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Editorial:

Dear Esteemed Readers,

We are pleased to share with you our latest newsletter covering tax and regulatory updates in India for the period October-November 2015.

The nation continues to wait with bated breath for the dawn of the GST era. GST is being seen as one of the biggest tax reform in the country. GST will subsume various taxes such as excise, service tax, sales tax, octroi, etc. and will ensure a single indirect tax regime. While the Constitution amendment bill to roll out GST has been passed in the Lok Sabha, it is awaiting clearance from the Rajya Sabha where the ruling dispensation lacks the numbers. The Government is meanwhile undertaking the preparatory work necessary for GST implementation. Draft business processes on GST registration, refunds and GST payments have been published and feedback has been obtained from stakeholders.

The Government, on its part, continues to stride on in order to revive sentiment, stimulate and sustain growth momentum in the economy.

The National Investment and Infrastructure Fund (NIIF) has been set-up by the Government of India, with an expected initial corpus of Rs. 40, 000 crores. The Fund is setup as a Fund of Funds (Category II Alternate Investment Fund) with a proposed series of funds with a view to maximizing economic impact mainly through infrastructure development in commercially viable projects, both greenfield and brownfield, including stalled projects. This Fund is expected to tap funds locally and globally.

The Gold bond and monetization schemes have been implemented with an objective to reduce the demand for physical gold and shift a part of the gold imported every year for investment purposes into financial savings through gold bonds. Public response seems to have been cautious and is expected to gain momentum in the forthcoming periods.

Talking of taxes, October and November 2015 would get counted for a number of measures put forth by the Government as it continues to walk the talk in simplifying tax procedures and strengthening tax administration in the country, with the following notable measures:

a) Simplifying tax procedures

- The CBDT has entered into 11 more unilateral Advance Pricing Agreements (APAs). These APAs were signed with Indian subsidiaries of foreign companies operating in various segments of the economy like investment advisory services, engineering design services, marine products, contract R&D, software development services, IT enabled services, cargo handling support services, etc. With this round of signing, CBDT has so far entered into 31 APAs (30 unilateral and one bilateral). The pace of negotiations has definitely picked-up in the current year. This year has already witnessed the conclusion of 22 APAs. It is the aim of the CBDT to finalize another 30 to 40 APAs before the end of this fiscal to provide stability and confidence to foreign enterprises operating in India.

- The Government has sought public and expert feedback regarding its proposed plan to phase-out exemptions and deductions.
- The Government has constituted a Committee with a view to simplify the provisions of the Income-tax Act, 1961 i) to study and identify the provisions/phrases in the Act which are leading to litigation due to different interpretations; ii) to study and identify the provisions which are impacting the ease of doing business; iii) to study and identify the areas and provisions of the Act for simplification in the light of the existing jurisprudence; and iv) to suggest alternatives and modifications to the existing provisions and areas so identified to bring about predictability and certainty in tax laws without substantial impact on the tax base and revenue collection. This Committee is expected to provide its report within 1 year.
- The CBEC announced that Indirect Tax Ombudsmen will be holding meetings with the trade and industry associations in their jurisdiction and encourage the taxpayers to bring forth their problems/ issues.
- The tenure of the High Level Committee ('HLC') constituted to interact with Trade & Industry on situations where clarity on tax laws is required, has been extended by one year. It has been announced that the CBDT/CBEC will issue the required clarifications, circulars and instructions etc. within a period of 2 months from the date of receipt of recommendations of the HLC.
- The CBDT has launched an "e-Sahyog" pilot project which furthers the tax department's commitment to work in an e-environment and reduces the need for the taxpayer to physically appear before tax authorities. The objective of "e-Sahyog" is to provide an online mechanism to resolve mismatches in Income-tax returns of those assesses whose returns have been selected for scrutiny, without visiting the income-tax Office.
- The CBDT has amended Rule 11DD of the Rules which relaxes the condition of obtaining the certificate for claiming expenditure under section 80DDB in respect of specified ailments from a specialist working in a Government hospital. As per amended Rule 11DD, the prescription can be issued by any specialist mentioned in the amended Rule. Henceforth, it will not be mandatory to obtain a certificate from a specialist working in a Government hospital.

b) Strengthening tax administration

- Swachh Bharat Cess has come into effect from 15th November 2015, at the rate of 0.5% on all services, which are presently liable to service tax. This will translate into a tax of 50 paisa only on every one hundred rupees worth of taxable services. The proceeds from this cess will be used for financing and promoting Swachh Bharat initiatives.
- India has sent 1600 requests for information under DTAAs this year as compared to 800 last fiscal.
- The government has received huge data from the US government under FATCA and is expected to work on it during the forthcoming months in its endeavor to put an end to the black money menace.
- The CBDT has directed its officers to enquire into cases of delay in giving effect to CIT(A) orders.
- The income-tax department launched a drive to provide public service at peoples' door step by holding "special PAN camps in remote areas". Under this campaign, special PAN camps were held over two days at forty- three remote, semi urban and rural locations across India in the first instance to facilitate obtaining of PAN card by persons residing in such areas.

The Government, on its part, continues to believe that the macro-economic indicators of late have shown positive trend and the structural reforms undertaken have started contributing to the sustainable growth through participation by States. Based on the parameters for second quarter of 2015-16 released by the Central Statistical Organization, the Finance Ministry expects the economy to grow in the vicinity of 7.5% during the current Financial Year 2015-16. The growth is being mainly driven by pick-up in the manufacturing sector, which has grown by 9.3 per cent in the second quarter whereas the service sector growth remained robust at 8.8 per cent, with the trade and transport services leading the way.

To support the economy, RBI had already announced a 50 bps cut in the policy rate, bringing the cumulative support of monetary policy to 125 basis points this calendar year. This should boost confidence and investment, and help shore up corporate balance sheets. The government has to play its part to ensure the benefits of accommodative monetary policy are transmitted to the economy at large.

With the recommendations of the Seventh Central Pay Commission expected to put additional fiscal strain (its implementation is effective from January 1, 2016) and the economy yet to recover fully (as shown by the lackluster direct tax collections, though indirect tax collections grew a healthy 34%), the Government is expected to walk a tight rope, at least in the short-term and hope that the current cushioning effect provided by the oil price slump would continue.

Tax and Regulatory updates

In our ‘Tax Controversy’ series, this time, we take a closer look at the concept of slump exchange, its taxability and how have the Indian Courts approached the taxability.

Amongst income-tax cases, we’ve digested the Mahindra & Mahindra Employee Stock Option Trust case where the Mumbai ITAT has held that gains on transfer of shares by an ESOP Trust taxable as capital gains and not business income as sought to be treated by the tax department. Our senior tax partner, Mr. H. P. Mahajani had successfully argued this case before the Mumbai ITAT.

In a ruling which would be significant for entities conducting audits for certification under ISO, the Delhi High Court has held that certification services which are in the nature of audit work cannot be characterized as ‘fees for technical services’ as per India-Germany Tax Treaty. MNC agencies such as TUV, DNV GL, Bureau Veritas, SGS India and so on are expected to be impacted by this judgement.

The Delhi ITAT has, in the case of GE Capital, held that payment towards software license with limited rights is allowable as revenue deduction.

In the Transfer pricing section, the Mumbai ITAT has held that FIPB approval for royalty payment cannot substitute ALP determination. Therefore, even if the royalty paid by the assessee was less than the rate approved by the FIPB, the same had still to be tested as per the provisions of the Act for the purpose of ALP.

On the procedural side, the CBDT has reiterated that appeal effect has to be promptly given to CIT(A) orders, something we had taken up in our pre-budget Memorandum to the CBDT. Such actions would go a long way in promoting a non-adversarial approach towards taxpayers.

On the regulatory front, the RBI issued operational guidelines for the gold monetization scheme and gold bonds. The RBI has extended the facility of filing single as well as bulk SOFTEX form in excel format to the competent authority for certification to all software exporters without any turnover or quantity limits. The RBI has issued guidelines for Residents having a long term foreign currency liability who are now permitted to enter into FCY- INR swap. The SEBI has amended the Listing Agreement requiring Annual reports of all listed companies to contain a Business Responsibility Report (BRR) describing the initiatives taken by the listed entity from an environmental, social and governance perspective.

The coverage of key decisions rendered by various appellate authorities and the summary of circulars issued by CBDT, RBI & SEBI have been compiled and presented for understanding, in the usual manner.

We hope you find this of interest. As always, we look forward to your feedback and comments which would enable us to further enhance the content of the newsletter.

Happy Reading!

Yours Sincerely,

Knowledgeware Team

B. K. Khare & Co.

Articles:

Slump Exchange – To tax or not to tax

The concept of slump sale under the Indian income-tax law would be well-known to many of you. However, the tax treatment of 'slump exchange' may not be that familiar. In this edition of our 'Tax Controversy' series, we take a closer look at the concept of slump exchange, its taxability and how have the Indian Courts approached the taxability.

When an undertaking is transferred for a consideration which is through either issue of shares, bonds, securities or any other consideration in kind, it is termed as 'slump exchange'. Put it differently, consideration for such transfer could be non-monetary as well.

Under the extant Income-tax Act, 1961 ('the Act'), there are no direct provisions providing guidance on the taxability of slump exchange situation, though it does deal with taxability of slump sale. Therefore, one has to take a cue from the law as interpreted and explained by judicial pronouncements while dealing with such situations.

Sale includes Exchange - Slump Exchange is taxable

Section 2(42C) of the Act defines slump sale as the **transfer** of one or more undertakings as a **result of sale** for a lump sum **consideration** without values being assigned to the individual assets and liabilities in such sales.

Section 50-B of the Act which provides guidance on computation of capital gains in case of slump sale was inserted in the Act vide Finance Act, 1999 w.e.f. April 1, 2000. Hitherto, it was not possible to compute the cost of acquisition and hence, charging section failed and this was judicially upheld including by the Apex Court in the PNB Finance Ltd. vs. CIT (2008) 307 ITR 75.

It was this intention of the Legislature behind introducing the provisions dealing with slump sale to bring it under tax net, which was given due weightage by the Delhi High Court in its March 2012 judgement in case of **SREI Infrastructure Finance Ltd. ('the appellant') which was reported at 2012-TIOL-277-HC-DEL-IT**. In this case, the appellant had filed a writ petition before the High Court against the order of the Settlement Commission which had earlier held that the consideration of Rs. 375 lakhs received by the appellant on the transfer of its project finance business and asset-based financing business, including its shareholding in a related company, under a Court-sanctioned scheme was taxable under the Section 50B of the Act as 'slump sale'. The Settlement Commission also computed the taxable capital gains under Section 50B of the Act.

The appellant's arguments centered on the following key contentions:

- The 'transfer' under the Scheme of Arrangement was not a sale u/s 50B of the Act.
- The Scheme of Arrangement was sanctioned by the High Court of Calcutta u/s 391 to 394 of the Companies Act, 1956 and was statutory in nature and character.

- Section 50B of the Act had no applicability as the ‘transaction’ was under the Scheme of Arrangement and the same was not a ‘slump sale’ as contemplated u/s 2(42C) of the Act.
- Section 2(42C) dealt with limited category/type of transactions i.e. sales, which are construed as a ‘slump sale’ and the broader and wider definition of the term ‘transfer’ as defined u/s 2(46) did not apply to “slump sales”.

The Delhi High Court did not agree with the appellant. Their Lordships noted that the term ‘transfer’ used in said section was with reference to the transaction in the nature of ‘slump sale’. Thus, any type of “transfer” which was in nature of slump sale i.e. when lump sum consideration was paid without values being assigned to individual assets and liabilities, was covered by the definition clause 2(42C) and then by Section 50B of the Act. This, their Lordships felt, was the reasonable, plausible and natural grammatical meaning which had to be given to the definition clause ‘slump sale’. They further observed that it was not correct to construe and regard the word ‘slump sale’ to mean that it applied to ‘sale’ in a narrow sense and as an antithesis to the word ‘transfer’ as used in Section 2(47) of the Act. The intention of the legislature was to plug in the gap and tax slump sales and not to leave them out of the tax net. The term ‘slump sale’ has been used in the enactment to describe a particular and specific type of transfers called slump sales. **Use of word ‘sale’ in the term ‘slump sale’ did not and was not intended to narrow down the concept of ‘transfer’ as defined and understood in Section 2(47) of the Act.**

On the basis of the above understanding, the Delhi High Court concluded that all transfers in nature of ‘sales’ i.e. ‘slump sales’ were covered by the definition clause 2 (42C) of the Act. The word ‘transfer’ as defined and understood in Section 2(47) of the Act was an inclusive definition of wide import. It included sale, exchange or relinquishment, extinguishment of any right in an asset, compulsory acquisition under the law etc. Accordingly, the Court held that in this case, the transaction was taxable as ‘slump sale’ and the consideration comprising of cash and shares was liable to be offered to tax.

Significantly, the Court observed that the petitioner did not contest and submit that the transaction in question is not covered by the word ‘transfer’ as defined in Section 2(47) and the contention raised was that Section 50B read with Section 2(42C) is only applicable to “sale” in a narrow sense and not to ‘transfer’ u/s 2(47) of the Act (which clearly includes exchange).

Absence of monetary consideration - Slump exchanges are not taxable

In a later judgement (May 2014) rendered in the case of **CIT vs. Bharat Bijlee Ltd. reported at 2014-TIOL-730-HC-MUM-IT,** the Bombay High Court differed from its Delhi counterpart on the taxability of slump exchange on the ground that in the latter case, consideration was involved in cash and in kind. In this case, the taxpayer transferred its Lift Division i.e. an undertaking to the transferee company under a court sanctioned Scheme of Arrangement in exchange for preference shares of the transferee company. No monetary consideration was involved. The Assessing Officer held that this transaction squarely fell within the definition of the term 'slump sale' as defined in Section 2(24C) of the Act. Therefore, the Assessing Officer held that the transfer of Lift Division was a slump sale and was taxable in terms of Section 50B of the Act. This order of the Assessing Officer was confirmed by the Commissioner of

Income-tax (Appeals). The Tribunal reversed it, allowing the assessee's appeal. Aggrieved by the Tribunal's order, the Revenue filed an appeal before the Hon'ble Bombay High Court.

Before the Court, the Revenue contended that the law had been amended specifically to take care of the tendency of assessees' in transferring the divisions or units and trying to pass off the transaction as not a sale but handing over of a running unit or going concern. The attempt was to circumvent and bypass the legal provisions with regard to the imposition of taxes on transfer. Earlier such transaction was not capable of being brought to tax. Therefore, the legislature had intervened and by an amendment to the Act inserted the definition of "slump sale" and thereafter inserted Section 50B. The transfer of the Lift Division was for consideration. The consideration is the value of the shares which have been handed over as a part of the transfer or the transaction. That did not mean that the transfer was not a slump sale. Merely because the transfer had been brought about by filing a petition before the Court and getting an order sanctioning the scheme of arrangement of transfer did not mean that it was not a slump sale.

