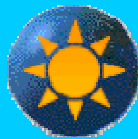




INDIA UPDATE

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CONTENTS

Economy:

- Reserve Bank's Mid-term Review of the Annual Policy projects GDP growth of 8% for 2006-07

Policies & Statutes:

- Norms for setting up Sugar mills tightened
- RBI liberalizes facilities for NRIs/PIOs
- RBI enhances Prudential limit in respect of Funded & Non-Funded Credit facilities to Indian JVs & WOS abroad.
- RBI: Issue of Bank Guarantees for Service Importers
- RBI: Rationalization of Norms for Bank's Exposure to Capital Markets
- RBI liberalizes investments by Mutual Funds in Overseas Securities
- RBI issues Final Guidelines on Managing Risks & Code of Conduct in outsourcing Financial Services by Banks
- SEBI restricts Individual stake in Stock Exchanges to 5%
- Wage limit increased to Rs.10,000/- per month under ESI Act

Tax/Legal Updates:

- CBDT extends due date for filing Corporate/FBT tax Returns upto 30th November 2006
- Procedure for Approval to Scientific Research Institutions for exemption of contributions made for scientific research amended
- Service Tax Rules amended to facilitate easier centralized registration
- Government bodies come in Service Tax net
- GSK agrees to pay US\$ 3.4 billion to settle Transfer Pricing Dispute with IRS, USA
- Apex Court provides relief to Exporter & imposes fine on Government
- HC: Constitutional validity of instruction regarding compulsory referral to TPO upheld

Other Matters:

- Snapshot of Global Markets - October 2006

RESERVE BANK'S MID TERM REVIEW OF THE ANNUAL POLICY PROJECTS GDP GROWTH AT 8% FOR 2006-07

The Reserve Bank of India (RBI) released its Mid Term review of the Annual Policy on 31st October 2006. RBI has projected GDP growth at around 8% during 2006-07. In this connection, the RBI has pointed out that the Real GDP growth during the first quarter of 2006-07 is placed at 8.9 per cent as against 8.5 per cent in the corresponding quarter a year ago. The RBI has stated that its objective is to ensure a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum while reinforcing price stability with a view to anchoring inflation expectations.

On the domestic front, RBI has pointed out that there is a pick-up in the momentum of growth which also appears to be spreading across all constituent sectors. Non-food credit exhibited a Y-o-Y growth of Rs.3,761.05 billion (30.5 per cent) as on October 13, 2006 on top of an increase of Rs.2,979.03 billion (31.8 per cent) a year ago. The Reserve Bank has emphasized that it would ensure that appropriate liquidity is maintained in the system so that all legitimate requirements of credit are met, particularly for productive purposes, consistent with the objective of price and financial stability. Towards this end, the Reserve Bank will continue with its policy of active demand management of liquidity through open market operations (OMO) including the MSS, LAF and CRR, and using all the policy instruments at its disposal flexibly, as and when the situation warrants.

The RBI has also pointed out that India's foreign exchange reserves increased to US \$ 166.2 billion on October 20, 2006 up from US \$ 151.6 billion at end-March, 2006. RBI has also increased the Repo Rate from 7.0% to 7.25% and has announced measures to further liberalize the foreign exchange control provisions. The highlights of the Mid Term Review are as under:

Highlights:

- Repo Rate increased to 7.25 per cent from 7.0 per cent.
- The flexibility to conduct overnight repo or longer term repo including the right to accept or reject tender(s) under the LAF, wholly or partially is retained.
- Reverse Repo Rate, Bank Rate and CRR kept unchanged.
- GDP growth forecast at around 8.0 per cent during 2006-07.
- Inflation to be contained within 5.0-5.5 per cent during 2006-07.
- Monetary and credit growth expected to be higher than the initial projections.
- 'When issued' trading to be extended to fresh issues of Central Government securities.
- Scheduled commercial banks and primary dealers to be allowed to cover their short positions in Central Government securities within an extended period of five trading days.
- Resident individuals would be free to remit up to US \$ 50,000 per financial year as against the earlier limit of US \$ 25,000.
- Foreign exchange earners may retain up to 100 per cent of their foreign exchange earnings in their Exchange Earners' Foreign Currency accounts.
- Authorised dealer banks may borrow funds from their overseas branches and correspondent banks (including borrowing for export credit, external commercial borrowings (ECBs) and overdrafts from their Head Office/Nostro account) up to a limit of 50 per cent of their unimpaired Tier I capital or US \$ 10 million, whichever is higher.
- Borrowers eligible for accessing ECBs can avail of an additional US \$ 250 million with average maturity of more than 10 years under the approval route.
- Prepayment of ECB up to US \$ 300 million without prior approval of the Reserve Bank.
- Authorised dealer banks may allow remittances on behalf of their customers up to 15 per cent of the average annual sales/income or turnover during the last two financial years or up to 25 per cent of their net worth, whichever is higher, for initial expenses, and remittances up to 10 per cent of the average annual sales/income or turnover during the last two financial years for recurring

expenses. They may also permit remittances for acquisition of immovable property for the overseas office, within these limits.

- The existing limit of US \$ 2 billion on investments in Government securities by foreign institutional investors (FIIs) to be enhanced in phases to US \$ 3.2 billion by March 31, 2007.
 - The extant ceiling of overseas investment by mutual funds of US \$ 2 billion is enhanced to US \$ 3 billion.
 - Importers to be permitted to book forward contracts for their customs duty component of imports.
 - FIIs to be allowed to rebook a part of the cancelled forward contracts.
 - Forward contracts booked by exporters and importers in excess of 50 per cent of the eligible limit to be on deliverable basis and cannot be cancelled.
 - Authorised dealer banks to be permitted to issue guarantees/letters of credit for import of services up to US \$ 100,000 for securing a direct contractual liability arising out of a contract between a resident and a non-resident
 - Lock-in period for sale proceeds of the immovable property credited to the NRO account to be eliminated, provided the amount being remitted in any financial year does not exceed US \$ one million.
-
- Banks, with approval of their boards, may formulate a transparent policy for providing One Time Settlement facility to those farmers whose accounts have been rescheduled/ restructured due to natural calamities as also those who have defaulted on account of circumstances beyond their control.
 - For opening small accounts, banks need to seek only a photograph of the account holder and self-certification of address.
 - Indian banks having presence outside India and foreign banks to migrate to the Basel II framework effective March 31, 2008 and other scheduled commercial banks to migrate in alignment but not later than March 31, 2009.
 - Prudential limit on credit and non-credit facilities to Indian Joint Ventures/Wholly Owned Subsidiaries abroad to be enhanced to 20 per cent of unimpaired capital funds.
 - Financially sound Urban Co-operative Banks (UCBs) registered in States that have signed MoU with the Reserve Bank and those registered under the Multi-State Co-operative Societies Act, 2002 to be allowed to convert existing extension counters into full-fledged branches.
 - Non-banking financial companies (NBFCs) to be allowed to issue co-branded credit cards with banks without risk sharing and to market and distribute mutual fund products.

NORMS FOR SETTING UP SUGAR MILLS TIGHTENED

Sugar companies filing Industrial Entrepreneur Memoranda (IEM) for setting up new mills would have to furnish performance guarantees of Rs 10 million each and also take "effective steps" for implementation within two years from the date of filing of IEM. Further, they are also required to commence commercial production within 4 years from the date of filing of IEM. Failing to do so would result in de-recognition of the IEM and forfeiture of the performance guarantee.

The amendment to the Sugarcane (Control) Order, 1966, notified by the Department of Food and Public Distribution on November 10, has defined "effective steps" to cover purchase of required land, placement of firm order for purchase of plant and machinery and payment of requisite advance or opening of irrevocable letter of credit with suppliers, commencement of civil work and construction of the factory building and sanction of requisite term loans from banks or financial institutions.

