



INDIA UPDATE

A monthly Newsletter on business intelligence and opportunities in India

AUGUST 2006



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GOVERNMENT OF INDIA : OUTLOOK OF INDIAN ECONOMY PROMISING

The Government of India has forecast the outlook for the current year as 'promising' but has identified increased global oil prices and hardening of interest rates as the main challenges facing the Indian economy. The finance ministry stated that it was hopeful of maintaining fiscal discipline by pushing expenditure management reforms.

"The first quarter signals are fairly satisfying in the backdrop of continuing macroeconomic stability," Finance Ministry Mr. P Chidambaram said in a statement on the first quarter review of the trends in receipts and expenditure of the current financial year. The document was tabled in Parliament on 26th August 2006.

As per the statement, the fiscal deficit touched 52.3 per cent of the Budget estimate at the end of the first quarter of 2006-07 compared with 36 per cent of the corresponding period last year, mainly on account of front loading of expenditure by various departments and ministries. The Government stated that it was confident significant imbalance in the first quarter between revenues and expenditure would even out as revenue receipts stepped up and expenditure pattern stabilized during the remaining part of the year.

In the first quarter of the current fiscal, tax revenues and non-tax revenues witnessed 32 per cent and 25 per cent growth respectively but these were overtaken by a sharper growth in total expenditure. The plan expenditure and non-plan expenditure increased by 59 per cent and 34 per cent respectively. The increase in plan expenditure was due to large advance transfers made for the rural employment guarantee scheme and other social sector schemes, while non-plan expenditure was mainly due to increase in food and fertiliser subsidy. The inflexible items of expenditure like interest payments and defence services together contributed 33 per cent of the total expenditure during the first quarter. The Government has stated that it is determined to contain the expenditure within the Budget.

As regards the performance during 2005-06, the ministry said that the government had not only been able to achieve the deficit targets set under the FRBM Act 2003 but had also reasonably enabled most state governments to reduce their fiscal stress through debt consolidation.

Views of our Economist:

The Indian economy is expected to grow at 7.5 to 8% during the fiscal year 2006-07 provided agricultural sector also contributes to GDP growth at least to the extent of its contribution in the previous year. Inflation and interest rate would be two worrying factors which would continue to haunt the Government.

The foreign exchange reserves continue to be comfortable at US\$ 165 billion but increase in the current account deficit is a matter of concern. Increase in inflation to 4.92% in the week ended 12th August 2006 is a pointer to the tough measures needed to be taken by the Government to curtail it below the crucial level of 5% in the wake of hardening oil prices

The increase in interest rate was also inevitable with the Reserve Bank of India increasing the reverse repo rate and repo rate by 25 basis points to 6% and 7% respectively. Many Indian Banks including Government owned banks have promptly increased their lending rates. The demand for funds is increasing significantly and most of the banks which were seeking borrowers about nine months back by offering funds at low rate of interest are imposing tougher terms for funding of new projects. If the demand for funds continues to grow significantly, liquidity position may harden resulting in further increase in interest rate apart from impacting real estate and equity market.

SEZ RULES AMENDED TO PLUG LOOPHOLES BUT NO CAP ON NUMBER OF SPECIAL ECONOMIC ZONES

The amendments made to the SEZ Rules seek to introduce conditions to qualify for the tax benefits to take care of the finance ministry's apprehensions of potential revenue leakage due to relocation.

As per the new rules, companies operating in SEZs will have to make fresh investments on plant and machinery. The other amendment relates to the definition of trading activities. The commerce ministry has now clarified that trading shall only mean import for the purpose of re-export. Therefore, only such companies who import goods to re-export can claim such trading activities for an income tax rebate. Trading by companies who source products from domestic tariff area (any domestic market outside the SEZ) for export, will not qualify for the tax benefits. Further, the minimum processing area for a multi-product SEZ being raised to 35% from 25% and the ceiling for free trade and warehousing zones fixed at 50%.

Besides, infrastructure for business and social purposes in SEZ will get exemption, concession and drawback to the extent the facilities are approved by the Board of Approval (BoA). However, SEZ developers are free to build facilities more than what is approved by the BoA but they would not get any exemption or concession of duties on those additional facilities.

Brushing aside concerns of a revenue loss raised by the finance ministry, the Empowered Group of Ministers on special economic zones today decided not to impose any further caps on the number of zones that can be set up in the country. The decision overrode objections raised by Finance Minister Mr.P Chidambaram, who circulated a note quantifying the revenue losses arising out of the tax giveaways for SEZs. He pointed out that the losses would total up to a staggering Rs 700 billion. The Commerce and Industry Minister Mr.Kamal Nath refuted this contention and pointed out that the zones would instead lead to revenue gains of around Rs 440 billion over the next 5-10 years, besides creating lakhs of jobs.

The group said it would examine the need for any further policy changes after 75 of the already approved zones became operational, or in six months from now, whichever is earlier.

RBI NOTIFIES REVISED PRUDENTIAL GUIDELINES ON BANK'S INVESTMENT IN VCF

The Reserve Bank of India has notified revised Prudential Guidelines on Bank's investment in Venture Capital Funds (VCF) in view of significant increase in the exposure of banks in this sector. The revised guidelines are given hereunder:

1. Prudential exposure limits

1.1 All exposures to VCFs (both registered and unregistered) will be deemed to be on par with equity and hence will be reckoned for compliance with the capital market exposure ceilings (ceiling for direct investment in equity and equity linked instruments as well as ceiling for overall capital market exposure).

1.2 The investment in VCFs set up in the form of companies will be subject to compliance with the provisions of Section 19(2) of Banking Regulation Act 1949 i.e the bank will not hold more than 30% of the paid up capital of the investee company or 30% of its own paid up share capital and reserves, whichever is lower.

