

Corporate Update – September 2011*

Content

	Page No.
TAX	
International Taxation	2
<u>Service Tax-</u>	
-Notification amending conditions for service tax exemption against R& D cess	3
-Circular clarifying the date of applicability of service tax liability on Import of services	3
- Note on decision of Delhi High Court (LB) in the case of Home Solutions on levy of service tax in relation to renting of immovable property	4
FOREIGN EXCHANGE MANAGEMENT ACT (FEMA)	
Amended Foreign Direct Investment (FDI) Policy	5
External Commercial Borrowing-Rationalization and Liberalization	5-7
COMPANY LAW	
No Stamp Duty is leviable in Delhi for increase in authorized share capital of a Company	7
IMPORTANT DATES TO REMEMBER	8

TAX**International Taxation****1. Liaison office set up to purchase goods in India held to be taxable:**

The Authority for Advance Rulings (AAR), in case of Columbia Sportswear Company (AAR No. 862/2009) has ruled that the liaison office whose activities included designing, quality control, identification of competent manufacturer, negotiation of competitive price, choosing the material to be used and ensuring that goods are manufactured by suppliers in India as per the policies of the buyers etc., did constitute "Permanent Establishment" ("P.E.") for the taxpayer in India.

It was held that the activities of the liaison office could not be said to be of 'preparatory' or 'auxiliary' in nature but constituted a 'fixed place of business'. It also held that exemption provided in Explanation 1(b) to Section 9(1)(i) of the Income-tax Act, 1961 ("the Act"), which states that no income shall be deemed to accrue or arise to the non-resident in India, through or from operations which are confined to the purchase of goods in India, for the purpose of exports, was not available.

2. Taxability of turnkey contracts:

The Delhi bench of the Tribunal, in case Samsung Heavy Industries Co. Ltd. (ITA No. 5237/Del/2010) has held that project office in India constituted 'fixed place P.E.' and that income derived in the execution of contract was taxable to the extent attributable to such PE.

3. The Authority for Advance Ruling (AAR):

Authority for Advance Ruling (AAR) in the case of LS Cables Limited, a Korean company which was engaged in execution of project involving offshore supply of equipments and materials including mandatory spares, involving transfer of title outside India and payment received outside India, held that no part of consideration for offshore supply was liable to tax in India, following the decision of Supreme Court in Ishikawajima-Harima Heavy Industries Ltd.

The scope of work of the applicant was covered under three contracts as under:

- (1) Offshore supply contract involving supply of equipment and materials including mandatory spares on CIF basis;
- (2) Onshore supply contract and;
- (3) Onshore service contract.

It was held that even if P.E. is involved in carrying some incidental activities such as clearance from the port and transportation, it cannot be said that P.E. is in connection with offshore supply.

Service Tax

Notification amending conditions for service tax exemption against R&D cess

Research and development cess is leviable on all payments made towards import of “technology” as per provisions of Research and Development Cess Act, 1986. Such import of technology may also be subject to service tax depending on nature of said technology.

Under earlier Notifications, the Govt. of India has exempted service tax liability on import of such technology, arising under the head “Consulting Engineer” to the extent of the amount paid as R&D Cess. Similar exemption is also available on service tax liability under the head “Intellectual Property Services” on such import.

The Govt. has now issued Notifications for regulating such exemptions. In terms of two Notifications - No.46/2011 and 47/2011 both dated 19th September 2011, exemption in relation to R&D Cess is to be allowed, subject to the following conditions:

1. R&D Cess is paid within 6 months from the date of invoice, or the date of credit in the books of accounts in case of associated enterprises.
2. R&D Cess is paid at the time or before the payment for the services.
3. Records of R&D cess are maintained for establishing the linkage between the invoice/ credit entry and R&D cess payment challan.

Circular clarifying the date of applicability of service tax liability on Import of services

Services provided by a person having place of business outside India and received by a person having a place of business in India, have been subject to service tax u/s 66A of Finance Act, 1994. Such charge is commonly known as reverse charge mechanism.

The service tax liability under reverse charge mechanism has remained a subject matter of dispute so far as its date of applicability is concerned. The same has also been subject to interpretation by various Tribunals and High Courts in India. The service tax department hitherto was taking a position, despite various High Court decisions including Indian National Ship Owners Association vs. Union of India (Bom), that liability under reverse charge is applicable for the period on or after 01.01.2005, in terms of notification issued by the Government of India in exercise of its power under sub-section (2) of section 68. The department has challenged the decision of high courts holding the levy w.e.f. 18.4.2006, the date on which section 66A was inserted, in the hon'ble Supreme Court of India.

