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Articles

Liability for Misstatement in Prospectus: Where to Stop?

Manendra Singh*

Introduction

This article focuses on the wide applicability of liability provisions with respect to any misstatement made in the context of a prospectus issued by any company whereby it asks the public to invest money. The liability regime for the misstatement has been fluctuating ever since the time corporate personality came into existence. However, it has always been a moot point to what extent could this liability be stretched and who all could be held responsible. The regime for liability varies nation by nation and thus this article deals with the hardcore legal regime relating to the liability for misstatement in India and then puts the position of law in other two economic power, USA and UK.

A. INDIA

1. What is a Prospectus?

The definition of "prospectus" in the Indian Companies Act, 1956, (the "Act") was based on the definition found in the English Companies Act [Section 455(1)]. It then underwent amendment in 1960 following the recommendation of the Companies Act Amendment Committee of 1957 and also in 1974. The current definition as per Section 2(36) stands as follows:

> "prospectus" means any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of, a body corporate.

It is doubtful whether a television or film advertisement, as distinguished from radio which appeals to the ear and not to the eye, may be treated as falling within the definition of prospectus, the definition of document in Section 3(18) of the General Clauses Act notwithstanding. On the other hand, a written invitation designed to induce persons invited to submit requests for purchasing or subscribing purchases will be a prospectus if it invites subscription or purchase for cash.[1]

A Prospectus issued by or on behalf of a public company must contain the matters specified in Part I of Schedule II set out the reports specified in Part II of that Schedule and Parts I and II of Schedule II have to be read in conjunction with the clarifications etc. given in Part III of the said Schedule.[2]

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The power to deal with issue of prospectus is given to SEBI in case of listed public companies and in case of those public companies which intend to get their securities listed on any recognised stock exchange in India and in any other case, the power lies with the Central Government.[3]

1.1 Deemed Prospectus

The Act also deals with the concept of deemed prospectus under Section 64 of the Act. This section is an exception to issue of prospectus. A company may allot or agree to allot any shares or debentures to an "issue house" without there being any intention on the part of the company to make shares or debentures available directly to the public through issue of prospectus. But then it shall, unless the contrary is proved, be evidence that an allotment of, or an agreement to allot, shares or debentures was made with a view to the shares or debentures being offered for sale to the public if it is shown:

(*a*) that an offer of the shares or debentures or of any of them for sale to the public was made within six months after the allotment or agreement to allot; or

(*b*) that at the date when the offer was made, the whole consideration to be received by the company in respect of the shares or debentures had not been received by it.

1.2 The "Golden Rule" for Prospectus Interpretation

The Golden Rule as regards the drafting of the prospectus was laid down in the leading case *New Brunswick and Canada Railway and Land Co.* v. *Muggeridge,*[4] as:

- Only true nature of the company's venture shall be disclosed;
- Strict and scrupulous accuracy shall be maintained in drafting prospectus as it invites the public to take shares on the faith of the representations contained in the prospectus;
- In addition to the mandatory information required to be given as per Parts I and II of Schedule II of the Act, there must be voluntary disclosures of information as would reasonably constitute a fair representation of facts for the public to act upon.

1.3 What Constitutes an "Offer to Public"

It is important to take a note in the definition of prospectus about the offer being made to the public and about accepting deposits from public. Section 67 of the Act takes an insight into the construction of references to offering shares or debentures to the public. The Act is clear that an offer of shares to the company's shareholders cannot be termed "an offer to the public". It is necessary to understand the meaning of this expression in order to find out as to what constitutes a prospectus. Where an invitation is made by the management of a company to selected persons for subscription or purchase by less than 50 persons receiving the offer or invitation, the shares or debentures and such invitation or offer is not calculated directly or indirectly to be availed of by other persons, such invitation or offer shall not be treated as an offer or invitation to the public. If a prospectus addressed to the general public, or to a section of the public, is published, that no doubt constitutes an offer to the public, even though none of the public come in; but possibly if this offer is made without any intention to let the public take up any of the shares, it might be found as a fact that there was no real offer to the public.[5]

2. Scope of Liability for Misstatement in Prospectus

2.1 What Is misstatement?

As per Section 65 of the Act, a statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included *inter alia* in the prospectus itself or contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith and where the omission from a prospectus of any manner is calculated to mislead, the prospectus shall be deemed, in respect of such omission, to be a prospectus in which an untrue statement is included. The liability accrues where any person subscribes for any shares or debentures on the faith of the prospectus for any loss or damage he may have sustained by reason of untrue statement included therein.[6]

Often matters related to representation for the future events have been questioned. A mere representation that something will be done or will happen in future is not a representation of fact which could invoke the liability for misstatement. In order to invoke it, there must be a misstatement as to an existing fact.[7] Representation would invoke the responsibility if it was true only at the time of issue of prospectus and not at the time of allotment.[8] A statement in a prospectus as to the persons who are to be directors is a material statement and if it is untrue, a person subscribing on the faith of it is *prima facie* entitled to rescind.[9] Similarly, an ambiguous statement which carries double meaning and an Applicant who reasonably puts one meaning and is misled would be entitled to relief and the maker of the statement would not be heard to say that some other meaning should have been put upon his words.[10] It has also been held that those who accepted false statements as true were not deprived of their remedy merely because they neglected to go and look at the correctness of the statements.[11] Where the statements in the prospectus are clear but an applicant happens to take a wrong meaning by misreading them he cannot complain so as to get rid of the allotment.[12] Any variation or modification of the terms and conditions of the issued prospectus and the prospectus approved by CCI would have the effect of misrepresentation.[13]

Any misstatement made in an advertisement inviting deposits made *via* Section 58A of the Act would also attract the applicability of liability provisions *vis-à-vis* prospectus.[14]

2.2 Persons Who Could Be Held Liable

- every person who is a director of the company at the time of the issue of the prospectus;
- every person who has authorised himself to be named and is named in the prospectus either as a director, or as having agreed to become a director, either immediately or after an interval of time;

- every person who is a promoter of the company;
- every person who has authorised the issue of the prospectus;
- an expert[15]: the liability of an expert surrounds around Sections 57 and 58 of the Act. These provisions make it clear that the liability would not accrue just because of his position as an expert but would be only for an untrue statement made by him in the capacity of an expert. The expert's consent should be endorsed on or annexed to the registration of the prospectus.[16] By consenting to the issue of the prospectus the expert does not undertake liability in respect of anything in the prospectus except his own statement.[17] This section, adopted from Section 40 of the English Act, 1948, enacts "a wholesome rule intended to protect an intending investor by making the expert a party to the issue of the prospectus and making him liable for untrue statements".[18]

2.3 If Minor Represented as Promoters in the Prospectus Could Be Held Liable for Misrepresentation and Fraud?

This question was dealt in detail by Supreme Court in *Ritesh Agarwal and Anr.* v. *Securities and Exchange Board of India and Ors.*[19], wherein the Court answered it in negative and held that minors having regard to the provisions of the Indian Contract Act, 1872, they could not have been proceeded against strictly in terms of the provisions of the said Act. SEBI, as the regulatory body, may take actions against the persons who undertook those fraudulent actions and they may also be held guilty of making a mis-representation and commission of fraud not only before the prospective purchasers of the shares but also before the statutory authority. The same, however, would itself not mean that a minor would not be penalised for entering into a contract which *per se* was not enforceable. A contract must be entered into by a person who can make a promise or make an offer. If he cannot make an offer or in his favour an offer cannot be made, the contract would be void as an agreement which is not enforceable in law would be void. Section 11 of the Indian Contract Act, 1872, provides that the person who is competent to contract must be of the age of majority. Thus, if it is shown by the birth certificates that the promoters were minor they cannot be held guilty.

