INDIA UPDATE

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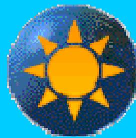

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INDIA'S EXPORT SURGES BUT INCREASE IN IMPORTS ENSURE WIDENING OF TRADE DEFICIT

The Indian exports during the first nine months of the current fiscal year 2006-07 registered a growth of 36% compared to the exports during the corresponding period of the previous year. However, increase of 39% in crude oil imports together with 19% increase in Non-oil imports ensured that the trade deficit was higher at US$ 41.72 billion during the first nine months of the current fiscal year.

The cumulative value of India's merchandise exports in the first nine months (April-December 2006) of the current financial year 2006-07 was US $ 89.49 billion as against US $ 65.67 billion during the same period last year, indicating a growth of 36% over April-December 2005-06, according to the provisional data available from Directorate General of Commercial Intelligence & Statistics (DGCI&S).

The cumulative value of imports during April-December, 2006 was US $ 131.21 billion, which was higher than imports at US $ 96.26 billion during April-December, 2005. Crude Oil imports during April-December 2006 were valued at US $ 43.82 billion, which was 39.23% higher than Crude Oil imports of US $ 31.47 billion in the corresponding period last year. Non-oil imports during April-December, 2006 were valued at US $ 87.40 billion which was 18.67% higher than the level of such imports valued at US $ 73.65 billion in April-December 2005.

The trade deficit for April-December, 2006 was estimated at US $ 41.72 billion, which was higher than the deficit of US $ 30.60 billion during April-December, 2005.

EXTENSION OF TIME LIMIT FOR TELECOM COMPANIES TO COMPLY WITH CONDITIONS

The Government of India had, vide Press Note 5 (2005 Series) dated 3.11.2005, notified the enhancement of Foreign Direct Investment (FDI) limits in the Telecom Sector subject to specified conditions. In terms of para 4 of the said Press Note, an initial correction time of 4 months from the date of issue of the Press Note was allowed to the existing licensee companies for adherence of the conditions. The correction time was extended from time to time and the last extension was allowed up to 2nd January 2007.

The Government has decided to further extend the time period for the telecom service provider companies to comply with the conditions set out in Press Note 5 (2005 Series) by three months w.e.f 3.1.2007 up to 2nd April 2007. Press Note 5 (2005 Series) dated 3.11.2005 stands modified to the above extent.

RBI LIBERALIZES PROCEDURES IN RESPECT OF PROJECT AND SERVICE EXPORTS

The Reserve Bank of India has decided to simplify the procedures and providing greater flexibility to project exporters and exporters of services in conducting their overseas transactions and accordingly, the guidelines stipulated vide paragraphs B.10 (i) (f), D.1 (i), D.3 and D.4(iv) of the PEM have been modified as set out below :

(i) Inter-Project Transfer of Machinery

At present, exporters executing turnkey / construction contracts abroad are required to dispose off the equipment, machinery, vehicles, etc., purchased abroad and / or to arrange their import into India after completion of the contracts. In case, the machinery, etc., is to be used for another overseas project, the market value (not less than book value) should be recovered from the project to which equipment / machinery has been transferred.

On a review, the stipulation regarding recovery of market value (not less than book value) of the machinery, etc., from the transferee project is withdrawn with immediate effect. Further, exporters may use the machinery / equipment for performing any other contract secured by them in any country subject to the satisfaction of the sponsoring AD Category - I bank(s) / Exim Bank / Working Group. The reporting requirement for transfer of machinery / equipment will continue as hitherto, and would be monitored by the AD Category - I bank(s) / Exim Bank / Working Group.

(ii) Inter-Project Transfer of Funds

At present, Project / Service exporters, as specified in the PEM, may maintain a single foreign currency account for more than one project being executed in the same country subject to the conditions as may be stipulated by the AD Category - I bank(s) / Exim Bank / Working Group. Further, the facility of temporary inter-project transfer of funds to meet cash flow deficits is available subject to approval from and reporting to the exporter's banker monitoring the project and with condition of re-transfer of the fund to the lending project as soon as possible.

It has now been decided by RBI that, henceforth, AD Category - I bank(s) / Exim Bank / Working Group may permit exporters to open, maintain and operate one or more foreign currency account/s in a currency/currencies of their choice with inter-project transferability of funds in any currency or country. The Inter-project transfer of funds will be monitored by the AD Category - I bank(s) / Exim Bank / Working Group.

3. Deployment of Temporary Cash Surpluses

At present, Project / Service exporters are required to approach the Reserve Bank for overseas deployment of their temporary cash surpluses. It has now been decided that, henceforth, Project / Service exporters may deploy their temporary cash surpluses, generated outside India, in the following instruments / products, subject to monitoring by the AD Category - I bank(s) / Exim Bank / Working Group :

(a) investments in short-term paper abroad including treasury bills and other monetary instruments with a maturity or remaining maturity of one year or less and the rating of which should be at least A-1/AAA by Standard & Poor or P-1/Aaa by Moody's or F1/AAA by Fitch IBCA etc.,

(b) deposits with branches / subsidiaries outside India of an AD Category - I bank in India.

RBI'S CLARIFICATION ON BANKS' EXPOSURE TO COMMODITY MARKETS

In terms of Master Circular on 'Guarantees and Co-acceptances' issued by the Reserve Bank of India (RBI), banks may issue guarantees on behalf of share and stock brokers in favour of stock exchanges in lieu of margin requirements as per stock exchange regulations. While issuing such guarantees banks should obtain a minimum margin of 50 percent. A minimum cash margin of 25 percent (within the above margin of 50 percent) should be maintained in respect of such guarantees issued by banks.