The assessee argued that for slump sale, the transfer has to be by way of sale. In the present case, the Lift Division of the assessee had been transferred to the other Company and in consideration of the same, that other Company had issued preference shares to the assessee. There was no price in money which was paid and received. The value of the shares, therefore, could not be taken as the basis. The Assessing Officer had erroneously assumed that the value of the shares is the price or monetary consideration for the transfer. The Tribunal had corrected this mistake by referring to the documents including the order passed by this Court. Once the Scheme was sanctioned by this Court and the Lift Division was transferred not by way of sale, then, the Tribunal's view could not be said to be erroneous in law nor could it be termed as perverse.

While delivering its verdict in favor of the taxpayer's contentions, the Tribunal had analyzed the transaction/transfer in the present case in the backdrop of the legal principles. The Tribunal referred to the judgment of the Hon'ble Supreme Court in the case of CIT, Andhra Pradesh vs. Motors & General Stores (P) Ltd., reported in (1967) 66 ITR 692. In that case, the Hon'ble Supreme Court referred to a transaction dated 21 February, 1956 wherein a cinema house owned by the assessee was transferred in exchange for shares and which was the subject matter of the appeal in the context of section 10(2)(vii) of the Indian Income-tax Act, 1922.

The Apex Court had posed the question to itself as to whether such a transaction as was subject matter of "exchange deed" could be termed as a sale. In answering this question, the Hon'ble Supreme Court held that, it is only if there is a sale of the cinema house and the other assets that the taxable profits and gains are to be computed under Section 10(2)(vii) as the amount by which the written down value exceeds the amount for which the assets are actually sold. The Supreme Court held that the word "sale" or "sold" have not been defined in the Indian Income-tax Act, 1922. These words, therefore, have to be construed by reference to other enactments. The Supreme Court then referred to the definition of the term "sale" as appearing in the Transfer of Property Act, 1882 and the Sale of Goods Act, 1930. The Hon'ble Supreme Court then referred to the definition of the term "Exchange" as appearing in the Transfer of Property Act, 1882. It then rejected the contention of the revenue that the transaction of 21 February, 1956 was a sale. The Hon'ble Supreme Court held that inasmuch as the consideration for the transfer was not money but only transfer of shares, they were of the view that the transaction in question was not a sale but an exchange.

Adverting to the Bharat Bijlee case (supra), the Tribunal then held that, a reading of the clauses in the Scheme of Arrangement showed that the transfer of the undertaking had taken place in exchange for issue of preference shares and bonds. It held that, merely because there was quantification when bonds/preference shares were issued, would not mean that the monetary consideration was determined and its discharge was only by way of issue of bonds/preference shares. In other words, the Tribunal held that this was not a case where the consideration was determined and decided by parties in terms of money but its disbursement was to be in terms of allotment or issue of bonds/preference shares. In fact, all the clauses read together and the entire Scheme of Arrangement envisaged transfer of the Lift Division not for any monetary consideration. **The Scheme did not refer to any monetary consideration for the transfer. The parties were agreed that the assessee was to transfer the undertaking and take bonds/preference shares as consideration. Thus, it was a case of exchange and not a sale. Therefore, the Tribunal held that Section 2(42C) of the Act was inapplicable. If that was not applicable and was not attracted, then, Section 50B was also inapplicable.**

Our Comments

It is learnt that the Revenue has appealed in the Bharat Bijlee matter (supra) before the Supreme Court and likewise, the taxpayer has appealed in the SREI Infrastructure Finance matter (supra) before the Supreme Court.

With due regard to the Delhi High Court judgement in SREI Infrastructure Finance matter (supra), it would appear that the Bombay High Court judgment is the better view on the subject . If the Legislature had intended so, they could have specifically included the word ‘exchange’ while defining slump sale in section 2(42C) of the Act. Currently, the definition refers to transfer by way of ‘sale’ alone.

It also re-emphasizes the pivotal role of the draftsman while framing the wordings of the legislations. If not attempted with care and caution, the sections and rules have to wait their chance to be interpreted by the Courts. In the interim, a lot of time, effort and avoidable expenditure is wasted, including precious judicial time.

As it stands today, the taxability of slump exchange has not yet reached finality, which issue is now before the highest Court in the Land.

Taxing Experiences

About twenty years ago, I strayed into the Central Vigilance Commission as its Additional Secretary. Ever since, I have often wondered why some bureaucracies are so much more corrupt and inefficient than others. I joined the Commission in the aftermath of the Harshad Mehta scam. During my six year tenure there I must have dealt with at least 15000 disciplinary cases. What did this experience tell me about how our system works?

Very few of the 15000 cases we dealt with related to blatant corruption, defined simply as abuse of power for personal purposes. When such a case, involving dishonesty, acceptance of illegal gratification or bribery came to the Commission, it invariably advised prosecution. The bulk of all other cases involved various degrees of violation of rules, some involving simple negligence, some supervisory lapses of failing to exercise due diligence over the work of subordinates; still others, failure of an officer in the Government or a manager in a public undertaking or a bank to follow rules. There were cases where an unpopular superior was cornered by his subordinates; or where the former gunned for his subordinates. But there were few cases of hardcore corruption, simply because the actors left absolutely no trace of their wrong doing.. The vigilance machinery was being used to settle personal scores; hardly ever to punish dishonesty. On anecdotal evidence, the situation has hardly changed over the years: and corruption continues unabated irrespective of which party is in power.

When asked why a particular lapse had occurred- for instance, why a loan was sanctioned without a proper appraisal-the charged officers often admitted informally that they could not resist the pressure that they were subjected to. In all such cases personal loyalties of caste, village, language, religion, network or region often trumped the charged officer's loyalty to his organization and its rules. This is the fault line where the western concept of bureaucracy- elaborately defined by Max Weber in terms of impersonal exercise of discretion in a rational and fair manner, in accordance with precedents- gets seriously compromised. The problem perhaps lies in the fact that we take our personal relationships much more seriously than westerners and often find it difficult to act impartially. E.M. Forester once remarked that India is the only country in the world where a friend's friend is a reality. He is certainly a valuable resource in negotiating the complex webs of rules, regulations and norms that we have generated over the years.

One explanation for the complexity of our procedures lies in the manner in which the government has responded to the various corruption crises that have arisen with unfailing regularity from time since independence. When pressure from Parliament, its Public Accounts Committee, the media or public opinion mounts and becomes irresistible, the department concerned responds by adding more checks and balances to the existing procedure. For example, when Jawaharlal Nehru found that certain ministers were packing their ministries with favorites, he instituted the Appointments Committee of the Cabinet (ACC) consisting of himself, the home minister and the minister concerned. This added three months to the appointments process, but irregularities in appointments still continued. The Government then made consultation with the Union Public Service Commission mandatory for various senior appointments. The consequence was another addition of nine months to the appointments process. Is it any wonder then why many positions remain vacant for months together: an appointment which would take just a day or two to finalise in the early fifties now takes nine months. Enormous efficiency losses are the inevitable consequence.

This complex system has other harmful effects as well. Accountability becomes difficult to determine simply because too many people are involved in decision-making. When it is determined, one customary defence of many a charged officer is that the procedure was so complex, that no one was following it. If indeed no one was following it, why should he be singled out for punishment? Whether he succeeds with this argument would depend on the evidence he leads to support this claim and the view that his inquiry officer and the disciplinary authority take of the same. But to an impartial observer it does seem strange that informal conventions should often be seen to be superseding formal regulations. Yet that is how our system runs simply because rules become archaic and are never updated to keep pace with changing ground realities.

The upshot is that whenever a scam breaks out, , angry public opinion, fed by a 24x7 media, begins to demand accountability. That is the time some scape goats have to be found and made sacrificial goat for vigilance action. If this person now being booked is otherwise well regarded, the consequence is risk aversion and policy paralysis. The three Cs-CAG, CVC and CBI- created to fight corruption and ensure that officers remain on the straight and narrow path, have hardly been able to ensure this objective. Ironically, often the action they do take against officers, perceived to be honest and hard-working, has the opposite effect of driving others towards inaction. As a result all kinds of perverse incentives are built up within organisations.

The crux of the problem, however, lies much less in the manner in which these organisations function than in the fact that over the years we have become a low trust society. We can hardly expect bureaucrats and governmental organisations to trust one another when we hardly trust anyone outside our immediate circle of friends and relatives. Overbearing, complex decision-making structures along with all kinds of adversarial relationships both between individuals and organisations are an inevitable consequence of this attitude. Suspicions also compel us to pore over complex documentation even while concluding petty agreements. This slows down decision making and increases both transaction and project costs.

Many of us accept this philosophically as a way of life; some try to beat the system by paying speed money. India thus ranks 85th out of 174 countries (China: 100th) of the world in terms of Transparency International's Corruption Perception Index for 2014 (in 2013, its ranking was 94 out 177 countries). Both India and China appear to be passing through a historical phase through which many developed countries have passed in the past. In the U.K., Robert Walpole, for example, once remarked, "All men have their price." Yet when time was ripe and public opinion favored it, Gladstone and Disraeli were able to reform the administration in about a decade during the late nineteenth century.

Perhaps the answer to our woes lies in economic progress. The impetus of development along with the spread of literacy and education, creates the demand for fast and efficient transactions, based on arm's length relationships. Demand for honesty, both as a factor of production as well as a consumer good, thus increases as people's incomes grow. If arm's length becomes the norm, those who violate the principle tend to get stigmatized, and find it difficult to enter the market and carry out transactions. We have a long way to go before we reach this stage.

Francis Fukiyama sums it up best: widespread distrust in a society imposes a kind of inefficient tax on all forms of economic activity, a tax that high-trust societies do not have to pay. We must suffer this tax till such time as attitudes improve and we become a developed nation. In the meantime, the Government should continue with its efforts to simplify procedures and improve the ease of doing business.

Supreme Court:

Power of review of the High Court cannot be treated and used as appeal in disguise

Facts:

Respondent, a Senior Assistant employed in the office of the Resident Commissioner, J&K, New Delhi, was served with a Memorandum of charges, which was unequivocally refuted by himself. The Inspector appointed by the Disciplinary Authority ('DA'), investigated and submitted that the respondent had misappropriated sums of money from the Government exchequer. The DA served the respondent a Show-cause as to why services of the Respondent should not be terminated. The DA, after considering the reply of the Respondent, passed an order, on September 06, 1999, of dismissal and termination effective immediately.

The respondent neither preferred a departmental appeal nor did he approach any superior authority for redressal of his grievance. On February 18, 2006, i.e. after about 7 years, the appellant filed a Writ Petition before the High Court challenging the dismissal order passed by the DA. The appellant asserted many grounds one of them being that the appellant was not granted an opportunity of being heard as per the procedure provided in the J&K Civil Service (CCA) Rules, 1956 ('Rules'). <u>However, nothing was submitted for the delay caused in challenging the dismissal order</u>. The State Government ('SG') countered the assertions of the appellant vide its counter affidavit. The stand of the SG was that the petition ought to be dismissed as the petition suffered from inordinate and unexplainable delay and latches.

The Single Judge vide his order opined that the SCN issued to the employee, in fact, did not contain copies of the proceedings as envisaged in the Rules, which in effect resulted in denial of a reasonable opportunity to the appellant. The Single judge following the order of the Constitution Bench in ECIL Vs B Karunakar allowed the Writ Petition and quashed the order of dismissal only on account of this technicality.

Being aggrieved by the aforesaid decision, the SG filed a Letters Patent Appeal before the Division Bench of the High Court on the ground that the Single Judge did not appreciate the imperative assertion that the appellant had slept over the matter of dismissal and approached the Court after a period of 7 years without explaining the delay and laches and that the Single Judge passed the order without remarking with a finding on this vital issue, and hence the order of the Single Judge be set aside.

The SG submitted before the Division Bench that it had been left without any remedy to proceed against the delinquent government servant and hence, the order of the Single Judge needed modification. The Division Bench opined that the SG's contention that it was left without any remedy to proceed against the respondent was not a correct proposition of law. The Division bench stated that it was disposing off this appeal by providing that the quashing of the appeal will not operate as impediment for the Appellants to proceed against the respondent after complying with the requirements of the Rules.

Even the review application against this order was dismissed by the High Court on the ground that there was no palpable error warranting review of the order.

Being aggrieved against this order, the SG approached the Supreme Court against the principal order and the other orders.

Contentions and arguments

Counsel for the SG stated that when a categorical stand was taken in the counter affidavit in this case about the inordinate delay in filing the appeal, the High Court should take into consideration the plea and not record a finding on that ground.

Counsel for the employee-appellant contended that the delay and laches cannot alone defeat the cause of justice and when substantial justice was delivered then the Supreme Court should not interfere with jurisdiction exercised under Article 136 of the Constitution of India.

Observations of the Supreme Court:

The Supreme Court observed that the appellant was dismissed from service in 1999 whereas the appellant approached the court for judicial remedy in 2006. The plea regarding unexplained delay of the respondent was not addressed in the order of the Single Judge of the High Court. The appellant bench viz. the Division Bench noted the submission and modified the order, after which, an application for review was filed on the ground that plea pertaining to delay and laches had not been considered. However, the review application was dismissed on the ground that power of review could not be treated like an appeal in disguise.

The Supreme Court referred to the judgment of **Shivdeo Singh & Ors. Vs State of Punjab & Ors.,** wherein it was held that nothing in Article 226 precludes a High Court from exercising the power of review which is inherent in every Court to prevent miscarriage of justice and to correct grave palpable errors. Reference to **Aribam Tuleshwar Sharma vs. Aribam Pishak Sharma and Ors.** wherein the High Court reached a similar conclusion in the case of Shivdeo Singh & Ors. Vs State of Punjab & Ors. and also observed that there were definitive limits to the exercise of power of review and the same could be exercised on the discovery of new and important matters of evidence which could not be produced at the time of the making of the order even after exercising due diligence and prudence; mistakes or errors apparent from the face of the record; or on any such similar grounds. However, it cannot be exercised on the ground questioning the merits of a decision because such ground comes within the province of the appellate jurisdiction of the court.

Reference was also drawn to the decision in case of **Thungabhadra Industries Ltd. Vs the Government of Andhra Pradesh (through Dy. Commissioner of Commercial Taxes),** wherein it was held that review is not an appeal in disguise wherein an erroneous decision is reheard and corrected, but lies only for patent errors. The error should be such that it can be pointed out without an elaborate argument and there could not be a possibility of two opinions. This decision was similar to the case of **Satyanarayan Laxminarayan Hegde Vs Mallikarjun Bhavanappa Tirumale**.

The Supreme Court stated that the above cases were referred to bring out the fact that the High Court had not taken note of the stand and stance of the SG regarding delay and laches. Even the Writ Petition was silent about the reason for delay and laches. The Division Bench in appeal addressed the submission being oblivious of the ground pertaining to delay and laches and modified the order passed by the Single Judge as if that was the sole submission. It was stated with conviction that there was palpable error, as the principal stand of the State with regards to delay and laches was not addressed and deserved consideration. The Supreme Court opined that this point required consideration and proceeded to decide on this aspect.