1.3 . Besides, investments in VCFs in the form of equity/units etc. will also be subjected to the limits stipulated vide para 3 of Master circular on Para Banking Activities DBOD.FSD.No.10/24.01.001/2005-06 dated July 1, 2005 in terms of which the investment by a bank in a subsidiary company, financial services company, financial institution, stock and other exchanges should not exceed 10 per cent of the bank's paid-up capital and reserves and the investments in all such companies, financial institutions, stock and other exchanges put together

should not exceed 20 per cent of the bank's paid-up capital and reserves.

2. Valuation and classification of banks' investment in VCFs

2.1 The quoted equity shares / bonds/ units of VCFs in the bank's portfolio should be held under Available for Sale (AFS) category and marked to market preferably on a daily basis, but at least on a weekly basis in line with valuation norms for other equity shares as per existing instructions.

2.2 Banks' investments in unquoted shares/bonds/units of VCFs made after issuance of these guidelines will be classified under Held to Maturity (HTM) category for initial period of three years and will be valued at cost during this period. For the investments made before issuance of these guidelines, the classification would be done as per the existing norms.

2.3 For this purpose, the period of three years will be reckoned separately for each disbursement made by the bank to VCF as and when the committed capital is called up. However, to ensure conformity with the existing norms for transferring securities from HTM category, transfer of all securities which have completed three years as mentioned above will be effected at the beginning of the next accounting year in one lot to coincide with the annual transfer of investments from HTM category.

2.4. After three years, the unquoted units/shares/bonds should be transferred to AFS category and valued as under:

i) Units :

In the case of investments in the form of units, the valuation will be done at the Net Asset Value (NAV) shown by the VCF in its financial statements. Depreciation, if any, on the units based on NAV has to be provided at the time of shifting the investments to AFS category from HTM category as also on subsequent valuations which should be done at quarterly or more frequent intervals based on the financial statements received from the VCF. At least once in a year, the units should be valued based on the audited results. However, if the audited balance sheet/ financial statements showing NAV figures are not available continuously for more than 18 months as on the date of valuation, the investments are to be valued at Rupee 1.00 per VCF.

ii) Equity:

In the case of investments in the form of shares, the valuation can be done at the required frequency based on the break-up value (without considering 'revaluation reserves', if any) which is to be ascertained from the company's (VCF's) latest balance sheet (which should not be more than 18 months prior to the date of valuation). Depreciation, if any on the shares has to be provided at the time of shifting the investments to AFS category as also on subsequent valuations which should be done at quarterly or more frequent intervals. If the latest balance sheet available is more than 18 months old, the shares are to be valued at Rupee.1.00 per company.

(iii) Bonds:

The investment in the bonds of VCFs, if any, should be valued as per prudential norms for classification, valuation and operation of investment portfolio by banks issued by RBI from time to time.

3. Risk Weight and capital charge for market risk for exposures in VCFs

3.1 Shares and units of VCFs: Investments in shares /units of VCFs may be assigned 150% risk weight for measuring the credit risk during first three years when these are held under HTM category. When these are held under or transferred to AFS, the capital charge for specific risk component of the market risk as required in terms of the present guidelines on computation of capital charge for market risk, may be fixed at 13.5% to reflect the risk weight of 150%. The charge for general market risk component would be at 9% as in the case of other equities.

3.2 Bonds of VCFs: Investments in bonds of VCFs will attract risk weight of 150% for measuring the credit risk during first three years when these are held under HTM category. When the bonds are held under or transferred to AFS category these would attract specific risk capital charge of 13.5%.

The charge for general market risk may be computed as in the case of investment in any other kind of bonds as per existing guidelines.

3.3 Exposures to VCFs other than investments: The exposures to VCFs other than investments may also be assigned a risk weight of 150%.

4. Exemption under guidelines relating to non-SLR securities

As per extant guidelines relating to non-SLR securities, a bank's investment in unlisted non-SLR securities should not exceed 10 per cent of its total investment in non-SLR securities as on March 31, of the previous year. Further, banks must not invest in unrated non-SLR securities. The investments in unlisted and unrated bonds of VCFs will be exempted from these guidelines.

5. RBI approval for strategic investments in VCFs by banks

Banks should obtain prior approval of RBI for making strategic investment in VCFs i.e. investments equivalent to more than 10% of the equity/unit capital of a VCF.

BANKS ALLOWED TO OFFER INTERNET BASED FOREIGN EXCHANGE SERVICES

In terms of the Reserve Bank of India's (RBI) circular DBOD. COMP. BC. No. 130/07.03.23/ 2001-01 dated June 14, 2001 that sets out the guidelines for banks on Internet Banking in India , the Internet banking services allowed to be offered by banks to residents of India should only include local currency products. A number of banks have been requesting the Reserve Bank of India (RBI) for permission to offer Internet based foreign exchange services, in addition to local currency products, on Internet based platforms. In view of this, RBI has decided that banks may be permitted to offer Internet based foreign exchange services, for permitted underlying transactions, in addition to the local currency products already allowed to be offered on Internet based platforms, subject to the following terms and conditions:

- Banks will remain responsible for secrecy, confidentiality and integrity of data.
- The data relating to Indian operations will be kept segregated.
- The data will be made available to RBI inspection / audit as and when called for.
- The services offered through Internet, for banks' customers on an Internet based platform for dealing in foreign exchange, should allow only reporting and initiation of foreign exchange related transactions, with the actual trade transactions being permitted only after verification of physical documents.
- Banks should comply with FEMA regulations in respect of instructions involving cross-border transactions.

Further, in all other matters relating to Internet banking services, banks may continue to be guided by the instructions contained in RBI circular DBOD. COMP. BC. No. 130/07.03.23/ 2001-01 dated June 14, 2001 on Internet Banking.

