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A Monthly Journal of
The Chamber of Tax Consultants

THE CHAMBER'S JOURNAL

JANUARY 2013

Vol. I | No. 4

Your Monthly Companion on Tax & Allied Subjects

TRANSFORMING INFORMATION INTO KNOWLEDGE

NBFC

NBFCs are an integral part of the Indian financial system, enhancing competition and diversification in the financial sector, spreading risks specifically at times of financial distress and have been increasingly recognised as complementary of banking system at competitive prices. The Banking sector has always been highly regulated, however simplified sanction procedures, flexibility and timeliness in meeting the credit needs and low cost operations resulted in the NBFCs getting an edge over banks in providing funding.

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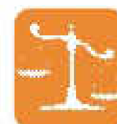
International Taxation

Indirect Taxes

Corporate Laws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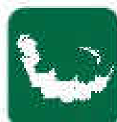
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Economy & Finance

Your Questions & Our Answers

The Chamber News

THE CHAMBER OF TAX CONSULTANTS

CMYK

INTERNATIONAL TAXATION COMMITTEE

4th International Tax Conference held on 21st & 22nd December, 2012 at Hotel J W Marriott, Juhu.

CA Manoj Shah, President welcoming the delegates. Seen from L to R : S/Shri CA Ganesh Rajgopalan, CA Yatin Desai, Vice President, CA T. P. Ostwal, Faculty, CA Hinesh Doshi, Chairman, CA Rutvik Sanghvi, Convenor.

CA Hinesh Doshi, Chairman welcoming the delegates. Seen from L to R : CA Ganesh Rajgopalan, CA Yatin Desai, Vice President, CA Manoj Shah, President, CA T. P. Ostwal, Faculty and CA Rutvik Sanghvi, Convenor.

CA Manoj Shah, President inaugurating conference by lighting the lamp. Seen from L to R : S/Shri CA Ganesh Rajgopalan, Devendra Mehta, Convenor, CA Paresh P. Shah, Vice Chairman, CA Yatin Desai, Vice President, CA Hinesh Doshi, Chairman.

Shri Sohrab E. Dastur, Senior Advocate releasing 3rd Edition of International Taxation Compendium. Seen from L to R : S/Shri CA Manoj Shah, President.

Shri Sohrab E. Dastur, Senior Advocate and Past President was felicitated by Shri Y. P. Trivedi, Senior Advocate and Past President for completing 50 years excellence in service. Seen from L to R : CA Hinesh Doshi, Chairman, CA Manoj Shah, President, CA Yatin Desai, Vice President, CA Hitesh Shah, Hon. Jt. Secretary.

Shri Sohrab E. Dastur, Senior Advocate addressing the delegates on his Journey of 50 years in Profession. Seen from L to R: S/Shri CA Hinesh Doshi, Chairman, CA Manoj Shah, President, Shri Y. P. Trivedi, Senior Advocate and Past President, CA Yatin Desai, Vice President, CA Hitesh Shah, Hon. Jt. Secretary.

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Editorial

Wish you all a very Happy and Prosperous New Year. While this is the traditional and often used wish, keeping in view the current times, I guess, we need to add a few more wishes – of safety, security, stability and mental peace. The year 2012 had to undergo prolonged labour to give birth to the year 2013. The events which unfolded during the last weeks of the year 2012 were too painful; the mindless shooting down of very young children in their school by a psychopath in the US and the brutal rape and the subsequent death of a young woman in Delhi have left people worldwide numb and agitated.

The Delhi incident has triggered another much awaited public discourse about the need for change in the mindset of the society as a whole. Ever since the very public agitation against corruption had begun in the year 2011, we all found comfort in dumping the blame and hounding just one class of the society – the political class. Though totally unconnected, the Delhi rape, the agitations that followed and the subsequent death of the victim has awakened people to the issue of social responsibility of all the stakeholders of the society – the political class, police, men and women – society as a whole. Though the cry for social responsibility for maladies had been left feeble by the cacophony of the incredulous and inchoate jibes of politicians of all ilk and the boos from ordinary citizens, many could hear it as loud as a clarion call. Politicians, judiciary and police are certainly responsible for development and law and order of the society; but, if people as individuals and society as a whole, do not wish to contribute to both development and law and order, then surely, we are asking for dictatorship of the political class and Taliban kind of policing; blaming the tools for all ills is a mark of weakness. Rather, time has come for the society to rethink its basic values first and then realign its tools.

Though there are several levels where the rethink of basic values has to be effected, it should begin necessarily, at the basic unit of the society – each individual family and its household. We do teach our girls defences and restraint; time has come for every household and family to teach the girls' counterpart – boys, to be responsible towards himself and others – not to be brazen and be caught in the idea of being macho. Here it would be worthwhile to quote William Wordsworth –

> "Not in utopia – subterranean fields,
> Or some secreted islands, heaven knows where,
> But, in the very world, which is the world
> Of all of us, - the place where, in the end
> We find our happiness, or not at all."

The special story of this issue of Chamber's Journal is on Non-Banking Financial Companies. Senior professionals have contributed to this issue by commenting on important and relevant issues pertaining to NBFCs. I thank past President Shri Bhavesh Vora and my dear friend Shri Vipul Choksi for all the help and assistance provided to me. I thank all the contributors to this issue of Chamber's Journal for sparing their valuable time and energy.

K. GOPAL
Editor

From the President

Dear Reader,

Let me begin with wishing all the readers, A Very Happy and Prosperous New Year 2013.

The Chamber had an eventful December 2012. Two mega – Two Days' Conferences – One on Real Estate, other one on International Taxation. The Chamber also organised a Panel Discussion on Disclosure Patterns under Revised Schedule VI. Each of these well structured programmes was very well received by the participants.

Real Estate Conference, which is becoming regular annual feature in Chamber's calendar of activities, is improving in terms of selection of newer topics. This time we had a session on FSI which was addressed by an Architect. Session addressed by a professional though not from taxation or accounting background, generated good discussion.

4th International Tax Conference witnessed release of 3rd Edition of 'International Taxation – A Compendium' at the hands of Senior Advocate and Past President of the Chamber, Shri S.E. Dastur. It is authored by 190 tax professionals and is divided into four volumes. It is a treatise on International Taxation. Team Compendium's marathon efforts under the guidance of CA Tarunkumar Singhal and zealous involvement of CA Hinesh Doshi, Chairman of International Taxation Committee needs special mention. But for their patient approach, passion and commitment, the compendium would not have become reality.

The Conference also turned out to be an occasion to felicitate Shri S.E. Dastur on his completing more than 50 years in profession. His talk on – Journey of 50 years in profession – was a treat to listen. Legal luminary and accomplished person like him sharing his experience about profession and people whom he met on his way was really inspiring.

Panel discussion on Disclosure Patterns under Revised Schedule VI was another unique event with professionals from Industry and Accounting sharing their views on same platform. The discussion was chaired by CA M. M. Chitale, the President of the NACAS. Panellists & Chairman's presence surely led to intellect stimulating thought process.

The Chamber got a vibrant beginning to the year 2013 with successful event of First RRC on Service Tax which took place on 4th to 6th January at Silent Hill Resort, Manor. First RRC evoked encouraging response with participation crossing century mark at 106. The other good aspects were excellent faculties for discussion and presentation papers and very well articulated itinerary which truly provided time for recreation as well as fellowship even after

leaving adequate time for three discussion papers and two presentation papers. Another noteworthy feature was beautiful weather at the venue which added towards making this RRC an Edutainment event. Cool mornings, coupled with mist and thereafter participating in group discussion in gurukool environment on the banks of River Vaitarna under warmth of sun has left its memorable impact on all the delegates of RRC. I must compliment Chairman of Indirect Taxes Committee CA Ashit Shah, and his team for laying firm foundation for Service Tax RRC.

Interesting programmes are lined up in January, 2013. As the Companies Bill, 2012 is passed by Lok Sabha, the Chamber has taken proactive approach and has organised lecture meeting on 14th January, 2013. 25th January, Friday is a day reserved for Cricket Tournament titled as Chamber Premier League (CPL), 2013. CPL is meant to provide recreational opportunity to members and to bring out the sportsman that is lost behind the facade of tax professional – let's forget taxation and our AC office for a day and spend it with fellow Chamberites. It would surely be a fun-day.

The Companies Act, 1956 is proposed to be amended. Prime Law to regulate corporate form of business are in existence for more than a century if one considers the erstwhile Companies Act of 1913. Trade and commerce would not have grown if corporate form of business was not conceived. It's a beautiful concept of separating business ownership with business management. Be it Industrial inventions of 19th Century or Information Technology inventions of 20th Century, both these major inventions/revolutions would not have materialised and flourished if it was not supported by corporate form of business. With the passage of time and changes in Indian economy as well as taking into consideration global developments, any legislation undergoes change and so is the Companies Act. One of the glaring feature of changes proposed is Compulsion on Corporate Citizen to spend towards social causes viz., Corporate Social Responsibility- CSR. While philanthropy and charity still remains a matter of choice for an Individual, it is for the first time, compulsion is proposed to be introduced on certain class of Corporate. In a way, indirectly, the share holders who would be individuals would be contributing towards social causes, as profit available for appropriation would come down because of CSR spending. Object in my view, seems to be quite noble. It's good to observe that proposals give directions on activity that would qualify as CSR compliant. The legislature has rightly refrained from prescribing Institutions or Charitable Trusts that would stand eligible as CSR compliant. Though most of large corporate houses in India do spent on social causes, the compulsion may make such causes to get sincere attention. May be a good move to bridge gap between haves and have-nots when one feels that benefits of liberalised business environment of last two decades is short on inclusive growth.

Keep enjoying Real Winter.

With Warm Regards

(Manoj C. Shah)
President

The Chamber of Tax Consultants

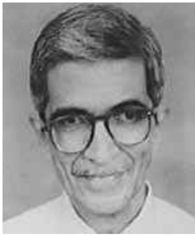
Vision Statement

The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre–eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.



V. H. Patil, *Advocate*

Ved and Vedanta

Bhagavad Gita

Before we deal with detailed analysis of Bhagavad Gita, Chapter wise, let us consider in brief the essence, and basic teachings of Bhagavad Gita.

The Bhagavad Gita, the "Song of the Lord", begins with the word Dharma and ends with the word mama. Together they mean `my dharma' or `my essential nature'. This phrase indicates the prime message of the Gita, that the ultimate purpose of life is to realise one's essential nature. To discover it within and become one with it. One's essential nature is the supreme Self within. It is God. The philosophy of the Gita guides one to the attainment of this supreme goal.

The Bhagavad Gita, the Upanishads and the Brahmasutras, together make up the Prasthanatraya, the traditional scriptural authority for the philosophy of Vedanta. The Gita's 701 verses comprise the philosophical kernel of the classic epic, the Mahabharata, which contains nearly one hundred thousand verses. A brief overview of the epic may aid in understanding the philosophy of the Gita. The Mahabharata is said to have been written by the sage Vyasa, known also as the codifier of the Vedas. The central narrative in this epic tells of the rivalry between two sets of cousins in a royal family, the Pandavas and Kauravas. The Pandavas were five brothers, moral and virtuous. The Kauravas were a hundred brothers, immoral and vicious.

Duryodhana, the eldest of the Kauravas, provoked by jealousy at the wealth and reknown of the Pandavas, continuously harassed them. He invited Yudhisthira, the eldest of the Pandavas, to a game of dice and won by cheating. As his prize, he stripped the Pandava princes of all their possessions. The settlement also included the stipulation that the five brothers, together with their wife, Draupadi, retire to the forest and live there in exile for twelve years. At the conclusion of that time they were to leave the forest and remain incognito for one year, undetected by the Kauravas. During these thirteen years Duryodhana would rule the Kingdom. If the Pandavas served this exile and remained undiscovered by the Kauravas in the thirteenth year, the kingdom would be restored to the Pandavas. The Pandavas accomplished their exile according to these terms and requested the return of their kingdom. Duryodhana then refused to abide by the settlement. The wise and elderly men of the land attempted unsuccessfully to negotiate in favour of the Pandavas. In the face of Duryodhana's adamance, both sides prepared for war.

Prince Arjuna, one of the Pandava brothers and Duryodhana both approached Lord Krishna simultaneously to join them as an ally. In response, Krsna offered to help both factions. One side would have his powerful army, the other side would have only himself, unarmed. Arjuna chose

the unarmed Krsna, Duryodhana happily accepted Krsna's mighty army.

On the eve of battle, Prince Arjuna, one of the outstanding warriors of the time sat, poised for battle, in his chariot. By Arjuna's request, Krsna served as his charioteer. To inspect the opposing force Arjuna asked Krsna to drive the chariot between the two armies. There he saw his own guru, Dronacharya, his grandsire, Bhisma, and a host of his dear friends and relatives – all arrayed on the enemy lines. Strong emotions suddenly overwhelmed him. Lost in confusion and delusion, the great warrior could not fight. He laid down his bow and arrow and surrendered to Lord Krsna for guidance. At that moment of total helplessness, the Lord delivered the sermon of the Bhagavad Gita to Arjuna. The text of the Gita is the conversation between Krsna and Arjuna emanating from Arjuna's surrender to and further questioning of Krsna. The philosophy of the Gita revived and recharged the Pandava prince with a higher vision. Towards the end of the last chapter, Arjuna's delusion vanished. He then picked up his weapons, fought the war and emerged victorious.

The story of the Mahabharatha itself has a philosophical significance. The Pandavas and he Kauravas represent the positive and the negative propensities within an individual. The Kauravas having larger forces than those of the Pandavas suggests that the negative thoughts and urges in a human being generally outnumber the positive. The civil war fought between the Pandavas and the Kauravas symbolises the conflict between the positive and the negative forces in a person. A perpetual war is being fought between the higher and lower natures within every human being.

The goal of human existence is realisation of Atman, the supreme Self within. You realise Atman when you rise above your involvement with the good and the bad forces of the world. Goodness and badness are the result of either virtuous or vicious desire-ridden actions. When you perform actions without egocentric desires motivating you, your mind will be free from the influence of the good and the bad. Such a neutral state of mind is most conducive for gaining knowledge of the Self within. Thus, Arjuna receives the sermon of the Gita while poised in his chariot between the Pandava and the Kaurava armies, between the good and the bad.

The chariot in which the Gita was given also has a significance. It is an allegory taken from the Kathopanisad. The chariot and the horses represent the human body and its sense organs. The reins stand for the mind and the charioteer for the intellect. The rider is the individual (jiva). If the charioteer falls asleep, the reins become loose and the horses go out of control. This results in the destruction of both chariot and rider. So too, when a person's intellect is not alert his mind loses control of the senses. This leads him to disaster. The chariot needs and individual who is in complete the chariot, the horses and reins – such a person alone can understand and derive the benefit of spiritual instruction.

The theme of the Bhagavad Gita is that an individual's friend and enemy both within him. They represent the higher spiritual aspirations and the lower sensual desires. You are advised to conquer your desires and regain your lost glory. Your glory is your essential nature. Your essential nature is the supreme Self within and not your body, your mind or your intellect. The true Self in all beings is God. The knowledge encapsule in the Gita helps you to unfold the Self. It takes you to Self-realisation which is God-realisation. You become one with God.

The eighteen Chapters of the Gita can be divided into three sets of six chapters each. These three sets actually represent and elaborate the divine aphorism of the Vedas – Tat tvam asi – That thou art. The first six chapters explain tvam (thou), the middle six, Tat (that), meaning God and the last six, asi (art), the oneness of you and God. The Gita thus leads one to the ultimate state of spiritual enlightenment. Moreover, it presents a magnificent philosophy of life which can be translated into practical living in one's social, official and domestic lives.

The eighteen chapters flow into one another to form a beautiful sequence of thought. The verses of each chapter have been grouped into different topics which indicate the development of thought. The division helps one to gain a total picture of the message in each chapter. Each chapter has an introduction which briefly summarises its topics. Thus, the topics and the chapters telescope into each other to provide a panoramic view of life and its underlying Reality.

Bhagavad Gita can be said to be encyclopaedia on the subject of spirituality. The Gita specifically deals broadly with Brahmavidya i.e. knowledge of God and Yoga Shastra i.e. the art and way of achieving the Union of Atma with Paramatma. The essence of its teachings can be summarised as under:

The message of Bhagavad Gita to all humans is "Know Thyself". You must know your true self and live as per your true self. As such, the search of your true self, the realisation of true self and the fulfilment of your true self is the object and purpose of your life as a human being. What is your true self will be known through the practice of Gnana Yoga. Realising your true self could be achieved by practice of Karma Yoga and fulfilment of your true self is through Bhakti Yoga. As such, the object and purpose of one's living in this world is to find out and live according to ones true self. The truth is not what you believe to be. You believe that you are a separate human being and that you are living your own separate life. You believe that you are living through your body, senses and mind and, as such, living in a lower self by treating yourself as a separate self i.e. you imagine and live your own separate existence, with all your likes and dislikes, with all your desires and by all your emotions and passions, imagine to live a separate human existence, having your own separate identity. As against the others, one believes because of his ego that he is a person with separate existence of his own, with all the qualities of nature i.e. one is living as one's lower self, as a jeeva, but as per the Bhagavad Gita, what you believe as yourself, is not at all your self. It is only your imagination, your thinking and your understanding for the time being, but your real self is not this body but your real soul (the Atma). Your true self is that you are the soul (the atma) and as a true self, you are a part and parcel of all pervasive Divinity. You have no separate existence of your own and you take birth and live and ultimately go back as a part of one whole Divinity. There is one Supreme power known as Paramatma or Brahma and each one of us is a part of that Paramatma, the real Divinity and our true self with all the qualities of the true Divinity of Brahma or Paramatma. The Supreme self i.e. the Brahma is the cause of the Atma coming into this world in the form of jeeva and apparently though not in reality, living a separate existence by mingling with nature and by acquiring the qualities of nature one would apparently acquire a separate form as jeeva, apparently, having a separate existence. As a product of nature, jeeva has all the qualities known as Gunas which are three-fold, Tamas, Rajas and Satvik. As such, Atma taking the form of jeeva in this world, is a product of these qualities of nature and every human being is a mixture of these three qualities of nature. Depending upon the proportion in which these qualities are present in a human being, he is classified as a good or bad person. As long as one is a human being, may be in a different proportion has all these qualities. In reality, everything in this universe is a reflection of the Supreme Self and everything is of Him, because of Him and in Him. As Gita puts it, vasudevam id sarvam i.e. everything is the abode of Iswar, the Sakar Brahma. Therefore, the first thing that we have to know is that our true self is different from what we think of it to be. We are not the body. We are the Atma (soul). It is an illusion, if, we think that we are the body and that we have a separate existence of our own, when in reality we are not the body. In fact, we have no separate existence of our own and we are part and parcel of the universal whole, that is, of all pervasive, Supreme Divinity and as a part of Divinity, we have all the qualities of Divinity i.e. apart from the qualities that we have acquired by nature i.e. Gunas as a part of Divinity, we have all the three Divine qualities of Sat, Chit and Anand.

The Supreme Self has all the qualities of Sat Chit and Anand and your true self being a part of the Supreme Divinity, you have the Divine qualities of Sat, Chit and Anand. As such, Gnana Yoga teaches us that there exists one universal, all pervasive Divinity which is the cause of all the existence of universe and its movements. We are a part of that Supreme Self and that is our true existence and there is no separate existence, separate from the Supreme Self. We are nothing but a reflection of that Supreme Self. The Supreme Self is all pervasive and everything occurs and moves as per the Will of the Supreme Self. After knowing your true self and that you have no separate existence and you are a part and parcel of the Supreme Self and the Supreme Self is all Supreme and you are just a reflection of that Supreme Self and everything in this world is because of that Supreme Self, as such, one has to live as per one's true Self and that one is a part of that universal Supreme Self having no separate existence of your own and ultimately the goal and purpose of human existence is the ultimate unity with the Supreme Self. Therefore, Gnana Yoga makes us realise the true nature of Supreme Self and of our own true nature and of the object and the purpose of human existence.

However, mere knowledge would not be equal to achievement of the ultimate goal of life. One has to live as per ones true Self. Now, how to live, how to act and how to work according to one's true self is the subject matter of Karma Yoga. Mere knowledge is not sufficient, one has to act according to that knowledge, to realise the ultimate goal of one's existence. As such, how to live according to one's true self, how one should work in this world according to one's real self is the subject matter of the teachings of Karma Yoga.

Now, according to Karma Yoga, the nature of a human being as such is that one cannot do without doing any work. Work is a MUST. One cannot run away from the work. As such, as per Bhagavad Gita, one cannot abandon the work itself and take shelter in a forest, by abandoning the universe itself. According to Bhagavad Gita, it is highly impossible for anybody to live even one moment without doing one work or the other. To do work is a part of one's nature as a human being. As such, Bhagavad Gita ordains that one has to do his work and one cannot run away from his work. If one has to do work which is a MUST according to Bhagavad Gita, what work should one do, Bhagavad Gita does not specifically deal with it. It only teaches the art of doing work. It is not what you do, but how you do a particular work is relevant. One can do any work, but the work must be done as per the dictates of Bhagavad Gita. One has to do whatever work one has to do, without any attachment and without any expectation for the fruits of the work that one is doing. The twin requisites of doing Karma as per Karma Yoga are non attachment to the work and not expecting any fruit for that particular work. That in short is dealt by Bhagavad Gita in the famous Sloka 47 which says "Karmanyeva Adhikaraste Ma Phalesu Kadachana Ma Karma Phalaheturbhuh Matus Sangats Karmani meaning thereby, that it is not your right, but duty to do work and you have no right to expect any fruits for the work you are doing. Do not have any expectations for the fruits of your work and you should work and not refrain from doing work. As such, Bhagavad Gita ordains that one has to work but work as a duty. One has no right either in the work or the fruits for the work done. As such, the art of doing work as per Karma Yoga is that one has to do the work as a duty and while doing this work as a duty, should have no attachment to the work and no expectation of the results of such work. If these two characteristics are kept in mind while doing the work, what work you do is immaterial i.e. each and every work that you are doing must be qualified by non attachment to the work and non expectation for the results of the work. Work for works sake and not for the results of the work. Now, for the work you are doing, results will follow, whether you expect them or not and then what is to be done to the results of the work. As per Karma Yoga of Bhagavad Gita, the fruits of the work you are doing must be

surrendered by way of sacrifice to the Supreme Self. They should be offered to the Supreme Self. It is not just not expecting the fruits of the work, but positively the fruits are to be surrendered at the feet of the God. As such, to start with, one has to do selfless work by way of service, without any attachment to that work and not only not expecting the results of such work but the fruits of such work, one has to offer at the feet of the God. Thus non attached selfless service without expectation of fruits and offer of the fruits to the Supreme Self is the essence of art of doing Karma as per Karma Yoga.

Bhagavad Gita does deal with certain consequences that would follow, the doing of a work, and normally a work done by a person will lead him to more and more bondage. To this universal rule that doing work will lead him to further bondage, Bhagavad Gita puts a very important exception to this Karma theory that any work done for Yagna purposes will not only not lead to bondage, but it will aid one to achieve the real goal of one's life i.e. to ultimately attain the union with the Supreme Self. Therefore, according to Bhagavad Gita, any work done in the spirit of Yagna, will not lead to bondage, but it will help one self to get away from the bondage. According to Bhagavad Gita, this institution of Yagna was born with the birth of human being and therefore, every human being is born with this quality of doing work in Yagna spirit, the doing of selfless service and of sacrifice. In any work done in the form of Yagna, one has to sacrifice the fruits and surrender these fruits at the feet of the Supreme Self. As such, any work done selflessly without attachment and with the spirit of surrendering these fruits to the Almighty is a work done in the spirit of Yagna.

As one progresses in the path of Karma Yoga, he would realise that what work one is doing is not, at his own instance, but the instance, at the command and as per the wishes of the Supreme Self. As such, whatever one is doing, one is doing as an agent of the Supreme Self. Here, one realises that all human beings including his own Self are doing work at the instance of the Supreme Self and, as such, all the work is to be done for the Supreme Self and the same is to be offered to the Supreme Self. As such, not only the fruits, but the work itself is to be offered to the Supreme Self. To start with, one has to begin with offering the fruits and later on in the spirit of offering the fruits, one realises that one has to offer the work itself and, as such, one has to realise as a real Karma Yogi that the work itself is of the Supreme Self and one is doing only his work. As such, in the advanced stage of Karma Yoga one would be doing the work of, work for and work with the Divinity. While doing the work of the Divinity in the spirit of Yagna, one has to always remember God, and act under his guidance and inspiration. That is what Bhagavad Gita says "At all times, remember me and work." As such, not only the work has to be Divine, but also the work to be done is for the Divine. One has to surrender the work itself and do the work as ordained by the Supreme Self. Then, comes the third stage where one gives up the authorship of the work. At this developed stage of doing the work as per Karma Yoga, one would not be claiming even the authorship of doing the work. One realises that the real work is done not by the individual but the work itself is done by the Supreme Self. Thus, one becomes the instrument or a medium through which the Universal Self works. One ceases to have the claim to the authorship of the work i.e. one is not doing the work at all. One is being used by the Universal Self as an instrument and as a medium through which the Universal Self works. Then, as per Karma Yoga, one has to realise that one is not doing anything and that one cannot do anything without the Universal Self, but in the real sense one has become only an instrument in the hands of the Supreme Self. First one has to surrender the fruits of the work and then the work itself and lastly to surrender the authorship of the work itself, is the sum and substance of living as per Karma Yoga dictates, i.e. in short, one has to live without any attachment to the work one has to do and do the work as a duty in the spirit of sacrifice – one has to not only

refrain from expecting any fruits, but surrender the fruits of the work to the Universal Self and then give away the authorship of the work itself, realising that one is nothing but an instrument in the hands of the Lord, and therefore, one surrenders the authorship of the work to the Divine Self and he ceases to do any work and just becoming an instrument in the hands of the Lord for the work to be done by Him. Then onwards, it is the Divine Self which works through him and he will cease do to any work by becoming an instrument in the hands of the Supreme Self. At the end of the Karma Yoga when it reaches its zenith, it results in one's sacrificing one's self and one surrendering one's separate existence. At the end, one sacrifices oneself to God. The sacrifice of the self `Ahankar' is the ultimate sacrifice that one has to make while following Karma Yoga and with such supreme sacrifice of one's self, one would achieve the goal of self, merging with the Universal Self, the Supreme Self. At that stage, one ceases to have any mind, one ceases to have any thoughts and one ceases to have any feelings and desires. In fact, one ceases to have any separate existence of one's own. One is perfectly united with the Universal Self and the original self being part of the Universal Self, such perfect union is the object and purpose of human existence.

With Gnana Yoga and Karma Yoga there must be a Yoga of devotion - Bhakti Yoga, Gnana Yoga teaches us the art of knowing oneself. Karma Yoga teaches us the art of living, but the ultimate crowning glory is the art of loving, the subject matter of Bhakti Yoga. As we have seen, there are three qualities of Universal Supreme Self. One acquires the quality of `Sat' by Gnana Yoga and the qualities of Chit by Karma Yoga and the last quality of Anand by Bhakti Yoga, the true fulfilment of one's existence can be acquired only by Bhakti Yoga. The art of loving and the art of devotion to the Almighty will make the art of living and the art of doing work more fruitful and comparatively easier and enjoyable. To put it in a different way, by Gnana Yoga, one would acquire the quality of Divinity in respect of one's intellect and one's thinking. By Karma Yoga, one would divinise one's senses, one's mind and one's work, but in addition to intellect, i.e., mind and senses there is a third aspect of the human being i.e. feeling which is governed by the heart. With intellect and senses, one has also to divinise one's heart. As such, divinising one's heart is a part and parcel of the total divinising of one's self before one achieves one's object in life of ultimate union with the Divinity. Divinising one's heart, is the subject matter of Bhakti Yoga, the way of devotion which is the total devotion to the Supreme Self through the art of total unqualified love and devotion to the Universal Self. With Bhakti Yoga, Karma Yoga becomes not only very fruitful but very enjoyable, also Bhakti Yoga not only makes the following of Karma Yoga easier, but it makes it more purposeful and more enjoyable and more fruitful. In Bhakti Yoga, in the total devotion to the creator one always remembers and does everything for God in the spirit of love. A real Bhakta cannot live a single moment without his devotion to God. The total selfless love towards the Universal Self is the crowning glory of the human existence and it is a crown of Gnana and Karma. As such, the total divinising of oneself and living in one's true self is possible only if one adopts all the three yogas, Gnana, Karma and Bhakti to divinise oneself completely in all aspects and living totally in the spirit of Divinity and to achieve ultimate goal of complete union with the Universal Self. A stage will come when one has to go beyond oneself and beyond one's nature beyond gunas. Even one would abandon the satvik qualities i.e. Divine qualities. That is what Lord Krishna ordained when he says (Sarva Dharman Parityajya Mam Ekan Sharanam Vraja) i.e. abandon all your nature, even your good works, good living and take complete shelter in me i.e. the total surrender of oneself to God is the ultimate message of Bhagavad Gita to achieve the perfect union with God.

It may be noted that Bhagavad Gita starts with the word "Dharma." The first verse starts with Dharma Kshetre and the Bhagavad Gita ends with the word "Mama". in essence Bhagavad Gita teaches what is Dharma of Mine. Mama

Dharma means my Dharma i.e. what is right to me. It deals with Brahma Vidya, the knowledge of Brahma and Yoga Shastra, the science and art of uniting with God. The art of living the art and science of human existence in essence is the subject matter of Bhagavad Gita. Therefore, the message of Bhagavad Gita is "Know Thyself. Know your own true nature and come out of your false impression that you have a separate existence of your own. Realise that you are a part and parcel of the Universal Self . You are not jeeva but you are atma and as atma you are a part and parcel of the Universal Self which is all pervasive and all powerful and everything in the universe is a reflection of the universal Supreme Self and your whole existence is a part and parcel of the Universal Self and after realising one's true nature, the object and purpose of your existence one should live to one's true self doing Karma, as per your true self and offer one's total devotion to the Universal Self and ultimately offer your everything including yourself at the altar of the Supreme Self and – achieve the ultimate purpose of your existence i.e. union with the Supreme Self.

Relevant of Bhagavad Gita's teachings

If we go through the background of Bhagavad Gita, it was delivered when there was total crisis in the society in all facets of political, social and religious fields. Religion itself was misused. Even the institution of Yagna was used for selfish purposes. All actions, forgetting the original teachings of Vedanta were self-oriented and when there was suppression and oppression in all walks of life – and at that stage to bring a total silent revolution in all walks of life, Bhagavad Gita was born. In addition to the spiritual need it, serves socio political needs of human society. Now, coming to the present times, if one considers the total chaos and total anarchy and all round crisis in the human society in all walks of life, one would realise that Bhagavad Gita's teachings are not only relevant, but they are more than relevant in today's atmosphere. The crisis faced by the society today is hundred times more serious than one which was faced by the society when Bhagavad Gita was delivered. In short, today the human being has ceased to be a human being. He has become worse than animal. In fact, as I always say, today to compare a human being with an animal, would be a great insult to the animal. Undoubtedly, in the present day, the human being is more intelligent, more capable, more daring and more active and capable of achieving anything. In fact, by his sheer capacity, he has almost conquered the entire nature. Today, man has all sorts of comforts and luxuries, the whole science is at his feet, to make his life more comfortable and more luxurious, but man today is not at all happy with all the material comforts at his service; he is perhaps at his lowest ebb. Today's situation really establishes the theory propounded by the scriptures like the Bhagavad Gita, that happiness is internal and not external. Our forefathers, with little or no comforts and luxuries were certainly happier than what we are today with all the comforts. Tension rules everywhere. It is an age of tension. In human life there is tension everywhere. Everybody is seeking pleasures, possessions and power. Everything is price based and not value based. All things are measured in the terms of money, in the terms of price and unfortunately values in life are at terrible discount. Man has become terribly selfish. He cares only for himself and none else, not even for his near relatives. The motto and purpose of life, is to acquire more and more wealth, more and more power and position to have more individual pleasures. Life is nothing but for the so-called enjoyment. To have the three deadly P's, Pleasures, Profit and Power or Position is the aim and object of one's living. While trying to acquire these, we mercilessly suppress and exploit others. Acquisition of wealth at any cost is a rule, and the means of its acquisition have become irrelevant. To acquire more and more wealth has become the mantra of today. The whole world is fast rushing towards total disaster. Concern for others, concern for society or social service, have practically disappeared.

For such malady, symptoms of total absence of sense of duty, sense of selfless work, sense

of service and concern for others. The basic teachings of Bhagavad Gita is a real medicine. To do everything as a duty and duty is to be done in the spirit of sacrifice. You have no right but only obligation. Whatever you have to do, you have to do as a duty and not as a right – still less with a desire for fruits of such work. Life itself is duty based and not right based. The message of Bhagavad Gita could be used to solve most of the problems facing us. At this stage, I recollect an episode from the life of Mahatma Gandhi. When he was sent a copy of Charter of Human Rights proposed to be adopted, Mahatma Gandhi remarked "there is no need of universal human rights, but what is the need of today is universal charter of human duties. This is what you can expect from this great follower of Bhagavad Gita. Doing everything as a duty in the spirit of love, sacrifice and universal love, characterised the life of Mahatma Gandhi. Once, in a typical American style, a press reporter from USA asked Mahatma Gandhi a question as to what was the secret of his success that may be expressed briefly. Gandhiji as per the requirement of the reporter just uttered three words by quoting from the Upanishads renounce and enjoy. That is the sum and substance of the entire teachings of the Bhagavad Gita. In my opinion, the essence of Bhagavad Gita teachings regarding the art of living, is to do everything as a duty. You are here to serve. Life is for service and sacrifice and whatever you do, do it in the sprit of sacrifice. Give everything to the society by way of sacrifice. Nothing belongs to you. Live in this world with detachment, live the life of sacrifice and surrender. Bhagavad Gita teaches that we have to see ourselves in others and others in ourselves. This is one great and simple principle of one's living. It is the very basis of total harmony in society. If one considers that others are like oneself and oneself like others, what a great revolution it can bring. Instead of living for oneself, one should live for others. If I have a right to live, others also have equal right to live. The medicine prescribed by Bhagavad Gita is more relevant and more required in the present world which is rotting due to total selfishness, exploitation, suppression and inequality – if this medicine suggested by Bhagavad Gita is adopted i.e. one has to see oneself in others and others in oneself and, as such, one has to live a life of sacrifice and service, it will completely transform the society. As such, in my opinion, not only the teachings of Bhagavad Gita are relevant today, but they are most essential as they would solve all the problems facing the society today. Today, we require the real followers of Bhagavad Gita, to have great individuals like Mahatma Gandhi, Maharshi Arabindo, Swami Vivekananda, Gautam Buddha and Vinobha Bhave who, in every sense, lived as per the teachings of Bhagavad Gita and who were real Karma Yogis. We require more and more Karma Yogis of this model to save the present society from the crisis which it is facing today.

As far as we ourselves individually are concerned, if we follow Bhagavad Gita way of life, we may not achieve the great heights of these great souls like Gandhiji but if we can make true efforts to imbibe the teachings of Bhagavad Gita, we may make our lives worth living. Let us try to live in the spirit of selfless sacrifice for the benefit of the society and of our own. If one has to really live a life of fulfilment, one has to follow the teachings of Bhagavad Gita to live a life of selfless service and sacrifice coupled with universal love.

Let us live at the higher Divine level. Let our actions, thoughts, words and feelings, be divine, full of love, compassion, service and sacrifice. Let us be governed by the spirit of universal love, selfless service and let us sacrifice. Let our lives not be governed by the three P's, Pleasure, Power and Profit. Let it be governed by three S's Sharing, Service and Sacrifice.

CA Sanjita Asnani

Types and Nature of NBFCs

Significance of NBFCs in India

NBFCs have come to be regarded as important financial intermediaries particularly for the small-scale and retail sectors with the growing importance assigned to financial inclusion.

In the multi-tier financial system of India, importance of NBFCs in the Indian financial system is much discussed by various committees appointed by RBI in the past and RBI has been modifying its regulatory and supervising policies from time to time to keep pace with the changes in the system.