The Supreme Court referred to the judgment of **City & Industrial Development Corporation Vs. Dosu Aardeshir Bhiwandiwala & Others, State of M.P. vs Nandalal Jaiswal, State of Maharashtra Vs Digambar and Chennai Metropolitan Water Supply and Sewerage Board & Ors Vs. T. T. Murali Babu**, wherein, broadly, the courts laid out points to consider when exercising jurisdiction under Article 226:

A. Whether complex and disputed questions of facts are involved and whether they can be satisfactorily resolved;
B. Whether the petition reveals all material facts;
C. Whether the petitioner has alternative or effective remedies to avail;
D. Whether the person invoking this jurisdiction, is guilty of unexplained delays and laches;
E. Whether the matter is ex facie barred by any laws of limitation
F. Whether grant of relief is against public policy or barred by any valid law.

The Supreme Court also stated that all questions of delay and laches would not curb or curtail the power of writ court to exercise the discretion. The reason attached to such delay must shake the judicial conscience and the reason for delay must show sufficient cause.

Decision of the Supreme Court

The Supreme Court held that the appellant approached the Courts for legal remedy after a span of about 7 years and allowed his claim to remain stale. The grievance of the appellant did not deserve addressing as there was delay which was unexplained.

It also stated that when a writ petition is to be decided by the Court, it must also consider the nature of the claim and the reason for delay. Stale claims are not to be adjudicated unless non-interference causes miscarriage of justice.

It held that in the present case the grievance did not necessitate adjudication. It deserved to be thrown out for the appellant had accepted the dismissal order at the outset for half a decade before again approaching the Courts. Thus, the order of the Single Judge was set aside.

Citation **State of Jammu and Kashmir Vs. R. K. Zalpuri (Civil Appeal Nos. 8390-8391 of 2015) (SLP Nos. 11203-11204 of 2014)**

Assessee entitled to seek exemption u/s 11(1)(a) once the same is exercised in the return of income

Facts and issue: Assessee a public charitable trust during AY 1994-95 had earned income of Rs. 99,41,221. Assessee in its return claimed that it had spent Rs. 47,27,533/- for the charitable objects of its trust. The assessee further also submitted that it had set apart a sum of Rs. 32 Lacs to be spent for charitable purposes in the concerned year, and accordingly claimed deduction of the said amount. During assessment, the AO allowed deduction in respect of the expenditure spent of Rs. 47,27,533. However AO noted that the assessee had not exercised the option of setting apart the amount of Rs 32 Lakhs before filing of its return. Assessee contended that in the return itself it was stated that the amount of Rs 32 Lakhs was set apart to be spent on charitable purposes in the following year. However AO held that this could not be treated as exercing the option in a valid manner as per provisions of section 11(1)(a) and accordingly denied the deduction. On appeal, the CIT(A) reversed the order of the AO. On further appeal, the ITAT as well as the High Court confirmed the order of the CIT(A).

Decision: *SC in regard to exercising of option of setting apart of a certain amount noted that the law does not mention any specific mode of exercising the said option in terms of Section 11(1)(a) and Explanation-2 thereto. The provisions of section 11(1)(a) entitle the assessee to set apart amount if not spent in the same year provided the option is exercised in that behalf. The only requirement is that the said option has to be exercised before filing of the return. SC noted the if the option is exercised in the return filed it would be treated as in conformity and comply with the provisions of section 11. In regard to the quantum of deduction the SC noted that the provision allows the assessee to exercise such an option only to the extent of 25% of income. However the assessee had exercised the option of setting apart an amount of Rs.32 lacs which was more than 25% of the income of Rs. 99,41,221 (i.e. Rs 24,85,305) . SC held that the entire amount of Rs. 32 lacs could not have been allowed as deduction and accordingly directed the AO to recompute the deduction in accordance with the provisions of section 11(1)(a). (It is remarkable that the SC has noticed and rectified a factual error in the application of section 11(1)(a) which apparently none of the lower authorities had noticed.)*

Citation: G R Govindarajulu and Sons, Supreme Court, Civil Appeal 4916 of 2006

High Court

Reassessment proceedings under section 147 of the Act taxing royalty income by invoking ‘force of attraction rule’ held to be invalid

Facts and issues: The assessee, a company incorporated in the USA was engaged in the business of supplying and replication of software. The AO for the AY 2001-02 passed an assessment order under section 143(3) of the Act, wherein the assessee was held to have a business connection as per section 9(1)(i) of the Act and a PE in India in the form of its subsidiary as per Article 5 of Tax Treaty between India and USA. The AO treated receipts from software business arising in India as “royalty”, taxable @ 15% as per Article 12(2)(a) of Tax Treaty.

The AO, after 4 years from the end of the relevant AY sought to reopen assessment under section 148 of the Act alleging that as the assessee had a PE in India, its receipts from software business should also be attributed to the PE in India in view of the “force of attraction” rule under Article 7. The AO held that no expenses would be allowable and gross receipts would be taxed as royalty under section 115A @ 20% and not 15%, being rate applied by the AO in the original assessment order. The AO thus reopened the assessment holding that it had sufficient reasons to believe that income chargeable to tax had escaped assessment.

The assessee filed objections against the reopening on two grounds – (i) there had been a change of opinion; and (ii) pre-conditions under first proviso to sec 147 i.e. there has to be a non-disclosure of material facts by the assessee, was not satisfied. The AO rejected the assessee’s submissions and passed an assessment order under section 143(3) read with section 147 of the Act.

The contention of the assessee

In original assessment, the AO had already examined “attribution of income” to PE. While doing so, he had attributed only part of income which had fallen within Article 7. The assessee had duly explained that it carried on two distinct businesses viz. (i) its distribution unit and (ii) its development unit. Royalties were attributable to distribution unit whereas, profits and gains arising out of development unit only were attributable to its PE in India. The assessee thus submitted that distribution unit (concerned with royalty attribution) was not its PE. Royalties could be taxed only under Article 12 and not under Article 7.

Observations of the High Court

There was no proper submission on behalf of the income tax department to establish the assessee's failure in disclosing material facts. Royalty income arising in India and paid to a USA resident would be taxed @ 15%. Article 12(6) carves out an exception and provides that provisions of paragraphs 1 and 2 of Article 12 would not apply where beneficial owner of the royalties or fees for included services, being a resident of USA, carries on business in India, through a PE. The assessee had already paid 15% tax in terms of Article 12(2)(a)(ii) of the Tax Treaty which was accepted by the AO at the time of original assessment u/s 143(3). Only later, the AO while reopening the assessment realized that Article 12(2)(a)(ii) would not apply because royalties were connected with the PE in India and therefore, by virtue of Article 12(6), royalties would be taxed under Article 7.

When the AO had accepted the assessees contentions that the royalty was taxable under Article 12 (2)(a)(ii) at the rate of 15%, it has to be presumed that the AO's attention was attracted to the entire Article 12 of the Tax Treaty. It cannot be accepted that the AO had not applied his mind to the exception under clause (6) of Article 12.

Decision: Aspect of attribution was too obvious and apparent for the AO to have ignored in the first round/ original proceedings. Accordingly, reopening of assessment was a mere change of opinion and when regular assessment was completed under section 143(3) of the Act, a presumption could be raised that such an order had been passed upon a proper application of mind. Thus, the order passed by the AO under section 143(3) read with section 147 was quashed.

Citation: Oracle Systems Corporation vs. ADIT [TS-601=HC-2015(Del)]

The High Court explains laws on admission of additional evidence by the CIT(A) in terms of Rule 46A of the Act

Facts & Issue: The assessee, an individual in partnership with his family members operated various business concerns. A search was conducted in the residential as well as business premises. Consequent to search, notice under section 153A was issued for AY 2002-2003 to 2007-2008 and notice under section 142(1) was issued for AY 2008-09. The AO completed assessment against which the assessee preferred an appeal before the CIT(A).

The assessee furnished certain additional evidences before the CIT(A) which was forwarded to the AO for examination. On examination of the said evidence the AO stated that this being fresh evidence was liable to be ignored in view of Rule 46A of the Rules. It was submitted to the CIT(A) that he cannot admit any additional evidence unless the AO has been allowed a reasonable opportunity for examination of evidence or to challenge its validity by adducing some new evidence. The CIT(A) admitted the additional evidence / details filed by the assessee and adjudicated on the same. The Income tax department preferred an appeal before the ITAT challenging admission of such additional evidence.

Argument of the Income Tax Department

The additional evidence should not have been admitted by the CIT(A). Even where the CIT(A) decided to admit the same, he should have remanded the case to the AO to consider the additional evidence produced and render his findings thereon.

Observation of the High Court

The CIT(A) had forwarded the paper-book itself to the AO and asked for his report. Only post submission of the requisite report, the order was passed by the CIT(A). The CIT(A) in the order passed had considered circumstances pleaded by the assessee and thereafter reached the conclusion that the assessee was prevented by reasonable and sufficient cause from furnishing the details/ evidence at the assessment stage.

Decision: The AO neither disputed genuineness of the additional evidence submitted by the assessee, nor called for any evidence in rebuttal of documents produced by assessee. Accordingly, the CIT(A) had complied with conditions of Rule 46A of the Rules.

Rule 46A(4) of the Rules does not specifically exclude the principles of natural justice and, therefore, these principles are to be read into the Rules. Accordingly, every additional evidence even where conclusive in nature is to be referred to the AO before admission.

Citation: Jyothy Laboratories Vs DCIT, JCIT and CIT – LTU [TS-566-HC-2015(KER)]

The High Court disallowed deduction of provision for expenses towards transit breakage, in the absence of a reasonable scientific method to estimate the same

Facts and Issues: The assessee was engaged in the business of manufacture and sale of Grain Neutral Spirit and India Made Foreign Liquor from its Nasik plant. The assessee transported the products in glass bottles by road to various states in the country. During transportation, these products were prone to breakages. The assessee while dispatching the products made provision for breakages on the basis of past history. Once the goods reached their destination, the assessee followed the practice of reversing the provision and debiting actual breakages to P&L account. At year end, the assessee made a similar provision for all goods under dispatch and debited the same to P&L account which was reversed on the first day of the following financial year. Only actual breakages were debited to P&L account in the succeeding year as and when the goods under dispatch reach the destination.

For AY 2001-02, the AO disallowed the provision made on the ground that breakage and pilferage was an uncertain liability and provision for same is not allowable as deduction. The ITAT disallowed the assessee's claim for deduction by holding that the provision made was without any scientific basis. The ITAT observed that in each year provision made was excessive in comparison with actual expenditure incurred and thus, it could not be said that provision was made on scientific basis.

The issue before the High Court was whether provision for transit breakages had a scientific basis and was allowable as deduction or was contingent in nature and thus, to be disallowed.

Observations of the High Court

The CBDT Notification No. SO 69(E) dated January 25, 1996 issued under section 145(2) states that provisions should be made for "all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

The definition of the term 'contingent' as appearing in AS-29 which deals with accounting of "Provisions, Contingent Liabilities and Contingent Assets" states that "a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise". <u>A 'provision' is recognized only where reliable estimate can be made of a present obligation based on past event which will require outflow of resources to settle it.</u>

The High Court took note of the SC decision in the case of Bharat Earth Movers [TS-4-SC-2000] , Rotork Controls India P. Ltd [TS-111-SC-2009] and Delhi High Court decision in case of Vinitec Corporation P. Ltd. [278 ITR 337] to ascertain the difference between 'known liability' and 'unascertained liability'. The High Court also took note of the fact that actual breakages were far less than the amount of provision created.

The High Court further took note of the Madras High Court's decision in CIT vs. Balaji Distilleries Ltd. [TCA 830 of 1997] and Karnataka High Court's decision in CIT vs. Brindavan Beverages (P) Ltd. [335 ITR 163 (Karn)] wherein it was held that transit breakages were normal to bottling business and, thus, allowable as a revenue expenditure.

Decision: AS-29 itself made it explicit that no provision for a contingent liability could be recognized as ascertained liability. The assessee had not followed any uniform scientific method in making provision for the breakages. In these circumstances, the liability on that score could at best be described as a 'contingent liability' as defined in AS-29.

In the absence of a reasonable scientific method to estimate the transit breakage, the provision would be regarded as for a contingent liability and thus, disallowable as deduction. Actual transit breakages would be allowable as revenue expenditure in the accounting year in which such breakages actually occur.

Citation: Seagram Distilleries Pvt. Ltd. vs. CIT (TS-575-HC-2015)(DEL)

International Tax & Transfer Pricing

Commission payment to AE after taking into consideration the comparative study of increase in export sales was held to be at ALP.

Facts and issues:

The assessee was engaged in manufacturing of Internal combustion Engine Valves used in four strokes engines of two wheeler, three wheeler and four wheeler vehicles and also in four stroke generator engines. The assessee was a joint venture between Varroc Group holding 74% stake and remaining 26% stake was held by Scarpa, Italian company. The assessee filed its return of income for AY 2008-09 declaring loss of Rs.48,93,720/-. During the impugned AY, the assessee had entered into international transactions. The assessee had paid commission at 2% of the sales. The TPO after considering the submissions of the assessee concluded that the assessee had not explained the need of the services and had also not demonstrated as to how the services were actually rendered by the AE. The TPO proposed to take the value of international transaction with respect to commission paid as NIL.

Observation of the ITAT

The TPO has gone beyond his jurisdiction in questioning necessity to pay sales commission and in determining the value of commission paid as NIL. The assessee has placed on record the agreement according to which the commission was paid. The financial records of the assessee company goes to show that there has been increase in the export sales since the time the assessee has engaged the services of AE. The Income tax department has not disputed the financial results and the figure of export sales furnished by the assessee

Decision:

The assessee was able to substantiate its claim for commission paid by comparative study of increase in export sales over the years. Thus, sales commission by the assessee to AE was held to be at arm’s length.

Citation: Durovalves india Pvt Ltd vs ACIT [2015-TII-423-ITAT-Pune-TP]

Consideration received by a non-resident for providing email and networking facility would be taxable in India as ‘royalty’ as per India-USA Tax Treaty

Facts & Issue: The assessee was a foreign company, engaged in the business of providing software solutions. The assessee entered with an agreement with an Indian Company to provide internet, other email and networking facilities. The assessee provided access to its internet by which it provided a gateway that would facilitate call centers with incoming and outgoing calls from India to the people of USA.

In consideration for providing these services, various payments were made to the assessee. For the AY 2002-03, the assessee itself offered the said income as ‘fees for included services’. The assessee before the CIT(A) contended that the amount was not taxable in India. The CIT(A) held that the payment was not in the nature of ‘fees for included services’. He however, held that the same would be taxable in India as ‘royalty’.

The assessee before the ITAT argued that the nature of services does not fall within the definition of ‘royalty’. The Income tax department argued that the services in question fall within the definition of 'royalty' as defined in Section 9(1)(vi) of the Act. It was further argued that the payment was not made for simple use of equipment but for the use of protected software.