The amendment provides for a minimum radial distance of 15 km between an "existing" and "new factory" as well as two "new" factories. The "existing" factories include both already operational mills as well as those that have taken all "effective steps" as per the definition.

A "new" factory, in turn, is one that has filed an IEM and further submitted a performance guarantee of Rs 10 million to the Chief Director (Sugar) as a surety for implementation of the IEM. If the IEM remains unimplemented within the stipulated time limit, the guarantee would be forfeited. A company before filing an IEM will now have to obtain a certificate from the State Government concerned that its proposed mill is not less than 15 km from the site of an existing or new factory. Once the IEM is filed, the company would have to furnish the performance guarantee within 30 days. Companies that had already filed IEMs prior to November 10 and still not taken "effective steps" have been given a six-month reprieve to furnish bank guarantees.

RBI LIBERALIZES FACILITIES TO NRIs/PIO

The existing regulations permit Non-Resident Indians (NRIs) and Persons of Indian Origin (PIO) to remit up to USD one million per calendar year for any bonafide purpose out of the balances in their Non-Resident Ordinary (NRO) accounts. The balance in the NRO accounts may also include the sale proceeds of immoveable property acquired by the non-resident out of her/his resources in India , or sale proceeds of property received by way of inheritance or gift. The remittance of sale proceeds of the immoveable property is at present subject to a lock-in period of 10 years.

With a view to further liberalise the procedure and provide greater flexibility, the lock-in period of 10 years for remittance of sale proceeds of immovable property has been dispensed with by RBI. Accordingly, AD Category - I banks may, now allow remittances out of balances in NRO accounts including sale proceeds of immovable property provided the amount does not exceed USD one million per financial year (April-March). Other terms and conditions will remain unchanged.

RBI ENHANCES PRUDENTIAL LIMIT IN RESPECT OF FUNDED & NON-FUNDED CREDIT FACILITIES TO INDIAN JVS & WOS ABROAD

As per the current guidelines issued by the Reserve Bank of India (RBI), banks were permitted to extend credit/non-credit facilities to Indian Joint Ventures (JVs) (where the holding by the Indian company is more than 51%) / Wholly Owned Subsidiaries (WOS) abroad up to the extent of 10 per cent of their unimpaired capital funds (Tier I and Tier II capital), subject to certain terms and conditions.

In order to facilitate the expansion of Indian corporates' business abroad, RBI has now been decided to enhance the prudential limit on credit and non-credit facilities extended by banks to Indian Joint Ventures (where the holding by the Indian company is more than 51%) /Wholly Owned Subsidiaries abroad from the existing limit of 10 per cent to 20 per cent of their unimpaired capital funds (Tier I and Tier II capital).

RBI: ISSUE OF BANK GUARANTEE ON BEHALF OF SERVICE IMPORTERS

With a view to further liberalize the procedure for import of services, RBI has permitted AD Category-I banks to issue guarantee on behalf of their customers importing services, provided:

- a. the guarantee amount does not exceed USD 100,000
- b. the AD Category-I bank is satisfied about the bonafides of the transaction
- c. the AD Category-I bank ensures submission of documentary evidence for import of services in the normal course, and
- d. the guarantee is to secure a direct contractual liability arising out of a contract between a resident and a non-resident.

In case of invocation of the guarantee, the AD Category-I bank is required to submit to the Chief General Manager-in-Charge, Foreign Exchange Department, Foreign Investments Division (EPD), Reserve Bank of India, Central Office, Mumbai-400001 a report on the circumstances leading to the invocation of the guarantee.

RBI : RATIONALIZATION OF NORMS FOR BANK'S EXPOSURE TO CAPITAL MARKETS

The Reserve Bank of India had announced in the Mid-Term Review of Annual Policy Statement for the year 2005-2006 that the prudential capital market exposure norms prescribed for banks would be rationalized in terms of base and coverage so as to:

- i) restrict a bank's aggregate capital market exposure to 40 per cent of its net worth on a solo and consolidated basis,
- ii) modify a consolidated bank's direct capital market exposure to 20 per cent of its consolidated net worth, and
- iii) simplify and rationalise the exemptions in regard to the coverage.

Accordingly, it has proposed to modify the existing guidelines on banks' exposure to capital markets. A draft of the proposed guidelines (to facilitate the obtainment of the views of banks) is furnished hereunder.

Revised instructions/norms

1.1 Components of Capital Market Exposure (CME)

As stated in our circular DBOD.BP.BC.119/21.04.137/2000-2001 dated May 11, 2001, banks' capital market exposures would include both their direct exposures and indirect exposures. The aggregate exposure (both fund and non-fund based) of banks to capital markets in all forms would include the following:

- i) direct investment in equity shares, convertible bonds, convertible debentures and units of equity-oriented mutual funds the corpus of which is not exclusively invested in corporate debts,
- ii) advances against shares/bonds/debentures or other securities or on clean basis to individuals for investment in shares (including IPOs/ESOPs), convertible bonds, convertible debentures, and units of equity-oriented mutual funds etc.,
- iii) advances for any other purposes where shares or convertible bonds or convertible debentures or units of equity oriented mutual funds are taken as primary or collateral security,
- vi) secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers,
- v) loans sanctioned to corporates against the security of shares / bonds/ debentures or other securities or on clean basis for meeting promoter's contribution to the equity of new companies in anticipation of raising resources,
- vi) bridge loans to companies against expected equity flows/issues,
- vii) underwriting commitments taken up by the banks in respect of primary issue of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds,
- viii) financing to stockbrokers for margin trading,
- ix) all exposures to Venture Capital Funds(both registered and unregistered) as mentioned in paragraph 6 of this circular and
- x) intra-day exposures as mentioned in paragraph 7 of this circular.

1.2 Limits on banks' exposure to Capital Markets

1.2.1 Solo Basis

The aggregate exposure of a bank to the capital markets in all forms (both fund based and non-fund based) should not exceed 40 per cent of its net worth (as defined in para 2.3), as on March 31 of the previous year. Within this overall ceiling, the bank's direct investment in shares, convertible bonds / debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered] should not exceed 20 per cent of its net worth.

1.2.2. Consolidated Basis

The aggregate exposure of a consolidated bank to capital markets (both fund based and non-fund based) should not exceed 40 per cent of its consolidated net worth as on March 31 of the previous year. Within this overall ceiling, the aggregate direct exposure by way of the consolidated bank's investment in shares, convertible bonds / debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered] should not exceed 20 per cent of its consolidated net worth.

1.3 Definition of Net Worth

Net worth would comprise of Paid-up equity capital plus Free Reserves including Share Premium plus credit balance in Profit & Loss account less accumulated losses, debit balance in the Profit and Loss account, intangible assets and Revaluation Reserves. Infusion of capital through equity shares either through domestic issues or overseas floats after the published balance sheet date may also be taken into account for determining the ceiling on exposure to capital market. Banks should obtain an external auditor's certificate on completion of the augmentation of capital and submit the same to the Reserve Bank of India (Department of Banking Supervision) before reckoning the additions, as stated above.

1.4 Items excluded from Capital Market Exposure

The aggregate exposure ceiling of 40 per cent of net worth would exclude the following:

- i) Banks' investments in own subsidiaries, joint ventures, sponsored Regional Rural Banks (RRBs) and investments in shares and convertible debentures, convertible bonds issued by National Securities Depository Ltd. (NSDL), Central Depository Services (India) Ltd. (CDSL), National Securities Clearing Corporation Ltd. (NSCCL), National Stock Exchange (NSE), Clearing Corporation of India Ltd., (CCIL), Credit Information Bureau of India Ltd. (CIBIL), Multi Commodity Exchange Ltd. (MCX), National Commodity and Derivatives Exchange Ltd. (NCDEX) and National Multi-Commodity Exchange of India Ltd. (NMCEIL). On listing, all the above exposures would form part of the Capital Market Exposure.
- ii) Tier 1 and Tier 2 debt instruments issued by other banks,
- iii) Investment in Certificate of Deposits (CDs) of other banks,
- iv) Preference Shares
- v) Non-convertible debentures and non-convertible bonds,
- vi) Units of Mutual Funds under schemes where the corpus is invested exclusively in debt instruments,
- vii) Shares acquired by banks as a result of conversion of debt/overdue interest into equity under Corporate Debt Restructuring (CDR) mechanism,
- viii) Term loans sanctioned to Indian promoters for acquisition of equity in overseas joint ventures / wholly owned subsidiaries under the refinance scheme of Export Import Bank of India (EXIM Bank).