NBFCs are an integral part of the Indian financial system, enhancing competition and diversification in the financial sector, spreading risks specifically at times of financial distress and have been increasingly recognised as complementary of banking system at competitive prices. The Banking sector has always been highly regulated, however simplified sanction procedures, flexibility and timeliness in meeting the credit needs and low cost operations resulted in the NBFCs getting an edge over banks in providing funding.

NBFCs have been pioneering at retail asset backed lending, lending against securities, microfinance, etc. and have been extending credit to retail customers in under-served areas and to unbanked customers.

Meaning and types of NBFCs

Section 45-I of the Reserve Bank of India Act, 1934 defines ''non-banking financial company'' as–

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

Hence, an NBFC may be defined as a company registered under the Companies Act, 1956 and also registered under the provisions of section 45-IA of the Reserve Bank of India Act, 1934 and which provides banking services without meeting the legal definition of bank such as holding a banking licence.

NBFCs are basically engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agricultural activity or any industrial activity or sale, purchase or construction of immovable property.

NBFCs vs. Conventional Banks

- It is not a part of payment and settlement system which is precisely the reason why it cannot issue cheques to its customers.
- Deposit insurance facility of DICGC is not available for NBFC depositors unlike in case of banks.
- SARFAESI Act provisions have not currently been extended to NBFCs. Besides the above, NBFCs pretty much do everything that banks do.

Classification of NBFCs based on the nature of its business

The NBFCs that are registered with RBI are basically divided into four categories depending upon its nature of business:

- hire-purchase company;
- equipment leasing company;
- loan company;
- investment company;
- infrastructure finance company

Reclassification of NBFCs w.e.f. 6th December, 2006

In terms of the NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 1988 with effect from December 6, 2006 the above NBFCs registered with

RBI have been reclassified as:

Loan Company (LC)

Loan company means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

Investment Company (IC)

Investment Company is a company which is a financial institution carrying on as its principal business the acquisition of securities.

Investment Companies are further divided into following sub-categories:

Core Investment Companies:

The Reserve Bank of India *vide* its Notification No. DNBS(PD)CC.No. 197/03.10.001/2010-11 dated August 12, 2010, a new class of NBFCs by the name of 'Core Investment Companies' (CIC) was added.

Core Investment Companies in terms of RBI's Notification means

A non-banking financial company carrying on the business of acquisition of shares and securities and which satisfies the following conditions as on the date of the last audited balance sheet:-

(i) it holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;

(ii) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its net assets

Net assets, for the purpose of this proviso, would mean total assets excluding –

- cash and bank balances;
- investment in money market instruments and money market mutual funds
- advance payments of taxes; and
- deferred tax payment.

(iii) it does not trade in shares, bonds, debentures, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;

(iv) it does not carry on any other financial activity referred to in section 45-I(c) and 45-I(f) of the Reserve Bank of India Act, 1934 except:

a) investment in

   i. bank deposits,

   ii. money market instruments, including money market mutual funds,

   iii. government securities, and

   iv. bonds or debentures issued by group companies;

b) granting of loans to group companies; and

c) issuing guarantees on behalf of group companies.

Asset Finance Company (AFC)

AFC would be defined as any company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines. Financing of physical assets may be by way of loans, lease or hire purchase transactions.

Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively.

Mutual Benefit Financial Company (MBFC)

Mutual Benefit Financial Company means a company which is a financial institution notified by the Central Government under section 620A of the Companies Act, 1956.

The above-mentioned types of NBFCs may be further classified into:

- NBFCs accepting public deposit (NBFCs-D) and
- NBFCs not accepting/holding public deposit (NBFCs-ND).

Operating leasing entities

Operating leasing companies do not come under the RBI definition of NBFCs since operating lease is not "equipment leasing" business as defined by the RBI. Only financial leasing is included in the RBI definition.

Further classification of NBFCs-ND based on the size of its Asset

NBFCs-ND may also be classified into (i) Systematic Investment and (ii) Non-Systematic Investment NBFCs based on the size of its asset.

NBFCs are typically into funding of:

- Construction equipment
- Commercial vehicles and cars
- Gold loans
- Microfinance
- Consumer durables and two wheelers
- Loan against shares, etc.

List of major products offered by NBFCs in India:

- Funding of commercial vehicles
- Funding of infrastructure assets
- Retail financing
- Loan against shares
- Funding of plant and machinery

Small and Medium Enterprises Financing

- Financing of specialised equipment
- Operating leases of cars, etc .

Types of instrument generally executed:

- Loans
- Hire purchase
- Financial lease
- Operating lease

Collateral definition and due diligence

The loan is granted against pledge of securities to the NBFC. More and more NBFCs are offering this option now and also expanding the financial assets that can be used as for a LAS option.

NBFCs usually define securities that can be pledged against the loan. These securities are very liquid, from high quality companies, and highly valued securities. The amount depends on valuation of securities, margin allowed by the NBFC, and past credit history.

The amount of loan is about 50% to 70% of the value of the securities pledged with the NBFC. Hence, if your stock portfolio for these securities is ₹ 10 lakh, you can get a loan of ₹ 5 lakh to ₹ 7 lakh against the stock portfolio.

The advantage of loan against securities is that you will be charged interest only on the amount you withdraw from the account and for the span of time the fund is utilised. The other advantage is that you require no personal guarantor for loan against securities.

Future prospects of NBFC sector

Summary

NBFCs have been playing a very important role both from the macro economic perspective and the structure of the Indian financial system. NBFCs are the perfect or even better alternatives to the conventional Banks for meeting various financial requirements of a business enterprise. They offer quick and efficient services without making one to go through the complex rigmarole of conventional banking formalities.

However to survive and to constantly grow, NBFCs have to focus on their core strengths while improving on weaknesses. They will have to be very dynamic and constantly endeavour to search for new products and services in order to survive in this ever competitive financial market.

RBI has been reviewing the existing NBFC guidelines and has proposed certain changes in the guidelines which could prove to have a significant impact on the NBFC space.

CA Jayant M. Thakur

Regulations pertaining to Deposit taking NBFCs

The law and practice relating to Non Banking Financial Companies (NBFCs) has undergone an enormous change over the last couple of decades. From a relatively simple set of regulations governing lakhs of NBFCs, we now have an exceedingly complex set of regulations governing few thousands of companies. The lesser number of NBFCs has resulted in professionals like CAs, CSs, Tax Advisors, etc., often not keeping abreast with all the latest developments – and developments are frequent – in this field. It is, then, not uncommon that – except for large and active NBFCs - it is only after non-compliance/violation of the requirements that the NBFC and its advisors are confronted with the situation. The objective of this paper – which is in the context of a comprehensive issue of this Journal on various issues relating to NBFCs - is to give a current overview of the law relating to deposit accepting NBFCs as governed by the Reserve Bank of India. NBFCs of course are governed by many other laws too such as the Companies Act, 1956, that governs every company, some special laws that may apply to NBFCs such as law relating to money lending and special issues that NBFCs face under tax law. However, this paper focuses only on the law as governed by the Reserve Bank of India.

Further, such law also governs non-companies engaged in non-banking finance activity. There are also numerous types of companies that are engaged in non-banking finance type of activities such as mutual funds, venture capital companies, collective investment schemes, etc., many of which are not governed by RBI but by SEBI or other regulators. Similarly, even RBI governs several types of companies that are engaged in such finance business but are given another name or category. All of these raise monies in various forms though technically called deposits and they do carry on business in finance. However, to maintain focus, this article covers the three main types of deposit accepting NBFCs, viz., loan companies, investment companies and asset finance companies. A recent report on the status of the law relating to NBFCs and recommendations for the same is also highlighted here.

Background

The business of non-banking finance is essentially of acting as a financial intermediary, akin to banks but with important differences. An NBFC raises moneys from people who have savings and lend these monies to those who need funds, keeping a spread for themselves. Aggressive and even misleading techniques by such NBFCs over a period resulted in large losses to depositors of such NBFCs, causing loss of credibility in the market and pressure on the Government and RBI to do something. The result

was a fairly stringent set of norms – drastic in one sense but creating close scrutiny and supervision in another. These were introduced in 1997 by amendments to the Reserve Bank of India Act, 1934.

The important amendments brought forth were as under:-

1) Compulsory prior registration with the Reserve Bank of India for acting as NBFCs. All existing NBFCs also had to apply for registration to continue as such.

2) Minimum net owned funds – as defined – of ₹ 2 crores (increased gradually from original ₹ 25 lakhs which limit continues for certain old non-deposit accepting companies).

3) Detailed Directions for acceptance of Public Deposits, Prudential Norms and special reporting by auditors.

4) Several other miscellaneous directions, circulars and notifications and even press releases.

The above resulted in, on one hand elimination of perhaps lakhs of NBFCs, and, on the other hand, resulting in company by company review for registration and monitoring thereafter. These Regulations have been amended and clarified on by the Reserve Bank of India numerous times over the years. A separate category of directions introduced for a sub-category of investment companies, i.e., Core Investment Companies (CICs) have also been notified recently.

Important laws regulated by Reserve Bank of India for NBFCs

The following are the principal provisions that govern NBFCs:-

1) The Reserve Bank of India Act, 1934 ("the Act"), particularly Chapters IIIB, IIIC and V.

2) The Non Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 ("the Deposits Directions").

3) The Non Banking Financial (Deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

4) The Non Banking Financial (Non-deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

5) The Non Banking Financial Companies Auditors' Report (Reserve Bank) Directions, 2008.

Apart from above, there are numerous other Directions, notifications, circulars, press releases, etc. Further, like some other laws administered by Reserve Bank of India, this law too needs keeping updated with actual practices and policies that Reserve Bank of India follows as regards interpretation, procedures and other requirements.

Finality of views on laws and facts of Reserve Bank of India on some important aspects

There are certain peculiar provisions in the law relating to NBFCs. This point is particularly relevant since the law relating to NBFCs has become fairly complex and punishment for violation fairly stringent. Often, two preliminary important questions arise. Is a particular company an NBFC? If it is an NBFC, what category does it belong to? The Directions of Reserve Bank of India say that if either of this question is an issue, the view of the Reserve Bank of India will be final on this matter. And the view of the Reserve Bank of India is not appealable. Further, even there are issues relating to the law relating to Prudential Norms by deposit accepting NBFCs, the interpretation of the Reserve Bank of India will be final and binding on the NBFC.

Law relating to NBFCs says some important aspects like whether a Company is an NBFC or

not, what category to which belongs, etc. are to be decided at sole discretion of the RBI, and is final and binding and not appealable.

Definition of NBFC

For a Company to be eligible to accept deposits, it has to first qualify to be an NBFC, then register itself as such and then comply with the requirements for accepting deposits. Now, what, in simple terms, is an NBFC?

A fairly convoluted definition of what is a non-banking financial company has been laid down in Section 45-IA and related provisions of the Act. Simplified and taking into account certain clarifications, a NBFC is, firstly, a Company. Its principal business is of specified types of finance activities which for the purposes of this paper is investments, loans and asset finance (i.e., hire purchase or leasing). What constitutes "principal" business is not specifically defined but taking into account certain circulars of the Reserve Bank of India, it can be said that if at least 50% of the income and 50% of the assets relate to specified finance activities, the Company is an NBFC.

An important concept often overlooked is even if a company seeks to carry on NBFC business with its own funds, registration is a must. In other words, borrowing funds from outside sources is not a pre-condition for the requirement of registration. There are of course additional provisions for deposit accepting NBFCs.

Registration as an NBFC is mandatory even if no Public Deposits are sought to be accepted and own funds are used for investments, lending, etc.

Registration as an NBFC

A prior registration as an NBFC is a must for commencing the business of NBFC. This rule applies not just to new NBFCs but even existing companies seeking to change their nature of business into an NBFC. Often companies who close down their existing business by sale, etc., end up carry on business of finance. Such companies too need prior registration as an NBFC with Reserve Bank of India. For acceptance of deposits, there are further requirements.

Carrying on business of NBFC without registration

The Reserve Bank of India Act, 1934, provides very stringent punishment for carrying on business of NBFC without registration. This is one of those rare violations whose consequences is mandatory imprisonment and that too of a minimum period of one year and up to five years and with fine. And there are no provisions of compounding.

Non-registration as NBFC is punishable, on prosecution, by mandatory imprisonment and fine and is not compoundable.

Net Owned Funds

Except for certain old, non-deposit accepting companies, generally, the rule is that for registration as an NBFC, a minimum net owned funds of ₹ 2 crores is mandatory. The definition of NOF is stringent to ensure that funds are not recirculated within group companies to build up the minimum ₹ 2 crores required. The minimum size of companies also ensures that not many companies are eligible for registration. This also thus ensures that the RBI has lesser number of companies to scrutinise and supervise.

The calculation of NOF is as per a detailed formula. It is basically a two step process. First, the "owned funds" has to be calculated. The "net owned funds" is calculated by carrying out certain prescribed deductions from such "owned funds". These two terms are used for various different purposes including registration, as a base for calculating limits for deposits acceptance, etc.

Categories of NBFCs

While NBFCs – whether regulated by the Reserve Bank of India or otherwise – come in

various types and objectives, for the purposes of the present article, the three relevant categories are:-

1) Loan Companies.
2) Investment Companies
3) Asset Finance Companies

Deposits and Public Deposits

The terms Deposits and Public Deposits are the core definitions of the law relating to NBFCs. However, the term is vastly different from what is commonly understood. It is artificially and widely defined. Apart from the widely framed definitions, there are numerous exceptions. These two terms have so many issues/controversies that a detailed discussion would be the subject matter of a separate lengthy article.

To quickly summarise, a few points are relevant. To begin with raising of funds in almost any form is Deposits, which is defined in Section 45-I(bb) of the Act. However, there are specific exclusions in that clause. The term Public Deposits is defined in the Deposits Directions. This definition essentially makes some more specific exceptions to the broad definition of Deposits under the Act. The net result is that while any amount raised is Public Deposits to begin with, there are some exceptions to this. Share Capital is obviously not Public Deposits. Loans from Directors and their relatives are also not Public Deposits. Loans from shareholders by a private limited company are not Public Deposits. Loans from another company are also not Public Deposits. And so on.

Suffice is to say that Public Deposits do not, as often commonly misconstrued, include only deposits raised from the public by issue of a public advertisement.

Public Deposits do not, as often commonly misconstrued, include only deposits raised from the public by issue of a public advertisement.

Acceptance of Deposits Directions

Unlike a commonly prevailing misconception, and as stated earlier, acceptance of deposits is not a pre-requisite for registration. Registration is required as NBFC even if the finance activity is carried on with own funds. However, if an NBFC wants to accept pubic deposits, it further needs to comply with several more requirements contained in the NBFC Public Deposits Directions. The requirements relate to limits up to which such deposits can be accepted, the minimum credit rating required, the capital adequacy ratio, etc.

"Public Deposits" is defined very widely and includes borrowings from any source though there are specific exemptions. The term "public" is thus misleading and it includes borrowings even from "private" sources. Moreover, the term "deposits" is also misleading since this term has a certain meaning in law while public deposits for the present context includes any form of borrowings or deposits.

Having said that, there are very few companies in India who are eligible, as per regulatory requirements relating to NBFCs, to accept public deposits. The concern, however, is that many NBFCs end up accepting public deposits without realising that what they have accepted is public deposits. The consequences of accepting public deposits without complying with the regulatory requirements are quite serious.

The Deposits Directions provide for detailed provisions relating to acceptance of deposits some of which are discussed later herein.

Prudential Norms Directions

All NBFCs are required to follow certain Prudential Norms. Those who are exposed to banking regulation are quite familiar with this term and indeed the Prudential Norms are derived from the Prudential Norms prescribed by Reserve Bank of India to banks those of course they are diluted and adapted to the circumstances of an NBFC.

Prudential Norms – as one can imagine from the word "prudential" – are norms to provide an extra level of prudency in accounting, disclosure, etc. Prudence is even otherwise a basic accounting concept followed in accounting. However, where one is dealing with other people's money, the standards of prudence are raised higher. Thus, the Prudential Norms require an NBFC to be extra prudent in some areas and more than as required by Accounting Standards. For example, provision for bad debts is required up to specified minimum levels once they are overdue beyond a certain period. Loans/investments in a single entity or a group of entities are permitted only to specified extent. A minimum capital adequacy requirement has been placed which will thus prevent NBFCs from over trading and over leveraging. RBI has prescribed separate Prudential Norms for deposit accepting and non-deposit accepting NBFCs. However, since Prudential Norms is covered by a separate detailed article in this issue, more discussion is not made herein.

Directions relating to reporting by Auditors

One of the most widely framed reporting requirements by Auditors are contained in these Directions. Even at a glance, it can be seen that the Auditors are not only required to check whether each and every requirement prescribed by Reserve Bank of India are complied with by the NBFC but they go even much beyond.

The Auditors are required to check things such as whether the Company has applied for registration as NBFC or not, whether the conditions of registrations are complied with or not, whether the Company has accepted deposits without being eligible to do so, or if eligible, whether it has complied with the requirements relating to acceptance of deposits, etc. The reporting requirements are detailed and comprehensive. However, what is of interest is an additional all-encompassing requirement that refers to almost all the requirements of law relating to NBFCs. It requires the auditor to specify whether these are not complied with. Further, in case of non-compliance, the Auditors are also required to report to the Reserve Bank of India directly.

It is quite common to find that Auditors have qualified their audit reports to point out some non-compliance of certain Directions of RBI but failed to report the same to the RBI. In some other cases, the RBI finds on its own that the NBFC has not complied with certain requirements and the Auditors have not reported the same to it. Notices are issued in such cases not just to the NBFC but even to the Auditors.

The Auditors have to verify almost every statutory provision relating to NBFC including some fundamental questions – is the Company an NBFC? Is the NBFC no more an NBFC? Is the NBFC eligible to accept deposits? Has its classification changed or eligibility changed which will result in reduced ability to accept Public Deposits? They even have to certify whether the NBFC is in a position to meet the liabilities to depositors.

Interest on deposits

Ideally, the rate of interest on deposits should be determined by market forces. An NBFC should be left to decide what rate of interest it can afford. The deposits are usually unsecured. Each NBFC is in a different situation. The credit rating may be different. The credibility of management, the track record otherwise of the NBFC are further differences. A company in a stronger position may offer lower rate of interest while a company in a weaker position may offer higher rate. A maximum limit of interest may disable some companies in acceptance of deposits.

However, the Reserve Bank of India has laid down a maximum rate of interest on deposits at 12.50% per annum. Such interest can be compounded at monthly rests. This comes to approximately 13.24% per annum on an annualised basis.

Brokerage on deposits

The Reserve Bank of India has also laid down limits over brokerage that can be paid to brokers for sourcing deposits from their clients. Brokerage was often misused and reportedly even misused now by passing on a part of it to the depositors. If no limit is provided on brokerage, the NBFCs may misuse this to bypass the provisions relating to maximum interest to depositors.

Thus, a maximum rate of brokerage of 2% of the amount of deposits so collected has been laid down. This includes brokerage, commission, incentive, or benefit called by any other name.

Further, expenses may also be reimbursed to such brokers provided that they are duly supported by bills/vouchers and that such expense do not amount to more than 0.50% of the amount collected.

The brokerage and expense limits remain unchanged irrespective of the tenure of deposits.

Reporting requirements

There are various reporting requirement by deposit accepting NBFCs for deposits, liquid assets, etc. Further, certain disclosures also have to be made in the Directors' Report particularly on matters relating to unclaimed amounts of Public Deposits.

Advertisements/statements in lieu of advertisements for accepting Public Deposits

Depending on whether the Public Deposits are sought to be raised from the public by solicitation or privately, advertisement or statement in lieu of advertisement has to be issued/filed in prescribed manner containing the prescribed disclosures.

Credit rating

As a general rule (but for one exception for asset finance companies), a minimum investment grade credit rating from one of the designated credit rating agency is a pre-requisite for acceptance of Public Deposits.

Minimum period and maximum period of Public Deposits

Limits are provided over the maximum and minimum period for which Public Deposits can be accepted. To begin with, deposits cannot be accepted repayable on demand. Further, the minimum period for which deposits can be accepted is 12 months and the maximum period for which deposits can be accepted is 60 months.

Premature repayment is possible before the maturity period at the discretion of the NBFC but not earlier than 3 months from the date of deposit. However, if such premature repayment is after three months but before six months of the acceptance of the deposit then no interest shall be paid on such deposits. However, if the premature repayment is after such period of six months but before the maturity period, then the interest rate shall be 2% lower than the contracted rate.

Certain exceptions are provided for tiny deposits upto ₹ 10,000 as well as in case of death of the depositor.

Limits on deposits

Acting as intermediary for finance is the essence of an NBFC. Accepting deposits from outsiders who have savings and finding people to lend it to and keeping a spread in the process is how generally an NBFC operates. There is a risk of bad debts in the process and hence a cushion in the form of shareholders' funds is needed to absorb losses to some extent before the depositors suffer from such loss. From point of view of profitability of the NBFC, the higher the leverage ratio, the higher the profits to the shareholders since the spread on the amounts received and lent would go to them on the same amount of share capital. However, higher the

leverage, the higher would be the risk of the NBFC defaulting on depositors since the capacity to absorb losses reduces.

To ensure that NBFCs do not over leverage, limits have been provided on the extent to which NBFCs can accept deposits.

A fairly complex set of formula has been provided for this purpose and it would not be possible to go into great detail into this here. The limits on deposits and conditions thereon vary on account of several factors. One is the classification of the company – whether it is a loan/investment company or an asset finance company. Another is the net owned funds of the company since it is a multiple of this that the maximum amount of deposits that can be accepted has been laid down. The capital adequacy ratio under the Prudential Norms as prescribed is another factor. Yet another factor is the credit rating. Taking various combinations of the above, Public Deposits are allowed to be accepted generally as a multiple of the net owned funds.

Liquid Assets

NBFCs are required to maintain a certain portion of the deposits in the form of liquid assets in the prescribed form and invested in the prescribed form of assets. This also helps enable meeting of needs of repayment at maturity from time to time.

The amount of such liquid assets are 15% of its Public Deposits as at the end of the preceding quarter. These liquid assets are required to be maintained in approved securities. Further, they need to be unencumbered and also maintained in the prescribed manner.

If an NBFC violates the requirements of these provisions, there are certain penal and other consequences. The NBFC is required to pay penal interest on the shortfall in maintenance of the liquid assets. Further, a fine may also be levied on the NBFC.

Auditors responsibilities

The Auditors have several responsibilities with regard to acceptance of deposits by an NBFC.

Under Section 45MA(1) of the Act, they are required to inquire whether the NBFC has furnished to the Reserve Bank of India the statements, information, etc., as prescribed relating to deposits accepted by it. If such information, etc., has not been provided, the Auditors are required to make a report to the Reserve Bank of India giving the aggregate amount of deposits held by the NBFC.

Apart from the above specific requirement under the Act, the Directions to Auditors are even more detailed as to various aspects of deposits accepted by the NBFC. The responsibilities of reporting by the Auditors are quite comprehensive. For example, if deposits are accepted by the NBFC, the Auditors are required to inquire whether the NBFC is eligible. Further, they are to inquire whether the deposits are within the prescribed limits. Whether the liquid assets required to be maintained in respect of such deposits are duly maintained. And so on. Generally, the Auditors are required to check on compliance with prescribed Directions for every aspect of acceptance of deposits.

If there is any non-compliance, the Auditors are required to report such non-compliances to the Reserve Bank of India.

Non-compliance with any direction given or order made by the Reserve Bank of India under Section 45MA would result in a fine on the auditors upto ₹ 5,000. This is of course apart from the action that the Institute of Chartered Accountants of India may take against such auditor, in case of violation of the applicable Code of Conduct, etc.

Penal provisions for excessive acceptance, acceptance without registration, violation of Directions, etc.

There are serious penal consequences for violations of provisions relating to acceptance of deposits and related matters. Accepting deposits in contravention of the Reserve Bank of India Act generally, issuing any advertisement otherwise than in accordance with the prescribed provisions, etc., attract imprisonment upto three years and fine.

Merger/amalgamation etc., of deposit accepting NBFCs

In case of mergers/amalgamations of NBFCs or takeover of control of such NBFCs, concern arises about the existing depositors. Accordingly, Reserve Bank of India has laid down formal Directions providing for the compliances to be made in case of such mergers/ amalgamations/takeovers of NBFCs accepting Public Deposits.

These Directions apply where there is a takeover or acquisition of control of a deposit-taking NBFC or merger or amalgamation of such an NBFC with another entity or merger/ amalgamation of any other entity with a deposit taking NBFC.

In such cases, the deposit taking NBFC is required to take prior written approval of the Reserve Bank of India.

Recent report of expert Working Group recommending substantial amendments

The Reserve Bank of India had constituted a Working Group whose Chairperson was Ms. Usha B. Thorat, to study and report on changes in the regulatory framework relating to changes required. The Group gave their report dated 23rd August 2011. Very far reaching changes have been suggested. For a non-deposit accepting NBFC, registration is sought to be waived if the total assets are less than ₹ 50 crores. Further, if a NBFC is not accepting public funds in any form, whether by Public Deposits, inter corporate loans, bank loans, etc. an even higher limit of ₹ 1000 crores of total assets is proposed up to which the NBFC need not be registered. Another change proposed is that in case of all types of NBFCs, whether deposit taking or not, change of control in excess of 25% of the paid up capital of the company would require prior approval of the Reserve Bank of India.

Another important change suggested is the very definition of an NBFC. A Company would be an NBFC provided that at least 75% of its assets are financial assets and 75% of its income is sourced from financial assets. This would exclude several existing and new NBFCs, whether deposit accepting or not, from the whole legal framework relating to NBFCs. The limits on acceptance of deposits as a multiple of NOF is suggested to be reduced.

There are several other major and minor suggestions made. It will have to be seen when this report is implemented by the Parliament and/or the Reserve Bank of India and which of its recommendations are accepted.

Conclusion

The law relating to NBFCs is complex, gives a lot of discretion and powers to Reserve Bank of India and has serious consequences for violations. It covers even companies where the public interest may not be seriously affected. However, it is hoped that over a period of time, the entities to which this strict and complex set of laws apply become less and less.

CA Bhavesh Vora

Prudential Norms for Non-banking Financial (Non-Deposit Accepting or Holding) Companies

Background

Non-Banking Financial Companies (NBFCs), forms an integral part of Indian financial system, providing various financial services. In recent times, activities of NBFCs have undergone variety of changes through financial innovation. NBFC initially gets incorporated under Indian Companies Act, 1956 and later on obtains Certificate of Incorporation from RBI. As compared to Banks, replace with such companies have greater flexibility and can undertake higher risks and tailor make the services to suit the requirements of clients. At present, NBFCs in India has become prominent in wide range of services such as Bill discounting, factoring, investment activities, hire-purchase finance, lease finance, loans, loans against securities, loan against gold, precious metals, etc. With increase in activities, it is also important to regulate and effectively monitor the functioning of such NBFCs. The RBI, having considered necessary in the public interest and being satisfied that for the purpose of enabling them to regulate the credit system to advantage of the country, has laid down the prudential norms.

The prudential norms directions were issued by RBI u/s 45JA of the Reserve Bank of India Act, 1934. The directions issued in 2007 *vide* Notification No. DNBS.192/ DG (VL)-2007 and DNBS.193/ DG (VL)-2007 dated February 22, 2007 supersede Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 contained in Notification No. DFC. 119/DG(SPT)/98 dated January 31, 1998.

RBI has recently announced draft guidelines in respect of NBFC sector which also includes aspects relating to various prudential norms. The same is being covered in separate article, and hence this article is based on extant regulations pertaining to prudential norms for NBFCs.

This article covers some of the important provisions stipulated under the prudential norms-

I. Accounting guidelines

II. Asset Classification and provisioning requirements for standard and Non-Performing assets

III. Disclosure in Balance sheet

IV. Accounting year to be followed

V. Concentration of credit/investments

VI. Other Compliance Aspects

I. Accounting Guidelines

Some of the Accounting related aspects includes Income Recognition criteria, Accounting of Investments, asset classification and provisioning requirements.

RBI has prescribed that Income recognition should be based on recognised accounting principles, however Accounting Standards and Guidance Notes from ICAI will be followed as far as they are not inconsistent with any of the RBI directions.

Income like interest /discount /any other charges on NPAs shall be recognised only when actually realised, RBI also requires that income recognised before asset becoming NPA should be reversed in the financial year in which such asset becomes NPA. The directions requires NBFCs to recognise income from dividends on shares of corporate bodies and units of mutual funds on cash basis, unless the company has declared the dividend in AGM and right of the company to receive the same has been established, in such cases, it can be recognized on accrual basis. Income from bonds and debentures of corporate bodies and from government securities/bonds may be taken into account on accrual basis provided it is paid regularly and is not in arrears. Income on securities of corporate bodies or public sector undertakings may be taken into account on accrual basis provided the payment of interest and repayment of the security has been guaranteed by Central Government.

Accounting of investments

Investing is one of the core activities of NBFCs, hence RBI requires the Board of Directors to Frame investment policy of the company and implement the same. The policy should include criteria laid down by the board for classification of investments into long-term and short term. The investments need to be classified into current or long term at the time of making each investment. There can be no inter-class transfer of investments on ad hoc basis later on. Inter class transfer should be done at the beginning of half year and with the approval of the board. The directions also specifies various valuation guidelines in respect of quoted and unquoted current investments leaving the Long term Investments to be valued as per ICAI Accounting Standards.

It requires quoted current investments to be grouped into specified categories and valuation of each "category" to be done at aggregate cost or aggregate market value whichever is lower. Depreciation should be provided and appreciation (if any) should be ignored category-wise and not scrip-wise.

Unquoted equity shares in the nature of current investments shall be valued at cost or break-up value, whichever is lower. RBI has prescribed that fair value for the break-up value of the shares may be replaced, if considered necessary. Where the balance sheet of the investee company is not available for two years, such shares shall be valued at one rupee only.

"Breakup value" means the equity capital and reserves as reduced by intangible assets and revaluation reserves, divided by the number of equity shares of the investee company.

II. Asset classification and provisioning requirements

The following categories are defined in the regulations mainly based on period of outstanding of the interest and principal.

(i) Standard assets;

(ii) Sub-standard assets;

(iii) Doubtful assets; and

(iv) Loss assets

Broad Provisioning Requirements are depicted in the table below.

Assets	Explanation	Period	Provision on Loan Balance	Provision on Security
Standard Assets	"Standard asset" means the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carry more than normal risk attached to the business	It is regular asset and does not orm part of NPA	0.25% of all standard assets	—
NPA	An asset, in respect of which, interest/ installment/reimbursement has remained overdue for a period of six months or more	6 months	—	—
Sub-standard assets	Asset classified as NPA for a period not exceeding 18 months; Asset where terms of agreement regarding interest/principal were renegotiated or rescheduled or restructured after commen-cement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms	Non-performing assets for a period of 18 months or Renegotiated loans up to one year of satisactory performance of new terms.	10% of the outstanding amount	No specific provisions regarding security
Doubtful assets	"Doubtful asset" means: (a) a term loan, or (b) a lease asset, or (c) a hire purchase asset, or (d) any other asset, which remains a sub-standard asset for a period exceeding 18 months	Remains sub standard asset for period of 18 months and above	100% over realisable value of Securities	To the extent of loan which is covered by value of realizable securities, the following provisioning is required based on the period the asset (the underlying loan) has been considered doubtful Up to - one year – 20% One - three years – 30% More than three years – 50%
Loss assets	As identified by Company, Auditor or RBI (Period is not specified) or Potential threat of Non Recoverability due to erosion in the value of securities or non-availability of security or any fraudulent act or omission on the part of the borrower.	Period not specified	100% write off in the books	—

The class of assets referred to above shall not be upgraded merely as a result of rescheduling/ renegotiation/restructuring, unless it satisfies the conditions required for the upgradation. The condition is that the assets should show satisfactory performance under the restructured and/or rescheduled and/or renegotiated terms at least for a year.

III. Disclosure in the balance sheet

The directions specify certain disclosure requirements in the balance sheet. Disclosure of provisions created without netting them from the income or against the value of assets. The provisions shall be distinctly indicated under separate heads of account as (i) Provisions for bad and doubtful debts; and (ii) Provisions for depreciation in investments. Provisions shall not be appropriated from the general provisions and loss reserves held. Provisions shall be debited to the profit and loss account. The excess of provisions, if any, held under the heads general provisions and loss reserves may be written back without making adjustment against the provisions.

Every non-banking financial company shall append a schedule to its balance sheet and give the particulars as set out in format provided in the prudential norms.

The following disclosure requirements are applicable only to systemically important (Asset Size more than ₹ 100 crores) non-deposit taking non-banking financial company -

- Capital to Risk Assets Ratio (CRAR)
- Exposure to real estate sector, both direct and indirect; and
- Maturity pattern of assets and liabilities."

The formats for the above disclosures are also specified by RBI.

IV. Accounting Year to be followed

Every non-banking financial company shall prepare its balance sheet and profit and loss account as on March 31 every year. Prior approval of RBI is needed, before approaching Registrar of Companies, if the company wants to extend the date as per provisions of the Companies Act, 1956. In case extension is granted, the company has to file proforma balance sheet and the statutory returns pertaining to March 31.

The balance sheet needs to be finalised within a period of three months from the date to which it pertains.

V. Concentration of credit/ investment

Systemically important non-deposit taking non-banking financial company cannot invest and/ or lend to a single borrower/investee or single group of borrowers/investee beyond specified limits laid down by RBI. The limits are given as a percentage of its owned funds.

To	Limits on lending	Limits on investment in shares	Combined limits on lending & investment
Single borrower/party	15% of owned funds	15% of owned funds	25% of owned funds
Single group of borrowers/parties	25% of owned funds	25% of owned funds	40% of owned funds
Infrastructure Loan/Investment Single Borrower Single Group of Borrowers (Only if the additional loan/ investment is infrastructure Loan/investment)	Additional 5% Additional 10%	Additional 5% Additional 10%	Additional 5% Additional 10%
For Infrastructure Finance Company Single Borrower Single Group of Borrowers	25% of Owned funds 40% of Owned funds		30% of Owned funds 50% of Owned funds

Provided that the ceiling on the investment in shares of another company shall not be applicable to a systemically important non-deposit taking non-banking financial company in respect of investment in the equity capital of an insurance company up to the extent specifically permitted, in writing, by the Reserve Bank of India.

Asset Finance Company may in exceptional circumstances, exceed the above ceilings on credit / investment concentration to a single party or a single group of parties by 5 per cent of its owned fund, with the approval of its Board.

Any systemically important non-deposit taking non-banking financial company not accessing public funds, either directly or indirectly, and not issuing guarantees (which may require access to public funds when the guarantees devolve) may make an application to the Bank for an appropriate alteration in the above limits.

Explanation : "Public funds" for the purpose of the proviso shall include funds raised either directly or indirectly through public deposits, Commercial Papers, debentures, inter-corporate deposits and bank finance.

The NBFCs also need to formulate policy in respect of exposures to a single party / a single group of parties.

VI. Other Compliances

(a) Submission of a certificate from Statutory Auditor to the Bank

Every non-banking financial company shall submit a Certificate from its Statutory Auditor that it is engaged in the business of non-banking financial institution along with the asset / income pattern, requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act. The same needs to be submitted within one month from the date of finalisation of the balance sheet and in any case not later than December 30 of that year. Such certificate shall also indicate the asset / income pattern of the non-banking financial company for making it eligible for classification as Asset Finance Company, Investment Company or Loan Company.

(b) Information in regard to change of address, directors, auditors, etc. to be submitted

Communicate within one month from the occurrence of any change in the postal address, telephone number/s and fax number/s of the registered/corporate office, the names and residential addresses of the directors of the company, the names and the official designations of its principal officers, the names and office address of the auditors of the company, and the specimen signatures of the officers authorised to sign on behalf of the company

(c) Loans against non-banking financial company's own shares prohibited

No non-banking financial company shall lend against its own shares.

(d) Loans against security of single product - Gold jewellery

NBFCs cannot lend against collateral of gold jewellery in excess of 60 per cent of its value and all NBFCs shall disclose in their balance sheet the percentage of such loans (gold loans) to their total assets.