Decision: The transaction of providing email and networking facility would relate to a "scientific work" and would partake the character of intellectual property. The payments received in such transactions are for the use of intellectual property and partake the character of royalty. The software is customized and secret. From the facilities provided by the assessee, which are of the nature of online, analytical data procession, the payment is received as "consideration for the use of, or the right to use design or model, plan, secret formula or process". The use by the Indian company of the CPU and the consolidated data network of the assessee is not merely "use of or the right to use any industrial, commercial or scientific equipment" as envisaged in Article 12(3)(b) of the Tax Treaty, but more than that. It is the use of embedded secret software (an encryption product) developed by the assessee for the purpose of processing raw data transmitted by the Indian company, which would also clearly fall within the ambit of article 12(3)(a) of the Tax Treaty between India and the USA.

Citation: Cincom System Inc. vs. DDIT (2015-TII-165-ITAT-DEL-INTL)(Del.)

ISO certification services which are in the nature of audit work cannot be characterized as 'fees for technical services' as per India Germany Tax Treaty.

Facts and issues: The assessee was a German company having a branch office in India. The Indian branch was engaged in the business of conducting audit for ISO 9000 certification. In the certification process, a quality system auditor of the assessee visits the company wanting to obtain ISO 9000 certificate. After carrying out a pre-assessment audit, a certification audit is conducted and a report is prepared which is checked and verified by the assessee. The report is thereafter sent to Germany for confirmation. Once confirmation is received from Germany, the Indian branch issues ISO 9000 Certificate to the company, which is valid for 3 years.

During assessment proceedings for AY 1998-99, the AO took the view that services rendered by the assessee were in the nature of technical, managerial, consultancy services. Accordingly, he taxed income earned by the assessee as fees for technical services ('FTS') under Article 12 of the India Germany Tax Treaty on gross basis, disallowing deduction of expenditure claimed by the assessee.

Observation of the Tribunal

Looking at the nature of services provided by the assessee, it was mostly in the nature of audit work. The services rendered could not be equated with rendering of technical, managerial or consultancy services. In an audit work, there may be some incidence of advice at the time of evaluation, but certainly it could not be termed as pure consultancy services. In the audit work, the auditor (i.e. the assessee) only evaluates the quality system and environmental system. The auditor was also prohibited from giving any prescriptive advice or consultancy as part of an assessment.

Thus, the activities carried out by the assessee could not be characterized as FTS as per section 9(1)(vii) of the Act as well as per Article 12(4) of the India Germany Tax Treaty.

Decision: The said certificates were issued by the assessee after reviewing the report and carrying out several stages of audit work. The subject services were neither technical, nor managerial, nor consultancy services. There was no advice given, insofar as this activity was concerned. The audit work and certification would not come within the realm of FTS. Accordingly, the income earned by the assessee was taxable under the head ‘business income’.

Citation: DIT vs. TUV Bayren (I) Ltd. (TS-586-HC-2015)(Bom.)

FIPB approval for Royalty payment cannot substitute ALP determination

Facts: The matter pertained to FY 2009-10.

The assessee was an Indian subsidiary of M/s A. W. Faber Castell AG, Germany which was an associated enterprise (‘AE’). During FY 2009-10, the assessee paid an amount of Rs. 1.51 crores towards royalty payment to its AE and benchmarked the same using the TNMM method. The TPO noted that the assessee had debited significant sales promotion expenses and advertisement expenses, collectively called Advertisement, Marketing and Promotion (‘AMP’) expenses. The TPO was of the view that by incurring the expenses on account of AMP, the assessee was enhancing the value of the brand of the AE. Applying the bright-line test, the TPO held that the AMP expenditure was a non-routine one and an excessive one and on these basis, made an upward TP adjustment. He determined the ALP for the royalty payment as NIL and disallowed the entire royalty payment which got subsumed in the AMP adjustment.

The assessee agitated this order before the DRP, but with no avail. Aggrieved by the DRP’s order, the assessee appealed before the ITAT.

Issue: The question before the ITAT was on facts, whether the TPO’s action was justified.

Contentions and counter-arguments & the ITAT’s decision: Before the ITAT, to negate the bright-line test argument of the TPO, the assessee claimed that it had a low AMP to Sales ratio of only 0.74%. The TPO had reworked this ratio by adding few items of selling expenses such as trading discounts, free samples, volume discounts and so on and contended that this ratio was indeed 6.06%. The Hon'ble ITAT relied upon the Special Bench decision of the Delhi ITAT in case of L. G. Electronics India Pvt. Ltd. [(2013) 22 ITR (Trib.) 1] and held in favor of the assessee on this point viz., expenses which are selling in nature and not in the nature and character of 'brand promotion' should not be considered for the purpose of AMP.

The assessee contended that the royalty paid @ 3% on sales could be benchmarked under the CUP method since the royalty was paid after due approvals from the FIPB, Government of India. Under the extant policy, FIPB permitted royalty payments upto 8% on exports and 5% on domestic sales. Therefore, the royalty payment of 3% was well below the rates permitted by FIPB and hence, should be construed as being at arm's length. The DR contended that the approval of the FIPB cannot be taken as ALP. The ITAT held that the approval granted by FIPB for payment of royalty was not in the context of ALP under the Act. Therefore, even if the royalty paid by the assessee was less than the rate approved by the FIPB, the same had still to be tested as per the provisions of the Act for the purpose of ALP.

The ITAT, however, noted that the TPO did not undertake any exercise as per the TP provisions to determine the ALP of royalty payment by the assessee to its AE and hence, restored the matter back to the AO/TPO for examination.

Our Comments: Due care needs to be taken to benchmark the royalty payments. Merely relying on the FIPB approval will not help the assessee's cause while demonstrating the ALP before the TPO. Benchmarking royalty payments vis-v-vis similar transactions undertaken internationally using independent databases such as RoyaltyStat, RoyaltySource and so on will definitely help.

Citation: A. W. Faber Castell (India) Pvt. Ltd. vs. DCIT, Mumbai [ITA 577/Mum/2015] reported in TS-447-ITAT-2015(Mum)-TP

No TP Adjustment on outstanding service receivables from AEs on notional basis

Facts: The matter pertained to FY 2009-10.

The assessee was a wholly owned subsidiary of Pegasystems USA which was an associated enterprise ('AE') for transfer pricing purposes.

During the transfer pricing assessment, the TPO noticed that the assessee had service receivables to an extent of Rs. 21,07,53,864/- at the year end. The TPO further noted that the receivables were not reported in Form 3CEB and no bench marking analysis has been done in the TP study. The TPO sought to make TP adjustment on the ground that service receivables represented capital financing transactions and hence, were required to be benchmarked. Assessee was asked to submit the details of raising the invoice and subsequent receipts which was duly complied with. After considering the details before him, the TPO made adjustment on receivables at 12% interest rate on the outstanding receivables which worked out to Rs. 1,26,40,592/-.

Aggrieved by this Order, the assessee prayed for relief before the DRP which, while upholding the AO's actions, reduced the interest rate from 12% to LIBOR plus 2.5%. It is against this Order, the assessee filed an appeal before the Hyderabad bench of the ITAT.

Issue: The question before the ITAT was on facts, whether the TPO was justified in computing notional interest rate on outstanding receivables from AE?

Contentions and counter-arguments:

Before the ITAT, the Assessee objected to the TP adjustment on service receivables and submitted that:

- The outstanding receivables related to the provision of services and were not in the nature of any advance/loans. The word 'capital financing' used in Explanation to section 92B(2) of the Act particularly refers to loans or advances given for capital financing, whereas in the assessee's case, these were outstanding for services rendered but not capital financing.
- The assessee had been fully funded by its AE since its inception for all its working capital requirements and receivables are running accounts.
- The assessee did not have any working capital risk and there is no interest payment also. No adjustment was called for on notional basis.
- A reasonable period should be provided as interest-free period and no interest should be calculated for such period.

- Even though assessee realized the amounts in later year, i.e., after 31-03-2010, interest was charged for whole of the period i.e. even for the period beyond the assessment year concerned.

ITAT's decision: The ITAT held that the word 'capital financing' used in Explanation to section 92B(2) of the Act had to be interpreted invoking the principles of *ejusdem generis* and hence, the outstanding service receivables cannot be equated to capital financing as per the provisions of the Act. The ITAT further observed that working capital adjustments were being made while analyzing the operational performance of the companies and therefore, outstanding amount get adjusted in working capital adjustments automatically and another separate addition was not required under the TP provisions.

The ITAT also relied on the Mumbai ITAT ruling in the case of Evonik Degussa India P. Ltd., [ITA No. 7653/Mum/2011], wherein it was held the TP adjustment cannot be made on hypothetical and notional basis, until and unless there is some material on record that there has been under charging of real income.

On the basis of the above points, the ITAT concluded that the outstanding amounts were not to be considered for upward TP adjustment.

Our Comments: This judgement is in line with recent ITAT decisions on the issue that no TP adjustment was called for on the pretext of outstanding receivables when working capital adjustment was already made. This judgement also highlights an important aspect – that of ensuring that the credit terms are at par with industry practices; else could lead to TP adjustments.

Citation: Pegasystems Worldwide (India) Pvt. Ltd. vs. ACIT, Hyderabad [ITA 1758/Hyd/2014] reported in TS-488-ITAT-2015(Hyd)-TP

Tribunal

Submission of Form no. 10 during the course of assessment proceeding was held to be sufficient compliance for accumulation of income. The depreciation on assets purchased was allowed as application of income, even when the assessee had claimed entire cost of assets as application of income in the year of purchase

Facts and Issue: The assessee was registered under section 12(A)(a) mainly for the objects and activities of promoting the Fashion Design Industry. For AY 2007-08 the assessee had filed its return of income disclosing nil income. In the computation of income, the assessee showed income from property held under trust amounting to Rs. 22,11,76,304/- and reduced therefrom amount spent during the previous year of Rs. 18,02,20,722/-, leaving surplus of Rs. 4,09,55,582/-. The assessee submitted declaration under explanation 2B of section 11(1)(B) as it had not utilized 85% of its receipts towards its objects. A resolution was submitted for accumulation of income. Subsequently Form no. 10 was submitted for accumulation. The main purpose for which the amount was accumulated and set apart was for promotion of fashion industry in India.

The AO denied the benefit of accumulation of surplus for the following reasons:

a. Resolution dated 25 October 2007 was submitted on 21 December 2009 at the fag end of the assessment proceedings. The AO also stated that certified copy of resolution was submitted and not the original resolution.
b. In the original resolution, Form no 10 was not attached. Therefore, the condition that Form no. 10 is to be filed along with the return of income was not complied with.

The AO further disallowed depreciation of Rs. 6,38,652/- At the time of acquisition of the capital assets, whole cost was claimed as application of income and once again depreciation if claimed would amount to double deduction.

Decision:

Submission of Form no. 10 during the assessment proceedings

The assessee had submitted Form no 10 before the completion of assessment proceedings and therefore, no fault could be found with the assessee. Form no. 10 submitted by the assessee before completion of assessment proceedings and mentioning the specific objective entitles the assessee for the accumulation of income.

Depreciation claim on the cost of assets

This issues is now covered in favor of the assesse because of the decision of the Honourable Delhi High Court in case of DCIT V Vishwa Jagriti Mission dated 29/3/2012. Accordingly, depreciation claimed would be considered as application of income even where cost of asset was allowed as application of income in the earlier year.

Citation: Fashion Design Council of India vs. The ADIT(E) [TS-637-ITAT-2015(DEL)]

Tribunal denies interest deduction on disputed arbitration, rejects incongruous stand vis-a-vis civil proceedings

Facts and issue: During the AY 2000-01 and AY 2001-02 the assessee had claimed deduction towards interest payable on account of arbitration award in respct of a dispute with a party, Alimenta of Rs 7.92 crores and of Rs 8.22 Crores respectively. The said liability was pursuant to Delhi HC Single Judge order whereby assessee was held liable for damages and interest for breach of contract. During assessment proceedings AO noted that the assessee had contested the same before the Division bench. Further the liability was not debited to the profit and loss account but was disclosed as a contingent liability and was claimed in the return of income. The AO denied deduction holding that the liability had not accrued since as at the year-end it could not be said that the assessee was liable to pay interest.

On appeal to the Tribunal, the assessee submitted that the Delhi ITAT in the assessee's own case in earlier year had allowed deduction of interest and thus same view should be followed for AY under consideration. Delhi ITAT was not convinced with the reasoning given by the Co-ordinate Bench of the ITAT in its earlier order in deleting disallowance of interest and accordingly made a reference for constitution of a Special Bench (SB).

Decision: ITAT SB noted that under the mercantile system of accounting, assessee is eligible for deduction when liability to pay an expense arises, notwithstanding its actual quantification and discharge taking place subsequently. ITAT further noted that if the liability itself was uncertain, it assumed the character of a contingent liability and ceased to be deductible and thus, a deduction could be allowed only when an assessee incurred liability to pay an amount in the nature of an expense.

ITAT SB observed that the single judge bench of the Delhi HC had directed vide its order payment of interest to Alimenta at 11.25% up to the date of award and @ 18% from the date of award till date of realization. Assessee had filed an appeal against the judgment and decree of the Single Judge and the Division bench thereafter had stayed the execution of the judgment of the single judge. Subsequently the third Judge (on a difference of opinion between the two ld. Judges who heard the appeal) finally decided the appeal of the assessee holding that an appeal was not maintainable against the judgment of the Single Judge.

ITAT Special bench opined that from this sequence of events it transpired that a legally enforceable liability against the assessee to pay interest at rate of 18% to Alimenta, which was created by decree of the Single Judge remained suspended from the date of stay granted by the division bench of the HC. It was only on passing of a consequential judgment and decree by the Delhi HC, subject to certain stays etc. granted against operation of this judgment, that the assessee incurred a legally enforceable liability to pay such interest to Alimenta.

Referring to the earlier year co-ordinate bench ruling in the assessee's own case for earlier year, ITAT Special bench noted that the co-ordinate bench was swayed by the fact that earlier the single judge passed an order against the assessee and there was no reference to the later development by way of order passed by the Division Bench staying operation of the earlier judgment and decree of the Single Judge. This crucial fact of paramount importance was not brought to the notice of the Tribunal and it is on these half presented facts that the Tribunal allowed deduction of interest.

ITAT noted that assessee had adopted diagonally opposite stands in civil proceedings vis-à-vis income-tax proceedings in so far as the question of interest liability was concerned. ITAT noted that, while on one hand, in civil proceedings the assessee was contesting its liability to pay interest, on the other hand, when the same question came up in income-tax proceedings, it had taken an opposite stand that it had incurred liability towards interest payment and the same be allowed as a deduction. Thus, Special Bench noted that there was an absolute mismatch between these two inconsistent stands taken by assessee and similar position prevailed in assessee’s reflection of such interest liability in its annual accounts.

ITAT Special Bench thus held that “Though the deductibility or otherwise of an expenditure in the income-tax proceedings depends on the appreciation of the correct legal position under the Act and not what the assessee claims under any proceedings or its treatment as contingent liability in the books of account, the idea behind incorporating these facts in the order is to accentuate the incongruous stand of the assessee on the same issue.”.

Thus, rejecting the assessee's appeal, ITAT Special Bench held that the assessee did not incur any liability for payment of interest since no legally enforceable liability existed against the assessee.

