



INDIA UPDATE

A monthly Newsletter on business intelligence and opportunities in India

SEPTEMBER 2006



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Industry House, Mahakali Caves Road, Andheri (E). Mumbai – 400 093, India

Telephone: 91-22- 2687 0310 • 91-22- 2207 1227 • Fax: 91-22-25643907 • E-mail: com@indiabizsolutions.com
Website: www.indiabizsolutions.com

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MANUFACTURING SECTOR BOOSTS GDP GROWTH TO A RECORD 8.9% IN Q1 2006-07

A strong growth in the manufacturing sector helped the Indian Economy to grow at a record 8.9% in Q1 (April-June 2006) of the Current Fiscal Year as compared to 8.5% recorded in Q1 of the previous Fiscal Year.

Mr. P.Chidambaram, the Indian Finance Minister pointed out that this was the highest first quarter growth recorded since 2000-01 and expressed satisfaction at the performance of the economy. Mr Chidambaram said that "In fact, my expectation is we can continue to maintain a growth rate close to 8 per cent every quarter provided we continue to follow prudent policies", immediately after the Central Statistical Organisation (CSO) released the first quarter GDP numbers.

Expressing satisfaction at the performance, the Finance Minister said that it should be possible to maintain a GDP growth of 7.5 per cent or above for every quarter if prudent economic policies were followed. "In fact, my expectation is we can continue to maintain a growth rate close to 8 per cent every quarter provided we continue to follow prudent policies", Mr. Chidambaram told presspersons after the Central Statistical Organisation (CSO) released the first quarter GDP numbers here today

The manufacturing sector continued to perform well by reporting a 11.3 per cent growth in Q1 2006-07 as against 10.7 per cent and 6.6 per cent in the first quarter of 2005-06 and 2004-05, respectively. Trade, hotels, transport & communication sector also grew by 13.2% as compared to 11.7% in the previous year. The agriculture grew by 3.4 per cent (the same as in the previous year), the services sector grew by 10.6 per cent (10.1 per cent). The only two sectors that recorded drop in growth rates were 'Construction' and 'Electricity, gas and water supply'. While the construction sector grew at 9.5 per cent (12.4 per cent in Q1 of 2005-06), the electricity sector grew by 5.4 per cent (7.4 per cent in Q1 of 2005-06).

The sector-wise GDP growth (%) for Q1 (April-June 2006) :

Industry	Q1 2006	Q1 2005
Agriculture, Forestry & Fishing	3.4	3.4
Mining & Quarrying	3.4	3.1
Manufacturing	11.3	10.7
Electricity, Gas & water Supply	5.4	7.4
Construction	9.5	12.4
Trade, Hotels, Transport & Communication	13.2	11.7
Financing, Insurance, Real Estate & Business Services	8.9	8.8
Community, Social & Personal Services	7.4	7.3
GDP At Factor Cost	8.9	8.5

Views of our Economist:

It is heartening to note that the Indian economy has posted a growth rate of 8.9% in Q1 of 2006-07 inspite of construction sector showing a drop in growth rate from 12.4% to 9.5%. The expected boom in realty sector has not materialized and this has affected the overall growth to a certain extent. It is quite possible for the economy to attain a growth rate of about 8% for the current year as hoped by the Finance Minister.

Our concern area continues to be current account deficit which is increasing every month. The deficit for April-August, 2006 is estimated at US \$ 20.21 billion which is higher than the deficit of US \$ 17.43 billion during April-August, 2005. While Exports during April-August, 2006 has increased by

34.48% to US \$ 48 billion from the level of US \$ 35.76 billion during April-August, 2005, the imports grew at 28.39% during April-August, 2006. The value imports during this period were at US \$ 68 billion is higher than the level of US \$ 53 billion during April-August 2005. Oil imports accounted for the major increase during April-August 2006 and were valued at US \$ 23.6 billion which is 39.48% higher than oil imports valued at US \$ 16.9 billion in the corresponding period last year. Non-oil imports during April-August, 2006 are estimated at US \$ 44.7 billion which is 8.76% higher than the level of such imports valued at US \$ 41.1 billion in April- August 2005.

LIST OF AUTHORISED ACTIVITIES IN NON-PROCESSING AREA OF SEZs TO BE NOTIFIED

The Board of Approvals in its meeting held on 21st September, 2006 discussed and decided the procedure to be adopted by the Board of Approval while approving infrastructure in the non-processing area of the Special Economic Zones. In this regard, it was decided that the Central Government will notify a list of authorized operations. This list (given hereunder) would be used by the Board of Approval for authorizing operations which only would qualify for exemptions, concessions and drawback. The Board of Approvals also agreed on certain criteria to be followed by the Board for approval of SEZ Developers which are given hereunder in the second part.

