of Total Expense Ratio (TER) has been allowed.
- To energize the distribution system and to increase the 'feet-on-street' in distribution, it was decided to:

  i. Simplify the distributors' registration process and increase base of mutual fund distributors by including postal agents, retired officials from government, banks, retired teachers etc. for distribution of simple products.

  ii. Introduce varied levels of certification and registration depending on products & services offered.

  iii. Reduce fees for NISM certification and AMFI registration.

b) Improve reach of MF products in smaller cities/ towns (beyond top 15 cities):

- To improve the geographical reach of mutual funds and bring in long term money from smaller towns, AMCs are allowed to charge additional TER (upto 30bps) depending upon the extent of new inflows from locations beyond top 15 cities. AMCs will be able to charge 30 bps if the new inflows from these cities/ towns are minimum 30% of the total inflows. In case of lesser inflows, the proportionate amount will be allowed as additional TER.

- Mutual funds shall make complete disclosure in the half yearly report of Trustees to SEBI regarding the actual efforts of the mutual funds to increase penetration and the details of opening of new branches especially beyond top 15 cities.

c) Alignment of interest of investors, distributors and AMCs:

- In order to have greater and more focused investor education, it was decided that the industry should set apart a portion of the asset management fees annually for the investor education campaign.
- To avoid differential treatment in the same scheme to different classes of investors, it was decided that all new investors will be subjected to single expense structure under a single plan. However, to be fair to direct investors and promote direct investment, it was decided to

have a separate plan for direct investments, with a lower expense ratio.

- Brokerage and transaction cost chargeable to the scheme for execution of trade to be capped to the extent of 12 bps in case of cash market transactions and 5 bps in case of F&O transactions.
- In order to help enhance the reach of mutual fund products amongst small investors, who may not be tax payers and may not have PAN/bank accounts such as farmers, small traders/businessmen/workers, cash transactions in mutual fund schemes to the extent of Rs. 20,000/- will be allowed subject to compliance with the Prevention of Money Laundering Act, 2002 (PMLA) requirements as allowed in case of some other financial products.
- To enable the mutual fund industry to be in line with all other industries where service tax is borne by the end user, it is decided that the service tax payable on investment management fees should be charged to the scheme.
- It has been decided that a transaction cost of Rs 100/- per transaction of Rs 10,000 and above (or Rs 150/- for first time investor in mutual fund), the option to "opt out" regarding transaction charges shall be on product basis at the discretion of AMC/distributor.

d) Investor protection – issues of misselling and churning.

- In order to encourage long term holding and to reduce churn and align the interests of the AMCs/ distributors with that of the investors, it was decided that (1) the entire exit loads would be credited to the scheme while the AMCs will be able to charge an additional TER to extent of 20 bps. This will not result in any additional cost to the investors. (2) claw back of additional TER (in the case of inflows from cities beyond top 15 cities) would be provided to the extent the investments are redeemed within a period of 1 year.
- To tackle the issue of mis-selling, the Board decided as follows:
  i. Create a system of identification of actual sales personnel of distributors,
  ii. Evolve a system of 'product labelling'
  iii. Inclusion of misselling as a 'fraudulent and unfair trade practice' in SEBI Regulations.

e) Strengthening regulatory framework for mutual Funds:

- AMCs to make monthly portfolio disclosures on their website.
- In order to provide fair treatment to existing investors of mutual fund schemes, it was decided to harmonize applicability of NAV across various schemes based on the day on which the funds are available for utilization, for an amount equal to or more than Rs. 2 lakhs.
- Setting up in the near future of a Self-Regulatory Organisation for regulation of distributors.
- AMCs to disclose half yearly financial results of mutual funds on their websites and an advertisement in this regard would be published in at least one national and one regional newspaper.
- Additional disclosures like gross inflows, net inflows, average assets under management, ratio of AUM/ gross inflows distributor wise, by the AMCs.

f) Rajiv Gandhi Equity Savings Scheme (RGESS):

The Government of India has introduced a RGESS for equity investors in India. All new retail investors are allowed to invest up to Rs.50,000/- directly in equity with the benefit of Income Tax deduction of 50% of the investment amount. However, this benefit is available only for direct equity investments and not through mutual funds. The SEBI Board decided that it should make a recommendation to the Government suggesting that RGESS may also provide for investments in equity schemes of mutual funds which have the securities allowed under RGESS as the underlying.

g) Long Term Measures:

The Board also felt that like other sectors of the economy where long term policies have been developed, there is a need to develop a policy for mutual funds taking into account its importance in mobilizing domestic savings for the growth of the economy. The policy would include all aspects - including enhancing the reach and promoting financial inclusion, tax treatment, obligation of various stakeholders, etc. Mutual Fund Advisory Committee of SEBI would recommend long-term policy measures after wider consultation with all the stakeholders in a reasonable time frame.

All these steps together is a big incentive to the Mutual Fund Industry and was the need of the hour to achieve the desired inclusive growth. The simplification of the registration process of the distributors and the inclusion of the postal agents, retired officials from Banks, government and teachers as distributors is the best the Board could do to expand the base of the distributors. These are the people who are in the reach of the economically lower strata of the population and with proper training they can mobilise funds from this segment. But the regulator must specify stricter due diligence mechanism for appointing brokers in these areas and must be vigilant, as any lack of control in this field (on the brokers) will have a very serious consequences on the investor confidence. The steps like the increase in the TER (total expenses ratio, the percentage on the AUM the AMC charges to the schemes for the expenses) by 30 bps for mobilisation of funds by the AMC from beyond the top 15 cities will directly bring the smaller cities into focus and this will act as a catalyst to setup offices by brokers in these cities. Cash transactions up to Rs.20,000/- is a good initiative but this should be limited to mobilisation by banks only to avoid any mis-use of the mobilised fund.

Another step, which was long overdue was harmonization of applicability of NAV across various schemes based on the day on which the funds are available for utilization, for an amount of Rs.2,00,000/-and above. The limit of Rs.2,00,000/- is to protect the small investors from smaller cities.

These initiatives are steps in the right direction for an Industry whose potential cannot be undermined in India. Now it is to be seen, how the Fund houses take advantage of the SEBI's intent to focus on the Mutual Fund Industry, and to target the economically lower segment of people, who until now were neglected by the sector, by giving them an opportunity to reap the benefit of growth and globalisation and achieve the economic inclusion in its true scene. □

Analysing ESOP needs

Finalising ESOP Scheme

Shortlisting candidates

Off site and onsite consultancy

Compliance assessment

Tax planning

ESOP valuations

g CAD

taking a look at the world from a different angle

Training Wing
G.P. Agrawal & Co.

"Books constitute capital. A library book lasts as long as a house, for hundreds of years. It is not, then, an article of mere consumption but fairly of capital, and often in the case of professional men, setting out in life, it is their only capital."

for private circulation only

for educational and informational purposes only

In house publication
G.P. AGRAWAL & CO.
CHARTERED ACCOUNTANTS
www.gpaco.net