RBI has now clarified that the above minimum margin of 50 percent and minimum cash margin requirement of 25 percent (within the margin of 50 percent) will also apply to guarantees issued by banks on behalf of commodity brokers in favour of the national level commodity exchanges, viz., National Commodity & Derivatives Exchange (NCDEX), Multi Commodity Exchange of India Limited (MCX) and National Multi-Commodity Exchange of India Limited (NMCEIL), in lieu of margin requirements as per the commodity exchange regulations.

RBI CLARIFICATION ON CREATION OF FLOATING CHARGE ON LIQUID ASSETS BY NBFCS

The Reserve Bank of India (RBI) had earlier issued a circular advising that all Non-Banking Financial Companies (NBFCs) accepting/ holding public deposits are required to create floating charge on the statutory liquid assets invested in terms of Section 45- IB of the RBI Act, 1934, in favour of their depositors.

In view of the practical difficulties expressed by the NBFCs in creating charge on the statutory liquid assets in favour of large number of depositors, RBI has decided that NBFCs accepting/ holding public deposits may create the floating charge on the statutory liquid assets maintained in terms of Section 45-IB of the RBI Act, 1934 and notifications issued by the Bank from time to time, in favour of their depositors through the mechanism of 'Trust Deed'. The charge is required to be registered with the Registrar of Companies and the information in this regard is required to be furnished to the trustees and the Reserve Bank of India. 'Draft Trust Deed' containing the details in this regard and The 'Trustee Guidelines' have been issued by RBI for the guidance of the NBFCs. The RBI has advised that its instructions in this regard may be placed before the Board of Directors and the system may be put in place latest by March 31, 2007.

All other provisions of RBI circular DNBS (PD) C.C No. 47/ 02.01/ 2004-05 dated February 07, 2005 shall continue to be in force. NBFCs have been advised to report compliance to the Regional Offices of the Bank in whose jurisdiction its registered office is situated.

RBI CLARIFICATION ON EMPANELMENT OF VALUERS FOR VALUATION OF PROPERTIES

The Reserve Bank of India (RBI) has pointed out that different banks follow different policies for valuation of properties and appointment of valuers for the purpose. The issue of correct and realistic valuation of fixed assets owned by banks and that accepted by them as collateral for a sizable portion of their advances portfolio assumes significance in view of its implications for correct measurement of capital adequacy position of banks. In this context, RBI has stressed that there is a need for putting in place a system/procedure for realistic valuation of fixed assets and also for empanelment of valuers for the purpose.

The RBI has advised that Banks may be guided by the following aspects while formulating a policy on valuation of properties and appointment of valuers:

(a) Policy for valuation of properties

i) Banks should have a Board approved policy in place for valuation of properties including collaterals accepted for their exposures.

ii) The valuation should be done by professionally qualified independent valuers i.e. the valuer should not have a direct or indirect interest.

iii) The banks should obtain minimum two Independent Valuation Reports for properties valued at Rs.50 crore or above.

(b) Revaluation of bank's own properties

In addition to the above, the banks may keep the following aspects in view while formulating policy for revaluation of their own properties.

i) The extant guidelines on Capital Adequacy permit banks to include revaluation reserves at a discount of 55% as a part of Tier II Capital. In view of this, it is necessary that revaluation reserves represent true appreciation in the market value of the properties and banks have in place a comprehensive policy for revaluation of fixed assets owned by them. Such a policy should interalia cover procedure for identification of assets for revaluation, maintenance of separate set of records for such assets, the frequency of revaluation, depreciation policy for such assets, policy for sale of such revalued assets etc. The policy should also cover the disclosure required to be made in the 'Notes on Account' regarding the details of revaluation such as the original cost of the fixed assets subject to revaluation and accounting treatment for appreciation / depreciation etc.

ii) As the revaluation should reflect the change in the fair value of the fixed asset, the frequency of revaluation should be determined based on the observed volatility in the prices of the assets in the past. Further, any change in the method of depreciation should reflect the change in the expected pattern of consumption of the future economic benefits of the assets. The banks should adhere to these principles meticulously while changing the frequency of revaluation/method of depreciation for a particular class of asset and should make proper disclosures in this regard.

(c) Policy for Empanelment of Independent valuers

i) Banks should have a procedure for empanelment of professional valuers and maintain a register of 'approved list of valuers'.

ii) Banks may prescribe a minimum qualification for empanelment of valuers. Different qualifications may be prescribed for different classes of assets (e.g. land and building, plant and machinery, agricultural land, etc.). While prescribing the qualification, banks may take into consideration the qualifications prescribed under Section 34AB (Rule 8A) of the Wealth Tax Act, 1957.

Banks may also be guided by the relevant Accounting Standard issued by the Institute of Chartered Accountants of India.

RBI ISSUES NOTIFICATION FOR FDI IN STOCK EXCHANGES & OTHER INFRASTRUCTURE COMPANIES IN SECURITIES MARKETS

The Reserve Bank of India (RBI) has decided in consultation with Government of India to allow foreign investment in Infrastructure Companies in Securities Markets, namely stock exchanges, depositories and clearing corporations, in compliance with SEBI Regulations and subject to the following conditions:

i) Foreign investment upto 49 per cent will be allowed in these companies with a separate Foreign Direct Investment (FDI) cap of 26 per cent and Foreign Institutional Investment (FII) cap of 23 per cent;

ii) FDI will be allowed with specific prior approval of FIPB; and

iii) FII will be allowed only through purchases in the secondary market.