List of authorised operations eligible for approval by the Board of Approval

(A) IT/ITES, Bio-technology & Gems & Jewellery SEZ:

1. Roads with Street lighting, Signals & Signage
2. Water treatment plant, water supply lines (dedicated lines upto source), sewage lines, storm water drains and water channels of appropriate capacity
3. Sewage and garbage disposal plant, pipelines and other necessary infrastructure for sewage and garbage disposal, Sewage treatment plants
4. Electrical, Gas & PNG Distribution Network including necessary sub-stations of appropriate capacity, pipeline network etc
5. Security offices, police posts, etc, at entry, exit and other points within and along the periphery of the site.
6. Effluent treatment plant and pipelines and other infrastructure for Effluent treatment
7. Office space
8. Parking including Multi-level car parking (automated / manual)
9. Telecom and other communication facilities including internet connectivity
10. Rain water harvesting plant
11. Power (including power back up facilities)
12. Air conditioning
13. Swimming pool
14. Fire protection system with sprinklers, fire and smoke detectors
15. Recreational facilities including club house, Indoor/Outdoor games, gymnasium
16. Employee welfare facilities like ATMs, Crèche, Medical center and other such facilities
17. Shopping arcade/Retail space
18. Business/Convention Centre
19. Common Data centre with inter-connectivity
20. Housing/Service apartments
21. Play ground
22. Bus bay
23. Food Services including Cafeteria, food court(s), Restaurants, coffee shops, canteens and catering facilities
24. Landscaping and water bodies

25. Clinic & Medical Centers
26. Wi Fi/Wi Max Services
27. Drip and Micro irrigation systems
28. Any other operation ancillary or incidental to operations specified above from (i) to (xxviii) which the Board of Approval may authorise from time to time.

(B) Sector Specific SEZs

1. Roads with Street lighting, Signals and Signage.
2. Water treatment plant, water supply lines, sewage lines, storm water drains and water channels of appropriate capacity
3. Sewage and garbage disposal plant, pipelines and other necessary infrastructure for sewage and garbage disposal and Sewage treatment plants
4. Electrical, Gas & PNG Distribution Network including necessary sub-stations of appropriate capacity, pipeline network etc
5. Security offices and police posts at entry, exit and other points within and along the periphery of the site.
6. Effluent treatment plant and pipelines and other infrastructure for Effluent treatment
7. Office space/Shopping arcade/Retail space/ Multiplex
8. Housing
9. Hotel/Service apartments
10. Clinic / Medical Centers/ Hospital
11. School/Technical Institution/Educational Institution
12. Parking including Multi-level car parking (automated / manual)
13. Telecom and other communication facilities including internet connectivity
14. Business/Convention Centre
15. Common Data centre with inter-connectivity
16. Rain water harvesting plant
17. Power (including power back up facilities)
18. Rail head
19. Access control and Monitoring system
20. Swimming pool
21. Fire Station, Fire protection system with sprinklers, fire and smoke detectors
22. Recreational facilities including club house, Indoor/Outdoor games and gymnasium
23. Employee welfare facilities like ATMs, Crèche, Medical center and other such facilities
24. Play grounds
25. Bus bays
26. Food Services including Cafeteria, food court(s), Restaurants, coffee shops, canteens and catering facilities
27. Landscaping and water bodies
28. Wi Fi/Wi Max Services
29. Drip and Micro irrigation systems
30. Any other operation ancillary or incidental to operations specified above from (i) to (xxix) which the Board of Approval may authorise from time to time.

(C) Multi Product SEZs

1. Roads with Street lighting, Signals and Signage
2. Water treatment plant, water supply lines, sewage lines, storm water drains and water channels of appropriate capacity
3. Sewage and garbage disposal plant, pipelines and other necessary infrastructure for sewage and

- garbage disposal and Sewage treatment plants
4. Electrical, Gas & PNG Distribution Network including necessary sub-stations of appropriate capacity, pipeline network etc
 5. Security offices and police posts at entry, exit and other points within and along the periphery of the site.
 6. Effluent treatment plant and pipelines and other infrastructure for Effluent treatment
 7. Office space/Shopping arcade/Retail space/multiplexes
 8. Housing
 9. Hotel
 10. Clinic /Medical Centers / Hospital
 11. School/Technical Institution/Educational Institution
 12. Parking including Multi-level car parking (automated / manual)
 13. Access control and Monitoring system
 14. Telecom and other communication facilities including internet connectivity
 15. Rain water harvesting plant
 16. Power (including power back up facilities)
 17. Swimming pool
 18. Fire Station, Fire protection system with sprinklers, fire and smoke detectors
 19. Rail head within the SEZ
 20. Port
 21. Airport/Air Cargo Complex
 22. ICD
 23. Recreational facilities including club house, Indoor/outdoor games and gymnasium.
 24. Employee welfare facilities like ATMs, Crèche, Medical center and other such facilities
 25. Play grounds
 26. Golf course
 27. Bus bays
 28. Food Services including Cafeteria, food court(s), Restaurants, coffee shops, canteens and catering facilities
 29. Landscaping and water bodies
 30. Wi Fi/Wi Max Services
 31. Drip and Micro irrigation systems
 32. Any other operation ancillary or incidental to operations specified above from (i) to (xxxii) which the Board of Approval may authorize from time to time.

B. Criteria to be followed by the Board for approval of SEZ Developers

1. Minimum Investment or Net worth of the Promoter Company & all Group

Companies & Flagship companies as follows

a) Sector specific SEZs:

Minimum investment of Rs.250 crores or net worth of Rs.50 crores

b) Multi product SEZs:

Minimum investment of Rs.1000 crores or net worth of Rs.250 crores.

2. Proposals not meeting the above minimum investment or net worth criteria with enough justification for the same, to be considered on merits by the Board of Approvals.