2.4 Penalty and Fine:

2.4.1 Any person who could be held liable for prospectus, if he does not mention the salient features in the prospectus which are prescribed,[20] then he shall be punishable with fine which may extend to Rs. 50,000.[21] The liability for this also extends under general law or under any other provision of the Act.[22]

2.4.2 Where any person who acts as an expert and who is or has been engaged or interested in the formation or promotion, or in the management, of the company or where a prospectus is issued which contains a statement made by an expert and the consent to such an effect has not been obtained or has been withdrawn, then the Company and every person, who is knowingly a party to the issue thereof, shall be punishable with find which may extend to Rs. 50,000.[23]

2.4.3 Any person who either by knowingly or recklessly making any statement, promise or forecast which is false, deceptive or misleading or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into or to offer to enter into (*a*) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting shares or debentures; (*b*) any agreement, the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of shares or debentures, or by reference to fluctuations in the value of shares or debentures, shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to Rs. 1 lac or with both. This liability is intended to apply not merely to company prospectuses but also to any proposal or offer for sale of shares by anybody whatsoever. This provision is expected to serve as a sufficient deterrent to unscrupulous company promoters against making untrue and deceptive statements in prospectuses with a view to obtaining capital from the public.[24]

3. Civil Liability

Section 62 of the Act incorporates the provision relating to the civil liability for misstatement in prospectus. It provides very clearly that where a prospectus invites persons to subscribe for shares in or debentures of a company liability accrues to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage he may have sustained by reason of any untrue statement included therein. Every person who becomes liable to make any payment by virtue of such misrepresentation may recover contribution as in cases of contract from any other person who, if sued separately, would have been liable to make the same payment unless the former person was and the latter person was not guilty of fraudulent misrepresentation. The measure of damages for the loss suffered by reason of the untrue statement, omission, etc. is the difference between the value which the shares would have had but for such statement or omission and the true value of the shares at the time of allotment.[25] In applying the correct measure of damages to be awarded to compensate a person who has been fraudulently induced to purchase shares, the crucial criterion is the difference between the purchase price and their actual value. It may be appropriate to use the subsequent market price of the shares after the fraud has come to light and the market has settled.[26] The period prescribed for a suit for damage by shareholder is three years as per Article 113 of the Limitation Act, 1963.

4. Criminal Liability

Section 63 of the Act incorporates the provision relating to the criminal liability for misstatement in prospectus. It provides that where a prospectus includes any untrue statement, every person who authorised the issue of prospectus shall be punishable with imprisonment for a term which may extend to two years or with fine which may extend to Rs 50,000 or with both. The offence is compoundable under Section 621A. It has to be noted that under such cases, once the prosecution establishes the falsity of statement in a prospectus signed by a director, etc., the onus is shifted to the defendant of proving either that the statement was immaterial or that he believed it to be true. An expert who has given the consent will not be deemed to be *ipso facto* a person who authorised the issue of prospectus.[27]

5. Defenses:

5.1 Defense vis-à-vis General Liability

A director or other person responsible for the prospectus shall not incur any liability by reason of any non-compliance with, or contravention of, any of the requirements with respect to the matters to be stated and reports to be set out in prospectus:

(*a*) as regards any matter not disclosed, he proves that he had no knowledge thereof; or

(*b*) he proves that the non-compliance or contravention arose from an honest mistake of fact on his part; or

(*c*) the non-compliance or contravention was in respect of matters which, in the opinion of the Court dealing with the case were immaterial or was otherwise such as ought, in the opinion of that court, having regard to all the circumstances of the case, reasonably to be excused, provided that no director or other person shall incur any liability in respect of the failure to include in a prospectus a statement with respect to the matters specified in clause 18 of Schedule II unless it is proved that he had knowledge of the matters not disclosed.

5.2 Defense Available to Any Person except an Expert vis-à-vis Civil Liability

No person shall be liable if he proves:

(*a*) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent;

(*b*) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his knowledge or consent;

(*c*) that, after the issue of the prospectus and before allotment thereunder, he, on becoming aware of any untrue statement therein, withdrew his consent to the prospectus and gave reasonable public notice of the withdrawal and of the reason therefor; or

(*d*) that

(*i*) as regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures, as the case may be, believe, that the statement was true; and

(*ii*) as regards every untrue statement purporting to be a statement by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe, and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that person had given the consent required by Section 58 to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment thereunder; and

(*iii*) as regards every untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the document.

5.3 Defence Available to an Expert vis-à-vis Civil Liability

An expert who has given his consent under Section 58 of the Act shall not be liable if he proves:

(*a*) that, having given his consent under Section 58 to the issue of the prospectus, he withdrew it in writing before delivery of a copy of the prospectus for registration;

(*b*) that, after delivery of a copy of the prospectus for registration and before allotment thereunder, he, on becoming aware of the untrue statement, withdrew his consent in writing and gave reasonable public notice of the withdrawal and of the reason therefor; or

(*c*) that he was competent to make the statement and that he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures, believe, that the statement was true.

5.4 Defense Available vis-à-vis Criminal Liability

Any person who could be held criminally liable shall not be deemed to be so if he proves either that the statement was immaterial or that he had reasonable ground to believe, and did up to the time of the issue of the prospectus believe that the statement was true.

LIABILITY FOR MISSTATEMENT IN OTHER COUNTRIES

B. UNITED KINGDOM

The publication in the UK (England and Wales) of offering documents exposes those responsible for their preparation and publication to potential liability for misrepresentation or negligent misstatement. Potentially simpler statutory liabilities arise under the Financial Services and Markets Act 2000 (the "FSMA"), previously contained in the Financial Services Act 1986. FSMA provides the framework within which the Financial Services Authority (the "FSA") will operate as the regulator for the financial services industry in the UK. Criminal liability may also arise, as well as liabilities under the Listing Rules or other self-regulatory schemes. In practice, without clear evidence of fraud, such claims are not clear-cut, and may face complex issues, particularly in relation to causation and reliance, in showing that the misleading information in fact caused the damage, or that the investor in fact relied on the misleading information in entering into the investment. This is presumably why few cases have reached trial in recent years. Faced with technical difficulties on one side, and publicity issues on the other, claims usually settle long before trial.

6. Who May Be Liable?

Section 90 of the FSMA provides that any person responsible for listing particulars[28] is liable to pay compensation to a person who has acquired securities to which the particulars apply and suffered loss in respect of them as a result of:

(*i*) any untrue or misleading statement[29] in the particulars; or

(*ii*) the omission from the particulars of any matter required to be included by Section 80 or 81.

Sections 80 and 81 state that the listing particulars must contain all such information as investors and their professional advisers would reasonably require and if at any time there occurs any significant change affecting any matter contained in those particulars the inclusion of which is mandated by the situation has to be included in unless its not a significant change of if the issuer of the securities is not aware of the change or new matter in question. If in case a person fails to include significant changes, then his liability can be invoked to pay compensation to any person who acquires securities of the kind in question and suffers loss in respect of them as a result of the failure. However, liability under Section 90 does not stop the general liability that may be incurred upon.[30]

6.1 Liability of Promoters

Section 90(8) deals with the liability of promoters as follows:

> No person shall, by reason of being a promoter of a company or otherwise, incur any liability for failing to disclose information which he would not be required to disclose in listing particulars in respect of a company's securities—
>
> (*a*) if he were responsible for those particulars; or
>
> (*b*) if he is responsible for them, which he is entitled to omit by virtue of Section 82.

6.2 Director's Liability under Section 463 of the UK Companies Act, 2006

Section 463 applies to directors of all companies. Under Section 463, subject to the knowledge requirement, a director is liable to compensate the company for any loss that the company suffers as a result of any untrue or misleading statement in, or omission from:

- the directors' report (including the business review section);
- the directors' remuneration report;

- a summary financial statement (SFS) so far as it is derived from either of the above reports.[31]

Section 463 provides a safe harbour in that a director is only liable to compensate the company for the loss suffered by the company in reimbursing an investor if the director knew or was reckless as to whether the statement was untrue or misleading or knew the omission to be dishonest concealment of a material fact.[32] The director's liability under Section 463 is limited to the company only and not to shareholders or third parties.[33] A director may still incur liability for a criminal offence, for example, under Section 397 of FSMA for misleading statements and practices and civil liability for market manipulation.[34]

6.3 Liability for Negligent Misstatement: Tort Liability: Controversy over "duty of care"

The liability under Section 90 revolves around the duty to care since it is based on fraud and negligence. Thus, if any person who was under a duty of care does any omission or fails to perform his duty his liability can be invoked if a loss is suffered due to such omission or failure or negligence. It has been held that if the investor can show that there was a misstatement by the maker of a statement in the offering document who owed him a duty of care, the investor can claim in negligence.[35] But the burden of proof is on the plaintiff that the defendant owed a duty of care towards him. However, a controversy has arose with respect to the position of after market purchasers, since an after market purchaser needs to show that the misleading statement in the particulars still influenced the market he bought, thus, wherein in an *obiter*[36] by Lightman J, he stated that FSMA compensation claim is available to purchasers in the after market, a contrary decision was given in *Al Nakib v Longcroft*,[37] where the Court held that given the difficulty in establishing a duty of care in relation to an unascertained class of people, it is thought that no duty of care is owed to after market purchasers. Thus, it is interesting to note that whether investors make a claim under FSMA or negligence, since FSMA does not require proof of negligence; however, for a wider group, a negligence claim might serve more beneficial.

7. Defence to Section 90 Liability

Schedule 10 of the FSMA frames out the possible situations where a person can save himself from being held liable under Section 90 of the FSMA. The defences provided under FSMA are quite similar to those provided under Indian Companies Act, 1956. It also classifies the different defences available to an expert and non-expert.