GOVERNMENT INCREASES INVESTMENT LIMIT FOR HIGH-TECH IT PROJECTS TO BE ELIGIBLE FOR SPECIAL INCENTIVES

The finance ministry has decided that semiconductor fabrication plants and manufacturers of other hi-tech information technology products will have to invest a minimum of Rs 25 billion to avail of government incentives. It had earlier planned to peg the minimum investment for semiconductor fabrication projects at Rs 25 billion and Rs 10 billion for manufacturers of other hi-tech IT products.

The changes are expected to be included in the new semiconductor fabrication (FAB) policy, for which the department of information technology has already moved a Cabinet note.

The finance ministry has also supported the Cabinet note, on providing fiscal incentive equal to 25 per cent of the capital expenditure incurred during the first 10 years of a project. It has been proposed that this would be in the form of investment grant, tax benefit and interest subsidy, valued at 15 per cent of the capital expenditure. In addition, the government is also expected to change its contribution of 10 per cent as equity in the capital expenditure, subject to a cap of 26 per cent of total stake in the unit.

The government is also working on extending the fiscal incentive package to hi-tech IT products' manufacturers in the software technology parks of India (STPIs) by 10 years from the current limit up to March 2010.

GOVERNMENT APPROVES AMENDMENTS TO THE CARRIAGE BY AIR ACT, 1972

The Government of India today has given approval for moving a Bill in Parliament for carrying out the proposed amendments in the Carriage by Air Act, 1972 and accession to the Montreal Convention 1999. There is an international legal regime governing the liability of air carriers for injury or death of their passengers, for destruction or loss of or damage to baggage and cargo and for losses caused by delay in international carriage of passengers, baggage and cargo. The regime is set out in a number of international instruments collectively known as the "Warsaw System" consisting of a number of instruments.

The Warsaw System comprises of eight International Instruments, out of which six are in force. However, India has ratified only two out of these eight instruments, namely the

Warsaw Convention and the Warsaw Convention as amended by the Hague Protocol. The existing law on the subject in so far as India is concerned is the Carriage by Air Act, 1972.

However, due to unilateral decisions together with the application of the Warsaw System in different forms by different States, some 44 different combinations of liability regimes came into existence. The major shortcoming of the Warsaw System, which was designed for the unification of certain rules relating to carriage by air, was now its lack of uniformity on a crucial issue, i.e. the level of compensation.

The Warsaw System provides for four choices of jurisdictions for filing of a claim by a passenger or his legal heirs, namely, (1) the place where the ticket was issued or the contract of carriage was made, (2) the principal place of business of the carrier, (3) the place of destination of the passenger, and (4) the place of domicile of the carrier. The Montreal Convention 1999 adds a fifth jurisdiction, i.e. the place of domicile of the passenger, provided the airlines has a presence there. Thus, this will enable an Indian to file his claim in India even if the journey was undertaken outside India and ticket purchased outside India, provided the carrier has a presence in India.

The Montreal Convention 1999 has already been ratified by 64 countries, out of which 21 have direct air links with India, including routes having high traffic density such as United States of America, United Kingdom, United Arab Emirates, Kuwait, Qatar, Bahrain, Saudi Arabia, Japan, Austria, France, Germany, Netherlands, Italy and Canada.

Since a large number of flights operate between India and many of the countries that have ratified or acceded to the Montreal Convention 1999 (for example, USA and UK), the Government has pointed out that non-accession of the Convention by India may give rise to a situation involving serious discrimination between the passengers of the same flight with regard to compensation.

The Government has accordingly proposed amendments to certain provisions of the Carriage by Air Act, 1972, to insert the text of the Montreal Convention by way of a new Schedule to the said Act and add an Annexure containing the names of High Contracting Parties and date of enforcement of the Convention.

COAL INDUSTRY TO CONTINUE AS PUBLIC UTILITY SERVICE FOR ANOTHER SIX MONTHS

Coal Industry has been declared a public utility service under the Industrial Disputes Act, 1947 for another six months with effect from December 28, 2006. According to a notification issued by the Ministry of Labour and Employment, this has been done in public interest. Coal Industry was earlier declared a public utility service for six months from June 28, 2006.

The employees in this industry, as a result, would among other things be required to give notice to their employer six weeks in advance of proceeding on strike so that conciliatory proceedings could be started. During the conciliatory proceedings and seven days after their completion, the employees cannot go on strike.

INVESTMENT IN ADRS/GDRS/FOREIGN SECURITIES AND OVERSEAS ETFS BY MUTUAL FUNDS

Pursuant to the enhancement in overseas investment limits by RBI, the Securities & Exchange Board of India (SEBI) has decided that mutual funds can invest in ADRs/GDRs/Foreign Securities within overall limit of US$3 billion. This will be a 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 and subject to a maximum of US $150 million per mutual fund. All other conditions specified earlier by SEBI remain unchanged.

LIMITS OF FII INVESTMENTS IN DEBT SECURITIES INCREASED BY SEBI

The Securities & Exchange Board of India (SEBI) vide Circular No. IMD/FII/20/2006 dated April 05, 2006 announced the increase in the cumulative debt investment limits from US $1.75 billion to US $2 billion and US $0.5 billion to US $1.5 billion for FII/Sub Account investments in Government Securities and Corporate Debt, respectively. SEBI has now decided to further enhance the existing limit of US $ 2 billion available for investment by FIIs in Government Securities/ T-Bills to US $2.60 billion. The incremental limit of US $ 0.6 billion is being added to the existing headroom of US $55 million available for investment by 100% debt FIIs in Government Securities/ T-Bills. The enhanced limit is being allocated among the 100% debt and general 70:30 FIIs/Sub Accounts in the following manner:

(figures in USD bn)

Type of FIIs	100% debt	70:30	Total permissible limit
Existing limits:			
Govt. securities/ T-Bills	1.4	0.6	2.00
Corporate Debt	1.0	0.5	1.50
Total			3.50
Revised Limits:			
Govt. securities/ T-Bills	2.00	0.6	2.60
Corporate Debt	1.0	0.5	1.50
Total			4.10

IRDA ISSUES GUIDELINES FOR OPENING REPRESENTATIVE/LIAISON OFFICES OVERSEAS

The Insurance Regulatory Authority (IRDA) has issued the following Guidelines for Indian insurers seeking permission to open representative/ liaison offices overseas.