1.5 Computation of exposure

For computing the exposure to the capital markets, loans/advances sanctioned and guarantees issued for capital market operations would be reckoned with reference to sanctioned limits or outstanding, whichever is higher. However, in the case of fully drawn term loans, where there is no scope for re-drawal of any portion of the sanctioned limit, banks may reckon the outstanding as the exposure. Further, banks' direct investment in shares, convertible bonds, convertible debentures and units of equity oriented mutual funds would be calculated at their cost price.

2. Ceiling on loans/advances against shares & debentures etc.

Loans/advances to any single borrower from the banking system against security of shares, convertible bonds, convertible debentures, units of equity oriented mutual funds and PSU bonds should not exceed the limit of Rs.10 lakh for subscribing to IPOs. Advances other than for IPOs to

any single borrower from the banking system against security of shares, convertible bonds, convertible debentures and units of equity oriented mutual funds held in physical and demat form should not exceed Rs.10 lakh and Rs.20 lakh respectively. Banks should obtain a declaration from the borrower indicating the details of the loans / advances availed against shares and other securities specified above, from any other bank/s in order to ensure compliance with the ceilings prescribed for the purpose.

3. Bank financing to individuals against shares to joint holders or third party beneficiaries

While granting advances against shares held in joint names to joint holders or third party beneficiaries, banks should be circumspect and ensure that the objective of the regulation is not defeated by granting advances to other joint holders or third party beneficiaries to circumvent the above limits placed on loans/advances against shares and other securities specified above.

4. Margins on advances against shares/issue of guarantees

A uniform margin of 50 per cent shall be applied on all advances/financing of IPOs/issue of guarantees for capital market operations. A minimum cash margin of 25 per cent (within the margin of 50%) shall have to be maintained in respect of guarantees issued by banks for capital market operations.

5. Investments in Venture Capital Funds (VCFs)

As announced in the Annual Policy Statement for the year 2006-2007 and advised in our circulars DBOD.BP.BC.84 & 27/21.01.002/2005-2006 dated May 25 and August 23, 2006 respectively, banks' exposures to VCFs (both registered and unregistered) will be deemed to be on par with equity and hence will be reckoned for compliance with the capital market exposure ceilings (both direct and indirect).

6. Intra-day Exposures

At present, there are no explicit guidelines for monitoring banks' intra-day exposure to the capital markets, which are inherently risky. Hence, the Board of each bank should evolve a policy for fixing intra-day limits for brokers and put in place an appropriate system to monitor the limits provided to brokers, on an ongoing basis. Further, the maximum intra-day exposure, sanctioned limit or outstanding, whichever is higher, should form part of the banks' exposure to capital markets.

7. Enhancement in Limits

Banks having sound internal controls and robust risk management systems can approach the Reserve Bank for higher limits together with details of their exposure and justification for such higher limit.

8. Effective date of circular

With a view to ensuring smooth transition the revised guidelines will come into effect from January 1, 2007 .

RBI LIBERALIZES INVESTMENT BY MUTUAL FUNDS IN OVERSEAS SECURITIES

With a view to providing greater opportunity to invest overseas, the existing ceiling on overseas investments by Mutual Funds, registered with Securities and Exchange Board of India (SEBI), has been enhanced by the Reserve Bank of India (RBI). Accordingly, the aggregate ceiling for overseas investment by Mutual Funds, registered with SEBI, is increased from USD 2 billion to USD 3 billion with immediate effect. All other terms and conditions and operational guidelines as issued by SEBI will remain unchanged.

RBI ISSUES FINAL GUIDELINES ON MANAGING RISKS & CODE OF CONDUCT IN OUTSOURCING OF FINANCIAL SERVICES BY BANKS

In view of the extensive use of outsourcing by banks, Reserve Bank had issued draft guidelines on 6th December 2005 for laying down a framework for managing the attendant risks in outsourcing. On the basis of the suggestions received from all concerned, the draft guidelines have been suitably modified.

It may be noted that it is entirely for the banks to take a view on the desirability of outsourcing a permissible activity related to financial services having regard to all relevant factors, including the commercial aspects of the decision. However, should a bank, in its own judgment, decide to outsource a financial services activity, necessary safeguards for addressing the risks inherent in such outsourcing should be put in place, as detailed in these guidelines. The final guidelines on managing risks in outsourcing as applicable to banks are furnished in the Annex.

These guidelines are concerned with managing risks in outsourcing of financial services and are not applicable to technology-related issues and activities not related to banking services like usage of courier, catering of staff, housekeeping and janitorial services, security of the premises, movement and archiving of records etc.

Audit-related assignments to Chartered Accountant firms will continue to be governed by the instructions/ policy as laid down by the Department of Banking Supervision.

Banks' attention is drawn to para 5.5.1 of the Annex in terms of which the outsourcing agreements should include enabling clauses to allow Reserve Bank or the persons authorized by it to access the relevant information/ records with the service provider relating to outsourced activities within a reasonable time.

Annex

1 Introduction

1.1 The world over, banks are increasingly using outsourcing as a means of both reducing cost and accessing specialist expertise, not available internally and achieving strategic aims. 'Outsourcing' may be defined as a bank's use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform activities on a continuing basis that would normally be undertaken by the bank itself, now or in the future.

' Continuing basis' would include agreements for a limited period.

In keeping with this international trend, it is observed, that banks in India too have been extensively outsourcing various activities. Needless to say, such outsourcing, results in banks being exposed to various risks as detailed in para 1.3. Further, the outsourcing activities are to be brought within regulatory purview and the interests of the customers have to be protected.

It is against this background, that Reserve Bank of India has deemed it appropriate to put in place a set of guidelines to address, the risks that bank would be exposed to in a milieu of growing outsourcing activity and to ensure that the bank concerned and the Reserve Bank of India have access to all books, records and information available with service provider. The guidelines also cover issues relating to safeguarding of customer interests.

Typically outsourced financial services include applications processing (loan origination, credit card), document processing, marketing and research, supervision of loans, data processing and back office related activities etc.

1.2 The Joint Forum, a tripartite body comprising Basel Committee on Banking Supervision, International Organization of Securities Commission and International Association of Insurance Supervisors had issued guidelines on outsourcing in financial services in February 2005. The Joint Forum has developed a set of Guiding Principles. These Guiding Principles have been suitably incorporated in the guidelines now being issued by RBI. Internationally, several countries have also

put in place, guidelines on outsourcing in financial services. These include USA , UK , Germany , Hong Kong , Australia and Singapore . The guidelines of RBI are based on international best practices.

1.3 Outsourcing brings in its wake, several risks. Some key risks in outsourcing may be Strategic Risk, Reputation Risk, Compliance Risk, Operational Risk, Legal Risk, Exit Strategy

Risk, Counter party Risk, Country Risk, Contractual Risk, Access Risk, Concentration and Systemic Risk. The failure of a service provider in providing a specified service, a breach in security/confidentiality, or non-compliance with legal and regulatory requirements by either the service provider or the outsourcing bank can lead to financial losses or loss of reputation for the bank and could also lead to systemic risks within the entire banking system in the country. It would therefore be imperative for the bank outsourcing its activities to ensure effective management of these risks.