7.1 For a Statement Made by a Non-expert

A person does not incur any liability under Section 90 for loss caused by a statement if he satisfies the court that at the time when the listing particulars were submitted to the competent authority, he reasonably believed (having made such enquiries, if any, as were reasonable) that:

- the statement was true and not misleading;
- the matter whose omission caused the loss was properly omitted, and that one or more of the following conditions are satisfied:

- he continued in his belief until the time when the securities in question were acquired;
- they were acquired before it was reasonably practicable to bring a correction to the attention of persons likely to acquire them;
- before the securities were acquired, he had taken all such steps as it was reasonable for him to have taken to secure that a correction was brought to the attention of those persons;
- he continued in his belief until after the commencement of dealings in the securities following their admission to the official list and they were acquired after such a lapse of time that he ought in the circumstances to be reasonably excused.

- *Defense by Correction of Statement:* Another defence that is available to a person from incurring the liability is when he satisfies the court that:
    - before the securities in question were acquired, a correction had been published in a manner calculated to bring it to the attention of persons likely to acquire the securities; or
    - he took all such steps as it was reasonable for him to take to secure such publication and reasonably believed that it had taken place before the securities were acquired.

7.2 For a Statement Made by an Expert

For FSMA an expert includes any engineer, valuer, accountant or other person whose profession, qualifications or experience give authority to a statement made by him. This definition is similar to that of expert in the Indian Companies Act, 1956.

An expert does not incur any liability under Section 90 for loss in respect of any securities caused by a statement if he satisfies the court that, at the time when the listing particulars were submitted to the competent authority, he reasonably believed that the other person:

- was competent to make or authorise the statement, and
- had consented to its inclusion in the form and context in which it was included, and that one or more of the following conditions are satisfied:
    - he continued in his belief until the time when the securities were acquired;
    - they were acquired before it was reasonably practicable to bring the fact that the expert was not competent, or had not consented, to the attention of persons likely to acquire the securities in question;
    - before the securities were acquired he had taken all such steps as it was reasonable for him to have taken to secure that that fact was brought to the attention of those persons;
    - he continued in his belief until after the commencement of dealings in the securities following their admission to the official list and they were acquired after such a lapse of time that he ought in the circumstances to be reasonably excused.

- *Defence by Correction of Statement:* Another defence that is available to an expert from incurring the liability is when he satisfies the court that:
  - before the securities in question were acquired, the fact that the he was not competent or had not consented had been published in a manner calculated to bring it to the attention of persons likely to acquire the securities; or
  - he took all such steps as it was reasonable for him to take to secure such publication and reasonably believed that it had taken place before the securities were acquired.

7.3 Defence Available to Both, Expert and Non-expert

A person does not incur any liability under Section 90 if he satisfies the court that the person suffering the loss acquired the securities in question with knowledge:

- that the statement was false or misleading; or
- of the omitted matter; or
- of the change or new matter, as the case may be.

8. Latest Development: Liability of Issuers in Connection with Published Information[38]

In order to clearly frame out the liabilities of issuers, United Kingdom legislation has come up with Financial Services and Markets Act, 2000 (Liability of Issuers) Regulations, 2010. This regime is different from the earlier regime, where liability was dependent on fraud and negligence whereas this new regime provides for the liability of issuers to pay compensation to third parties who have suffered loss as a result of misstatements, or dishonest omissions in information published by the issuer, or dishonest delay by the issuer in publishing information. The purpose of the second set of regulations is to extend the current statutory regime for the liability of issuers for misstatements set out in Section 90A of FSMA. Under the existing statutory regime, issuers of securities traded on regulated markets in the United Kingdom are liable for fraudulent misstatements made to the market in a limited class of publications. The regulations extend the regime to cover issuers of any securities admitted to trading on a securities market in the UK, and issuers for which the UK is the issuer's home state. Claims for misstatement may be brought not only by buyers of securities but also by sellers and holders of securities, if they have acted in reliance on a fraudulent misstatement and suffered loss as a result.

However, a question has been left to the interpretation: Does that imply that the regulations apply to a new issuer of a security, or to continuing provision of information for a security that has already been issued?

8.1 What Is Published Information?

Published information means information published by the issuer of securities either by recognised means or by other means where the availability of the information has been announced by the issuer by recognised means. It is immaterial whether the information is required to be published by recognised means or otherwise.

8.2 Issuer Is liable to Whom?

An issuer of securities is liable to pay compensation to a person who:

- acquires, continues to hold or disposes of the securities in reliance on published information; and
- suffers loss in respect of the securities as a result of:
    - ✦ any untrue or misleading statement in that published information, or
    - ✦ the omission from that published information of any matter required to be included in it.

8.3 Plaintiff Has to Prove What?

In order to invoke the liability of the issuer, the plaintiff is required to prove that he suffered loss as a result of the statement or omission and because he acquired, continued to hold or disposed of the relevant securities:

- ✦ in reliance on the information in question, and
- ✦ at a time when, and in circumstances in which, it was reasonable for him to rely on it.

9. Issuer's Scope of Liability

An Issuer is liable in respect of an untrue or misleading statement only if a person discharging managerial responsibilities within the issuer knew the statement to be untrue or misleading or was reckless as to whether it was untrue or misleading or when there is a dishonest delay in publishing information. His liability extends when in respect of the omission of any matter required to be included in published information only if a person discharging managerial responsibilities within the issuer knew the omission to be a dishonest concealment of a material fact. However, he is not liable for the latter if the published information is contained in listing particulars or a prospectus and the issuer is liable under Section 90 of the FSMA. A person's conduct is regarded as dishonest if and only if it is regarded as dishonest by persons who regularly trade on the securities market in question, and the person was aware or must be taken to have been aware that it was so regarded. A person discharging managerial responsibilities could be any director of the issuer (or a person occupying the position of director, by whatever name called) or in the case of an issuer whose affairs are managed by its members, any member of the issuer or any senior executive of the issuer having responsibilities in relation to the information in question or its publication.

However, this liability does not affect:

- civil liability—
    - ✦ under Section 90 (compensation for statements in listing particulars or prospectus),
    - ✦ under rules made by virtue of Section 954 of the Companies Act, 2006 (compensation),
    - ✦ for breach of contract,

    - under the Misrepresentation Act, 1967, or
    - arising from a person's having assumed responsibility, to a particular person for a particular purpose, for the accuracy or completeness of the information concerned;
- liability to a civil penalty; or
- criminal liability.

C. UNITED STATES OF AMERICA

In the United States, the federal Securities Law provides ample opportunities for private claimants to seek remedies through the courts for misleading disclosures in relation to broad range of public statements, both written and oral. The Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act") provide aggrieved buyers and sellers of securities with several express and implied causes of action. In addition, the Securities and Exchange Commission ("SEC") can impose sanctions on the offering participants for violations of the Securities Act and the Exchange Act.

10. Types of Statements for which Liability Can Accrue

Federal securities laws provide remedies for misleading disclosure for a broad range of misleading public statements, both written and oral.

10.1 Registration Statements[39]

Registration statements filed with the SEC (including the prospectus contained in the registration statement) can be a source of liability for untrue statements of material fact and materially misleading omissions (Section 11 of the Securities Act). A registration statement means the statement provided for in Section 6, and includes any amendment thereto and any report, document, or memorandum filed as part of such statement or incorporated therein by reference.

10.2 Prospectus Liability[40]

Prospectus means any prospectus, notice, circular, advertisement, letter, or communication, written[41] or by radio or television, which offers any security for sale or confirms the sale of any security. A seller may be liable for a prospectus (or oral communication) containing untrue statements of material fact or materially misleading omissions made in connection with a public offering, whether or not the offering is made pursuant to a registration statement filed with the SEC (Section 12(*a*)(2) of the Securities Act).

10.3 Other Public Statements

Rule 10(*b*)(5) provides one of the most significant remedies for disclosure violations, even extending to secondary market trading. Rule 10(*b*)(5) lawsuits may spring from material misstatements or omissions relied upon by investors, including press releases, financial reports and even analyst reports posted on an issuer's website. Investors may also sue sellers under Section 12(*a*)(1) of the Securities Act if securities were offered in violation of the registration requirements of that Act. A successful suit under Section 12(*a*)(1) gives the investor a "put right" which refunds the purchase price of the securities.

Sections 11 and 12(*a*)(2) and Rule 10(b)(5) do not provide the only statutory remedies for improper disclosure in connection with securities offerings. For instance, Section 17(*a*) of the Securities Act contains a broad anti-fraud provision similar to Rule 10(*b*)(5), which would apply to both public and private offerings as well as secondary trading. Section 17(*a*) does not, however, provide a private right of action, and suits can only be initiated by the SEC. This article therefore focuses only on those remedies provided by Sections 11 and 12(*a*)(2) and Rule 10(b)(5).