NBFCs cannot grant any advance against bullion / primary gold and gold coins. NBFCs primarily engaged in lending against gold jewellery (such loans comprising 50 percent or more of their financial assets) shall maintain a minimum Tier l capital of 12 per cent by April 1, 2014.

(e) NBFCs not to be partners in partnership firms

No NBFC shall contribute to the capital of a partnership firm or become a partner of such firm.

(f) Demand or call loans

In case the NBFC provides Demand Loan or call loans (a type of loan where both the parties are free to call back or pay back loan as per their will, subject to agreement of the loan and minimum notice period decided in the agreement) Board of Directors need to Frame policy for granting call/demand loans and implement the policy to stipulate various aspects as specified in the prudential norms such as Rate of Interest, Cutoff date for review of the loans, period of the loan, reasons if no interest is stipulated or when moratorium is granted.

(g) Constitution of Audit Committee by non-banking financial companies

NBFC with assets of ₹ 50 crore and above as per its last audited balance sheet shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors.

Audit Committee as required under Section 292A of the Companies Act, 1956 shall be the Audit Committee for the purposes of this paragraph and it will have same powers, functions and duties as laid down in section 292A of the Companies Act, 1956.

(h) Requirement as to capital adequacy

Every systemically important NBFC shall maintain minimum capital ratio consisting of Tier I and Tier II capital which shall not be less than fifteen per cent of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off-balance sheet items.

The total of Tier II capital, at any point of time, shall not exceed one hundred per cent of Tier I capital.

Calculation of Tier I, Tier II and Risk weighted assets has been specified in the regulations, Risk Weights for various on balance sheet items and off balance sheet items also have been specified.

Exemptions

The Reserve Bank of India may, if it considers it necessary for avoiding any hardship or for any other just and sufficient reason, grant extension of time to comply with or exempt any non-banking financial company or class of non-banking financial companies, from all or any of the provisions of these directions either generally or for any specified period, subject to such conditions as the Reserve Bank of India may impose.

As mentioned in the opening part of this article that RBI has proposed substantial changes in regulations pertaining to aspects such as `registration conditions, continuity, disclosure requirements and functioning of NBFCs, one will have to apply the relevant part of the guidelines once enacted.

The world is a beautiful book,
but of little use to him who cannot read it.

— Goldoni

The remedy for wrongs is to forget them.

— Syrus

CA Vipul K. Choksi & CA Heneel K. Patel

Auditing of NBFCs

Introduction

Over recent years the Non Banking Financial Companies ('NBFCs') have assumed increasing significance and have added considerable depth to the overall financial sector. Non-banking financial sector has evolved considerably in terms of operations, variety of market products and instruments, technological sophistication, etc. NBFCs play an important part of the Indian economy.

The regulatory responses on the part of Reserve Bank of India ('RBI') have also kept pace with the evolution of this sector. In particular, regulation has adequately addressed the issue of depositor protection, a major concern of RBI.

This article provides practical assistance to auditors by applying good practice given in the Standards on Auditing (SAs) and Technical Guide on audit of financial statements of NBFCs issued by the ICAI. It however, does not deal in detail with the procedures and practices to be used in such an audit.

Financial Reporting Framework

RBI's prudential norms provide guidance to NBFCs on recognition and measurement of loans, establishment of loan loss provisions, credit risk disclosure in financial statements and related matters. It sets out views on sound loan accounting and disclosure practices and so may influence the financial reporting framework within which a NBFC prepares its financial statements.

In terms of non-NBFCs directives issued by RBI, Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India (ICAI) shall be followed in so far as they are not inconsistent with any of these directions. Subsequent to notification of Central Government (Accounting Standard) Rules, 2006, same needs to be complied with by the NBFC if it is a company. Ministry of Corporate Affairs *vide* its Notification No. S.O.447(E) dated February 28, 2011 (As amended by Notification No. F. No.2/6/2008-CLV dated March 30, 2011) has revised the existing Schedule VI to the Companies Act, 1956 and made it applicable to all companies including NBFCs for the financial statements.

Apart from above, RBI also mandates separate disclosure requirements by way of issuing directives from time to time. In terms of Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 every non-banking finance company is required to separately disclose in its Balance Sheet the provisions made under the directions without

netting them from the income or against the value of assets.

Auditing

The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements of the NBFC are prepared, in all material respects, in accordance with an applicable financial reporting framework. The auditor's report indicates the financial reporting framework that has been used to prepare the NBFCs financial statements.

Understanding the entity and its environment

NBFCs are required to register under the following three broad categories, viz. (i) NBFCs accepting public deposit, (ii) NBFCs not accepting/holding public deposit and (iii) Core investment companies. Details of regulatory requirement under each category of NBFCs have been dealt with by the different authors elsewhere in this journal.

It is important for the auditor to understand the nature of business environment. This would help the auditor to plan and conduct audit in an efficient manner. Auditor uses professional judgment to determine the extent of understanding required.

Audit planning is intended to meet the overall audit objective of expressing an opinion on the truth & fairness of the financial statements. In the planning stage the auditor should gather relevant organisational information for creating his audit plan. The preliminary study would help the auditor in the following:

- Understand the business issues and the associated risks.
- Help in communication with the management and where required, with those charged with governance on timely basis.
- It would help the auditor to identify the issues that may require special attention in the audit.
- The auditor would be able to develop an audit scope that may add value to the entity by focusing on areas more meaningful to the management.

Internal controls and risk assessment

The auditor should assess the effectiveness of controls over a period of time and develop the audit plan on the basis of evaluation of the internal controls. For instance, in using computer programmes to test data files, the auditor, probably with the help of system auditor, should evaluate controls over programme libraries containing programmes being used for audit purposes to determine the extent to which the programmes are protected from unauthorised access/modification.

Audit areas

The process of establishing the overall audit strategy assists the auditor to determine specific audit areas considering the audit risk assessment procedure. The auditor has to identify the typical items in a NBFC's financial statements to plan substantive procedures and suggest technique that could be used for testing. Following are the key audit areas which the audit must be aware while conducting the audit (It does not represent the exhaustive list of procedures nor do they represents the minimum procedure):

Credit & Legal – Loans

Many NBFCs are in to the business of lending and borrowing of funds. The auditor should keep in mind various elements such as lending/disbursement, monitoring, recovery/collection and review/renewals while verification of credit function.

The auditor should consider the loan booking, approval and disbursement process, subsequent collections and collateral

management including appropriateness of the provision for loan.

- The auditors should verify whether various procedures/rules prescribed for sanctioning the credit has been adhered to including obtaining credit report or have independent investigation on borrowers.
- The auditors understand and review the NBFCs procedure of controlling credit risk. Auditor should also learn the NBFCs method for appraising the value of exposure, securities, collateral and for identifying potential and definite losses.
- In order to assess the effectiveness of the credit administration and portfolio management the auditor should review credit policies, management reports to understand whether it is adequately detailed to evaluate risk factors. Based on previously generated information, the auditors should review the causes of existing problems or weaknesses within the system. The auditor should consider whether these problems or weaknesses present the potential for future problems.
- Examining effectiveness of credit administration and portfolio management includes review of NBFCs procedure for,
  - review of lending policies and consider whether the policies are reviewed and updated periodically to ensure they are relevant with changing market conditions; and whether those charged with governance have approved the policies and whether the NBFC is in compliance.
  - analysis of current financial condition of the borrower which addresses repayment ability, tests for documentation exceptions, policy exceptions, non-compliance with internal procedures, and violations of laws and regulations
  - Tests for documentation exceptions, policy exceptions, non-compliance with internal procedures, and violations of laws and regulations. The effect of credit for which exposure and collateral documentation are deficient.
  - Examination of volume of exposure not supported by current and complete financial information and analysis of repayment liability, concentration of credit including concentration of classified credits.
  - review of credit monitoring system including its schedule, exposure review plan, contents such as identification of problem credit, current information regarding portfolio risks, information on emerging trend in portfolio and lending areas, and should consider whether it is thorough, accurate and timely and whether it will provide sufficient information to allow management to both identify and control risk.
  - Competency of senior management and credit department personnel and their knowledge of the NBFCs own credit exposure problems. The accuracy and completeness of credit monitoring reports.
- Auditors could apply the following selection criteria for exposure file review under substantive procedures,
  - New sanctions and accounts with an outstanding balance equal to or greater than a specified amount.

- Accounts on a "Watch List" with an outstanding balance in excess of a specified amount.
- Accounts where the amount outstanding is in excess of the authorised credit line/limit. Accounts with a provision in excess of a specified amount.
- Accounts where principal or interest of more than a specified amount is in arrears for more than a specified period.
- Accounts with entities operating in industries or countries that the auditor's own general economic knowledge indicates could be at risk.
- Problem accounts (including NPAs) identified by the NBFC's regulatory authorities and problem accounts selected in the prior year.

- Auditors should take in consideration following,
  - Determine whether the appropriate authority levels within the NBFC have approved the exposure application or renewal
  - Consider whether security documents bear evidence of registration as appropriate, and that the NBFC has received appropriate legal advice about the security's legal enforceability
  - Consider whether the fair value of the security appears adequate to secure the exposure and that where applicable, the security has been properly insured.
  - Review periodic financial statements of the borrower and note significant amounts and operating ratios (that is, working capital, earnings, shareholders' equity and debt-to-equity ratios etc); and
  - Review any notes and correspondence contained in the exposure review file. Note the frequency of review performed by the NBFC's staff and considers whether it is within NBFC guidelines.
  - The auditor should consider whether any additional provisions need to be established against particular categories or classes of exposures and assesses the adequacy of any provisions that the NBFC may have established through discussions with management

Treasury operations – Investments

Treasury operations of NBFCs represent all activities relating to the purchase, sale, borrowing and lending of financial instruments like securities, money market instruments or derivative instruments. Investment companies/NBFCs usually enter into such transactions for the purpose of hedging risk exposures or for meeting customers' needs. At times they also carry out trading activities of financial instruments (including derivatives) with the intention of deriving a gain from the change in market price parameters (for example, foreign exchange rates, interest rates, equity prices) over time. NBFCs manage and control their treasury activities on the basis of the various risks involved rather than on the basis of the particular type of financial instrument dealt with.

- The auditor should consider the investment policy describing the nature of treasury operations proposed to be undertaken by the company as well as

setting out the limits/authorisation for such operations.

- The auditor initially should obtain an understanding of the scale, volume, complexity and risk of treasury activities. It is also important to understand the significance of treasury activities relative to other business of the NBFC and should understand the framework within which the treasury activities take place. Treasury operations involve transactions that are recorded by IT systems. Consequently, the auditor should test whether key processing controls and procedures are operating effectively before assessing the level of inherent and control risks as low

- The auditor should ensure the accuracy of recording transactions and related profits and losses. Verification process includes,

  – reference to deal tickets and confirmation slips;

  – the completeness of transactions and proper reconciliation between the front office and accounting systems of open positions at the period end;

  – the existence of outstanding positions by means of third party confirmations at an interim date or at the period end;

  – the appropriateness of the exchange rates, interest rates or other underlying market rates used at the period end date to calculate unrealised gains and losses;

  – the appropriateness of the valuation models and assumptions used to determine the fair value of financial instruments outstanding as at the year end; and

  – the appropriateness of the accounting policies used particularly around income recognition and the distinction between hedged and trading instruments.

- Specific audit risks in treasury operation mentioned hereafter.

  – Newly traded instruments are ordinarily subject to careful review by the auditor, who should initially obtain a list of all new products traded during the period. Smooth flow of the new transactions through the controls system should be ensured in the relevant IT systems.

  – The auditor should ordinarily seek the assistance of IT experts to supply appropriate skills and knowledge in the testing of systems and relevant account balances as considering the volume of data practically all the NBFCs uses IT system for maintaining treasury operations.

  – The auditor should see that purpose of transaction i.e. speculative or hedging should be identified at the inception stage so as to apply the correct accounting treatment. The auditors should ensure the presentation and disclosures of transaction entered into by the NBFCs in accordance with the relevant accounting requirements.

  – The auditor might test all portfolio valuations as of the date of the financial statements. The auditor should obtain the understanding of the entity's process of determining fair value of the instruments.

- IT system plays important role in the Valuation process of various instruments. The auditor should check the controls, security procedures for valuation models, significant assumptions used in determining fair value, as well as the process used to develop and apply management's assumptions, including whether management used available market information in order to develop the assumptions and controls over the consistency, timeliness, completeness and reliability of data used in valuation models.

- The auditor should ordinarily test the valuation models used, including the controls surrounding their operation, and considers whether details of individual contracts, valuation rates and assumptions are appropriately entered into such models documents supporting management's assumptions.

- Considering the global economic scenario and volatile market conditions sometimes it may be difficult to predict with a sufficient degree of certainty the price correlation with other offsetting instruments used by the NBFC to hedge its positions. The models used for valuing such instruments may not operate properly in such conditions. The complexity of certain instruments requires specialised skill and knowledge. If the auditor does not have the professional competence to perform the necessary audit procedures, advice should be sought from experts in this field.

- The auditor must pay particular attention to establishing the ownership of instruments held in bearer form. The auditor should consider the need for physical inspection or confirmation with external custodians and the reconciliation of the related amounts with the accounting records.

- Source of revenue

  a. The auditor should review source of revenue and assure the accuracy and completeness of the NBFCs accounting record relating to such transactions.

  b. The auditor should verify the existence and operative effectiveness of key controls to control the risk arising of such transactions.

  c. The auditor also should consider whether the relationship between the types of securities owned and the related income is reasonable; and all significant gains and losses from sales and revaluations have been reported in accordance with the financial reporting framework.

- Investments

  a. The auditor should consider the RBI prudential norms guidelines with regard to accounting for investments. There should be properly implemented investment policy.

  b. The criteria to classify the investments as current

investments and long-term investments should be clearly spelt out the aforesaid classification should be made at the time of making the investments.

c. There should not be inter-class transfer on *ad hoc* basis and if necessary, it should be done only at the beginning of each half year with the approval of the Board and the transfer should be scrip wise at book value or market value, whichever is lower. Depreciation, if any, in each scrip shall be provided and appreciation, if any, should be ignored and there should not be netting off of any gain in one scrip against depreciation in another scrip.

d. Investment should be grouped under appropriate categories as defined in the financial applicable reporting frame work. Valuation of quoted investments in each category shall be considered scrip-wise and cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than aggregate cost for that category, net depreciation shall be provided for or charged to the profit and loss account. If aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Depreciation in one category of investments shall not be set off against appreciation in another category.

e. Unquoted equity shares in the nature of current investments shall be valued at cost or break-up value, whichever is lower. However, non-banking financial companies may substitute fair value for the break-up value of the shares, if considered necessary. Where the balance sheet of the investee company is not available for two years, such shares shall be valued at one Rupee only.

Detection of fraud and error

Fraudulent activities may take place within a NBFC by, or with the knowing involvement of, management or personnel of the NBFC. Auditor should obtain an understanding of the NBFCs corporate governance structure and how those charged with governance discharge their responsibilities for the supervision, control and direction of the NBFC. Alternatively, fraud may be perpetrated on a NBFC without the knowledge or complicity of the NBFC's employees.

Communication among the audit team members about the risks of material misstatement due to fraud also should continue throughout the audit. It includes a consideration of the known external and internal factors affecting the entity that might (a) create incentives or pressures for management and others to commit fraud, (b) provide the opportunity for fraud to be perpetrated, and (c) indicate a culture or environment that enables management to rationalise committing fraud. SA 240, "The Auditor's Responsibility to Consider Fraud

and Error in an Audit of Financial Statements" gives detailed guidance on the nature of the auditor's responsibilities with respect to fraud.

Consideration of laws and regulations

NBFCs are governed by various regulations of RBI concerning their conduct of business and reporting requirements. With the business getting complex and globalisation of finance business, the monitoring agencies make amendments to the existing rules and regulations. The auditor should be aware of such amendments affecting the entity audited.

Audit considerations to be given to:

- The economic and regulatory environment prevailing in the principal countries in which the NBFC operates.
- The market conditions existing in each of the significant sectors in which the NBFC operates.
- Understanding of the nature of services rendered or financial transactions undertaken through instruments such as letters of credit, acceptances, interest rate futures, forward and swap contracts, options and other similar instruments in order to understand the inherent risks and the auditing, accounting and disclosure implications thereof.
- The auditor should consider legal and regulatory restrictions, and obtain an understanding of how the management and those charged with governance monitor that the system of internal control (including internal audit) operates effectively. SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation" gives further guidance on this subject.
- Many NBFC are into the business of lending money against the security of bullions, shares, securities, land, properties, etc. The auditor needs to verify the records maintained by the NBFC relating to the assets given as securities against the lending of NBFCs. Verification of this includes valuation of certain type of assets, for example, land and building, plant and building, etc., legal opinion concerning interpretation of agreements, statutes, regulations, notifications, circulars, etc. The auditor after considering the nature and complexity of item and after examining the materiality need to take assistance of the work of the expert in obtaining appropriate audit evidence. SA 620, "Using the Work of an Auditor's Expert" gives further guidance on this subject.

Audit evidence

Audit evidence is necessary to support the auditor's opinion and report and is primarily obtained from audit procedures performed during the course of the audit. Auditor gains increased assurance when audit evidence obtained from different sources is consistent. Various methods for obtaining audit evidence include inspection, observation, inquiry and confirmation, computation and analytical review.

Since the transactions of NBFCs are substantially financial in nature, the underlying documents/agreements form important audit evidence for the auditor. The auditor should verify all the relevant documents for gathering sufficient appropriate audit evidence.

Reporting obligations

Reporting requirements of auditors under the applicable regulations:

- **Companies Act, 1956**
  Auditors' reporting under sections 227(2) and 227(4A) [CARO] of the Companies Act, 1956

- **Reserve Bank of India Act, 1934**
  - Section 45 MA(1) of the RBI Act – Casts duty on auditors to inquire if NBFC has submitted to the RBI, the requisite information, statements or particulars regarding deposits accepted by it. On exception, the auditors need to report to RBI the "aggregate of such deposits held" by NBFC.
  - Section 45MA(2) of the RBI Act – Where auditor's report or intend to report to RBI under section 45 MA(1) above, the matter should also be included in his report u/s 227(2) of Companies Act, 1956

- **Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions**

The auditor, in addition to the report under section 227 of the Companies Act, 1956, should also make a separate report to the Board of Directors on specific matters. Matters to be reported to Board of Directors are as follows:

For Non-Deposit taking NBFCs

Whether the NBFC has obtained a Certificate of Registration in terms of NBFC directives

- Whether the Board of Directors has passed a resolution for non-acceptance of any public deposits;
- Whether the company has accepted any public deposit during the year/period; and
- Whether the company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, etc.

For Non-Deposit taking Systemically Important NBFCs (NBFC-SI-ND) – in addition to above auditor need to comment

- on correctness of Capital Adequacy Ratio (CAR); and
- conformity/compliance with the minimum Capital to Risk Assets Ratio (CRAR), it disclosed in the return submitted to the RBI in Form NBS 7;
- the adherence to timelines for furnishing NBS 7.

For Deposit taking NBFCs – in addition to above auditor need to comment

- Whether public deposits (including unsecured non-convertible debentures/ bonds and deposits from shareholders in case of a public limited company) accepted are within the limits prescribed under the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998. (Referred to as Public Deposits Directions);
- If the deposits accepted are in excess of limits prescribed above, whether the same has been regularised as per Public Deposit Directions;
- Whether an Assets Finance Company (AFC) having a CRAR less than 15% or an Investment Company or Loan Company is accepting deposits without Minimum Investment Grade Credit Rating from an approved credit rating agency;
- Whether the company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, and concentration of credit/investments as specified in the directions issued by the RBI in terms of the Non-Banking Financial (Deposit

Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;

- Whether the credit rating is in force and deposits outstanding at any point of time during the year was within the limit prescribed by rating agency;
- Whether the company has defaulted in payment of interest and principal to depositors when such interest and/or principal became due, asset classification, provisioning for bad and doubtful debts and so on have been complied with;
- Whether the company has complied with the liquid assets requirement as prescribed by the RBI in exercise of powers under section 45-IB of the Act.
- Whether there has been any non-compliance with Chapter III-B of RBI Act, the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and the Non- Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

Practical issues

1. Company doing investing activities of its surplus – Reporting requirements

In terms if NBFCs regulations, a company is treated as NBFC once its financial assets are more than 50 per cent of its total assets and income from these financial assets is more than 50 per cent of its gross income. Once a company falls within the said criteria and having required Net Owned Fund, it needs to apply to RBI for registration. A company not intended to be formed for doing NBFC activities however, at times may be covered by the said criteria due to investment of its surplus fund generated from the relevant business.

2. Company whose application for Registration rejected by RBI – Reporting requirements

In the case of a company whose application of being registered as NBFCs gets rejected by the RBI is required to wind up its NBFC activities.

In such a situation auditors need to verify that such company does not carry out any NBFC activity.

3. Compliance with the Revised Schedule VI

Classification of current/non-current and operating cycle

In terms of Revised Schedule VI all the items in the balance sheet are to be classified as either current or non-current based on its operating cycle. An operating cycle is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. In case of NBFCs defining operating cycle is highly subjective considering the nature of its business especially in the case where NBFCs takes borrowings having duration of three to five years and utilising it for giving project loans (having tenure for more than five years)

Classification of interest receivable as trade Receivables

Trade receivables are defined as dues arising only from goods sold or services rendered in the normal course of business. Considering the said definition interest accrued and due on loans given may be regarded as trade receivables and accordingly classified 'trade receivable' rather than 'interest accrued and due' in the financial statements.

Shinjini Kumar, Director – Leader of Financial Services Regulatory Practice - PWC
& CA Mayur Gala

FDI Provisions for NBFCs

1. Background

In the Indian financial landscape, the non-banking financial services sector is admittedly a very significant component and non-banking financial companies ('NBFCs') have become an integral part of the Indian financial system. NBFCs in India have come a long way from an era of regional concentration, low credibility and poor risk management practices to highly sophisticated operations, pan-India presence and most importantly, an alternate choice of financial intermediation.

In the last decade, NBFCs have also become attractive financing vehicles for foreign players such as foreign banks/ lending institutions, private equity/hedge funds, manufacturing and trading companies, etc. This is primarily because of the flexibility provided by NBFC vehicle in structuring finance deals as per the needs and commercial objectives which broadly ranges from pure secured lending / investment activity to mezzanine financing and structured debt, providing captive financing etc. Both, the domestic and foreign players have penetrated deep into the non-banking financial system fuelling the rapid growth of the sector in India.

While the operational flexibility has worked as a very powerful enabler for attracting foreign investments in India, the Indian regulatory landscape has also been forthcoming to foster the sustainable growth and development of foreign investment in the system.

2. Evolution of Foreign Direct Investment ('FDI') Policy Framework

The evolution of the regulatory framework for FDI in India has gone through several phases – from the phase of highly regulated and cautious welcome to foreign investment to the phase of liberalisation of the FDI policy as part of the Government's economic reforms programme. FDI was initially allowed under the automatic route up to 51% in 35 high priority industries which was later on expanded to 111 industries. Foreign Investment Promotion Board ('FIPB') was constituted to consider cases under the approval route.

In 1997, guidelines were introduced for permitting foreign investment in the non-banking financial services sector under FIPB approval route including norms subject to compliance with minimum capitalisation requirement ranging from USD 5 million to USD 60 million based on percentage of foreign investment. However, the same was introduced only as a new sector classification without specific list of business activities covered therein. Subsequently, the Government prescribed the list of 14 activities that would be covered

under the said 'non-banking financial services' sector. Also, the range of the minimum capitalisation requirements was revised to be between US $ 0.5 million to US $ 50 million with an extended time frame to bring the funds within 24 months in case of US $ 50 million capitalisation requirement. In due course, rules (including capitalisation requirements) were also introduced for undertaking step down investments in subsidiaries of 100% foreign owned companies.

In 1999, the Government segregated the prescribed activities as fund based and non fund based activities along with a fixed minimum capitalisation requirement of US $ 0.5 million for non-fund based activities (irrespective of the percentage of foreign investment).

In the year 2000, a paradigm shift occurred in the FDI policy regime, wherein, except for a negative list, all the remaining activities were placed under the automatic route and caps were also gradually raised in a number of sectors / activities. Even non-banking financial service activities were brought under the automatic route, thereby not requiring government approval, subject to compliance with the prescribed minimum capitalisation requirements.

3. Extant FDI Regulatory Framework For NBFCs

Permissible activities

As per the extant FDI policy, foreign investment is permitted under automatic route in the following prescribed non-banking financial service activities:

Fund based activities

1) Merchant Banking
2) Underwriting
3) Portfolio Management Services
4) Stock Broking
5) Asset Management
6) Venture Capital
7) Custodian Services
8) Factoring
9) Leasing & Finance
10) Housing Finance
11) Credit Card Business
12) Micro Credit
13) Rural Credit

Non-fund based activities

14) Investment Advisory Services
15) Financial Consultancy
16) Forex Broking
17) Credit Rating Agencies
18) Money Changing Business

Capitalisation requirements

Foreign investment is permitted subject to compliance with following conditions:

Minimum capitalisation requirement

Activity	*Minimum capitalisation amount (in USD)*
Fund based activities – foreign capital up to 51%	0.5 million; to be brought upfront
– foreign capital more than 51% and up to 75%	5 million; to be brought upfront
– foreign capital more than 75%	50 million; USD 7.5 million to be brought upfront and the balance in 24 months
Non-fund based activities	0.5 million; to be brought upfront

Instruments

For FDI purposes, investment only by way of Equity shares, preference shares compulsorily convertible into equity shares and debentures compulsorily convertible into equity shares are permitted.

Infusion through any other instruments would not be considered as FDI and would be considered as an External Commercial Borrowing which would be subject to stringent restrictions with respect to end use, interest limits, etc.

Domestic leverage

Under the extant FDI policy, domestic leverage by any entity not permitted to be utilised towards downstream investment.

Diversification through step-down subsidiaries

Step down subsidiaries

100% foreign owned NBFCs with a minimum capitalisation of US $ 50 million are permitted to set-up step down subsidiaries for specific NBFC activities without any restrictions on number of operating subsidiaries and without bringing in additional capital.

Till recently, there was no clarity on whether this specific dispensation from capitalisation would be available to NBFCs wherein foreign investment is between 75% to 100%. However, by way of Press Note No. 9 (2012 Series), the Government brought such NBFCs on par with 100% foreign owned NBFCs, thereby, extending the aforesaid dispensation to such NBFCs as well.

Joint venture operating NBFCs that have 75% or less than 75% foreign investment can also set-up step down subsidiaries for undertaking any of the prescribed 18 NBFC activities, subject to subsidiaries also complying with the applicable minimum capitalisation norms.

Non-fund based NBFCs are not permitted to set-up any step-down subsidiary for any other activity, nor can they participate in any equity of an NBFC holding / operating company.

4. Regulatory Framework – Areas requiring attention

In the context of foreign owned NBFCs proposing to undertake financial activities, being lending, investment or asset finance ('RBI NBFCs'), as its principal business, apart from adherence to the foreign investment norms as discussed above, the said entities would also require registration from the Reserve Bank of India ('RBI'). The said entities would also be subject to the prescribed regulations ('RBI Regulations') for undertaking the aforesaid financial activities (lending, investment or asset financing).

The Indian regulators have been pro-active in regulating foreign investments in this sector and have also taken measures to relax the investment norms to open the doors for foreign investors. However, there are several unclear and ambiguous areas in the current regulatory framework which create operational challenges as well as deny NBFCs with foreign investment level playing field *vis-a-vis* domestic owned NBFCs. Some of these areas have been discussed below:

- ***Permissibility for RBI NBFCs to undertake 'investment' activities***

As per the RBI norms, lending, investing and asset financing are the financing activities permitted to be undertaken by a registered NBFC. Under the FDI norms, the only broad head under which the above activities would be permitted under automatic route is 'Leasing and finance'. However, the term 'finance' has not been defined. Based on its general meaning, while 'lending' activity would get covered, 'investment' activity does not specifically get covered.

Further, under the FDI policy, undertaking any other financial activity would require FIPB approval. Accordingly, RBI NBFCs would need

to obtain an FIPB approval for undertaking investment activity as a financial activity.

Since both foreign and domestic NBFCs are licenced under the same Act, as far as RBI regulation are concerned, they are assumed to have the same ability to do business However, RBI has made it incumbent upon Statutory Auditors to separately certify adherence to FDI conditions. In view of the ambiguity surrounding the phrase 'leasing and finance', it has been a challenge for auditors to map activities permissible under the NBFC directions with the broad heading of Leasing and Finance. What complicates this situation as that while the legal position on proprietory investments has been clarified by the Department of Industrial Policy and Promotion ('DIPP'), the broad brush prohibition against 'investment' creates uncertainty around investments done in the course of normal liquidity and treasury management, which is a necessary action for all NBFCs. Interestingly, while there is no bar on Indian companies with FDI from investing in such instruments, the NBFCs with FDI struggle with this issue due to the lack of harmonisation in definitions provided under the FDI policy with the definition under NBFC Directions.

- ***Permissibility for RBI NBFCs to diversify into other business activities***

As per the RBI NBFC regulations, a foreign owned RBI NBFC is required to obtain a prior FIPB approval for undertaking activities 'other than 18 activities' as prescribed under the FDI policy. By virtue of this, a foreign owned RBI NBFC proposing to undertake any other business activity would need to obtain an FIPB approval which may otherwise be permitted as per the FDI policy without an approval.

Comparing the above with domestic owned RBI NBFCs, the said entities as per the RBI regulations are permitted to undertake any non-financial activities so long as the same are not a principal business. Also, as stated above, the FDI policy allows companies with FDI to engage in all businesses where FDI is allowed under automatic route. For example, if an NBFC wants to undertake a service activity wherein FDI is allowed as a minor activity, as per the RBI regulation above, it would need to seek prior FIPB approval. On the other hand, FDI policy already allows 100% FDI in services and hence such approval should not be necessary. Once again, there is a need of harmonisation between the FDI policy and the RBI regulations which would result in more operational flexibility as well as set a better level playing field for NBFCs with FDI.

- ***Minimum capital requirement***

Domestic owned RBI NBFCs as per the RBI regulations are required to have a minimum capital amount (₹ 2 crore). In addition to this capital requirement, there is no further mandatory capital required by the said entities. As against this, foreign owned NBFCs mandatorily need to infuse the prescribed minimum capitalisation amounts (ranging from US $ 0.5 million to US $ 50 million based on the percentage of foreign capital) which is also locked in until the continuity of business by the said investor. While the minimum capitalisation requirement has been prescribed to ensure serious players enter the market, the high capitalisation can create distortions in the business model. Although this issue is far more relevant in case of other NBFCs where capital requirement is really much lower, even for lending NBFCs the ability to scale up business is tied to the economic growth and business opportunities. The ambiguity around investments constraints the business model further and impacts profitability. The minimum capitalisation norms need to be reviewed and greater flexibility needs to be provided.

In addition, there are certain other aspects under the FDI framework that need specific attention which have been emphasised below:

- ***Foreign infusion by way of Share Premium***

For minimum capitalisation purposes

The term minimum capitalization has not been defined in law. Under the FDI policy, the term 'capital' has been defined to mean equity shares; fully, compulsorily and mandatorily convertible preference shares ('CCPSs'); and fully, compulsorily and mandatorily convertible debentures ('CCDs'). However, there is no specific clarification on whether securities premium should also be included.

In 2008, the Government had issued a press note wherein it was stated that for the purpose of the minimum capitalisation norms, 'capital' would consist of ordinary shares. The literal reading of the above reflected that only foreign funds infused through equity shares should be considered for the purpose of capitalisation requirement. Any instrument other than equity shares such as CCPSs, CCDs or share premium should not be included. Subsequently, the Government had issued a corrigendum to the above press note and deleted the above statement. Pursuant to the deletion, the original confusion on the inclusions for minimum capitalisation continues specifically with respect to inclusion of share premium amount.

For determining domestic investor's contribution

Minimum capitalisation for fund based activities is prescribed based on percentage of foreign capital. In a scenario, where there is a foreign as well as a domestic investor in an NBFC, the contribution amount that needs to be brought by each investor would vary depending on the percentage of capital. The term capital as stated above specifically does not include share premium.

Accordingly, the issue that arises is whether the domestic investor needs to determine his contribution amount considering only the infusion through instruments as covered in the term 'capital' or should also consider any 'share premium' infusion by the foreign investor.

- ***No definition of financial services***

The automatic route specifies 18 activities that are eligible to receive 100% FDI in non-banking financial service sector. Undertaking any other financial activity requires a government approval. There is no exhaustive list of financial service activities from which these 18 activities have been derived, leaving a scope for interpretation. Financial services being a dynamic sector, the nature of services has been evolving and there is no practical mechanism for investors to ask questions relating to whether or not a certain activity is covered within financial service. For example, such questions are floating around with respect to activities of trustees managing funds of their investors, banking correspondent services, research in financial sector for clients.

4. Conclusion

The introduction of foreign investments in the non-banking financial sector has resulted into better risk management, well capitalised entities, transfer of financial know-how and increased efficiency. However, the lack of clarity in the norms and regulations governing such foreign investments, as elaborated above, could have a detrimental effect on the investment sentiment of foreign investors.

It is important for the Indian Government and regulators to ensure better inter agency co-ordination and synchronise the regulations for governing foreign investment in NBFCs and regularly review the regulations to ensure it is in alignment with the status of the sector and needs of the economy. In addition, a fast mechanism for answering queries needs to be instituted, either centrally or at each regulator, i.e., RBI, FIPB/DIPP, the Securities and Exchange Board of India. Steps need to be taken to make the FDI regime better comprehensible to foreign investors so as to enhance their confidence and contribution in the India growth story and thereby result in a level playing filed for the said foreign owned RBI NBFCs *vis-à-vis* domestic owned RBI NBFCs.

CA Navin R. Jain

Returns to be filed by NBFCs

NBFCs are required to submit various returns to RBI w.r.t. their deposit acceptance, prudential norms compliance, Asset Liability Management, position of Capital Funds, Risk Assets, Important Financial Parameters, etc. Detailed instructions regarding submission of various returns by NBFCs have been issued through various notifications.