RBI : OVERSEAS DIRECT INVESTMENT BY REGULATED ENTITIES IN THE FINANCIAL SECTOR

At present, entities engaged in financial services activities in India making investment in non-financial services activities overseas are not required to comply with the additional conditions

mentioned in Regulation 7 of the Notification No.FEMA120 / RB-2004 dated July 7, 2004 . With a view to assess the impact of the overseas operations of such entities on a consolidated basis, the Reserve Bank of India (RBI) has decided that regulated entities in financial sector in India investing overseas in any activity will also have to comply with the conditions stipulated in Regulation 7 of the aforesaid Notification. The additional conditions specified in the Regulation 7 of the said Notification for making investment in financial services activities overseas are given hereunder:

The Indian party has earned net profit during the preceding three financial years from the financial services activities;

1. The Indian party is registered with the regulatory authority in India for conducting the financial services activities;
2. The Indian party has obtained approval from the concerned regulatory authorities both in India and abroad, for venturing into such financial sector activity;
3. The Indian party has fulfilled the prudential norms relating to capital adequacy as prescribed by the concerned regulatory authority in India.

Further any additional investment by an existing JV/WOS or its step down company shall be made only after complying with the conditions stipulated hereinabove.

RBI has further clarified that trading in Commodities Exchanges overseas and setting up JV/WOS for trading in Overseas Commodities Exchanges will be reckoned as financial services activity and will require clearance from the Forward Markets Commission (FMC). The FMC has recently put in place guidelines for allowing FMC registered members of Commodity Exchanges to undertake commodity related activities abroad. Indian entities desirous of setting up of JV/WOS overseas for trading in overseas commodities exchanges should, therefore, approach the FMC for regulatory clearance.

RBI has also specified that unregulated Indian entities engaged in the financial services activities in India may invest in non-financial sector activities overseas subject to Regulation 6 of the aforesaid Notification.

RBI: BANK'S EXPOSURE TO ENTITIES FOR SETTING UP SEZs & ACQUISITION OF UNITS IN SEZs TO BE TREATED AS EXPOSURE TO COMMERCIAL REAL ESTATE SECTOR

The Reserve Bank of India (RBI) has, keeping in view the current market conditions, decided that the exposure of banks to entities for setting up Special Economic Zones (SEZs) or for acquisition of units in SEZs which includes real estate would be treated as exposure to commercial real estate sector with immediate effect and banks would have to make provisions as also assign appropriate risk weights for such exposures as per the existing guidelines.

RBI: APPROPRIATION FROM RESERVE FUND – SECTION 17(2) OF BANKING REGULATION ACT

In terms of section 17 (1) and 11 (1)(b) (ii) of the Banking Regulation Act, 1949 banks are required to transfer, out of the balance of profit as disclosed in the profit and loss account, a sum equivalent to not less than 20 per cent of such profit to Reserve Fund. This provision is a minimum requirement. Considering the imperative need for augmenting the reserves, it was advised by RBI vide circular DBOD.No.BP.BC.24/21.04.018/ 2000-2001 dated September 23, 2000 that all scheduled commercial banks operating in India (including foreign banks) should transfer not less than 25 per cent of the 'net profit' (before appropriations) to the Reserve Fund with effect from the year ending 31 March 2001.

In terms of Sec 17(2), where a banking company appropriates any sum or sums from the reserve fund or the share premium account, it shall, within twenty-one days from the date of such

appropriation, report the fact to the Reserve Bank explaining the circumstances relating to such appropriation. In order to ensure that their recourse to drawing down the Statutory Reserve is done prudently and is not in violation of any of the regulatory prescriptions, banks are advised in their own interest to take prior approval from the Reserve Bank before any appropriation is made from the statutory reserve or any other reserves.

RBI has further advised banks that:

- (i) all expenses including provisions and write-offs recognized in a period, whether mandatory or prudential, should be reflected in the profit and loss account for the period as an 'above the line' item (i.e. before arriving at the net profit);
- (ii) Wherever draw down from reserves takes place with the prior approval of Reserve Bank, it should be effected only 'below the line' (i.e. after arriving at the profit/loss for the year); and
- (iii) it should also be ensured that suitable disclosures are made of such draw down of reserves in the 'Notes on Accounts' to the Balance Sheet.

RBI : AMENDMENTS TO FOREIGN EXCHANGE MANAGEMENT (TRANSFER OR ISSUE OF ANY FOREIGN SECURITY) REGULATIONS

The Reserve Bank of India (RBI) has effected the following amendments to Foreign Exchange Management (Transfer or Issue of any foreign security) regulations.

1. Amendments in regulation 6B. —

- for the words, "A person resident in India , being an individual or a listed Indian company or a mutual fund registered in India ", the words, "A person resident in India , being an individual or a listed Indian company" shall be substituted.
- in clause (b), in the proviso, clause (ii) shall be omitted.
- in clause (b) , in the proviso, clause (iii) shall be renumbered as clause (ii).

2. Insertion of new regulation 6C. —

After regulation 6B of the principal regulations, the following regulation shall be inserted, namely:—

6C Investment by Mutual Funds

(1) Mutual Funds registered with the Securities & Exchange Board of India, may invest within specified limits, in the shares or the rated bonds/fixed income securities of an overseas company listed on a recognised stock exchange or in Exchange Traded Funds, or other securities as may be stipulated by the Reserve Bank of India from time to time.

(2) Every transaction relating to purchase and sale of foreign security by Mutual Funds shall be routed through the designated branch of an authorised dealer in India."

3. Amendment of regulation 26

For Regulation 26 of the principal regulations, the following shall be substituted namely,—

"26. The purchase of foreign securities by Mutual Funds shall be subject to these regulations, and such other terms and conditions as may be notified by the SEBI from time to time."