RBI CLARIFICATION ON MODE OF PAYMENT FOR PURCHASE OF IMMOVABLE PROPERTY BY NRIs & PIOs

In terms of the current foreign exchange regulations, Indian citizens resident outside India and Persons of Indian origin can acquire immovable property in India other than agricultural property, plantation or a farm house. The Reserve Bank of India (RBI) has clarified that the payment for such acquisition shall be made out of (i) funds received in India through normal banking channels by way of inward remittance from any place outside India or (ii) funds held in any non-resident account maintained in accordance with the provisions of the Foreign Exchange Management Act, 1999 and the regulations made by Reserve Bank of India from time to time.

RBI has accordingly clarified that such payment cannot be made either by traveller's cheque or by foreign currency notes or by other mode other than those specifically mentioned hereinabove.

AMENDMENT TO GUIDELINES FOR BANKS UNDERTAKING PD BUSINESS

The Reserve Bank of India (RBI) has, on a re-examination of the matter, decided that it would not be necessary for banks to maintain a separate SGL account for PD business, as envisaged in terms of paragraphs 4 and 5 (iv) of the guidelines issued vide its circular DBOD. FSD.BC. No. 64/24.92.001/ 2005-06 dated February 27, 2006. Banks undertaking PD business departmentally may maintain a single SGL account. The banks would, however, need to keep separate books of accounts internally for monitoring on an ongoing basis, maintenance of the minimum stipulated balance of Rs. 1 billion of Government Securities and for recording the transactions undertaken by the PD business.

SEBI GUIDELINES FOR INVESTMENT IN ADRs/GDRs/FOREIGN SECURITIES AND OVERSEAS ETFs BY MUTUAL FUNDS

The Securities & Exchange Board of India (SEBI) has issued guidelines for investment in ADRs/GDRs/foreign securities and they are summarized hereunder:

1. These guidelines are with reference to various circulars issued by SEBI pertaining to investment by mutual funds in ADRs/GDRs/foreign securities.
2. The aggregate ceiling for the mutual fund industry to invest in ADRs/GDRs issued by Indian companies, equity of overseas companies listed on recognized stock exchanges overseas and rated debt securities (subsequently referred to as "foreign securities") has been raised from US \$ 1 billion to US \$ 2 billion in the Finance Bill 2006 – 07.
3. Conditions for investments in ADRs/GDRs/Foreign Securities
 - a. The mutual funds can make investments in
 - ADRs/GDRs issued by Indian companies
 - equity of overseas companies listed on recognized stock exchanges overseas
 - foreign debt securities in the countries with fully convertible currencies, short term as well as long term debt instruments with highest rating (foreign currency credit rating) by accredited/registered credit rating agencies, say A-1/AAA by Standard & Poor, P-1/AAA by Moody's, F1/AAA by Fitch IBCA, etc.
 - government securities where the countries are AAA rated.
 - units/securities issued by overseas mutual funds or unit trusts which invest in the aforesaid securities or are rated as mentioned above and are registered with overseas regulators.
 - b. The mutual funds can invest in ADRs/GDRs/Foreign Securities within overall limit of US\$ 2 bn. with a sub-ceiling for individual mutual funds which should not exceed 10% of the net assets managed by them as on March 31 of each relevant year, subject to a maximum of US \$100 million per mutual fund.
4. Conditions for Investment in Overseas exchange traded funds(ETFs):

Finance Bill for the year 2006-2007 permits a limited number of qualified Indian mutual funds to invest, cumulatively up to \$ 1 billion, in overseas exchange traded funds.

 - a. Eligibility : To be eligible to invest in overseas ETFs, either of the two conditions shall be satisfied:
 1. The Mutual Fund shall be in existence for a minimum period of 10 years as on July 31, 2006 and managing schemes.

2. The Mutual Fund or its Sponsors shall have experience, to be certified by the Trustees, of investing in foreign securities, and an appropriate disclosure regarding the nature of experience shall be made in the offer document.

b. Limits : The mutual funds can invest in overseas ETFs within overall limit of US\$ 1 billion with a sub-ceiling for individual mutual fund which should not exceed 10% of the net assets managed by them as on March 31 of each relevant year, subject to a maximum of US \$50 million per mutual fund.

5. Other Conditions:

Apart from applicability of SEBI (Mutual Funds) Regulations, 1996 and guidelines issued from time to time, the mutual funds shall adhere to the following specific guidelines for making investments in ADRs/GDRs/Foreign Securities and overseas ETFs by the Mutual Fund schemes:

a. Appointment of dedicated Fund Manager

The Mutual Fund shall appoint a dedicated Fund Manager for making investments in ADRs/GDRs/Foreign Securities and overseas ETFs. However, the existing schemes which have already invested in ADRs/GDRs/Foreign Securities shall ensure compliance with the said requirement within a period of six months from the date of this circular.

b. Due Diligence

Boards of Asset Management Companies (AMCs) and trustees shall exercise due diligence in making investment decisions as required under Regulation 25 (2). They shall make a detailed analysis of risks and returns of investment in foreign securities and overseas ETFs, comparing them with likely yields of the securities available in domestic markets and how these investments would be in the interest of investors. Investment must be made in liquid actively traded securities. Boards of AMCs and trustees may prescribe detailed parameters for making such investments which may include identification of countries, country rating, country limits, etc. They shall satisfy themselves that the AMC has experienced key personnel, research facilities and infrastructure for making such investments. Other specialised agencies and service providers associated with such investments e.g. custodian, bank, advisors, etc should also have adequate expertise and infrastructure facilities. Their past track record of performance and regulatory compliance record, if they are registered with foreign regulators, may also be considered. Necessary agreements may be entered into with them as considered necessary.