The following is a compilation of certain important returns to be submitted by NBFCs-D, NBFCs-ND-SI and others:

1. List of important returns and submissions irrespective of asset size and type

Sr. No.	Form Number and Description of the return	Frequency	Due date	For which period
1.	Report of participation in interest rate future segment	Half Yearly	Within a period of one month from the close of the half year.	Half year ended
2.	Any NBFCs which has FDI whether under automatic route or under approval route – Submit certificate from their Statutory Auditors on half yearly basis certifying compliance with the existing terms and conditions of FDI	Half Yearly	Within one month from the close of the half year	Half year ended
3.	Quarterly Return to be submitted by NBFCs having overseas investment	Quarterly	Within one month from the close of the quarter.	Quarter ended

2. List of important returns applicable only for systemically important NBFCs (Asset size ₹ 100 crores and above)

Sr. No.	Form Number and Description of the return	Frequency	Due Date	For which period
1.	Return on specified financial parameters – All NBFCs (ND-SI)	Monthly	Provisional Return within 7 days from the end of the month For Month Ending March 31 Final Return, alongwith Audited Accounts within 7 days of Accounts finalisation date.	Relevant month ended
2.	Statement of short term dynamic liquidity in format [NBS-ALM1]	Monthly	Within 10 days from close of the month	Month ended
3.	Statement of structural liquidity in format NBS-ALM2	Half yearly	Within 20 days from Half year ending	Half year ended
4.	Statement of Interest Rate Sensitivity in Format [NBS-ALM3].	Half Yearly	20 days from the close of the half year	Half year ended
5.	A Quarterly statement of capital funds, risk asset ratio etc in Form NBS-7 Applicable to non-deposit taking NBFCs-systemically important NBFCs	Quarterly	Fifteen days from the close of the quarter	Quarter ended
6.	Monthly return in specified format – If raised short term foreign currency borrowings under the approval route in terms of	Monthly	Within 10 days of the close of the month	Month ended

3. Important returns applicable only for NBFCs (Asset Size ₹ 50 crores and above but less than ₹ 100 crores)

Sr. No.	Form Number and Description of the return	Frequency	Due date	For which period
1	Quarterly return on Important Financial Parameters	Quarterly	One month from the end of the Quarter	Quarter ended

4. List of returns and submission with RBI – applicable only to Deposit taking NBFCs

Sr. No.	Form Number and Description of the return	Frequency	Due Date	Applicability	Submit to whom
1.	NBS 1 Returns on deposits in First Schedule. (Details of Assets and Liabilities)	Quarterly	Fifteen days from the close of the quarter	All NBFC-D	Regional Office
2.	NBS 2 Quarterly return on Prudential Norms is required to be submitted by NBFC accepting public deposits – Capital Funds, Assets Classification, etc.	Quarterly	Fifteen days from the close of the quarter	All NBFC-D	Regional Office
3.	NBS 3 Quarterly return on Liquid Assets as per section 45IB of RBI Act by deposit taking NBFC – Statutory liquid assets position	Quarterly	Within 15 days from the end of the Quarter	All NBFC-D	Regional Office
4.	NBS 4 Yearly return of critical parameters by a company whose application for registration was rejected and holding public deposits	Yearly	Within 30 days from the end of the year	All NBFC-D	Regional Office
5.	NBS 6 Monthly return on exposure to capital market by deposit taking NBFC with total assets of ₹ 100 crore and above	Monthly	Within 7 days from month end	NBFC-D with Asset size ₹ 100 Crores and above	Regional Office
6.	Asset-Liability Management (ALM) Return	Half Yearly	1 month from the half year ended	NBFCs-D having public deposit of ₹ 20 crore	Regional Office
7.	Fraud Report above 1 lakh – FMR 1	As and when detected	Within three weeks from the date of detection	NBFC-D	Central office of RBI where amount involved in fraud is ₹ 25 lakhs and above. Regional office if amount is less than ₹ 25 lakhs

8.	Fraud report – amount involved ₹ 25 lakhs and above	As and when detected	Within one week from fraud coming to notice	NBFC-D	D.O. letter to the Chief General Manager-in-Charge of the Department of Banking Supervision, RBI, Frauds Monitoring Cell, Central Office and a copy endorsed to the Chief General Manager-in-charge of the DNBS, RBI, Central Office
9.	Cases of attempted fraud Cases of attempted fraud, where the likely loss would have been ₹ 25 lakh or more, had the fraud taken place Indicate the modus operandi and how the fraud was detected.	As and when detected	Within one week from fraud coming to notice	NBFC-D	Central Office, Department of Banking Supervision, Frauds Monitoring Cell and a copy to Central Office DNBS
10.	Reporting on frauds outstanding – Format FMR-2 (Note 1)	Quarterly	Within 15 days of Quarter end	NBFC-D	Regional Office
11.	Progress Report on Frauds NBFCs should furnish case-wise quarterly progress reports on frauds involving Rs. 1 lakh and above in the format given in FMR – 3 (Note 2)	Quarterly	Within 15 days of Quarter End	NBFC-D	Regional Office (When amount involved is ₹ 25 Lakhs – report to RBI, DBS, Frauds Monitoring cell)

Notes: 1. *NBFCs should furnish a certificate, as part of the above report, to the effect that all individual fraud cases of ₹ 1 lakh and above reported to the Reserve Bank in FMR – 1 during the quarter have also been put up to the NBFC's Board and have been incorporated in Part – A (columns 4 and 5) and Parts B and C of FMR – 2.*

2. *Frauds where there are no developments during a quarter, a list of such cases with a brief description including name of branch and date of reporting may be furnished as per FMR – 3.*

CA Anish Thacker

Taxation of Non-Banking Finance Companies

1. Introduction

Frequently Asked Questions (FAQs' on the website of the Reserve Bank of India (RBI) state that Non Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 (Cos Act) and is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures / securities issued by a Government or a local authority or other securities of like marketable nature, leasing, hire purchase, insurance business, chit business but does not include any institution whose principal business is that of agricultural activity / industrial activity / sale / purchase / construction of immovable property.

The FAQs further highlight the following differences between a NBFC and a Bank

(i) A NBFC cannot accept demand deposits

(ii) A NBFC is not part of the payment and settlement system and as such, a NBFC cannot issue cheques drawn on itself

(iii) Deposit issuance facility of Deposit Insurance and Credit Guarantee Corporation (DICGC) is not available for NBFC depositors unlike in case of banks

In terms of section 45-IA of the Reserve Bank of India Act, 1934 (RBI Act) it is mandatory that every NBFC should be registered with the RBI to commence to carry on any business of a Non Banking Financial Institution (NBFI) as defined in section 45-I (a) of the RBI Act. An exception is however provided to those NBFCs which are regulated by other regulators like the Securities and Exchange Board of India (broking and investment banking companies for example) or the Insurance Regulatory and Development Authority (IRDA) etc.

To even highlight all the Income-tax Issues relevant to each category of NBFCs would therefore be a herculean task and may possibly be the subject matter of an entire book. The author respectfully therefore, has decided to restrict the scope of this article to taking a look at Income tax issues faces by NBFCs in general and not get into the specific income tax issues relevant to a specific category of NBFCs.

2. Taxation of NBFCs

NBFCs are regulated entities whose operations, manner of presentation of financial statements, etc, are regulated by directions / guidelines issued by the RBI. The Income-tax Act 1961 (Act) however does not contain specific provision which may be relevant in computing the taxable income of a NBFC unlike in the case of banks or insurance companies. The accounts of a NBFC are also drawn up as per Schedule VI of the Cos Act unlike in the case of banks and insurance

companies. The RBI guidelines however do prescribe certain accounting practices which NBFCs need to follow which may be relevant and will be looked at later in the article.

To sum up, therefore, income of NBFCs needs to be computed under each head of income mentioned in section 14 of the Act. All the general provisions for computation of income therefore apply to a NBFC also.

3. Specific Issues in Taxation of NBFCs

Certain specific issues which are relevant in the taxation of NBFCs are discussed below :

3.1 Date of set up of a NBFC

It is common knowledge that expenses incurred by a taxpayer prior to the set up of a business are not deductible. It is therefore, relevant to understand when the business of a NBFC can be said to have been set up. Courts have made a clear distinction between the date of set up and the date of commencement of a business. Various decisions have been laid down that a business shall be said to have been set up when it is established and ready to commence business. It is also well recognised by now that these may (and in most cases is) an interval or interregnum between the set up and commencement of business.[1] In case of an NBFC, the process of commencement is that a person intending to commence business as a NBFC has to make an application to the RBI in a prescribed format. The RBI scrutinises the application and gives an 'in principle' approval. After getting the said 'in principle' approval the applicant has to start getting together the various things that the NBFC would require like the key personnel, the relevant infrastructure, the systems, the processes, the software, etc. Once all of these are in place i.e. the NBFC is absolutely ready to commence business, the applicant has to intimate the RBI. The RBI's officials then come to the applicant's premises for an inspection, look at the infrastructure in detail, have discussions with key personnel to assess their readiness etc. Once the RBI is satisfied that the applicant is absolutely ready to commence operations, it issues a final approval to the applicant after receipt of which the applicant can 'go live' i.e. commence its operations.

The issue that arises here is what should be construed to be the date of set up of the business. Should it be the date on which the approval or should it be the date on which the applicant intimates the RBI that it is ready to commence business? Or should it be neither, but be date on which the RBI gives the final approval to the applicant?

This issue assumes significance because between the date of receipt of the 'in principle' approval and the date of the final approval, an applicant incurs significant expenditure which is not capital in nature. If the date of set up is to be taken as the date of the final RBI approval, the 'non capital' expenditure incurred between the date of in principle approval and the date of the final approval is likely to be a 'sunk cost', and no deduction for the same would be allowed. The date of the 'in principle' approval clearly cannot be taken to be the date of set-up while giving the 'in principle' approval, the RBI only looks at the applicant's antecedents and permits it to start developing the infrastructure required to commence the business. On that date therefore, the business of the applicant has neither been 'established' nor is it 'ready to commence'.

The next relevant date is the date on which the applicant invites the RBI for inspection. On that date, as per the applicatnt, it has all the infrastructure and facilities required to 'go live' and it only has to wait to contend that this date should be construed to be the date of set up. In the author's view, taking this position is not correct. On the date on which the applicant invites the RBI for inspection, it

1. *Western India Vegetable Products Ltd vs. CIT [1954] 2617R 151 (Bom)*

is only the applicants' belief that 'all is well'. After inspection, the RBI may want it to make certain amendments / alterations post which the RBI may grant a final approval. Even if that is not the case and an applicant is required to make no changes, this date cannot be regarded as the date of set up as the applicant cannot be said to be 'ready to commence' business without the receipt of the RBI approval. The RBI approval is a very vital ingredient of the readiness to commence and even if the applicant has everything else in place, the business cannot commence until the final approval is received from the RBI. It is only once this approval is received that the applicant may be said to be 'ready' to commence business. Even after it receives the final approval, it might commence the business after an interregnum. To therefore, take the date of receipt of the final RBI approval as the date of set up would be appropriate, in the author's view.

Consequently, all revenue expenses incurred prior to the said date ought not to be allowed as a deduction. Interest income that applicant might earn on account of placing the money received on account of share capital, in fixed deposits, ought to be taxed under the head 'Income from other sources'.

This unfortunately, is a 'double whammy' for the applicant who, in reality, may not have earned any 'real income' (the expenses would be in all probability, be far greater than the interest it earns) and pays tax on the interest but gets no deduction for its expenses. This is the position that most applicants find themselves in with no way out as the provisions of the Act are drafted as such.

3.2 Taxation of interest income from investment of 'temporary surplus'

Cases have come to light where particularly in case of investment companies, NBFCs may have a short interval between raising the capital / debt funding required to make a particular investment and actually making that investment. To optimally utilise the funds gathered, the NBFCs usually place the funds in short-term fixed deposits which earn some interest. The tax authorities have usually taxed the interest under the head 'income from other sources' as against the head 'Profits & Gains of Business or Profession'.

With due respect, in the author's view, the said interest should clearly be taxable under the head 'Profits and Gains of Business or Profession'. As funds otherwise used for business have been parked for temporary periods only and that ought not to alter the character of these funds and make them surplus funds. Unfortunately, the Tribunals too have taken a contrary view in some cases. A case in point is a case of an investment holding company. In that case[2], the assessee, a subsidiary of the Financiere Lafarge, was incorporated to acquire and hold controlling interest in the equity share capital or preference or loan capital of any company/ companies in India engaged in any business of cement, ready mix concrete and aggregate.

The Mumbai Bench of the Tribunal held that the contention of the Assessing Officer that the assessee was not carrying on any business since there was no activity leading to the earning of income was erroneous and unsustainable. Further, it stated that given that the assessee had been set up with an object of making strategic investment in the shares of companies involved in the cement business, it could not be held that the assessee is not carrying on any business.

3.3 Income recognition

NBFCs engage in lending of money similar to banks. NBFCs unlike banks do not enjoy the shelter of section 43D of the Act which taxes interest on 'sticky loans' or 'doubtful advances' either in the year of recognition in the books or in the year of actual receipt, whichever is

2. *ACIT vs. Lafarge India Holding (P) Limited [2008] (19 SOT 121) (Mum)*

earlier. The tax authorities' therefore usually take the view that even in case of a 'sticky loan' irrespective of whether the NBFC recognises interest income on such advances in its books or not, the income accrues to it for the purpose of levy of income tax and should therefore be taxed as and when the due date of receipt arises.

This issue has been addressed by the Courts. The Delhi High Court in a recent decision[3] has held that in case of assets which a NBFC is bound to recognise as Non Performing under the RBI directions, the interest therefon cannot be brought to tax. In case of these Non Performing Assets (NPAs) there is uncertainty as to the recovery of the principal itself. Also, a NBFC is bound by the directions of the RBI and if the RBI directions do not require it to account for the interest, such interest cannot be offered to tax.

Apart from interest on NPAs, NBFCs may receive income which may be required to be recognised over more than one financial year in their books of account but for income tax purposes may require to be taxed in the year of receipt. Some examples could be income received on securitisation of future receivable, loan processing fees received by housing finance companies, etc. There may be a mismatch in the year in which income is accounted for in the books of account with the year in which it would be required to be offered to income-tax. In such cases of apparent mismatch, facts of each case and the nature and timing of accrual of each source of income should be examined in order to arrive at a reasoned view on the year of its taxability. Another controversy that typically arises in context of computation of taxable interest income of a NBFC is whether interest should be offered to tax on a day-to-day basis as is recognised for accrual in the books of account or only on the date (and therefore in the year) of its becoming due. To illustrate, if a NBFC has subscribed to debenture where the interest is due on 30th June and 31st December of each year, for accounting purposes, in the first year, the interest would be recognised in its books from say, 18th January (the date of investment) to 31st March, the last day of the year. For income -tax purposes however, the interest would not be taxed in that previous year, but the entire interest from 18th January to 30th June, (the next due date of payment of interest) would be taxable only in the subsequent previous year. This gives rise to a timing mismatch between recognition of income for accounting and income tax.

Typically, tax authorities would seek to tax the said income in the year in which the same was accrued in the books. The correct position in law is however that interest is taxable only when it becomes due[4].

3.4 Deductibility of provision for doubtful debts made in accordance with RBI guidelines

As per the guidelines (prudential norms) issued by the RBI for preparation of the financial statements of NBFCs, NBFCs are required to make certain provisions for NBPAs as prescribed thereunder. NBFCs have contended that the said provisions ought to be allowed as deductible. It may be worth noting that unlike in the case of banks, where provision for bad and doubtful debt is specifically deductible under section 36(1)(via) of the Act, there is no specific provision which allows a deduction to NBFCs.

The matter went right up to the Supreme Court. The Supreme Court[5] held that the RBI directions are only relevant for the presentation of NPA in the financial statements and have nothing to do with the computation of taxable income or accounting concepts. The Act and the RBI directions operate in different fields. The nature of expenditure under the Act cannot be conclusively determined by the manner in which accounts are presented under the RBI directions.

3. *CIT vs. Vasisth Chay Vyapar Ltd [2011] 330 ITR 440*
4. *See CIT vs. Bank of Rajasthan Ltd [2010] 326 ITR 526 (Raj) and GE Capital Services India v DCTI [2007] 106 TTJ (Del) 65*
5. *Southern Technologies Ltd vs. JCIT [2010] 320 ITRS77*

A provision for NPA is an expense only for presentation under the RBI directions and in that sense it is notional. Income tax is a tax on real income and unless there is a specific provision in the Act, there is no scope for allowing a deduction of a notional expense.

NBFCs carry out similar activities to banks as far as lending is concerned and probably are justified in feeling discriminated against as compared to banks on account of the Supreme Court's decision. It may be noteworthy that the proposals in the Direct Taxes Code Bill, 2010, (DTC) seek remove the 'discrimination' and place both banks and NBFCs at par.

3.5 Penalty for infringement of RBI guidelines

The business of NBFCs is heavily regulated by the RBI and the RBI has issued numerous guidelines / prudential norms / directions which NBFCs are expected to comply with. Non compliance with some of these would NBFCs to financial consequences and may result in payment of 'penalty' to the RBI. It may need to be examined whether such payments would be deductible in computing the income of the NBFCs particularly in view of the explanation to section 37(1) of the Act which disallows expenditure incurred for any purpose which is an offence or which is prohibiited by law. The Supreme Court[6] while dealing with the said explanation has held that it would be against public policy to allow a deduction in a statute for payments made in contravention of another statute, however commercially expedient their payments may be.

The Kerala High Court[7] has held in the context of payments made to the RBI in contravention of Banking Laws that due regard must be given to the nature of the levy. If the levy is compensatory in nature, it should be allowed as a deduction. If however, it is penal in nature, the same ought to be disallowed in view of the Explanation to section 37 (1) of the Act.

A few other questions merit consideration in this context. Are the RBI guidelines / directions 'law' and do they have the force of law or are they made applicable to NBFCs to regulate their functioning and operation? Also is payment of the 'penalty' an expenditure against public policy? These are questions which still remain and in view of the author, will travel to the courts to be decided one way or another.

3.6 Other issues

A few other issues that may be relevant for NBFCs are :

(a) Section 14A of the Act impacts NBFCs as well. They might, under the prudential norms require to hold securities the income from which may not be subject to income tax. The application of Rule 8D of the Income-tax Rules, 1962 (Rules) may hit them hard as they may hit other tax payers.

(b) A dispute may arise with the tax authorities with regard to 'Mark to Markets' losses in case of securities held by NBFCs as stock-in-trade. Tax authorities may seek to disallow these losses as being notional in character. NBFCs would in the author's view be justified in getting a deduction for these losses.

4. Conclusion

This article only scratches the surface as far as tax issues relevant to NBFCs are concerned. NBFCs have significant role to play in the development of the economy as they can really reach out to under banked areas and therefore aid in financial inclusion. As in case of other tax payers, the challenges for NBFCs as far as taxing provisions are concerned are not so much in terms of absence of policy put in terms of correct implementation and of interpretation of the existing tax provisions.

6. *Maddi Venkatraman & Co P Ltd vs. (IT [1998] 229 ITR 534*
7. *CIT vs. Catholic Syrian Bank Ltd [2004] 265 ITR 177*

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CA Bhavesh Vora

2012 : Draft Guidelines for NBFCs

Reserve Bank of India has issued the draft guidelines for NBFCs on 12th December, 2012 which are substantive in nature mainly focusing on aspects such as conditional exemptions from registration, revision in prudential norms mainly for asset classification and provisioning for NPAs, criteria for new entrants as NBFCs, stringent norms for deposit taking NBFCs, aspects pertaining to liquidity management, corporate governance, etc.

These guidelines are based on the report of Working Group on the Issues and Concerns in the NBFC Sector constituted and chaired by Mrs. Usha Thorat which was issued in August 2011. These guidelines are open for public comments till 10th January, 2013 when this article is being written.

Conditional exemptions from registration

RBI is set to provide exemption from registration to those NBFCs where total assets are below ₹ 25 crores, whether or not such companies accesses public funds. Companies having total assets above ₹ 25 crores and up to ₹ 500 crores are also exempt on the condition that they don't access public funds.

For companies accepting public deposits, registration is compulsory irrespective of its total assets size.

There is no change in the definition of public deposit, however "Public funds" shall include funds raised either directly or indirectly through public deposits, commercial papers, debentures, inter-corporate deposits and bank finance but excludes funds raised by issue of instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue.

Revision in certain Prudential Norms

Tier I capital requirement has been raised from 7.5% to 12% for captive NBFCs, and NBFCs which invests or lends in sensitive sectors such as Capital Market, Commodities or Real Estate Sectors to the extent of 75% or more of their total assets (net of intangible assets). Other NBFCs (including Infrastructure Finance Companies) need to keep tier I capital at 10%. The compliance will be required to be achieved in phased manner over 3 years for both types of NBFCs.

For other NBFCs, not falling in above para, risk weights for Capital Market exposure and Real Estate exposure has been raised to 150% and 125% respectively.

Captive NBFCs are defined as NBFCs where 90 per cent and above of total assets (net of intangibles) are deployed for financing parent company's products /services.

All Government companies that qualify as NBFCs under the revised principal business criteria will be required to comply with the regulatory framework applicable to NBFCs at the earliest.

Asset Classification – NPA

Prudential Norms in respect of provisioning against Non-Performing Assets will be in alignment with those of Banks. Assets will become NPA if interest or principal repayment is overdue for 90 days instead of 180 days criteria at present. The same will be implemented in phased manner. Provision on Standard Asset shall be increased to 0.40% from present requirement of 0.25%.

Deposit taking NBFCs

All Existing Deposit Taking NBFCs should be credit rated; existing unrated NBFCs-D will be given a year's time to get them rated if they wish to continue to accept deposits. They will not be allowed to accept any fresh deposits or renew existing deposits till they get ratings.

Upper limit for acceptance of deposits for rated Asset Finance Companies is reduced to 2.5 times of Net Owned Funds (NOF) as against present limit of 4 times of NOF. This is going to have impact on asset financing NBFCs negatively in terms of business growth unless the NBFCs are able to pump in more of tier I funds in terms of issue of Equity Capital and such similar items which can be counted for the purpose of Net Owned Fund.

Each of such AFCs would be given specific time period within which they should comply with the norm of 2.5 times the NOF.

Criteria for new entrants as NBFCs

Before applying for registration, minimum asset size needs to be ₹ 25 crores. The company should fulfil 75% Financial Assets AND 75% Income from Financial Assets Criteria (at present the same are 50%). No change has been proposed for minimum Net Owned Funds requirements which continues to be ₹ 2 crores. For FINANCIAL ENTITIES having asset size ₹ 1000 crores or more, need to register if Financial Assets OR Income from Financial Assets exceeds 50%.

Position of existing NBFCs

NBFCs having total assets below ₹ 25 crores are required to notify RBI within 3 months from date of notification with a roadmap to increase the asset size to ₹ 25 crores (2 years period allowed to achieve the same). Revised Principal Business criteria (75% instead of 50%) to be fulfilled in phased manner. If NBFC has no plan to go above ₹ 25 crores asset size, the company needs to surrender CoR and get it de-registered.

The company will need to approach RBI afresh thereafter for CoR if asset size exceeds ₹ 25 crores and company desires to access public funds or in case where asset size exceeds ₹ 500 crores even if no public funds are accessed. Assets of all NBFCs in single group will be aggregated for checking applicability of revised regulations.

Liquidity management

All registered NBFCs (Whether deposit taking or non-deposit taking) should maintain high quality liquid assets, equal to the gap between expected cash outflows and inflows in the immediate 1 to 30 days' time bucket. Quality liquid assets include cash, bank deposits available within 30 days, money market instruments maturing within 30 days, actively traded debt securities with ratings.

Corporate governance

NBFCs need to take prior approval from RBI for change in control and/or shareholding of more than 25%, directly or indirectly. However, acquisitions in the ordinary course of business by an underwriter, a stock broker and a merchant banker are not covered by this requirement.

"control" shall have the same meaning as is assigned to it under clause (c) of sub-regulation (1) of regulation 2 of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. (Right to appoint majority of the Directors or to control management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their share-holding or management rights or shareholders agreement or voting agreements or in any other manner).

For any acquisitions and for all mergers under Section 391-394 of the Companies Act, 1956 by or of an NBFC, the NBFC involved should approach the Reserve Bank (even before filing for the same in the Courts) to ensure adherence to the basic tenets of corporate governance and overall health of the sector.

In addition to above norms, there can be no change in control of the NBFC prior to commencement of business and regularization of its CoR.

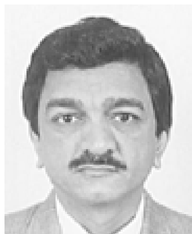
Companies having asset size Rs. 1000 crore or more will have to follow 'Clause 49' of Listing Agreement compulsorily. In addition, there are further compliances to be fulfilled such as need to form remuneration and compensation committee, to disclose their provision coverage ratio, liquidity ratio, asset liability profile, extent of financing of parent company products, NPAs and movement of NPAs, details of all off-balance sheet exposures, structured products issued by them as also securitization/assignment transactions and other disclosures as given in annexure detailed vide draft guidelines announced.

Disclosure Norms in balance sheet has been enhanced to include disclosure of any registration under SEBI, IRDA, Stock Exchange, Commodity Exchanges, any credit ratings assigned by rating agencies and also disclose penalties charged by any of the regulators.

Norms Affecting Directors and Directorships

- Need to take prior approval for appointment of CEO for NBFCs having assets ₹ 1,000 crores and above. In companies with assets ₹ 1000 crores and above, the number of Directorships held by a single director of any NBFC, public or private, may not exceed the maximum number prescribed under section 275 of the Companies Act, 1956.
- NBFCs need to put in place an internal supervisory process on a continuing basis to carry out due diligence on directors, all NBFCs-ND-SI and NBFC-D shall have a policy in place for ascertaining fit & proper criteria for appointment of directors and shall certify annually to RBI about fit and proper status of the Directors.
- At the time of appointment or reappointment of directors, NBFCs will need to undertake due diligence process to determine the suitability of the person for appointment/ continuing to hold appointment as a director on the Board, based upon qualification, expertise, track record, integrity and other 'fit and proper' criteria.
- Fit and proper person declaration to be given by Directors including the list of relatives, associated entities connected or interested in any other NBFCs.
- Fund and non-fund based facility presently availed by Director himself or by his relatives or associated concerns from any NBFCs
- Nominated/elected directors need to execute the deeds of covenants in the format given by RBI.

The proposed amendments seek to change the entry point norms, major regulations and norms pertaining to NBFC sector. However, one has to wait and watch for the final notification when and how ultimately it will take shape.



B.V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

Addition on account of difference between outstanding amount due as per the bank and amount payable as per the books of account of the assessee. – No penalty u/s. 271(1)(c)

Northland Dev. & Hotel Corporation vs. CIT, Agra [Civil Appeal No. 2134 of 2007], dated 18th Sept., 2012 [349 ITR 363]

The assessee took loan from Citi Bank N.A. to buy a hotel but defaulted in re-payment of loan. Suit was filed for recovery, which was settled by signing consent decree on 30th April, 1982. The consent decree recited that the borrowers acknowledge their liability to the plaintiff-bank for the sum of ₹ 42,45,477/-, being the outstanding amount in the loan account of the Bank as on 30th April, 1982. However, in the books of account of the assessee, the outstanding amount repayable to the Bank was ₹ 52,07,873/- as on 30th April, 1982. Consequently, the Department considered the difference of approx. ₹ 10 lakhs being waiver by the Bank as income of the assessee. Further, the Department initiated penalty proceedings against the assessee u/s 271(1)(c) of the Act.

The Hon'ble Supreme Court held as under:

"It is true that, in the books of account of the assessee, the outstanding amount, as on 30th April, 1982, was ₹ 52,07,873/-, including interest. However, the decree in favour of the bank was for ₹ 42,45,477/- because that was the amount indicated as the outstanding amount due and payable by the assessee to the Bank in its books of account. It appears that the Bank has not calculated the interest over the years possibly for the reason that, in its Accounts, this amount was classified as 'NPA'.

In the peculiar facts and circumstances of this case, Section 271(1)(c) of the Income-tax Act, 1961, is not applicable."

Section 154 not applicable where the question of law is involved

Dinosaur Steels Ltd. vs. Joint Commissioner of Income-tax [Civil Appeal No. 2135 of 2007] – dated 13th Sept., 2012 [349 ITR 360]

The assessee, an industrial undertaking engaged in the manufacture of steel products. For the assessment year 1997-98, a return of income was filed disclosing an income of ₹ 3,31,188/-. The total income declared by the assessee was ₹ 34,92,096/- on which amount, a deduction under section 80-IA @ 30% amounting to ₹ 10,47,629/- was claimed. The balance sum of ₹ 24,44,467/-, was adjusted against a sum of ₹ 21,13,280/- being carried forward losses of earlier assessment years. The said return was processed under section 143(1)(a) of the Income-tax Act.

Subsequently, the AO, in the proceedings u/s. 154 of the Act, restricted the deduction u/s 80 IA to the profits after setting off losses of earlier years rejecting the objections of the assessee, who had relied on the decision of *CIT vs. K. N. Oil Industries (226 ITR 547, MP)*. It was also contested by the assessee that section 154 of the Act was not applicable as there was no patent error in the order passed u/s 143(1) of the Act. The CIT(A) dismissed the appeal of the assessee.

Relying on the decision of the Hon'ble Supreme Court in the case of *CIT vs. Kotagiri Industrial Co-operative Tea Factory Ltd [224 ITR 604]*, the Tribunal dismissed the appeal of the assessee holding that the deduction under section 80-IA can be allowed only after setting off the carried forward losses of the earlier years in accordance with section 72 of the Act. Therefore, according to the Tribunal, there was a patent mistake in the assessment order passed under section 143(1)(a) and consequently, the AO was right invoking section 154 of the Act. This decision of the Tribunal was upheld by the High Court.

Allowing the appeal of the assessee, the Hon'ble Supreme Court held as under:

"In our view, section 154 of the Act was not applicable in this case. It is important to note that the provisions of Chapter VIA, particularly those dealing with quantification of deductions have been amended at least eleven times. Moreover, even section 80IA, was earlier preceded by sections 80HH and 80-I, which has resulted in plethora of cases. In fact, some of the amendments have been enacted even after the judgment of this Court in the case of Kotagiri Industrial Co-operative Tea Factory Ltd. (supra) delivered on 5-3-1997. In the circumstances, we are of the view that one cannot say that this is a case of a patent mistake. The assessee followed the judgment of the Madhya Pradesh High Court in K. N. Oil Industries (supra). Hence, the assessee is right in submitting that the issue involved a moot question of law, particularly at the relevant time (assessment year 1997-98)."

The sum, not placed in separate interest-bearing account but formed a part of total income, constitutes income and can't be treated as 'contingent deposit'

M/s. Sundaram Finance Ltd. vs. Assistant Commissioner of Income Tax, Chennai, [Civil Appeal No. 5895 of 2008] –dated 11th Sept., 2012 [349 ITR 356]

The assessee, a NBFC, filed its return of income for assessment year 1998-99 for total income of ₹ 50,38,16,950/-. During the said A.Y., the assessee collected a sum of ₹ 36,47,585/- as 'contingent deposit' from leasing and hire purchase customers on an *ad hoc* basis with a view to protect it from sales tax liability, which the assessee was disputing. The assessee didn't offer such sums as income as the said sums were 'contingent deposits' being refundable.

The Tribunal held the said sum as income of the assessee and Hon'ble Madras High Court also confirmed the decision of Tribunal.

The Hon'ble Supreme Court observed that it is now well settled that in determining whether a receipt is liable to be taxed, the taxing authorities cannot ignore the legal character of the transaction which is the source of the receipt. The taxing authorities are bound to determine the true legal character of the transaction. Applying the substance over form test, it was held that since the sum of ₹ 36,47,585/- collected from the customers towards sale tax liability, was not kept in a separate interest bearing bank account but it formed part of the business turnover of the assessee, the said sum constituted income. Hence, the appeal of the assessee was dismissed.

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DIRECT TAXES
High Court

1. Powers of Appellate Authorities – Appellate Authorities have not only additional legal but also claims not made in return of income – A.Y. 2004-05

CIT vs. Pruthvi Brokers and Shareholders Pvt. Ltd. [2012] 349 ITR 336 (Bom.)

In the instant case the Hon'ble High Court held that an assessee is entitled to raise not merely additional legal submissions before Appellate Authorities but is also entitled to raise additional claims. The High Court further held that Appellate Authorities have jurisdiction to deal not merely with additional grounds, which became available on account of change of circumstances or law, but also additional grounds which were available when return was filed.

2. Depreciation – Sec. 32 – Differrence between building and plant – Cold storage constitues plant – Eligible for higher depreciation – A.Y. 2004-05

Shyam Enterprises vs. CIT [2012] 349 ITR 418 (All)

The assessee was carrying on the business activity of a cold storage. It claimed depreciation on the cold storage at the rate of 25%, which included the cooling plant, and special storage lined with thermocole, as in the view of the appellant the storage chambers did not have any separate existence from the cooling plant. The Department allowed the rate of depreciation at the rate of 10% on the storage chambers. The Tribunal held in favour of the Department. On appeal to the High Court, the Hon'ble High Court while allowing the appeal held that, the whole building which houses the chambers has to be constructed according to specifications in a particular manner. The cooling plant, building and thermocole used to line the storage chamber cannot function independently, like a refrigerator cannot be divided into two parts namely the cooling system behind the refrigerator and the cabinet in front. Therefore the cooling plant cannot be separated in a manner that the special chamber may have separate existence and be treated as building for allowing a lower rate of deprecition.

3. Penalty – Sec. 271(1)(C) – AOP filing nil returns – Profits distributed among members – Two views possible – penalty not levy able – A.Y. 2003-04

CIT vs. Pradeep Agencies Joint Venture [2012] 349 ITR 477 (Delhi)

The assessee AOP filed nil returns and claimed refund of the TDS. The assessee was required to explain incomes for the relevant year, where it was explained that the profits were distributed to the AOP member and the same income was offered in their hand. The issue was decided against the assessee by the High Court, which held that the income should have been assessed in the hands of AOP. Penalty was levied and the matter reached to the High Court, the High Court held that two views were possible, and for that reason alone, at the Tribunal level, it was referred to a special bench for consideration, and therefore penalty was not leviable in the said matter.

4. Time limit for assessment – Sec. 153(2A) – Assessment completed after two years from end of the financial year in which it was remanded – Assesement barred by limitation – A.Y. 1988-89

Instruments and Control Co. vs. CCIT [2012] 349 ITR 571 (Guj.)

Assessee for the relevant year had filed its return of income. The return was selected for scrutiny and additions were made to the same. The CIT(A) confirmed the additions of the appellant. The Tribunal remanded the matter back to the file of the AO with a direction that the assessee should be given an opportunity to cross examine the parties on the basis of whose statements addition to the income of the assessee were made. The AO did not act on the said order to the Tribunal. The assessee made representations, but AO did not take any steps pursuant to the order. The assessee filed a writ petition claiming a refund. During pending of writ, the AO tried to revive the assessment which had remained dormant for years. The assessee filed a writ, that the assessement was barred by limitation. The High Court while allowing the writ held that pursuant to the Tribunal's order, the AO had to pass a fresh assessment order, and the period of limitation as prescribed u/s 154(2A) would apply.

5. Provisional Attachment – Sec. 281B – Validity period of six months of provisional attachment will amount to order will be extinguished after passing of assessment order

Motorola Solutions India (P) Ltd. vs. CIT [2012] 27 taxmann.com 327 (Punjab and Haryana)

A draft assessment order under section 144C was passed by Assistant Commissioner wherein certain additions were made in the petitioner's income. The petitioner filed objections before the DRP to the draft assessment order. In the meanwhile, a proposal for provisional attachment of the assets of the petitioner under section 281B was sent to the Commissioner which was approved. Letters/notices were issued to the Bank and sundry debtors of the petitioner so as not to make any payments to the petitioner. Therefore the petitioner filed the instant petition for issuance of an appropriate writ, direction or order for quashing the order whereby the provisional attachment was ordered and for quashing of letters/notices directing the banks and debtors not to make payment to the petitioner. The Petitioner submitted that during the pendency of the writ petition, the assessment order had been passed and, therefore, the provisional attachment order ceased to operate. According to the revenue, the validity period of six months of the provisional attachment order would

not be extinguished after passing of the assessment order. The issue before High Court was whether provisional attachment order would cease to operate after passing of assessment order. Allowing the Writ Petition, the court relied on provisions of section 281B wherein the court held that as per this provision, during the pendency of any assessment proceeding or proceedings in pursuance to reassessment that in order to safeguard the interests of the revenue, after recording reasons for the same in writing and seeking the approval from the concerned authority, an order for provisional attachment can be passed further relying on & CBDT Circular No. 179 dated 30-9-1975, the court held that the above circular clearly envisaged that where during the pendency of any proceeding for assessment or reassessment of any income, the raising of demand is likely to take time due to investigations and there is apprehension that the assessee may thwart the collection of that demand, provisional attachment can be made. The court held that it is only till actual demand is created by passing an assessment order that the provisional attachment order will remain in operation. Another factor which deserves to be noticed relates to first proviso to sub-section (1) of section 220 of the Act where the Assessing Officer has been given an authority to reduce the full period of 30 days wherever he has reasons to believe that it would be detrimental to the revenue by allowing the full period of 30 days to deposit the demand in terms of section 220(1) of the Act. The Assessing Officer is required to have previous approval of the Joint Commissioner in this regard. Thus, there are sufficient provisions in the Act to safeguard the interest of the revenue in case the Assessing Officer has apprehension that the assessee by adopting extraneous method may thwart the recovery of the legitimate tax dues of the State.