1.4 These guidelines on managing risks in Outsourcing are intended to provide direction and guidance to banks which choose to outsource financial services to adopt sound and responsive risk management practices for effective oversight, due diligence and management of risks arising from such outsourcing activities. The guidelines are applicable to outsourcing arrangements entered into by a bank with a service provider located in India or elsewhere. The service provider may either be a member of the group/conglomerate to which the bank belongs, or an unrelated party.

1.5 The underlying principles behind these guidelines are that the regulated entity should ensure that outsourcing arrangements neither diminish its ability to fulfil its obligations to customers and RBI nor impede effective supervision by RBI. Banks, therefore, have to take steps to ensure that the service provider employs the same high standard of care in performing the services as would be employed by the banks, if the activities were conducted within the banks and not outsourced. Accordingly banks should not engage in outsourcing that would result in their internal control, business conduct or reputation being compromised or weakened.

1.6 (i) Banks which desire to outsource financial services would not require prior approval from RBI whether the service provider is located in India or outside India .

(ii) In regard to outsourced services relating to credit cards, RBI's detailed instructions contained in its circular on credit card activities vide DBOD. FSD. BC. 49/24.01.011/2005-06 dated 21st November 2005 would be applicable.

2 Activities that should not be Outsourced

Banks which choose to outsource financial services should however not outsource core management functions including Internal Audit, Compliance function and decision-making functions like determining compliance with KYC norms for opening deposit accounts, according sanction for loans (including retail loans) and management of investment portfolio.

3 Material Outsourcing

During Annual Financial Inspections, RBI will review the implementation of these guidelines to assess the quality of related risk management systems particularly in respect of material outsourcing. Material outsourcing arrangements are those, which if disrupted, have the potential to significantly impact the business operations, reputation or profitability. Materiality of outsourcing would be based on :

- The level of importance to the bank of the activity being outsourced
- The potential impact of the outsourcing on the bank on various parameters such as earnings, solvency, liquidity, funding capital and risk profile;
- The likely impact on the bank's reputation and brand value, and ability to achieve its business objectives, strategy and plans, should the service provider fail to perform the service;
- The cost of the outsourcing as a proportion of total operating costs of the bank;
- The aggregate exposure to that particular service provider, in cases where the bank out sources

various functions to the same service provider.

4 Bank's role and Regulatory and Supervisory requirements

4.1 The outsourcing of any activity by bank does not diminish its obligations, and those of its Board and senior management, who have the ultimate responsibility for the outsourced activity. Banks would therefore be responsible for the actions of their service provider including Direct Sales Agents/ Direct Marketing Agents and recovery agents and the confidentiality of information pertaining to the customers that is available with the service provider. Banks should retain ultimate control of the outsourced activity.

4.2 It is imperative for the bank, when performing its due diligence in relation to outsourcing, to consider all relevant laws, regulations, guidelines and conditions of approval, licensing or registration.

4.3 Outsourcing arrangements should not affect the rights of a customer against the bank, including the ability of the customer to obtain redress as applicable under relevant laws. Since the customers are required to deal with the service providers in the process of dealing with the bank, banks should incorporate a clause in the product literature /brochures etc., stating that they may use the services of agents in sales/marketing etc of the products. The role of agents may be indicated in broad terms.

4.4 Outsourcing, whether the service provider is located in India or abroad should not impede or interfere with the ability of the bank to effectively oversee and manage its activities nor should it impede the Reserve Bank of India in carrying out its supervisory functions and objectives.

4.5 Banks need to have a robust grievance redressal mechanism, which in no way should be compromised on account of outsourcing.

4.6 The service provider if it is not a subsidiary of the bank should not be owned or controlled by any director or officer/employee of the bank or their relatives having the same meaning as assigned under Section 6 of the Companies Act, 1956.

5. Risk Management practices for outsourced Financial Services

5.1 Outsourcing Policy

A bank intending to outsource any of its financial activities should put in place a comprehensive outsourcing policy, approved by its Board, which incorporates, inter alia, criteria for selection of such activities as well as service providers, parameters for defining material outsourcing based on the broad criteria indicated in para 3, delegation of authority depending on risks and materiality and systems to monitor and review the operations of these activities.

5.2 Role of the Board and Senior Management

5.2.1 The Board of the bank, or a Committee of the Board to which powers have been delegated should be responsible inter alia for: -

- Approving a framework to evaluate the risks and materiality of all existing and prospective outsourcing and the policies that apply to such arrangements;
- Laying down appropriate approval authorities for outsourcing depending on risks and materiality.
- Undertaking regular review of outsourcing strategies and arrangements for their continued relevance, and safety and soundness and
- Deciding on business activities of a material nature to be outsourced, and approving such arrangements.

5.2.2 Senior Management would be responsible for :

- Evaluating the risks and materiality of all existing and prospective outsourcing, based on the

framework approved by the Board;

- Developing and implementing sound and prudent outsourcing policies and procedures commensurate with the nature, scope and complexity of the outsourcing;
- Reviewing periodically the effectiveness of policies and procedures;
- Communicating information pertaining to material outsourcing risks to the Board in a timely manner;
- Ensuring that contingency plans, based on realistic and probable disruptive scenarios, are in place and tested;
- Ensuring that there is independent review and audit for compliance with set policies.
- Undertaking periodic review of outsourcing arrangements to identify new material outsourcing risks as they arise.

5.3 Evaluation of the Risks

The key risks in outsourcing that need to be evaluated by the banks are: -

(a) Strategic Risk – The service provider may conduct business on its own behalf, which is inconsistent with the overall strategic goals of the bank.

(b) Reputation Risk – Poor service from the service provider, its customer interaction not being consistent with the overall standards of the bank.

(c) Compliance Risk – Privacy, consumer and prudential laws not adequately complied with.

(d) Operational Risk – Arising due to technology failure, fraud, error, inadequate financial capacity to fulfil obligations and/or provide remedies.

(e) Legal Risk- includes but is not limited to exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements due to omissions and commissions of the service provider.

(f) Exit Strategy Risk – This could arise from over-reliance on one firm, the loss of relevant skills in the bank itself preventing it from bringing the activity back in-house and contracts entered into wherein speedy exits would be prohibitively expensive.

(g) Counter party Risk – Due to inappropriate underwriting or credit assessments.

(h) Country Risk – Due to the political, social or legal climate creating added risk.

(i) Contractual risk – arising from whether or not the bank has the ability to enforce the contract.

(j) Concentration and Systemic Risk – Due to lack of control of individual banks over a service provider, more so when overall banking industry has considerable exposure to one service provider.

5.4 Evaluating the Capability of the Service Provider

5.4.1 In considering or renewing an outsourcing arrangement, appropriate due diligence should be performed to assess the capability of the service provider to comply with obligations in the outsourcing agreement. Due diligence should take into consideration qualitative and quantitative, financial, operational and reputational factors. Banks should consider whether the

service providers' systems are compatible with their own and also whether their standards of performance including in the area of customer service are acceptable to it. Banks should also consider, while evaluating the capability of the service provider, issues relating to undue concentration of outsourcing arrangements with a single service provider. Where possible, the bank should obtain independent reviews and market feedback on the service provider to supplement its own findings.

5.4.2 Due diligence should involve an evaluation of all available information about the service provider, including but not limited to: -

- Past experience and competence to implement and support the proposed activity over the

- contracted period;
- Financial soundness and ability to service commitments even under adverse conditions;
- Business reputation and culture, compliance, complaints and outstanding or potential litigation;
- Security and internal control, audit coverage, reporting and monitoring environment, Business continuity management;
- External factors like political, economic, social and legal environment of the jurisdiction in which the service provider operates and other events that may impact service performance.
- Ensuring due diligence by service provider of its employees.