All investment decisions shall be recorded in accordance with SEBI circular dated July 27, 2000.

c. Disclosure Requirements

The following disclosure requirements shall be mandatory for mutual fund schemes proposing to invest in foreign securities.

1. Intention to invest in foreign securities/ ETFs shall be disclosed in the offer documents of the schemes. The attendant risk factors and returns ensuing from such investments shall be explained clearly in offer documents. The mutual funds shall also disclose as to how such investments will help in the furtherance of the investment objectives of the schemes. Such disclosures shall be in a language comprehensible to an average investor in mutual funds.
2. The mutual funds shall disclose the name of the dedicated Fund Manager for making investments in ADRs/GDRs/Foreign Securities and Overseas ETFs.
3. In case of schemes investing in ETFs the nature of experience of mutual fund or its Sponsors of having invested in foreign securities shall be disclosed shall be appropriately disclosed in the offer document.
4. The mutual funds shall disclose exposure limits i.e. the percentage of assets of the scheme they would invest in foreign securities/ ETFs.
5. Such investments shall be disclosed while disclosing half-yearly portfolios in the prescribed format

by making a separate heading "Foreign Securities/overseas ETFs." Scheme-wise percentage of investments made in such securities shall be disclosed while publishing half-yearly results in the prescribed format, as a footnote.

d. Investment by Existing Schemes:

Existing schemes of mutual funds where the offer document provides for investment in foreign securities and attendant risk factors but which have not yet invested, may invest in foreign securities, consistent with the investment objectives of the schemes, provided a dedicated fund manager has been appointed for making investments in ADRs/GDRs/Foreign Securities. Any additional disclosure as specified above shall be informed to unit holders by way of addendum.

In case the offer document of an existing scheme does not provide for investment in ADRs/GDRs /foreign securities and overseas ETFs, the scheme, if it so desires, may make such investments in accordance with these guidelines, provided that: prior to investment in ADRs/GDRs /foreign securities and overseas ETFs for the first time, the AMC shall ensure that a written communication about the proposed investment is sent to each unit holder and an advertisement is given in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of the region where the Head Office of the mutual fund is situated. The communication to unitholders shall also disclose the risk factors associated with such investments.

e. Reporting to Trustees:

The AMCs shall send detailed periodical reports to the trustees which shall include the following aspects:

1. Performance of investments made in foreign securities and overseas ETFs in various countries.
2. Amount invested in various schemes and any breach of the exposure limit laid down in the scheme offer documents.

f. Review of Performance

Boards of AMCs and trustees shall review the performance of investments made in foreign securities/overseas ETFs in their meetings by comparing the yield with that of investment opportunities available in domestic markets and shall decide further course of action. In case of schemes investing exclusively in foreign securities/overseas ETFs, performance may also be compared with appropriate benchmark(s).

g. Reporting to SEBI

The AMCs and trustees shall offer their comments on the compliance of these guidelines in the quarterly and half-yearly reports filed with SEBI.

h. Clause 4 of Seventh Schedule of the SEBI (Mutual Funds) Regulations 1996

It has been clarified that Clause 4 of Seventh Schedule of the SEBI (Mutual Funds) Regulations 1996 which restricts investments in mutual fund units upto 5% of net assets and prohibits charging of fees, shall not be applicable to investments in mutual funds in foreign countries made in accordance with guidelines as per aforesaid circular. However, the management fees and other expenses charged by the mutual fund(s) in foreign countries along with the management fee and recurring expenses charged to the domestic mutual fund scheme shall not exceed the total limits on expenses as prescribed under Regulation 52(6). Where the scheme is investing only a part of the net assets in the foreign mutual fund(s), the same principle shall be applicable for that part of investment. The details of calculation for charging such expenses shall be reported to the Boards of AMC and trustees and shall also be disclosed in the Annual Report of the scheme.

6. SEBI Circulars MFD/CIR No. 4/052/99 dated September 1, 1999, MFD/CIR No. 5/062/99 dated September 30, 1999, MFD/CIR/17/419/02 dated March 30, 2002, MFD/CIR/18/21826/2002 dated November 7, 2002, SEBI/MFD/CIR No.02/6855/03 dated April 4, 2003, SEBI/MFD/CIR No.07/5573/04 dated March 19, 2004 and SEBI/IMD/CIR No.3/50241/05 dated September 26, 2005 pertaining to investment by mutual funds in ADRs/GDRs/foreign securities stand withdrawn.

7. The procedure for applying to SEBI for making investments in ADRs/GDRs/foreign securities and overseas ETFs has been prescribed by SEBI.

8. These guidelines are issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 read with the provisions of Regulation 77 of SEBI (Mutual Funds) Regulations, 1996 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

SEBI : GUIDELINES FOR CAPITAL PROTECTION ORIENTED SCHEME

The Securities & Exchange Board of India (SEBI) has notified the amendments to SEBI (Mutual Funds) (Third Amendment) Regulations, 2006 and they are summarized hereunder.

1. Capital Protection Oriented Scheme

In case of Capital Protection Oriented Scheme, the mutual funds shall disclose in the offer document, Key Information Memorandum (KIM) as well as in the advertisements that the scheme offered is "oriented towards protection of capital" and "not with guaranteed returns". It should also be indicated that the orientation towards protection of the capital originates from the portfolio structure of the scheme and not from any bank guarantee, insurance cover etc.

The proposed portfolio structure indicated in the offer document and KIM must be rated by a SEBI registered credit rating agency from the view point of assessing the degree of certainty for achieving the objective of capital protection. Moreover, the rating should be reviewed on a quarterly basis.

In this regard, the Trustees should also continuously monitor the structure of the portfolio of the capital protection oriented scheme and should report the same in the half-yearly Trustee Report. The AMC should also report about the same in the bi-monthly Compliance Test Report.