6. Cancellation of registration – Secs. 12A; 10(23C)(VI) – Disallowance of under section 10(23C)(VI) Registration doesn't mean withdrawal of section 12 registration as well

CIT vs. Jeevan Deep Charitable Trust [2012] 28 taxmann.com 242 (Allahabad)

The assessee was granted registration under section 12A being a charitable institution. It claimed exemption under section 10(23C)(vi) on the ground that the income earned by it was relating to educational institution as the institution was solely for the educational purposes. The Chief Commissioner disallowed the claim of exemption under section 10(23C)(vi) on the ground that the institution had not solely been established for educational purposes. The Commissioner relying on the order of the Chief Commissioner initiated proceedings under section 12AA(3) upon the assessee and cancelled the registration granted to it under section 12A. On appeal, the Tribunal held that the proceeding under section 10(23C)(vi) was an independent proceeding and could not be made the sole ground for cancellation of the registration granted under section 12A. The deduction under section 11 had been allowed to the assessee for the assessment year 2006-07 and in the assessment order passed for the assessment year 2004-05 exemption under section 11 was disallowed, which order was reversed by the Commissioner (Appeals) allowing the deduction under section 11. It, therefore, set aside the order of the Commissioner and restored the registration. On an appeal in High Court, the court dismissed the appeal of the assessee and held that exemption under section 10(23C)(vi) of the Act can be claimed by an assessee without applying for registration under section 12A of the Act as it is not required to fulfil the conditions mentioned under section 11 of the Act while

claiming exemption under section 10(23C)(vi) of the Act. Further the court held that in the order passed by the Commissioner of Income Tax, there was no whisper that the assessee has not fulfilled any of the conditions of the section 11 of the Act for claiming it to be a charitable institution. The Commissioner had solely relied on the order of the Chief Commissioner of Income Tax passed under section 10(23C)(vi) of the Act while denying the exemption under the aforesaid sub-section. Therefore the court held that Tribunal had rightly restored the registration on the ground that in the Assessment Years 2004-05 and 2006-07 benefit of exemption/deduction under section 11 of the Act was allowed to the respondent-assessee.

7. Rectification – Sec. 154 – Assessing Officer is debarred from rectifying order passed by an Appellate Authority

CIT vs. V.S. Dempo & Co. Ltd. [2012] 28 taxmann.com 235 (Bom.)

The Assessing Officer allowed claim for depreciation excluding customs duty payable by assessee while determining actual cost of its vessel. The Tribunal directed to compute cost of assets by including customs duty and allowed depreciation accordingly. However, the Assessing Officer determined the cost of vessel by excluding the customs duty. The Commissioner (Appeals) held that the Assessing Officer was not entitled to ignore the orders of the Tribunal and, therefore, directed the Assessing Officer to implement the direction of the Tribunal. The Assessing Officer, accordingly, gave effect to the order of the Tribunal. However, the Assessing Officer rectified the Tribunal's order on the ground that a mistake had crept in. Commissioner (Appeals) upheld said order. The Tribunal quashed the order. On an appeal in High Court, the point of law involved was that whether an Assessing Officer is entitled to invoke section 154 to correct an assessment order which gives effect to the orders of the Appellate authorities based on his opinion that the orders of the Commissioner (Appeals) and the Tribunal are erroneous and contrary to law. The court dismissed the appeal of the revenue and held that in the present case, the Revenue did not challenge the order of the Tribunal. The matter should have ended by the AO implementing the order of the Tribunal. In fact, upon remand, the AO erroneously did not implement the order of the Tribunal. The AO, ultimately, did so only when the CIT(A) by the said order dated 19th March, 1997 directed him to do so, stating that the AO was bound by the judgment of the Tribunal. The Revenue did not challenge this Order of the CIT(A) either. The matter regarding the claim for depreciation stood concluded, as far as the AO, the CIT(A), as well as the Tribunal are concerned. If the Revenue considered the order of the Tribunal incorrect, it was bound to challenge the same in accordance with law. The AO was not entitled *suo motu* under section 154 to do so. The court further held that as rightly held by the Tribunal, section 154 can be invoked in respect of an order by the AO who passes the order. The AO cannot invoke section 154 in respect of the orders passed by the Appellate Authorities – whether it is the CIT(A) or the ITAT. In other words, the AO can rectify a mistake in his own orders and not in the orders passed by the appellate authorities. Indeed in this case, the AO had not only stated that the Tribunal did not have the benefit of the decision of the Supreme Court as it was rendered earlier, but has taken liberty of criticising the Tribunal stating that the Tribunal granted depreciation "even though the ITAT was aware that such custom duty was not payable by a subsequent notification

by the Govt. of India in 1987." He ought not to have done so.

8. Revision of orders prejudicial to revenue – Sec. 263 – Not sustainable if AO chose to allow same after due analysis

Commissioner of Income-tax vs. Vodafone Essar South Ltd. [2012] 28 taxmann.com 273 (Delhi)

The assessee paid certain amount towards regulatory fee and stamp duty and claimed deduction of same as a revenue expenditure. The Assessing Officer during the course of the original assessment proceedings issued a questionnaire to the assessee and after considering all the details furnished by it allowed the claim of deduction and passed assessment order under section 143(3). The Commissioner issued on the assessee a notice under section 263 stating that the licence fee, loan arrangement charges and stamp duty under the bank guarantee were capital expenditure. He rejected the assessee's contentions and passed an order on it. The Tribunal set aside the order passed by the Commissioner. On further appeal in High court, the court dismissed the appeal of the revenue and held that in this case, the assessee contended that the view taken by the Commissioner was not the only possible one and that even before finalisation of his order, the decision in Comsat Max Ltd. (supra) rendered by the Delhi Tribunal by order dated 30-1-2009 was specifically brought to the notice. It specifically mentioned that such a licence fee does not confer an enduring benefit or advantage and that it would fall in the Revenue field. The relevant extract of the citation too was reproduced in the letter dated 24-3-2009. However, the Commissioner in his order under section 263 did not even advert to it. In such circumstances, the court was of the opinion that the view adopted by the Assessing Officer was clearly one among the two plausible views that could have been taken which clearly dis-entitled the CIT (Appeals) to exercise his jurisdiction under section 263, in terms of the decision of the Supreme Court in Malabar Industrial Co. Ltd. (supra). In the present case, the records revealed that the assessee was specifically queried regarding the nature and character of the one-time regulatory fee paid by it as well as the bank and stamp duty charges. A detailed explanation in the form of statements and other documents required of by the Assessing Officer were produced at the stage of original assessment. Clearly this was not a case of "No Enquiry". The lack of any discussion on this cannot lead to the assumption that the Assessing Officer did not apply his mind. The proceeding in fact showed that Assessing Officer directed his mind specifically on this aspect and then concluded that the expenditure was in the revenue field. Moreover the decision in Comsat Max Ltd. (supra) has ruled that the expenditure was revenue; it constituted one plausible or reasonable view. Under such circumstances, the Commissioner could not have validly exercised his supervisory or revisionary power under section 263. As far as the other issues i.e. bank guarantee charges and stamp duty were concerned, the Court was of the opinion that the decision in *India Cements Ltd. vs. CIT [1966] 60 ITR 52 (SC)* and *Jeewan Lal (1929) Ltd. vs. CIT [1971] 74 ITR 143 (Cal.)*, concluded the issue. These expenses had to be regarded as falling properly in revenue filed. The court also held that CIT (Appeals) did not specifically furnished any reasons to say why the original assessment order was unsupportable in law, in the final order made by him on 30-3-2009.

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DIRECT TAXES
Tribunal

Reported Decisions

1. Charitable trust – Registration – Sec. 12A – Where the objects of trust had been altered without consent of department – Director (Exemption) cannot cancel registration under section 12AA(3) without giving a finding that objects of trust are no longer charitable. A.Y.: 2009-10

Krupanidhi Educational Trust vs. DIT (E) (2012) 139 ITD 228 (Bang.)

The assessee a charitable trust was formed with main object of imparting education the trust was granted registration u/s 12A of the Act. Thereafter, assessee amended certain clauses in its original trust deed to include technical and medical education within its ambit. The amendment was carried out without intimating the DIT (E). The DIT(E) was of the view that the assessee ought to have informed the department and ought to have got their permission, before carrying out amendment to the trust deed. Accordingly, the DIT(E) relying upon the decision, in the case of, *Allahabad Agricultural Institute vs. UOI - [(2007) 163 Taxman 67 (All)]* cancelled the registration already granted to the assessee.

On appeal the Tribunal held that, the objects of the assessee were charitable and on this aspect there is no dispute or doubt. There is no finding that the objects of the trust after the amendment of the trust deed are not charitable, nature of the trust remained the charitable even after the amendment. The mere fact that the objects of the appellant were altered without the consent of the department would not be sufficient to cancel the registration granted under section 12 A of the Act without giving a finding that the assessee's objects are no longer charitable. The Tribunal further held that the power to cancel registration already granted under section 12A of the Act can be done in two situations:

(a) satisfaction of the DIT (E) that the activities of the trust or institution are not genuine;

(b) satisfaction of the DIT(E) that the activities of the trust or institution are not being carried out in accordance with the objects of the trust or institution.

In the assessee's case there is no finding on the satisfaction of any of the above two conditions also.

2. Reassessment – S. 147 – Deduction under section 80HHC allowed after scrutiny under section 143(3) – Reassessment proceedings initiated thereafter for the reason that the deduction was excessive was held not valid. A.Y. 2004-05

Dy. CIT vs. Lee Pharma P. Ltd. (2012) 20 ITR (Trib.) 499 (Hyd)

The assessee company was engaged in the business of manufacturing bulk drugs and intermediates.

The case of assessee was selected for scrutiny and order u/s. 143(3) was passed after allowing deduction u/s. 80HHC of the Act. Subsequently the Assessing Officer observed that the assessee had adopted incorrect adjusted export turnover and adjusted total turnover and also the eligible profits for working out deduction u/s. 80HHC. Accordingly, the Assessing Officer reopened the assessment under section 147 of the Act. The assessee contended that the action of the Assessing Officer amounted to only a change of opinion on account of an audit objection. Therefore, the reassessment was not valid.

On appeal the Tribunal quashing the reassessment proceedings held that that when a regular assessment order is passed in terms of the sub-section (3) of section 143 presumption can be raised that such an order has passed on application of mind. It is well known that a presumption can also be raised to the effect that in terms of clause (e) of section 114 of the Indian Evidence Act, 1872, judicial and official acts have been regularly performed. The Tribunal further, held that if it is assumed that an order passed without application of mind would confer jurisdiction upon the Assessing Officer to reopen the proceeding, the same would amount to giving a premium to an authority exercising quasi-judicial function to take benefit of its own wrong.

3. Assessment of search case made under Chapter XIV-B cannot be reopened under section 147. A.Y. 1999-2000

ACIT vs. Vidit Kumar Agarwal [2012] 26 taxmann.com 185 (Agra-Trib.)

The Police Authorities at Jhansi intercepted a car in which three persons namely Shri Ram Kishan Agarwal, Shri Vidit Kumar Agarwal (assessee) and Shri Deepak Agarwal were travelling. The Driver of the car was Shri Kamta Prasad Agarwal. On search of the vehicle, the Police authorities found cash of ₹ 32,34,600/- in three bags. The Police authorities recorded the statement of occupants of the car and the information was passed on to Income-tax Department. Consequently cash of ₹ 32,34,600/- was requisitioned by the Department under section 132A of the Income Tax Act, 1961 ('the Act' hereinafter). As per the A.O. the assessment proceedings in the name of A.O.P. consisting of Shri Vidit Kumar Agarwal, Shri Ram Kishan Agarwal & Shri Deepak Agarwal were initiated under the provisions of Chapter XIVB of the Act. Thereafter all the three individual Shri Vidit Kumar Agarwal, Shri Ram Kishan Agarwal & Shri Deepak Agarwal filed Wit Petitions before the Hon'ble Allahabad High Court challenging the initiation of assessment proceedings. The Hon'ble High Court disposed of all these writs with the direction to the Department to decide as to whether the aforesaid amount which was seized was disclosed or undisclosed income of the petitioners and thereafter the Department should proceed in the matter. In consequence to the direction of the Hon'ble High Court, the DCIT, Circle-1, Jhansi passed an order dated 14-1-2000 and came to the conclusion that the seized amount was undisclosed income of these three persons from whose possession the cash was recovered and requisitioned under section 132A of the Act. The A.O. also initiated proceeding under section 158BC of the Act was initiated in the status of A.O.P. consisting of Shri Vidit Kumar Agarwal, Shri Ram Kishan Agarwal & Shri Deepak Agarwal. The assessment was made in the status of A.O.P. *vide* order dated 29-6-2000. The A.O.P. preferred appeal before the CIT(A). The CIT(A) *vide* his order dated 31-5-2002 held that the cash seized represented undisclosed income of the A.O.P. The A.O.P. further filed appeal before the I.T.A.T. and the I.T.A.T. *vide* its order dated 20-1-2005 in IT(SS) A No. 21/Agr/2002 allowed the appeal of A.O.P. by holding that the assessment in the status of A.O.P. was bad in law and, therefore, quashed the order passed under section 158BC of the Act. On receipt of I.T.A.T.'s order, the A.O. initiated proceedings under section 148 of the Act and passed the Assessment Order under the provisions of section 143(3) r.w.s. 147 of the Act. The Assessee being aggrieved by the above Assessment Order preferred an appeal before the Learned CIT(A) challenging the validity of reopening on the ground that in case of documents or any asset requisitioned under section 132A, then the A.O. shall proceed to

assess the undisclosed income in accordance with the provisions of Chapter XIVB of the Act. The CIT(A), after considering the assessee's submissions and various judgments and orders, found that the reassessment proceedings are void *ab-initio*. The department being aggrieved by the above order preferred an appeal before the Hon'ble Appellate Tribunal. The Appellate Tribunal dismissed the appeal of the department and held that section 147 of the Act itself indicate that the same is in relation to income escaping assessment and applies in a case where income chargeable to tax has escaped assessment by virtue of either non-disclosure by way of non-filing of return, or non-disclosure by way of omission to disclose fully and truly all material facts for the purpose of assessment, or processing of material already available on record, if the same is within the stipulated period of limitation. Therefore, to contend that undisclosed income has escaped assessment despite an assessment having been framed under Chapter XIV-B of the Act by adopting the special procedure prescribed by the said Chapter is to contend what is inherently not possible.

Unreported decisions

4. Appellate Tribunal – Sec. 254 – Extension of stay of outstanding demand – Assessee had been granted stay of demand on three occasions and all conditions of stay had been complied with by him – The delay in disposal of appeals was not attributable to assessee – In the aforesaid circumstances, assessee's application for extension of stay was to be allowed. A.Y.'s: 2000-01 to 2006-07

Qualcomm Incorporated vs. Asstt. DIT (Int. Tax) [I.T.A. Nos. 3696 to 3702 / Del. / 2011 in Stay Nos. 177 to 183 / Del / 2009; Order dated 28-9-2012 (Delhi Tribunal)]

Assessee had filed stay applications praying for extension of stay of outstanding demand for the stay on collection of demand was extended by the Tribunal on past three occasions as there was delay in disposal of the appeal. At the time of hearing the assessee relied upon the decision of *CIT vs. Ronuk Industries Ltd. [(2011) 333 ITR 99 (Bom)]* where the Hon'ble High Court held that in the case where the delay in disposal of pending appeal is not attributable to the assessee, the Tribunal has the power extend the stay beyond the period of 365 days even after the amendment of third proviso to Section 254(2A) of the Act w.e.f. 1-10-2008. The Revenue on the other hand relying upon the decision of *CIT vs. Ecom Gill Coffee Trading (P.) Ltd. [(2012) 209 Taxman 190 (Karn)* contended that the interim order of stay cannot be granted in the pending appeal beyond the period of 365 days, which is the outer limit stipulated in the statutory provision.

The Tribunal held that it is also not in dispute that the delay in disposal of appeals is not attributable to the assessee. Therefore, in the interest of natural justice as held by Hon'ble Bombay High Court in the case of Ronuk Industries Ltd. (supra), the stay of collection of outstanding demand ought to be granted to the assessee. The Tribunal further held that if there be cleavage of opinion amongst different High Courts as in the present case and there being no decision of the jurisdictional High Court on the issue, then the view favourable to the assessee has to be adopted.

5. Expenditure incurred in relation to exempt income – Sec. 14A, read with rule 8D of Income-tax Rules, 1962 – Assessee had investment in shares on which it earned exempt income – It had not disallowed any expenditure relating to administrative and managerial services in respect of earning of said exempt income –Assessing Officer applied rule 8D and disallowed under section 14A 0.5 per cent of average investment in shares without pointing out that any direct expense had been incurred for earning exempt income – Held disallowance under section 14A requires a clear finding of incurring of expenditure, in absence of same, no disallowance could be made. A.Y. 2008-09

Priya Exhibitors P. Ltd. vs. Asstt. CIT [I.T.A. No.: 1707 / Del. / 2011; Order dated. 11-5-2012 (Delhi Tribunal)]

The assessee had made investments in shares from which it earned dividend income which was exempt. The assessee had itself disallowed interest of ₹ 79,82,413/- which was directly attributable to the investment in shares however, it had not disallowed any expenditure relating to administrative and managerial services, as according to it expenses other than interest were incurred for earning dividend income. The assessing officer without identifying any expenditure incurred by the assessee for earning dividend income invoking the provisions of Rule 8D added back an amount being 0.5% of average investment in shares.

On appeal the Tribunal held that the Assessing Officer must in the first instance determine whether the claim of the assessee is correct and such determination must be made having regard to the accounts of the assessee. The Legislature directs him to follow Rule 8D only where he is not satisfied with the claim of assessee. In the present case, the Assessing Officer has not specifically pointed out any direct expense apart from interest expenses which was already disallowed by the assessee. Further, the Tribunal held that the Assessing Officer had also not given any finding regarding the correctness of claim of the assessee that no expenditure has been incurred for earning exempt income. The Assessing Officer had simply relied upon the plain reading of section 14A read with Rule 8D without properly analysing it which is not the justified.

6. Penalty under section 271(1)(c) of the Act – bona fide claim – All material facts relevant to the claim furnished truly and fully – penalty not leviable. A.Y. 2005-06

Radhe Krishna Fiscal Pvt. Ltd. vs. Dy. CIT [I.T.A. No. 6256 / Mum. / 2011; Order dated 14-12-2012 (Mumbai Tribunal)]

The assessee filed its return of income declaring a loss of ₹ 97,26,132/-which comprised loss of ₹ 96,61,297/- on account of trading in derivatives. The A.O. while finalising the assessment order under section 143(3), computed loss at ₹ 8,35,500/- after disallowing loss of ₹ 96,61,291/- on account of trading in derivatives as normal business loss observing that the nature of derivative transaction itself was nothing but purely speculative transaction and the loss arising from such transaction was speculation loss which could be carried forward and set off only against speculation income. The A.O. rejected the contention raised by the assessee that the amendment made in section 43(5) of the Act by inserting clause (d) by the Finance Act, 2005 to exclude derivative transaction from the ambit of speculative transaction is applicable retrospectively holding that the said amendment being substantive in nature is applicable with effect from 1st April, 2006. The A.O. has levied penalty under section 271(1)(c) of the Act in respect of addition made on account of disallowance of its claim for loss arising from derivative transactions holding that the assessee has furnished inaccurate particulars of its income. On appeal the First Appellate Authority confirmed the order of the A.O. in levying the penalty.

The assessee being aggrieved by the order passed by the Learned CIT(A) preferred further appeal to the Hon'ble Income Tax Appellate Tribunal, Mumbai. Hon'ble Appellate Tribunal cancelled penalty levied by the A.O. by holding that although the issue relating to assessee's claim for loss on account of trading in derivatives being a normal business loss or speculation loss has been decided by the Hon'ble Bombay High Court in the case of *CIT vs. Shri Bharat R. Ruia (HUF) [2011] 337 ITR 452 (Bom.)* against the assessee on April 18, 2011, there were decisions rendered by the Tribunal prior thereto accepting the stand of the assessee that loss on account of derivative trading was not a speculation loss but was allowable as a business loss. Keeping in view the said decisions of the Tribunal cited by the learned counsel for the assessee, we agree with his contention that the view taken by the assessee while claiming the loss on account of derivative trading as a normal business loss was a possible view and the claim so made by adopting a possible view was *bona fide*. Moreover, the SLP filed by the assessee against the decision

of Hon'ble Bombay High Court in the case of Shri Bharat R. Ruia (HUF) (supra) has already been admitted by the Hon'ble Supreme Court *vide* its order dated 5-9-2011 which shows that the issue relating to assessee's claim for loss on account of derivative trading being a normal business loss involve a substantial question of law and as held by the co-ordinate bench of this Tribunal in the case of Nayan Builders & Developers Pvt. Ltd. (TTA No. 2379/Mum/2009 dated 18th March, 2011), no penalty under section 271(1)(c) can be imposed in respect of disallowance on the issue which involves a substantial question of law.

7. Expenses or payments not deductible in certain circumstances – Section 40A(3) – Assessee made purchases in cash – None of the cash payments exceeded ₹ 20,000/- – provisions of section 40A(3) are not applicable – A.Y. 2007-08

Shri Firoz Lokandwala [Prop. M/s. Swan Leather Exports] vs. Asstt. CIT- 15(3) [I.T.A. No. 8524 / Mum. / 2011; Order dated 7-12-2012 (Mumbai Tribunal)]

The assessee during the impugned assessment year made purchases in cash amounting to ₹ 11,73,816/-. The Assessing Officer, while passing the assessment order, invoked the provisions of section 40A(3) and disallowed 20% of above cash payments amounting to ₹ 2,34,763/-. The assessee being aggrieved by the assessment order preferred an appeal before the Learned CIT(A). The assessee contended before the Learned CIT(A) that the provisions of section 40A(3) is not applicable in his case as all the payments made were below ₹ 20,000/-. However, the Learned CIT(A) has confirmed the action of the A.O., *inter alia*, observing that the assessee has made bulk purchases at one go but while making payment, it has deliberately shown the payment for consecutive days keeping the amount slightly less than ₹ 20,000/-. The Learned CIT(A) concluded that the assessee has deliberately violated the provisions of Sec. 40A(3).

The assessee carried the matter further in appeal before the Income Tax Appellate Tribunal, Mumbai. Hon'ble Appellate Tribunal after considering the facts and circumstances of the case deleted the disallowance made by lower authorities by observing that the language of the section 40A(3) is absolutely clear that the expenditure can be disallowed only when the payment is made in cash for a sum exceeding ₹ 20,000/-. As the assessee has not made the payment exceeding sum of ₹ 20,000/-, provisions of sec. 40A(3) are clearly not applicable.

8. Deemed dividend – Section 2(22)(e) – Assessee received loan from M/s. Bad Boys Pvt. Ltd – Assessee was neither a shareholder nor have any substantial interest in the lender company – Provisions of Section 2(22)(e) are not applicable – A.Y. 2007-08

ITO 10(1)(4) vs. M/s. Victoria Realty Pvt. Ltd. [I.T.A. No. 7232 / Mum. / 2010; Order dated 7-12-2012 (Mumbai tribunal)]

The assessee received loan from M/s. Bad Boys Pvt. Ltd. The A.O. while passing the Assessment Order treated the above receipt as deemed dividend invoking the provisions of section 2(22)(e) and added the same to the assessee's income. The assessee being aggrieved by the Assessment Order preferred and appeal before the Learned CIT(A). The Learned CIT(A) deleted the addition made under section 2(22)(e) of the Act by relying on the decision of the ITAT Mumbai Special Bench in the case of *ACIT, Mumbai vs. Bhaumik Colour (P.) Ltd. (2009) 118 ITD 1 (Mum.) (Special Bench)* where it was held that the deemed divided can be assessed only in the hands of a person who is shareholder of lender company and not in the hands of the borrowing concern in which such shareholder is Member or partner having substantial interest.

The department being aggrieved by the above order passed by the Learned CIT(A) preferred an appeal before the Appellate Tribunal. The Appellate Tribunal dismissed the appeal by observing that the decision of Special Bench has been approved by the Hon'ble Bombay High Court in the case of *CIT vs. Universal Medicare Private Limited (2010) 324 ITR 263 (Bom.)*. Thus, following the decision of Hon'ble Bombay High Court, the Hon'ble Appellate Tribunal held that the provisions of section 2(22)(e) is not applicable in the facts of the assessee's case.

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DIRECT TAXES
Statutes, Circulars & Notifications

Income-tax (Fifteenth Amendment) Rules, 2012 – Amendment in Rules 11U and 11UA

The CBDT has amended rules 11U and 11UA of the Income-tax rules 1962, regarding meaning of expressions used in determination of fair market value and Determination of Fair Market Value respectively as 15thAmendment Rules, 2012 which shall be in force on the date of their publication in the Official Gazette, substituting the definition of "accountant", "balance sheet" and "valuation date" in rule 11U and renumbering rule 11UA giving working of fair market value of unquoted equity shares to be determined by a merchant banker or an accountant.

(Notification No. 52/2012 -IT dated 29-11-2012)

Posting Policy for posting of officers in the Directorates of International Taxation & Transfer Pricing

This notification is issued by CBDT in supersession of the notification of even number dated December 15, 2010 and will apply to all future postings in the Directorates of International Taxation & Transfer Pricing with immediate effect. The Department's Annual General Transfer Pricing Policy shall apply for selection of officers for being posted in the Directorates of International Taxation &. Transfer Pricing subject to the conditions mentioned in the said notification.

(Notification No. [HRD/CM/103/2010-11/1055], dated 30-11-2012)

Rajiv Gandhi Equity Savings Scheme, 2012 – Corrigendum

In the notification of Government of India, Ministry of Finance, Department of Revenue, No. 51/2012, dated 23rd November, 2012 some corrigendum's related to definitions on page 10 of the earlier notification have been issued for information.

(Notification No. 53/2012 [F. No. 142/35/2012 -TPL]/SO 2835(E), dated 5-12-2012)

Section 90 of the Income-tax Act, 1961 – Double taxation agreement – Agreement with foreign countries or specified territories – Notified 'Specified Territory'

As per section 90 of the Income- tax Act, 1961 the Central Government notified Sint Maarten, a part of Kingdom of Netherlands, the area outside India as the 'specified territory' for the purposes of the said section which shall come into force with immediate effect.

(Notification No. 54/2012 [F. No. 503/14/2012-FTD-I (PT)], dated 17-12-2012)

Protocol amending the convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of India for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains

The Government of the United Kingdom of Great Britain and Northern Ireland and the Government of

the Republic of India, desiring to amend the earlier Convention of 1993, for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains and agreed on matters related to Dividends, Exchange of Information, Tax Examinations Abroad and Assistance in the collection of Taxes.

(Press release dated 9-11-2012)

Government in a statement states that appropriate action has been taken on the information received by it from the Government of France in June 2011

Information was received in June, 2011 by the Government of India from the Government of France relating to certain bank accounts reportedly held by certain individuals/non-individuals in a foreign bank. Reference to this matter was made by the then Finance Minister during the course of the debate on an adjournment motion in the Lok Sabha on 14-12-2011. Subsequently, answers to questions on this matter were furnished in the Rajya Sabha on 23-8-2012.

Information received from the Government of France has been analysed and investigations into the information have been undertaken by the different jurisdictional authorities under the Income-tax Act, 1961. Investigations in the matter are under progress including with the foreign tax authorities to obtain more information with regard to the reported account holders. Appropriate action has been taken on these cases and further action including assessment, tax collection and levy of penalty will be taken as per the provisions of the Income-tax Act, 1961 and based on the facts of each case.

It would be pertinent to point out that the information received from the Government of France is covered by the confidentiality clause under the Double Taxation Avoidance Convention (DTAC) between India and France and can be used only for the tax purposes specified there in. (Press release dated 10-11-2012)

Step-wise procedure for adjustments of refunds by CPC

With regard to the adjustment of refunds against the outstanding demands, various communications have been issued in the past. A brief reference of the same is as under:

i. AST Instruction No. 82 on the subject 'Functionality for uploading arrear demands to CPC accounting system', dated 13-8-2010, issued from F. No. CPC/1/1/2007/02-DIT(S) III- Part File.

ii. Departmental Instruction addressed to all CCsIT/DGsIT on the subject 'Instructions to Assessing Officers – Rectification in case of demand adjusted against refund at CPC and assessee disputing such adjustments -reg', dated 19-11-2011, issued from F.No. DGIT(S)/ Misc./2011-12.

iii. DO letter from Member CBDT to all CCsIT/DGsIT on the subject 'Reconciliation of demand on CPC Portal, IRLA, CAP-I and Dossier – reg', dated 14-3-2012, issued from F.No. DIT(S)-III/CPC Portal/2011-12.

iv. Letter from CBDT to all CCsIT/DGsIT on the subject 'Uploading of demand and/ or correction of demand already uploaded on CPC Portal – Instruction to Assessing Officers – reg', dated 20-3-2012, issued from F. No.401/01/2012/ITCC.

v. Letter from DIT(S)III to all CCsIT/DGsIT on the subject 'Reconciliation of Demand on CPC Portal, IRLA, CAP-I and Dossiers', dated 23-3-2012, issued from F. No. DIT(S)III/CPC Portal/2011-12.

vi. AST Instruction No. 105 on the subject 'Current and Contemporary Figures of demand in IRLA for a PAN-AY or for a defined period – Identification of demands yet to be uploaded on to CPC Portal', dated 4-5-2012, issued from F. No. SW/3/9/2010-ll/DIT(S) III.

vii. Letter from DIT(S)III to all CCsIT/DGsIT on the subject 'Reconciliation of Demand on CPC Portal, IRLA, CAP-I and Dossiers', dated 5-6-2012, issued from F.No. DIT(S) III/CPC Portal/2011-12.

viii. Letter from DIT(S)-III to all CCsIT (CCA) on the subject 'Clean-up of demand uploaded to CPC FAS before issue of refund in cases- processing of e-returns of A. Y 2012-13', dated 5-11-2012, issued from F. No. DIT(S) III/CPC /2011-12.

In furtherance of the subject and in continuation of the above-mentioned communications and to mitigate the problem of demand raised due to mismatch of tax and TDS credits, the step by step procedure for adjustment of refunds to be followed by Assessing Officers and Centralised Processing Centre (CPC) is as under:

i. Physical verification of Demands from all sources – Arrear Demands from IRLA, TMS and Manual Demands prior to 1-4-2010; and Demands from AST, TMS, Manual and CPC.

ii. The Assessing Officers have to communicate the legitimate actionable demands to the assessees and provide an opportunity of being heard to the assessees for verification and confirmation of the genuineness of the demands. Modifications of the demands to be made by the AO following verification of documents submitted by the assessees.

iii. The Assessing Officer and the Range head to certify the correctness and genuineness of the actionable demands.

iv. The Assessing Officer to upload the above genuine demands on the CPC-FAS.

v. The Demands are also uploaded by system in the "My Account" of the assessees on the www.incometaxindiaefiling.gov.in website.

vi. In case of refunds due, on the basis of the demand so uploaded on CPC-FAS, CPC shall issue a prior intimation u/s. 245 of the IT Act, 1961 to the assessee to adjust the refund against the correct and legitimate actionable demands due. Simultaneously, CPC will inform the Chief Commissioners of Income-tax (CCsIT) concerned regarding the intimation sent for his charge fortnightly. The assessees can approach Assessing Officer regarding grievance relating to demand, if any, within 15 days of receipt of intimation.

vii. The AO within 30 days of receipt of grievance in response to the notice u/s 245 shall either rectify or confirm the demand. The demand so crystallized shall be communicated back to the CPC in reference to the same communication *vide* which the AO was initially communicated regarding the demand. Functionality will be developed within the next six months to intimate CPC online by AO. In the interim period AO will intimate the CPC within 30 days from the date, the assessee approaches the AO.

viii. CPC to hold the refunds (refunds may be determined but kept on hold) in the interim period and following confirmation from the AO carry out adjustment of refund against the demands.

(Instruction [F.No. DIT(S)-III/CPC/2012-13], dated 27-11-2012)

General Anti-avoidance Rules

The GAAR (General Anti-avoidance Rule) provisions have not been put on hold. The Finance Act, 2012 had provided that these provisions shall be effective from the 1st day of April, 2014 and apply to Assessment year 2014-15 onwards. One of the recommendations of the Parthasarathi Shome Committee is that 'The implementation of GAAR may be deferred by three years on administrative grounds. GAAR is an extremely advanced instrument of tax administration - one of deterrence, rather than for revenue generation - for which intensive training of tax officers, who would specialise in the finer aspects of international taxation, is needed'.

(Press Release, dated 29-11-2012)

Instructions – E-payment of Tribunal Fees the respective Challans are to be countersigned by the concerned bank manager or attested by the authorised Representatives or assessees themselves

Advocates/Chartered Accountant /Authorized Representative and assessees are hereby informed that in case of E-Payment of Tribunal Fees the respective Challans are to be counter signed by the concerned bank manager or attested by the authorised Representatives or assessees themselves. In case of non-compliance of these instructions the remittance of Tribunal fees will not be treated valid.

(Office order - Dated 13-12-2012)

CA Tarunkumar Singhal & CA Sunil Lala

INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT JUDGMENTS

I. Whether where non-resident assessee's services are specifically covered under special provisions of section 44BB, then section 44DA, which is broader and more general in nature, is not applicable based on the rule that specific provision excludes the general provision? Held : Yes – Whether acceptance of contention that section 44DA covers all types of services rendered by the non-residents means reducing section 44BB to a useless lumber or dead letter and such a result would be opposed to the rule of harmonious construction? Held : Yes

DIT-II vs. OHM Ltd. [2012] 28 taxmann.com 120 (Del.)

Facts

1. The assessee, a tax resident and a company incorporated under the laws of the United Kingdom was engaged in the business of providing geophysical services to oil and gas exploration industry; and conducted electromagnetic survey, processing and interpretation of data.

2. The assessee was awarded contracts by Petro Gas E & P, LLC and CGG Veritas Services SA for procuring data, processing and interpreting the data in respect of an offshore exploration block in India.

3. The assessee applied to the concerned authority under section 197 of the Income-tax Act, 1961 ("the Act") for issuance of a certificate for receiving payments after deduction of tax at the lesser rate of 4.223% as per the provisions of section 44BB of the Act. The concerned authority however, did not accept the assessee's contention and passed an order, directing the assessee to receive payments after suffering tax deduction at source at the rate of 10% (+ surcharge + education cess) in respect of all revenues received from Petro Gas and CGG Veritas.

4. Aggrieved by the order passed under section 197 of the Act, the assessee filed an application before the Hon'ble AAR pleading that its services clearly fell within the ambit of section 44BB of the Act.

5. The Hon'ble AAR accepted the assessee's claim and ruled that the receipts were taxable at the rate of 4.223% as per the provisions of section 44BB of the Act.

6. Aggrieved, the Revenue filed a writ petition before the Hon'ble High Court questioning the correctness of the conclusion of the Hon'ble AAR.

7. The Revenue contended that the Hon'ble AAR erred in its decision that section 44BB of the

Act would apply to the present case and that it failed to note that the appropriate provision to be applied was section 44DA read with section 9(1)(vii), Explanation 2 of the Act.

8. The assessee contended that it is section 44BB which is the more specific of the two sections and which made "special provision for computing profits and gains in connection with the business of exploration, etc. of mineral oils" that was applicable and not section 44DA.

Ruling

1. The Hon'ble High Court held that there was no error in the view taken by the AAR that section 44BB of the Act is the appropriate section which is applicable to the assessee by applying the basic rule that the specific provision excludes the general provision. It observed that in coming to its decision the AAR followed its earlier decision in Geofizyka Torun Sp. Zo.o. It further observed that a similar view was also taken by a Division Bench of this Court in *Director of Income-tax vs. Jindal Drilling & Industries Ltd.*

2. The Hon'ble AAR observed that section 44BB of the Act is a special provision for computing the profits and gains of a non-resident in connection with the business of providing services or facilities in connection with, or supplying plant and machinery on hire, used or to be used, in the prospecting for, or extraction or production of mineral oils including petroleum and natural gas. On the other hand, section 44DA, however, is broader and more general in nature and provides for assessment of the income of the non-residents by way of royalty or fees for technical services, where such non-resident carries on business in India through a PE.

3. It further observed that under section 44BB of the Act, there is no reference to a PE in India and the type of services contemplated by this provision is more specific than what is contemplated by section 44DA of the Act. Thus applying the well settled rule of interpretation that if a special provision is made respecting a certain matter, that matter is excluded from the general provision under the rule which is expressed by the maxim "Generalia specialibus non derogant", it held that Section 44BB of the Act would be applicable.