10.4 Section-11 Liability

Section 11 of the Securities Act creates an obligation of openness and full disclosure in the context of any registered offering. It provides buyers of the securities with an express right of action for damages if any part of the issuer's registration statement (when it is declared effective by the SEC) contains an "untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading".

To establish a valid Section-11 claim, a plaintiff must show all of the following:

- The registration statement, at the time it became effective, contained a misstatement or omission;
- The misstatement or omission was material;
- The plaintiff bought securities registered pursuant to the misleading registration statement. This includes anyone who bought the security directly from the issuer or underwriter and anyone who bought the security later in the open market;
- The plaintiff has complied with the statute of limitations.

11. Who Is liable?

Section 11 of the Securities Act states that, in the event of a material misstatement or omission in a registration statement, an investor can sue:

- every person who signed the registration statement;
- every person who was a director of (or person performing similar functions) or partner in, the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;
- every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions or partner;
- every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;
- every underwriter with respect to such security.

However, the Securities Act also provides that all or any one or more of the persons who can be liable, shall be jointly and severally liable, and every person who becomes liable to make any payment may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

12. Persons Not Liable

An investor cannot hold a selling stockholder liable for a material misstatement or omission in a registration statement under Section 11, as a selling stockholder does not sign the issuer's registration statement. This applies even where the registration statement only registers stock of selling stockholders and does not register any additional stock of the issuer. A selling stockholder can be liable under Section 11 only if they are also a director or officer and held liable in that capacity. Issuer's counsel and underwriters' counsel are not considered to be either experts or controlling persons where counsel does no more than perform legal services or act only in his professional capacity for its clients which includes preparing the registration statement.

13. Defences to Section-11 Liability

The defendant can avoid liability if it can prove one of the available defences:

13.1 Plaintiff's Knowledge of the Untruth or Omission at the Time It Acquired the Securities:[42]

This defence is available to all defendants, including the issuer. Defendants must show actual, not constructive, knowledge.

13.2 Resignation:[43]

This defence is available to a named party that is, an officer or director of the issuer, the auditor or any other expert identified in the registration statement, who resigns and informs the SEC of the materially false or misleading statement before the registration statement becomes effective.

13.3 Effectiveness without Knowledge:[44]

This defence is available to a named party who upon becoming aware of such fact informs the SEC and the public that a registration statement has become effective without his knowledge.

13.4 Non-causation:[45]

This defence is available to all defendants, including the issuer. The defendant will not be liable if it can prove that the decline in the security's value was due to a general decline in the market and was not a result of any untruths or omissions in the registration statement.

13.5 Due Diligence or Reasonable Investigation:[46]

This defence is available to all parties other than the issuer. The issuer is strictly liable for material misstatements or omissions contained in the registration statement. Each potentially liable party (other than the issuer) can, however, assert a so-called due diligence defence as an escape from liability.[47] To assert a due diligence defence, the defendant must establish that, based on a reasonable investigation, their belief that the registration statement was accurate and complete was reasonable. It is provided that what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property. Due diligence is the term used to describe the process by which parties who may be liable for material misstatements or omissions in a registration statement seek to verify the disclosures in the registration statement. The standard of reasonableness is that required of a prudent man in the management of his own property.[48] The activities that create the reasonable investigation or due diligence defense can also mitigate potential liability under Section 12 of the Securities Act and Rule 10(*b*)(5) of the Exchange Act. Section 12(*a*)(2) expressly provides that a defendant is not liable if he did not know, and in the exercise of reasonable care could not have known, of the misstatements or omissions.

A proper due diligence investigation into the preparation of the issuer's registration statement can effectively minimise potential liability. There is some uncertainty about what is necessary to establish a due diligence defence, since the courts have held that due diligence for a Section-11 person will vary with the degree of involvement of the individual, his expertise, and his access to the pertinent information and data.[49] Accordingly, the SEC issued its own statement on the subject of due diligence.[50] Rule 176 lists circumstances that determine whether an investigation is reasonable and reasonable grounds for belief under Section 11. The SEC has interpreted the rule to allow each person who may have liability under Section 11 to evaluate the surrounding facts, including the extent of his previous relationship with the issuer, and use investigation techniques that are appropriate to the circumstances of the offering. The rule confirms that the degree of investigation is not the same for all Section-11 persons. The availability of the due diligence defence depends on the following factors:

- type of issuer;
- type of person;
- type of security;
- if the person is an officer, the office held;
- if the person is a director or proposed director, the presence (or absence) of another relationship to the issuer;
- reasonable reliance on officers, employees and others whose duties should have given them knowledge of the particular facts (in light of the functions and responsibilities of the person with respect to the issuer and the filing);
- if the person is an underwriter, the type of underwriting arrangement, the role of the person as an underwriter and the availability of information concerning the registration;
- whether the person had any responsibility for a fact or document incorporated by reference at the time of the filing from which it was incorporated.

13.6 Due Diligence Defence for "Expertise"/"Non-expertise" Sections

The due diligence burden also varies with the class of the potential defendant (whether they are an expert or non-expert) and whether the portion of the registration statement giving rise to the potential liability has been expertised. Section 11 divides the registration statement into two types:

13.6.1 Expertised Sections

These are principally the audited financial statements, which include an audit opinion prepared by the auditors. In most underwritten offerings (including an IPO) the only expert involved is the auditor. Auditors and other experts can only be held liable if they are named, with their consent, in the registration statement as having prepared or certified any part of the registration statement or any report or valuation mentioned in it. An expert facing potential liability for statements made on his authority as an expert, or as a copy or extract from his report or valuation as an expert contained in an expertised section of a registration statement, must show one of the following to assert a due diligence defence[51], that:

- he had, after reasonable investigation, reasonable grounds to believe and did believe, at the time the portion of the registration statement giving rise to the potential liability was declared effective by the SEC, that the statements in that portion of the registration statement were true and that there was no omission to state a material fact required to be stated or necessary to make the statements not misleading.
- the portion of the registration statement giving rise to the potential liability did not fairly represent that expert's statement as an expert or was not a fair copy of, or extract from, his report or valuation as an expert.
- *Non-expertised sections:* These are all the other sections of the registration statement. To assert a due diligence defence, a non-expert facing potential liability for statements contained in a non-expertised section of a registration statement must prove that he had, after reasonable investigation, reasonable grounds to believe and did believe, at the time the portion of the registration statement giving rise to the potential liability was declared effective by the SEC, both of the following[52]:

  (*i*) Statements in that portion of the registration statement were true.

  (*ii*) There was no omission to state a material fact required to be stated or necessary to make the statements not misleading.

  To assert a due diligence defense, a non-expert facing potential liability for statements contained in an expertised section of a registration statement must show that he had no reasonable grounds to believe and did not believe, at the time the portion of the registration statement giving rise to the potential liability was declared effective by the SEC, any one of the following[53]:

  (*i*) The statements were untrue.

  (*ii*) There was an omission to state a material fact required to be stated or necessary to make the statements not misleading.

(*iii*) That portion of the registration statement did not fairly represent the statement of the expert or was not a fair copy of, or extract from, the report or valuation of the expert.

- For expertised sections, non-expert defendants are not required to conduct a reasonable investigation to have reasonable grounds for their belief, but they must investigate "*red flags*" in expertised sections, including the financial statements. A red flag would include anything that would indicate that the expertised section should not be relied on. Red flags depend on the circumstances unique to each defendant. In the WorldCom decision, Judge Cote described a red flag for the financial statements as "any information which strips, or should strip, underwriters of their confidence in the accuracy of an offering memorandum premised on audited financial statements".[54] This defense is commonly referred to as the reliance defense, as the non-expert defendant relies on the authority of an expert for certain parts of the registration statement.

14. Section-12 Liability

Section 12(*a*)(1) of the Securities Act imposes absolute liability on any person who offers or sells a security in violation of the registration requirements of Section 5[55] of the Securities Act. A "seller" is any person who successfully solicits a purchase of securities on the basis of a desire to serve the person's own financial interests or those of the owner of the security. Effectively, this means that underwriters, broker-dealers, selling agents and others directly involved in the selling process are exposed to liability under Section 12(*a*)(1) for any violation of the registration requirements. Under Section 12(*a*)(1), a seller can be held strictly liable to any purchaser of securities who can prove that he purchased securities that were sold by the seller that should have been registered under Section 5 of the Securities Act but were not. The seller has the burden of proving either of the following:

- there was a valid exemption from registration;
- the purchaser was responsible for the violation.