Further, it should also be ensured that the debt component of the portfolio structure has the highest investment grade rating.

2. Revision in Fees payable by Mutual Funds

Regarding filing fees for offer documents SEBI has clarified that the revised filing fee would be applicable to those scheme(s) whose offer document(s) has been filed with SEBI on or after August 3, 2006 and has advised them to comply with the regulatory provisions to enable SEBI to give its observations on the said scheme offer document(s).

CORPORATES TO FILE ANNUAL ACCOUNTS/RETURNS ELECTRONICALLY FROM 16th SEPTEMBER 2006

All Corporates will be required to mandatorily file Annual Returns and Annual Accounts electronically as the Registrars of Companies (ROCs) will stop accepting these documents in physical form from September 16, 2006.

All the company representatives authorized to sign the documents are required to obtain digital signatures by that time to ensure the security and authenticity of filings in the electronic mode, Company Affairs Minister P C Gupta said.

GOVERNMENT EMPOWERED TO DECLARE ESSENTIAL COMMODITIES BY NOTIFICATION

The Government has brought about major changes in the Essential Commodities Act, 1955, aimed at having powers to declare any item as an essential commodity for six months, even while pruning down the current list of essential items from 15 to 7.

The most significant amendment to the Act has been made through the inclusion of a new section empowering the central government to add or delete items from the list of essential commodities merely through a notification, valid for six months. However, the Government will need to justify its action on grounds like public interest or scarcity. The validity period of such notifications can be extended for another six months by citing the reasons to do so. These statutory changes have been brought about through the Essential Commodities (amendment) Bill, 2005, which was passed by Rajya Sabha yesterday.

The categories of items deleted from the current list of essential commodities include iron, steel, and their manufactured products; automobile components and accessories; coal, coke, and other derivatives; cotton and woollen textiles; raw and ginned cotton, and cotton seed; paper, newsprint, paperboard and strawboard; and cattle fodder, oilcakes and other concentrates.

The categories of goods that have been retained on the list of essential items include drugs; food stuffs, oilseeds and oils; inorganic, organic, and mixed fertilisers; petroleum and petroleum products; hank yarn made wholly from cotton; raw jute and jute textiles; and seeds of food crops, fruit, vegetables, cattle fodders and jute.

After the amendment of the Act, the Centre will be able to declare any item as essential on its own, without getting the prior approval of Parliament. The notification for this purpose will only have to be tabled in Parliament.

NEW TAX RETURN FORMS NOS. 1, 2, 3 & 3B NOTIFIED

The Central Board of Direct Taxes (CBDT) have notified the new return Form No.1 (for corporate tax payers), Form No.2 (for non-corporate tax payers having business income), Form No.3 (for non-corporate tax payers not having business income) and Form No.3B (for fringe benefits) vide Notification S.O. No. 1163(E) dated 24th July, 2006, issued here today. The new Form Nos.1, 2 and 3 substitute the existing Form Nos. 1, 2 and 3 and come into force immediately. The new Forms are comprehensively designed so as to do away with all kinds of attachments and facilitate electronic filing. The Central Board of Direct Taxes has also consulted the Institute of Chartered Accountants of India and has taken into account their suggestions in designing the forms. The Form No. 1 and Form No. 2 are combined return of income and fringe benefits. However, a separate return for fringe benefits (Form No. 3B) has also been notified for tax payers who have already filed their income tax return or choose to file their income tax return in Form No. 2D or who are liable to furnish the return of fringe benefits only. The Form No. 3 is a return of income for non corporate tax payers not having any business income.

The new return Form No.1, applicable to corporate taxpayers, is required to be compulsorily filed electronically. If the return is digitally signed, electronic transmission is sufficient and it would not be necessary to file the paper return. However, if the corporate return is not digitally signed, it will be necessary to file the return by following a two step procedure. First, the return and the schedules thereto must be transmitted electronically (without digital signature) to web-site <http://www.incometaxindiaefiling.gov.in>. The acknowledgement number and the date of electronic transmission issued by the Income-tax Department should be entered in the certificate below the verification of the return and, thereafter, the paper return should be filed with the Income-tax Department. The new return Form Nos. 2, 3 and 3B can also be filed in the same manner as corporate tax returns. However, it is optional for the taxpayer to file the return electronically.

DUE DATE FOR FILING RETURN OF INCOME & RETURN OF FRINGE BENEFITS EXTENDED FOR NON CORPORATE TAXPAYERS

In order to enable the taxpayers to familiarize themselves with the new return Forms and compile the information called for therein, the Central Board of Direct Taxes has issued an order under section 119(2)(b) of the Income-tax Act extending the due date for furnishing return of income and return of fringe benefits for assessment year 2006-07 from 31st July, 2006 to 31st October, 2006 in all cases of non-corporate taxpayers (including partners of the firms and charitable trusts and institutions).

However, in the case of individuals and HUFs not having income under the head "Profits and gains from business or profession" (i.e. in the case of individuals and HUFs having income only from salary or house property or capital gains or 'Other sources'), the due date for filing of return of income shall continue to be 31st July, 2006.

AMENDMENTS TO FORM 3CD

The Government of India has made certain changes in Form No. 3CD which is prescribed under the Income-tax Rules, 1962 for audit report in respect of the accounts of any specified person carrying on business or profession. A Notification S.O. 1287 (E) dated 10-08-2006 has been issued in this regard. A summary of significant changes are given hereunder:

- (i) New item 12A has been inserted to seek information regarding a capital asset converted into stock in trade.
- (ii) New sub-item 17(l) has been inserted to capture information regarding expenses incurred in relation to exempt income which is disallowable under section 14A of the Income-tax Act, 1961.
- (iii) New sub-item 17(m) has been inserted to obtain information regarding amount inadmissible under the proviso to section 36(1)(iii).
- (iv) Item No. 27 has been substituted to elicit information regarding instances where tax has not been deducted, deducted late or short deducted or tax deducted but not paid to the Central Government account.
- (v) A separate Annexure - II has been added to Form No. 3CD to incorporate 'data-field' regarding Fringe Benefit Tax introduced by the Finance Act, 2005 with effect from the Assessment Year 2006-07.