1. A "Representative/ Liaison Office" would mean a place of business to act as a channel of communication between the Principal place of business or Head Office by whatever name called and entities in India but which does not undertake any commercial/ trading/ industrial activity, directly or indirectly, and maintains itself out of inward remittances received from abroad through normal banking channel.

2. All Indian insurance companies registered with IRDA shall seek prior approval of the Authority for opening offices abroad.

3. Indian insurance companies desirous of opening offices overseas shall apply to the Insurance Regulatory and Development Authority in Form IRDA-FO-1.

4. The opening of representative/ liaison offices would be subject to the following requirements:

a) The representative office would function as an extended arm of Indian insurance company and no underwriting will be done outside India or other than in Indian rupees.
b) Though it may be permissible to identify the overseas prospects who could be non-resident Indian through the offices abroad, the completion of the underwriting contracts should be done only in India.
c) No payment of fees by whatever name called would be permitted outside the country for lead generation, etc notwithstanding any relaxation from the FEMA angle. This entire activity would invariably done by accredited Indian staff of the insurers placed in the liaison office or at HeadQuarters in India.

5. IRDA may consider permitting Indian insurance companies to set-up representative offices overseas so long as

a) Insurer has a good financial strength (as exhibited in the accounts) and maintains the prescribed solvency requirement of 1.5.

b) Track record on market conduct, regulatory compliances, redressal of complaints, etc. indicates that there are no serious adverse features on the functioning of the company on the record of IRDA.

6. The insurance companies would be required to furnish information to IRDA on the business mobilized through the representative office and a certificate that the expenditure incurred at the overseas centre together with the Indian operation is well within the limits specified.

7. The Indian insurance company shall be required to comply with the Foreign Exchange Management Act, 1999 and any other law in force.

8. The permission for opening of representative/ liaison office overseas by an Indian insurance company registered with IRDA shall be subject to the terms and conditions as may be stipulated by the Authority from time to time.

DPC NOT REQUIRED FOR SEZ UNITS

The Finance ministry has issued a circular doing away with the provision, which had made it mandatory for units Special Economic Zones (SEZ) to obtain a 'domestic procurement certificate' (DPC) from the central excise officers to procure goods from Domestic Tariff Area (DTA).

This move recognises the fact that the SEZ Act and Rules shall completely prevail over the customs and central excise legislations and the circular points out that with effect from March 14, 2006, Customs Act, 1962 will not be applicable to SEZs. The circular also says SEZs shall be deemed to be a territory outside the customs territory and accordingly supplies from DTA to SEZs will be deemed as exports. The move comes after the difficulties in obtaining the DPC from the customs and central excise officers was raised by the Export Promotion Council for EOUs and SEZs (EPCES) during the meeting with Government officials

EXEMPTION OF READYMADE GARMENTS FROM TEXTILES COMMITTEE CESS

The Union Cabinet today gave its approval for exemption of readymade garments from Textiles Committee cess under Section 5E of the Textiles Committee Act, 1963. The exemption of Textiles Committee cess under section 5E of the Textiles Committee Act, 1963 will rationalize the tax and cess burden on the readymade garments in the changed scenario of global competitiveness and thus improve competitiveness of Indian readymade garment sector in global markets.

CBEC ISSUES NOTIFICATION ON ACTION AGAINST TAX EVADERS

The Central Board of Excise and Customs (CBEC) has inserted rule 12CC in the Central Excise Rules, 2002 and rule 12 AA in the CENVAT Credit Rules, 2004 to provide for the withdrawing of certain facilities or restrict the utilisation of credit by units involved in tax evasion of serious nature. Notification No.32/2006 C.E.(NT) dated 30th December, 2006 has also been issued specifying the offences, and the facilities that are likely to be withdrawn or restricted. These provisions will come into force immediately after the detection of a case against any manufacturer, first or second stage dealer or an exporter involving duty or credit amount more than Rs. 10 lakhs. Serious offences such as clandestine removal of goods without payment of duty or taking CENVAT credit on bogus or forged invoices without receipt of inputs etc will attract these stringent measures.

As far as possible, within 30 days after the detection of the case, the Commissioner will forward the proposal for initiation of such action to the zonal Chief Commissioner. The Chief Commissioner, after due consideration of the facts of the case, the evidence relied upon by the Commissioner, will give the manufacturer, dealer or an exporter an opportunity to be heard. The final proposal will be forwarded to the officer authorized by the Central Board of Excise and Customs, who will pass the order. Facilities such as monthly payment of duty will be withdrawn or utilisation of CENVAT credit can also be restricted for a specified period. The department can place the factory of a manufacturer under physical control, if he is found to be indulging in similar offence for the second time and for all subsequent offences.