5.5 The Outsourcing Agreement

5.5.1 The terms and conditions governing the contract between the bank and the service provider should be carefully defined in written agreements and vetted by bank's legal counsel on their legal effect and enforceability. Every such agreement should address the risks and risk mitigation strategies. The agreement should be sufficiently flexible to allow the bank to retain an appropriate level of control over the outsourcing and the right to intervene with appropriate measures to meet legal and regulatory obligations. The agreement should also bring out the nature of legal relationship between the parties – i.e. whether agent, principal or otherwise. Some of the key provisions of the contract would be:

- The contract should clearly define what activities are going to be outsourced including appropriate service and performance standards.
- The bank must ensure it has the ability to access all books, records and information relevant to the outsourced activity available with the service provider.
- The contract should provide for continuous monitoring and assessment by the bank of the service provider so that any necessary corrective measure can be taken immediately.
- A termination clause and minimum periods to execute a termination provision, if deemed necessary, should be included.
- Controls to ensure customer data confidentiality and service providers' liability in case of breach of security and leakage of confidential customer related information.
- Contingency plans to ensure business continuity.
- The contract should provide for the prior approval/consent by the bank of the use of subcontractors by the service provider for all or part of an outsourced activity.
- Provide the bank with the right to conduct audits on the service provider whether by its internal or external auditors, or by agents appointed to act on its behalf and to obtain copies of any audit or review reports and findings made on the service provider in conjunction with the services performed for the bank.
- Outsourcing agreements should include clauses to allow the Reserve Bank of India or persons authorised by it to access the bank's documents, records of transactions, and other necessary information given to, stored or processed by the service provider within a reasonable time.
- Outsourcing agreement should also include clause to recognise the right of the Reserve Bank to cause an inspection to be made of a service provider of a bank and its books and account by one or more of its officers or employees or other persons.
- In cases where the controlling/Head offices of foreign banks operating in India outsource the activities related to the Indian operations, the Agreement should include clauses to allow the RBI or persons authorized by it to access the bank's documents, records of transactions and other necessary information given or stored or processed by the service provider within a reasonable time as also clauses to recognise the right of RBI to cause an inspection to be made of a service provider and its books and accounts by one or more of its officers or employees or other persons.
- The outsourcing agreement should also provide that confidentiality of customer's information should be maintained even after the contract expires or gets terminated.

- The outsourcing agreement should provide for the preservation of documents and data by the service provider in accordance with the legal/regulatory obligation of the bank in this regard.

5.6 Confidentiality and Security

5.6.1 Public confidence and customer trust in the bank is a prerequisite for the stability and reputation of the bank. Hence the bank should seek to ensure the preservation and protection of the security and confidentiality of customer information in the custody or possession of the service provider.

5.6.2 Access to customer information by staff of the service provider should be on 'need to know' basis i.e., limited to those areas where the information is required in order to perform the outsourced function.

5.6.3 The bank should ensure that the service provider is able to isolate and clearly identify the bank's customer information, documents, records and assets to protect the confidentiality of the information. In instances, where service provider acts as an outsourcing agent for multiple banks, care should be taken to build strong safeguards so that there is no comingling of information/documents, records and assets.

5.6.4 The bank should review and monitor the security practices and control processes of the service provider on a regular basis and require the service provider to disclose security breaches.

5.6.5 The bank should immediately notify RBI in the event of any breach of security and leakage of confidential customer related information. In these eventualities, the bank would be liable to its customers for any damage.

5.7 Responsibilities of DSA/ DMA/ Recovery Agents

5.7.1 Code of conduct for Direct Sales Agents formulated by the Indian Banks' Association (IBA) could be used in formulating their own codes for Direct Sales Agents / Direct Marketing Agents/ Recovery Agents. Banks should ensure that the Direct Sales Agents / Direct Marketing Agents/ Recovery Agents are properly trained to handle with care and sensitivity, their responsibilities particularly aspects like soliciting customers, hours of calling, privacy of customer information and conveying the correct terms and conditions of the products on offer etc.

5.7.2 Recovery Agents should adhere to extant instructions on Fair Practices Code for lending (Circular DBOD. Leg. No. BC.104 /09.07.007 /2002-03 dated 5 th May 2003) as also their own code for collection of dues. If the banks do not have their own code they should, at the minimum, adopt the Indian Banks Association's code for collection of dues and repossession of security. It is essential that the Recovery Agents refrain from action that could damage the integrity and reputation of the bank and that they observe strict customer confidentiality.

5.7.3 The bank and their agents should not resort to intimidation or harassment of any kind either verbal or physical against any person in their debt collection efforts, including acts intended to humiliate publicly or intrude the privacy of the debtors' family members, referees and friends, making threatening and anonymous calls or making false and misleading representations.

5.8 Business Continuity and Management of Disaster Recovery Plan

5.8.1 A bank should require its service providers to develop and establish a robust framework for documenting, maintaining and testing business continuity and recovery procedures. Banks need to ensure that the service provider periodically tests the Business Continuity and Recovery Plan and may also consider occasional joint testing and recovery exercises with its service provider.

5.8.2 In order to mitigate the risk of unexpected termination of the outsourcing agreement or liquidation of the service provider, banks should retain an appropriate level of control over their outsourcing and the right to intervene with appropriate measures to continue its business operations in such cases without incurring prohibitive expenses and without any break in the operations of the bank and its services to the customers.

5.8.3 In establishing a viable contingency plan, banks should consider the availability of alternative service providers or the possibility of bringing the outsourced activity back in-house in an emergency and the costs, time and resources that would be involved.

5.8.4 Outsourcing often leads to the sharing of facilities operated by the service provider. The bank should ensure that service providers are able to isolate the bank's information, documents and records, and other assets. This is to ensure that in adverse conditions, all documents, records of transactions and information given to the service provider, and assets of the bank, can be removed from the possession of the service provider in order to continue its business operations, or deleted, destroyed or rendered unusable.

5.9 Monitoring and Control of Outsourced Activities

5.9.1 The bank should have in place a management structure to monitor and control its outsourcing activities. It should ensure that outsourcing agreements with the service provider contain provisions to address their monitoring and control of outsourced activities.

5.9.2 A central record of all material outsourcing that is readily accessible for review by the Board and senior management of the bank should be maintained. The records should be updated promptly and half yearly reviews should be placed before the Board.

5.9.3 Regular audits by either the internal auditors or external auditors of the bank should assess the adequacy of the risk management practices adopted in overseeing and managing the outsourcing arrangement, the bank's compliance with its risk management framework and the requirements of these guidelines.

5.9.4 Banks should at least on an annual basis, review the financial and operational condition of the service provider to assess its ability to continue to meet its outsourcing obligations. Such due diligence reviews, which can be based on all available information about the service provider should highlight any deterioration or breach in performance standards, confidentiality and security, and in business continuity preparedness.

5.9.5 In the event of termination of the agreement for any reason, this should be publicized so as to ensure that the customers do not continue to entertain the service provider.

5.10 Redressal of Grievances related to Outsourced services

a) Banks should constitute Grievance Redressal Machinery within the bank and give wide publicity about it through electronic and print media. The name and contact number of designated grievance redressal officer of the bank should be made known and widely publicised. The designated officer should ensure that genuine grievances of customers are redressed promptly without involving delay. It should be clearly indicated that banks' Grievance Redressal Machinery will also deal with the issue relating to services provided by the outsourced agency.

b) Generally, a time limit of 30 days may be given to the customers for preferring their complaints / grievances. The grievance redressal procedure of the bank and the time frame fixed for responding to the complaints should be placed on the bank's website.

c) If a complainant does not get satisfactory response from the bank within 60 days from the date of his lodging the complaint, he will have the option to approach the Office of the concerned Banking Ombudsman for redressal of his grievance/s.