SC: ASSESSING OFFICER HAS NO POWER TO ENTERTAIN CLAIMS DURING ASSESSMENT PROCEEDINGS

The Supreme Court (SC) in its recent judgment in case of Goetze (India) Ltd v CIT has held that the assessing officer has no power to entertain a claim made otherwise than by filing a revised return of income.

Facts of the case were that the assessee filed its return of income on November 30, 1995 for assessment year 1995-96, and on January 12, 1998 the assessee claimed a deduction by way of a letter addressed to the assessing officer. The assessing officer did not allow it on the ground that there was no provision in the Income-Tax Act, 1961 (the Act) to make an amendment in the return of income at the assessment stage without revising the return of income. The decision was confirmed by the appellate tribunal as well as the high court. The question that was raised before the Supreme Court was whether the assessee could make a claim for deduction during the assessment proceedings without filing a revised return.

The assessee relied upon the judgment of the Supreme Court in the case of National Thermal Power Company Ltd v CIT (1998) 229 ITR 383 (SC). The issue in the said case was whether the appellate tribunal has jurisdiction to examine a question of law which arises from the facts as found by the authorities below and having a bearing on the tax liability of the assessee. This question was answered in affirmative by the Supreme Court. The Supreme Court, however, observed that the judgment in NTPC's case relates to the power of appellate tribunal and the decision does not in any way relate to the power of the assessing officer. The Supreme Court dismissed the civil appeal with the remark that the issue in this case is limited to the power of the assessing authority and does not impinge on the power of the appellate tribunal under section 254 of the Act.

It may be pertinent to note that the judgment in Goetze's case did not take cognizance of the judicial view that the assessee is entitled to make any claim of deduction in the course of assessment proceedings. Also, there is no discussion regarding the difference between revision of return and modification (correction) of return. Before the judgment in Goetze's case, the difference between the two was fairly well understood and recognised. The Allahabad High Court in case of Dhampur Sugar Mills v CIT (1972) 90 ITR 236 (All) had clarified that if an assessee files an application for modifying or correcting a return filed, it would not mean that he has filed a revised return. The original return filed by him will retain the character as original return, but subject to modifications requested by the assessee. But once a revised return is filed, the original return must be taken to have been withdrawn and to have been substituted by a fresh return for the purpose of the assessment.

The judgment uproots the settled practice and is contrary to the view expressed by the Central Board of Direct Taxes (CBDT) vide Circular No 14 (XL-35) dated April 11, 1955, that the assessing officers should not take advantage of the ignorance of the assessee regarding their rights and draw their attention to any relief to which they are entitled and guide the assessee in making correct claim. One wonders how this will be possible if the assessing officers are now not allowed to entertain a claim of the assessee at the stage of assessment proceedings.

Source: The Financial Express

SC NOTICE IN MORGAN STANLEY CASE RAISES THE SPECTRE OF UNCERTAINTY

The Authority for Advance Ruling (AAR) had held in the case of the US based investment bank, Morgan Stanley Advisory Services (MSAS) that its captive BPO in India does not constitute a permanent establishment (PE). The AAR had also held that MSAS is not a fixed place business of Morgan Stanley and it does not have the authority to conclude contracts. Morgan Stanley will, therefore, not be liable to pay tax on a portion of its global profits if it pays the arm's length price to its Indian subsidiary.

The income-tax department has filed a special leave petition in the SC contesting some of the grounds of the AAR ruling. Morgan Stanley will file a cross-objection to the notice given by the SC on the SLP. Such a notice is the first step before the SC takes a call on whether or not to admit the petition. If the SC admits the case, it could have wide-ranging implications on the tax liability of several foreign companies outsourcing their back-office functions to Indian companies. Keeping in mind the spirit of advance rulings to grant certainty to foreign investors as to their tax consequences, it is expected that the SC would be hearing this matter on an expedited basis.

The rulings of the AAR, which is a quasi judicial authority, are binding on both the tax payer and the income-tax department. Therefore, a pertinent question arises as to the finality of various rulings of the AAR since if the SC admits appeal against such rulings, it would open Pandora's Box. In such an event, the entire sanctity of the scheme of Advance Rulings would definitely get eroded and uncertainty would prevail since no certainty would be attached to any rulings of the AAR.

ITAT: DOWNLINKING SERVICES NOT LIABLE TO TAX IF NO PE EXISTS

In a ruling which is bound to provide significant relief to foreign satellite companies, the Delhi Bench of the Income-Tax Appellate Tribunal (ITAT) has held that there would be no tax liability for downlinking services of satellite companies based in countries that have a Double Taxation Avoidance Agreement (DTAA) with India. In view of this, the broadcasters would not be required to deduct tax at source on this account.

This decision was given by ITAT in the case of US-based PanAmSat International Systems Inc, which provides downlinking of channels in India for broadcasters like Doordarshan, BBC, Sony, Turner, ESPN, Ten Sports, CNN and Discovery Channel, etc.

The issue had been under litigation since 1997-98 when it involved a sum of Rs 300 million. "Over the last 10 years, PanAmSat had provided to the Government of India, bank guarantees for a significant amount.

The ITAT has held that fees for downlinking of television signals into India paid to Pan Am Sat, which is a tax resident of the US, would not be taxable in India, in the absence of its permanent establishment in India as per Article 7 of the Indo-US DTAA. These fees could not be taxed either as royalties or as fees for included services under Article 12 of the DTAA, the Tribunal noted.

