



INDIA UPDATE

A monthly Newsletter on business intelligence and opportunities in India

FEBRUARY 2006



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MONETARY POLICY REVIEW:- RESERVE BANK OF INDIA INCREASES REPO & REVERSE REPO RATES

Reserve Bank of India (RBI) has increased the reverse repo and repo rates by 25 basis points with immediate effect while releasing the third quarter review of the Annual Monetary Policy on 24th January 2006. In view of this, the reverse repo rate has increased to 5.50% and repo rate stands increased to 6.50%. The primary aim stated by RBI for this increase is to control inflation which was at 5.3% in November 2005 as against 4.2% a year ago. However, there has been no increase in the bank rate and cash reserve ratio. The increase in repo & reverse repo rates is bound to have some impact on lending rates of banks and already a few banks have announced that there will be increase in lending rates.

RBI has pointed out that the real GDP growth in India has averaged 8.0 per cent over the past nine quarters and based on the current assessment of a pick up in agricultural output and in the momentum in industrial and services sectors, it has slightly revised upwards the GDP growth in 2005-06 which is now placed in the range of 7.5-8.0 per cent. However, there has been no revision in inflation figures and it is placed in the range of 5.0-5.5 per cent as projected earlier.

India's foreign exchange reserves declined by US \$ 2.1 billion from US \$ 141.5 billion at the end of March 2005 to US \$ 139.4 billion as on January 13, 2006. Excluding the one-off impact of IMD redemptions, the foreign exchange reserves would have shown an increase of US \$ 5.0 billion. Foreign direct investment (FDI) picked up on sustained growth in industrial and service sector activity and the positive investment climate. A turnaround in Foreign Institutional Investors (FII) inflows that occurred in June continued through 2005, on the back of strong growth expectations and corporate performance. Portfolio flows rose to US \$ 4.8 billion from US \$ 1.3 billion, mainly on account of net investment by FIIs which went up to US \$ 3.4 billion from US \$ 1.1 billion.

India's external debt rose by US \$ 1.0 billion over end-March, 2005 to US \$ 124.3 billion at the end of September, 2005. The increase was mainly in the form of External Commercial Borrowings and short-term debt, attributable to financing requirements necessitated by the large expansion in both oil and non-oil imports. Accordingly, the ratio of short-term debt to total debt increased marginally from 6.1 per cent at the end of March 2005 to 6.7 per cent at the end of September 2005.

One worrying aspect is current account deficit which is widening indicating slower than projected exports growth and also increased imports. Merchandise export growth at 18.1 per cent in US dollar terms during April-December, 2005 slowed down from 26.6 per cent in the corresponding period of the previous year. The deceleration in export growth was due to a slowdown in exports of engineering goods, textiles and clothing, and gems and jewellery in an environment of strong domestic demand. Imports rose by 27.3 per cent as against 36.3 per cent a year ago. Oil imports recorded a growth of 45.3 per cent marginally down from 45.7 per cent a year ago. Non-oil imports increased by 20.2 per cent during April-December, 2005 on top of 32.9 per cent in the corresponding period last year. Consequently, the overall trade deficit widened to US \$ 29.8 billion, higher by 54.2 per cent than US \$ 19.3 billion in the corresponding period of the previous year.

Views of our Economist:

Increase in reverse rep and repo rates indicates that RBI is very much concerned about inflation. Even though the Indian Finance Minister has indicated that he is in favour of softer interest regime and RBI would consider rolling back the increase once the situation improves, it is quite unlikely that it may not be possible to do the same in the near future. The lending rates are bound to go up and while a few banks have announced slight increase in lending rates, all eyes are State Bank of India, the prime mover in the money market, which is bound to increase the lending rates shortly.

The continued increase Current Account deficit is really a worrisome aspect as a substantial part of increase in imports is accounted by items other than capital goods. The Finance Minister needs to address this issue while presenting his Budget for the year 2006-07 since continued slippage on this front is bound to affect the economy.

BSE SENSEX CONTINUES TO SIZZLE

The Bombay Stock Exchange Index - "Sensex" continued to rise and it scaled a new peak when it touched 10192 on 15th February 2006. NSE Nifty also improved its levels and touched an all time high of 3052 on 14th February 2006. Both BSE and NSE witnessed strong buying sentiments and the markets continued to grow despite a few technical corrections in between. The general continued expectation is that the market will continue to remain strong at least till the presentation of the Union Budget towards the end of February 2006.

Foreign Institutional Investors (FIIs) continued to be active in the equity markets and their net investment in December 2005 amounted to US\$ 805 million and with this, the total FII investment in the equity market as at the end January 2006 amounted to US\$ 41.91 billion.

FOREIGN DIRECT INVESTMENT IN SEVERAL SECTORS LIBERALISED

The Government of India took a major policy initiative on 24th January 2006 to liberalize Foreign Direct Investment (FDI) in several sectors with a view to simplify the procedures for investing in India and also to avoid multiple layers of approvals presently required in some activities.

These decisions have been taken a couple of days before the commencement of the Annual Meet of the World Economic Forum at Davos, Switzerland. The Government of India wanted to send a right signal to the world business leaders at Davos and elsewhere that India is committed to opening up its economy further in order to boost foreign investment in India. With this liberalization, there are only a few sectors where there are restrictions on FDI

1. FDI is allowed up to 100% in the following sectors under the Automatic Route (that is, no approval from Foreign Investment Promotion Board (FIPB) is required):
 - setting up greenfield airport projects (so far FDI up to only 74% was allowed under automatic route)
 - laying of natural gas/LNG pipelines (so far required prior Government approval)
 - market study and formulation and investment/financing in the petroleum and natural gas sector (so far with prior Government approval)
 - cash and carry wholesale trading and export trading (so far, FDI in wholesale cash and carry trading and FDI beyond 51% in export trading required prior government approval);
 - exploration of mining of diamonds and other precious stones. (so far, allowed on automatic route only up to 74%)
 - processing and warehousing in coffee and rubber industry.
 - Power trading, subject to provisions of the Electricity Act, 2003
 - investment in creation of infrastructure related to marketing in petroleum sector
 - captive mining of coal and lignite for consumption by eligible users. (so far, mining of coal and lignite for captive consumption – FDI up to 74% with FDI above 50% requiring prior Government approval)
 - (i) distillation and brewing of potable alcohol (ii) manufacture of industrial explosives and (iii) manufacture of hazardous chemicals. These would, however, be subject to other applicable regulations. These activities, presently require Industrial Licence and hence while no approval of FIPB will be required for foreign investment up to 100%, an Industrial Licence is required to be obtained for setting up a facility to undertake any of these activities

2. The Government of India has also allowed:

FDI up to 51% with prior Government approval for retail trade in 'Single Brand' products. This is aimed at attracting investment, technology and best global practices as also catering to the demand of such branded goods in India. This would imply that foreign companies would be allowed to sell goods sold internationally under a single brand, viz., Reebok, Nokia, Adidas. Retailing of goods of multiple brands, even if such products are produced by the same manufacturer, would not be allowed.

The Government has also issued Guidelines clarifying certain matters with respect to FDI in retail trade of Single Brand Products which are given hereunder:

Guidelines for FDI in Retail Trade of 'Single Brand' Products

The Government has decided to allow FDI up to 51%, with prior Government approval, in retail trade of 'Single Brand' products. This is, *inter alia*, aimed at attracting investments in production and marketing, improving the availability of such goods for the consumer, encouraging increased sourcing of goods from India, and enhancing competitiveness of Indian enterprises through access to global designs, technologies and management practices.