CBEC SETS TIME LIMITS FOR CLEARANCES/APPROVALS

The Central Board of Excise & Customs (CBEC) has set time limits for various clearances/approvals and these are briefly summarized hereunder:

The officers in charge of export oriented units have to clear on the same day the applications for acceptance of additional B-17 bond, broad-banding of goods, issuance of procurement certificates and CT3 certificates etc. They can take at most one day for execution and acceptance of a B-17 bond, warehousing of raw materials, capital goods, consumables etc., issuance of re-warehousing certificates, renewal of job-work/ sub-contracting permission where there is no change in the application and so on. They can take two days to give permission to re-export the rejected raw materials, capital goods etc and three days for extension or broad-banding of warehousing licences or broad-banding of licences. Even somewhat complex matters like issuance of licences under Section 58 or Section 65 of the Customs Act, 1962, and permission of job-work must be granted within five days. Examination of export and re-export consignments should be done even with shorter notice than one day.

The CBEC says that the stipulated time period will be exclusive of holidays and that where any deficiency is found in the application, the proposed time period will apply only after rectification of the deficiency and re-submission of the complete application.

Wherever cases are remanded for de-novo consideration, the CBEC wants to give six months or one year for passing orders according to the guidelines prescribed under Section 28 (2A) of the Customs Act, 1962. The six months/one-year time limits can be extended if the supervisory officer allows more time to the adjudicating authority.

As regards adjudication of cases relating to seizure of assets or records, the commissioner gets one year, the assistant commissioner gets six months and a lesser officer gets three months. These time limits can be extended if the supervisory officer allows more time.

The CBEC had already issued instructions regarding time limits for payment of duty on confirmation on demand beyond which coercive action can be taken for recovery. The instructions relate to the excise cases. Now the CBEC has said that the same time limits shall apply to customs cases.

TAX ON ROYALTY REDUCED UNDER INDIA-NORWAY TREATY

The Government of India has reduced the rate of tax for royalty and fee for technical services from 20% to 10% under the India-Norway tax treaty. The India-Norway tax treaty has in built the most favoured nation clause. As other tax treaties like India-Cyprus treaty, India-Armenia, India-Sudan and India-Hungary, which came into force after the India-Norway tax treaty have a tax rate of 10% for royalty and fee for technical services, the Government of India had to bring down the rate.

While one could avail 10% tax rate under Section 115A of the Income Tax Act, in order to avail this rate, the taxpayer would have to comply with the conditions mentioned therein where the agreement is with the Indian concern, the agreement should be approved by the central government and where the agreement is related to a matter included in the industrial policy, the agreement should be in accordance with such industrial policy. However, to avail the rate of 10 % under the Norway treaty, no such conditions are

required to be fulfilled. Further, the treaty rate would be all inclusive and there would not be any surcharge (2.5%) or education cess (2%).

APEX COURT: NO TAX ON OVERSEAS OPERATIONS

The Apex Court has ruled that offshore services rendered by a foreign company are not the same as services rendered by its permanent establishment in India for tax purposes. The apex court said the Authority for Advanced Ruling (AAR) had erred in imposing tax on income arising from the supply of offshore equipment and services by foreign companies. Setting aside an order of AAR, the apex court said, "In our opinion, the authority has committed an error, as if services rendered by the head office are considered to be services rendered by the PE, the distinction between Indian and foreign operations and the apportionment of the income of the operations shall stand obliterated". The tax authority had said that for the income arising from supply of offshore equipment and services, a foreign company was liable to pay tax in India.

Overruling the order, the apex court said two issues deserved to be properly construed. First, the taxation of the price of offshore equipment. Second, the tax on the income from offshore services. The court gave a big relief to foreign companies by not allowing the authority to levy taxes on both. The court did not agree with the AAR that offshore services are liable for taxation as it is intimately connected with the project here. "In our opinion, the concept of profits from business connection and PE should not be mixed up. Whereas business connection is relevant for the purpose of application of Section 9 of I-T Act, the concept of PE is relevant for assessing income of a non-resident under Double Taxation Avoidance Agreement," the Apex Court said.

The ruling came on an appeal by Japanese MNC Ishikawajima-Harima Heavy Industries, which had formed a consortium with five others and entered into an agreement with Petronet LNG to set up a LNG receiving, storage and degassification facility at Dahej in Gujarat. The court, zeroing in on the contract's nature, said it could not be treated as an integrated one so as to tax the company. "By entering into a contract in India, although parts thereof will have to be carried outside India, would not make the entire income derived by contractor to be taxable," it noted.

Source: Times of India

APEX COURT: INDIRECT INPUTS TOO ARE ELIGIBLE FOR TAX CONCESSIONS

The Apex Court has ruled that the sales-tax exemption can be availed on raw materials eligible for tax concessions even if they are used indirectly in manufacturing the final product. The government cannot levy sales tax on items under the plea that they were intermediates and not directly used for manufacturing the final product, the apex court said while dismissing an appeal of Udaipur's commercial taxation officer.

The case pertains to diesel used for generation of power consumed to manufacture polyester yarn. The appeal had argued that diesel was not a raw material for polyester yarn. Disagreeing with the contention, the Apex Court said, "It is seen that as diesel is specifically and intentionally included in the definition of raw material by the legislature, the question that whether it is directly or indirectly used in the process of manufacture is irrelevant." The court said it is not in dispute that the company is a manufacturer of synthetic blended

yarn for which it purchased diesel in accordance with the provisions of Rajasthan Sales Tax Act, 1994. As notified by the government, it is eligible for such tax sop, said the court.

Rajasthan Taxchem, the company in question, is engaged in the business of manufacturing polyester yarn. The company purchased diesel and used it for generating power using DG sets. Therefore, it claimed benefit under Section 10(1) of Rajasthan Sales Tax Act, 1994, claiming that diesel purchased is a raw material for the manufacture of polyester yarn.