RBI : MODIFICATION TO SECURITIZATION COMPANIES & RECONSTRUCTION COMPANIES GUIDELINES

The Reserve Bank of India(RBI), vide Notification No.DNBS.4/ED (SG)/-2004 dated March 29, 2004 had increased the minimum owned fund requirement for commencing the business of securitization or asset reconstruction to an amount not less than 15% of the total financial assets acquired or to be acquired by the Securitization Company or Reconstruction Company on an aggregate basis or Rs 1

billion whichever is lower irrespective of whether the assets are transferred to a trust set up for the purpose of securitization or not. The Bank had therein directed that the Securitization Company or Reconstruction Company may invest the amount of owned fund in addition to the modes specified in clause (ii) of Paragraph 10 of the Securitization Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 in the Security Receipts issued by the trust set up for the purpose of securitization.

RBI has decided that Securitization Companies or Reconstruction Companies shall invest in security receipts an amount not less than 5% issued under each scheme with immediate effect. In the case of Securitization Companies or Reconstruction Companies which have already issued the security receipts, such companies shall achieve the minimum subscription limit in security receipts under each scheme, within a period of six months from the date of Notification (September 20, 2006) issued in this regard.

FII INVESTMENTS IN UPPER TIER II INSTRUMENTS

The Reserve Bank of India in its Circular dated July 21, 2006 reviewed the guidelines governing the Innovative Perpetual Debt Instruments eligible for inclusion as Tier 1 Capital and Debt Capital Instruments qualifying for Upper Tier II Capital. As per the aforementioned Circular, investment by Foreign Institutional Investors (FIIs) in Upper Tier II instruments raised in Indian Rupees shall be outside the limit for investment in corporate debt instruments, i.e., USD 1.5 billion. However, investment by FIIs in these instruments will be subject to a separate ceiling of USD 500 million.

In view of the above, the Securities Exchange Board of India (SEBI) has decided that the following shall be applicable with immediate effect:

The limit of USD 500 million will be allocated among the 100% debt and general 70:30 FIIs/ sub accounts in the following manner:

Type of FIIs	100% Debt	70:30	Total Permissible limit
Limit Allocated	390	110	500
Total			500

2. A 'headroom' of USD 20 million will be maintained for investments by general 70:30 FIIs/ sub accounts in Upper Tier II instruments i.e. the FIIs/ Sub Accounts are free to invest till the total investment limit reaches USD 90 million. Thereafter, the approvals for limit allocation shall be granted as per the procedure mentioned in SEBI Circular No. IMD/FII/16/2004 dated November 2, 2004. It is to be noted that the SEBI reserves the right to withdraw unused allocation in case there is demand from any FII which has already exhausted the limits, in order to enable optimum use of the allocations.

3. The individual limits for investment in Upper Tier II instruments will be advised to the 100% debt FIIs/ sub accounts separately.

SEBI REVISES FII /SUB-ACCOUNT APPLICATION FORMS

The Securities & Exchange Board of India (SEBI) has notified the following new forms for registering a FII or a sub-account in the First schedule to the SEBI (FII) Regulations.

- Revised Form A in order to apply for FII registration in place of existing Form A; and
- Form AA in order to apply for sub-account registration in place of Annexure B to the existing Form A.

The revised Form A for FII registration, inter alia, contains the following specific requirements:

- Detailed information requirements on resident/home country regulations governing the FII and activities permitted under the licence granted to it in that country
- Name of the investment advisor/manager
- Details of associates and group companies having office in India and registered with SEBI

The revised Form AA for sub-account registration, inter alia, contains the following specific requirements:

- The sub-account (the applicant) and the FII to submit a joint undertaking
- The applicant to declare that its income is from known and legitimate sources
- The applicant to declare that it is not a non-resident Indian or an overseas corporate body
- Sub-accounts are required to provide information on their domestic taxation

SEBI EXTENDS PAN DEADLINE TO 31 ST DECEMBER 2006

SEBI has extended the deadline for making Permanent Account Number (PAN) compulsory for all stock market transactions by three months to December 31, 2006 from October 1.

SERVICE TAX TO BE PAID ELECTRONICALLY BY CERTAIN LARGE ASSESSEES

The Service Tax Rules have been amended to provide that the assessee, who has paid service tax of rupees five million or above in the preceding financial year or has already paid service tax of rupees five million in the current financial year, shall deposit the service tax liable to be paid by him electronically, through internet banking.

SERVICE TAX CIRCULAR ON THE SCOPE OF TERM "CHARITABLE" USED IN THE DEFINITION OF CLUB OR ASSOCIATION SERVICE

The Service Tax Department has issued a circular on the scope of the term "Charitable" used in the definition of club or association service and the contents of the same are as under:

The issue is whether any club or association that enjoys exemption under the provisions of Income Tax Act on the ground of being a public charitable institution gets automatically excluded from levy of service tax under section 65(105)(zzze) read with section 65(25a) of the Finance Act, 1994.

Exemption under the Income Tax Act on the ground of being a public charitable institution is of no consequence to levy of service tax. Levy of service tax is entirely governed by the provisions contained in the Finance Act, 1994 and the rules made thereunder.

The definition of "charity" and "charitable" as defined in Black's Law Dictionary may be kept in mind. "Charity" is defined as "aid given to the poor, the suffering or the general community for religious, educational, economic, public safety, or medical purposes", and "charitable" as "dedicated to a general public purpose, usually for the benefit of needy people who cannot pay for the benefits received".

The officer concerned should examine the matter on a case-by-case basis, and the decision should be made after taking into account all material facts and statutory provisions.