2. FDI up to 51% in retail trade of 'Single Brand' products would be subject to the following conditions:

- i. Products to be sold should be of a 'Single Brand' only.
- ii. Products should be sold under the same brand internationally.
- iii. 'Single Brand' product-retailing would cover only products which are branded during manufacturing.

3. FDI would be allowed only with prior approval of the Government. Application seeking permission of the Government for FDI in retail trade of 'Single Brand' products would be made to the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion. The application would specifically indicate the product/ product categories which are proposed to be sold under a 'Single Brand'. Any addition to the product/ product categories to be sold under 'Single Brand' would require a fresh approval of the Government.

4. Applications would be processed in the Department of Industrial Policy & Promotion, to determine whether the products proposed to be sold satisfy the notified guidelines, before being considered by the FIPB for Government approval.

3. The Government of India has also effected following liberalization in respect of FDI:

- Has removed the divestment condition, which had been imposed earlier, with respect to business-to-business e-commerce. Hitherto while FDI upto 100% was allowed, the investor was required to divest 26% of the foreign equity within 5 years of making the investment. This was seen to be restricting the level of FDI in these sectors.
- Has dispensed with the requirement of prior government approval for FDI in industrial projects located within 25 KM of the Standard Urban Area limits of 23 cities having population of 1 million as per 1991 census. So far, these required prior government approval besides an industrial licence. Now no FIPB or Government approval is required for such FDI if such investment is covered under the automatic route. However, Industrial Licence is required to be obtained for location of industrial projects within the aforesaid 25 Km.
- Has dispensed with the requirement of approval of FIPB for transfer of shares in an existing Indian company from Indian investors to foreign investors in the financial services and where the provisions of the Securities and Exchange Board of India (SEBI) Takeover Code are applicable in cases where approval of RBI/SEBI/Insurance Regulatory Development Authority of India (IRDA) is also required.

The above initiative has come a couple of months after the enhancement of Foreign Direct Investment ceiling from 49 per cent to 74 per cent in certain telecom services [such as Basic, Cellular, Unified Access Services, National/International Long Distance, V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS) and other value added services], subject to certain conditions.

SPECIAL ECONOMIC ZONES (SEZ) TO ATTRACT MASSIVE INVESTMENTS IN INDIA

The Special Economic Zones (SEZs) Act 2005 has come into force with effect from 10 th February, 2006, with SEZ Rules having been legally vetted, approved and notified by the Government of India. The SEZ Rules, inter-alia, provide for drastic simplification of procedures and for single window clearance on matters relating to central as well as state governments.

Special Economic Zones (SEZs) in India have hitherto been functioning under the provisions of the Foreign Trade Policy and were eligible for fiscal incentives as provided under the relevant statutes. To instill confidence in investors and signal the Government of India's commitment to a stable SEZ policy regime, a comprehensive Special Economic Zones Act, 2005, was passed by the Indian Parliament.

Special Economic Zone (SEZ) is a specifically delineated duty free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs. Goods and services going into the SEZ area from DTA shall be treated as exports and goods coming from the SEZ area into DTA shall be treated as if these are being imported.

The Government of India expects investment of the order of Rs.1000 billion (approximately, US\$ 22 billion) over the next 3 years with an employment potential of over half a million from the new SEZs apart from indirect employment during the construction period of the SEZs. Heavy investments are expected in sectors like IT, pharma, bio-technology, textiles, petro-chemicals, auto-components etc.

The Government of India has provided several benefits/relaxations not only to SEZ Developers but also to units set up in SEZ. The details of the benefits and criteria for setting up the same are given hereunder.

*** SPECIAL ECONOMIC ZONES * UNITS IN SPECIAL ECONOMIC ZONES ***

SPECIAL ECONOMIC ZONES

BENEFITS TO SEZ DEVELOPERS:

- Single window clearance for setting up of an SEZ
- Simplification of procedures for development, operation, and maintenance of the Special Economic Zones and for setting up and conducting business in SEZs
- Single Window clearance on matters relating to Central as well as State Governments
- SEZ developers are also exempted from customs duty on all imported inputs for the development, operation and maintenance of SEZ
- On products sourced from the domestic market, they are entitled to excise duty exemption. Supplies of goods from Domestic Tariff Area for development, operation and maintenance of SEZ are exempt from payment of Central Sales Tax, under CST Act. Some of the State Government have exempted transactions made between units/establishment within SEZ and supply of goods and services from Domestic Tariff Area to SEZ developers from all State and local taxes and levies, including sales tax, purchase tax, octroi, cess etc.
- Income tax exemption for a block of 10 year in 15 years at the option of developer as per section 80-IA of the Income Tax Act. In case SEZ developer develops or operates and maintains or develops, operates and maintains any specified infrastructure facility, income tax exemption shall be available for a block of 15 year in 20 years at the option of developer in respect of profits and gains from such infrastructure facility.
- Exemption to taxable Services provided by a Service provider to Special Economic Zone (SEZ) Developer – Approval is required from a committee headed by Chief Commissioner of Central Excise having jurisdiction over said Special Economic Zone for getting exemption
- Generation, Transmission and Distribution of Power in SEZs allowed.
- FDI can be made for development of integrated townships, including housing, commercial premises, hotels, resorts, and regional level urban infrastructure facilities such as roads and bridges, mass rapid transit systems etc in a SEZ.

- Full freedom in allocation of developed plots to approved SEZ units on purely commercial basis.
- Full authority to provide services like water, electricity, security, restaurants, recreation centers etc. on commercial lines.
- Develop Standard Design Factory (SDF) building in exiting Special Economic Zones.
- Income Tax exemption to Investor's in SEZs under section 10 (23) G of Income Tax Act.
- Assured and adequate water supply within SEZ
- Declaration of SEZs as industrial townships to enable the SEZs to function as self-governing, autonomous municipal bodies.
- Appropriate and exclusive arrangements within the SEZ for maintenance of law and order.

CRITERIA FOR APPROVAL OF SEZ

1. Area Requirement of SEZ:

A. SEZ for Multi-product:

Definition:

“Special Economic Zone for multi-product” means a Special Economic Zone where Units may be set up for manufacture of two or more goods in a sector or goods falling in two or more sectors or for trading and warehousing or rendering of two or more services in a sector or rendering of services falling in two or more sectors;

Area Requirement

A Special Economic Zone for multi product shall have a contiguous area of 1000 hectares or more. This would however, not apply to existing Export Processing Zones (EPZs) converting into SEZs as such or for notifying additional area as a part of such SEZ. Further, in the case of following, the minimum size requirement is as under:

- a Special Economic Zone established exclusively for services may have an area of 100 hectares or more
- in case a Special Economic Zone is proposed to be set up in Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Manipur, Tripura, Himachal Pradesh, Uttaranchal, Sikkim, Jammu and Kashmir, Goa or in a Union territory, the area shall be 200 hectares or more

It is also necessary to ensure that at least twenty five per cent. of the area shall be earmarked for developing processing area

It has been further provided that the fulfillment of the requirement of the contiguous area shall be considered and decided by the Board of Approval functioning under the Ministry of Commerce & Industry on a case to case basis on merits

B. SEZ for a specific sector or in a port or airport:

Definitions:

“Special Economic Zone for specific sector” means a Special Economic Zone meant exclusively for one or more products in a sector or one or more services in a sector.