However, the assessing authority held that since diesel was not directly used for the manufacture of final product, the company was not entitled to the benefit of tax concession. Accordingly, it levied the tax on diesel against which the company approached the deputy commissioner (appeal) which had dismissed the appeal. Not satisfied, the company then moved the Rajasthan Tax Board which quashed the tax demand order. The state then moved the Rajasthan High Court which dismissed the appeal. The case finally reached the Supreme Court which has ruled in favour of the company.

Source: Economic Times

APEX COURT: INTEREST ON BORROWED FUNDS TRANSFERRRED TO SUBSIDIARY FOR COMMERCIAL REASONS DEDUCTIBLE

In a far-reaching judgement on intra-corporate advances, the Supreme Court has held that tax cannot be levied on a corporate if it transfers borrowed money to its subsidiary or any other entity, if the transaction is driven by commercial reasons.

The Supreme Court was deciding on the issue of whether interest on borrowed fund can be deducted in the computation of taxable income, even if the borrowed fund is transferred to a subsidiary company. The apex court held that the only factor the income tax department should consider is that if borrowing and advancing to a sister company is driven by commercial expediency. If the transaction is driven by objectives other than commercial, such deals cannot claim exemption from tax.

The Supreme Court added that if the directors of the sister concern utilise the money advanced to it for their personal benefit, it cannot be said such money has been given for commercial purpose. The Apex Court said that "We wish to make it clear that it is not in our opinion that in every case, interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the case,"

This court's judgement was related to a case involving SA Builders. This company had transferred Rs 8.2 million to its subsidiary company SAB Credit, out of the cash credit account in which there is a huge debit balance. It was an interest-free loan to the subsidiary. The I-T department did not take the interest-free loan theory for granted. The department's opinion was that interest should have been claimed from the subsidiary by SA Builders.
It, therefore, disallowed deduction of over Rs 0.5 million as interest that should have been claimed from the subsidiary, while computing the expenditure by way of interest paid to the bank by SA Builders.

The Supreme Court held: "It is true that borrowed amount in question was not utilised by the assessee in its own business but had been advanced as interest-free loan to its sister concern. However, in our opinion, that fact is not really relevant. What is relevant is

whether the assessee advanced such amount to its sister concern as a measure of commercial expediency."

The apex court disagreed with contrary views taken by other appellate forums, including a Bombay High Court decision in Phaltan Sugar Works Vs Commissioner of Wealth Tax (1994) in which it was held that deduction under Section 36 (1) (iii) can only be allowed on the interest if the assessee borrows capital for its own business.

Source: Times of India

ITAT: INCOME FROM TRANSACTIONS BETWEEN BRANCH AND HO TAXABLE TO THE EXTENT ATTRIBUTABLE TO BUSINESS CARRIED OUT IN INDIA

The Income Tax Apellate Tribunal (ITAT) has in the case of Dresdner Bank, expounded the principles to compute income accruing in India to a foreign enterprise. The assessee is a Germany based non-resident banking company — Dresdner Bank — with branch in India. In the assessment proceedings, the bank maintained that the branch and head office transactions are transactions with oneself and emphasised that the incomes from inter-branch transactions are not taxable in India. The AO however differed from this view and held that this income of the assessee would be covered by section 9(1) of the Act. The same view was expounded by the Commissioner of Income Tax (Appeals).

After hearing the arguments the ITAT observed that for the income accruing or arising in India, an income which accrues or arises to a foreign enterprise company in India can essentially be only such a portion of income accruing or arising to such a foreign enterprise as is attributable to its business carried out in India.

The ITAT however observed that the expression 'income deemed to accrue or arise in India' is concerned, section 9 of the IT Act elaborately deals with the same, but the expression 'income accruing or arising in India' is not defined in the Act nor any judicial precedent has been cited. Seeing this ITAT observed that, to determine income accruing or arising in India to a foreign enterprise ('general enterprise' or as 'GE') one has to compute income attributable to such branch(es) in India, or other form(s) of presence (or 'permanent establishment' or 'PE').

The only way to ascertain profits arising in is by treating the Indian PE as a fictionally separate profit centre. ITAT held that cross-border dealings within an enterprise, which necessarily concern at least two tax jurisdictions; need to be examined in a different perspective. The tribunal held that "the interest earnings from the head office are to be taken into account for the purposes of computing profits arising in or accruing in India". It also held that the income to be accruing or arising in India and therefore, it is not really relevant whether the income can be treated as 'deemed to accrue or arise in India'".

Source: Financial express

ITAT: EXISTENCE OF PE AT THE TIME OF RECEIPT OF INCOME NOT NECESSARY & HENCE SUCH INCOME TAXABLE

The Income Tax Appellate Tribunal (ITAT) has ruled that foreign companies doing project-specific work in India are liable to pay tax even if they do not have a permanent establishment when they actually receive the income for projects carried out earlier.

The income-tax department has been facing situations where foreign companies were not paying tax on income earned in India on the grounds that they did not have permanent establishments when the income was received.

A division bench of ITAT held that, "There is no condition that PE should be in existence in India in the year of receipt of the amount by the enterprise." The ruling was passed in the case of Van Oord Dredging and Marine Contractors BV, formerly known as Ballast Ham Dredging BV, one of the largest dredging companies.