APEX COURT STAYS SAT ORDER IN DLF CASE

The Supreme Court (the Apex Court) has stayed a Securities Appellate Tribunal (SAT) order, passed in May 2006, granting relief to the promoters of Bhoruka Financial Services (BFSL) in the sale of shares to DLF group company DLF Commercial Developers. This order has given a boost to the Securities and Exchange Board of India (SEBI), which is investigating alleged irregularities in the sale.

DLF Commercial Developers (DLF) had entered into a share purchase agreement with the promoters of BFSL in July 2005 to buy out their 98.73% stake. The remaining 1.27% stake representing 2,550 shares were held by 26 public shareholders. DLF had filed an application with SEBI seeking an exemption from making an open offer to the public shareholders, which was granted. BFSL shares were listed on the Bangalore Stock Exchange. However, DLF purchased the shares from the promoters of BFSL through transactions on the Magadh SE.

In an ex-parte interim order passed on August 19, 2005, SEBI barred DLF from dealing in the scrip of BFSL. The promoters of BFSL were directed to deposit the proceeds of the sale in an escrow account with a nationalised bank. The SEBI order said that "DLF acquired 98.73% of the shares of BFSL from the promoters by executing the transactions not on Bangalore Stock Exchange, on which the shares were listed, but on Magadh Stock Exchange (MSEA), where the shares were not listed but were hurriedly allowed to be traded in permitted category using the services of a broker of MSEA." SEBI said the transactions were in violation of the by-laws of the exchange and, hence, termed them illegal. The SEBI order further noted that "The concatenation of events when seen together suggested deviousness in the whole set of transactions and led to the prima facie conclusion that the acquirer DLF and the sellers/promoters consciously and with pre-meditated design chose to execute the trades on MSEA, with a view to avoiding regulatory attention and scrutiny."

Source: Economic Times

APEX COURT RESERVES JUDGEMENT ON APPEAL AGAINST AAR RULING

The Supreme Court recently entertained a petition challenging an order by the Authority for Advance Rulings (AAR) to tax a foreign company operating in the country. This was the first such petition that the apex court admitted. The court, however, reserved its judgement on the petition by Japan's Ishibkawajima-Harima Heavy Industries, challenging the ruling of AAR.

In January 2001, Petronet LNG Ltd awarded the Japanese company, and five others, a \$65.2 million contract to set up a liquefied natural gas (LNG) facility in Dahej, Gujarat. In October 2004, AAR ruled that the amount received/receivable by the Japanese company from Petronet LNG for offshore services and supply of equipment & material was also liable to be taxed in India as it is connected to the company's permanent establishment in India. Before passing the order, AAR had examined the contract, the Income Tax Act as well as the India-Japan Double Taxation Avoidance treaty. The AAR said certain operations of the offshore supply were inextricably linked with its permanent establishment in India. This includes the signing of contract in India, which imposes liability on the Japanese company to procure equipment and machinery in India. The income accrued to the company was from offshore supply through business connection in India and therefore could be taxed, the AAR ruled.

On its part, the Japanese company contended that it was paying income tax on the income from onshore supply and onshore services. However, as regards to offshore supply of equipment and materials, the price of the equipment and the machinery was paid outside India and the property in the goods passed to Petronet on high seas. The company said, since the sale was completed outside

India, the profit arising to the applicant on the offshore supply of equipment and machinery would not be taxable in India.

In the apex court, the Government defended the AAR ruling, arguing that in case of composite turnkey contracts, like the present one, there was no question of artificially splitting it into “offshore” and “onshore” elements. The Government further contended that the location of the source of income from offshore elements within India gives sufficient nexus to tax the income from that source.

AAR : NON-RESIDENT EMPLOYER LIABLE TO PAY FBT EVEN IF ITS INCOME IS NOT CHARGEABLE TO INCOME TAX

The Authority for Advance Rulings (AAR) has ruled in the case of The Population Council Inc (PCI)., that a foreign employer is liable to pay Fringe Benefit Tax (FBT) in India even if no income-tax is payable on its total income computed in accordance with the provisions of the Income Tax Act (the Act).

PCI, a resident of USA, an international non-profit and non-governmental organization had a regional office and a country office in India. It carried on charitable, scientific and educational activities and it enjoyed tax exemption from Federal Income-tax. The expenses incurred by it in India which included fringe benefits provided to the employees were met by remittances from its head office in New York.

PCI contended that it was not liable to pay FBT under section 115WA of the Act since FBT could be levied only when an employer was chargeable to income-tax. It further contended that it was not chargeable to income-tax in India in view of Article 1(2) of the Double Tax Avoidance Agreement between India and USA (DTAA).

The Commissioner contended that as per section 2(17)(ii) of the Act, the status of PCI was that of a company incorporated by the laws of a country outside India and was therefore, a ‘company’ as given in article 3(f) of the DTAA. Article 1(2) of the DTAA could not be interpreted to mean that the other contracting state was also bound to grant tax exemption under its domestic laws to a tax exempted resident of a contracting state. The article, however, did not provide any exemption from FBT to an organization like PCI and the provisions thereof had no relevance to the question raised by PCI. PCI was an ‘employer’ for FBT under section 115WA(1) of the Act. PCI could claim exemption under sections 10(23C) or 12AA of the Act, however, it did not claim to have been notified or approved for the purpose of exemption under the said provisions. PCI had a Permanent Establishment in the form of its regional office in India. The Commissioner further relied on Circular No. 8 of 2005 dated 29 August 2005, where it was provided that foreign companies which had employees based in India were liable to pay FBT even if their income was exempt under the DTAA.