“Special Economic Zone in a port or airport” means a Special Economic Zone in an existing port or airport for manufacture of goods in two or more goods in a sector or goods falling in two or more sectors or for trading and warehousing or rendering of services;

Area Requirement:

A Special Economic Zone for a specific sector or in a port or airport, shall have a contiguous area of one hundred hectares or more. However, in the case of following, the minimum size requirement is as under:

(a) Provided that in case a Special Economic Zone is proposed to be set up exclusively for electronics hardware and software, including information technology enabled services, the area shall be ten hectares or more with a minimum built up processing area of one hundred thousand square meters

(b) Provided further that in case a Special Economic Zone is proposed to be set up exclusively for bio-technology, non-conventional energy, including solar energy equipments/cell, or gem and jewellery sectors, the area shall be ten hectares or more

(c) Provided also that in case a Special Economic Zone for a specific sector is proposed to be set up in Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Manipur, Tripura, Himachal Pradesh, Uttaranchal, Sikkim, Jammu and Kashmir, Goa or in a Union territory, the area shall be fifty hectares or more for the Special Economic Zones not covered under (a) & (b) above.

It is also necessary to ensure that at least fifty per cent. of the area shall be earmarked for developing processing area

C. A Special Economic Zone for Free Trade and Warehousing shall have an area of 40 hectares or more with a built up area of not less than one hundred thousand square meters

- Provided that a Free Trade and Warehousing Zones may also be set up as part of a Special Economic Zone for multi-products.
- Provided further that in a Special Economic Zone for a specific sector, Free Trade and Warehousing Zone may be permitted with no minimum area requirement but subject to the condition that the maximum area of such Free Trade and Warehousing Zone shall not exceed twenty per cent of the processing area.

2. The Developer or Co-Developer of a SEZ shall have at least twenty-six percent of the equity in the entity proposing to create business, residential or recreational facilities in a Special Economic Zone in case such development is proposed to be carried out through a separate entity or a special purpose vehicle being a company formed and registered under the Companies Act, 1956

3. The SEZ and units therein shall abide by local laws, rules, regulations or bye-laws in regard to area planning, sewerage disposal, pollution control and the like. They shall also comply with industrial and labour laws and such other laws/rules and regulations as may be locally applicable.

4. Such SEZ shall make adequate arrangements to fulfill all the requirements of the laws, rules and procedures applicable to such SEZ.

5. Only units approved under the SEZ Scheme would be permitted to be located in these SEZ.

RELAXATION IN ENVIRONMENT NORMS RELATING TO LOCATION OF SEZ

1. No Environment Impact Assessment is required for setting up of SEZs.

2. In case the SEZ area is located near the coast, clearance is required from the Ministry of Environment and Forests under Coastal Regulation Zone (CRZ) Notification. The following activities have been permitted within the coastal area of the SEZ:-

(i) Non-polluting industries in the field of Information and Technology and other service industries are permissible in the CRZ area of Special Economic Zone.

(ii) In CRZ-III area development activities may be permissible for recreational facilities, including golf courses, desalination plants, hotels and non-polluting service industries.

(iii) The embargo that in CRZ-III, an area upto 200 metres from the High Tide Line would be 'no development zone' will not apply to areas falling within the notified SEZ;

3. Clearance from the concerned State Government would be required in the case the SEZ area contain forestland. Pollution Clearance within the Zone shall be given by the empowered officer of the State Pollution

Control Board.

4. It has been proposed that authority to grant approval for the following be delegated to a Committee under the Development Commissioner of the Zone:

- (i) For allowing utilization of forest land as well as permitting compensatory afforestation and
- (ii) Activities within Coastal Zone.

However, this will be effective only when this proposal is formally approved by the Government.

UNITS IN SPECIAL ECONOMIC ZONES

SEZ units may be set up in any SEZ for manufacture of goods and rendering of services. SEZ units may export goods and services including agro-products, partly processed goods, sub-assemblies and components except prohibited items of exports in ITC (HS). The units may also export by-products, rejects, waste scrap arising out of the production process. Export of Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET) shall be subject to fulfillment of the conditions indicated in the ITC (HS) Classification of Export and Import Items. SEZ units, other than trading/service unit, may also export to Russian Federation in Indian Rupees against repayment of State Credit/Escrow Rupee Account of the buyer, subject to RBI clearance, if any.

The rules also provide for setting up of overseas banking units, which will have to comply with Indian regulations. Such units will also be exempt from income tax and NRI deposits in these banks will not attract tax deduction at source on interest payments.

BENEFITS TO SEZ UNITS:

- Single window clearance for setting up a unit in a Special Economic Zone
- Single Window clearance on matters relating to Central as well as State Governments;
- Simplified compliance procedures and documentation with an emphasis on self-certification; All activities of SEZ units within the Zone, unless otherwise specified, including export and re-import of goods shall be through self certification procedure
- SEZ units are exempted from customs duty on all imported inputs for the development, operation and maintenance of SEZ. No licence is required for import of capital goods and inputs like raw materials, etc.
- On products sourced from the domestic market, they are entitled to excise duty exemption. Supplies of goods from Domestic Tariff Area for development, operation and maintenance of SEZ units are exempt from payment of Central Sales Tax, under CST Act. Some of the State Government has exempted transactions made between units/establishment within SEZ and supply of goods and services from Domestic Tariff Area to SEZ units from all State and local taxes and levies, including sales tax, purchase tax, octroi, cess etc.
- Export of finished products (other than sale to Domestic Tariff Area subject to certain exceptions) shall be exempt from Central levies.
- SEZ units are entitled for 100% Income Tax Exemption in respect of profits and gains derived from the export of such articles or things or computer software for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software, as the case may be, and for 50% exemption for further two assessment years.

Further, Income Tax Exemption shall be available for the next three consecutive assessment years after the abovementioned seven years on so much of the amount not exceeding fifty per cent of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Allowance Reserve Account") to be created and utilized:

- (i) for the purposes of acquiring new machinery or plant which is first put to use before the expiry of a period of three years next following the previous year in which the reserve was created; and

(ii) until the acquisition of new machinery or plant as aforesaid, for the purposes of the business of the undertaking other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India

- Exemption from dividend distribution tax, Minimum Alternate Tax (MAT), and capital gains tax on transfer of assets in case of shift of an industrial undertaking from an urban area to an SEZ.
- Overseas banking units get exemption on their profits in the SEZ. There is also no withholding tax on interest payment to non-residents and not-ordinarily residents
- Exemption to taxable Services provided by a Service provider to a unit located in SEZ – Approval is required from a committee headed by Chief Commissioner of Central Excise having jurisdiction over said Special Economic Zone for getting exemption
- Foreign Equity up to 100% is permissible for all manufacturing activities under automatic route except for the following:

(a) Arms and ammunition, explosives and allied items of defence equipment, defence aircraft and warships

(b) Atomic substances;

(c) Narcotics and psychotropic substances and hazardous chemicals

(d) Distillation and brewing of alcoholic drinks; and

(e) Cigarettes/cigars and manufactured tobacco substitutes

Sectoral norms as notified by the Government shall apply to foreign investment in services and trading activities

- 100% FDI is permissible for franchisees of basic telephone services for providing basic telephone service in SEZ areas
- No cap on foreign investment for SSI reserved items
- Exemption from Industrial Licensing for manufacture of items reserved for SSI sector
- SEZ unit, including gem and jewellery units, may subcontract a part of their production or production process through units in the DTA or through other SEZ/EOU/EHTP/ STP units with the annual permission of Customs authorities. This will be subject to certain conditions. Subcontracting of part of production process may also be permitted abroad with the approval of the Development Commissioner
- Job work on behalf of domestic exporters for direct export allowed
- A Unit may sell goods and services including rejects or wastes or scraps or remnants or broken diamonds or by-products arising during the manufacturing process or in connection therewith, in the Domestic Tariff Area on payment of Customs duties. Further in cases where import licence is required for the import of similar goods into India, under the provisions of the Foreign Trade Policy, then such DTA sale shall be done only on submission of import licence by the buyer.
- No fixed wastage norms in respect of production
- FOB Value of export of a SEZ unit can be clubbed with FOB value of export of its parent company in the DTA, or vice versa, for the purpose of according Export House, Trading House, Star Trading House or Super Star Trading House status
- Units set up in SEZs established by the Government will be charged rent for lease of industrial plots and standard design factory buildings/ sheds as per rates fixed from time to time
- SEZ units may retain 100% of their export proceeds in their EEFC account
- Surplus power generated by the captive Power plants of SEZ may be purchased by the State Electricity Board or any power company on mutually agreed terms
- State Electricity Board/ Power Company would provide commitment for supply of back up power at reasonable rates
- Export value of goods, software and services by SEZ units may be realized and repatriated to India as per the RBI instructions in the matter
- Commodity hedging by SEZ units permitted
- Banks are free to allow remittances towards premium for general insurance policies taken by units located in

SEZs from insurers outside India provided the premium is paid by the units out of their foreign exchange balances.