Citation: National Agricultural Cooperative Marketing Federation of India Limited, Delhi Tribunal, ITA No 1999 & 2000/Del/2008

AO cannot make Sec 40A(2) disallowance in addition to a disallowance made u/s 92CA

Facts and issue: The assessee was engaged in the business of production and sale of nutritional and dietary supplements for weight management and personal care and had obtained relevant technology and knowhow from its group companies.

During AY 2008- 09, the assessee had paid administrative service fee of Rs 5.84 crores to its AEs. TPO determined ALP for transaction of administrative services fee paid by the assessee to its AE as Nil by holding that the assessee had not received any services from its AE. TPO was of the view that the assessee did not derive any benefit from paying administrative service fee to the AE because the assessee was incurring losses. Accordingly, the TPO proposed upward adjustment of Rs 5.84 crores towards administrative service fees. While framing the draft assessment order, the AO apart from making disallowance of said amount under TP provisions and treating ALP as Nil also disallowed part of the payment of Rs 4.81 crores u/s 40A(2).

Decision: ITAT noted that the transaction of payment of administrative service fee was declared as an international transaction and was subjected to TP provisions u/s 92CA. However, AO made an alternative addition by invoking provisions of Sec 40A(2). AO and TPO both had accepted the transaction as an international transaction, ITAT held that "once a particular transaction is admitted as an international transaction then the same falls in the ambit of the provisions of Chapter X of the Act which are specific provisions to deal with such transactions between the assessee and its AE. Therefore, once the transaction is undisputedly subject matter of Chapter X of the IT Act, then the other general provisions of the Act cannot be applied simultaneously." Accordingly, ITAT held that AO cannot go back to the provisions of Sec 40A(2) for determining the reasonableness of the price paid by the assessee once reference is made to TPO for determination of ALP.

ITAT observed that in earlier years payment in question was subjected to assessment and only 25% was charged to tax. Thus, it was accepted that services were rendered by the AE to the assessee. Further, the ITAT noted that the AO had not conducted any inquiry or investigation to find out the excessiveness of the payment made by the assessee to its AE. Relying on coordinate bench ruling in Cisco Systems Capital (India) Pvt. Ltd, ITAT held that "when the AO has not conducted any inquiry or brought any material on record to prove that payment made by the assessee is excessive and unreasonable making an adhoc disallowance by invoking the provisions of sec.40A(2) of the Act is not justified." Accordingly, ITAT deleted addition made u/s 40A(2).

In regard to payment of administrative service fee by assessee to AE, TPO observed that there was no evidence to show that service was rendered and the same was beneficial to the assessee.

Relying on the Delhi HC ruling in Ekta Appliances Ltd. and coordinate bench ruling in Festro Controls Pvt. Ltd. vs. DCIT, ITAT held that the TPO is not empowered to determine the ALP at nil though the quantum/size has to be decided along with the ALP as per Chapter X of the Act. Further, noting that assessee had filed additional evidence in support of its claim that the AE had rendered services and it was relevant in adjudicating the issue, ITAT set aside the issue to the file of the AO/TPO for adjudication after considering relevant evidence

Citation: Herbalife International India Pvt. Ltd (ITAT 1679 / Bang/2012 and ITA 184/Bang/2013), Bangalore Delhi Tribunal

Loss incurred in derivative transaction would not be considered as speculative loss

Facts and issues: The assessee, a knowledge Process Outsourcing Unit was primarily involved in the business of Revenue Cycle Management for their clients across US. The assessee for AY 2009-10 entered into foreign exchange derivative contracts on NSE to hedge itself against foreign exchange fluctuations (between Indian Rupee and USD) on account of underlying account receivables which were denominated in USD. The assessee claimed that the losses on derivative transactions represented loss on account of restatement of foreign currency forward contract in accordance with AS-11 issued by the ICAI. It booked marked to market losses on such foreign exchange derivative transactions as at the end of AY in the books of accounts and claimed deduction thereof. The assessee contented that the above losses were neither notional nor speculative as per proviso (d) to section 43(5).

The AO refused to accept the above losses as non – speculative and considered the losses as speculative. The AO further did not allow the set off against the income from business. As per the AO the said mark to market losses on forward contracts of foreign exchange were contingent and notional loss, therefore disallowable as deduction under the Act.

The CIT(A) held that the mark to market losses were notional losses as the amount of loss would not be known till the forward contract of foreign currency expires and hence the same cannot be allowed as deduction.

Argument of the assessee

Section 43(5) provides for the definition of speculative transaction, which means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. Clause (d) of Sec 43(5) provides that derivative transactions in shares are not speculation transaction. The hedging transactions against the foreign currency loss on account of receivables were not speculative and thus they were mainly marked to market losses on the foreign exchange derivative contracts.

Argument of the Income tax department

The forward foreign exchange contracts were not backed by any business transactions and thus it was not hedging transactions. Also marked to market loss cannot be allowed.

Decision: The eligible transactions in derivatives carried out through recognized stock exchanges are exempted from the purview of speculation transactions under section 43(5) of the Act provided other conditions are satisfied. The derivative transactions were carried through SEBI registered broker who was a member of NSE which in turn was a recognized stock exchange. Accordingly, the transactions were covered by exception in proviso (d) to section 43(5) and thus loss incurred in derivative transaction would not be speculative loss under section 43(5).

Marked to market loss whether a notional or contingent loss

The marked to market losses incurred by the assessee due to movement in prevailing exchange rate of foreign currency i.e USD vis a vis Indian rupee cannot be considered as a notional or contingent loss. It was an ascertained liability which had crystallized on the balance sheet date i.e 31 March in respect of outstanding forward contract and therefore, allowable as deduction.

Citation: Inventurus Knowledge Services Pvt Ltd [TS-605-ITAT-2015 (Mum)]

Capital gain on sale of depreciable assets invested in section 54EC bonds entitled to deduction under section 54EC

Facts and issues:

The assessee was engaged in the business of photography. The assessee for AY 2009-10 earned long term capital gain ('LTCG') which was claimed as exempt under section 54EC of the Act. The assessee had sold one shop on which it earned capital gain. The said capital gain was invested in capital gain bonds of NHAI. The assessee claimed that since the capital asset was held for a period in excess of three years, it would qualify to be a long-term capital asset ('LTCA') under section 2(29A). Thus resultant gains on its transfer would be eligible for exemption under section 54EC. The AO denied the said benefit on the ground that shop was a depreciable asset and resultant gain was short term capital gain ('STCG') whereas exemption under section 54EC was available only on LTCG. The CIT(A) allowed the assessee's claim. The CIT(A) held that the exemption provisions in section 54E / 54EC / 54F etc. are not linked to section 50 and therefore, if the assessee complies with conditions necessary under section 54EC, he will be entitled to the benefit envisaged in section 54EC, even on transfer of depreciable assets held for more than 36 months.

Observation of the ITAT

Allowance of deduction under section 54EC on capital gains arising under section 45 r.w.s 50

Section 50 clearly applied in the assessee's case notwithstanding anything contained in section 2(42A), which defines short-term capital asset ('STCA') with reference to its holding period. Section 2(29A) defined LTCA negatively to mean an asset which is not a STCA. Section 50 overrides both section 2(42A), as explicitly stated therein and, section 2(29A) by implication. Accordingly, by virtue of the deeming provision of section 50, cost of LTCA [i.e. as per Section

2(29A)], where depreciable, forming part of a block assets on which depreciation stands claimed, capital gain on its transfer would have to be computed by treating WDV of the relevant block of assets as its cost of acquisition. The second deeming per the provision of section 50 is *qua* the nature of such capital gains, (i.e., as capital gains arising from the transfer of a STCA). Section 54EC is available on capital gain arising on transfer of a LTCA, i.e., which is not a STCA by definition and thus, it shall not apply to capital gains computed under section 50.

Decision:

Section 50 is a self contained code for determining the nature and the quantum of capital gain arising on transfer of depreciated assets and it's deeming, even otherwise separately provided under section 50(2), and would thus prevail. Accordingly, the assessee was entitled to deduction under section 54EC on capital gain earned on sale of depreciable assets.

Citation: Durgaprasad Agnihotri[TS-628-ITAT-2015 (Mum)]

The taxability of the income is determined only when it is actually received. The same cannot be taxed on being reflected in the Form 26AS

Facts and Issue: The assessee was a retired soldier, who upon his retirement as Lieutenant Colonel, under a settlement scheme framed by the Government of India, received certain security contracts from the Government bodies such as BHEL. During the course of scrutiny assessment proceedings, the AO based on information as per Form 26AS noted that the assessee had not disclosed following contractual receipts:

BPCL	Rs. 44,39,357
All India Radio (AIR)	Rs. 3,07,868
Indian Oil Corp. (IOC)	Rs. 3,86,334

The AO proceeded to bring to tax these receipts as unaccounted income. There were also a discrepancy in the receipts from BHEL to the extent of Rs. 24,89,710 which were also brought to tax.

The AO further noticed that while the assessee had claimed deduction of Rs. 5,22,214 in respect of service tax, his actual service tax payment was only Rs. 9,55,713. The AO treated these unexplained expenses as income of the assessee under section 69C of the Act.

Decision: Merely because a payment is reflected in Form 26AS and it was shown to have been paid to the assessee, it cannot be brought to tax in the hands of the assessee when the said money is not actually received by him. The stand of the assessee was that these payments made by BPCL, AIR and IOC were never received by the assessee. The said monies, received fraudulently in the name of and behalf of the assessee, were received by some other person. Neither this aspect of the matter was examined by the AO on merits, nor effort made to find out through appropriate inquiries through related banks, the actual beneficiary of these payments. The AO ought to have had established the trail of money and to actual beneficiary of the payments which were admittedly made through banking channels. The assessee had given ample evidence that some other person had opened a bank account in the assessee's name and appropriated the funds to himself, in such account. All these facts require to be properly investigated and therefore, the matter was restored back to the AO for fresh examination.

Citation: Ravindra Pratap Thareja vs. The ITO [I.T.A. No. 137/Jab/2014]

Deductions u/s 80HH and 80I are allowable for one division without losses incurred in other division, when amendment u/s 80A is not applicable in the relevant assessment year

The assessee was a company that manufactured products ranging from cosmetics, soaps, detergents, salt, soda ash, LAB and injectables. It filed its return for relevant AY, claiming deductions u/s 80HH and 80I without adjusting losses of other divisions against the profit derived from the eligible undertaking.

The AO rejected this action of the assessee, computing the gross income after adjusting losses of other divisions against profit derived from the eligible undertaking. The AO based this adjustment on the basis of the decision of the Supreme Court in *Synco Industries Vs ITO (2008) 299 ITR 444 (SC)* and amendment in Section 80A by the Finance Act, 2009.

Aggrieved by the order of the AO, the assessee appealed before the CIT(A). The AR submitted that the computation of profits eligible for deductions u/s 80I and 80HH were set aside to be recomputed in terms of parameters indicated in the case of the Synco Industries. The AO computed such profits after setting of loss of the Toilet Soap Division, after referring to the said judgment and section 80A as amended by Finance Act, 2009.

The AR contended that decision in the case of Synco Industries Ltd. did not overrule the decision of the Supreme Court in the case of Canara Workshop. The AR also relied on the case of Goldmine Shares wherein the ITAT held that deduction u/s 80I should be allowed on the profits of the undertaking without setting off loss of another undertaking.

The AR also contended that the amendment u/s 80A by Finance Act, 2003 was not applicable as the amendment was effective from 01.04.2003 and the impugned order related to AY 1991-1992.

The CIT(A) upheld the order of the AO on the ground that there was no infirmity in the said order vis-à-vis the ratio of the decision in Synco Industries.

Aggrieved with the order of the CIT(A) the assessee further appealed to the ITAT.

ITAT's Decision:

The ITAT noted that there was no dispute regarding the facts being considered under the present case. ITAT specially asked the parties as to whether there was a judicial precedent of the jurisdictional High Court existing on the issue disputed before it. The answer was in negative.

The ITAT noted that principle of law that emerged from this case was that for the purpose of computing gross income, losses of other units are to be taken into consideration. However, for the purpose of computing deduction u/s 80HH & 80I profits of the undertaking are not to be reduced by losses of the other units the Revenue failed to quote any distinction on facts or in law and hence the ITAT accepted the contention of the assessee.

The ITAT also held that Section 80A (amended) was not applicable to the facts in this case as the impugned assessment year is 1991-1992 and the amended section was applicable w.e.f. 01/04/2003

Citation: **Nirma Limited Vs DCIT (ITA No. 2171/Ahd/2011)(ITAT Ahmedabad)**

The Tribunal laid down principles to be followed by the AO to verify source of funds to the sister concern and make proportionate disallowance of interest after verifying whether funds were interest free or interest bearing

Facts and Issue: The assessee, during the year under consideration paid interest which was claimed as deduction under section 36(1)(iii) of the Act. The AO made disallowance of interest of Rs.70,78,411/-, which was confirmed by the CIT(A) to the extent of Rs.66,44,817/-.

The assessee argued before the Tribunal that it had advanced funds to its sister concern, out of interest free funds/ money for commercial expediency. The assessee further argued that the Income tax department in earlier years had not made any disallowances on account of interest and in view of the fact that no loans were granted during the year, no disallowance on account of interest can be made in the current year. The Income tax department argued that the assessee had invested available funds in other assets also and therefore, it cannot be concluded that only interest free funds were utilized for the purpose of giving interest free funds to its sister concerns. The Income tax department also submitted that there is no material on record to suggest that on the date of advance made by the assessee, it was having enough interest free funds.

Decision: As per section 36(1)(iii) of the Act, the assessee is entitled to deduction of interest on the capital borrowed, which had been utilized for the purpose of business or profession. There was no dispute with regard to the fact that the assessee had borrowed capital for the purpose of business, but at the same time, the assessee had also advanced to its sister concerns interest free funds. There was no dispute with regard to the proposition that, in the event the assessee gives advances to its sister concerns without charging any interest out of borrowed funds, in that event the AO was justified in making the disallowance of such interest claimed as deduction under section 36(1)(iii) of the Act, as the borrowings were not utilized for the purpose of business. But where the assessee demonstrates and satisfies the Income tax department, that the advances were out of interest free funds available with the assessee or the advances made to the sister concerns are for the purpose of commercial expediency, no disallowance can be made.

The Tribunal laid down the following principles to be followed by the AO for making disallowance of interest:

- The AO should verify from the records placed before him the fact of availability of interest free funds for the purpose of making advances to its sister concerns. In case, the AO finds that the assessee was having sufficient interest free funds available for making advances to its sister concerns, the AO should delete the disallowance.
- The AO should verify whether the borrowed funds had been utilized for business purposes or not.
- Where mixed funds viz. interest free funds as well as interest bearing funds have been utilized in making interest free advance, the AO should verify the quantum of advances made. If the AO finds that the amount of interest free funds was higher than the advances made, in that event, the AO should delete the addition made on account of disallowance of interest on borrowed funds.