In the assessment year 2001-02 (financial year 2000-01), Van Oord executed various contracts in India and it maintained a project site office. In the tax returns filed by the company in 2000-01 it did not add Rs 307.8 million received from New Mangalore Port Trust (NMPT) to its income. Van Oord said it was for a project completed in 1995-96 and for which there was no PE. In 1994-95 and 1995-96, Van Oord carried out maintenance and capital dredging work for the development of additional facilities at NM Port for which, the company had set up a project site which qualified as a PE under Article 5(3) of the relevant Indo-Dutch treaty. In 1995-96, NMPT project was completed and the site office ceased to exist. Van Oord made a claim of Rs 892.5 million for additional work. NMPT, however, made counter claims leading to arbitration and later, court proceedings between the two players.

The ruling of ITAT emphasizes the principle that existence of PE at the time of carrying out the activities for which income is received is relevant and it is not necessary that PE should be in existence even at the time of receipt of actual amount.

Source: Economic Times

AAR: INCOME FROM SALE OF EQUITIES BY FIIS TAXABLE AS CAPITAL GAINS

The Authority for Advance Ruling (AAR) has given a new dimension to the tax-treatment of income earned by Foreign Institutional Investors (FIIs) investing directly in Indian stocks. In a landmark ruling given to US- and Canada-based Fidelity Group, the quasi judicial authority has ruled that the income from sale of Indian equities by the 38-odd off-shore funds managed by this group will be treated as capital gains. What this implies is that the profits of these funds from investments in securities will be treated as capital gains and not as business income.

The AAR provides a ruling on the potential tax liabilities of foreign investors operating in India. The latest ruling could mean that foreign portfolio investors may have to pay a 10% capital gains tax, if they off-load shares within one year of holding them. Investments in stocks, if held for a year or more, are exempt from long-term capital gains tax.

The ruling will, however, not have any impact on FIIs routing investments through Mauritius or Singapore. Mauritius does not tax capital gains and Mauritius-based FIIs are exempted from paying capital gains tax here. This benefit has now been extended to Singapore-based

FIIs under the improved protocol on double taxation between India and Singapore, subject to certain conditions.

The AAR's ruling comes as a blow to several US-based FIIs, who were hoping to get a capital gains tax waiver. These FIIs were banking on an earlier ruling by the authority to Fidelity Series VIII. The AAR had held that the trading income of this company would be taxable only in the US and not in India as it did not have a permanent establishment (PE) here. After this ruling, around 38 FIIs of the Fidelity Group, having a similar structure and operating through sub-accounts, sought a ruling on the tax treatment on investments in shares in India. Although an advance ruling is binding only on the applicant and the tax department, it has a "persuasive" value as other taxpayers can quote this ruling.

Fidelty Advisor Series VIII was a business trust organised under the US law. It was registered with Sebi as a sub-account of an FII and had appointed an Indian custodian — a bank providing custodial and banking services to a number of clients. The trading operations were carried out through brokers in India. The company had approached the AAR to specifically determine whether gains accruing from trading in Indian securities would be treated as business income or capital gains. The authority, which looked at the frequency of purchase and sale of shares, held that the gains were in the nature of "business income" and should be taxable according to the provisions of the Indo-US Tax Treaty. Since the company was executing the trades through a custodian in India, who was also offering similar services to several FIIs, the AAR held that the agent had an independent status and cannot be treated as a permanent establishment in India. In the absence of a PE in India, the trading income of Fidely Advisor Series VIII was held to be taxable only in the US and not in India.

Most of the FIIs come from countries that have a tax-treaty with India and most of them do not have a permanent establishment or a fixed place of business in India. In such cases, in view of the new ruling, if their income from sale of shares is categorised as capital gains, they will have to pay a 10% short-term capital gains.

Source: Economic Times

SAT STAYS SEBI'S DISGORGEMENT ORDER

The Securities Appellate Tribunal (SAT) has stayed the market regulator Security & Exchange Board of India's (SEBI) disgorgement order that had asked 10 entities, including country's two main depositories NSDL and CDSL, to pay up for their alleged role in the IPO share allotment scam.

SEBI had ordered two depositories and eight depository participants, which were found guilty in the IPO allotment case, to pay back around Rs 1.16 billion, which the regulator believes, was unjustly gained by these entities at the cost of small investors.

SAT felt that there was no urgency for SEBI to go with disgorgement order when the inquiry was still continuing. It felt that the board needs to wait and complete the inquiry first and then pass the disgorgement order. "I find it to be a unique and strange order where quantum of penalty has been determined even before the inquiry has been completed," SAT's presiding officer said in his judgement.

PARTIY WITH NATIONALS FOR OCIS IN DOMESTIC AIR FARES

The Union Minister for Overseas Indian Affairs, Mr. Vayalar Ravi has said that 'Overseas Citizenship of India' (OCI) cardholders will be given parity with resident Indian nationals in domestic air fares. Mr. Ravi said that the OCI Scheme introduced by the Prime Minister last year had met with overwhelming response and so far ninety thousand such cards were already issued. The Minister said that the efforts are on to cover a much larger number of overseas Indians in the ensuing year and to extend a wider range of benefits to OCI card holders. The three new benefits announced by the Minister include: -

- Parity with NRIs in Inter-country adoption
- Parity with Resident Indians in Domestic Airfares and
- Parity with Indian Nationals in entry fees for National Parks and Wild Life Sanctuaries.