- SEZ units have been exempted from the requirements of Import licence, import registration and import through notified ports in respect to drugs and cosmetics under Drugs and Cosmetics Rules, 1945
- Relaxation of one year residency in India for a person not resident in India prior to appointment as Managing Director in SEZ units
- Enhanced managerial remuneration not exceeding Rs.2,40,00,000/- per annum or Rs.20,00,000 per month is permitted under Schedule XIII of the Companies Act, 1956 in respect of companies in Special Economic Zones. However, this relaxation is subject to the following conditions:

These companies have not raised any money by public issue of shares or debentures in India

Such companies have not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in any financial year.

- An unit in the SEZ may, without prior approval of the Reserve Bank enter into a contract in a commodity exchange or market outside India to hedge the price risk in the commodity on export / import subject to the condition that such contract is entered into on a "stand-alone" basis. The term "stand-alone" means that the unit in the SEZ is completely isolated from financial contracts with its parent or subsidiary in the mainland or within the SEZ(s) as far as its import/export transactions are concerned.
- Payment of export may also be received by the Gem & Jewellery units in SEZs in form of precious metals i.e. Gold / Silver / Platinum equivalent to value of jewellery exported on the condition that the sale contract provides for the same and the approximate value of the precious metal is indicated in the relevant GR/SDF/PP forms.
- Units in SEZs may be allowed to raise External Commercial Borrowings without any maturity restriction but through recognized banking channels and strictly on a "stand alone basis". By "stand alone" it is meant that units in the SEZs would be completely isolated from financial contacts with their subsidiaries or their parent in the mainland or within the SEZs as far as repayment of ECB interest/principal is concerned. Therefore, in effect only those units, which are either subsidiary/branch of a company registered outside India or where a company is registered independently for operating in one or more zone in the country, would qualify for stand along criteria. Borrowers in the SEZs are to be allowed to raise ECB under the special window as announced in the EXIM policy. They would service the loan (principal + Interest + any other fee, charge etc.) out of proceeds by the SEZ units.

There would be an annual cap of US\$ 500 million for such units SEZs to avail this facility. Reserve Bank of India (RBI) would monitor the overall cap. Necessary Guidelines will be issues by RBI in this regard.

- Units in SEZs are permitted to issue equity shares to non-residents against import of capital goods subject to the following :-
- The valuation should be verified by a Committee consisting of Development Commissioner and the appropriate Customs officials.
- The SEZ units issuing equity in the above manner should report the particulars of the shares issued to RBI & Ministry of Commerce in the prescribed form
- No approval shall be necessary from RBI for a company to establish a branch/unit in SEZs to undertake manufacturing and service activities subject to the following conditions:
 - Such units are functioning in those sectors where 100 per cent FDI is permitted
 - Such units comply with part XI of the Companies Act (Section 592 to 602)
 - Such units function on a stand-alone basis. 'Stand alone basis' means such branch offices would be isolated and restricted to the Special Economic Zone alone and no business activity/ transaction will be allowed outside the Special Economic Zones in India which includes branches/subsidiaries of its parent office in India.
 - In the event of winding-up of business and for remittance of winding-up proceeds, the branch shall approach an Authorized Dealer in Foreign Exchange for the same

- It has been decided that authorized dealers may allow requests received from exporters for ' netting off ' of export receivables against import payments for units located in Special Economic Zones subject to the following :
 - The ' netting off ' of export receivables against import payments is in respect of the same Indian entity and the overseas buyer / supplier (bilateral netting). The netting may be done as on date of balance sheet of the unit in SEZ.
 - The details of export of goods are documented in GR (O) forms/DTR as the case may be while details of import of goods / services are recorded through A1/A2 form as the case may be. The relative GR / SDF forms will be treated as complete by the designated authorised dealer only after the entire proceeds are adjusted / received.
 - The export / import transactions with ACU countries are kept outside the arrangement.

BASIC REQUIREMENT OF SEZ UNITS

SEZ unit shall be a positive Net Foreign Exchange Earner. Net Foreign Exchange Earnings (NFE) shall be calculated cumulatively for a period of five years from the commencement of production according to the following formula:

$$\text{Positive NFE} = A - B > 0$$

Where:

A : is FOB value of exports, including exports to Nepal and Bhutan against freely convertible currency, by the Unit and the value of following

(a) Supplies effected in DTA to holders of advance licence for annual requirement/DFRC under the duty exemption/remission scheme/ Diamond Imprest Licence and supply of capital goods under EPCG scheme.

(b) Supply of goods to projects financed by multilateral or bilateral agencies or funds as notified by the Ministry of Finance under International Competitive Bidding in accordance with the procedures of those agencies or funds, where the legal agreements provide for tender evaluation without including the customs duty;

(c) Supply of capital goods, including those in unassembled or disassembled condition as well as plants, machinery, accessories, tools, dies and such goods which are used for installation purposes till the stage of production and spares to the extent of ten per cent. of the free on rail value to fertilizer plants;

(d) Supply of goods to any project or purpose in respect of which the Ministry of Finance, by a notification, permits the import of such goods at zero customs duty

(e) Supply of goods to the power projects and refineries not covered in (d) above;

(f) Supply to projects funded by United Nations Agencies;

(g) Supply of goods to nuclear power projects through competitive bidding as opposed to International Competitive Bidding;

(h) Supply made to bonded warehouses set up under the Foreign Trade Policy or under section 65 of the Customs Act and free trade and warehousing zones, where payment is received in foreign exchange;

(i) Supplies against special entitlements of duty free import of goods under the Foreign Trade Policy;

(j) Export of services by services units including services rendered within Special Economic Zone or services rendered in the Domestic Tariff Area and paid for in free foreign exchange or such services rendered in Indian Rupees which are otherwise considered as having been paid for in free foreign exchange by the Reserve Bank of India;

(k) Supply of Information Technology Agreement items and notified zero duty telecom or electronic items, namely, Color Display Tubes for monitors and Deflection components for colour monitors or any other items as may be notified by the Central Government;

(l) Supplies to other units and Developers in the same or other SEZ or other EOU/SEZ/ EHTP/ STP/ Bio-technology Park Unit provided that such goods and services are permissible for import or procurement by such units and

Developers;

(m) Supply of goods to Domestic Tariff Area against payment in foreign exchange from the Exchange Earners Foreign Currency account of the Domestic Tariff Area buyer or Free Foreign Exchange received from overseas

(n) Supplies made to free trade Warehousing set up under the Policy and/or under Section 65 of the Customs Act where payment is received in free foreign exchange.