Citation: LMP Motors Pvt. Ltd. [2015-TIOL-1532-ITAT-AHM]

Having offered gross income to income tax, corresponding expenses provided for in earning the said income would be an ascertained liability allowable as deduction

Facts and issues: The assessee was in the business of disposal of waste material generated out of offshore oil rigging. As per the norms prescribed by Pollution Control Board (PCB) and Ministry of Environment, oil Exploration Companies have to dispose off the waste generated out of oil drilling process by undertaking certain prescribed methods. The assessee possessed necessary equipments and expertise in collecting the said waste from the drilling companies and processing the same by meeting the standards of PCB. Such processed waste is dumped in the filling site as per the PCB standards. During the AY 2008-09, the assessee entered into an agreement with GSPC for waste management of drill cutting of SOBM system and cleaning the same for KG Exploration Block. The assessee raised bills on M/s GSPC for entire contract amount upon lifting of drilling waste. The wastes were transported to the assessee's facility, which was processed later. As there was a time lag between collection and final processing, the cost of processing relating to the unprocessed waste lying in stock at the end of the year spilled over to the next financial year. The assessee followed the accounting practice of offering the entire amount of contract receipts as its income in the year of receipt. Therefore, the assessee made a provision in the books of account towards the cost of processing waste lying in stock at the year end.

During the AY 2008-09, the assessee had lifted 8018.340 tonnes of waste from M/s. GSPC and received the entire amount under the Contract. The assessee offered the same as its revenue receipt in the Profit and Loss account. The assessee however, could process waste to the extent of 946.640 tonnes only and the remaining quantity of 7071.700 tonnes was taken as closing stock. The assessee provided for the expenses that were required to be incurred for processing the waste lying as closing stock and claimed the same as deduction.

The AO held that the provision so made by the assessee was relating to the future expenses, which are neither crystalised nor accrued. The AO disallowed the claim while computing total income under the normal provisions of the Act and also while computing the book profit under section 115 JB of the Act.

The CIT(A) held that the assessee is obliged to provide for expenditure relating to the contract receipts, since the entire contract receipts was offered as its income. The CIT(A) further held that the provision so made by the assessee was in the nature of ascertained liability and same was deductible both under the normal provisions of the Act and also while computing the book profit under section 115JB of the Act.

Decision:

The assessee had received entire contract amount upon lifting of the waste materials. The responsibility to process the materials had shifted to the assessee upon lifting of the materials. Hence, it may not be proper to presume that the entire contract receipts represent the income of the assessee. Income represents receipts less expenditure incurred or required to be incurred in connection with such receipts. In the instant case, the assessee had to incur various expenses for processing the materials lifted by it and hence those expenses should be considered as the expenditure relating to the contract receipts already received by the assessee. Under the accounting principles, all the known expenses, liabilities and losses have to be provided for, in order to arrive at the net profit. Hence the provision for expenses made by the assessee cannot be considered to be a contingent liability. It can only be considered to be an ascertained liability.

The assessee was justified in providing for those expenses in order to arrive at the net profit. In respect of liability already accrued, the actual date of incurring of expenses would be irrelevant and hence the payment could be postponed in subsequent years. The assessee had also reversed the provision in the immediately succeeding year, i.e., the said provision was offered as income in the succeeding year in the form of reduction of corresponding expenditure. In view of the above, the ITAT allowed the matter in favour of the assessee.

Citation: ACIT vs SAR Chandra Environ Solutions Pvt Ltd [2015-TIOL-1538-ITAT-VIZAG]

No penalty under section 271(1)(c) of the Act where penalty is leviable under section 271AAA. Penalty under section 271(1)(c) would apply to all other previous years except the specified year in which search was conducted

Facts and issue: On 21 August 2008, the assessee was subjected to search and seizure operation under section 132 of the Act. The search was conducted before the due-date of filing return of income for AY 2008-09 i.e. September 2008. The assessee had paid Rs. 68 lakhs in cash as his contribution for the acquisition of land for the hospital project. On 30 November 2009, the assessee filed a return of income disclosing the aforesaid Rs. 68 lakhs as income from other sources. During the course of scrutiny proceedings, the assessee had confirmed such cash payment.

The AO, therefore, initiated penalty proceedings under section 271AAA of the Act for the ‘undisclosed income’ of Rs. 68 lakhs pertaining to that specified previous year. Subsequently the AO imposed penalty under section 271(1)(c) of the Act also. The CIT(A) upheld the AO’s order.

Section 271AAA provides for penalty @ 10% of ‘undisclosed income’ of the ‘specified previous year’ in cases where search has been initiated. Further clause (3) of the section provides that no penalty would be imposed under section 271(1)(c) of the Act in respect of undisclosed income referred to in section 271AAA(1) of the Act.

Decision: The Tribunal observed that for the cases in which search is initiated, the penalty under section 271AAA will come into play in respect of ‘undisclosed income’ of ‘specified previous year’, and, to that extent, the provisions of Section 271(1)(c) would not be applicable. However, it clarified that the penalty under section 271(1)(c) would apply to all other previous years except the specified previous year. The expression ‘specified previous year’ referred to the previous year in which the search was conducted or the year which has ended before the due of search but the due date for filing of income tax return in respect of the same has not ended before the date of search and the assessee has not furnished his return of income for the previous year before that date. It was noted that the situations under which provisions of Section 271AAA and the provisions of Section 271(1)(c) can apply are inherently mutually exclusive. Accordingly, the provisions of section 271(1)(c) were not applicable to AY 2008-09.

The assessee's counsel thereafter submitted that it had no objection for levying of penalty under section 271AAA even though the time for imposition of penalty had expired. He stated that 'his clients, as law abiding citizens, are content with the relief legally due to them and they do not wish to capitalize on the technicalities. This was appreciated as a rare gesture of fairness by the Tribunal. The Tribunal left the final decision on levy of penalty under section 271AAA to the AO and the assessee.

Citation: Naman A Shastri Vs. ACIT [IT (SS) A No. 561/Ahd/2011]

Payment towards software license with limited rights is allowable as revenue deduction

Facts and issues: The assessee was engaged in the business of rendering process management services for credit cards. The AO for AY 2007-08 and 2008-09 noticed that the assessee made payment towards license fee, connectivity charges and co-ordination charges to a US based entity. The assessee claimed deduction of the entire payment, as revenue expenditure under section 37 of the Act. The AO requested the assessee to show cause as to why the said expenditure should not be treated as capital expenditure. The assessee explained that license fee was due for use of 'vision plus software' which was an accounts receivable processing software for credit cards transactions. The AO concluded that acquisition of license granted by licensor in itself is a capital asset and payment made for such acquisition of the license is capital in nature. The AO disallowed the deduction treating the said expenditure as capital in nature.

Observation of the ITAT

As per the End-User license Agreement, the assessee was specifically restricted to make copies of the software. There was also a bar on the assessee for use of software for the purpose other than that mentioned in the Agreement. The assessee did not possess any right either to sell it or alienate in any other manner. <u>The assessee was required to deliver back the licensed program back immediately after removing the same from its systems on termination of Agreement.</u>

Decision: The assessee was vested with limited right to use the licensed program during the currency of license Agreement. The Agreement nowhere provided any exclusive right to the assessee. The assessee was vested with the right to use the licensed program for facilitating its business operations enabling day-to-day management of business and to work with more efficiency. End user license Agreement did not have effect of any enduring benefit to the assessee for being treated as capital in nature. The right to use 'vision plus software' program did not have any effect of providing enduring benefit. The payment made to US based entity was only the license fees and not the price for acquisition of capital asset. Accordingly, it was held that license fee etc. paid by assessee to US based entity was a revenue expenditure deductible under section 37 of the Act.

Citation: GE Capital Business Process Management Services Pvt Ltd [TS-598-ITAT-2015(DEL)]

Gains on transfer of shares by an ESOP Trust taxable as capital gains and not business income

Facts and Issue:

Mahindra & Mahindra Employees' Stock Option Trust, the assessee, was formed by Mahindra & Mahindra ('Settler-Co') for the subscription to its equity shares to be held for the welfare of its employees. The assessee was engaged in investing the general corpus in the equity shares of Settler-Co and holding the same for distribution among employees eligible under its ESOP Scheme. The eligible employees were selected by the Compensation Committee (constituted by the Settler-Co). Pursuant to recommendation by the Compensation Committee the assessee granted options to eligible employees who could apply for equity shares of Settler-Co, at a future date, at exercise price. On exercise of the options by employees, as mentioned above, the assessee scrutinised the details, realised the amount of exercise price and then issued the equity shares.

For AY 2010-11, the assessee had issued underlying shares to several eligible employees as per their exercise of the options. Based on these proceeds received from the Eligible Employees, the assesse had recognized the revenue and offered the difference between its cost and the aforesaid revenue as long term capital gains in its return of income. The assessee had also shown interest from deposits with banks under the head Income from Other Sources. The AO held that the equity shares of Settler-Co constituted business assets in the hands of the assessee and consequently income arising from its transfer was to be assessed under the head Income from Business.

The AO also contended that the asset held by the assessee was an 'Option' and 'not Share', which was exercised by the eligible employees during the year under consideration, and such options were not listed securities. These options would not fall within the ambit of capital asset as per the Act and therefore would not be taxable under the head capital gains. It was further contended that the activities carried out by the assessee were conducted on a regular basis and in systematic and organized manner showing income/profits since last several years and these were characteristics of business activity.

The CIT(A) upheld the AO's order.

The assessee contended that presence of business activity could not be judged only from the fact it is an activity carried on a regular basis and in a systematic and organized manner, but the other important factor is that such activity should be carried out with a view to earn income. In the instant case, the only object for carrying out the activity by the assessee was to administer the ESOP scheme of the Setter-Co and to transfer shares to the employees at the point of time they decide to exercise the option.

There was neither a commercial motive, nor a profit motive, as is normally involved while carrying out business.

The assessee relied on the CBDT Circular stating that in the given facts and circumstances, the shares held by the assessee would constitute a capital asset.

Decision:

With reference to the trust the Tribunal noted that the assessee was formed in a manner that real control for operating the scheme was retained by the Settler-Co and the assessee was to act as an extended arm of Settler-Co. On reading the Employees Stock Option Scheme, the Tribunal noted that shares of the Settler-Co were given to assessee to be held by it for the benefit of eligible employees.

The Tribunal further pointed out that the attributes in the subject transactions were more like that of an investor as the assessee was not free or authorized to sell the shares to any person in the free market at fair market price. The assessee therefore could not be said to be in the business of trading in shares and the shares held by the assessee could not be categorised as its "stock- in-trade".

The Tribunal further noted that even if shares would have been issued to the employees at a cost higher than face value, then such excess amount would have constituted share premium in the hands of Settler-Co and could not have been treated as profit earned from business activities. The Tribunal thus observed that as assessee was like an extended arm "the nature and character of shares held by the assessee trust, on behalf of the assessee should be same as what it would have been in the hands of Settler-Co."

The Tribunal also noted that since its inception in 2001, the assessee had been following the same treatment which was allowed by the Department. The Tribunal thus opined that where assessee's stand was accepted by department consistently in many years then Revenue doesn't have unfettered powers to disturb this consistent stand.

Thus, the shares held by the assessee are capital assets in its hands and gain arising on the transfer of these shares by the assessee, shall be taxable under the head income from the capital gains. The Tribunal also held that tax was payable at the rate provided in section 112 of the Act and not at the maximum marginal rate of 30% as contended by the department.

Citation: Mahindra & Mahindra Employee Stock Option Trust (ITA No. 2389) [Mumbai Tribunal]

The Mumbai Tribunal confirms disallowance under section 14A on interest. Rejects the theory of sufficient own funds accepted by the Bombay High Court in its own case on the reasons that such finding of facts needs to be factually proved

Facts and issue: The assessee had earned income by way of interest on tax free PSU bonds, dividend on preference shares and mutual funds. The AO, in the assessment proceeding for AY 2008-09 sought to disallow interest expense by invoking section 14A r/w Rule 8D. The assessee agitated the disallowance made by the AO on two grounds:

a) firstly, the amount invested in tax-free investments were funded by its own capital, available with it in the form of current deposit accounts. No borrowed funds were utilized and therefore, there could be no disallowance of interest in terms of Rule8D(2)(ii),

b) Secondly, the assessee contended that the investments included securities forming part of stock in trade of assessee’s business, acquired in regular course of business. Thus, they would not attract disallowance under section 14A.

The AO did not accept the assessee’s contention and made disallowance under section 14A by applying Rule 8D. The disallowance made by the AO was confirmed by the CIT(A).

Proceeding before the ITAT

Investment out of own funds

The Income tax department submitted that disallowance under section 14A was justified as the capital raised by assessee was to specifically meet the capital adequacy norms and thus it could not be presumed or inferred that investment in shares or bonds had been made out of own funds.

The assessee argued that it had sufficient balance in current deposits accounts on which no interest was suffered. It must therefore be considered as applied towards earning tax-free investments. The assessee relied on the decision of Bombay High Court in its own case reported at 366 ITR 505, which had followed the decision of Bombay High Court in CIT vs. Reliance Utilities and Power Ltd (313 ITR 340)(Bom).

Observations: The decision in Reliance Utilities was duly considered by the Bombay High Court in Godrej & Boyce. The said decision was rendered on a finding of fact by the Tribunal that there were sufficient interest-free funds available. The decision of the Bombay High Court in own case was again rendered on the basis of the facts of the case as being covered by the decision of Reliance Utilities.

The question as explained in Godrej & Boyce was not of the availability of the funds per se, but whether it could be said that it was only these funds that had gone to fund the relevant investments in view of the statutory presumption cast by section 14A. The decision in the case of Reliance Utilities was in context of section 36(1)(iii) for which the parameters are different. In fact, the Bombay High Court in Godrej & Boyce had gone to the extent of stating that the fact that the assessee had utilized its own funds in making the investments would not be dispositive of the question of whether the assessee had incurred the expenditure in relation to earning such (tax-free) income. Even if, therefore, it had utilized its own funds for making investment which had resulted in income not forming part of the total income under the Act, the expenditure which is incurred in earning the income would have to be disallowed.

Decision: In view of the fact that the assessee was not able to exhibit the exact funding of the tax-free investments from current deposit, acquired over the years in the course of its business, the disallowance under section 14A(1) r/w Rule 8D was confirmed.

Tax free investments held as stock in trade of the business

Facts and issue: The assessee contended that disallowance under section 14A would not be applicable to investment held as stock in trade of the business.

Decision: The sole premise of section 14A was to effectuate the basic postulate of taxation that it is only the net income, i.e., net of all expenditure incurred in relation thereto, that is to be subject to tax. It contemplates and seeks to put in place an effective mechanism for apportionment of expenditure where a composite business or activity yields both taxable and non-taxable incomes. The issue of apportionment was settled as per Walfort Share and Stock Brokers P. Ltd. (SC) and Godrej & Boyce wherein it has been held that it is immaterial whether the shares are held as investment or stock-in-trade. Both being assets of a composite business giving rise to two sets of income viz. taxable and non-taxable. Accordingly, tax free investment held as stock in trade of the business would also be subject to disallowance under section 14A of the Act.