Section 12(*a*)(2) of the Securities Act supplements liability under Section 11 by imposing on any seller potential liability for material misstatements or omissions made by that seller in any prospectus or oral communication in the offer or sale of the issuer's securities, whether or not those securities are exempt from registration (subject to limited exceptions for certain government exempt securities). It is the only provision of the federal securities laws that provides a broad, express remedy to purchasers of securities. Traditionally, Section 12(*a*)(2) was given broad scope with courts interpreting it to apply to public offerings, private transactions (exempt offerings) and ordinary aftermarket trading so long as the purchaser could show, among other things, that the seller sold by means of a communication that included a material misstatement or omission. However, in *Gustafson v Alloyd Co.*,[56] the Supreme Court held that Section 12(*a*)(2) only applies in the case of a public offering by an issuer, not private placements or ordinary aftermarket trading. The court concluded that Section 12(*a*)(2) did not apply to the privately negotiated stock purchase agreement (for a secondary market sale of securities) at issue in the case. The court's decision in *Gustafson* leaves unclear the applicability of Section 12(*a*)(2) to private offerings. Accordingly, until *Gustafson* is overturned, it appears that Section 12(*a*)(2) only applies to public offerings. Following *Gustafson*, a Plaintiff that purchases securities in an exempt offering (such as a Section 4(2) private placement or Rule 144A offering) should bring its federal securities law claims under Rule 10(*b*)(5), which shifts the burden of proof to the plaintiff to show *scienter* (the intent to deceive, manipulate or defraud) on the part of the defendant. Parties who are potentially liable under Section 12(*a*)(2) can rely on the same defences available under Section 11, including the due diligence defence.

15. Section 10(*b*) of the Exchange Act and SEC Rule 10(*b*)(5) Liability

Section 10(*b*) of the Exchange Act makes it unlawful for any person "to use or employ in connection with the purchase or sale of any security any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors". Section 10(*b*) applies to all registered and unregistered offerings of securities (debt and equity). However, the statute requires the SEC to prescribe rules to implement it. There are 14 of these rules in force under Section 10(*b*), the most important of which is Rule 10(*b*)(5), the general anti-fraud rule. Rule 10(*b*)(5) prohibits any of the following in connection with the purchase or sale of a security:

- fraudulent devices and schemes, material misstatements and omissions of any material facts;
- acts and practices that operate as a fraud or deceit on any person.

Unlike Sections 11 and 12 of the Securities Act, neither Section 10(*b*) nor Rule 10(*b*)(5) provides an express private right of action to securities buyers injured by a violation. However, an implied right of action has developed over time in the federal courts based on basic common law principles used in fraud cases. For civil liability to attach under Section 10(b) and Rule 10(*b*)(5):

- there must be a false statement about, or omission of, a material fact;
- the false statement or omission must be made with *scienter*;
- there must be evidence that the plaintiff justifiably relied on the statement or omission;
- there must be evidence that reliance on the false statement or omission caused damages.

16. Liability of Control Persons

Control person liability can arise under Section 15 of the Securities Act or Section 20 of the Exchange Act. Section 15 of the Securities Act provides that any person who controls a person liable under Sections 11 and 12 is jointly and severally liable with, and to the same extent as, the controlled person. The term "controls" is broadly defined by the SEC; it can include directors, officers and principal stockholders, depending on the facts and circumstances. Rule 405 of the Securities Act defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." However, a controlling person will not be held liable under Section 15 if he can prove that he had no knowledge of, or reasonable grounds to believe in the existence of, the facts that make the controlled person liable. This is an affirmative defence, to be pleaded and proved. On the other hand, Section 20(*a*) of the Exchange Act imposes liability on any person who directly or indirectly controls any person liable under Section 10(*b*) or Rule 10(*b*)(5). This controlling person can be held liable to the same extent as the controlled person. This provision does not require *scienter* or negligence. However, the controlling person is not liable if he acted in good faith and did not induce the acts on which the liability of the controlled person is founded. This is an affirmative defense, to be pleaded and proved by defendants.

Section 15 of the Securities Act and Section 20 of the Exchange Act have been interpreted as parallel statutes. Since Sections 15 and 20 are secondary liability provisions, a primary violation must be established before liability arises under Section 15 or Section 20. However, the controlled person does not need to be held primarily liable to be joined in an action under Section 15 or Section 20.

Endnotes

1. *Government Stock and other Security Investment Co. Ltd.* v. *Christopher*, (1956) 26 Com Cases 210.
2. Section 56 of the Act.
3. Section 55A of the Act.
4. (1860) 1 Dr. & Sm. 363, 381.
5. Palmer's Company Precedents, 59 (17th edn., 1956).
6. Section 62 of the Act.
7. *Bentley* v. *Black*, (1893) 9 TLR 580 (CA).
8. *Rajagopala Iyer* v. *The South Indian Rubber Works*, AIR 1942 Mad 656.
9. *Ibid.*
10. *R.* v. *Kylsant*, (1932) 1 KB 442.
11. *Smith v Chadwick*, (1882) 20 Ch D 27, 57.
12. *Bansidhar Durga Dutt v Tata Power Co. Ltd.*, AIR 1925 Bom 272.
13. *N. Parthasarathy* v. *CCI*, AIR 1991 SC 1420.
14. Section 58-B of the Act.
15. The expression "expert" includes an engineer, a valuer, an accountant and any other person whose profession gives authority to a statement made by him.
16. Section 60(1) of the Act.
17. Sections 62(1) and 63 (2) of the Act.
18. Company Law Committee Report, para 59.
19. MANU/SC/7687/2008: (2008) 8 SCC 205.
20. See Form 2A under Companies (Central Government's) General Rules & Forms, 1956.
21. Section 56(3) of the Act.
22. Section 56(6) of the Act.
23. Section 59(1) of the Act.

24. Company Law Committee Report, Para 62.

25. *McConnel v Wright*, (1903) 1 Ch 546.

26. *Smith New Court Securities Ltd.* v. *Scrimgeour Vickers (Asset Management) Ltd.*, (1997) 1 BCLC 350 (HL).

27. Company Law Committee Report, Para 62.

28. As per Section 79(2), "Listing particulars" means a document in such form and containing such information as may be specified in listing rules.

29. FSMA classifies the responsibility that can be incurred on account of statements made by any person. The two categories are experts and non-experts. Thus, a statement which is not made by an expert has been defined as: any untrue or misleading statement in listing particulars or the omission from listing particulars of any matter required to be included by Section 80 or 81.

A statement by an expert which incurs liability upon him means a statement included in listing particulars which purports to be made by, or on the authority of, another person as an expert and is stated to be included in the listing particulars with that other person's consent.

30. Section 90(6)

31. Sections 463(1) and (2),UK Companies Act, 2006.

32. Section 463(3), UK Companies Act, 2006.

33. Section 463(4), UK Companies Act, 2006.

34. Section 463(6), UK Companies Act, 2006.

35. *Hedley Byrne* v. *Heller* [1964] AC 465.

36. *Possfund Custodian Trustee Limited* v. *Diamond* [1966] 2 All ER 774.

37. [1990] 3 All ER 321.

38. Inserted by Section 1270 of the UK Companies Act, 2006 and to be effective from 1st October 2010.

39. Defined in Section 2(8) of the Securities Act, 1933.

40. Defined in Section 2(10) of the Securities Act, 1933.

41. The term "write" or "written" shall include printed, lithographed, or any means of graphic communication.

42. Section 11(*a*), Securities Act.

43. Section 11(*b*)(1), Securities Act.

44. Section 11(*b*)(2), Securities Act.

45. Section 11(*e*), Securities Act.

46. Section 11(*b*)(3), Securities Act.

47. Section 11(*b*)(3), Securities Act.

48. Section 11(*c*), Securities Act.

49. *Feit* v. *Leasco Data Processing Equipment Corp.*, 332 F. Supp. at 577 (EDNY 1971).

50. Rule 176, Securities Act.

51. Section 11(*b*)(3)(B), Securities Act.

52. Section 11(*b*)(3)(A), Securities Act.

53. Section 11(*b*)(3)(C), Securities Act.

54. *In re Worldcom, Inc. Sec. Litig.* 346 F.Supp. 2d 628 (SDNY) 2004.

55. Prohibitions Relating to Interstate Commerce and the Mails.

56. 513 US 561 (1995).

Arbitration: Present Status of Indian Law on Treatment of International Arbitration Agreements

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This paper discusses in detail the present status of Indian law on international arbitration agreement. It looks at relevant case law especially prior and post Bhatia International case, which was a landmark decision with respect to this field. It also tries to chalk out the existing lacunae that need to be addressed by Indian courts that have not been addressed in the Bhatia International case.

Introduction

Arbitration is increasingly becoming a popular mode of dispute resolution due to several factors – its consensual nature, dispute resolution by non-governmental decision-makers, flexibility as compared to most court proceedings and a binding award capable of enforcement.[1]

It is generally accepted that arbitration is international if it consists of parties belonging to different jurisdictions. International arbitration is a means by which international disputes can be definitively resolved, pursuant to the parties' agreement, by independent, non-governmental decision-makers. It is a consensual means of dispute resolution, by a non-governmental decision-maker, that produces a legally binding and enforceable ruling. It has several characteristics that distinguish it from domestic arbitration. Most importantly, international arbitration is designed and accepted particularly to assure parties from different jurisdictions that their disputes will be resolved neutrally. Among other things, the parties usually seek an independent decision-maker, detached from the courts, governmental institutions and cultural biases of either party. They also ordinarily contemplate the arbitrator's application of internationally neutral procedural rules, rather than a particular national legal regime.