4. The Hon'ble AAR further relied on "rule of harmonious construction" laid down by the Supreme Court in *Venkataramana Devaru vs. State of Mysore* that when, in an enactment two provisions exist, which cannot be reconciled with each other, they should be so interpreted that, if possible, effect should be given to both.

5. It observed that if as contended by the Revenue, section 44DA of the Act covers all types of services rendered by the non-resident, that would reduce section 44BB of the Act to a useless lumber or dead letter and such a result would be opposed to the very essence of the rule of harmonious construction.

6. Accordingly, it held that if both the sections have to be read harmoniously and in such a manner that neither of them becomes a useless lumber then the only way in which the provisos can be given effect to is to understand them as referring only to the computation of profits, and to understand the amendments as having been inserted only to clarify the position.

7. The Hon'ble High Court thus observed that the proviso to sub-section (1) of section 44BB can only mean that the flat rate of 10 per cent of the revenues cannot be deemed to be the profits of the non-resident where the services are of the type which do not fall under that section, but are more general in nature so as to fall under section 44DA. Similarly, the second proviso to sub-section (1) of section 44DA can only be interpreted to mean that where the services are general in nature and fall under the sub-section read with Explanation 2 to section 9(1)(vii), then an assessee rendering such services as provided in section 44BB cannot claim the benefit of being assessed on the basis that 10 per cent of the revenues will be deemed to be the profits as provided in section 44BB. In other words, the amendment made w.e.f. 1-4-2011 in both the sections cannot have the effect of altering or effacing the fundamental nature of both the provisions or their respective spheres of operation or to take away the separate identity of section 44BB.

8. The Hon'ble High Court thus concluded that the decision of the Hon'ble AAR that the profits shall be computed in accordance with the provisions of section 44BB and not section 44DA, was to be agreed.

B. Tribunal Decisions

I. Taxability of Mobilisation Revenue u/s 44BB – Whether mobilisation revenue was liable to tax in India, and was to be included as receipts for computing income u/s 4BB – Held : Yes

EMGS Project Office vs. DDIT [2012] 27 taxmann.com 147 (Delhi) Assessment Year : 2006-07

Facts

i) The assessee was a non-resident company showing revenue from a contract with ONGC. It offered its revenue under the said contract for assessment under section 44BB(1). The contract was for offshore activities in the nature of seismic data acquisition (i.e., sea bed logging/electro-magnetic imaging), processing and interpretation, for which activities the assessee used a vessel in connection with prospecting of oil and natural gas. The assessee, for managing the said contract, had established a project office in India.

ii) The assessee contended before the Assessing Officer that mobilisation revenue attributable to the operation of the vessel beyond 200 nautical miles from the Indian coastline was not liable to tax in India, as per the provisions of the Act and also according to the DTAA between India and Norway, the country in which the assessee company was incorporated.

iii) The Assessing Officer held that the mobilisation fee received by the assessee under the contract was to be included as receipts for computing income under section 4BB, at 10% on a deemed profit basis. The Commissioner (Appeals) confirmed the aforesaid action of the Assessing Officer.

Decision

The Tribunal held in favour of the Revenue as follows:

i) In *Sedco Forex International Inc. vs. CIT [2008] 299 ITR 238 (Uttarakhand)*, it was held that the payment made to the assessee was made outside India and the mobilisation charges paid to the assessee had no nexus with the actual amount incurred by the assessee for transportation of drilling units of rigs to these specified drilling locations in India, that the payer was liable to pay a fixed sum as stipulated in the contract regardless of the actual expenditure which might be incurred by the assessee for the purpose; that in view of the fictional taxing provision contained in section 44BB, the Assessing Officer was right in adding the amount received by the assessee towards mobilisation charges for the purpose of imposing income-tax.

ii) Sedco Forex International Inc. case (supra) has been rendered by the Uttarakhand High Court, which happens to be the jurisdictional High Court in the present case. Sedco Forex International Inc. (supra), therefore, is squarely applicable to this case. It is binding on the Tribunal.

II. Disallowance u/s 40(1)(ia) – When there is shortfall in deduction of tax at source due to any difference of opinion as to taxability of any item or nature of payments falling under various TDS provisions, can the assessee be declared to be an assessee-in-default u/s 201 but no disallowance can be made by invoking provisions of section 40(a)(ia) – Held : Yes, in assessee's favour.

UE Trade Corpn. (India) Ltd. vs. DCIT [2012] 28 taxmann.com 77 (Delhi – Trib.) Assessment Year : 2007-08

Facts

i) The assessee was engaged in trading of agricultural products. During the course of assessment proceedings, from the tax audit

report in Form No. 3CD the A.O. noted that the tax auditor had quantified the amount of ₹ 40,41,233 disallowable under section 40(a)(ia). However, in computation of income the assessee had added back only ₹ 20,16,778. The remaining amount of ₹ 20,24,455 was therefore, disallowed by the A.O.

ii) Before the Commissioner (Appeals), the assessee submitted that the Assessing Officer ought to have allowed expenditure on which tax had been deducted and should have disallowed the expenditure on which no tax had been deducted. Alternatively, it was argued that proportionate disallowance should have been made.

iii) The Commissioner (Appeals) holding that there was no scope for making proportionate disallowance under section 40(a)(ia), upheld the disallowance made by the Assessing Officer.

Decision

The Tribunal held in favour of the assessee as follows:

- The assessee contended that it deducted TDS under section 194C on storage charges whereas Assessing Officer applied provisions of section 194-I. Similarly, with reference to survey fee, the assessee had applied provisions of section 194C whereas as per Assessing Officer, the provisions of section 194J had to be applied. According to assessee, if there is shortfall in deduction of tax at source due to any difference of opinion as to taxability of any item or nature of payments falling under various TDS provisions, assessee can be declared to be an assessee-in-default under section 201 but no disallowance can be made by invoking provisions of section 40(a)(ia).
- In this case the difference in shortfall was due to the applicability of provisions. The assessee has deducted tax at source under section 194C whereas according to the Assessing Officer provisions of section 194-I are applicable. No doubt assessee is in default as per provisions of section 201 but disallowance of the expenditure is not permissible under section 40(a)(ia). Therefore, disallowance of ₹ 20,24,455 is not justified.

III. Taxability u/s 44BB – Would the consideration received as fee for technical services rendered in connection with prospecting for or extraction or production of mineral oil though effectively connected with PE or fixed place of profession would fall outside scope of section 44DA and would be assessable under section 44BB – Held : Yes, in assessee's favour.

Schlumberger Asia Services Ltd. vs ADIT [2012] 22 taxmann.com 165 (Delhi) Assessment Year : 2007-08

Facts

i) The assessee was a foreign company incorporated in the HongKong. It was engaged in the business of wire line logging, perforation and other related activities. The assessee had worked out on a number of contracts for various Oil and Gas Companies. The assessee claimed that its activities were in connection with prospecting for, or extraction or production of mineral oil and, thus, income from such activities was taxable as per the provisions of section 44BB.

ii) The A.O. did not agree with the view of the assessee. According to the A.O., such receipts were fee for technical services i.e. FTS and did not fall in purview of section 44BB. Against the draft assessment order of the Assessing Officer, assessee preferred objection before the Disputes Resolution Panel (DRP). The DRP rejected the assessee's contentions placed before it. In the impugned assessment order passed in pursuance of DRP directions, it was held that the activity undertaken by the assessee were royalty or fee for technical services and, thus, assessable under section 115A and not under section 44BB. Only the

activities of rental income from equipment leased to companies engaged in production/ exploration of oil by themselves had been held as amenable to benefit of section 44BB by authorities below.

iii) With respect to issue as to whether benefit of provisions of section 44BB was available to assessee for such services, the DRP referring to proviso to section 44BB(1) held that it clearly stipulates that this section does not apply in cases where section 115A or section 44D is applicable. For taxation of income which was taxable by virtue of special provisions for computing income by way of royalties, etc. in the case of foreign companies u/s. 44D, section 44DA was brought on the statute. DRP noted that provisions of sections 44BB and 44DA have been amended w.e.f. 1st April, 2011. However, it held that these amendments were clarificatory in nature as was evident from the relevant para of Finance Bill, 2010.

Decision

The Tribunal held in favour of the assessee as follows:

i) Section 44BB was introduced in the Finance Act, 1987 with effect from 1-4-1983 and the assessee has been assessed under section 44BB since assessment year 1983 consistently till assessment year 2006-07. For the assessment year 2007-08 the assessee had also sought its assessment under section 44BB. However, by the impugned assessment order passed in pursuance of directions of the Dispute Resolution Panel ('DRP') it has been held that the activities undertaken by the assessee are royalty or fee for technical services and, thus, assessable under section 115A and not section 44BB. Only the rental income from equipment leased to companies engaged in production/exploration of oil by themselves has been held as amenable to benefit of section 44BB by authorities below. In coming to this conclusion, both the Assessing Officer as well as the DRP has held that the agreements are not composite and have to be bifurcated.

ii) The assessee submitted that it is an undisputed position that its income is governed by section 44BB(1). The only contention of the revenue is that by virtue of the proviso to the said section the case of the assessee is out of the purview of section 44BB and is instead governed by section 115A. It has further been submitted that it is an admitted fact that the assessee operates in India through a Permanent Establishment (PE) which has earned the income under consideration. The assessee contends that the exclusion under the proviso to section 44BB does not apply to the assessee for the year under consideration inasmuch as section 115A is not applicable for the assessee who earns income through a PE. It has further been submitted that section 44DA is effective in the proviso only from assessment year 2011-12.

iii) It is the contention of the assessee that in the case of a group company of the assessee, the Tribunal has concluded the availability of section 44BB to the activities undertaken therein which are similar to those of the assessee. Further, it is the contention of the assessee that it is engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of mineral oils and, therefore, it is entitled to benefit of section 44BB as held in several cases laws.

iv) It has further been the contention of the assessee that the activities of the assessee are not affected by the proviso to section 44BB. This is on account of following reasons:

   a) Section 42 is applicable to those assessees who are themselves engaged in prospecting/production of mineral oil and, hence, not applicable to assessee being a service provider.

   b) Section 44D is not applicable since the contracts entered into by assessee are after 1-4-2003.

c) Section 293A is not applicable since no notification has been issued in this regard.

d) Section 115A is not applicable since the assessee is carrying on its activities through a Permanent Establishment in India.

e) Even section 44DA is not applicable for the year under appeal as the same is applicable only from assessment year 2011-12.

v) It has further been the contention of the assessee that the appeal is covered in its favour by the decision of *CGG Veritas Services, SA vs. Addl. DTI, International Taxation [2012] 18 taxmann.com 13 (Delhi)*. In this decision, the Tribunal has elaborately discussed the interplay of section 44BB with sections 115A and 44DA. The Tribunal has expounded in this case that the fee for technical services can be divided in following categories:

a) Fee for technical services rendered in connection with prospecting for or extraction or production of mineral oil having business PE or fixed place of profession – (section 44DA);

b) Fee for technical services rendered in connection with prospecting for or extraction or production of mineral oil without having business PE or fixed place of profession – (section 115A);

c) Other fee for technical services having business PE or fixed place of profession – (section 44DA);

d) Other fee for technical services without business PE or fixed place of profession – (section 115A).

vi) The Tribunal has further held that it is abundantly clear that with effect from assessment year 2011-12 fee for technical services whether rendered in connection with prospecting for or extraction or production of mineral oil or otherwise will be assessable either under section 44DA or section 115A of the Act depending on fact whether such receipts are effectively connected with PE or fixed place of profession, or not. However, for assessment years 2004-05 to 2010-11 the consideration received as fee for technical services rendered in connection with prospecting for or extraction or production of mineral oil though effectively connected with PE or fixed place of profession will fall outside the scope of section 44DA and will be assessable under section 44BB (1) for the simple reason that proviso to section 44BB(1) does not contain section 44DA for these years.

vii) Thus, it is evident that in the decision of CGG Veritas Services, SA (supra), it has been held that even if the assessee is engaged in earning income in the nature of 'fee for technical services' or 'royalty' and if the income is in connection with the business of exploration, etc. of mineral oils for the assessment year prior to 1-4-2011 then the income will be assessed under section 44BB if the income is effectively connected with the permanent establishment. Further, section 115A applies only to case of income in the nature of 'fee for technical services' if no Permanent Establishment is involved.

viii) Further, the Jurisdictional High Court in the case of the assessee itself in *Schlumberger Asia Services Ltd. vs. ACIT [Writ Petition No. 2510 of 2010]* held that the amendment by Finance Act, 2010, excluding the application of section 44BB in cases where section 44DA applies, is prospective and applies from assessment year 2011-12. Thus, inasmuch as in the present appeal the assessment year is 2007-08 is involved and admittedly the income earned by the assessee is effectively connected with the permanent establishment, even if the income is indeed in the nature of 'fee for technical services', still assessment cannot be made under section 115A of the Act. Further, the assessment year being 2007-08, section 44DA is also not applicable. For this reason alone,

the impugned assessment order which has assessed the income under section 115A of the Act is liable to be set aside.

ix) It has further been noted that the Assessing Officer has included a sum of ₹ 7,23,59,963 received by the assessee as reimbursements of certain expenses being customs duties paid by the assessee on behalf of its clients, equipments lost in hole etc. It has been submitted that the inclusion of this amount within the scope of receipts for purpose of determining income of the assessee is contrary to the settled law on the issue and decisions in the case of the assessee itself. Income-tax is leviable only on those receipts, which constitute 'income'. 'Income' as contemplated under the Act does not include 'reimbursement of expenses'. There is no element of profit and gains in the reimbursements received by the assessee, which has incurred expenses for and on behalf of other companies. Contractually the liability to incur these expenses was with those companies. Therefore the amounts towards reimbursement cannot be considered as income of the assessee. Furthermore, assessee's contention is that that Assessing Officer has also erred on facts and in law in not following the decision of the jurisdictional High Court of Uttarakhand in, assessee's own cases *DIT, International Taxation vs. Schlumberger Asia Services Ltd. [2009] 317 ITR 156 /[2010] 186 Taxman 436* and *CIT vs. Schlumberger Asia Services Ltd. [IT Appeal No. 58 of 2006, dated 26-10-2007]* in which it was held that such reimbursement does not constitute income. These decisions have also been followed by the Tribunal in assessee's own case *ACIT vs. Schlumberger Asia Services Ltd. [IT Appeal No. 4180 (Delhi) of 2006, dated 13-4-2007].* There is considerable cogency in assessee's submission as above. Hence, it is to be held that the Assessing Officer has erred in including ₹ 723,59,963 received by the assessee as reimbursements for determining the taxable income of the assessee.

x) It has further been the contention of the revenue that the amendments *vide* Finance Act, 2010, inserting mutually exclusionary clauses in section 44BB and section 44DA are clarificatory, and, hence, are retrospective in operation, with effect from assessment year 2004-05. This contention is not at all correct as the said provision of the Act cannot be said to be clarificatory and, hence, retrospective in operation. In this regard in the case of CGG Veritas Services, SA (supra) comes to the rescue of the assessee. Furthermore, the Jurisdictional High Court in the case of the assessee itself in Schlumberger Asia Services, SA (supra) has held that the amendment by Finance Act, 2010, excluding the application of section 44BB in cases where section 44DA applies, is prospective and applies from assessment year 2011-12.

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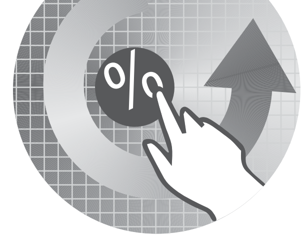


CA. Hasmukh Kamdar

INDIRECT TAXES
Central Excise and Customs – Case Law Update

CENVAT Credit

BEFORE THE COMMISSIONER OF CENTRAL EXCISE (APPEALS); CHENNAI IN RE: CHENNAI PETROLEUM CORPORATION LTD.

The brief facts of this case are that the appellant, a petroleum refinery, opted for Rule 6(3)(ii) of CENVAT Credit Rules 2004, (the Rules), for reversal of CENVAT Credit attributable to inputs and input services used in, or in relation to, the manufacturer of exempted goods or for provision of exempted services for the F.Y. 2008-2009. The total CENVAT credit required to be reversed in F.Y. worked out to be ₹ 3.57 crores. The appellant reversed ₹ 3.51 crores during the year and balance 6 lakhs in June 2009 as per Rule 6(3A)(b). The Appellant revised their computation of final reversal of CENVAT Credit under Rule 6(3)(ii) for the financial year 2008-09 stating that they had, earlier, omitted to exclude the clearance to SEZ/EOU/United Nations/Export under bond/CT2 clearance which fall under Rule 6(6) for the purpose of computation of final reversal under Rule 6(3A)(c) of the said Rules. As per this revised working the final reversal of CENVAT credit under the said rule was computed by them at ₹ 2.02 crore as against the CENVAT credit of ₹ 3.57 crores actually reversed by them. Thus, arriving at an excess reversal of ₹ 1.55 crores the appellant, sought the adjustment of the excess amount by taking credit in terms of Rule 6(3A)(f) of the said Rules

After making enquiry and adjudication the Department held that the appellant had considered only the 'common inputs' and 'common inputs services' for the purpose of computation for Rule 6(3A)(c)(ii) and (iii) of the said Rules respectively whereas the total CENVAT credit taken on input/ inputs services have to be adopted for the computation. Therefore, the final reversal of CENVAT credit under the said Rule was computed at ₹ 2.87 crores and therefore considering the reversal already made, the appellant was permitted to take the excess reversal of ₹ 70 lakhs in their CENVAT A/c under Rule 6(3A)(f) of the said Rules.

In other words issue was regarding the proportionate credit reversal in terms of Rule 6(3A), whether common credits should be taken or entire CENVAT credit, including CENVAT credit used in respect of dutiable goods and taxable services should be subjected to proportionate reversal.

On behalf of the appellants it was submitted that in terms of Rule 6(1) of the Rules, CENVAT credit can not be taken on such quantity of input and input services which are used in exempted goods. Rule 6(2) requires a manufacturer to maintain separate accounts of the inputs and input services used in providing both taxable

and exempt services and avail credit only on such portion of inputs and input services used in providing taxable services. It was further submitted that a careful reading of sub-rule 1 along with sub rule 6 of 6 would show that that application of provision itself is in respect of common inputs and input service that have been used in providing both taxable and exempted services and not to only taxable or only exempted services. Further rule 3 provides that CENVAT credit can be taken by the manufacturer of final product and taxable service provider and rule casts certain obligation on the manufacturer of dutiable and exempted goods. Thus the credit of service tax paid on input service exclusively used in dutiable goods is not covered under Rule 6 but covered under Rule 3 of the Rules. Accordingly the service tax paid on input services used exclusively in providing taxable services will also remain outside the ambit of application of Rule 6. The provisions of rule 6(3) are only procedural and cannot take away the right to avail credit fully on inputs and input services used in the dutiable goods or taxable services. Reliance was placed on the Supreme Court judgment in the case of *CCE vs. Home Ashok Leyland Ltd. [2007 (210) ELT 178 (S.C.)]* and Tribunal decision in the case of *Foods, Fats, & Fertilizers Ltd. vs. CCE [2009 (247) ELT 209 (Tri. Bang.)].*

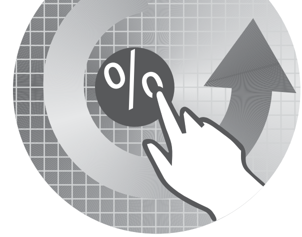
It was further submitted that Rule 6(3)(ii) provides that, the manufacturer of goods or the provider of output service shall pay an amount equivalent to the CENVAT Credit attributable to inputs and input services used in or in relation to the manufacture of exempted goods or for provision of exempted services subject to conditions and procedure specified in sub-rule (3A), so the credit to be paid back is the credit attributable to manufacture of exempted goods only. Thus going by this sub rule there is no need to include the duty paid on input and tax paid on input services that were used exclusively in the manufacture of dutiable goods

The appellant further submitted that the denominator in the formulae ["N" as per Rule 6(3A)} is the value of all clearances and not all clearances after excluding Rule 6(6) clearances as adopted in impugned order.

The Appellate Authority observed that as per Rule 6(3A)(c)(iii) formulae (M/N) multiplied by P, (M) denotes total value of exempted services provided plus the total value of exempted goods manufactured and removed during the financial year and (N) denotes total value of taxable and exempted services provided, and total value of dutiable and exempted goods manufactured and removed during the financial year. As per rule 6(6), in respect of goods specified in the said Rule, the provisions of sub-rules (1), (2), (3), and (4) of Rule 6 will not apply. The appellants submission is that, the value of Rule 6(6) clearances should be excluded from the value of exempted goods for the purpose of numerator (M) while it should be included for the denominator (N). I find that plea of the appellant is inconsistent. The instant case falls under Rule 6(3)(ii) of CENVAT Credit Rules 2004 [for which the procedure is prescribed in Rule 6(3A),] the value of goods removed which are specified under Rule 6(6) has to be excluded in computing the CENVAT credit attributable to exempted goods and exempted services under Rule 6 (3A).

It was held that the value of such clearances should not be taken into account at all for the purpose of Rule 6(3A)(c) and it has to be excluded both from the numerator (M) and the denominator (N) in the aforesaid formulae. It was also found that the appellant has excluded these clearances in computing the denominator (N) while determining finally under rule 6(3A) (c) of CENVAT Credit Rules 2004, the amount of CENVAT credit attributable to exempted goods and exempted services.

In view of the above facts and discussion, the impugned order was set aside by allowing the appeal.



CA. Rajkamal Shah & CA. Naresh Sheth

INDIRECT TAXES
Service Tax – Statute update

Exemption to specified insurance policies/schemes

Mega Exemption Notification No. 25/2012-ST dated 20th June 2012 has been amended to provide service tax exemption to life insurance companies in respect of following insurance schemes:

a) Janashree Bima Yojana (JBY) or

b) Aam Aadmi Bima Yojana (AABY)

The insurance premiums on above referred schemes will be exempted from service tax w.e.f. 24-12-2012.

(Notification No. 49/2012 – ST dated 24th December, 2012)

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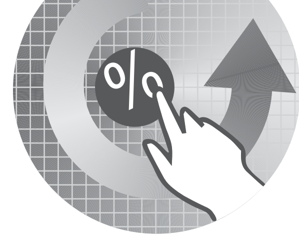

CA. Bharat Shemlani

INDIRECT TAXES
Service Tax – Case Law Update

1. Services

Construction of Residential Complex Service

1.1 A. S. Sikarwar vs. CCE, Indore 2012 (28) STR 479 (Tri.-Del.)

The Tribunal in this case held that, definition of Residential Complex under section 65(91a) of FA, 1994 is applicable to both category of services i.e. Construction of Residential Complex and Works Contract Service. Further, levy of service tax under this service is inapplicable to compound having many buildings of not more than 12 residential units.

Consulting Engineers Service

1.2 Mitsui & Co. Ltd. vs. CCE & ST, Jamshedpur 2012 (28) STR 491 (Tri.-Kolkata)

In this case, the assessee treated imported and indigenously procured drawing and designs as Goods assessable under Customs Act, 1962 and Central Excise Act, 1944. The Tribunal held that, under such circumstances value of such designs and drawings is not subjected to service tax.

Business Auxiliary Service

1.3 Spectrum Coal & Power Ltd. vs. CCE, Raipur 2012 (28) STR 510(Tri.-Del.)

In this case, the Tribunal after relying on decision in *Aryan Energy Pvt. Ltd. 2009 (13) STR 42 (Tribunal)* held that, benefication/washing raw coal at washery is part of mining service liable to service tax w.e.f. 1-6-2007.

Supply of Tangible Goods Service

1.4 In Re: Hardy Exploration & Production (I) Inc. 2012 (28) STR 513 (Commr. Appl.)

The Tribunal held that, activity under Mining Service is restricted to actual extraction of oil or gas from beneath the earth. Supply of impugned rigs for post-extraction activity without transferring possession and effective control is liable to service tax under Supply of Tangible Goods service.

It is further held that, time prescribed under section 11B of CEA, 1944 for refund of tax is applicable to tax collected as permitted by statute and not applicable to tax collected without authority.

Cargo Handling Service

1.5 In Re: Freight Systems (India) Private Limited 2012 (28) STR 521(Commr. Appl.)

In this case it is held that, transportation of household articles not to be equated with cargo or goods handling. Cargo itself suggests handling of cargo in bulk and goods suggest some goods/items in commercial quantity. The household items cannot be equated with bulk cargo or goods. Therefore, cannot be brought to tax under Cargo Handling Service.

1.6 I.A. Dhas vs. CCE, Raipur 2012 (28) STR 630 (Tri.-Del.)

The Tribunal in this case held that, loading, unloading, transportation and stacking of various iron and steel products within stockyard of M/s SAIL cannot be held to be covered by the activity of Cargo Handling Service.

Storage and Warehousing Service

1.7 In Re: Sical Distriparks Ltd. 2012 (28) STR 525 (Commr. Appl.)

The assessee a container freight station retained auction proceeds of abandoned cargo by importers in lieu of storage and warehousing charges due from importers. It is held that, the assessee is a custodian of goods and transfer of title of goods during auction is to be treated as sale. The auction proceeds received do not represent storage and warehousing charges hence no service tax is payable.

1.8 Kerala State Indl. Enterprises Ltd. vs. CCEC & ST Kochi 2012 (28) STR 574 (Ker.)

The appellant in this case allowed terminal building to Airlines for handling both Air Cargo as well as passenger baggage. They allowed Airlines, 48 hours to lift cargo without any liability for storage and warehousing charges. The High Court held that, charges collected are liable to service under storage and warehousing only when retention of Air cargo or passenger baggage was beyond 48 hours. Other they were not liable to Service tax since exclusion from Cargo Handling service.

It is further held that, what is specifically excluded from levy could not be brought to tax under another charging entry and if this is permitted, it will frustrate exclusion clause.

1.9 Abban Lloyd Chiles Offshore Ltd. vs. CST, Chennai 2012 (28) STR 622(Tri.-Chennai)

The appellant in this case as a Floating Production Unit (FPU) engaged in offshore for drawing crude oil from subsea wells in sea and processes and transfers processed crude oil through a buoy into a vessel called Floating Storage and Offloading Unit (FSO) through which the crude is further transported to fleets. The appellant paid certain amounts to foreign company PROSAFE for provision of operations personnel, maintenance, spare parts, supplies and all other resources necessary for operation of FSO. The department sought to tax these services under Storage and Warehousing under reverse charge mechanism. The Tribunal held that, PROSAFE was a part of operating team for processing and transferring crude oil and being an agent of the process of production it was not a storage or warehouse keeper.

Works Contract Service

1.10 Nagarjuna Constructions Co. Ltd. vs. GOI 2012 (28) STR 561 (SC.)

The Supreme Court in this case held that, CBEC Circular No. 98/1/2008 ST 04/01/2008 stipulating that it was not permissible to vivisect single composite service to classify it under two different taxable services depending upon time of receipt of consideration. It is held that, circular merely explained Rule 3(3) that option to pay service tax in respect of works contract must be exercised before payment of service tax and it was not discriminatory. Even if the circular was set aside, Rule 3(3) would remain in the statute. Thus, works contract composition scheme was not applicable to ongoing contracts as on 1-6-2007.

Tour Operators Service

1.11 Andhra Pradesh Tourism Devl. Corpn. Ltd. vs. CCE, Hyderabad 2012 (28) STR 595 (Tri.-Bang.)

In this case, the Tribunal held that, components of taxable value of package tour operators services have to be decided based on definition of tour, tour operator and tour operators service. Meaning of 'package tour' in common parlance was recognised in CBEC Circulars issued prior to 23-8-2007 and same concept was incorporated in Notification No. 38/2007-ST. Also definition of taxable service under section 65(105)(n) at all time had room for including supplementary services within ambit of 'any service provided in relation to tour'.

Exemption Notification could not be used to construe statutory provisions, and in case of inconsistency between the two, latter prevail. Further, absence of words 'other similar services' in definition of 'package tour' prior to 23-8-2007 in Notification could not mean that, charges for supplementary services were not to be included in taxable value for period prior to that date. On facts, taxable value found to include costs of supplementary services viz. Darshan fee, Entry fee, cruise/water fleet charges, hill transportation charges and cost of railway segment of tour as these charges cannot be classified as 'reimbursement'. The appellant is entitled to claim abatement on gross taxable value under Notification Nos. 39/97-ST, 1/2006-ST and 38/2007-ST.

Management Consultants Service

1.12 In Re: Pricewaterhousecoopers Pvt. Ltd. 2012 (28) STR 659 (Commr. Appl.)

The department in this case denied benefit of exemption Notification No. 4/2004-ST to internal audit and indirect support services to SEZ units on the ground of non-consumption of services within SEZ. It is held that, services rendered ultimately consumed by SEZ and fact of utilisation of services by SEZ is undisputed by lower authorities. Also by virtue of section 51 of SEZ Act, 2005 it has overriding effect over Notification No. 4/2004-ST.

2. Interest/Penalties/Others

2.1 In re: Sundaram Auto Components Ltd. 2012 (28) STR 545 (Commr. Appl.)

In this case department demanded service tax on Tax Deducted at Source (TDS) borne by the assessee in case of foreign remittances. It is held that, the foreign company is entitled to receive fixed net amount payable in four installments and any tax liability is to be borne by the assessee, therefore the consideration received by service provider is independent of TDS amount. This is not a case where tax is deducted from gross amount charged and service tax paid on net amount. Therefore, in the present case, TDS is not to be included in taxable value for discharging service tax.

2.2 Mohendra Construction vs. CCE, Allahabad 2012 (28) STR 632 (Tri-Del)

In this case the Commissioner (A) reproduced submission contained in memo of appeal and confirmed demand giving an impression of admission of duty liability by the assessee. The Tribunal held that, style of approach and passing of order shakes faith of public in judicial remedy. The Commissioner (A) being First Appellate Authority expected to go through facts and grounds raised, record submission and give own findings. Disposal of appeal with distorted reproduction of assessees submission and mere endorsement of original authority's order cannot be appreciated at all. The OIA is set aside and matter remanded for fresh decision.

3. CENVAT Credit

3.1 Valco Industries Limited vs. CCE, Chandigarh 2012 (28) STR 457 (Tri.-Del.)

The Tribunal in this case allowed CENVAT credit in following cases:

- Service tax paid on insurance for vehicle in personal name of the Directors as the vehicle is used in interest of business of the company.
- Transfer of bills from HO to factory does not amount to distribution of service. Credit is admissible at factory on the basis of duty paying document addressed to HO, even without HO registered as ISD.
- Mobiles phones used by Directors of assessee company.
- Credit on invoices in the name of brand name and registered name of the assessee company cannot be denied in view of proviso to Rule 9(2) of CCR, 2004.

3.2 C. Metric Solution Pvt. Ltd. vs. CCE, Ahmedabad 2012 (28) STR 460 (Tri.-Ahmd)

The Tribunal in this case after relying on earlier decision of Tribunal in Well Known Polyesters Limited 2012 (25) STR 411 (Tribunal) held that, CENVAT credit of service tax paid on input services received prior to registration is admissible.

3.3 In re: DBS Cholamandalam Securities Ltd. 2012 (28) STR 529 (Commr. Appl.)

In this case, the appellant authority allowed CENVAT credit of service tax paid on stock exchange service, employee insurance, food charges, subscription/ books/periodicals and travelling expenses as services were utilised during course of business activity.

It is further held that, in Debit Note all the relevant information/details as mentioned in any Invoice are available hence, credit is allowed on debit notes.

3.4 CCE, Surat vs. Aneri Construction 2012 (28) STR 578 (Tri.-Ahmd.)

In this case, the assessee availed CENVAT credit of duty paid on air compressor used for output service taxable under 'Commercial and Industrial Construction service' but received it before the said services became taxable. The Tribunal held that, decision of Gujarat Propack 2009 (234) ELT 409 (Guj.) is distinguishable as factually different and after relying on decision in Spenta International Limited 2007 (216) ELT 133 (Tri-LB) held that, credit eligibility is to be determined with reference to dutiability on date of receipt of goods.

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Company Law Update

Case Law No. 1

[2012] 111 CLA 426 (Mad.), In the High Court of Madras., Renuka Ramanath vs. Yes Bank Ltd.

A nominee director is primarily responsible to a company which nominated him and send his resignation to that company and such company may without resignation letter withdraw his nomination.

Brief facts

The Petitioner is the one of the accused for a case under section 138 of the Negotiable Instruments Act, 1881 ("NIA") for bouncing of cheque. As per the case filed, the Petitioner was claimed to be one of the directors of main accused company i.e Subhiksha Trading Service Ltd ("Company"). To quash the above proceedings against her, Petitioner has filed this petition.

The submissions made by the Petitioner are as follows:

i. The cheque was signed by another authorised signatories of the company who are also the accused in the case filed.

ii. Petitioner was not a director at the time of the above incidence of bouncing cheque.

iii. Petitioner, being a nominee director of ICICI Venture Funds Management Co. Ltd. ("IVFM") on the Board of the Company by virtue of Shareholders Agreement.

iv. Petitioner has sent her resignation letter to the IVFM intimating her resignation as a director from the board of the company.

v. Based on the above letter, IVFM has sent a letter to the company withdrawing the nomination of a Petitioner as a nominee director.

vi. IVFM has also sent a letter to the RoC, Chennai intimating that IVFM has withdrawn the nomination of the petitioner as a nominee director of the company.

vii. Thus, Petitioner is not responsible as a director as she has already resigned as a director.

viii. The cheque was issued subsequent to the date of resignation/withdrawal of nominee directorship of the petitioner from the board of accused company.

ix. Even though, if she assumed to be director, there is no *prim facie* case in the complaint that she is in-charge of day-to-day affairs of the company. Reliance was placed on the judgment of this court in re *S S Lakshmana Pillai vs. RoC [1977] 47 Comp Cas 652 (Mad.)*, wherein view was taken by this court that the moment, the resignation letter is sent, the director is deemed to have resigned from the company.

x. The another judgment of Karnataka High Court in *Mother Care (India) Ltd. vs. Prof. Ramaswamy P. Aiyar [2004] 60 CLA 249 (Kar.) / Manu/KA/0760/2003* also has taken a same view that there is no provisions under the Companies Act for acceptance of the resignation of a director. Further, filing of Form 32 for resignation is only a consequential act to be performed.

From the respondent side they have submitted that

i. From verification of records of RoC, petitioner name as director is there and thus she continues to be a director of the company even on the day of issue of cheque. The genuineness of the documents related to resignation as director by the petitioner is also doubtful.

ii. As per the Memorandum and Article 21A of the Articles of Association of the company, IVFM continue to have one nominee director on the board of the company so long it holds more than 2% shares. Thus, so called withdrawal and resignation as nominee director has no validity in law.

iii. The reliance was placed in Supreme Court judgment in *Harshendra Kumar D. V Rebatilata Koley [2011] 101 CLA 330 SC / AIR 2011 SC 1090,* High Court cannot make an oral enquiry under section 482 of the Criminal Procedure, 1973 (Cr.CP) for quashing the criminal complaint and has relied on unimpeachable documents.

Judgments and reasoning

The Court has allowed the petition and quashed the complaint against the petitioner.

The court has relied on various judgments and analysis of the Companies Act. Based on the resignation letters submitted by the petitioner and letter sent by IVFM to company and RoC, the RoC letter duly acknowledged disclose the intimation of resignation/withdrawal of the petitioner as a director. The doubt of genuineness of above documents raised by the respondents has no force as RoC office is being a public authority cannot be doubted. The seal and signature of the RoC office on the letter make this document believable and impeachable.

On contention of respondent that by virtue of Article 21A of the Articles of Association, IVFM must have one nominee director is not correct. It was observed that upon perusal of language of said Article, IVFM has a right to nominate a director but does not create a liability or compulsion on it to have one nominee director.