The appeals filed by the department before the Hon'ble Supreme Court for defending the levy of service tax on such services w.e.f. 01.01.2005 have been dismissed recently and further review petition has also been dismissed by the Hon'ble Supreme Court in one of the cases.

In view of these developments, the CBEC has accepted the position that liability under reverse charge would arise w.e.f. 18/04/2006 (vide Circular No. 276/8/2009 CX dt. 26.9.2011) and accordingly has rescinded its earlier position of taxability w.e.f. 01/01/2005 as clarified under instruction F No.275/7/2010-CX-A dated 30/06/2010.

Note on decision of Delhi High Court (LB) in the case of Home Solutions on levy of service tax in relation to renting of immovable property

The validity of the levy of service tax on service provided in relation to renting of immovable property and the Notification No. 24/2007 dated 22.05.2007 and Circular dated 04.01.2008 were earlier challenged before a Division Bench of this High Court in Home Solution Retail India Ltd & Ors vs. UOI (the First Home Solutions case) wherein it was held that section 65(105)(zzzz) could not have brought in its ambit and sweep the renting out of immovable property for use in the course of furtherance of business or commerce to constitute a taxable service and thereby exigible to service tax and accordingly, the notification and circular were declared ultra vires.

After the judgment of the Division Bench in the First Home Solutions case, the provisions of sections 65(90a), 65 and 66 were amended by Finance Act, 2010 with retrospective effect. Now, these amendments and their Constitutional validity including applicability of these amendments retrospectively were challenged in subsequent writ petitions in Delhi High Court.

The issues raised in the writ petitions were referred to a Larger Bench of three judges of the Delhi High Court. After detailed hearings, the High Court has now ruled as under:

(a) The provisions, namely, section 65(105)(zzzz) and section 66 of the Finance Act, 1994 as amended by the Finance Act, 2010, are intra vires the Constitution of India.

(b) The decision rendered in the First Home Solutions case does not lay down the correct law as there is value addition when the premises is let out for use in the course of or furtherance of business or commerce and it has, accordingly been overruled.

(c) The challenge to the amendment giving it retrospective effect is unsustainable and, accordingly, the same stands repelled and the retrospective amendment is declared as constitutionally valid.

(d) On the question of penalty due to non-payment of tax, the High Court observed that it is open to the Government to examine whether any waiver or exemption can be granted.

Note: It may be noted that certain other High Courts such as the Bombay High Court and the Gujarat High Court have also upheld the validity of the said levy.

FEMA**Amended Foreign Direct Investment (FDI) Policy**

On September 30, 2011, the Department of Industrial Policy and Promotion (DIPP) updated its FDI policy and procedures and released its revised circular. The new policy is effective from October 1, 2011, and will be valid till 31st March, 2012.

Significant changes introduced in the new FDI policy are as follows:

- 1) The new policy imposes an additional condition on FDI in single-brand retail, saying that the foreign investor must also own the brand.
- 2) The new policy clarifies that, "Only equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares, with no in-built options of any type, would qualify as eligible instruments for FDI." Equity instruments issued/transferred to non-residents having in-built options or supported by options sold by third parties would lose their equity character and such instruments would have to comply with the extant External Commercial Borrowings (ECB) guidelines.
- 3) FDI in terrestrial Broadcasting/FM radio increased to 26 percent from 20 percent.
- 4) 100 percent FDI permitted in honey bee-keeping under controlled conditions in order to bring in international best practices to upgrade the product. Apiculture is an important agro-based industry and has the potential of bringing in high economic returns with comparatively low levels of investment. Being a decentralized activity, it does not bring pressure on land and can flourish as a household activity in villages.
- 5) The updated policy exempts construction for the education sector and old-age homes from the various conditions imposed on FDI in the construction development sector, such as minimum area, built-up area requirement, minimum capitalization requirement, and lock-in period.
- 6) The policy includes easier rules for conversion of imported capital goods and machinery and pre-operative expenses into equity instruments. Payments for pre-operative/incorporation expenses can now be made directly by the foreign investor to the company or through a bank account, opened by the foreign investor, as provided under the FEMA regulations.
- 7) Bio-technology, pharmaceuticals, and life sciences and research and development in these sectors to be covered under the "Industrial Parks" category where 100 percent FDI is allowed under the automatic route.

External Commercial Borrowing- Rationalization and Liberalization

Considering the specific needs of the infrastructure sector, the existing ECB policy has been reviewed by Reserve Bank of India in consultation with the Government of India. The ECB policy has further been rationalized and liberalized. The said amendments have been brought about by issuance of five recent circulars namely A.P. (DIR Series) Circular No. 25, 26, 27 dated 23rd Sep, 2011 and circular no. 28 and 29 dated 26th Sep, 2011.