In addition, international arbitration is frequently regarded as a means of mitigating the peculiar uncertainties of transnational litigation. These uncertainties can include protracted jurisdictional disputes, expensive parallel proceedings and choice-of-law debates. International arbitration seeks to avoid these uncertainties by designating a single, exclusive dispute resolution mechanism for settling the parties' disagreements. Moreover, international arbitration awards are often more readily enforceable in jurisdictions other than their place of origin than national court judgments.[2]

Although international arbitration is a consensual means of dispute resolution, it has binding effect only by virtue of a complex framework of national and international law. International conventions, national arbitration legislation and institutional arbitration rules provide a specialised

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legal regime for most international arbitrations. This legal regime enhances the enforceability of both arbitration agreements and arbitral awards, and seeks to insulate the arbitral process from interference by national courts or other governmental authorities.

The foundation for almost every international arbitration is an international arbitration agreement. In the absence of a valid agreement to arbitrate, there is generally no basis for requiring arbitration or for enforcing an arbitral award against a party. Typically, an arbitration agreement will be a provision in an underlying commercial contract, calling for arbitration of any future disputes relating to the contract.[3] It is therefore designed in such a way that disputes are resolved neutrally applying internationally neutral procedural rules, often selecting a seat of arbitration which is native to neither of the parties.[4]

The United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards[5] (*hereinafter* New York Convention), which has been ratified by 144 countries,[6] makes it obligatory for Member Nations to enforce both agreements to arbitrate as well as arbitration awards.[7] To ensure uniformity in national arbitration statutes, Model Law on International Commercial Arbitration (*hereinafter* "Model Law") was adopted by the United Nations Commission on International Trade Law (*hereinafter* "UNCITRAL") in 1985. Model Law provides for judicial intervention under certain circumstances, such as interim measures of protection, appointment of arbitrators and setting aside, recognition and enforcement of arbitral awards. Most modern arbitration legislations narrowly limit the power of national courts to interfere in the arbitration process, both when arbitral proceedings are pending and in reviewing ultimate arbitration awards.

A degree of uncertainty enters into the international arbitral process, due to the subjectivity of municipal court and national court decisions. This paper seeks to study this and address the treatment of international arbitration agreements in the Indian context, including its treatment on several other points where Indian courts differ in their stance on arbitration, such as their position on public policy[8]. In addition, it also seeks to provide a realistic and evaluative assessment of the present status of Indian law (comprising of both judicial decisions and legislations) on international arbitration agreements.

The Arbitration and Conciliation Act, 1996 (*hereinafter*, the "Act") is an endeavour to put into practice the Model Law[9] and to construct a pro-arbitration legal system in India, something which was a mere idea under the Arbitration Act, 1940, upon which Desai, J[10] said:

> "[…] the way in which the proceedings under the Act are conducted and without exception challenged in courts, has made lawyers laugh and legal philosophers weep. Experience shows and law reports bear ample testimony that the proceedings under the Act have become highly technical[,] accompanied by unending prolixity, at every stage providing a legal trap to the unwary. Informal forum chosen by the parties for the expeditious disposal of their disputes has by the decisions of the Courts been clothed with 'legalese' of unforeseen complexity."

The Act seeks to minimise judicial interference in arbitration.[11] It is through a perspicacious examination of the interpretation of Section 2(2) of the Act that the extent of judicial intervention can be observed. Section 2(2)[12] of this Act is in consonance with the principle that arbitral procedure is governed by the *lex arbitri*. This section clearly states that Part I of the Act is applicable where the place of arbitration is in India.

A prominent Delhi High Court decision first stated the scope of Section 2(2) as being extensive enough to include arbitrations even taking place outside India[13]. However, this was far from what could be taken as an established point of law in this regard. The Calcutta High Court[14] departed from this exposition and stated that Section 2(2) of the Act confines the applicability of Part I of the Act to arbitrations in India. It further stated that Section 2(2) acts as a limitation for all other provisions in Part I, especially Sections 2(3)[15] and 2(4)[16], thereby restricting the applicability to only those arbitrations which are held within India. The Delhi High Court had taken a view corresponding to the above in the case of *Kitchnology N.V. and Another* v. *Unicor Gmbh Rahn and Another.*[17]

Yet, discord in explanation was evident as even within the Delhi High Court different outlooks became apparent. The view that it took in the *Dominant Offset* case was followed by them in *Suzuki Motors Corporation v. Union of India*[18], *Olex Focas Pvt. Ltd* v. *Skoda Export Company Limited and Another*[19] and also by the Single Bench decision in *Marriott International Inc.* v. *Ansal Hotels*[20]. This single-bench decision was overruled by the Division Bench which constrained the applicability of Part I to only Indian Territory.[21]

The Bombay High Court opined on similar lines and constrained the applicability of Section 2(2) of this Act.[22] The Andhra Pradesh High Court has endorsed the view that "the very fact that Section 11(9)[23] of Part I applies to an international commercial arbitration, is in itself sufficient for ruling out the suggestion that no part of Part I can apply to such arbitrations."[24] Notably so, the Supreme Court had itself indirectly ruled in *Thyssen Stahlunion GmbH* v. *Steel Authority of India Ltd.*[25] that Part I must be applied restrictively. Thus, such contradictions and irregularities pointed out to an urgent need for clarifying the point of law in this regard.

In an effort to settle the somewhat confused position of law, a three-judge Bench in *Bhatia International* v. *Bulk Trading S.A.*[26] gave its verdict.

In this case, the contract entered into had an arbitration clause providing for arbitration as per the ICC Rules. A sole arbitrator was agreed upon by the ICC on request of the Respondent and the parties agreed for arbitration to be held in Paris. Thereafter, the Respondent filed an application under Section 9[27] of the Act in the District Court of Indore, for obtaining an order of injunction restraining the Appellant from transferring its business assets and properties located in India. The Appellant resisted the application by contending that Part I of the Act, which contains Section 9, applies only to arbitrations conducted in India. Dismissing this objection, the lower court admitted the application of Part I of the Act. The Appellant then filed a writ petition before the Madhya Pradesh High Court which was dismissed on 10th October, 2000. Hence, an appeal was made to the Supreme Court against this judgment of the High Court to decide whether an Indian court can provide interim relief under Section 9 of the Act in cases where an international commercial arbitration is held outside India.

The Supreme Court in essence ruled that Part I of the Act, which gives effect to the UNCITRAL Model Law and bestows power on the court to grant interim measures, applied even to arbitration held outside India. In cases of international commercial arbitrations held outside India provisions of Part I would apply unless the parties by agreement, express or implied, excluded all or any of its provisions The Supreme Court reasoned that if the Act provides that Part I is applicable to India, it is not equivalent to being applicable either "only" in India or being inapplicable if it is out of India.

However, there has been an alternate observation altogether by other judicial decisions regarding the interpretation of the Act and its provisions. In the ruling of *J. K. Cotton Mills Spinning and Weaving Milk Co. Ltd* v. *State of U. P.*[28], it was observed: "In the interpretation of statutes the courts always presume that the legislature inserted every part thereof for a purpose and the legislative intention is that every part of the statute should have effect." This principle has been acknowledged in numerous decisions[29]. Thus, Section 2(2) of the Act, in its plain and unambiguous meaning, excludes the application of Part I of the Act to international arbitrations when the place of arbitration is outside India. Justice R. C. Lahoti, speaking for the Supreme Court, held in *Shreejee Traco (I) Pvt. Ltd.* v. *Paperline International Inc.*[30] that it is implicit in the language of the Act that Part I "will not apply where place of arbitration is not in India".

Furthermore, the status of Indian law relating to awards in non-convention countries in the has been laid down by the Apex Court, before the enactment of this Act, in the case of *Badat and Company, Bombay* v. *East India Trading Company*[31]. It has been held that an award given in a non-convention country is enforceable in India on the same grounds and in the same circumstances in which it is enforceable in England under the common law on grounds of justice, equity and good conscience. This can be done by bringing a suit provided the agreement to arbitrate was made within the limits of the jurisdiction of Indian Court and the award is final and binding. Since the present Act of 1996 has not altered that position of law, there would be laws existing in India governing awards in non-convention countries.

The principle of party autonomy as stated under Section 20(1) of the Act gives parties freedom of choice with regard to the place of arbitration. Where the parties are fully aware of the provisions to choose the place of arbitration outside India, agreeing to go outside jurisdiction of Indian courts, after due deliberation and knowledge, they cannot complain against the award.