Citation: HDFC Bank Ltd. vs. DCIT (TS-553-ITAT-2015)(Mum)

CBDT Notification/ Circular

CBDT reiterates that appeal effects should be promptly and properly given upon receipt of CIT(A) orders

Recently, the CBDT issued a circular directing the AOs to promptly and properly give appeal effect to the CIT(A) orders. To be sure, the AOs were already duty bound to give appeal effect promptly and properly to the CIT(A) orders in view of an earlier Instruction issued by the CBDT on the same issue. In this Circular, the CBDT has reiterated para 4 of the instruction referred to above, which lists out the following:

i) The Range Head shall be responsible to ensure that appeal effects are given promptly and properly.

ii) In case the appeal effect is not given within a month of receipt of CIT(A) order, then the same shall be reported, along with reasons, to the CIT in the monthly reporting. Format for such report has also been specified.

Our Comments:

This move of CBDT is a welcome one as it seeks to promote a non-adversarial approach towards taxpayers. However, as the Circular itself has observed, the implementation of the Instruction has been found wanting.

In fact, in our pre-budget Memorandum to the CBDT, our Firm had taken up the issue of appeal effects and provided the following suggestions:

- There should be a provision making it mandatory for the Assessing Officer to give full effect to the order of a superior or appellate authority, after giving the tax payer a reasonable opportunity of being heard.
- A formal procedure be introduced in the form of the tax payer being required to file in a prescribed format and within a prescribed time period, a working of the desired appeal effect which the Assessing Officer should be duty bound to accept or reject or modify within a prescribed time limit from the date of such filing.

We are glad to see our suggestions being accepted, at least in part, by the CBDT.

Correctness and completeness of appeal effects has to be ensured since these involve assessment of income or computation of tax or both and hence, are appealable orders as was held by the Andhra Pradesh High Court in case of Bakelite Hylam Ltd. vs. CIT 37 Taxman 210.

Promptness of giving appeal effects is imperative if the Tax Department has to improve its image before the taxpayers. Often, it has been found that appeal effects require lot of follow-ups and are caused especially, at the grass-root machinery levels. It is sincerely hoped that this Circular of CBDT serves to achieve its objective – that of appeal effects to CIT(A) orders be given without much follow-up from the taxpayer.

CBDT Circular F. No. 279/Misc./141/2015-ITJ dated October 7, 2015

Reserve Bank of India (RBI)

RBI allows cooperative banks to use recent commodity exchange gold rates for valuation of gold collateral against lending

The said option was not available earlier and rates specified by Indian Bullion and Jewellers Association Limited (IBJA) were to be used for valuation

Earlier RBI, vide circulars dated July 9, 2014 and May 1, 2014 issued guidelines for valuation of gold given as a collateral security against loans given by banks including cooperative banks. The circulars gave two main conditions; first being maximum allowable LTV of 75% and second being rates for valuation of gold which were to be taken from the IBJA for 22 carat gold.

However, on a review, RBI has now allowed cooperative banks to use the historical spot gold price data of the preceding 30 days publicly disseminated by a Commodity Exchange regulated by the Securities and Exchange Board of India, thereby allowing some flexibility to the valuation if not much.

RBI Circular Reference: RBI/2015-16/207

RBI liberalises limit placed by FEMA regulations on hedging of a forex exposure based on self-declaration

The regulator revises limit to 10 Lakh USD from earlier 2.5 Lakhs USD.

As per the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (the Regulation), RBI had allowed resident individuals, firms and companies, to manage / hedge their foreign exchange exposures arising out of actual or anticipated remittances, both inward and outward, by way of forward contracts, without production of underlying documents, up to a limit of USD 250,000 based on self-declaration.

However, as announced in the Fourth Bi-monthly Monetary Policy Statement on September 29, 2015, with a view to further liberalising the existing hedging facilities, it has been decided to allow all resident individuals, firms and companies, who have actual or anticipated foreign exchange exposures, to book foreign exchange forward and FCY-INR options contracts up to USD 10,00,000 without any requirement of documentation on the basis of a simple declaration. While the contracts booked under this facility would normally be on a deliverable basis, cancellation and rebooking of contracts are permitted. Other conditions in the Regulation will still apply.

RBI Circular Reference: RBI/2015-2016/201

Reserve Bank of India (RBI) allows subscription to National Pension Schemes by Non-resident Indians (NRIs)

The **National Pension System** (NPS) is a defined-contribution pension system operated by the Government of India. In 2004, the Government of India decided to move from a defined-benefit pension system to a defined-contribution pension system. Apart from offering a range of investment options to employees, the scheme allows individuals to make decisions about where their pension fund is invested, permits limited withdrawal prior to retirement and reduces the total pension liabilities of the Government of India.

With a view to enabling NRIs' access to old age income security, it has now been decided, in consultation with the Government of India, to enable National Pension System (NPS) as an investment option for NRIs under FEMA, 1999. Accordingly, NRIs may subscribe to the NPS governed and administered by the Pension Fund Regulatory and Development Authority (PFRDA), provided such subscriptions are made through normal banking channels and the person is eligible to invest as per the provisions of the PFRDA Act.

The subscription amounts shall be paid by the NRIs either by inward remittance through normal banking channels or out of funds held in their NRE/FCNR/NRO account. There shall be no restriction on repatriation of the annuity/ accumulated savings.

The NPS is a quiet vehicle for inflow of foreign exchange that can boost India's reserves. Also, those eligible may be tempted to join as investors as India becomes an economy promising a sustained high growth with prospects for a boom in equities. As much of 50% of NPS funds can be invested in equities. This move is an incentive to NRIs to invest in India as well as a potential source of economic stability especially on the balance of payment front.

RBI Circular Reference: RBI/2015-16/216 A.P. (DIR Series) Circular No.24 dated October 29, 2015

Reserve Bank of India (RBI) circular: No fresh permission/ renewal of permission for opening the Liaison Offices (LOs') of foreign law firms

The Hon'ble Supreme Court vide its interim orders dated July 4, 2012 and September 14, 2015, passed in the case of the Bar Council of India vs A.K. Balaji & Ors., has directed RBI not to grant any permission to any foreign law firm, on or after the date of the said interim order, for opening of Liaison Office (LO) in India.

Accordingly, no foreign law firm shall be permitted to open any LO in India till further orders/notification in this regard. However, foreign law firms which have been granted permission prior to the date of interim order for opening LOs in India may be allowed to continue provided such permission is still in force. No fresh permission/ renewal of permission shall be granted by RBI/AD banks respectively till the policy is reviewed based on, among others, final disposal of the matter by the Hon'ble Supreme Court.

RBI circular reference: RBI/2015-16/215 A. P. (DIR Series) Circular No. 23 dated October 29, 2015

Reserve Bank of India (Gold Monetization Scheme) direction, 2015 (the Directions) to all scheduled commercial banks to adhere to the Gold Monetization Scheme issued on September 15, 2015

The said directions replace the erstwhile gold deposit scheme and gold metal loan scheme issued in 1999

RBI, vide circulars dated October 22, 2015 issued the Directions for administration of the gold given as a deposit to the banks under the said scheme. The directions are not applicable to Regional Rural Banks.

Certain specific provisions in the said Directions are as follows:

1. Two types of deposits will be in place namely, Short Term Bank Deposits and Medium and Long Term Bank Deposits;
2. Applicability of same KYC norms as are for regular deposits;
3. Directions for purity testing centres for assessing the quality of gold;
4. Directions as to mobilisation of gold deposited under this scheme;
5. Establishment of the Gold Metal Loan Scheme whereby the gold can be given to jewellers under certain circumstances.

Circular Reference: RBI/2015-16/211

RBI extends requirement of filing Annual Return of Foreign Liabilities and Assets (ARFLA) to Limited Liability Partnerships (LLP)

The regulator now requires the ARFLA to be filed by LLPs which have received Foreign Direct Investment (FDI) or have made FDI abroad

As per the extant regulations, the requirement of filing the ARFLA was restricted to companies which have received or made FDI. However, in light of changing business scenario, RBI vide its circular dated October 21, 2015 has mandated that LLPs which have received or made FDI should also file the return.

The circular also addresses certain practical issues. The ARFLA requires the companies to put in their corporate identification number, which is substituted by ‘A99999AA9999LLP999999’, a common number for all LLPs.

RBI Circular Reference: RBI/2015-2016/210

Individual Housing Loans: rationalisation of Risk-Weights and Loan to Value (LTV) Ratios

Banks are required to make provisions and assign risk-weight for their housing loans to individuals, commercial real estate (CRE) and commercial real estate – residential housing (CRE – RH) exposures as per the amount of loans and LTV ratio for such loans.

Assignment of risk weights for individual housing loans have been revised based on amount of loan and LTV ratio as under:

Before				After			
Amount of Loan	**LTV Ratio**	**Risk Weight**	**Standard assets Provision**	**Amount of Loan**	**LTV Ratio**	**Risk Weight**	**Standard assets provision**
(a) Individual Housing Loan				(a) Individual Housing Loan			
Upto 20 lacs	90%	50%	O.40%	Upto 30 lacs	<= 80%	35%	0.40%
					>80% and <= 90%	50%	
Above 20 lacs and upto 75 lacs	80%	50%	0.40%	Above 30 lacs and upto 75 lacs	<= 75%	35%	0.40%
					>75% and <= 80%	50%	
Above 75 lacs	75%	75%	0.40%	Above 75 lacs	75%	75%	0.40%
(b) CRE - RH	NA	75%	0.75%	(b) CRE – RH	NA	75%	0.75%
(c) CRE	NA	100%	1.00%	(c) CRE	NA	100%	1.00%

The amendment would result in relaxation of LTV norms and risk weights. This arises to:

i) More credit available to borrowers and boost demand for low cost housing
ii) Stabilise the property sector from a prolonged slowdown

RBI Circular reference: RBI/2015-2016/200

Reserve Bank of India (RBI) Directions: Prior approval for acquisition of shares or voting rights in private sector banks

RBI, the banking regulator, in the public interest, has recently released the directions i.e. Reserve Bank of India (Prior approval for acquisition of shares or voting rights in private sector banks) Directions, 2015.

Provisions of the circular are applicable to proposed and existing ‘major shareholders’ of private sector banks (holding 5% or more).

Circular covers person/s who intend to make an acquisition / make an agreement for acquisition which will / is likely to take the aggregate holding of such person/s together with shares / voting rights / compulsorily convertible debentures / bonds held by them, their relatives, associate enterprises and persons acting in concert with him, to 5 per cent or more of the paid-up share capital of the concerned bank or entitles him to exercise 5 per cent or more of the total voting rights of the concerned bank. The person/s shall seek prior approval of the Reserve Bank in the manner specified in Chapter III and IV of these directions.

Directions contain nine chapters including determination/assessment of fit & proper status, procedure for application, continuous monitoring arrangements etc.

The key intention of the said Directions seems to ensure the ‘Fit and Proper’ criteria for directors/CEOs who are presently major shareholders in the private sector banks. Fit and

Proper criteria for Directors on the Boards of Banks takes into account various attributes such as qualifications, relevant relationships of director, details of any proceedings etc. in a specific format called 'Declaration and Undertaking' (Refer RBI Circular RBI/2010-11/541 dated May 23, 2011).

Key contents are:

- In case of subsequent increase in shareholding i.e. post the initial approval of 5%, the said approval is not required for next 500 basis points i.e. upto 10%. If the fresh incremental acquisition is likely to result in enhancing the aggregate shareholding of the existing major shareholder in the bank beyond 10%, the major shareholder will have to obtain a fresh prior approval from the RBI for the proposed incremental shareholding.
- Major shareholders of the bank would also have to give an annual declaration to the concerned bank on their 'fit and proper' status. If in the bank's assessment, any major shareholder is not 'fit and proper', it will have to immediately furnish the requisite information to the RBI.

With the possibility of increased banking M&As and financial market activities, this step may help regulator to effectively monitor the same for the public good.

RBI Directions: RBI/2015-16/240 Master Direction No.DBR.PSBD.No.56/16.13.100/2015-16

Reserve Bank of India (RBI) circular: Definition of Qualifying Assets - Revision of the loan amount with tenure not less than 24 months

RBI had earlier released Non-Banking Financial Company-Micro Finance Institutions–(NBFC-MFIs) Directions ("the Directions") in the form of Master circular (as updated till May 25, 2015). These Directions define NBFC-MFI by two principal criteria viz. Minimum net owned fund of INR 5 Crores, and not less than 85% of its net assets should be in the nature of qualifying assets.

In light of various representations made to RBI from the subject 'sector' and also with the purpose of enabling the banking channel to effectively regulate the Indian credit system, the banking regulator through this circular has amended these Directions to include the tenure for the loan not to be less than 24 months for a loan amount upto INR 30,000 (instead present limit of INR 15,000/-) with prepayment without penalty.

Considering the average small ticket size of loan disbursals in this sector, the list of intended beneficiaries will expand and the system may achieve multiple benefits for both consumers and NBFC-MFIs.

RBI Circular Reference: RBI/2015-16/250 DNBR.CC.PD.No. 071/03.10.038/2015-16

RBI issues operational guidelines in respect of Sovereign Gold Bonds, 2015-16

Subsequent to GoI notification F.No.4(19)-W&M/2014 and RBI circular IDMD. CDD.No.939/14.04.050/2015-16 dated October 30, 2015 on Sovereign Gold Bonds, 2015-16, RBI has issued following operational guidelines for the said scheme along with FAQs on its website www.rbi.org.in.

- ***Application forms*** from investors duly filled in along with additional details if any shall be accepted at branches during normal banking hours from 5th to 20th November, 2015. Receiving offices need to preserve all the applications till bonds are matured and are repaid.

- ***Multiple joint holders and nominees*** (of first holder) is permitted.

- ***Interest on application money*** will be paid to applicants at prevailing savings bank rate from the date of realization of payment to the settlement date, ie. the period for which they are out of funds.

- ***Cancellation of application*** is permitted till closure of the issue, i.e., 20th November, 2015. In such cases, interest on application money shall not be payable. Further, part cancellation would not be permitted.

- ***Lien marking of bonds*** being Government securities would be as per provisions of Government Securities Act, 2006 and rules framed there under.

- Scheduled commercial banks can enter into ***agency arrangements / tie-up with NBFCs, NSC agents*** and others to collect application forms on their behalf.

- Sovereign Gold Bonds would also be available for ***subscription at scheduled commercial bank branches and designated post offices through RBI's e-kuber system.*** The receiving offices would be required to enter the data or carry out bulk upload for the subscriptions received on the system and for which a confirmation scroll will be provided.

- ***Printing of Holding Certificate:*** On the date of allotment, ie., 26th November, 2015, holding certificates for all the subscriptions can be generated from the system in addition to being sent through e-mail to the investors. ***The certificate should be printed in colour on A4 size 100 GSM paper.*** Such securities would be credited in demat accounts of the investors, who have specified their account details.

- Receiving offices, i.e., branches of scheduled commercial banks and post offices will provide all the necessary ***servicing and follow up in respect of bonds to the customers*** such as update contact details, receive requests for premature encashment, etc.