Explanation: For the purposes of this sub-rule, the supplies under clause (l) shall be against procurement certificate, as applicable and the supplies under clauses (c) to (g) and (i) shall be as per the terms and conditions of the respective duty exemption notified by the Central Government, in the Ministry of Finance;

B: shall be the aggregate of the following:

(i) sum total of the CIF value of all imported inputs ("Inputs" mean raw materials, intermediates, components, consumables, parts and packing materials) used for authorized operations during the relevant period and the CIF value of all imported capital goods including goods purchased on high seas basis even though paid for in Indian Rupees and the value of all payments made in foreign exchange by way of export commission, royalty, fees, dividends, interest on external commercial borrowings during the first five year period or any other charges.

(ii) Value of goods obtained from other Unit or Export Oriented Unit or Electronic Hardware Technology Park or Software Technology Park Unit or Bio-technology Park Unit or from bonded warehouses or procured from international exhibitions held in India or precious metals procured from nominated agencies;

(iii) the CIF value of the goods and services, including pro-rata CIF of capital goods, imported duty free or leased from a leasing company or received free of cost and or on loan basis or on transfer for the period they remain with Unit;

For annual calculation of Net Foreign Exchange, value of imported capital goods and lump sum payment of foreign technical know-how fee shall be amortized at the rate of ten per cent every year from the first year to tenth year.

The unit shall execute a legal undertaking with the Development Commissioner concerned and in the event of failure to achieve positive foreign exchange earning it shall be liable to penalty in terms of the legal undertaking or under any other law for the time being in force.

OTHER REQUIREMENTS:

- Environmental Impact Assessment is required for 30 notified industries such as petroleum refineries, chemical fertilizers, pesticides, petro-chemical complexes, bulk drugs and pharmaceuticals, oil exploration, synthetic rubber, distilleries, raw skins and hides, dyes, cement, foundries, electro plating etc. In such cases clearance from the Ministry of Environment and Forest are required. However, the requirement of public hearing in such cases has been exempted for the units in Special Economic Zones.
- The SEZ units shall abide by local laws, rules, regulations or bye-laws in regard to area planning, sewerage disposal, pollution control and the like. They shall also comply with industrial and labour laws and such other laws/rules and regulations as may be locally applicable.
- Performance of the unit will be monitored by a Committee consisting of Development Commissioner of the Zone and Customs.
- Units shall maintain proper accounts and furnish details regarding value of import, export etc. to Development Commissioner on a quarterly basis.

SECTOR SPECIFIC REQUIREMENTS FOR EOU/SEZ UNITS:

(1) Coffee

Export of imported coffee shall be subject to approval from Coffee Board under relevant Act.

(2) HIGH GRADE IRON ORE

Proposals for export of high-grade i.e. 64% Fe Iron Ore and above, except iron ore of Goa origin and Redi origin are presently canalized through MMTC and its exports would be subject to annual quantity allocation by the BOA.

(3) POLYESTER YARN:

(i) No job work with EOU/SEZ/DTA unit shall be permitted. However, this shall not be applicable to units who intend to send the fabric {made out of Polyester (or) texturised yarn within the unit} for job work to EOU/SEZ/DTA unit for dyeing of the fabric.

(ii) None of the units making polyester yarn - existing or new - shall be permitted to do exports through third party and they have to export directly

(iii) These restrictions shall not apply to units in the same SEZ.

(4) SALE OF SURPLUS POWER:

The following procedure shall apply in regard to sale of surplus power by EOU/SEZ units:-

(i) Whenever the Development Commissioner receives proposals for sale of surplus power, it would be examined in consultation with the State Government, including State Electricity Board. This shall, however, not apply to sale of power within the SEZ. The Development Commissioner will report the norms of raw materials and consumables required for generation of a unit of power for consideration and approval by the Board of Approval.

(ii) No duty shall be required to be paid on sale of surplus power from an EOU/SEZ unit to another EOU/ SEZ unit. Development Commissioner of SEZ concerned would be informed in writing of such supply and proper account of the consumption of raw material would be maintained by the supplying unit. The value of imported inputs and consumables shall be taken into account for NFE calculations of the supplying unit.

(iii)The unit will obtain permission of the Assistant Commissioner of Customs/ Central Excise for sale of surplus power in the DTA, after obtaining permission from the SEBs under the relevant statute. Duty on sale of power to the DTA shall be as per the Notification of the Department of Revenue in this regard.

(iv)Due care shall be taken by the Development Commissioner / Board of Approval while approving the power plants by EOU/SEZ units vis a vis their actual requirement.

5. Guidelines for the existing Plastic units

The following shall be guidelines for the existing plastic units under EOU/SEZ scheme: -

(i) Extension of LOP of the existing units under EOU/SEZ Scheme may be granted based on the terms & conditions of earlier LOP.

(ii) No enhancement of the production capacity be allowed.

(iii)Relocation of the existing units from one Zone to another will be approved on case to case basis.

(iv)EOU/SEZ units be exempted from the purview of Public Notice No. 392 dated 1.1.1997 regarding restrictions on physical forms & sizes and inspection would be done by Zone. However for any supply into DTA, all conditions of public notice will apply.

(6) NON ITA-I ITEMS THAT MAY BE SOLD IN DTA

Following non-ITA-I items may be sold in the DTA in terms of para 13.1(f) of the EOU Scheme and 16(f) of the SEZ Scheme:

- (i) Colour Display Tubes (CDT) for monitors
- (ii) Deflection components for colour monitors

SEZ - THE ROAD AHEAD

The new SEZ Policy which has come into effect from 10th February 2006 is likely to result in significant investment not only in the development of SEZs but also setting up of various units in these zones.

The Government of India has so far given approvals for the setting up of 117 zones, including three free trade warehousing zones, spread over 15 states and two Union Territories. 51 have been given final approval while the rest have received clearance in principle. Of the approved zones, seven are multi-sector while 43 are specific to infotech, apparel, telecom, gems and jewellery and automobiles.

Seven of these new zones have become functional, including a Rs 12 billion Nokia zone that has gone into commercial production.

CLARIFICATION REGARDING FDI IN TOWNSHIPS, HOUSING, BUILT-UP INFRASTRUCTURE AND CONSTRUCTION-DEVELOPMENT PROJECTS

The Government of India, vide Press Note 2 (2005 Series) dated 2.3.2005, had notified the policy for Foreign Direct Investment (FDI) in townships, housing, built-up infrastructure and construction-development projects. As the Government had received a few requests from investors seeking clarifications on applicability of these policy guidelines to some other sectors such as Special Economic Zones, Hotels, Hospitals, etc., the following clarification has been issued by the Government on 18th January 2006.

The matter has been considered by the Government in the light of the policy prevailing prior to issue of the subject Press Note. FDI up to 100% was already allowed under the automatic route in the Hotel and tourism sector vide Press Note 4 (2001 Series) and in the Hospital sector vide Press Note 2 (2000 Series). Special Economic Zones are separately regulated under the Special Economic Zone Act, 2005.

It has been clarified by the Government that the provisions of Press Note 2 (2005 Series) shall not apply to Special Economic Zones; neither shall it apply to establishment and operation of hotels and hospitals which shall continue to be governed by Press Note 4 (2001 Series) and Press Note 2 (2000 Series) respectively.

FOREIGN DIRECT INVESTMENT (FDI) IN UP-LINKING OF TV CHANNELS

At present, foreign direct investment (FDI) up to 49% is permitted for setting up hardware, Up-linking HUB, etc., subject to compliance with the Broadcasting Laws and Regulations and subject to the detailed guidelines for Up-linking announced by the Ministry of Information and Broadcasting from time to time.