SNAPSHOT OF GLOBAL MARKETS - DECEMBER 2006

KEY STOCK MARKET INDICES

INDEX	OPENING (01/12/2006)	HIGHEST IN DECEMBER 2006	LOWEST IN DECEMBER 2006	CLOSING (31/12/2006)
BSE SENSEX	13729.67	14028.47	12801.65	13770.06
S&P CNX NIFTY	3955.70	4046.85	3657.65	3966.40
DOW JONES I.A.	12220.97	12566.17	12070.52	12463.15
NASDAQ COMPOSITE	2430.75	2470.95	2392.95	2413.43
FTSE 100	6048.80	6258.70	5985.20	6220.80
NIKKEI	16313.02	17301.69	16185.92	17225.83

PRICES OF KEY COMMODITIES (US$)

COMMODITY	OPENING (01/12/2006)	HIGHEST IN DECEMBER 2006	LOWEST IN DECEMBER 2006	CLOSING (31/12/2006)
GOLD - SPOT (NY)	644.00	648.00	611.50	634.30
SILVER - SPOT (NY)	13.88	14.18	12.26	12.78
PLATINUM - SPOT(NY)	1172	1178	1096	1133
COPPER (COMEX)	3.18	3.25	2.84	2.87
ALUMINIUM (COMEX)	1.265	1.280	1.235	1.260
BRENT CRUDE (IPE)	65.60	66.35	61.13	62.67
NYMEX CRUDE OIL	65.45	66.07	61.35	62.38

KEY GLOBAL CURRENCY RATES AGAINST USD

CURRENCY	OPENING RATE (01/12/2006)	HIGHEST IN DECEMBER 2006	LOWEST IN DECEMBER 2006	CLOSING RATE (31/12/2006)
EURO/USD	1.319	1.336	1.305	1.320
GBP/USD	1.954	1.985	1.943	1.959
USD/JPY	116.14	119.21	114.43	119.11
USD/INR	44.75	44.93	44.10	44.12

MAJOR CURRENCIES AGAINST INR

CURRENCY	OPENING RATE (01/12/2006)	HIGHEST IN DECEMBER 2006	LOWEST IN DECEMBER 2006	CLOSING RATE (31/12/2006)
USD/INR	44.75	44.93	44.10	44.12
EURO/INR	59.03	59.61	58.20	58.25
GBP/INR	87.45	88.51	86.44	86.44
JPY/INR	38.54	38.87	37.07	37.07

INTEREST RATES

MIBOR

PERIOD	OPENING RATE (01/12/2006)	HIGHEST IN DECEMBER 2006	LOWEST IN DECEMBER 2006	CLOSING RATE (31/12/2006)
OVERNIGHT	6.20	17.61	6.16	15.79
14 DAY	7.00	10.79	6.90	10.47
3-MONTH	7.72	10.22	7.66	9.56

LIBOR - USD

PERIOD	OPENING RATE (01/12/2006)	HIGHEST IN DECEMBER 2006	LOWEST IN DECEMBER 2006	CLOSING RATE (31/12/2006)
1-MONTH	5.35	5.35	5.35	5.35
3-MONTH	5.37	5.37	5.35	5.36
6-MONTH	5.33	5.38	5.29	5.36
12-MONTH	5.21	5.30	5.11	5.26

LIBOR - EURO

PERIOD	OPENING RATE (01/12/2006)	HIGHEST IN DECEMBER 2006	LOWEST IN DECEMBER 2006	CLOSING RATE (31/12/2006)
1-MONTH	3.59	3.67	3.59	3.67
3-MONTH	3.64	3.72	3.64	3.72
6-MONTH	3.74	3.72	3.83	3.83
12-MONTH	3.85	3.80	3.99	3.99

LIBOR - GBP

PERIOD	OPENING RATE (01/12/2006)	HIGHEST IN DECEMBER 2006	LOWEST IN DECEMBER 2006	CLOSING RATE (31/12/2006)
1-MONTH	5.21	5.26	5.21	5.25
3-MONTH	5.26	5.31	5.26	5.31
6-MONTH	5.33	5.42	5.31	5.42
12-MONTH	5.42	5.56	5.37	5.56

LIBOR - JPY

PERIOD	OPENING RATE (01/12/2006)	HIGHEST IN DECEMBER 2006	LOWEST IN DECEMBER 2006	CLOSING RATE (31/12/2006)
1-MONTH	0.42	0.51	0.41	0.47
3-MONTH	0.52	0.60	0.51	0.54
6-MONTH	0.60	0.67	0.60	0.61
12-MONTH	0.73	0.79	0.73	0.72

US T-BILL

PERIOD	OPENING RATE (01/12/2006)	HIGHEST IN DECEMBER 2006	LOWEST IN DECEMBER 2006	CLOSING RATE (31/12/2006)
	Discount/Yield	Discount/Yield	Discount/Yield	Discount/Yield
1-MONTH	5.14/5.21	5.14/5.21	4.64/4.74	4.65/4.75
3-MONTH	4.90/5.03	4.90/5.03	4.79/4.91	4.89/5.02
6-MONTH	4.86/5.05	4.91/5.11	4.84/5.03	4.90/5.09

KEY CENTRAL BANK RATES

	31/12/2006	1 MONTH PRIOR	3 MONTH PRIOR	6 MONTH PRIOR	1 YEAR PRIOR
US FEDERAL RESERVE FUNDS RATE	5.25	5.25	5.25	5.25	4.50
EUROPEAN CENTRAL BANK RATE	3.50	3.25	3.00	2.50	2.25
BANK OF ENGLAND RATE*	5.00	5.00	4.75	4.50	4.50
RESERVE BANK OF INDIA - BANK RATE	6.00	6.00	6.00	6.00	6.00

* BOE HAS INCREASED THE RATE TO 5.25% IN JANUARY 2007

PRIME RATES

CURRENCY	RATE (31/12/2006)
USD	8.25
EURO	4.50
GBP	5.00
JPY	1.63
INR	10.25 to 10.75

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