Circular no. RBI/2015-16/222 IDMD.CDD.No.968/14.04.050/2015-16 dated 4th November 2015

Notification of Interest Rates for Medium and Long term Deposits under Gold Monetisation Scheme, 2015

As per Para 2.2.2 (iv) on Medium and Long Term Government Deposit (MLTGD) under RBI's Master Direction No.DBR.IBD.No.45/ 23.67.003/ 2015-16 dated October 22, 2015 on Gold Monetisation Scheme (GMS), 2015., rate of interest on such deposits was to be decided by Central Government and notified by RBI from time to time.

The Central Government has now fixed the ***rate of interest on MLTGD under the GMS as follows:***

- On Medium Term Deposit – 2.25% p.a.
- On Long Term Deposit – 2.50% p.a.

Further, a copy of the list of the Collection and Purity Testing Centres (CPTCs) and the Refiners participating in the GMS, as notified by the GOI on 2nd November, 2015 has also been annexed with the said circular.

Circular no.RBI/2015-16/220DBR.IBD.BC.53/23.67.003/2015-16 dated 3rd November, 2015

Software Export – Filing Of Bulk Softex Form In Excel Format

A software exporter, whose annual turnover is at least Rs.1000 crores or who files at least 600 SOFTEX forms annually on an all India basis, is eligible to declare all the off-site software exports in bulk in the form of a statement in excel format, to the competent authority for certification on monthly basis.

Facility of filing single as well as bulk SOFTEX form in excel format to the competent authority for certification is extended to all software exporters without any turnover or quantity limits.

The software exporters can generate SOFTEX form number (single as well as bulk - maximum 200 forms numbers in case bulk option is selected) for use in off-site software exports from the website www.rbi.org.in by filling the online form.
The Foreign Exchange Management Act (FEMA), 1999 requires exporters to complete the SOFTEX form using the number so allotted by RBI and submit it first to the competent authority for certification and then to the authorised dealers (AD) for further necessary actions.

Since the SOFTEX data from STPI/SEZ is being transmitted in electronic format to RBI, the exporters are required to submit the SOFTEX form in duplicate as per the revised procedure. STPI/SEZ will retain one copy and handover the duplicate copy to the exporters after due certification.

Benefit of filing of SOFTTEX data to competent authority is liberalised for all the software exporters.

Circular reference:
RBI/2015-16/231 A.P. (DIR Series) Circular No.27

Risk Management & Inter-Bank Dealings: Relaxation of facilities for residents for hedging of foreign currency borrowings

Residents having a long term foreign currency liability in terms of Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000, are permitted to hedge exchange rate and/or interest rate risk exposure thereof by undertaking a foreign currency (FCY) - INR swap to move from a foreign currency liability to a rupee liability with an Authorised Dealer (AD) Category - I bank as per the operational guidelines, terms and conditions.

Residents are now permitted to enter into FCY- INR swap to move from a foreign currency liability to a rupee liability with Multilateral or International Financial Institutions (MFI/IFI) in which Government of India is a shareholding member subject to the following additional terms and conditions:

i) Such swap transactions shall be undertaken by the MFI / IFI concerned on a back-to-back basis with an AD Category-I bank in India.
ii) For this purpose, AD Category-I banks shall interface with only those Multilateral Financial Institutions (MFIs) and International Financial Institutions (IFIs) in which Government of India is a shareholding member.
iii) The FCY-INR swaps shall have a minimum tenor of three years.

In the event of a default by the resident borrower on its swap obligations, the MFI / IFI concerned shall bring in foreign currency funds to meet its corresponding liabilities to the counterparty AD Category -I bank in India.

AD Category-I bank shall report the FCY-INR swaps transactions entered into with the MFIs / IFIs on a back-to-back basis to Clearing corporation of India Limited reporting platform, including details of the foreign currency borrower.

Circular Reference:
RBI/2015-16/232 A.P. (DIR Series) Circular No. 28

Amendment in the Asset and Income criteria of factoring companies eligible for bank finance

As per circular no. DBOD.BP.BC.No.40/21.04.172/2012-13 dated September 11, 2012 on "Bank Finance to Factoring Companies", banks could provide financial assistance to Factoring Companies with certain criteria that inter-alia, stated that the Factoring Companies should derive at least 75 % of their income from factoring activity and the receivables purchased / financed, whether on 'with recourse' or 'without recourse' basis and such assets should form at least 75 % of its total assets.

Subsequent to the amendment in Non-Banking Financial Company – Factors (Reserve Bank) Directions, 2012 vide Circular no. DNBR (PD) CC.No.003/22.10.91/2014-15 dated November 10, 2014, wherein an NBFC registering as NBFC-Factor would be required to ensure that its financial assets as well as income derived from factoring business constitutes at least 50 % of its total assets and its gross income; ***the said criteria has also been revised to 50% from 75% with respect to eligibility for bank finance.***

<u>Circular no. RBI/2015-16/247 DBR.BP.BC.No.55/21.04.172/2015-16 dated November 26, 2015</u>

Securities and Exchange Board of India (SEBI)

Securities and Exchange Board of India (SEBI) circular cuts the Initial Public Offering related paperwork: Revised Disclosures to be made in the Abridged Prospectus and Price Information of past issues handled by Merchant Bankers

Requirements with respect to disclosures in the abridged prospectus have been prescribed by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and the Companies Act, 2013.

However, the current structure of abridged prospectus has become voluminous and so defeats the very purpose of abridged prospectus. With a view to address the issue, the disclosure requirements in the abridged prospectus have been rationalized in consultation with Investor Associations and market participants. The revised abridged prospectus improves the readability and contains relevant information for the investor to take well informed investment decision.

Further, the format for disclosure of price information of past issues handled by the merchant bankers as specified vides SEBI Circular no. CIR/CFD/DIL/5/2011 dated September 27, 2011, has been revised and is placed at Annexure II of this Circular. Key contents would be Price information, Promoters details, Business model/business overview and stratergy, Restated financials etc.

The new format will come into effect from December 1, 2015.

Currently, the full prospectus that companies file for their public offers including IPOs runs into circa 400-500 pages generally and it has often been felt that the investors find it difficult to get the key information from such bulky documents. As per the industry experts, a copy of abridged prospectus along with an application form won’t exceed beyond five sheets after considering both sides printing. While unveiling the format, SEBI has emphasized that information as is material and appropriate to enable the investors to make an informed decision shall be disclosed in the abridged prospectus. This may change the outlook of primary equity markets investments with an anticipation of increased subscription levels especially from retail/small investors as it will be easier for them to understand key disclosures.

Introduction of a uniform Listing agreement format

SEBI has recently introduced a uniform listing agreement format incorporating the revised disclosure and regulatory requirements applicable for all listed entities as per the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

The uniform listing agreement which is a ***simplified format*** (approximately 3 pages) would be applicable with respect to the following securities issued under respective regulations:

- Specified securities (equity and convertible securities on Main board, SME platform or Institutional Trading Platform)
- Indian Depository Receipts
- Non-convertible debt securities,
- Non-convertible redeemable preference shares,
- Securitised debt instruments (equity and convertible securities on the main board, SME platform and Institutional Trading Platform) and
- Mutual funds

All existing listed entities would also be required to execute a fresh listing agreement within six months of the date of notification of SEBI (Listing Obligations and Disclosure Requirements) Regulations i.e., September 2, 2015. Compliance Officers need to make note of this important compliance requirement coming up.

The detailed format has been annexed in the said circular No. CIR/CFD/CMD/6/2015 dated October 13, 2015 and has been displayed on the SEBI website.

SEBI's move to introduce uniform listing agreement is a welcome one and a long pending one, at that, as it aims to consolidate and strengthen the provisions of the existing listing agreements for different segments of the capital markets.
SEBI Circular No. CIR/CFD/CMD/6/2015 dated October 13, 2015

Enhancement in limit of investments by FPIs in Government securities

Subsequent to the RBI's Fourth Bi-monthly Policy Statement for the year 2015-16, dated September 29, 2015 wherein it had announced a Medium Term Framework for FPI limits in Government securities in consultation with the GOI, ***the limit for investment by FPIs (henceforth would be announced in rupee terms instead of US$) in Government securities has been enhanced in 2 tranches as under:***

Amount in Crores

Revised Limits w.e.f	Central Government Securities (CGSs)			State Development Loans (SDLs)	Overall Limit Total
	For all FPIs	Additional Limit for Long Term FPIs*	Total	For all FPIs	

Existing Limit	1,24,432	29,137	1,53,569	NIL	1,53,569
12-10-2015	1,29,900	36,600	1,66,500	3500	1,70,000
01-01-2016	1,35,400	44,100	1,79,500	7000	1,86,500

**Sovereign Wealth Funds (SWFs), Multilateral Agencies, Endowment Funds, Insurance Funds, Pension Funds and Foreign Central Banks)*

Besides enhancing the aforesaid investment limits, following additional conditions have been stipulated:

- A security-wise limit of 20% of the amount outstanding under each CGS has been put in place prospectively from 12 October 2015.

- The security-wise limit would be monitored on a day-end basis and the CGSs wherein aggregate investment exceeds 20%, shall be put in a negative investment list. Fresh investments in such securities will be permitted only after removal from the negative list.

- All future investments by Long Term FPIs in CGSs as well as SDLs shall have a minimum residual maturity of 3 years.

- There will be no security-wise limit for State Development Loans.

- However, investment of coupons received by FPIs on their existing investments in CGSs as well as SDLs will continue to be outside the applicable limits. The terms and conditions for investment of coupons specified vide SEBI circular CIR/IND/FIIC/2/2015 dated February 05, 2015 shall, mutatis mutandis, apply to SDLs.

  This move of the Government is expected to allow it to raise additional funds of Rs. 1.2 lakh crores by March 2018 and is a welcome step aimed at further easing norms for foreign ownership of government debt. Permitting the State Governments to avail FPI funding is a move aimed clearly at making funding available to the States for their development plans and this latest development is expected to bring in about Rs. 50,000 crores to the States.

SEBI Circular No. CIR/IMD/FPIC/8/2015 dated October 06, 2015

Business responsibility reporting – formats prescribed

Over the years, the accountability of enterprises has expanded from their being accountable to only the shareholders to a wider accountability to the larger society, particularly for listed entities that have accessed funds from the public.

In accordance with this thinking, clause (f) of sub regulation (2) of regulation 34 of Listing Regulations issued by SEBI required A**nnual reports** of all listed companies to contain a **Business Responsibility Report** (BRR) describing the initiatives taken by the listed entity from an environmental, social and governance perspective. The format of BRR was to be prescribed.

Vide circular dated November 4th, 2015 a format for BRR has now being prescribed.

Effective date of the circular: December 1, 2015.

An exception to the format prescribed by SEBI applies to listed entities that submit sustainability reports to overseas regulatory agencies/stakeholders based on internationally accepted reporting frameworks. Such entities are not required to prepare a separate report per the new format – existing BRR can be furnished along with details of the framework under which existing BRR has been prepared and mapping of guidelines principles of the current circular to the disclosures in the existing BRR.

The circular includes two annexures; **Annexure 1** prescribes format of the report and **Annexure 2** prescribes the principles to be followed in preparing the report.

The suggested format of the Business Responsibility Report per **Annexure 1** comprises following sections:

i. Section **A** requires general information such as CIN No., name, Registered Address, Sectors of Business Company is engaged into, locations of company and markets to which company serves etc.
ii. Section **B** requires financial information such as Paid-up Capital (INR), Total Turnover, Total PAT and spending on CSR as percentage of PAT including activities for which it is spent.
iii. Section **C** requires details of subsidiary companies and also whether such subsidiaries (and other companies with whom the listed entities does business) participate in the Business Responsibility activities of the listed entity.
iv. Section **D** requires details of directors, the BR head and a detailed questionnaire about how BR policy is formulated.
v. Section **E** includes a questionnaire on performance of the company based on guiding principles on various aspects of company's operations such as ethics, employees, human rights etc.

Annexure 2 prescribes the principles to assess compliance with environmental, social and governance norms covering Ethics, sustainability, employee wellbeing, responsiveness to stakeholders, environment, inclusive growth and customer engagement. The thrust of the principles is to ensure businesses conduct their operations in an ethical manner and with due consideration of environmental and human impact of their operations.

CIR/CFD/CMD/10/2015

Streamlining process of public issue of Equity Shares and convertibles

SEBI had earlier amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 to streamline the process of public issue of equity shares by reducing time taken to listing after issue closure to 6 working days (from 12 working days) and to increase investor reach by increasing points where applications can be submitted.

Vide this circular; SEBI has now issued operational guidelines for implementation of the above including indicative timelines for completion of various activities during the public issue.

Effective date: public issues opening **on or after January 1, 2016.**

Key guidelines provided by SEBI comprise:

1. Investors applying for public issue shall use **only Application Supported by Blocked Amount (ASBA)** facility for making payment.

2. In addition to Self Certified Syndicate Banks (SCSBs), Syndicate Members and Registered Brokers of Stock Exchanges, the Registrars to an Issue and Share Transfer Agents (RTAs) and Depository Participants (DPs) registered with SEBI are now permitted to accept application forms (both physical as well as online) in public issues.

3. The RTAs and DPs are to provide contact information for collection of application forms to recognized stock exchanges by November 30, 2015 – the same shall be disclosed by the stock exchanges on their websites.

4. Similar to secondary market, stock exchanges are required to devise a mechanism so that investor can receive updates regarding their applications through SMS and E-mail alerts.

CIR/CFD/POLICYCELL/11/2015

Indian Depositary Receipts – guidance on disclosure norms and two way fungibility

i. The circular provides disclosure norms for Indian Depository Receipts (IDRs) in relation to corporate governance and share holding pattern. The circular also provides guidance on manner of compliance with two-way fungibility for IDRs.

   Effective date: December 1st, 2015.

ii. As per regulation 69 (1) of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations"), listed entities that have issued IDRs are required to file the shareholding pattern of IDRs within 15days of the end of the quarter with the stock exchange. The format of disclosure to be made has now been specified vide the current circular.

iii. Further, regulation 72(1) of Listing Regulations requires listed entities to comply with the corporate governance provisions as applicable in the entity's home country and other jurisdictions in which its equity shares are listed. Further, regulation 72(2) requires listed entities to submit a comparative analysis of the corporate governance provisions applicable in the respective countries and such requirements applicable under regulation 17 to 27 to other than listed entities.

   Format for such reporting was earlier specified by SEBI vide its circular CIR/CFD/CMD/5/2015 dated September 24, 2015. Vide the current circular; listed entities are required to additionally disclose whether the IDR disclosure requirements are applicable in the Home country/other jurisdictions where such entity is listed.

iv. Listed entities are also required to disclose the above information on their website.

v. Additionally, regulation 76(3) of Listing Regulations requires IDRs to have two-way fungibility in the manner specified by the Board from time to time. Procedures to be followed for partial two-way fungibility within available headroom has been specified vide the current circular.

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Other Regulators – Competition Commission, Ministry of Company Affairs