Under the revised guidelines for Up-linking notified on 2.12.2005, the Government of India has decided to allow FDI in the Up-linking of TV Channels as under:

FDI up to 49% would be permitted with prior approval of the Government for setting up Up-linking HUB/ Teleports; FDI up to 100% would be allowed with prior approval of the Government for Up-linking a Non-News & Current Affairs TV Channel; FDI (including investment by Foreign Institutional Investors (FIIs) up to 26% would be permitted with prior approval of the Government for Up-linking a News & Current Affairs TV Channel subject to the condition that the portfolio investment in the form of FII/ NRI deposits shall not be "persons acting in concert" with FDI investors, as defined in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. The Company permitted to uplink the channel shall certify the continued compliance of this requirement through the Company Secretary at the end of each financial year.

The Government has clarified on 17th January, 2006 that while calculating foreign equity of the applicant company, the foreign holding component, if any, in the equity of the Indian shareholder companies of the

applicant company will be duly reckoned on pro-rata basis, so as to arrive at the total foreign holding in the applicant company. However, the indirect FII equity in a company as on 31st March of the year would be taken for the purposes of pro-rata reckoning of foreign holdings.

FDI for Up-linking TV Channels will be subject to compliance with the Up-linking Policy of the Government of India notified by the Ministry of Information & Broadcasting from time to time.

AMENDMENT IN ECB POLICY TO PERMIT MULTI STATE CO-OPERATIVE SOCIETIES TO ACCESS ECB UNDER APPROVAL ROUTE

The Government of India has amended the External Commercial Borrowing (ECB) policy to permit the Multi State Co-operative Societies engaged in manufacturing activities in real sector with financial solvency and up-to-date audited balance sheet to access ECB under the Approval Route. The borrower of such ECB would comply with all parameters of ECB guidelines such as recognized lender, permitted end-use, average maturity period, all-in-cost ceiling etc.

LANDMARK DECISION OF INCOME TAX TRIBUNAL REGARDING WITHHOLDING TAX OBLIGATION OF TELECASTING COMPANY

The Mumbai Bench of the Income Tax Appellate Tribunal (ITAT) in the case of Satellite Television Asian Region Ltd. Hong Kong (Star TV), has held in a landmark decision that Star TV making payment for purchase of advertisement air-time to its group companies engaged in telecasting of programmes, is obliged to withhold tax on such payments and the withholding tax obligation on the foreign company survives independent of the fact that the payer company and the payee company are both non-residents. It also further held that the incomes of the channel companies are taxable in India.

FACTS OF THE CASE:

Star TV, a non-resident company incorporated in Hong Kong, was carrying on the business of selling "Air Time" to various Indian advertisers through an advertising sales agent. It acquired the air time from various television channel companies like Star News, Star Plus, etc. that were its group Companies incorporated in Hong Kong. Star TV claimed a deduction of payments made to the channel companies against its taxable income. The claim was disallowed by the tax authorities since it had failed to withhold tax on the payments made to the channel companies.

CONTENTIONS OF RIVAL PARTIES:

Star TV appealed against the decision of revenue authorities and claimed that

the Income-tax Act does not contain any provision stipulating its applicability beyond India . On the contrary, it contended that the applicability of the Income Tax Act, 1961 is specifically restricted only to India. Support was drawn from previously decided cases by the Indian & UK Courts and commentaries on tax jurisprudence. It also argued that there could be situations where although income is chargeable to tax in India, in the absence of machinery to withhold tax, tax withholding cannot be prescribed from the payments and the chargeability of income to tax in the hands of the recipient and withholding of tax by the payer are independent of each other.

Star TV further argued that the chargeability of payments to tax in India in the hands of the recipient is a pre-condition / prerequisite for triggering the withholding tax provisions and the chargeability of the recipient cannot be decided in an assessment proceeding of the payer but only in the recipients' own case after providing such recipient, full opportunity of being heard. It is not proper to expect a payer to prove / establish whether or not the recipient is chargeable to tax in India. Thus, Star TV contended that the chargeability needs to be first determined in the hands of the channel companies without which the provisional nature of the withholding tax proceedings

cannot be completed and a disallowance cannot be made in the hands of the payer.

On the question of taxability of income of channel companies, Star TV contended that all the activities of the channel companies were carried on outside India and none in India. The content for the channels was procured by the channel companies from a central content procurement company outside India. The channel companies do not enter into any contract with Indian Content Providers or with any Indian party for the sale of Ad Airtime in India. The channels were up-linked outside India and then down linked in India by the cable operators on their own account. The entire Ad Airtime on the channels was sold by the channel companies to the Company and the sale was made outside India on a principal to principal basis. The channel companies were incorporated outside India and they did not have any office or agent or subsidiary in India. They did not have their men or material or machinery or combination thereof used in India. The business strategy, marketing and all other operational features are determined by Star TV. Star TV also claimed that the channel companies did neither have any business connection in India nor did they carry out any operations in India and further it was not an agent of the channel companies.

The revenue authorities argued that the Income-tax Act, 1961 (the Act) applies to the whole of India and if any entity whether resident or non resident, by virtue of its residence, or having a source of income, falls into the tax net, then all the provisions of the Act are applicable. They also contended that while the withholding tax provisions do not extend the Act to territories outside India, if any foreign entity has income chargeable to tax in India, it is bound by all the provisions of the Indian Income-tax law and such an entity has to follow the domestic taxation laws of India. The withholding tax provisions do not make any distinction between payments within India and payments outside India and the situs of payment or the source of payment is not relevant and further the withholding tax provisions provide for a mechanism whereby an application can be made to the tax authorities to decide the rate at which tax is to be deducted or whether no tax withholding is required.

The revenue authorities also pointed out that the statute casts an onus on the payer to accord a satisfaction regarding the chargeability of the payments for withholding of tax or obtaining of appropriate direction for NIL withholding or withholding at a lower rate. Further, separate consequences are prescribed on the payer for non-compliance with the withholding tax provisions. They also emphasized that the opportunity to be provided to the payer is limited to the chargeability of the payments to tax in India and the law does not provide that the payee should also be given an opportunity while doing the assessment of the payer.

On the question of taxability of the income of channel companies, the revenue authorities contended that the nature of telecasting activities carried on by the channel companies and the functional relationship amongst the channel companies, the assessee and other associate concerns showed that the channel companies had a business connection with India. Their business operations were being carried out in India and the relationship between the channel companies and the assessee were not of a principal to principal.

DECISION OF TRIBUNAL:

ITAT observed that the sovereign jurisdiction of a country is confined to its own territorial boundaries as expounded by the principle embedded in "the doctrine of territorial nexus" and the writ of a state is ultimately to be executed by the strength of the force available at its command. It pointed out that the substantial provisions of chargeability and the machinery provisions of deductibility are inseparable pillars of a tax code and if the collection machinery cannot be initiated in a case even after chargeability is established, the substantial provisions of law governing the chargeability themselves become redundant. ITAT held that even if a tax demand raised by income-tax authorities in India against a foreign party in foreign soil cannot be executed in the absence of machinery, it is not a defense to plead exoneration from withholding tax provisions and withholding of tax at source is one of the modes of collection / recovery of the tax. The provision for recovery of tax directly from the recipient is only an alternate mode of collection of tax and does not exonerate a non-resident payer from its withholding tax obligations and further, the withholding tax provisions do not differ depending on the residential status of the payer. ITAT further held that even if the payment is made to a non resident whether in India or outside or in any manner, the payer is liable for deducting tax at source. The governing force of the withholding tax law is not the payment, but payment of income chargeable to tax. The situs of the payment or the source of the payment is not

relevant and the law provides for a taxpayer to approach the tax authorities to decide the rate at which tax is to be withheld or for that matter whether tax is to be withheld or not. A failure of the taxpayer to exercise this option fastens such taxpayer with an obligation to withhold tax and the payer is bound to comply with the withholding tax provisions and in the absence of such compliance, it shall invite the consequences specified in the statute.