5.11 Reporting of transactions to FIU or other competent authorities

Banks would be responsible for making Currency Transactions Reports and Suspicious Transactions Reports to FIU or any other competent authority in respect of the banks' customer related activities carried out by the service providers.

6. Centralised List of Outsourced Agents

If a service providers services are terminated by a bank, IBA would have to be informed with reasons for termination. IBA would be maintaining a caution list of such service providers for the

entire banking industry for sharing among banks.

7 Off-shore outsourcing of Financial Services

7.1 The engagement of service providers in a foreign country exposes a bank to country risk - economic, social and political conditions and events in a foreign country that may adversely affect the bank. Such conditions and events could prevent the service provider from carrying out the terms of its agreement with the bank. To manage the country risk involved in such outsourcing activities, the bank should take into account and closely monitor government policies and political, social, economic and legal conditions in countries where the service provider is based, during the risk assessment process and on a continuous basis, and establish sound procedures for dealing with country risk problems. This includes having appropriate contingency and exit strategies. In principle, arrangements should only be entered into with parties operating in jurisdictions generally upholding confidentiality clauses and agreements. The governing law of the arrangement should also be clearly specified.

7.2 The activities outsourced outside India should be conducted in a manner so as not to hinder efforts to supervise or reconstruct the India activities of the bank in a timely manner.

7.3 The outsourcing related to overseas operations of Indian banks would be governed by both, these guidelines and the host country guidelines. Where there are differences, the more stringent of the two would prevail. However where there is any conflict, the host country guidelines would prevail.

8. Outsourcing within a Group/ Conglomerate

The risk management practices expected to be adopted by a bank while outsourcing to a related party (i.e party within the Group/ Conglomerate) would be identical to those specified in Para 5 of this guidelines.

9. Self- Assessment of Existing/Proposed Outsourcing Arrangements

Banks may conduct a self-assessment of their existing outsourcing agreements within a time bound plan and bring them in line with the above guidelines expeditiously.

SEBI RESTRICTS INDIVIDUAL STAKE IN STOCK EXCHANGES TO 5%

The 'Securities Contracts (Regulation) - Manner of increasing and maintaining public shareholding in recognised stock exchanges, Regulations - 2006' (Regulations) issued by Securities and Exchange Board of India (SEBI) has barred individuals from directly or indirectly acquiring or holding more than 5% in an exchange but these are silent on rules relating to sale of stake to foreign investors. It is felt that the 5% ceiling for individuals would also be applicable to corporates and domestic institutions.

The Regulations also specifies that public shareholding should remain at not less than 51% all the time. On private placement of equity stake, the Regulations provide that the Stock Exchanges should seek prior approval from SEBI before short-listing persons or institutions for such placements. The Regulations further provides that stock exchanges should dematerialise their equity shares proposed to be issued or sold.

WAGE-LIMIT INCREASED TO RS. 10,000/- PER MONTH UNDER ESI ACT

The wage-limit for coverage under the Employees State Insurance Act has been increased to Rs.10,000/- per month with effect from 1st October 2006 from the earlier limit of Rs. 7,500/- per month.

CBDT EXTENDS DUE DATE FOR FILING OF CORPORATE/FBT TAX RETURNS UPTO 30 TH NOVEMBER 2006

The Central Board of Direct Taxes (CBDT) has extended the due date furnishing the return of income under section 139(1) of the Income Tax Act (Act), furnishing the return of Fringe Benefits under section 115WD(1) of the Act and obtaining the Tax Audit Report under section 44AB of the Act for Assessment Year 2006-07 from 31 October 2006 to 30 November 2006

However, the above does not apply to the State of Gujarat where the due date for tax audit report and furnishing returns of income and fringe benefits in respect of taxpayers in has already been extended from 31 October 2006 to 31 December 2006 vide CBDT order dated 13 October 2006.

PROCEDURE FOR APPROVAL TO SCIENTIFIC RESEARCH INSTITUTIONS FOR EXEMPTION OF CONTRIBUTIONS MADE FOR SCIENTIFIC RESEARCH AMENDED

Section 35 of the Income-tax Act, 1961 relates to deduction of expenditure incurred on scientific research, research in social science or statistical research. Vide Notification S.O. No. 1856 (E) dated 30-10-2006, the Central Board of Direct Taxes have notified rules to prescribe guidelines, the manner and the conditions subject to which approval is to be granted on an application made under section 35(1)(ii) & 35(1)(iii) by a scientific research association, university, college or other institution. New Rules 5C, 5D and 5E have been inserted in the Income-tax Rules, 1962 and new application Forms No. 3CF-I and 3CF-II, have been inserted in Appendix-II of. Salient features of the new Rules and Forms are:-

(i) The amended provisions of section 35 now provide for one time approval. The one time approval can be withdrawn only if the Central Government is satisfied that the scientific research association or university or college or other institution has ceased its activities or its activities are not genuine or are not being carried out in accordance with all or any of the conditions prescribed under Rule 5D or Rule 5E.

(ii) The amended provision now provides for time bound disposal of applications for approval. Approval is to be granted or rejected before expiry of one year from the end of the month in which 'the copy of the application Form' referred to at (iii) above from the applicant is received in the office of Member (IT), CBDT.

(iii) An application for approval in Form No. 3CF-I or Form No. 3CF-II is to be made, at any time during the Financial Year immediately preceding the Assessment Year from which the approval is sought.

(iv) The application in the aforesaid Form Nos. should be made to the Commissioner of Income-tax or the Director of Income-tax having jurisdiction over the applicant.

(v) The applicant should send a copy of the application form in Form No. 3CF-I or Form No. 3CF-II to Member (IT), CBDT along with the acknowledgment receipt of the application form submitted by him to the Commissioner of Income-tax or Director of Income-tax having jurisdiction over the case.

(vi) Separate Forms for scientific research association and for university/college/other institution have been provided. Form No. 3CF-I is meant for application by a scientific research association and Form No. 3CF-II for application by a university, college or other institution.

(vii) For approval of a scientific research association, the sole object of the association should be to undertake scientific research and the scientific research activity is to be carried out by the association itself.

(viii) For approval of a university, college or other institution, the sum paid to it is to be used for scientific research and research in social science or statistical research and such research should be carried out through its faculty members or enrolled students.

The amended provisions take care of the long-standing need of scientific research institutions in

raising funds for scientific research. The amended provisions will enable enhanced investment in research and development (R&D) activity in the country.

SERVICE TAX RULES AMENDED TO FACILITATE EASIER CENTRALIZED REGISTRATION

The procedure for grant of centralised registration for service taxpayers who provides service from multi-location has been simplified. The new procedure would ensure that obtaining such registration is faster and easier. The scheme has also been extended to such taxpayers, who though not providing taxable service are liable to pay service tax under the provisions of service tax law. In addition certain technical amendments to facilitate audit of service tax assessee has also been made. For this, the Service Tax Rules, 1994, have been amended vide notification No. 29/2006-ST, dated 2.11.2006, to make following changes.

(I) Centralised registration of assessee:

(A) Category of person eligible for centralized registration: Hitherto, only the person providing taxable service from more than one premises and having centralized billing or accounting in respect of such service could take centralized registration of premises from which such centralized billing was done or where such centralized accounting system was maintained. However, this facility was not allowed to the service receiver or any person other than service provider, who is liable to pay service tax. For example in case of goods transported by road, the person liable to pay service tax is the person who pays freight for such service in specified cases. Similarly, in case of service provider located outside India, the person receiving service in India is liable to pay service tax. The Service Tax Rules have been amended to extend the facility of centralized registration to any person liable to pay service tax. Therefore, with this amendment, the service receiver or any other person made liable to pay service tax, having centralized accounting/billing for such service will be eligible to take centralized registration.