In a recent decision in *Max India Limited* v. *General Binding Corporation*[32], a division bench of the Delhi High Court rejected the Appellant's plea to arbitrate since the parties in an agreement provided for disputes to be resolved by arbitration in Singapore under the rules of the Singapore International Arbitration Centre (SIAC) and for the Singapore courts to otherwise have jurisdiction.

A dispute arose between the parties and Max India tried to prevent arbitration proceedings in Singapore and sought intervention from the Indian Court. General Binding challenged the injunction on the grounds that the Delhi High Court had no jurisdiction in the matter. The court decided in favour of General Binding after which the Max filed an appeal with the division bench. The division bench found that the agreement provided for Singapore as the governing law and stated that the Singapore courts would have jurisdiction over disputes arising out of the agreement. Furthermore, the agreement specified that the arbitration would be conducted as per SIAC Rules in Singapore. In view of this, the Delhi High Court held that the arbitration clause evidently excluded the jurisdiction of Indian courts and therefore denied Max's appeal. The Delhi High Court relied on the Supreme Court's decision in *National Thermal Power Corporation* case (*National Thermal Power Corporation* v. *The Singer Company and Ors)* [33] holding that in an international commercial arbitration agreement, the parties are at liberty to choose, expressly or by necessary implication, the proper or substantive law, as well as the applicable procedural law.

Furthermore, the presumption laid down in *NTPC v. Singer* that the proper law of contract may be equated with the *lex arbitri* or law governing the arbitration agreement should be understood in the light of the *Bhatia* case.[34] In addition, in *INDTEL Technical Services Pvt. Ltd.* v. *W.S. Atkins PLC*,[35] the Court applied the rule in *Bhatia* to the circumstances of the case, where the parties had stated their choice of law as the laws of England and Wales.

This decision spells out that where all four elements (i.e. the law governing the contract, the rules governing the arbitration, the court's jurisdiction and the place of arbitration) are outside India and the parties' intention is unambiguous, this amounts to specific exclusion of the Indian courts' jurisdiction and the applicability of Part I of the Arbitration Act that provides for the procedural aspects of arbitration. The decision also confirms that it would be more appropriate for the party seeking relief to approach the court chosen by the parties in the contract instead of the Indian courts.

Furthermore, a possible solution to this conflict in international commercial arbitrations held outside India lies in the interpretation of Section 28 of the Act. It lays down rules and regulations governing domestic arbitrations and international commercial arbitrations, limiting it to only those where the place is India. Section 28 is within Part I of the Act and does not attempt to frame any rule for any arbitration held outside India. It can be thus said that this is evidence of the fact that Part I of the Act is itself limited to arbitrations within India.

Moreover, the *Bhatia* case held that although the Arbitral Tribunal could pass an interim award, such an award would not be enforceable in India. This meant that even in respect of arbitrations covered by Part II, a party would be precluded from getting any interim relief. However, this comes into direct conflict with the ICC Rules. Article 23 of the ICC Rules empowers the Arbitral Tribunal to direct "interim measures" either in the form of an "order" or an "interim award". This is to enable a foreign party to approach the Tribunal and obtain interim measure in the form of "interim award" and sought its execution in agreement with the New York Convention. Instead of interpreting Article 23 in this light, the Court refers to that part of Article 23 which allows a party to approach a court and assumes that the Indian court is that proper court. Then, by stating that such an interim award by the Tribunal will not be enforceable in India, there remain doubts of whether the Indian courts would enforce an interim measure granted in the form of an interim award in an ICC arbitration.

This oversight of the Court can be successfully comprehended by the ruling in *Hardly Oil and Gas Limited* v. *Hindustan Oil Exploration Company Limited*[36]. It was held that mere designation of foreign law was adequate to eliminate the applicability of Section 9. The doubts on the parties being rendered remediless were unfounded as the foreign courts could pass appropriate orders.

Relying on its own judgment in the *Bhatia* case, the Apex Court in a recent ruling, *Venture Global Engineering* v. *Satyam Computer Services Ltd. and Another*,[37] ruled that a foreign award was open to challenge under Section 34 on a construction that Part I of the Act applies to foreign awards. It was only in a case where the parties expressly chose to leave out the application of Part I of the Act that such challenge would not be available.

However, the *Bhatia* decision has attracted disparagement even from the international authorities in this field. In a speech, the Rt. Hon. Lady Justice Mary Howarth Arden DBE, Lord Justice of Appeal, UK at the Second Conference on Dispute Resolution on 13th September, 2003, observed regarding the *Bhatia* decision, that the application of Part I to arbitrations outside India was not consonant with party autonomy and that the *Bhatia* decision seemed to emasculate India's adherence to the New York Convention.[38]

Furthermore, the Indian law relating to the power to appoint an arbitrator in a commercial dispute where the contract was not governed by Indian law was recently examined by the Supreme Court (as in *Citation Infowares Ltd.* v. *Equinox Corporation*[39]*)*. The Chief Justice of India ruled that unless it is expressly disqualified in an agreement between the parties or by implication, the provisions of Part I of the Indian Arbitration Act apply to international commercial arbitrations, even though the contract is governed by foreign law. Part I of the Indian Arbitration Act provides for, among others things, the appointment of arbitrators.

The Supreme Court, in the aforementioned case, observed that although the parties had chosen Californian law as the law governing the contract, there was no agreement with respect to the law governing the procedure for appointment or even the venue of arbitration. It further observed that one of the parties was an Indian entity, and the obligations under the contract were to be fulfilled in India. In view of this, the Supreme Court did not find an implied exclusion of the Arbitration Act and thus went on to appoint an arbitrator in the matter. This judgment reaffirms that under Indian law, if parties in an international commercial transaction wish to exclude the provisions of the Arbitration Act, they should do so in express terms.

It has been observed that the popularity of arbitration as a means for resolving international commercial disputes has grown tremendously over the past several decades. In some developing and other countries, there has been a perception that international commercial arbitration was developed by, and was biased in favour of, Western commercial interests. As a consequence, national law in many countries was historically hostile towards international arbitration, which can therefore still pose significant obstacles to the effective enforcement of international arbitration agreements and awards. In general, this hostility has waned somewhat over the past decade, with many states acceding to the New York Convention and enacting "pro-arbitration" legislation.

Though the Arbitration and Conciliation Act, 1996, has been legislated in order to have a harmonious and uniform dispute settlement mechanism implemented in the Indian context, little seems to have been achieved in terms of amicably and expeditiously settling international disputes.[40]

In fact, the ruling by the Supreme Court of India in the *Bhatia* case could have disastrous consequences for commercial agreements and foreign awards passed thereon by opening up the floodgates for challenge. The object of the Act is to assist international commerce and business, to guarantee finality of foreign awards and to decrease judicial interference, especially when awards have been passed by international commercial experts. This judgment however has the opposing effect as it makes even internal arbitrations subject to domestic law.

This Act came into force to overcome the hindrance of court interference. But with these judicial interpretations, the very purpose of this Act has been condensed to a nullity. Unless the Indian courts resist the appeal to intervene in arbitrations, it will always depict a picture of cynicism amongst the probable foreign investors having any kind of trade relations with India while incorporating an arbitration clause.

There exists a pressing need to repair the state of affairs. Apart from the palpable requirement to confine applicability of Part I of the Act to any sort of international arbitration, certain changes need to be brought about even within Section 9 of the Act to minimise delays and unnecessary interventions. Provisions contained in Section 9 regarding availability of interim relief even before the arbitration proceedings commence may be distorted by a party, especially if made applicable even to international arbitrations. It may so happen that after obtaining an interim order from the court it may not take initiative to have an arbitral tribunal constituted.

A solution to this, as proposed by the Amendment Bill of 2003, seeks to introduce Sub-sections (4) to (6) in the existing Section 9 as follows: As per Sub-section (4), where a party makes an application under Sub-section (1) for the grant of interim measures before the commencement of arbitration, the Court shall direct the party in whose favour the interim measure is granted, to take effective steps for the appointment of the arbitral tribunal in accordance with the procedure specified in Section 11, within a period of 30 days from the date of such direction. As per Sub-section (5), the Court may direct that if the steps referred to in Sub-section (1) are not taken within the period specified in Sub-section (4), the interim measure granted under Sub-section (2) shall stand vacated on the expiry of the said period; provided that the court may, on sufficient cause being shown for the delay in taking such steps, extend the said period. In Sub-section (6), where an interim measure granted stands vacated under Sub-section (5), the Court may pass such further direction as to restitution as it may deem fit against the party in whose favour the interim measure was granted under this section.

Thus, if the Amendment Bill is passed, it will be then mandatory on the part of the party who has obtained interim relief from a court to constitute the arbitral tribunal expeditiously. Failure to do so, a party may run the risk of consequential vacation of the interim measure.