As regards taxability of income if the channel companies, ITAT held that The business of the channel companies was that of telecasting through different brand channels using the medium of satellite and transponders, along with the supporting network provided by the cable operators, these could not be divided and segregated into transferable modules from channel companies to the Company and then to other selling agents and these have to be carried out simultaneously. It observed that advertisement Airtime was the telecasting time utilized for commercial purposes and it was not something like an ordinary commodity, merchandise, property or asset and could not be a subject matter of "outright sale". Airtime was borne and exhausted instantaneously, moment after moment and could not be delivered in advance. Therefore, it was not possible for Channel companies to make any "outright sale" of Airtime to the Company outside India. ITAT pointed out the agreements between the Company and the channel companies provide only a permissive right to the assessee to use and exhaust the Airtime within Indian territory. Though, there could be other countries other than India coming under the footprint of the satellite telecast, this was not a reason to hold that the activities of telecasting were not done in India. ITAT also observed that the channel companies had maintained their commercial and financial interest in the activities carried on by the Company. The revenue collected by the Company was shared with the channel companies and the channel companies monitored all the business and operational aspects of the Company relating to viewership, marketing and other strategic aspects of the Airtime business. The flow of the telecasting began with the up-linking done by the channel companies outside India and terminated with downlinking done by the cable operators in India and ultimately reaching to the screens of the viewers at large.

In view of the foregoing, ITAT held that there was a direct connection between the channel companies and the cable operators that was involved in the actual operation of the process of telecasting and this resulted in establishing a business connection with India. It pointed out that the ultimate delivery of programmes was made by the channel companies in India through the medium of its agent and the cable operators and therefore, the channel companies had a continuous business relation supported by a continuous business operation in India that was a source of revenue for them. ITAT finally observed that even though for the purpose of engineering and technology, the telecasting was transmitted through the satellites situated in the high sky, Indian space was a definite place of business. The business connection, business activity, place of business and every such ingredient of a taxable relation between non-residents and India were to be inferred from the nature of the business operations carried on by the concerned parties.

Based on these observations, ITAT concluded that the incomes of the channel companies were taxable in India.

ITAT: ACTUAL PAYMENT OF INCOME TAX IN A COUNTRY NOT A PRE-REQUISITE FOR CLAIMING DTAA BENEFITS

In a recent decision, a Mumbai Bench of the Income Tax Appellate Tribunal (ITAT) has held that the actual tax payment in a country was not necessary for a taxpayer to claim the benefits under a Double Tax Avoidance Agreement (DTAA)

Facts of the case:

The taxpayer was a shipping line based in the United Arab Emirates (UAE) and it claimed in its tax return that its income from shipping operations is taxable only in UAE in terms of Article 8 of the DTAA between India and UAE.

The Assessing Officer (AO) rejected the taxpayer's claim on the ground that as the taxpayer was not paying income tax in UAE, it was not eligible to the relief under the DTAA. The AO relied on the decision of Authority for Advance Ruling ('AAR') in the case of *Cyriel Eugene Pereria inre [1999] 239 ITR 650* in support of his conclusion.

The Commissioner of Income-tax Appeals (CIT-A) set aside the order of the AO. The CIT-A held that as the

taxpayer had produced a tax residency certificate issued by the Ministry of Finance and Industry in the UAE, the taxpayer was entitled to relief under the DTAA.

TRIBUNAL'S DECISION:

The Tribunal upheld the order of CIT-A based on the following reasoning:

As the Supreme Court has held in the case of *Azadi Bachao Andolan v. U.O.I.* [2003] 263 ITR 706, rulings of the AAR are not binding on the persons other than the applicant and since it is a well settled proposition that decisions of the Supreme Court are binding on the Courts below and on the tax authorities, the reliance placed by the AO on the ruling of the AAR in *Cyriel Eugene Pereria (supra)* was misplaced.

As the Supreme Court had in *Azadi Bachao Andolan's case (supra)* rejected the contention that avoidance of double taxation arises only when a taxpayer pays income-tax in one of the treaty countries, the contention of the AO that the taxpayer was not entitled to treaty benefits as it did not pay tax in UAE was without merit.

The reliance by the tax authorities on the subsequent ruling of the AAR in the case of *Abdul Razak A. Menon in re* [2005] 276 ITR 306 was also not acceptable as rulings of the AAR have no precedence value in general and that the ruling by itself was not sufficient to decide the issue one way or the other.

ITAT also observed that DTAA not only prevents 'current' but also 'potential' double taxation and irrespective of whether UAE actually levies income-tax on corporate entities, once the right to tax UAE resident's vests only with the

UAE Government, that right, whether exercised or not, continues to remain an exclusive right of the UAE Government.

ITAT concluded that to allow treaty benefits, all that is necessary to be seen is that the claimant of treaty benefits should be 'liable to tax' in the contracting state by reason of domicile, residence, place of management, place of incorporation or any other criterion of a similar nature which essentially referred to the fiscal domicile of such a person.

INCOME TAX TRIBUNAL ENHANCES TAX LIABILITY

The Income Tax Appellate Tribunal (ITAT) has taken an unusual and extraordinary stand of enhancing the tax liability in the case of Sakura Bank (bank) by applying a higher income-tax rate based on subsequent retrospective amendment to the Income Tax Act.

FACTS OF THE CASE:

There was a Double Taxation Avoidance Agreement (DTAA) between India and Japan which has provisions against discrimination. The case was in relation to the assessment in the year 1992-93. The assessing officer first taxed it at a higher rate applicable to foreign companies, but the Commissioner of Income Tax –Appeals (CIT) referred the case back to the assessing officer for revision in favour of the assessee. Thereafter, the assessing officer and the CIT took a stand in favour of the bank, taxing it at the rate domestic companies are taxed. The CIT also allowed the company's plea that it be considered as a widely held company where, the rate of tax is less than the tax leviable on closely held companies. Incidentally, the rate of tax applicable to domestic companies during the relevant period was 45% and it was 60% for foreign companies. The appeal against the CIT's order was filed by the department. In this case, the issue was whether the bank should be taxed at the rate of tax applicable to the Indian companies or at the higher rate of tax applicable to foreign companies.

DECISION OF ITAT:

The ITAT held in this landmark judgment that the powers of ITAT are not confined to deal with the issues arising out of the orders of the authorities below, who are the Commissioner (Appeal) and the assessing officer. As long as, an issue has relevance regarding the accurate determination of taxes payable, in respect of the year, and

particularly when relevant facts can be found from the material already on record, it is open to the parties concerned to raise that issue. The Tribunal also pointed out that there has been cases in the past where the Tribunal enhanced the income of the assessee resulting in more tax liability than the liability that would have arisen if the taxpayer had opted to accept the original tax demand.

The interesting fact about the ITAT decision was that it took into account a material that was not part of the earlier decisions by AO or the CIT (Appeal). This additional material is the Finance Act 2001, which amended section 90 of the I-T Act, which allows taxation of a foreign company at a higher rate, despite the provisions in DTAA against discrimination. This amendment was part of the Finance Act 2001, and with retrospective effect. Since the amendment with retrospective effect was enacted after the matter was decided by the AO and CIT, the ITAT decided to take into account this amendment, though such a practice was against the convention of not entertaining new grounds.

This judgment of ITAT has raised a few contentious issues regarding admissibility of new materials which did not exist at the time when the decisions were given by the lower revenue authorities and it will be interesting to see the outcome if this matter is taken up before the High Court.