(B) Manner of granting centralized registration: Hitherto, centralized registration could be granted by the Commissioner or the Chief Commissioner of Central Excise, only if all premises where centralized billing or accounting system is maintained as well as from where the taxable service is provided, were within their jurisdictions. If the premises of a service taxpayer were spread beyond a Zone, the registration was to be granted by the Director General (Service Tax) located in Mumbai. This was causing delays in granting of registration and unnecessary movement of documents. The Service Tax Rules have been amended to simplify this procedure. It has now been prescribed that henceforth, in all cases where taxpayer opts for Centralised registration (including those who have applied for such registration but have not been granted such centralised registration), the registration will be granted by the Commissioner of Central Excise/ Service Tax having jurisdiction over the premises for which centralized registration is sought (from where centralized billing is done or centralized accounting system is maintained). However, this amendment would not affect centralized registration already issued before 2.11.2006.

(II) It has been prescribed that on demand by audit parties deputed by the Comptroller and Auditor General of India, the assessee will make available the records as maintained by him with respect to taxable services. Similar provision already exists in the Central Excise Act.

GOVERNMENT BODIES COME IN SERVICE TAX NET

The revenue department has issued a clarification which makes it mandatory for government bodies rendering taxable services to pay service tax. However, if one central government department renders service to other, no service tax will be levied, as this would not be treated as two separate entities. The same would be the case if one state government department provides service to another in the same state. But, if one central government department provides a taxable service to a public sector undertaking, it would be treated as one entity providing service to other, and would attract service tax.

The issue whether services rendered by government entities are taxable or not was raised by the field formations after the Budget 2006-07 replaced the word 'commercial concern' with 'any person'.

The Central Board Excise and Customs has now issued an instruction saying, that wherever the service provider is mentioned as 'any person', the term 'person' ordinarily includes government unless, in the context, government is excluded by applying the rules of statutory interpretation. But the board has also asked the field formations to examine individual cases carefully. Also, in case of any doubt in individual cases having all India implication, they will have to refer the case to the board, before taking any decision.

Source: Economic Times

GSK AGREES TO PAY US\$ 3.4 BILLION TO SETTLE TRANSFER PRICING DISPUTE WITH IRS, USA

GlaxoSmithKline (GSK), the UK-based pharmaceutical group has agreed to pay US\$3.4 billion to settle a blockbuster transfer pricing tax dispute with the US Internal Revenue Service. The company's decision comes in the build-up to a trial set for February 2007 to consider the long-running tax feud which, combined with interest, could have amounted to as much as US\$15bn.

This case, which is pending in the United States Tax Court, represents the largest tax dispute in the history of the Internal Revenue Service (IRS). Under the settlement agreement, GSK will pay the Internal Revenue Service approximately \$3.4 billion, and will abandon its claim seeking a refund of \$1.8 billion in overpaid income taxes, as part of an agreement to resolve the parties' long-running transfer pricing dispute for the tax years 1989 through 2005.

The agreement between GSK and the IRS brings to a conclusion a dispute dating back to the 1980s and involves adjustments to GSK's tax years from 1989 through 2000. The Tax Court case concerns "transfer pricing," an accounting method requiring that related parties engage in transactions at arm's length to ensure the proper reporting of taxable income. GSK and the IRS have also reached agreement for tax years 2001 through 2005 with respect to the transfer pricing issues arising in those years.

The Tax Court dispute for years 1989-2000 involves inter-company transactions between GSK and certain of its foreign affiliates relating to various GSK "heritage" pharmaceutical products. Specifically at issue is the level of U.S. profits reported by GSK after making inter-company payments that took into account product intangibles developed by and trademarks owned by its U.K. parent, and other activities outside the U.S., and the value of GSK's marketing and other contributions in the U.S. Under the settlement agreement, GSK has conceded over 60% of the total amount put in issue by the two parties for the years pending in Tax Court.

The GSK's dispute with the IRS revolves around GSK's blockbuster drug, the antacid Zantac. The IRS said that GSK had shifted profits from its US to its UK operations, that while Zantac was only an improvement on the earlier Tagamet, the reason why it did so well in the US was due to the extra sales efforts of GSK's sales team in the US. GSK, however, said the sharp rise in US sales of Zantac was not so much due to the marketing team there but the result of the research development efforts of the UK team. IRS's contention was that there was an overcharge on the royalty from the US arm by GSK so as to transfer profits to the UK.

GSK's \$3.4 billion payment to the IRS (which includes interest) is the largest single payment made to the IRS to resolve a tax dispute, bringing the company current with respect to its transfer pricing of the "heritage" products through 2005.

APEX COURT PROVIDES RELIEF TO EXPORTER & IMPOSES FINE ON GOVERNMENT

In a relief to the exporters, the Supreme Court has ruled that consignments cleared by Customs officials cannot be subsequently held back from exports due to policy decisions. The Supreme Court has held that "As soon as the permission is granted by the officer, procedures laid down for export must be held to have been complied with" The case relates to export of pulses at the Kandla port and the government ban on export of the commodity. While dismissing an appeal of the Centre, the Apex court also imposed an exemplary fine and counsel's fee of Rs 1 lakh on the government for denying export permission for export consignments which was already cleared by the concerned officials.

The petitioner, Asian Food Industries, had entered into an agreement with the Overseas Importers, a trading firm based in Middle East, for supply of pulses. The contract was executed between April 22 and May 2, 2006. Shipment of 20 containers took place between June 22 and June 24.

The remaining 87 containers were cleared and let export orders dated June 23, 24 and 26 were issued by the custom authorities at Kandla Port. The bills of landing were also issued.

In the meanwhile, a decision was taken by the central government to ban the export of pulses on June 22. It was widely reported in media but the notification to that effect was issued on June 27. On June 28, the superintendent of Customs, dealing with the transaction, directed the Kandla Port Trust not to allow further consignments for shipment. The assistant traffic manager then informed that even if goods have been cleared by the issuance of let export orders, the same cannot be loaded on the shipping vessels in view of the said prohibition.

Challenging that, the exporter approached the Gujarat High Court which had ruled that they were entitled to export the goods despite June 27 notification, banning such export. The government then moved the apex court which has also ruled in favour of the exporter.

Source: Economic Times

HC: CONSTITUTIONAL VALIDITY OF INSTRUCTION REGARDING COMPULSORY REFERRAL TO TPO UPHELD

The Delhi High Court has upheld the constitutional validity of the Instruction issued by the Central Board of Direct Taxes (CBDT) to refer all cases where the value of International Transactions more than Rs. 50 million, to the Transfer Pricing Officer.

The provisions relating to transfer pricing require the Assessing Officer (AO) to examine whether the international transactions of the assessee with its Associated Enterprises are at Arms length. In arriving at this decision the AO, may refer a case to the concern Transfer Pricing Officer (TPO) if he considers it necessary and expedient to do so.

In its petition, Sony India (the Petitioner) had challenged the legal validity of an instruction issued in '03 by the Central Board of Direct Taxes (CBDT) to refer all cross-border transactions worth Rs 50 million and above to the TPO. The petitioner in its writ petition before the High Court had sought relief on:

Quashing Instruction No. 3 to the extent it requires compulsory reference to the TPO where aggregate value of international transactions exceeds Rs. 50 million and Setting aside the assessment order and directing the AO to exercise his power ignoring Instruction relating to compulsory referral of the matter to the TPO

Petitioner's Arguments

(i) The classification of international transactions into two categories i.e. those of the value exceeding Rs. 50 million and those below is suspect and violative of Article 14 of the Constitution and further since the Act itself makes no such classification, this classification cannot be introduced by an administrative Instruction.

(ii) The discretion of the AO to make a reference to the TPO only where he considers it 'necessary and expedient' has been taken away by the Instruction.