After considering the contentions of both the parties, the AAR ruled that PCI could not contend that since its total income could not be computed in accordance with the provisions of the Act, no FBT would be payable by it as an ‘employer’. Such an interpretation would be contrary, not only to the intention of the Parliament, but also to the plain language of the provision and the basic principles of interpretation. The AAR therefore held that PCI was liable to pay fringe benefit tax under section 115WA of Act even if no income-tax was payable in India.

AAR: WITHHOLDING TAX TO BE DEDUCTED WHILE MAKING PURCHASE OF SOFTWARE FROM A NON-RESIDENT COMPANY

In the case of Headstart Business Solutions Private Limited (‘HBSPL’), The Authority for Advance Rulings (AAR) has held that there exists a legal obligation on the part of HBSPL to withhold taxes whilst making payment for the software purchased from MRSC.

Facts of the case:

Microsoft Regional Sales Corporation, Singapore (‘MRSC’) is a non-resident company based in

Singapore had entered into a Solution Provider Agreement ('SPA') with HBSPL for supplying packaged business software solutions. The product is delivered in physical form through a compact disc accompanied by a software licence key, which is delivered electronically through e-mail over the internet. The software licence key that is purchased from MRSC always bears the name of the client to whom the software is to be delivered.

HBSPL, in its application before the AAR raised only one question as to whether there exists a legal obligation on the part of HBSPL to withhold taxes whilst making payment for the software purchased from MRSC.

Contentions of the parties:

HBSPL argued that the payments for software are taxable as royalty only if the software imported is accompanied by the copyrights enabling the importer to replicate it and relied on decisions of ITAT in case of Motorola Communications Inc., Ericsson Radio Systems AB, Nokia Networks OY. The company has also referred to the cases of Lucent Technologies and Samsung Electronics Company Ltd. in its submission. The company has further stated that its agreement with MRSC is without any copyrights and it grants only distribution rights. Therefore, the remittance made by the company to MRSC does not require withholding of taxes. The claim of the assessee does not appear to be correct. From a perusal of the agreement enclosed by the company, it is seen that it can make copies of the software purchased from MRSC by taking prior permission from MRSC {as per clause 4.9 of Solution Provider Agreement (SPA)} and further the company can customize the softwares for its clients according to their need. Thus, the MRSC appears to be providing technical know-how by providing licensed software and other assistance to the company. In view of this, the payments to be made to the MRSC will also include an element of royalty and, therefore, the tax will be deductible from such payments."

The jurisdictional Commissioner contended that as per the terms of the agreement entered into by HBSPL, it can make copies of the software purchased from MRSC by taking prior permission from MRSC and further the company can customize the softwares for its clients according to their need. Thus, the Commissioner contended that MRSC appears to be providing technical know-how by providing licensed software and other assistance to the company. In view of this, the payments to be made to the MRSC will also include an element of royalty and, therefore, the tax will be deductible from such payments."

HBSPL, during the hearing, contended that the SPA along with the Addendum clearly and unambiguously classifies the agreement to be in the nature of a purchase of software without any copyright associated with the purchase. As provided under Article 4.1 and 5 of the SPA, HBSPL has obtained only a right to provide licensed software directly to the customers, with no additional distributionship rights being granted. It further contended that the SPA expressly prohibits assignment of any of the intellectual rights vested with MRSC to be HBSPL under Article 5(a) and it does not give HBSPL any right to commercially exploit the product. It also pointed out that the Income Tax Appellate Tribunal (ITAT) has in several cases laid down that the buyer of software is liable to pay royalty only when the copyright is transferred to it. It further contended that the income arising in India to MRSC from the sale of software is business income and in the absence of any linkage to the PE of MRSC in India, the same cannot be brought to tax.

Ruling of the AAR :

The AAR held that the arguments advanced by HBSPL with regard to there being no royalty income or the statement that MRSC has no PE in India are beyond the scope of consideration and subject matter of this application. The question raised by HBSPL does not require it to examine the nature of the payment or to give a finding whether any element of income arises in India for the purposes of taxation under Income-tax Act, 1961. The question raised is only with regard to the liability to withhold taxes while payment is being made to a non-resident company (MRSC).

The AAR pointed out that the expression "any other sum chargeable under the provisions of this Act"

would mean a sum on which income-tax is leviable. In other words, the said sum is chargeable to tax and could be assessed to tax under the Act. The only consideration would be whether payment of the sum to the non-resident is chargeable to tax under the provisions of the Act. The sum may or may not be income or income hidden or otherwise embedded therein. The scheme of tax deduction at source applies not only to the amount paid which wholly bears "income" character but also to gross sums, the whole of which may not be income or profits of the recipient. The AAR approvingly quoted the judgement of the Supreme Court in the case of Transmission Corporation of A.P.Ltd. vs. Commissioner of Income-tax (239 ITR 587) that "The purpose of sub-section (1) of section 195 is to see that the sum which is chargeable under section 4 of the Act for levy and collection of income-tax, the payer should deduct income-tax thereon at the rates in force, if the amount is to be paid to a non-resident. The said provision is for tentative deduction of income-tax thereon subject to regular assessment and by the deduction of income-tax, the rights of the parties are not, in any manner, adversely affected. Further, the rights of the payee or recipient are fully safeguarded under sections 195(2), 195(3) and 197. The only thing which is required to be done by them is to file an application for determination by the Assessing officer that such sum would not be chargeable to tax in the case of the recipient, or for determination of the appropriate proportion of such sum so chargeable, or for grant of certificate authorizing the recipient to receive the amount without deduction of tax, or deduction of income-tax at any lower rates or no deduction. On such determination, tax at the appropriate rate could be deducted at the source. If no such application is filed, income-tax on such sum is to be deducted and it is the statutory obligation of the person responsible for paying such "sum" to deduct tax thereon before making payment. He has to discharge the obligation of tax deduction at source."