NO ENTRY FOR FOREIGN LAW FIRMS IN INDIA

The Government of India has ruled out foreign firms from entering the Indian courts. Britain and Australia had approached the Bar Council of India seeking permission to set up their law firms in the country. But the Bar Council of India made it clear to them that it is opposed to the entry of foreign lawyers and foreign law firms in the country. An American law firm had also approached the Bar Council of India to open its branch office here to render legal services. But its request was turned down.

PROPOSED IMPORT OF SERVICES RULES TO PROVIDE FOR CLEAR CUT NORMS

The Government is working on a fresh set of FDI guidelines for parts of the NBFC sector. The new guidelines will determine FDI inflow in residential mortgage credit default protection.

This is currently not covered under the 19 NBFC financial services activities where foreign investment is allowed. The matter came up after an American financial services company, Genworth Financial, asked for permission to set up a 100% subsidiary in India. The subsidiary, which was to be set up as an NBFC, will offer mortgage guarantee products providing residential credit default protection to lenders. In other words, the product will offer a risk coverage to lenders of home loans and mortgages like banks and financial institutions. Genworth's proposal was to invest over Rs. 200 crore in its Indian subsidiary. The company had planned to bring in \$7.5m upfront and the balance \$42.5m over the next two years.

According to the current policy, 100% FDI in NBFC is allowed under the automatic route. However, there are some minimum capitalisation norms, under which, up to 51% FDI stake requires \$0.5m to be invested upfront. For 51%-75% FDI stake, \$5m needs to be invested upfront and for 75%-100% foreign investment, the minimum mandated investment amount is \$50m of which at least \$7.5m should be invested upfront. For non-fund based NBFCs with foreign investment, the minimum capitalisation level is \$0.5m.

The department of economic affairs has asked for comments from the RBI/insurance division. Accordingly, the Genworth proposal has been deferred till mid-December 2005.

Source: Economic Times

SNAPSHOT OF GLOBAL MARKETS - JANUARY 2006

KEY STOCK MARKET INDICES

INDEX	OPENING (01/01/2006)	HIGHEST IN JANUARY 2006	LOWEST IN JANUARY 2006	CLOSING (31/01/2006)
BSE SENSEX	9422.49	9939.55	9158.44	9919.89
S&P CNX NIFTY	2836.80	3005.10	2783.85	3001.10
DOW JONES I.A.	10780.02	11099.15	10607.36	10864.86
NASDAQ COMPOSITE	2216.60	2332.92	2189.91	2305.82
FTSE 100	5618.80	5796.10	5618.80	5779.80
NIKKEI	16294.65	16754.60	15059.52	16649.82

PRICES OF KEY COMMODITIES (US\$)

COMMODITY	OPENING (01/01/2006)	HIGHEST IN JANUARY 2006	LOWEST IN JANUARY 2006	CLOSING (31/01/2006)
GOLD - SPOT (NY)	519.00	572.00	519.00	570.70
SILVER - SPOT (NY)	9.06	9.91	8.83	9.83
PLATINUM - SPOT(NY)	964.00	1074.00	942.00	1074.00
COPPER (COMEX)	2.077	2.246	2.077	2.236
ALUMINIUM (COMEX)	1.0555	1.1550	1.0525	1.1550
BRENT CRUDE (IPE)	59.65	69.03	59.49	65.99
NYMEX CRUDE OIL	62.70	69.15	62.50	67.92

KEY GLOBAL CURRENCY RATES AGAINST USD

CURRENCY	OPENING RATE (01/01/2006)	HIGHEST IN JANUARY 2006	LOWEST IN JANUARY 2006	CLOSING RATE (31/01/2006)
EURO/USD	1.1842	1.2323	1.1778	1.2095
GBP/USD	1.7238	1.7933	1.7164	1.7675
USD/JPY	117.68	118.17	113.40	117.45
USD/INR	45.20	45.05	43.84	44.16

MAJOR CURRENCIES AGAINST INR

CURRENCY	OPENING RATE (01/01/2006)	HIGHEST IN JANUARY 2006	LOWEST IN JANUARY 2006	CLOSING RATE (31/01/2006)
USD/INR	45.20	45.05	43.84	44.16
EURO/INR	53.52	54.41	53.22	53.41
GBP/INR	77.91	79.07	77.61	78.05
JPY/INR	38.41	38.97	37.58	37.61

INTEREST RATES

MIBOR

PERIOD	OPENING RATE (01/01/2006)	HIGHEST IN JANUARY 2006	LOWEST IN JANUARY 2006	CLOSING RATE (31/01/2006)
OVERNIGHT	6.83	8.00	5.58	7.56
14 DAY	6.62	7.48	6.23	7.42
1-MONTH	6.67	7.53	6.38	7.40
3-MONTH	6.77	7.62	6.65	7.57

LIBOR - USD

PERIOD	OPENING RATE (01/01/2006)	HIGHEST IN JANUARY 2006	LOWEST IN JANUARY 2006	CLOSING RATE (31/01/2006)
1-MONTH	4.40	4.57	4.40	4.57
3-MONTH	4.54	4.68	4.54	4.68
6-MONTH	4.71	4.81	4.68	4.81
12-MONTH	4.85	4.94	4.79	4.94

LIBOR - EURO

PERIOD	OPENING RATE (01/01/2006)	HIGHEST IN JANUARY 2006	LOWEST IN JANUARY 2006	CLOSING RATE (31/01/2006)
1-MONTH	2.40	2.40	2.39	2.39
3-MONTH	2.49	2.54	2.49	2.54
6-MONTH	2.65	2.69	2.62	2.69
12-MONTH	2.86	2.89	2.77	2.89

LIBOR - GBP

PERIOD	OPENING RATE (01/01/2006)	HIGHEST IN JANUARY 2006	LOWEST IN JANUARY 2006	CLOSING RATE (31/01/2006)
1-MONTH	4.65	4.65	4.58	4.59
3-MONTH	4.63	4.63	4.59	4.59
6-MONTH	4.59	4.62	4.58	4.61
12-MONTH	4.58	4.68	4.58	4.68

LIBOR - JPY

PERIOD	OPENING RATE (01/01/2006)	HIGHEST IN JANUARY 2006	LOWEST IN JANUARY 2006	CLOSING RATE (31/01/2006)
1-MONTH	0.050	0.052	0.050	0.052
3-MONTH	0.067	0.070	0.065	0.070
6-MONTH	0.082	0.090	0.081	0.090
12-MONTH	0.119	0.130	0.119	0.130

US T-BILL

PERIOD	OPENING RATE (01/01/2006)	HIGHEST IN JANUARY 2006	LOWEST IN JANUARY 2006	CLOSING RATE (31/01/2006)
	Discount/Yield	Discount/Yield	Discount/Yield	Discount/Yield
1-MONTH	3.97/4.05	4.30/4.37	3.85/3.95	4.30/4.37
3-MONTH	4.07/4.16	4.38/4.48	4.07/4.16	4.37/4.47
6-MONTH	4.25/4.40	4.45/4.62	4.22/4.37	4.43/4.59

KEY CENTRAL BANK RATES

	31/01/2006	1 MONTH PRIOR	3 MONTH PRIOR	6 MONTH PRIOR	1 YEAR PRIOR
US FEDERAL RESERVE FUNDS RATE*	4.25	4.00	3.75	3.25	2.25
EUROPEAN CENTRAL BANK RATE	2.25	2.00	2.00	2.00	2.00
BANK OF ENGLAND RATE	4.50	4.50	4.50	4.75	4.75
RESERVE BANK OF INDIA - BANK RATE	6.00	6.00	6.00	6.00	6.00

* US FED RATE has been increased to 4.5% w.e.f. 2nd February 2005

PRIME RATES

CURRENCY	RATE
USD	7.50
EURO	3.00
GBP	4.50
JPY	1.38
INR	10.25 to 10.75

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