(iii) The ultimate decision on the computation of the arm's length price is that of the AO. However, that is now supplanted by the decision of the TPO. Moreover, the TPO is not bound to follow the steps outlined in sections 92(1), (2) and (3) which are otherwise mandatory for the AO to follow. A CBDT Instruction cannot be permitted to bring about this change.

The Department's contentions:

1) A reference to the TPO will be made by the AO only where he "considers it necessary or expedient to do". There may be several instances in which the AO may exercise his discretion and this would include transactions of value in excess of Rs. 50 million.

2) The view expressed by the TPO is not binding on the AO. The assessee may be able to persuade the AO even after the report of the TPO that the arm's length price determined by the TPO should not be acted upon.

3) The apprehension expressed by the petitioner that the TPO is not bound to follow the procedure outlined under section 92C(1) to (3) is misconceived. The Instruction only facilitates the work of both the AO and TPO and cannot be characterized as usurping their discretion or ultra vires the Act.

High Court's Decision

a) The discretion of the AO to refer the matter of computation of ALP to the TPO is not unfettered. Any misuse of such exercise of discretion can be corrected by way of judicial review.

b) The words "necessary and expedient" require the formation of an opinion by the AO of the need to make such a reference. However, the AO is not required to form a prior considered opinion even before making a reference to the TPO. A prima facie opinion would suffice for making the reference.

c) The TPO is expected to perform the same exercise as envisaged under S.92C (1) to (3) while determining the ALP under S.92CA (3).

d) The AO is not bound to accept the ALP as determined by the TPO. He can always be persuaded by the assessee at that stage to reject the TPO's Report and proceed to still determine the ALP himself.

e) The Instruction cannot be held to be violative of Article 14 of the Constitution. Transactions of a high value require a careful examination and it may not be expedient for the AO to efficiently deal with the assessment involving such an exercise.

f) The Instruction also does not take away the discretion of the AO in relation to an international transaction of the value exceeding Rs. 50 million but rather acts as a guideline in the exercise of this discretion.

SNAPSHOT OF GLOBAL MARKETS - OCTOBER 2006

KEY STOCK MARKET INDICES

INDEX	OPENING (01/10/2006)	HIGHEST IN OCTOBER 2006	LOWEST IN OCTOBER 2006	CLOSING (31/10/2006)
BSE SENSEX	12473.79	13075.85	12178.83	12961.90
S&P CNX NIFTY	3588.95	3782.85	3508.65	3744.10
DOW JONES I.A.	11678.99	12236.10	11608.23	12080.73
NASDAQ COMPOSITE	2257.00	2379.29	2224.21	2366.71
FTSE 100	5960.80	6244.60	5897.30	6129.20
NIKKEI	16169.00	16901.53	16028.32	16399.39

PRICES OF KEY COMMODITIES (US\$)

COMMODITY	OPENING (01/10/2006)	HIGHEST IN OCTOBER 2006	LOWEST IN OCTOBER 2006	CLOSING (31/10/2006)
GOLD - SPOT (NY)	598.50	610.50	559.50	607.20
SILVER - SPOT (NY)	11.41	12.25	10.53	12.24
PLATINUM - SPOT(NY)	1139	1139	1045	1086
COPPER (COMEX)	3.48	3.57	3.20	3.34
ALUMINIUM (COMEX)	1.173	1.295	1.130	1.291
BRENT CRUDE (IPE)	64.00	64.15	57.39	59.03
NYMEX CRUDE OIL	63.75	63.85	57.05	58.73

KEY GLOBAL CURRENCY RATES AGAINST USD

CURRENCY	OPENING RATE (01/10/2006)	HIGHEST IN OCTOBER 2006	LOWEST IN OCTOBER 2006	CLOSING RATE (31/10/2006)
EURO/USD	1.268	1.278	1.248	1.273
GBP/USD	1.873	1.904	1.852	1.899
USD/JPY	118.22	119.87	117.15	117.45
USD/INR	45.87	45.87	44.83	45.08

MAJOR CURRENCIES AGAINST INR

CURRENCY	OPENING RATE (01/10/2006)	HIGHEST IN OCTOBER 2006	LOWEST IN OCTOBER 2006	CLOSING RATE (31/10/2006)
USD/INR	45.87	45.87	44.83	45.08
EURO/INR	58.16	58.45	56.82	57.37
GBP/INR	85.90	86.60	84.28	85.62
JPY/INR	38.83	38.98	37.97	38.39

INTEREST RATES

MI BOR

PERIOD	OPENING RATE (01/10/2006)	HIGHEST IN OCTOBER 2006	LOWEST IN OCTOBER 2006	CLOSING RATE (31/10/2006)
OVERNIGHT	6.62	7.23	6.43	7.03
14 DAY	6.59	7.05	6.57	7.04
1-MONTH	6.86	7.29	6.83	7.29
3-MONTH	7.38	7.66	7.31	7.63

LIBOR - USD

PERIOD	OPENING RATE (01/10/2006)	HIGHEST IN OCTOBER 2006	LOWEST IN OCTOBER 2006	CLOSING RATE (31/10/2006)
1-MONTH	5.32	5.32	5.32	5.32
3-MONTH	5.37	5.38	5.37	5.37
6-MONTH	5.38	5.43	5.36	5.39
12-MONTH	5.32	5.44	5.24	5.34

LIBOR - EURO

PERIOD	OPENING RATE (01/10/2006)	HIGHEST IN OCTOBER 2006	LOWEST IN OCTOBER 2006	CLOSING RATE (31/10/2006)
1-MONTH	3.29	3.38	3.29	3.38
3-MONTH	3.42	3.57	3.42	3.57
6-MONTH	3.58	3.71	3.58	3.71
12-MONTH	3.74	3.87	3.72	3.86

LIBOR - GBP

PERIOD	OPENING RATE (01/10/2006)	HIGHEST IN OCTOBER 2006	LOWEST IN OCTOBER 2006	CLOSING RATE (31/10/2006)
1-MONTH	4.95	5.06	4.89	5.06
3-MONTH	5.08	5.19	5.08	5.19
6-MONTH	5.20	5.30	5.20	5.30
12-MONTH	5.27	5.46	5.27	5.44

LIBOR - JPY

PERIOD	OPENING RATE (01/10/2006)	HIGHEST IN OCTOBER 2006	LOWEST IN OCTOBER 2006	CLOSING RATE (31/10/2006)
1-MONTH	0.38	0.38	0.37	0.37
3-MONTH	0.43	0.45	0.43	0.44
6-MONTH	0.49	0.54	0.49	0.54
12-MONTH	0.60	0.70	0.60	0.67

US T-BILL

PERIOD	OPENING RATE (01/10/2006)	HIGHEST IN OCTOBER 2006	LOWEST IN OCTOBER 2006	CLOSING RATE (31/10/2006)
	Discount/Yield	Discount/Yield	Discount/Yield	Discount/Yield
1-MONTH	4.56/4.67	5.09/5.18	4.56/4.67	5.09/5.18
3-MONTH	4.76/4.88	4.99/5.13	4.76/4.88	4.95/5.08
6-MONTH	4.83/5.02	4.99/5.19	4.81/5.00	4.93/5.13

KEY CENTRAL BANK RATES

	31/10/2006	1 MONTH PRIOR	3 MONTH PRIOR	6 MONTH PRIOR	1 YEAR PRIOR
US FEDERAL RESERVE FUNDS RATE	5.25	5.25	5.25	5.00	4.00
EUROPEAN CENTRAL BANK RATE	3.25	3.00	2.75	2.25	2.00
BANK OF ENGLAND RATE	4.75	4.50	4.50	4.50	4.50
RESERVE BANK OF INDIA - BANK RATE	6.00	6.00	6.00	6.00	6.00

PRIME RATES

CURRENCY	RATE (31/10/2006)
USD	8.25
EURO	4.25
GBP	5.00
JPY	1.63
INR	10.25 to 10.75

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