The AAR, following the principle laid down by the Hon'ble Supreme Court, held that the expression "any other sum chargeable under the provisions of this Act" in section 195(1) contemplates not only amounts, the whole of which is taxable without deduction, but also amounts of a mixed composition, a part of which only might turn out to be taxable income, as well as other disbursements which are of the nature of gross revenue receipts, are yet sums chargeable under the provisions of Act and come within the ambit of section 195(1) of the Act. Therefore, the AAR ruled that in view of the provisions of section 195(1) there exists a legal obligation on the part of HBSPL to withhold taxes whilst making payment for the software purchased from MRSC.

SERVICE TAX ON MOBILES ELIGIBLE FOR CENVAT CREDIT

The Mumbai Customs, Excise and Service Tax Appellate Tribunal (The Tribunal) has ruled that service tax paid on mobile phones is available as credit to eligible service providers of output service and manufacturers.

The Tribunal held that the term 'cellular phone' would include all kinds of phones which work on cellular technology. The revenue department has been insisting that the credit was applicable only on fixed line phone. Giving its judgement on a case between Indian Rayon and the commissioner of customs and excise, Bhavnagar, the tribunal made it clear that the department could not rely on the old Central Board of Excise and Customs circular of '03 to deny the credit of service tax. The Tribunal said the old circular was relevant under old service tax credit rules, 2002, which required the telephones to be installed in the business premises of the service provider. And, since there was no such stipulation in the new Cenvat credit rules, 2004, the department could not press the old circular into service. Also, the Tribunal pointed out that there was no provision anywhere in the rules disallowing the credit of service tax paid on mobile phones, which in any case was fast replacing fixed line phones in many establishments. It was held that the term 'cellular phone' would include all kinds of phones which would work on cellular technology.

The Tribunal pointed out that "Cenvat credit on mobile phones was never intended to be disallowed under the present Cenvat credit rules. It was under the service tax rules '02 that credit was allowed

only for fixed line connections. Therefore, clarification issued on the basis of services credit rules '02, that credit of services on the mobile phones will not be allowed as credit has no applicability.

Source: Economic Times

SEBI SLAPS PENALTY OF RS. 250 MILLION ON HOLCIM

The Securities and Exchange Board of India (SEBI) on Friday slapped a penalty of Rs. 250 million on Holcim (India) for violation of SEBI's open offer norms with respect to its indirect acquisition of a majority stake in Everest Industries (EIL). This is the highest penalty imposed by SEBI after the ministries of law and home and the Department of Company Affairs (DCA) empowered it in '01 to impose a maximum penalty of Rs. 250 million or three times the profit earned from any transaction in violation of capital market norms.

Holcim, in concert with Holderind Investments, Gujarat Ambuja Cement and Ambuja Cement India, had made an open offer to ACC shareholders in March '05. Holcim raised its stake in ACC to 34.71% from 13.82% through the open offer. Since ACC held 76.01% of EIL's equity, it was alleged that the acquisition of the ACC stake led to indirect acquisition of EIL shares. Holcim, however, did not make an open offer to EIL shareholders.

In its reply to an earlier SEBI show-cause notice on the issue, Holcim said that since 2003 it does not own any asset that used fibre cement in production, as use of asbestos fibres is prohibited in Switzerland since 1994 and in EU since 2005. Holcim did not want to manufacture products using asbestos fibre in India, though it is permitted here, as it wanted similarity of standards in all the markets it operated, it said. Holcim in its reply to SEBI also stated that it entered into an agreement with Accurate Finstock Pvt Ltd (AFPL) on January 20, 2005 whereby AFPL agreed to acquire 76.01% of EIL's equity from ACC, as and when Holcim acquires control of ACC. Accordingly, AFPL made a public announcement on January 24, 2005 to the shareholders of EIL in terms of Regulation 10 and 12 of SAST to acquire 20% of EIL equity at Rs 147 a share.

As ACC held 76.01% of EIL's equity, it was alleged by some of the minority shareholders that the acquisition of 34.71% shares of ACC, also led to indirect acquisition of EIL by the acquirers.

SEBI order pointed out that while SAT rulings that have downplayed the role of monetary penalty in cases where the acquirer subsequently made an open offer to the shareholder of the target company, since Holcim has not made any open offer to the shareholder of EIL, it does not qualify for this benefit also.

Source: Economic Times

SNAPSHOT OF GLOBAL MARKETS - AUGUST 2006

KEY STOCK MARKET INDICES

INDEX	OPENING (01/08/2006)	HIGHEST IN AUGUST 2006	LOWEST IN AUGUST 2006	CLOSING (31/08/2006)
BSE SENSEX	10737.50	11794.43	10646.65	11699.05
S&P CNX NIFTY	3128.20	3452.30	3113.60	3413.90
DOW JONES I.A.	11184.80	11452.95	10998.06	11381.15
NASDAQ COMPOSITE	2080.34	2193.34	2048.22	2183.75
FTSE 100	5928.30	5945.30	5752.60	5906.10
NIKKEI	15387.52	16226.59	15154.06	16140.76

PRICES OF KEY COMMODITIES (US\$)