On judgments which was relied upon for acceptance of the resignation of a director under the Companies Act and whether it would effect from the date of resignation or date of acceptance, based on analysis as provided therein, it was observed that there is no such provisions under the Companies Act and hence reliance was placed on common law principles. Court has also accepted the contention that resignation shall be effective from the date submitted. Court also noted the judgment of Karnataka High Court which is also referred by the petitioner. Court also observed that in case of a nominee director, he or she is primarily responsible for the company which nominated him and send his resignation to that company. It is that company to act upon the same and withdraw the nomination. There is no provisions of resignation in the Companies Act, so also the withdrawal of the nomination and thus governed by the provisions under the memorandum and articles of association.

Case Law No. 2

[2012] 175 Comp Cas 248 (Mad.) – In the Madras High Court – Dasaprakash P. Ltd. vs. Registrar of Companies.

A company who has voluntarily filed an application for striking-off its name from the Registrar of Companies cannot be an aggrieved

party for making application for restoration of its name with the Registrar of Companies.

Brief facts

This petition has been filed under section 560(6) of the Companies Act, 1956 ("Act") for restoration of the name of the Petitioner company.

As many companies due to various reasons are not operating and hence Government of India, Ministry of Corporate Affairs launch a Fast Track Scheme ("FTA"). Under FTA, the companies which are not starter, without going through long process of voluntary winding up, can get their name removed from the Registrar of Companies ("RoC"). Such companies are required to submit the application in prescribed fee.

Petitioner company wanted to avail the benefit of FTA and hence submitted the application and accordingly the name of the petitioner company was struck off from the RoC.

After 12 years, the petitioner–company has filed this petition u/s 560(6) for restoration of its name with RoC. The submission made by it is even though name of the company was struck off, it was doing its business and all meetings as required under the Act were regularly being held. The argument placed is that as per the Act, the restoration of name of the company which was struck-off can be done within 20 years from such date.

Judgments and reasoning

The court has set aside the petition of the company for restoration of its name with the RoC. The court has analysed the provisions of section 560(6) regarding restoration of name which provides that petition can be made by a company or any member or any creditor if they feel aggrieved by the decision of RoC for striking of its name. However, in current situation, the company itself has applied under FTA for striking–off its name and thus cannot be said to be an aggrieved person for seeking restoration of its name to the RoC.

Regulatory Update

Company Law / SEBI
Abbreviations

Act	The Companies Act, 1956
MCA	Ministry of Corporate Affairs
RoC	Registrar of Companies
R.D.	Regional Director
C.G.	Central Government
CLB or Bench	Company Law Board
O.L	Official Liquidator
DIN	Director's Identification Number
DPIN	Designated Partners Identification Number
XBLR	eXtensible Business Reporting Language

A. Company Law

1. General Circular No. 40/2012 dated December 17, 2012 on No Objection from the concerned regulator/institute for LLP name approval and incorporation

In the case of LLP for carrying out profession of Chartered Accountant, Company Secretary, Cost Accountant, Architect, etc., the consent of council / regulator governing the profession shall be obtained at the time of incorporation as well as for changing name of the existing LLP.

2. Notification dated December 19, 2012 on new Form 23C for the appointment of Cost Auditor.

By this notification, Central Government has amended rules related to the Companies (Central Government's) General Rules and Forms (Seventh Amendment) Rules, 2012. These rules shall be applicable from December 23, 2012 by which existing Form 23C has been substituted with new Form 23C related to the appointment of Cost-Auditor.

3. Notification dated December 24, 2012 on new Form 18 for notice of situation or change of situation of registered office

By this notification, Central Government has amended rules related to the Companies (Central Government's) General Rules and Forms (Seventh Amendment) Rules, 2012. These rules shall be applicable from December 25, 2012 by which existing Form 18 has been substituted with new Form 18 related to informing the Registrar of Companies as to address of the registered office of the company.

As per new form, the following information must be verified and attached with the Form 18 as applicable by the professional like Chartered Accountant, Company Secretary and Cost Accountant while certifying the above form.

a. Proof of Registered Office address in case same is on lease or owned by the company.

b. If registered office is owned by a director, then no objection from such director.

c. If, it is owned by such other entity and not taken on lease by the company, then a proof that the company is permitted to use the said address is to be obtained.

4. Notification dated December 24, 2012 on new Form DIN 1 for obtaining Directors Identification Number

By this notification, Central Government has amended rules related to the Companies Directors Identification Numbers (Third Amendment) Rules, 2006. These rules shall be applicable from December 25, 2012 by which existing Form DIN 1 has been substituted with new Form DIN 1.

As per new form, the following information must be verified and attached with the Form DIN-1 as applicable by the professional like Chartered Accountant, Company Secretary and Cost Accountant while certifying the above form.

a. In case, when professional itself certifying DIN related documents, then it has to confirm while attesting the photo of the applicant that applicant is known to him or applicant met the professional in person alongwith the original of the attached documents.

b. Further, NOW, applicant has to provide the affidavit of verification on non-judicial stamp paper of ₹ 10/- each regarding his or her personal information which earlier was only to be provided by way of declaration. More importantly it has to confirm that "particular of address provided are correct beyond all reasonable doubts.

5. Notification dated December 24, 2012 on certification of DIN 4 for changing information related to Directors Identification Number

By this notification, Central Government has amended rules related to the Companies Directors Identification Numbers (Third Amendment) Rules 2006. These rules shall be applicable from December 25, 2012. The following new information need to be certified by the professional.

a. To satisfy about the identity of the director /designated partner based on original documents.

b. The photograph should be attested based on either knowing him personally or who has met him personally along with the original attached documents and that all relevant attachments are attached with the application.

CA. Natwar Thakrar & CA. Pankaj Bhuta

OTHER LAWS
FEMA Update

In this article, we have discussed changes in FEMA through recent RBI circulars:

1. External Commercial Borrowings (ECB) Policy – ECB by Small Industries Development Bank of India (SIDBI)

Upon review of the extant External Commercial Borrowings Policy, RBI has included SIDBI as an eligible borrower for availing of ECB for on-lending to MSME sector, as defined under Micro, Small and Medium Enterprises Development (MSMED) Act , 2006 subject to the following conditions :–

a) such on-lending by SIDBI shall be to the borrowers' directly either in INR or in foreign currency (FCY);

   (i) the foreign currency risk shall be hedged by SIDBI in full in case of on-lending to MSME sector in INR; and

   (ii) on-lending in foreign currency shall be subject to Regulation 5(5) of FEMA Notification No. 3/2000-RB dated May 3, 2000, as amended from time to time and shall only be to those beneficiaries which have natural hedge by way of foreign exchange earnings;

b) availment of ECBs, including the outstanding ECBs, up to 50 per cent of their owned funds, for on-lending to MSME sector, will be under the automatic route and beyond 50 per cent of owned funds, will be under the approval route, subject to a ceiling of USD 500 million per financial year; and

c) the proceeds of ECB availed by SIDBI, shall be used for on-lending to MSME sector only for the permissible end-uses as provided under the extant ECB policy.

All other conditions of ECB, such as recognised lender, all-in-cost, average maturity, prepayment, refinancing of existing ECB and reporting arrangements shall remain unchanged.

(A.P. (DIR Series) Circular No. 48 dated 6th November, 2012)

This is a welcome move by RBI which will increase the flow of cheaper foreign currency funds to SIDBI/ the eligible MSME Borrowers.

2. Money Transfer Service Scheme – List of Sub-Agents

Presently, Authorised Persons (APs), who are Indian Agents under the Money Transfer Service Scheme (MTSS), have to submit list of their Sub-Agents to the Foreign Exchange Department (FED), Central Office (CO) of the Reserve Bank on a half yearly basis.

On a review, RBI has discontinued the submission of the said half yearly statement to FED and CO. The list of Sub-Agents has already been placed on the RBI website. Authorised Persons (Indian Agents) have to inform any addition/deletion to the list (names and addresses of Sub-Agents) immediately, as and when they appoint/remove any Sub-Agent under the scheme, to the concerned Regional Offices (ROs) of the Foreign Exchange Department (FED) of the Reserve Bank, under whose jurisdiction their registered offices fall and the Forex Markets Division, Foreign Exchange Department, Reserve Bank of India, Central Office, Mumbai – 400 001. Authorised Persons (Indian Agents) should visit the RBI website and verify the list of Sub-Agents on regular intervals and any aberration to the list observed is to immediately brought to the notice of the concerned FED ROs and FED Central Office (CO). Further, Authorised Persons (Indian Agents) should confirm the veracity of the list placed on RBI wesbite to FED CO either in form of a letter or by e-mail at within 15 days of the end of a quarter.

(A.P. (DIR Series) Circular No. 49 dated 7th November, 2012)

This is a welcome move by the RBI to streamline reporting procedures for the Authorised Persons in respect of their Sub-Agents.

3. Memorandum of Instructions governing Money Changing Activities

In terms of Para 17 of Part E of the Annex-I to the Memorandum of Instructions to Authorised Money Changers (AMCs) issued *vide* A.P. (DIR Series) Circular No. 57 dated March 9, 2009 all single branch Authorised Money Changers (AMCs) having a turnover of more than US $ 100,000 or equivalent per month and all multiple branch AMCs have to institute a system of monthly audit.

On the basis of representations received, RBI has allowed AMCs having multiple branches to put in place a system of Concurrent Audit which will cover 80 per cent of the transactions value-wise under a system of monthly audit and rest 20 per cent of the transactions value-wise under quarterly audit.

(A.P. (DIR Series) Circular No. 50 dated 7th November, 2012)

This is a welcome move by the RBI which will provide much needed relief to the Authorised Money Changers (AMCs) through relaxation in the requirement of monthly audit.

4. KYC norms/AML standards/ CFT obligation of Authorised Persons under PMLA 2002, as amended by PML Amendment Act, 2009 – Money changing activities

Based on several representations received from Full Fledged Money Changers (FFMCs), regarding difficulties in obtaining documents other than passport, and taking into account the procedure followed for money changing in other countries, RBI has amended certain instructions contained in F-Part II of the Annex to the A.P. (DIR Series) Circular No. 17 dated November 27, 2009 as amended by the A.P. (DIR Series) Circular No. 60 dated 22, 2011.

All other instructions contained in the A.P. (DIR Series) Circular no. 17 dated November 27, 2009, as amended from time to time shall remain unchanged.

These Revised Guidelines are also applicable *mutadis mutandis* to all agents/ franchises of Authorised Persons and it will be the sole responsibility of the franchisers to ensure that their agents/ franchises also adhere to these guidelines.

(A.P. (DIR Series) Circular No. 51 dt. 15th November, 2012)

5. Export of Goods and Software – Realisation and repatriation of export proceeds – Liberalisation

In terms of A.P. (DIR Series) Circular No. 40 dated November 01, 2011, the period of realisation and repatriation to India of the amount representing the full export value of goods or software exported was enhanced, from six months to twelve months from the date of export. This relaxation was available up to September 30, 2012.

RBI has since reviewed this issue and has extended, in consultation with the Government of India, the above relaxation w.e.f. October 1, 2012 till March 31, 2013.

The provisions in regard to period of realisation and repatriation to India of the full export value of goods or software exported by a unit situated in a Special Economic Zone (SEZ) as well as exports made to warehouses established outside India remain unchanged.

(A.P. (DIR Series) Circular No. 52 dt. 20th November, 2012)

This is a welcome move by the RBI to extend the relaxation period of 12 months to help exporters as the global liquidity crunch has still continued.

6. Deferred Payment Protocols between Government of India and erstwhile USSR

In terms of A.P. (DIR Series) Circular No. 38 dated October 4, 2012, the Rupee value of the Special Currency Basket was indicated as ₹ 75.037184 effective from September 27, 2012.

Upon revision, RBI has fixed the Rupee value of the Special Currency Basket at ₹ 75.570411 with effect from October 25, 2012.

(A.P. (DIR Series) Circular No. 53 dated 20th November, 2012)

7. External Commercial Borrowings (ECB) Policy for 2G spectrum allocation

Presently, eligible borrowers in the telecommunication sector are permitted to avail of ECB for the purpose of payment for spectrum allocation, under the automatic route.

Successful bidders of 3G auction were also permitted to make the payment for spectrum allocation initially out of Rupee resources to be refinanced with a long term ECB under the approval route subject to certain conditions.

As large outlay of funds is required to be paid directly to the Government within a limited period of time, RBI has provided following relaxations for the 2G Spectrum auction :

1. Refinancing of Rupee Resources

The payment for spectrum allocation is to be initially met out of Rupee resources by the successful bidders, to be refinanced with a long-term ECB, under the automatic route, subject to fulfilment of the undermentioned conditions :

a) the long-term ECB shall be raised within a period of 18 months from the date of sanction of such Rupee loans for the stated purpose from the domestic lenders;

b) the designated AD Category I bank has evidenced the payment of upfront fees to GoI in the form of a receipt/challan from DoT; and

c) the designated AD - Category I bank shall monitor the end-use of funds.

2. Relaxation in ECB-liability ratio and percentage of shareholding

The successful bidders in the 2G auction will be allowed to avail of ECB under the 'automatic route' from their ultimate parent company without any maximum ECB liability-equity ratio subject to the condition that the lender holds minimum paid-up equity of 25 per cent in the borrower company, either directly or indirectly.

3. Bridge finance facility

The successful bidders can avail of short term foreign currency loan in the nature of bridge finance under the 'automatic route' for the purpose of making upfront payment towards 2G spectrum allocation and replace the same with a long-term ECB under the automatic route subject to the following conditions:-

a) the long-term ECB is raised within a period of 18 months from the date of drawdown of bridge finance; and

b) the long-term ECB is in compliance with all the extant guidelines on ECB.

The relaxations in respect of the ECB liability-equity ratio, percentage of shareholding by the ultimate parent, refinancing of Rupee loans and bridge finance are part of a special dispensation applicable only to the successful bidders in the upcoming 2G spectrum auction.

All other aspects of ECB policy, such as USD 750 million limit per company per financial year under the automatic route, eligible borrower, recognised lender, end-use, average maturity period, prepayment, refinancing of existing ECB and reporting arrangements remain unchanged.

(A.P. (DIR Series) Circular No. 54 dated 26th November, 2012)

This is a welcome move by the RBI necessitated by the need to ensure success of the auction for 3G Spectrum which could provide much needed resources to the GOI and also help contain the fiscal deficit. This move will also ensure cheaper forex funds to the successful bidders in the 3G Spectrum Auction.

8. Liaison Office (LO)/Branch Office (BO) in India by Foreign Entities – Reporting to Income Tax Authorities

In terms of A. P. (DIR Series) Circular No. 24 dated 30-12-2009, Loos/BOs have to furnish the Annual Activity Certificate (AAC) to AD Category – I banks and a copy to Director General of Income Tax (International Taxation), Drum Shaped Building, I.P. Estate, New Delhi - 110 002.

RBI has clarified that the copies of AACs submitted to the DGIT (International Taxation) will have to be accompanied by Audited Financial Statements including Receipt and Payment Account.

RBI further clarified that at the time of renewal of permission of LOs by AD Banks, the copy of the same will have to be submitted to the office of the DGIT (International Taxation).

(A.P. (DIR Series) Circular No. 55 dated 26th November, 2012)

It was being reported in newspapers that many Liaison Offices (LO) / Branch Offices (BO) have carried out their operations which are much beyond the scope of LOs/ BOs permissible under the RBI guidelines. This move by the RBI will enable DGIT (International Taxation) to keep a watch on the activities of LOs/ BOs in India.

9. Exim Bank's Line of Credit of USD 13.095 million to the Government of the Republic of Togo

The Credit Agreement under the LOC is effective from April 27, 2012 and the date of execution of Agreement is January 12, 2012.

(A.P. (DIR Series) Circular No. 56 dated 27th November, 2012)

10. Exim Bank's Line of Credit of USD 178.125 million to the Government of the United Republic of Tanzania

The Credit Agreement under the LOC is effective from November 21, 2012 and the date of execution of Agreement is October 2, 2012.

(A.P. (DIR Series) Circular No. 57 dated 11 th December, 2012)

11. Trade Credits for Imports into India – Review of in all-in-cost ceiling

The RBI has extended the all-in-cost ceilings of 350 basis points over six months LIBOR for maturity periods from one year and above to 3 years LIBOR as specified in A.P. (DIR Series) Circular No. 44 dated November 15, 2011 for trade credits for imports into India till March 31, 2013 and subject to further review.

All other aspects of Trade Credit Policy will remain unchanged.

(A.P. (DIR Series) Circular No. 58 dated 14th December, 2012)

This is a welcome move by the RBI to extend the relaxation of all –in-cost ceiling till 31st March, 2013 as the global liquidity crunch has still continued increasing cost of borrowings overseas.

12. Trade Credits for Imports into India

In terms of A.P. (DIR Series) Circular No. 28 dated 11-9-2012, RBI has allowed companies in the infrastructure sector, where "infrastructure" is as defined under the extant guidelines on External Commercial Borrowings to avail of trade credit up to a maximum period of five years for import of capital goods as classified by DGFT subject to the following conditions :

(i) The trade credit must be *ab initio* contracted for a period not less than fifteen months and should not be in the nature of short-term roll overs; and

(ii) AD banks are not permitted to issue Letters of Credit/guarantees/Letter of Undertaking (LoU) /Letter of Comfort (LoC) in favour of overseas supplier, bank and financial institution for the extended period beyond three years.

The RBI has further relaxed the condition of *'ab initio'* buyers' credit for fifteen months to six months for existing trade credits. However, the condition regarding *'ab initio'* buyers' credit for fifteen months will prevail for future trade credit.

(A.P. (DIR Series) Circular No. 59 dated 14th December, 2012)

This is welcome development for companies in the infrastructure sector. Earlier circular had enabled such companies to extend original maturity period of buyers/ suppliers credit only when the *ab initio* maturity period was for at least for 15 months. Now companies with *ab initio* maturity period of at least six months will also be able to extend the maturity period by maximum of two years in addition to the original contracted period, provided the overall credit period does not exceed 5 years. This will help companies in the infrastructure sector to avail long term buyers/ suppliers credit at much cheaper rates and simultaneously this measure will also help reduce pressure on the Indian rupee.

13. External Commercial Borrowings (ECB) Policy – Review of in all-in-cost ceiling

The RBI has extended the all-in-cost ceilings of 350 basis points over six months LIBOR for maturity periods from three years and above to 5 years LIBOR and 500 basis points over six months LIBOR for maturity periods above five years LIBOR as specified in A.P. (DIR Series) Circular No. 99 dated March 30, 2012 for ECB till March 31, 2013 and subject to further review.

All other aspects of ECB Policy will remain unchanged.

(A.P. (DIR Series) Circular No. 60 dated 14th December, 2012)

This is a welcome move by the RBI to extend the relaxation of all-in-cost ceiling till 31st March, 2013 as the global liquidity crunch has still continued increasing the cost of borrowings overseas.

14. External Commercial Borrowings (ECB) for the low cost affordable housing projects

1. On review of extant guidelines relating to ECB Policy contained in A.P. (DIR Series) Circular No. 5 dated August 1, 2005, RBI has allowed ECB for low cost affordable housing projects as a permissible end-use, under the approval route.
2. ECB can be availed by developers/builders, Housing Finance Companies (HFCs)/ National Housing Bank (NHB) for financing prospective owners of low cost affordable housing units.
3. Detailed guidelines to avail ECB for low cost affordable housing scheme are set out in this circular, in relation to :–

    a) Definition of Eligible Project

b) Eligible Borrowers

c) End-use

d) Nodal Agency for deciding project's eligibility for low cost affordable housing.

4. Developers/Builders, Housing Finance Companies (HFCs) / National Housing Bank (NHB) will not be permitted to raise Foreign Currency Convertible Bonds (FCCBs) under this scheme.

5. For the financial year 2012-13, an aggregate limit of USD one billion is fixed for ECB under the low cost affordable housing scheme which includes ECBs to be raised by developers/builders and NHB/specified HFCs. This limit will be subject to annual review.

6. All other ECB parameters, such as, recognised lender, minimum average maturity period, all-in-cost ceilings, restrictions on issuance of guarantee, choice of security, parking of ECB proceeds, prepayment, refinancing of ECB, reporting requirements remain unchanged and will have to be complied with.

(A.P. (DIR Series) Circular No. 61 dated 17th December, 2012)

This is a welcome move by the RBI which will provide much needed boost to the low cost housing sector through cheaper financing.

15. Exim Bank's Line of Credit of USD 16.88 million to the Government of the Republic of Gambia

The Credit Agreement under the LOC is effective from December 4, 2012 and the date of execution of Agreement is October 19, 2012.

(A.P. (DIR Series) Circular No. 62 dated 18th December, 2012)

16. External Commercial Borrowings (ECB) for Micro Finance Institutions (MFIs) and Non-Government Organisations (NGOs) – Engaged in micro finance activities under Automatic Route

The extant guidelines in terms of A.P. (DIR Series) Circular No. 59 dated December 19, 2011 wherein MFIs were permitted to raise ECB up to USD 10 million or equivalent during a financial year for permitted end-uses, under the Automatic Route subject to fulfilment of detailed guidelines; has been allowed by RBI to continue to be applicable until further review.

ECB by MFIs/NGOs is to be fully hedged. Designated AD has to ensure at the time of drawdown that the forex exposure of the borrower is fully hedged.

(A.P. (DIR Series) Circular No. 63 dated 20th December, 2012)

This is a welcome move by the RBI to regularise and continue the window of cheaper ECB funds for MFIs in times of global liquidity crunch.

17. Exim Bank's Line of Credit of USD 19 million to the Government of the Co-operative Republic of Guyana

The Credit Agreement under the LOC is effective from December 20, 2012 and the date of execution of Agreement is October 30, 2012.

(A.P. (DIR Series) Circular No. 64 dated 27 th December, 2012)

18. Exim Bank's Line of Credit of USD 250 million to the Government of the Republic of Mozambique

The Credit Agreement under the LOC is effective from December 26, 2012 and the date of execution of Agreement is September 20, 2012.

(A.P. (DIR Series) Circular No. 65 dated 27th December, 2012)

Ajay Singh & Suchitra Kamble, *Advocates*

BEST OF THE REST

1. Appellate Tribunal – Part time Member – Delegated legislation – Rule framed by delegatee cannot travel beyond Parliament statute – Cannot also go beyond rule making power conferred by statute. Constitution of India, Article 246 – FEMA 1999

A batch of appeals by way of special leave under Article 136 of the Constitution had been filed. The three reliefs which were sought before the High Court were – Rule 5 of the Appellate Tribunal for Foreign Exchange (Recruitment, Salary and Allowances and Other Conditions of Service of Chairperson and Members) Rules, 2000 ('the Rules') is *ultra vires* the Foreign Exchange Management Act, 1999; for quashment of certain notifications issued by the Government of India, Ministry of Law, Justice and Company Affairs, appointing part time Members of the Appellate Tribunal by issue of a writ of *quo warranto* as they did not satisfy the eligibility criteria as stipulated in the Act; and further to quash the appointment of respondent No. 3 to act as the Chairperson as he was a part time Member and also was not eligible to hold the post.

It was urged before the High Court that when the Act did not conceive of part time Members, even a person meeting the eligibility criteria could not be appointed as a part time Member. It was further contended that a part time Member who was disqualified to hold the post could not have been allowed to act as the Chairperson as that would destroy the spirit of the Act.

The High Court declared the first and second proviso to Rule 5 of the Rules as *ultra vires* section 21(1)(b) of the FEMA Act and quashed the appointments of respondent Nos. 3 and 4 who were appointed as part time Members and further quashed the appointment of respondent No. 3 as the acting Chairperson of the Appellate Tribunal.

The Hon'ble Supreme Court observed that the Appellate Tribunal has been conferred jurisdiction to decide an appeal from orders passed by adjudicating authorities and Special Director Appeal and it has to deal with matters relating to foreign exchange. A fixed tenure has been stipulated for the Chairperson and Members. They are entitled to resign subject to certain conditions and they can be removed on proven misbehaviour or incapacity. Thus, if the object and purpose of the Act is to confer power on the Appellate Board to deal with the issue of economy under the scheme of the Act, it is well high impossible to conceive of the appointment of a part time member. S. 20 the enabling provision, empower's the Central Government to fix such number of persons as the Government may deem fit. The main part of Rule 5 provides that a Tribunal shall have one Chairperson and Members not exceeding four. To that extent, Rule 5 is in consonance with the Act and it comes within the framework of the

provision. The first proviso to Rule 5 stipulates that the number of either full time Members or part time Members shall not exceed two. This proviso introduces the concept of part time Member. Section 46 which is the enabling provision to frame Rules nowhere envisages about the part time members. The first proviso to Rule 5 thus travels beyond the enabling provision and is totally inconsistent with it. The proviso also does not conform to the main enactment. The first proviso to Rule 5 is therefore *ultra vires* the Act.

The second proviso to Rule 5 provides for qualification of a part time Member who can be appointed from amongst officers belonging to the Indian Legal Service who fulfil the qualification prescribed under Clause (b) of sub-rule (1) of Rule 2 of the Rules. Once it is held that there cannot be a part time Member there remains no justification for the introduction of the second proviso to bring in officers from the Indian Legal Service who are qualified to become district judges to be part time Members. The second proviso to Rule 5 is therefore also *ultra vires*.

If a rule goes beyond the rule making power conferred by the statute, the same has to be declared *ultra vires*. If a rule supplants any provision for which power has not been conferred, it becomes *ultra vires*. The basic test is to determine and consider the source of power, which is relelatable to the rule. Similarly, a rule must be in accord with the parent statute, as it cannot travel beyond it.

As the appointment of part time Member was quashed by the High Court as a logical corollary, such a person could not be allowed to be appointed to the post of Chairperson.

Union of India & Ors. vs. S. Srinivasan AIR 2012 SC 3791

2. Stamp duty payable – Lease granted for 15 years rectified and extended up to 30 years – Stamp duty for earlier 15 years lease deed already paid by lessee – Levy of stamp duty for entire period of rectified lease deed i.e. 30 years, improper. Stamp Act of 1899, Art. 31(v)

M/s. Hindustan Petroleum Corporation Limited invited applications for establishment of a petroleum outlet. The applicant must be either a owner of the land, which is required for establishment of the outlet, or a lessee. The Petitioner submitted application for establishment of the outlet by taking a land in the locality on lease. He was granted licence. As required under the business regulations or conditions, the petitioner took the property on lease for a period of 15 years through a document, dated 18-11-2009. Stamp duty of ₹ 2,46,300/- and registration charges of ₹ 3,210/- were paid. The document was submitted to the Corporation. However, the Corporation is said to have insisted that the lease must be for a period of 30 years. In view of this, the Petitioner obtained a deed of rectification, dated 11-10-2010, from the lessors for a period of 30 years. The document was presented for registration before the Sub-Registrar who was Respondent No. 3 in the petition for registration. The grievance of the petitioner was that instead of collecting the stamp duty and registration charges for the extended period of lease, the sub-registrar has collected the stamp duty for the entire 30 years period.

The Hon'ble Court held that had the lease deed for a period of 30 years been executed for the first time, there would certainly have been justification for sub-registrar in levying the entire amount referred to above. The very deed of rectification discloses that there existed a lease deed for a period of 15 years and the rectification has the effect of extending the term of lease by another 15 years. Sub-Registrar at the most, could have collected the stamp duty and registration charges for the extended period may be in terms of Clause (v) of Article 31 of the Act. The reason is that the parameters for determination of the stamp duty on lease deed fluctuate depending upon the duration of the lease. Once the Petitioner has paid the stamp

duty and registration charges for the lease for a period of 15 years, the same was required to be taken into account. There was no justification for Sub-Registrar in collecting the stamp duty for the entire period on the deed of rectification.

The Court directed Sub-Registrar to refund the stamp duty and registration charges paid on lease deed to the petitioner in case the stamp duty and registration charges for the entire period of 30 years is levied on the deed of rectification.

Gopal Singh vs. Inspector General, Stamps and Registration NTR Cross Roads Hyderabad & Ors. AIR 2012 Andhra Pradesh 189

3. Review Petition – Maintainability – Petitioner had already preferred appeal against the order passed in writ petition – Doctrine of merger –Applicability CPC – Sec. 114, O. 47

The question raised for consideration in the review petition, was having already preferred an appeal and the appeal having been dismissed, whether it is still open to the appellants of the said appeal to seek review of the judgment and order passed against which the Appeal, had been preferred and dismissed?

The jurisdiction, conferred by Article 136 of the Constitution, is divisible into two stages. The first stage is up to the disposal of the prayer for special leave to file an appeal. The second stage commences if and when the leave to appeal is granted and the special leave petition is converted into an appeal. The doctrine of merger is not a doctrine of Universal or unlimited application.

Under Article 136 of the Constitution, the Supreme Court may reverse, modify or affirm the judgment decree or order appealed against only when it exercises appellate jurisdiction (i.e., after the leave to appeal is granted) and not while it exercises the discretionary jurisdiction on the question as to whether the petition for special leave to appeal shall be granted or not. The doctrine of merger, therefore, in such cases, comes into play if the special leave to appeal is granted and not when the question as to whether the leave would be granted or not is considered and decided.

Once leave to appeal has been granted and the appellate jurisdiction of Supreme Court has been invoked, the order passed, in appeal, having been converted into an appeal before the Supreme Court, the jurisdiction of High Court to entertain a review petition is lost, thereafter, as provided by sub-rule (1) of Rule (1) of Order 47 of the Code of Civil Procedure.

The facts of the present case, is that there is no dispute that the judgment and order passed in the writ petition, was appealable and that the review applicants had the option of either preferring an appeal or applying for review of the order and the review applicants expressed their option by preferring appeal. With the dismissal of the appeal, which had been so preferred by the present review petitioners, the review petitioners are debarred from preferring review petition against the directions, which were given in the writ petition. Thus, the judgment and order, which were, otherwise, appealable, have been made non-appealable by the act or omission of the review petitioners themselves.

Anup Kumar Roy & Ors. vs. State of Tripura & Ors. AIR 2012 Guwahati 163

4. Grant of Succession Certificate – Validity – Wife of deceased had walked out on him during his lifetime and started living with another man – No divorce between deceased and his wife – Unchastity of widow is no bar to inherit her deceased husband's estate – Grant of succession certificate proper. Succession Act, S. 372 – Hindu Marriage Act, 1955, Ss. 5(i), 24 & 28

One Ashok Moti Ram Kamley died and Respondent Nos. 1 to 3 claiming to be wife and children of late Ashok Moti Ram Kamley filed an application under section 372 of the Act for

grant of Succession certificate, to receive retiral dues as well as various deposits in the banks with the LIC. The trial court held, marriage of Respondent No. 1 with deceased Ashok Moti Ram Kamley as null and void; Respondent Nos. 2 and 3 as his illegitimate children; appellant as legally wedded wife of deceased; and respondent No. 8 as his mother, granted succession certificate in their favour.

On appeal preferred by Respondent Nos. 1 to 3, the First Appellate Court held, the appellant (Wife) re-married with one Chandan Singh in the life time of deceased and has forfeited her right to succeed the estate of the deceased, modified, the order and granted succession certificate in favour of Respondent Nos. 2, 3 (Children) and 8 (Mother). Hence Revision filed under section 384 (3) of the Indian Succession Act, 1925 against the appellate order passed by District Judge.

The Learned Counsel of Appellant referring to sections 24 to 28 of Hindu Marriage Act and submitted that in view of section 5(i) of Hindu Marriage Act, 1955 the marriage is no marriage in the eye of law. The Appellant is also nominee in the service record of deceased Ashok Motiram Kamley and the mother of deceased also deposed the same.

The learned Counsel for Respondent submitted that Appellant walked out of her husband and started living with Chandan Singh. Walking out of appellant from the house of her first husband/ deceased was irretrievable and irreversible and raises an inference that their marriage stands dissolved and, therefore the first Appellate Court had rightly decided the matter which does not call for any interference.

The Hon'ble Court observed that under the old Hindu Law, a widow who is unchaste at the time of her husband's death was not entitled to inherit his estate. But section 28 of the Hindu Marriage Act, 1956 discards almost all the grounds, which imposed exclusion from inheritance. It rules out disqualification on any ground whatsoever excepting those expressly recognised by any provisions of the Act. Unchastity of a widow is not a disqualification under the Act of 1956.

The unchastity of a wife is certainly a ground for divorce but in the absence of a decree of divorce, cannot be pressed into service to disinherit even an unchaste wife from claiming her rights as a widow. A decree of divorce can only be granted by a Court of competent jurisdiction, exercising powers under the Hindu Marriage Act. The mere fact that a woman is abandoned by her husband or that a woman after being abandoned by her husband lives with another man, would not raise an inference that their marriage stands dissolved and, therefore, in the absence of proof of divorce between appellant and deceased, appellant's right to inherit the property of her husband cannot be denied.

Enquiry for grant of Succession Certificate is summary enquiry to facilitate collection of debts to deceased and prevent their being time barred and to afford protection to debtors by appointing a representative of deceased and authorising him to give a valid discharge for debt. Grant of certificate does not give absolute right to debt nor does it bar regular suit for adjustment of claims of heir *inter se.*

The order of first Appellate court was set aside and order passed by trial court was restored.

Ranjana Kamble vs. Smt. Ranjana alias Vimaltai & Ors. AIR 2012 Chhattisgarh 167

5. Gift – Ex parte registration of deed of cancellation – Validity – Mutual consent of both parties – Ex parte Registration held not proper – Persons professing Islam: Transfer of Property Act, 1882, S. 123 – Registration Act, 1908, S. 68

The Petitioner is the younger brother of Respondent No. 3. The latter owned the property near Hyderabad. He executed a gift deed in favour of the petitioner. There was a recital to the effect

that possession of the property is delivered to the petitioner on the same day.

The Petitioner contends that after the gift became complete with the delivery of possession, entries were made in his name, in the municipal records. The ration card and other amenities are extended to him with reference to the address of the said house and that he is paying the electricity and other charges for the property.

Respondent No. 3 executed a deed of cancellation on cancelling the gift deed. The document was registered by the Sub-Registrar, Respondent No. 2. The Petitioner challenges the action of the Respondent No. 2 in registering the deed of cancellation. He contends that the registration of document by Respondent No. 2 is contrary to Rule 26 (k) (i) of the A. P. Rules under the Registration Act, 1908 and the law laid down by the Hon'ble Supreme Court.

The Respondent No. 2 stated that the judgment rendered by the Hon'ble Supreme Court in Civil Appeal No. 317 of 2007 is in relation to the cancellation of a sale deed and the same does not apply to the cancellation of a gift deed. The Respondent No. 3 stated that though there is a recital in the gift deed, to the effect that possession of the property was delivered, the physical possession of the property is still with him. Since the possession was not actually delivered, no transaction of gift contemplated under Mohammedan Law can be said to have taken place.

The Hon'ble Court observed that the procedure prescribed under the Transfer of Property Act in relation to the gifts does not apply to the gifts to be made by persons professing Islam. However, there is no prohibition for them, to adopt the procedure prescribed under the Act. In India, they have the option either to follow their personal law, in the matter of making the gifts, or to follow the law contained in the Act.

Whether a gift is made either in terms of Section 123 of the Act, or orally by a Mohammedan, the necessary ingredients that must exist to bring about the valid gift are; a) making of gift by donor; b) acceptance of the same by the donee; and c) delivery of possession of the gifted property. A party to transfer can certainly cancel it in case necessary ingredients as provided for under the law, are established. Though transaction such as sale and gift are brought into existence with unilateral acts of execution of the documents, the legal effect thereof is that the title in respect of the property stands transferred in favour of the transferee may not have subscribed his signature in that documents. From this point of view the sale deed on the one hand and the gift deed on the other hand, stand on the same footing.

The questions are whether a sale deed which is validly executed can be cancelled by the vendor at a subsequent point of time and whether the very act of registration of such deeds of cancellation can be challenged? The Hon'ble Supreme Court in Civil Appeal No. 317 of 2007 took the view that once the title in respect of the property is transferred through a transaction, the same cannot be cancelled without the participation of both the parties. Reference was made to Rule 26 (i) (k) of the Rules framed by the Government. A perusal of the said Rule discloses that it covers not only the sale deeds but also transactions of conveyance, which obviously would take in its fold the transactions of gift also. It has already been mentioned that whether it is a sale deed or gift deed, they are executed by the owners of the property and the beneficiaries thereunder get the title by way of transfer. The only difference is that a sale is supported by consideration whereas in case of gift, consideration in terms of money or other tangible asset is absent. Hence the writ petition was allowed and the registration of the deed of cancellation executed by the Respondent No. 3 was set aside. It was left open to Respondent No. 3 to pursue his remedies in accordance with law.