However, this ruling had not been applied in the case of Asia Satellite Television Ltd, a tax resident of Hong Kong whose subscription fees were deemed to be taxable in India as royalties, as India does not have a DTAA with Hong Kong.

ITAT: TDS PAYMENT NOT ALLOWABLE AS DEDUCTION IN THE ABSENCE OF CONTRACTUAL LIABILITY

The Income Tax Tribunal (ITAT) has rejected the claim of Marubeni India (a wholly-owned subsidiary of Marubeni Corporation, Japan) to allow tax paid on behalf of the employees as deduction from its income.

The ITAT held that the tax paid so paid cannot be allowed as deduction since there is no contractual agreement in writing between Marubeni India and Marubeni Corporation, Japan for paying the taxes for the employees, on the salary they receive in Japan. These employees were on the rolls of Marubeni Japan. However, their services were utilized by Marubeni India, its Indian subsidiary. Marubeni India waited for two years before making the tax payment.

The ITAT held that the Japanese company should have deducted the tax in respect of salaries received by the employees outside India from the parent and paid to the Indian government. This was not done for the assessment period 1996-1998 and the Indian company paid the taxes later under an arrangement with the income tax authorities. The deduction was claimed for the assessment years 1997-98 and 1998-99.

The ITAT has also clarified that there was no contractual liability on the part of Marubeni India to pay the tax and the taxes paid on the salary was not expended out of necessity or need to support the trade but for commercial expediency of the company's business.

Source: Business Standard

AAR : EMPLOYEES TRAVELLING OVERSEAS FOR 180 DAYS TO BE TREATED AS NON-RESIDENTS FOR TAX PURPOSES

In an order that would provide great relief to corporate executives going abroad for 182 days or more, the Authority for Advance Ruling (AAR) has decided that tax is not leviable on the salary they receive in India since they will be considered as non-residents during the year.

AAR, a quasi judicial body on tax matters, gave this verdict on a petition filed by British Gas. AAR was clarifying the doubts over the issue whether a person can be considered non-resident Indian if he travels outside India for more than 182 days in a year even as his travel is linked to his employment in India.

A person who travels outside India to take up a job is a non-resident and hence not taxable in India. However, the issue before AAR was whether a person travelling overseas for more than 182 days in connection with his employment in India was entitled to pay tax or not. The Income Tax Department sought to levy tax on the income of such executives who travelled abroad for more than 182 days by denying them the status of a non-resident. The department sought to deny the non-resident status on the ground of having been employed in India.

In the case of a British Gas employee who was deputed to the UK for two years from May 25, '05, the department took a stand that tax was leviable in India because he stayed in India for 88 days. The department was relying on a provision in the Income Tax Act by which one can be considered a resident of India even if he stays in the relevant year only for 60 days but has been in India all the days in the four previous years.

AAR said there are two requirements in Section 6 (1) which defines residence of an individual in India. (1) If the individual is in India in the relevant year for 182 days or more. Second, he can be construed a resident even if he stays only for 60 days but has been in India all days for the previous four years. Now in a new explanation in the Income-tax Act, the provision of 60 days has been replaced by 182 days. This change implies that if a person is not in India for more than 182 days in a given year, he could not be construed as resident in India and hence the income generated outside India during this period would not attract tax in India. According to the explanation, this is the case even if the person's employment is in India.

The AAR gave effect to this explanation in deciding the case of the British Gas employee. According to the AAR, a careful reading of the explanation (a) to section 6 (1) of the I-T Act would show that the requirement of the explanation is not leaving India for employment outside India. For the purpose of the explanation an individual need not be an unemployed person who leaves India for employment. Therefore, the fact that the person was already an employee at the time of leaving India is hardly material or relevant. For all these reasons, the AAR held that he was not a resident in India in Financial Year 2006.

Source: The Economic Times

GOVERNMENT TO PROVIDE EQUITY SUPPORT & SOPS TO CHIP MANUFACTURERS

Chip manufacturers who plans to set up manufacturing facilities in the country will enjoy 15% equity support from the Government of India. The Government is finalizing plans to provide equity support of up to 15 per cent of the total project equity (having due regard to the size of the project), and subordinate loans amounting to 5 per cent of the project cost at Government securities rates to the chip companies in the country.

The Government has already said the India Infrastructure Finance Company will take equity stakes in new semiconductor plants. The incentive package is likely to grant all such projects special economic zone status.

In addition, these projects may be provided 100 per cent depreciation in the year of investment into the project, while the excise duty paid on inputs is likely to be made cenvatable against excise duty paid on final products like wafers and semiconductors. Such units will also continue to enjoy import of raw materials and capital goods at zero customs duty.

The Government is also clear that it should have an exit option at a suitable point of time in the future after the project goes on stream. With regard to raising loans to the projects coming up for setting up units for semiconductor fab/assembling, testing & manufacturing facility, the sources said that there would be subordinate loans at Government securities rates of up to five per cent of the project cost, to be repaid in five equal instalments after principal loan has been fully repaid.

The Finance Ministry has reportedly informed the Department of Information & Technology (DIT) that these incentives would define the "ceiling" for Central Government concessions, over and above the benefits already conferred on such units. It is further contended that each case would have to be evaluated on merits by an Inter-Ministerial Focus Group to be set up under Secretary, DIT, comprising representatives of Planning Commission, Departments of Economic Affairs, Expenditure and Revenue in the Ministry of Finance and Department of Commerce to deliberate on such proposals, execute techno-economic surveys and resolve on the eligibility of proposals under the Policy.