COMMODITY	OPENING (01/08/2006)	HIGHEST IN AUGUST 2006	LOWEST IN AUGUST 2006	CLOSING (31/08/2006)
GOLD - SPOT (NY)	633.80	656.00	607.00	626.90
SILVER - SPOT (NY)	11.33	12.87	11.26	12.82
PLATINUM - SPOT(NY)	1222.00	1248.00	1203.00	1236.00
COPPER (COMEX)	3.585	3.732	3.290	3.469
ALUMINIUM (COMEX)	1.164	1.175	1.115	1.133
BRENT CRUDE (IPE)	75.11	78.45	68.82	70.25
NYMEX CRUDE OIL	75.95	78.80	68.65	70.26

KEY GLOBAL CURRENCY RATES AGAINST USD

CURRENCY	OPENING RATE (01/08/2006)	HIGHEST IN AUGUST 2006	LOWEST IN AUGUST 2006	CLOSING RATE (31/08/2006)
EURO/USD	1.276	1.294	1.269	1.283
GBP/USD	1.865	1.914	1.862	1.901
USD/JPY	114.52	117.39	113.98	116.94
USD/INR	46.62	46.68	46.22	46.52

MAJOR CURRENCIES AGAINST INR

CURRENCY	OPENING RATE (01/08/2006)	HIGHEST IN AUGUST 2006	LOWEST IN AUGUST 2006	CLOSING RATE (31/08/2006)
USD/INR	46.62	46.68	46.22	46.52
EURO/INR	59.49	60.01	59.26	59.69
GBP/INR	86.95	88.95	86.95	88.44
JPY/INR	40.71	40.76	39.66	39.79

INTEREST RATES

MI BOR

PERIOD	OPENING RATE (01/08/2006)	HIGHEST IN AUGUST 2006	LOWEST IN AUGUST 2006	CLOSING RATE (31/08/2006)
OVERNIGHT	6.10	6.12	6.09	6.10
14 DAY	6.39	6.40	6.28	6.36
1-MONTH	6.64	6.73	6.62	6.68
3-MONTH	7.24	7.26	7.13	7.21

LIBOR - USD

PERIOD	OPENING RATE (01/08/2006)	HIGHEST IN AUGUST 2006	LOWEST IN AUGUST 2006	CLOSING RATE (31/08/2006)
1-MONTH	5.39	5.42	5.32	5.33
3-MONTH	5.47	5.50	5.39	5.40
6-MONTH	5.51	5.55	5.43	5.43
12-MONTH	5.54	5.57	5.41	5.41

LIBOR - EURO

PERIOD	OPENING RATE (01/08/2006)	HIGHEST IN AUGUST 2006	LOWEST IN AUGUST 2006	CLOSING RATE (31/08/2006)
1-MONTH	3.04	3.11	3.04	3.10
3-MONTH	3.17	3.26	3.17	3.26
6-MONTH	3.34	3.45	3.34	3.45
12-MONTH	3.54	3.68	3.53	3.63

LIBOR - GBP

PERIOD	OPENING RATE (01/08/2006)	HIGHEST IN AUGUST 2006	LOWEST IN AUGUST 2006	CLOSING RATE (31/08/2006)
1-MONTH	4.70	4.91	4.70	4.92
3-MONTH	4.79	4.98	4.79	4.98
6-MONTH	4.88	5.09	4.88	5.09
12-MONTH	5.04	5.29	5.04	5.24

LIBOR - JPY

PERIOD	OPENING RATE (01/08/2006)	HIGHEST IN AUGUST 2006	LOWEST IN AUGUST 2006	CLOSING RATE (31/08/2006)
1-MONTH	0.36	0.37	0.36	0.36
3-MONTH	0.42	0.42	0.40	0.40
6-MONTH	0.49	0.50	0.45	0.45
12-MONTH	0.66	0.67	0.57	0.57

US T-BILL

PERIOD	OPENING RATE (01/08/2006)	HIGHEST IN AUGUST 2006	LOWEST IN AUGUST 2006	CLOSING RATE (31/08/2006)
	Discount/Yield	Discount/Yield	Discount/Yield	Discount/Yield
1-MONTH	5.11/5.20	5.11/5.20	5.03/5.12	5.03/5.12
3-MONTH	4.99/5.12	4.99/5.12	4.92/5.05	4.92/5.05
6-MONTH	4.98/5.18	5.04/5.24	4.92/5.11	4.92/5.11

KEY CENTRAL BANK RATES

	31/08/2006	1 MONTH PRIOR	3 MONTH PRIOR	6 MONTH PRIOR	1 YEAR PRIOR
US FEDERAL RESERVE FUNDS RATE	5.25	5.25	5.00	4.50	3.50
EUROPEAN CENTRAL BANK RATE	3.00	2.75	2.50	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

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

PRIME RATES

CURRENCY	RATE (31/08/2006)
USD	8.25
EURO	4.00
GBP	4.75
JPY	1.63
INR	10.25 to 10.75

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For your queries and further details contact :

Indiabizsolutions

A division of:

Weblines India Pvt. Limited

10-A, Hornby Building. 2nd Floor

D.N. Road. Fort. Mumbai - 400 001

India

Telephones: + 91 22 2207 1227, + 91 22 2564 3907

Tel/Fax : + 91 22 2564 3907

E-mail : com@indiabizsolutions.com

Website : www.indiabizsolutions.com

Branch Offices:

Bangalore Office - E-mail : bng@indiabizsolutions.com

Chennai Office - E-mail : chn@indiabizsolutions.com

Hyderabad Office - E-mail : hyd@indiabizsolutions.com

New Delhi Office - E-mail : del@indiabizsolutions.com