Fazalullah Khan vs. State of Andhra Pradesh AIR 2012 Andhra Pradesh 163.

CA. Rajaram Ajgaonkar

ECONOMY AND FINANCE

OFF THE FISCAL CLIFF

The month of December had a mixed bag of fortune for the global economy. Though many global indicators were looking positive, the issue of the US Fiscal Cliff remained unresolved till the end of the month and that increased the level of anxiety in the minds of not only investors in the US but also the investors across the globe. It is only in the beginning of January, 2013 that the picture started getting clear and now it seems that the issue will be resolved as none of the political parties in the US wanted to face the calamity of a Fiscal Cliff, which would have automatically resulted in an increase in taxes by a huge sum of 600 billion US Dollars and also a cut in Government expenditure. This is good news for the country and its economy and the sentiments have started improving.

The Chinese economy has started showing improvement since the last three months and that is perking up the sentiment, not only in China, but also across the Asia Pacific region. The US is now likely to sustain the trend of increase in consumption which will have a positive impact on the Chinese manufacturing and also on the small economies in the Asia Pacific region. The increase in manufacturing in China is showing sustainability over the last few months and current developments are positive for such sustenance. The Chinese stock market has started improving. The rising stock market suggests increased investment in China by locals as well as foreigners.

The Japanese economy has continued to stagnate and there is no immediate solution to its woes. Most of the standard stimulus measures are not working for that economy, which is peculiarly placed. Unhealthy demographic composition and the ageing population of Japan have also had a role to play in the economic problems. There is no easy solution for immediate improvement. The positive trend in the US economy will lend some support to the stagnating Japanese economy, but the impact may not be substantial. Japan's economy is likely to improve slowly.

Europe has started experiencing a bit of a warm breeze in its cold economy. The crisis in Greek sovereign bonds is averted. A kind of steadiness is emerging in the European economies. There are signs of improvement and a feeling is emerging that the worst may be over. If the economies in the region can consolidate for a while, they can breed in positive sentiment and the growth rate may start improving. Though the economies may not improve quickly, the positive sentiment will surely boost the morale.

Brazil and Russia who are a part of the BRIC nations seem to have lost their economic momentum displayed a few years back. Their economies seem to have shifted to lower gears and no dramatic improvement is expected. Some emerging economies such as Turkey and Indonesia are well placed to improve their growth rate. More opportunities will come up in the emerging economies than the matured markets. Global investors will need to keep an eye on this change and developing equations.

The Indian economy seems to have received an impetus on the back of economic reforms announced

recently by the Government. There is a realisation that on account of inadequate actions on economic reforms over the last few years, the economy has slowed down. Even by adopting dear money policy, the country has not been able to control inflation to the desired extent. India desperately needs long-term investments to keep its tempo of growth intact. The required huge investment cannot come easily from only Indian investors. A lot of foreign money is needed to flow in for improvement of the economic growth rate in India. Such money can come in; provided that the reform process remains on track. Though in the recent months, substantial money has been invested in the Indian stock market by the Foreign Institutional Investors (FIIs); such money can be light footed. Its exodus can cause damage to an economy. India needs more Foreign Direct Investment (FDI), which is long-term in nature. Such investment is dependent on the economic climate of an economy and its political stability. India needs to act on the reforms as quickly as possible. Of late, the Government seems to have taken steps for introducing reforms and thereby reassuring the potential of the Indian markets to foreign investors. If the current tempo of reforms continues, the Indian economy will turn around in the ensuing quarter. Further, its growth rate can exceed 6% for F.Y. 2013-14. The challenges are many and the country cannot afford to falter any more.

Stock markets in India have moved positively in the month of December. However, the improvement was selective. Sensex could not reach the expected mark of 20,000 but it remained range bound between the levels of 19,100 and 19,700. Still, the overall sentiment was positive and investors have started expecting the Indian stock markets to perform better in the months to come. The anxiety of the Fiscal Cliff in the US hampered the rally in the Indian stock markets towards the end of December. Now the issue is resolved and it will have a positive impact on the Indian stock markets. FII money continues to flow into Indian stocks. If the trend continues, the Indian stock market can perform very well in 2013. Unfortunately, the current economic realities in India are not very encouraging. The current account deficit continues to widen. Budgetary deficit is expected to overshoot the target. Still, the sentiments are positive and the economy is expected to improve in the near future. The positive trend in the global economies will help the Indian stock markets to perform better in the near future. It is widely expected that the Sensex should reach 22,000 levels by December 2013. The positive sentiment may continue unless the Union Budget dampens it or there are certain political developments which may make the investment in India riskier for the non residents. The returns on investments in shares in India are expected to beat the return on most of the other asset classes in the near future. Investors are advised to be more aggressive on their equity allocation for 2013. Though there may be temporary ups and downs, by and large the markets will move in a positive direction. To gain from the stock market uptrend, it may be advisable to invest in the Systematic Investment Plans (SIPs) of equity oriented mutual funds. Enlightened investors can choose specific stocks for investments. Approach of 'value investment' is likely to give superior returns.

Stocks of American and European multinationals are looking quite attractive. Valuations of many such companies are looking cheap due to their low price-earning ratios. Especially the American multinational companies are expected to perform well as the economy of their parent country is reviving and these multinationals will also gain due to improvement in many developing countries in which they have presence. Stocks of European companies which have a major presence in the developing world are also looking attractive. Profit from the foreign subsidiaries will boost their consolidated bottom lines. The world is expected to grow slowly but steadily in 2013, which will have a positive impact on the stock prices. Indian investors can invest in foreign companies within the permissible limit under the Liberalised Remittance Scheme of the Reserve Bank of India and gain from global developments.

Though the property prices were appearing sluggish in 2012, the Ready Reckoner rates announced for 2013 by the Government have appreciated fairly over those of 2012. This rise indicates that the property markets have appreciated reasonably well during 2012. The improved stock markets in India, the likely reduction of interest rates in India and the improving sentiments across the world are likely to make a positive impact on the Indian property market and the appreciation of property prices will continue in most of the areas. The downward risk

in this asset class looks limited and the investors may increase their asset allocation to properties. The current rental yields on commercial as well as residential properties are fairly poor and they are not likely to improve in the near future. So the investors are advised to take appropriate calls in respect of under construction properties booked by them, once they near completion and possession. Tax considerations, many a times, impact the decision making of the investors. However, it is advisable not to get carried away and take decisions based on purely tax considerations. While investing, major consideration should be given to gaining profits rather than getting bothered about tax and making mistakes of deferring decisions.

The benchmark interest rates have not been changed by the Reserve Bank of India in its recent policy but there are ample indications that reduction of interest rates is inevitable in 2013 and it is only a question of time before such reduction takes place. On the back of improved agricultural output, it is expected that inflation will continue to taper in the months to come and the reduction of interest rates will start very soon. Yields of many bonds and debentures have already started to come down. The new offerings of fixed rate investments are lowering the interest rates. Time seems to be running out for the investors who want to lock in high interest rate investments. The investors should take appropriate calls in respect of the asset allocation and lock in their fixed income investments at the earliest.

Gold seems to be losing its steam in the global markets and it has depreciated in the month of December in terms of Dollar as well as Rupee. Uncertainty in the global markets has receded due to avoidance of the Fiscal Cliff by the US and that will make the investors more adventurous in the days to come. Gold may lose its appeal, if the other classes of investment give decent returns to the investors. Gold prices may continue to sag in Dollar terms in the near future although some investors are bullish on gold prices over the horizon of next few years. Gold may not depreciate substantially in India as the Rupee is weakening against the major currencies of the world. However, gold is not expected to give high returns in the near future and it should be kept in a balanced portfolio as a defensive investment. Additional investment in gold may not turn out to be very attractive.

The Indian Rupee has been depreciating on the back of widening fiscal deficit and large gap in balance of trade. The issues may not get addressed very easily and the Rupee is not expected to appreciate much in the near future. In light of this fact, foreign assets look attractive and so seasoned investors need to take a close look at them.

In the new year, the sentiment has improved across the globe. In spite of the risk in the European economies, the overall expectations of a steady economic growth in the rest of the world has emerged and it is likely to strengthen further. Investors can afford to be more aggressive in their approach and there can be a scope for taking higher risk for better returns.

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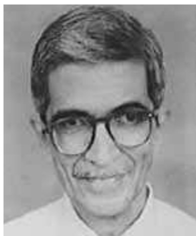

V. H. Patil, *Advocate*

YOUR QUESTIONS & OUR ANSWERS

Facts & Query

Q.1 An individual assessee has acquired Tenancy Rights in a Shop in 1988. Rent to Landlord was paid from the Proprietory Concern of the assessee. Now, the assessee has surrendered the tenancy rights. The assessee has purchased new office premises. Please give your opinion on :

a) whether amount received on surrender of tenancy right is taxable or not ?

b) if taxable, then as Capital Gain or Business Income ?

c) whether both the assets form or fall under one Block, so that depreciation can be claimed on Net Closing balance of the Block ?

Ans. Tenancy rights are an interest in immovable property and as such transfer of such rights would constitute transfer for the purpose of capital gain tax.

The question of taxing any consideration received for transfer of an asset as business income will arise if the transfer is a transfer of a stock-in-trade of the business. The office premises only because it is an office premises used for company's business and such premises is sold, the consideration received is receipt for transfer of capital asset and not for transfer of stock in trade. As such the consideration received does not constitute income from business.

As such the consideration received for surrender of tenancy rights, is not income from business of the assessee. It is only a capital gain.

Now tenancy rights is not asset on which any rate of depreciation allowance, prescribed for the allowing of depreciation allowance.

Now two assets form part of one block of asset only which depreciation allowance rate prescribed is the same, the tenancy rights and new office premises do not form part of block of asset.

In view of above discussion my answer to the queries raised are as under:

Q.a) Whether amount received on surrender of tenancy right is taxable or not ?

Ans. Yes. It is taxable.

Q.b) If taxable, then as Capital Gain or Business Income?

Ans. As capital asset.

Q.c) Whether Both the assets form or fall under one Block, so that depreciation can be claimed on Net Closing balance of the Block?

Ans. No.

Q.2 Assessee a company has given advances for property of ₹ 1 Cr and is partner in partnership firm where its capital balance is ₹ 25 L. The amounts invested are out of its accumulated profits and paid up capital. During the course of scrutiny, the officer has issued show cause notice as under;

a) why interest @ 12% should not be assessed to tax on the amount of ₹ 1. Cr advanced for property as the property has not yet been taken possession and is under construction

b) why interest @ 12% should not be assessed to tax on the balance in capital account in accordance with section 40(b)?

Is the Assessing Officer correct in his contentions? Whether notional income can be brought to tax?

Ans. Under S.40 of the I.T. Act, certain business expenditures are allowable otherwise, under the said section they may be disallowed under the specified circumstances.

The said provisions relevant for our purpose are as under:

S.40(b) in the case of any firm assessable as such, —

(i) any payment of salary, bonus, commission or remuneration, by whatever name called (hereinafter referred to as "remuneration") to any partner who is not a working partner; or

(ii) any payment of remuneration to any partner who is a working partner, or of interest to any partner, which, in either case, is not authorised by, or is not in accordance with, the terms of the partnership deed; or

(iii) any payment of remuneration to any partner who is a working partner, or of interest to any partner, which, in either case, is authorised by, and is in accordance with, the terms of the partnership deed, but which relates to any period (falling prior to the date of such partnership deed) for which such payment was not authorised by, or is not in accordance with, any earlier partnership deed, so, however, that the period of authorisation for such payment by any earlier partnership deed does not cover any period prior to the date of such earlier partnership deed; or

(iv) any payment of interest to any partner which is authorised by, and is in accordance with, the terms of the partnership deed and relates to any period falling after the date of such partnership deed in so far as such amount exceeds the amount calculated at the rate of [twelve] per cent simple interest per annum; or

Now when one goes through these provisions one will notice that they are applicable only in case of payment by way of remuneration interest commission etc.

As such for said provision are not applicable to cases where no payment of interest is made. There is no provision under the Act for disallowance on the basis of deemed payment of salary interest etc. As such as no payment of interest is made in the querist case, the said proposal of making assessment by the ITO to add at 12% interest on the capital is not sustainable in law.

As such the ITO cannot bring notional income to tax.

Q.3 Any Government or any other Company has issued Bonds / Debentures on 1st January and interest is payable half yearly on 30th June and on 31st December.

The assessee has invested in Bonds on 1st March from the secondary market; in which interest is deemed to have been accrued for 2 months i.e for January and February. As per Accounting, Standard 13 (para 12 of AS 13), interest accrued for two months is to be deducted from the cost of acquisition as it is pertaining to pre-acquisition period.

Now, in the next Financial Year, the assessee sold these Bonds on 1st June. The assessee has not received any interest on these Bonds.

On these facts the querist has raised the following queries"

1) Whether the assessee has to provide for accrued interest for the month of March?

2) Whether interest for two months will be taxable as interest in the year of purchase?

3) How to Compute Capital Gain in the next Financial Year, when the assessee has sold these Bonds?

Now as per Supreme Court ruling in the following cases, any expenditures which are directly connected with the acquisition of an asset would go to reduce the cost of acquisition.

227 ITR 172 – Tuticorin Alkali Chemicals & Fertilizers Ltd. vs. CIT

236 ITR 315 – CIT vs. Bokaro Steel Ltd.

Now in the case of the querist the bonds which are purchased in secondary market, the interest due, in the part of the year of acquisition of the bonds is not directly connected with the cost of acquisition of bonds. As such the same does not go to reduce the cost of acquisition of the bonds in question AS No.13 has not been adopted for the purpose of I.T. Act 1961 under S.145(2) of the Act. As such the same is not applicable for computing the tax liability under the provisions of I.T. Act. Our answers to the queries raised by the querist are as under:

Q.1 Whether the assessee has to provide for accrued interest for the month of March?

Ans. No.

Q.2 Whether interest for two months will be taxable as interest in the year of purchase?

Ans. Yes.

Q.3 How to Compute Capital Gain in the next Financial Year, when the assessee has sold these Bonds?

Ans. As we are not deducting the interest due it will be cost acquisition, it will be deducted from the cost of acquisition of bonds for capital gain tax purposes.

Hitesh R. Shah & Paras Savla, *Hon. Jt. Secretaries*

THE CHAMBER NEWS

Through this column, we communicate with you about, and keep you abreast with, the events and the happenings that took place at the CTC. The events that have taken place after the previous issue of the Income Tax Review from 8th December, 2012 till 8th January, 2013 and also some of the important future events which are as under –

1. Admission of New Members

The following are the new members, who were admitted in the Managing Council Meetings held on 12th December, 2012 and 2nd January, 2013.

LIFE MEMBERSHIP

Name	Qualification	City
SHRI SHAH CHINTAN SHARATCHANDRA	CA	MUMBAI
SHRI HIMMATSINGHKA PRAMOD KUMAR LAKHI PRASAD	CA	KOLKATA
SHRI K.S. BALASUBRAMANIAN	CA	MUMBAI
SHRI PATEL DHIRAJLAL ZINABHAI	ADV	MUMBAI
SHRI SHIRUDE KAUSTUBH MADHUKAR	CA	JALGAON

ORDINARY MEMBERSHIP

Name	Qualification	City
SHRI KANICHAI SATHISH JOHN (Oct 12 to Mar 13)	CA	KERALA
SHRI SHAH JAY ARVIND (Oct 12 to Mar 13)	CA	MUMBAI
SHRI SAVLA KARTIK JAYANTILAL (Oct 12 to Mar 13)	CA	MUMBAI
SHRI HARIYA KUNJAN SATISH (Oct 12 to Mar 13)	CA	MUMBAI
MS. CHELLA.S J. VIJAY RAMCHANDRAN (Oct 12 to Mar 13)	CS	CHENNAI
SHRI DALMIA SHAILESH SHRIKANT (Oct 12 to Mar 13)	ITP	MUMBAI
SHRI SHIRSAT RAJESH RAMAKANT (Oct 12 to Mar 13)	B.COM	MUMBAI
SHRI VORA PRASHANT M. (Oct 12 to Mar 13)	CA	MUMBAI
SHRI SHAH BISHAN RAMESHCHANDRA (Oct 12 to Mar 13)	CA	AHMEDABAD
MS. AMIN SMRUTI MUKESH (Oct 12 to Mar 13)	CA	AHMEDABAD
SHRI DOSHI ABHISHEK (Oct 12 to Mar 13)	CA	RAJKOT
SHRI LINGSUR RAMAKRISHNA R.	CA	MUMBAI
SHRI SHAH SANDEEP NATWARLAL (Oct 12 to Mar 13)	CA	MUMBAI
SHRI VIRANI ABDUL AZIZ (Oct 12 to Mar 13)	CA	NAGPUR
SHRI AGRAWAL NEERAJ	CA	JABALPUR
SHRI MANEK VAIBHAV SURENDRA (Oct 12 to Mar 13)	CA	MUMBAI
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SHRI KULAPKAR PRITAM P. (Oct 12 to Mar 13)	CA	MUMBAI

SHRI DESHPANDE ABHIJIT B. (Oct 12 to Mar 13)	CA	MUMBAI
SHRI SARAF VIKAS SURESH (Oct 12 to Mar 13)	CA	SECUNDERABAD
MS SHAH PAYAL RAMNIKBHAI (Oct 12 to Mar 13)	CA	MUMBAI
SHRI SHRIMAL DHARMENDRA P. (Oct 12 to Mar 13)	CA	MUMBAI
SHRI JADHAV KIRAN MARUTI (Oct 12 to Mar 13)	ADV	MUMBAI
MS. SHAH VISHAKA SHRENIK (Oct 12 to Mar 13)	CA	MUMBAI
SHRI GUPTA GAURAV SURESH (Oct 12 to Mar 13)	CA	DELHI
MS. VACHHARAJANI PURTI MANAN (Oct 12 to Mar 13)	CA	VALSAD
SHRI WADHWANI NITIN NARIANDAS (Oct 12 to Mar 13)	CA	MUMBAI
SHRI GANDHI DHIRENDRA RAMNIKLAL (Oct 12 to Mar 13)	ITP	MUMBAI
SHRI SHAH SUNIL AMRITLAL (Oct 12 to Mar 13)	CA	MUMBAI
SHRI SOLANKI VICKY ARVIND (Oct 12 to Mar 13)	CA	MUMBAI
SHRI KOTHARI PRANAY NARENDRA (Oct 12 to Mar 13)	CA	MUMBAI
SHRI SHAH NEMIN SIDHARTH (Oct 12 to Mar 13)	CA	MUMBAI
SHRI TIWARI RAJESH PARASNATH (Oct 12 to Mar 13)	CA	MUMBAI
SHRI VASANI VIHIT HIMANSHU (Oct 12 to Mar 13)	CA	MUMBAI
SHRI JOSHI VISHAL SURENDRA (Oct 12 to Mar 13)	CA	MUMBAI

STUDENT MEMBERSHIP

SHRI JAIN DEEPAK RAMESH	CA FINAL	MUMBAI
MS. SHAH DEVANSHI HEMANT	CA FINAL	MUMBAI

2. Past Events

1 ALLIED LAWS COMMITTEE

Allied Laws Committee & Membership Committee organised a half day Students Workshop on E-Filing under various Act jointly with Tax Practitioners Association-Thane on 13th December, 2012 at Thane. The Workshop was addressed by CA Pranav Kapadia, CA Jinit Shah and Shri Kaushik Jhaveri, Company Secretary.

Two Days Seminar on "Real Estate Development" jointly with AIFTP (WZ) and STPAM was held on 14th & 15th December, 2012 at West End Hotel. Shri V. C. Daga, Retd. Judge Bombay High Court delivered Key Note Address. S/Shri A. R. Jani, Solicitor, P. C. Joshi, Advocate & Vikram Nankani, Advocate chaired the sessions. S/Shri Parimal Shroff, Solicitor, Shailesh Mahimtura, Solicitor, Amit Sapre, Architect, J. S. Soloman, Solicitor, P. A. Jani, Solicitor, Mahesh Shah, Solicitor, CA P. R. Ramesh, CA Pradip Kapasi, CA Prem Chhatpar and Shri Vipin Jain, Advocate addressed the delegates.

2. CORPORATE MEMBERS COMMITTEE

A Panel Discussion on the "Revised Schedule VI – Disclosure Patterns and Practical Issues" was held on 19th December, 2012 at IMC. The discussion was led by CA Mukund Chitale, Past President of ICAI, and President of NACAS and the Panelists were Shri P. R. Ramesh, Chairman, Deloitte, India and Dr. Paritosh Basu, Group Controller, Essar Group, CA Ashesh Jani, and CA Jayesh Gandhi

3. INDIRECT TAXES COMMITTEE

The Indirect Tax Study Circle Meetings were held as under:

On 12th December, 2012 where Ms. Padmavati Patil, Advocate addressed the members on the subject "Recent Judgment in Service Tax". The meeting was chaired by Shri Prakash Shah, Advocate.

On 22nd December, 2012 where CA Naresh Sheth addressed the members on the subject "Service Tax issues relating to Real Estate".

The First Residential Refresher Course on Service Tax was held at Silent Hill Resort, Manor, Palghar between 4th January and 6th January, 2013. The course was addressed by CA A. R. Krishnan, CA Rajiv Luthia, CA VIpin Jain, CA Sunil Gabhawalla and Shri K. Vaitheesvaran, Advocate. The RRC was attended by 106 delegates and was a grand success.

The Workshop on MVAT & Service Tax jointly with AIFTP (WZ), BCAS, MCTC and STPAM was held on

a) 15th December, 2012 where Shri Naresh Sheth addressed the members on the subject "Issues in Valuation of Services, Abatement & Reverse Charge Mechanism".

b) 29th December, 2012 where Shri Girish Raman addressed the members on the subject "Issues in Place of Provision of Service Rules, 2012".

3. INTERNATIONAL TAXATION COMMITTEE

4th International Tax Conference was held on 21st & 22nd December, 2012 at Hotel J. W. Marriot, Juhu. Shri Soli E Dastur, Senior Advocate and Past President, was felicitated on Completing 50 years in Profession by Shri Y. P. Trivedi, Senior Advocate and Past President. Shri S. E. Dastur, Senior Advocate addressed the members about his journey of 50 years in Profession. The Third Edition of International Taxation – A Compendium was released by Shri S. E. Dastur followed by felicitation of the members of the team Compendium. The Conference was addressed by eminent faculties in the field of International Taxation.

The Intensive Study Group on International Taxation was held on 11th December, 2012. The first session was continuation of the meeting held on 9th November, 2012 on the subject "Tax issues related to Cross border exchange of employees" by Shri Prashant Maheshwari and Second session was on the subject "Cross Border Secondment of Employees – Implications from an Employee Perspective" addressed by Shri Mitul Shah.

4. STUDY CIRCLE & STUDY GROUP COMMITTEE

The Study Circle on International Taxation Meetings were held as under:

On 10th December, 2012 on the subject "Relevance of Domestic Tax Laws in Tax Treaty Interpretation". The meeting was addressed by CA Chandresh Bhimani.

On 17th December, 2012 on the subject "Agency PE" and was addressed by CA Pallavi Tallavlikar.

The Study Group Meeting was held on 13th December, 2012 on the subject "Recent Judgments under Direct Taxes". The meeting was addressed by CA Mahendra Sanghvi.

3. Future Events

1. ALLIED LAWS COMMITTEE

Study Circle Meeting is scheduled to be held on 12th February, 2013 on the subject "Cyber Crime Dangers and Its Prevention". The meeting will be addressed by CA Sachin Dedhia.

2. CORPORATE MEMBERS COMMITTEE

Lecture Meeting on Companies Bill, 2012 will be held on 14th January, 2013 at IMC. The meeting will be addressed by Shri Bharat Vasani, Chief Legal & Group General Counsel, TATA Group.

3. DIRECT TAXES COMMITTEE

The Committee is pleased to announce its second "The Dastur Essay Competition-2013" for students of Law & Article Trainees pursuing C.A. Course. The Rules governing the competition are available on our website www.citcindia.org.

The 6th Intensive Study Group (Direct Tax) Meeting will be held on 21st, January, 2013 on the subject "Recent Important Decisions under Direct Taxes". The meeting will be addressed by CA. Samir Kapadia.

The Study Course on Interpretation of Taxing Statutes will be held on 1st, 2nd, 8th & 9th February, 2013 at IMC. The Study Course would cover the basic principles of interpretation. The course will be addressed by S/Shri Aaron Solomon, Solicitor & Advocate, B. V. Jhaveri, Advocate, Hiro Rai, Advocate, S. D. Shrivastava, CIT (DR), ITAT, Vipul Joshi, Advocate, CA Dhishat Mehta at the Study Course. This course will give a thorough understanding of the various principles, theories and techniques relevant to the interpretation of enacted Law & Case laws.

4. DELHI CHAPTER

The 1st Study Circle Meeting on Direct Taxes will be held on 19th January, 2013 on the subject "Recent Judgment under Direct Taxes" at India Habitat Centre, New Delhi. The meeting will be addressed by Shri R. P. Garg, Advocate and Shri K. C. Singhal, Advocate. All members are cordially invited.

Full Day Conference on "Estate and Succession Planning, Use of Domestic and International Trusts and Wills" will be held on 2nd February, 2013 at Inspire, Hotel Le Meridien. The Conference will be addressed by CA Dileep C. Choksi, CA Divya Bawja, CA Paresh Shah and CA Mugdha Sahal.

5. INDIRECT TAXES COMMITTEE

The Workshop on MVAT & Service Tax has organised jointly with AIFTP (WZ), BCAS, MCTC and STPAM. The Workshop will be held on 19th January, 2013, 2nd & 16th February 2013, and 2nd, 16th and 30th March, 2013.

The Indirect Tax Study Circle Meetings will be held on 16th January, 2013 where CA Saket Patwari will address the members on the subject "Issues in Place of Provision of Services Rules, 2012" ". The meeting will be chaired by Ms Tejal Mehta.

6. INTERNATIONAL TAXATION COMMITTEE

The 3rd Intensive Study Course on Transfer Pricing (Including Domestic Transfer Pricing) will be held on 16th & 23rd February, 2013, 16th, 23rd & 30th March, 2013 and 6th April, 2013. The course will be addressed by eminent speakers from the Profession and Revenue Department.

7. JOURNAL COMMITTEE

The Committee is planning to bring Special Story "Company Bill - 2012" in the forthcoming issue for the month of February, 2013.

8. MEMBERSHIP & EOP COMMITTEE

The Membership & EOP Committee and Allied Laws Committee is pleased to announce a Lecture Meeting on Wills on 22nd January, 2013 at Thane jointly with Tax Practitioners Association-Thane. The meeting will be addressed by Shri K. K. Ramani, Advocate.

The Membership & EOP Committee jointly with RRC & PR Committee of the Chamber is pleased to announce Limited over Cricket Tournament (with Tennis Ball) Chamber Premier League, 2013 (CPL) for the members on 25th January, 2013. The format of the tournament and charges are announced in the Newsletter.

The Self Awareness Series will be held on 9th January, 2013 on the subject "Power of Money". The meeting will be addressed by Shri Sanjay K. Nawalkha.

9. RESIDENTIAL REFRESHER COURSE & PUBLIC RELATIONS COMMITTEE

The 36th Residential Refresher Course will be held on 21st February to 24th February, 2013 at Heritage Village Resort & SPA, Manesar, Gurgaon. An interesting event of Panel Discussion is being introduced for the first time during this RRC.

10. STUDY CIRCLE & STUDY GROUP COMMITTEE

The Study Circle on International Taxation Meeting will be held on 11th January, 2013 on the subject "Taxation of Software". The meeting will be addressed by CA Hariharan Gangadhar.

The Study Circle Meeting will be held on 17th January, 2013, on the subject "Issues under Capital Gains – Sections 54, 54F, 54EC & Section 50C". The meeting will be Chaired by Shri Vipul Joshi, Advocate and will be addressed by Shri Mandar Vaidya, Advocate. The meeting is in continuation of earlier meeting held on 31st October, 2012.

11. AMITA MEMORIAL LECTURE MEETING

A lecture meeting under the auspicious of Amita Memorial Trust, jointly with BCAS is organised on 11th February, 2013. The meeting will be addressed by Brahmakumari Shivani on the subject "Future without fear"

12. PUBLICATIONS FOR SALE

Indispensable Publications on Allied Laws:

The Allied Laws Committee has come out with a Monograph Series of Four Mini publications on various subjects relating to Allied Laws along with CD. The details of the publications are as under:

Sr. No.	*Subjects*	*Author*
1	Mediation & Conciliation	Shri Prathmesh Popat, Counsel and Mediator
2	The Consumer Protection Act, 1986	CS Surendra Kanstiya
3	Prevention of Money Laundering Act, 2002	Shri Sanjay Chadha, Advocate
4	Micro, Small and Medium Enterprises Act, 2006	CA Abhay Arolkar

(Price for set of Four Books along with CD is ₹ 500/-. Single book is ₹ 150/- without CD).

- Publication of Practical Guide to Indian Transfer Pricing – ₹ 650/-
- 6th Residential Refresher Conference on International Taxation- 2012 Study Material – ₹ 650/-.

(For Enrollment and further details of all the future Events, please refer to the January, 2013 Issue of CITC News or visit the website www.citcindia.org)

STUDY CIRCLE & STUDY GROUP COMMITTEE

Study Circle on International Taxation held on 10th December, 2012 on the subject "Relevence of Domestic Tax Laws in Tax Treaty Interpretation".

CA Chandresh Bhimani addressing the members.

Study Circle on International Taxation held on 17th December, 2012 on the subject "Agency PE".

CA Pallavi Tallavlikar addressing the members.

Study Group Meeting held on 13th December, 2012 on the subject "Recent Judgments under Direct Taxes"

CA Mahendra Sanghvi addressing the members. Seen from L to R: S/Shri CA Ashok Sharma, CA Mulesh Savla, Convenor, CA Haresh Kenia, Chairman, CA Yatin Desai, Vice President, CA Dilip Sanghvi, Vice Chairman.

INDIRECT TAXES COMMITTEE

Study Circle Meeting held on 12th December, 2012 on the subject "Recent Judgment in Service Tax".

Ms. Padmavati Patil, Advocate addressing the members.

Study Circle Meeting held on 22nd December, 2012 on the subject "Service Tax Issues relating to Real Estate".

CA Naresh Sheth addressing the members.

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INTERNATIONAL TAXATION COMMITTEE

4th International Tax Conference held on 21st & 22nd December, 2012 at Hotel J W Marriott, Juhu.

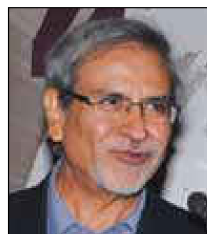
Shri Y. P. Trivedi, Senior Advocate and Past President sharing his memories in Profession with Shri Sohrab E. Dastur. Seen from L to R: CA Hinesh Doshi, Chairman, CA Manoj Shah, President, Shri Sohrab E. Dastur, Senior Advocate, CA Yatin Desai, Vice President, CA Hitesh Shah, Hon. Jt. Secretary.

Chairmen

CA T. P. Ostwal

Shri Girish Dave

CA Pinakin D. Desai



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CA Munjal Almoula

Shri N. Venkataraman Advocate

CA H. Padamchand Khincha

Ms. Alpana Saksena

Section of Delegates

ALLIED LAWS COMMITTEE

Two Days Seminar on Real Estate Development jointly with All India Federation of Tax Practitioners (WZ) and The Sales Tax Practitioners Association of Maharashtra held on 14th & 15th December, 2012 at West End Hotel.

CA Manoj Shah, President, CTC giving opening remarks at the seminar. Seen from L to R : CA Ashok Sharma, Chairman, Allied Laws Committee, CTC, Vijay C. Daga, Retd. Hon'ble Justice, P. C. Joshi, Faculty, Sachin Gandhi, Hon. Treasurer, STPAM.

CA Ashok Sharma, Chairman, Allied Laws Committee, CTC welcoming the delegates. Seen from L to R : S/Shri Vipul Joshi, Past President, CTC, CA Manoj Shah, President, CA Pankaj Parekh, Vice President, STPAM.

Shri Vijay C. Daga, Retd. Hon'ble Justice addressing the delegates. Seen from L to R : S/Shri CA Ashok Sharma, Chairman, Allied Laws Committee, CTC, CA Manoj Shah, President, CTC. P. C. Joshi, Faculty, Sachin Gandhi, Hon. Treasurer, STPAM.

Chairmen of the session

Shri A. R. Jani
Solicitor

Shri P. C. Joshi
Advocate

Shri Vikram Nankani
Advocate

Section of Delegates

ALLIED LAWS COMMITTEE

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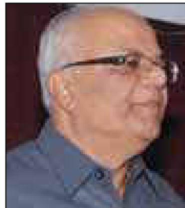
Shri Mahesh Shah Solicitor

CA P. R. Ramesh

CA Prem Chhatpar

Shri Vipin Jain Advocate

Half Day Student Workshop on E-filing under Various Acts jointly with Membership & EOP Committee, CTC and Tax Practitioners Association, Thane held on 13th December, 2012 at TSSIA Hall, Thane.

CA Manoj Shah, President, CTC welcoming the delegates. Seen from L to R : S/Shri CA Hemant Parab, Vice Chairman, Membership & EOP Committee, CTC, CA Paras Savla, Hon. Jt. Secretary, CTC, CA Pranav Kapadia, Faculty, C. L. Bhanushali, Secretary, TPA, CA Navin Dedhia, TPA.

CA Pranav Kapadia addressing the delegates on the subject "E-filing of applications, Returns, Audit Reports under MVAT Act, 2002, CST and Profession Tax".

CA Jinit Shah addressing the delegates on the subject "E-filing of Applications, Returns Surrender under Service Tax".

Shri Kaushik Jhaveri, Company Secretary addressing the delegates on the subject "E-filing of Applications and Returns under Companies Act, 1956".

Section of delegates.

CORPORATE MEMBERS COMMITTEE

A Panel Discussion on Revised Schedule VI – Disclosure Patterns and Practical Issues held on 19th December, 2012 at IMC.

CA Vipul Choksi, Chairman, welcoming the delegates. Seen from L to R : CA Hasmukh Dedhia, Vice Chairman, CA Manoj Shah, President, CA Mukund M. Chitale, Moderator, CA Jayesh Gandhi and Dr. Paritosh Basu.

CA Ashesh Jani panel speaker addressing the delegates. Seen from L to R : S/Shri CA Hasmukh Dedhia, Vice Chairman, CA Manoj Shah, President, CA Mukund M. Chitale, Moderator, CA Vipul Choksi, Chairman, CA P. R. Ramesh, CA Jayesh Gandhi and Dr. Paritosh Basu Panel Speakers.

Section of Delegates

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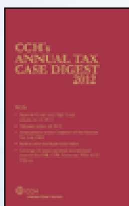

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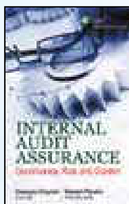

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THE CHAMBER'S JOURNAL
Posted at the Mumbai Patrika Channel
Sorting Office, Mumbai 400 001.
Date of Posting: 15th & 16th January 2013
No. MA/MR/South-365/2013-15
R.N.I. No. MAHENG/2012/47041
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By K.R.SAMPATH
Advocate and Solicitor to
The Supreme Court of England & Wales

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PUBLICATIONS PVT. LTD.

Printed and Published by Shri. Kishor D. Vanjara on behalf of The Chamber of Tax Consultants, 3 Rewa Chamber, Ground Floor, 31, New Marine Lines, Mumbai - 400 020 and Printed at Finesse Graphics & Prints Pvt. Ltd., 309 Parvati Industrial Premises, Sun Mill Compound, Lower Parel (W), Mumbai - 400 013. Tel: 4036 4600 and published at The Chamber of Tax Consultants, 3, Rewa Chamber, Ground Floor, 31, New Marine Lines, Mumbai - 400 020.