SNAPSHOT OF GLOBAL MARKETS - JULY 2006

KEY STOCK MARKET INDICES

INDEX	OPENING (01/07/2006)	HIGHEST IN JULY 2006	LOWEST IN JULY 2006	CLOSING (31/07/2006)
BSE SENSEX	10616.97	10940.45	9972.73	10743.00
S&P CNX NIFTY	3128.75	3208.85	2878.25	3143.20
DOW JONES I.A.	11199.93	11301.58	10658.35	11185.68
NASDAQ COMPOSITE	2177.74	2190.44	2012.78	2091.47
FTSE 100	5833.40	5982.50	5654.60	5974.90
NIKKEI	15573.35	15710.39	14437.24	15456.80

PRICES OF KEY COMMODITIES (US\$)

COMMODITY	OPENING (01/07/2006)	HIGHEST IN JULY 2006	LOWEST IN JULY 2006	CLOSING (31/07/2006)
GOLD - SPOT (NY)	613.50	667.50	613.50	634.40
SILVER - SPOT (NY)	10.97	11.81	10.44	11.34
PLATINUM - SPOT(NY)	1237.00	1255.00	1210.00	1223.00
COPPER (COMEX)	3.445	3.810	3.295	3.610
ALUMINIUM (COMEX)	1.135	1.225	1.117	1.171
BRENT CRUDE (IPE)	74.11	78.66	72.59	75.15
NYMEX CRUDE OIL	74.90	79.45	72.80	74.40

KEY GLOBAL CURRENCY RATES AGAINST USD

CURRENCY	OPENING RATE (01/07/2006)	HIGHEST IN JULY 2006	LOWEST IN JULY 2006	CLOSING RATE (31/07/2006)
EURO/USD	1.2721	1.2857	1.2456	1.2759
GBP/USD	1.8365	1.8675	1.8175	1.8636
USD/JPY	114.75	117.87	113.45	114.66
USD/INR	45.13	46.94	45.78	46.62

MAJOR CURRENCIES AGAINST INR

CURRENCY	OPENING RATE (01/07/2006)	HIGHEST IN JULY 2006	LOWEST IN JULY 2006	CLOSING RATE (31/07/2006)
USD/INR	45.13	46.94	45.78	46.62
EURO/INR	58.68	59.48	58.56	59.48
GBP/INR	84.71	87.09	84.71	86.87
JPY/INR	40.20	40.66	39.87	40.66

INTEREST RATES

MI BOR

PERIOD	OPENING RATE (01/07/2006)	HIGHEST IN JULY 2006	LOWEST IN JULY 2006	CLOSING RATE (31/07/2006)
OVERNIGHT	5.85	6.10	5.85	6.10
14 DAY	6.20	6.39	6.14	6.33
1-MONTH	6.67	6.70	6.61	6.62
3-MONTH	7.12	7.29	7.07	7.20

LIBOR - USD

PERIOD	OPENING RATE (01/07/2006)	HIGHEST IN JULY 2006	LOWEST IN JULY 2006	CLOSING RATE (31/07/2006)
1-MONTH	5.33	5.40	5.33	5.39
3-MONTH	5.48	5.52	5.47	5.47
6-MONTH	5.58	5.63	5.51	5.51
12-MONTH	5.68	5.75	5.54	5.54

LIBOR - EURO

PERIOD	OPENING RATE (01/07/2006)	HIGHEST IN JULY 2006	LOWEST IN JULY 2006	CLOSING RATE (31/07/2006)
1-MONTH	2.90	3.03	2.88	3.03
3-MONTH	3.06	3.16	3.06	3.16
6-MONTH	3.24	3.33	3.24	3.33
12-MONTH	3.51	3.56	3.51	3.55

LIBOR - GBP

PERIOD	OPENING RATE (01/07/2006)	HIGHEST IN JULY 2006	LOWEST IN JULY 2006	CLOSING RATE (31/07/2006)
1-MONTH	4.68	4.69	4.63	4.69
3-MONTH	4.75	4.78	4.69	4.78
6-MONTH	4.81	4.87	4.76	4.87
12-MONTH	5.01	5.05	4.93	5.04

LIBOR - JPY

PERIOD	OPENING RATE (01/07/2006)	HIGHEST IN JULY 2006	LOWEST IN JULY 2006	CLOSING RATE (31/07/2006)
1-MONTH	0.213	0.362	0.213	0.361
3-MONTH	0.358	0.413	0.358	0.413
6-MONTH	0.454	0.504	0.454	0.486
12-MONTH	0.625	0.684	0.625	0.658

US T-BILL

PERIOD	OPENING RATE (01/07/2006)	HIGHEST IN JULY 2006	LOWEST IN JULY 2006	CLOSING RATE (31/07/2006)
	Discount/Yield	Discount/Yield	Discount/Yield	Discount/Yield
1-MONTH	4.55/4.69	4.93/5.02	4.55/4.69	4.93/5.02
3-MONTH	4.96/5.08	5.00/5.13	4.87/5.00	4.97/5.10
6-MONTH	5.10/5.31	5.12/5.33	4.96/5.18	4.98/5.18

KEY CENTRAL BANK RATES

	31/07/2006	1 MONTH PRIOR	3 MONTH PRIOR	6 MONTH PRIOR	1 YEAR PRIOR
US FEDERAL RESERVE FUNDS RATE	5.25	5.00	5.00	4.50	3.50
EUROPEAN CENTRAL BANK RATE*	2.75	2.50	2.50	2.25	2.00
BANK OF ENGLAND RATE**	4.50	4.50	4.50	4.50	4.75
RESERVE BANK OF INDIA - BANK RATE	6.00	6.00	6.00	6.00	6.00

* ECB Rate increased to 3.00% in August 2006 ** BOE Rate increased to 4.75% in August 2006

PRIME RATES

CURRENCY	RATE (31/07/2006)
USD	8.25
EURO	3.50
GBP	4.50
JPY	1.38
INR	10.25 to 10.75

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