India

September 2011

A gist of the recent amendments in the ECB policy as brought about by these circulars is given below-

1. As per extant guidelines, repayment of existing Rupee loans is not a permissible end-use for ECB. It has now been decided to allow Indian companies which are in the infrastructure sector, where "infrastructure" is as defined under the extant guidelines on External Commercial Borrowings (ECB), to utilise 25 per cent of the fresh ECB raised by the corporate towards refinancing of the Rupee loan/s availed by them from the domestic banking system, under the approval route, subject to certain conditions, as laid down in circular no. 25.
2. It has now been decided to allow Indian companies which are in the infrastructure sector, where "infrastructure" is as defined under the extant guidelines on External Commercial Borrowings (ECB), to import capital goods by availing of short term credit (including buyers' / suppliers' credit) in the nature of 'bridge finance', under the approval route, subject to certain conditions as laid down in circular no. 26.
3. Eligible borrowers in real sector-industrial sector-infrastructure sector can now avail of ECB up to USD 750 million or equivalent per financial year under the automatic route as against the present limit of USD 500 million or equivalent per financial year. Corporates in specified service sectors viz. hotel, hospital and software, can avail of ECB up to USD 200 million or equivalent during a financial year as against the present limit of USD 100 million or equivalent per financial year subject to the condition that the proceeds of the ECBs should not be used for acquisition of land.
4. 'All eligible borrowers' can avail of ECBs designated in INR from foreign equity holders under the automatic/ approval route, as the case may be, as per the extant ECB guidelines.
5. It has also been decided to consider Interest During Construction (IDC) as a permissible end-use for the Indian companies which are in the infrastructure sector, where "infrastructure" is defined in terms of the extant guidelines on External Commercial Borrowings (ECB) under the automatic/approval route, as the case may be, subject to the condition that the IDC is capitalized and is part of the project cost.
6. As per the extant ECB policy, a 'foreign equity holder' to be eligible as 'recognised lender' under the automatic route would require minimum holding of paid-up equity in the borrower company as set out below:
 - (i) for ECB up to USD 5 million – minimum paid-up equity of 25 per cent held directly by the lender, (ii) for ECB more than USD 5 million – minimum paid-up equity of 25 per cent held directly by the lender and debt-equity ratio not exceeding 4:1 (i.e. the proposed ECB does not exceeds four times the direct foreign equity holding).

To further rationalize the policy in this regard, the following clarifications have been issued:-

(i) Now onwards the term 'debt' in the debt-equity ratio will be replaced with 'ECB liability' and the ratio will be known as 'ECB liability'-equity ratio to make the term signify true position as other borrowings/debt are not considered in working out this ratio;

(ii) The paid-up capital contributed by the foreign equity holder is considered under the extant guidelines for the purpose of calculation of equity for ECBs of or beyond USD 5 million from direct foreign equity holders. Henceforth, besides the paid-up capital, free reserves (including the share premium received in foreign currency) as per the latest audited balance sheet shall be reckoned for the purpose of calculating the equity of the foreign equity holder.

(iii) For calculating the ECB liability, not only the proposed borrowing but also the outstanding ECB from the same foreign equity holder lender should be reckoned.

All other aspects of the ECB policy such as eligible borrower, recognised lender, all-in-cost, average maturity period, prepayment, refinancing of existing ECB and reporting arrangements shall remain unchanged.

India

September 2011

Copies of circulars are being attached herewith.



APD2230911FC.pdf



APD26092011.pdf



APR230911EC.pdf



APD28260911EC.pdf



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COMPANY LAW

No Stamp Duty is leviable in Delhi for increase in authorized share capital of a Company

In pursuance of the decision made by Hon'ble High Court of Delhi in the matter of S. E. Investments Limited Vs Union of India and Others [W.P. (C) 2393/2010 and CM Appl.4794/2010], stating that there is no provision in the Delhi Stamp Act for payment of stamp duty on "increased authorised capital", the payment of stamp duty for increase of authorised share capital payable with filing of eForm No.5, with respect to State of National Capital Territory of Delhi, is now made optional. Accordingly Form 5 has also been revised. The new Form 5 is enclosed herewith.

It may be noted that the share position does NOT hold good for other States. In each State, the applicable stamp duty schedule has to be looked into to establish whether the said stamp duty is payable in that State.



1032-Form5.PDF

Important Dates To Remember

	Last Date
Deposit of TDS for the month of October, 2011	7th November, 2011
Deposit of Service Tax for Companies for the month of October, 2011 -by e-payment	5th November, 2011 6th November, 2011

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