Furthermore, the structure of dual agency for providing relief needs to be eradicated or otherwise some enforcement mechanism be provided for enforcement of the interim measures of protections ordered by the Arbitral Tribunal. It would be better that application of interim measures is put to the arbitral tribunals as they are seized of the subject matter under disputes. Only when a party is not able to get relief from the arbitral tribunal, it should be allowed to approach the domestic Courts. This will be in line with the intention of the Act to curtail the intervention of the Court in arbitral proceedings.

The predicament of the Indian situation, manifestly, has its roots in the failure to embrace different standards for foreign and domestic awards. It is because of this lack of clarity that the judiciary has been unable to delineate standards for domestic and foreign awards. A useful solution to this problem can be sought in international practice.

As noted earlier, some countries do follow independent standards for domestic and international arbitrations. There are incompatible policy interests that underlie the question of whether to expand court assistance in granting interim relief and the concomitant supervision and enforcement of such orders. Not extending it to arbitrations held overseas may encourage arbitrations to be held in countries such as Singapore and arbitration agreements would provide as such. This may also lead to forum-shopping, which is not to be encouraged. A seat of arbitration is selected for its neutrality, which has no relation with the commercial relationship of the parties. To promote international commerce and cordial resolution of disputes, domestic court interference should be limited and not extend to arbitrations held overseas. This would also promote and facilitate holding of arbitrations in India. For this very reason, places like Singapore are fast growing as centres of arbitration. If one is to follow their example, courts in India should not cross the fine line between assistance and meddling and should endeavour to have a pro-arbitration stance. This would, in due course, draw more parties to India and choose it as a place of arbitration. Arbitral institutions in India along with arbitrators and other associated persons would also gain, encouraging the expansion of commerce and business in India.

Endnotes

1. Gary B. Born, International Commercial Arbitration 1 (2001).
2. Alan Redfern and Martin Hunter, Law and Practice of International Commercial Arbitration ¶1-42 (2004).
3. UNCITRAL Model Law on International Commercial Arbitration, 1985 (*hereinafter* Model Law), Article 1.3.
4. Alan Redfern and Martin Hunter, Law and Practice of International Commercial Arbitration ¶1-42 (2004).
5. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 330 U. N. T. S. 38.
6. United Nations Commission on International Trade Law, *Status: Convention on Recognition and Enforcement of Foreign Arbitral Awards*, available at http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html (Last visited on September 2, 2009).
7. New York Convention, Article II.
8. *See generally Renusagar Power Plant Co. Ltd.* v. *General Electric Co.* MANU/SC/0195/1994: AIR 1994 SC 860; *ONGC* v. *Saw Pipes Ltd.* MANU/SC/0314/2003: AIR 2003 SC 2629.

9. *R.M. Investment & Trading Co. Pvt. Ltd.* v *Boeing Co.* MANU/SC/0246/1994: (1994) 4 SCC 541; *Sundaram Finance Ltd.* v. *NEPC India Ltd.* MANU/SC/0012/1999: (1999) 2 SCC 479; *Malaysian Airlines Systems Bhd (II)* v. *STIC Travels (P) Ltd.* MANU/SC/0743/2000: 2000 (7) SCALE 724; *Rashtriya Ispat Nigam Ltd.* v. *Verma Transport Company* MANU/SC/3491/2006: (2006) 7 SCC 275; *Gas Authority of India Ltd.* v. *Keti Construction (I) Ltd.* MANU/SC/7647/2007: (2007) 5 SCC 38; *India Household and Healthcare Ltd.* v. *LG Household and Healthcare Ltd.* MANU/SC/1253/2007: (2007) 5 SCC 510.

10. *Guru Nanak Foundation* v. *Rattan Singh & Sons*, MANU/SC/0001/1981: AIR 1981 SC 2075 at 2076-2077, per Desai J.

11. The Act, Section 5: "Notwithstanding anything contained in any other law for the time being in force, in matters governed by this Part, no judicial authority shall intervene except where so provided in this Part."

12. *Id*, Section 2(2): "This Part shall apply where the place of arbitration is in India."

13. *Dominant Offset Pvt. Ltd.* v. *Adamovske Strojitrny A.S.*, MANU/DE/0827/2000: AIR 2000 Del 254.

14. *East Coast Shipping Limited* v. *M.J. Scrap Pvt. Ltd,* 1997 (1) HN 444.

15. The Act, Section 2(3): "This Part shall not affect any other law for the time being in force by virtue of which certain disputes may not be submitted to arbitration."

16. *Id*, Section 2(4): "This Part except sub-section (1) of section 40, sections 41 and 43 shall apply to every arbitration under any other enactment for the time being in force, as if the arbitration were pursuant to an arbitration agreement and as if that other enactment were an arbitration agreement, except insofar as the provisions of this Part are inconsistent with that other enactment or with any rules made thereunder."

17. *Kitchnology N. V. and Another* v. *Unicor Gmbh Rahn and Another*, 1999 (1) Arb. L. R. 452 (Delhi).

18. *Suzuki Motors Corporation* v. *Union of India*, MANU/DE/1197/1997: 1997 (2) Arb.L.R. 477 (Delhi).

19. *Olex Focas Pvt. Ltd* v. *Skoda Export Co. Ltd. and Another*, 2000 C.L.C. 382 (Delhi).

20. *See infra* note 101, para 12.

21. *Marriott International Inc.* v. *Ansal Hotels*, MANU/DE/0218/1999: AIR 2000 Del. 377.

22. *Jindal Durga Ltd* v. *Noy Vallesina Engineering SpA.*, 2002 (2) Arb.L.R. 323.

23. The Act, Section 11(9): "In the case of appointment of sole or third arbitrator in an international commercial arbitration, the Chief Justice of India or the person or institution designated by him may appoint an arbitrator of a nationality other than the nationalities of the parties where the parties belong to different nationalities."

24. *Cultor Food Science Inc.* v. *Nicholas Piramal India Ltd.*, MANU/AP/0072/2002: 2001 (6) ALT 706.

25. *Thyssen Stahlunion GMBH* v. *Steel Authority of India Ltd.*, MANU/SC/0652/1999: AIR 1999 SC 3923.

26. *Bhatia International* v. *Bulk Trading S.A.*, MANU/SC/0185/2002: AIR 2002 SC 1432.

27. *See generally*, The Act, Section 9. A party may, before, or during arbitral proceedings or at any time after the making of the arbitral award but before it is enforced in accordance with section 36, apply to a Court –

(*i*) for the appointment of a guardian for a minor or person of unsound mind for the purposes of arbitral proceedings; or

(*ii*) for an interim measure of protection in respect of any of the following matters, namely –

(*a*) the preservation, interim custody or sale of any goods which are the subject-matter of the arbitration agreement;

(*b*) securing the amount in dispute in the arbitration;

(*c*) the detention, preservation or inspection of any property or thing which is the subject-matter of the dispute in arbitration, or as to which any question may arise therein and authorising for any of the aforesaid purposes any person to enter upon any land or building in the possession of any party, or authorising any samples to be taken or any observation to be made, or experiment to be tried, which may be necessary or expedient for the purpose of obtaining full information or evidence;

(*d*) interim injunction or the appointment of a receiver;

(*e*) such other interim measure of protection as may appear to the Court to be just and convenient,

and the Court shall have the same power for making orders as it has for the purpose of, and in relation to, any proceedings before it.'

28. *J.K. Cotton Mills Spinning and Weaving Milk Co. Ltd* v. *State of U.P.* MANU/SC/0287/1960: AIR 1961 SC 1170.

29. *Aswini Kumar* v. *Arabinda Bose* MANU/SC/0022/1952: AIR 1952 SC 369; *Nathi Devi* v. *Radha Devi Gupta* MANU/SC/1071/2004: AIR 2005 SC 648; *Ghanshyamdas* v. *Regional Assistant Commissioner* MANU/SC/0216/1963: AIR 1964 SC 766.

30. *Shreejee Traco (I) Pvt. Ltd.* v. *Paperline International Inc.*, (2003) 9 SCC 79. Shreejee Traco was a case on the appointment of arbitrator under Section 11(4) of the Act and heard by a single judge of the Supreme Court being the designated judge appointed by the Chief Justice of India under the Act. It is pertinent to mention herein that the decision was passed by the learned Single Judge after the decision of the three-judge bench in Bhatia International case. note 101, para 14.

31. *Badat and Company, Bombay* v *East India Trading Company* MANU/SC/0011/1963: AIR 1964 SC 538.

32. OMP NO 136/2009.

33. *National Thermal Power Corporation* v. *The Singer Company and Ors.* MANU/SC/0146/1993: (1992) 3 SCC 551. (The dispute in the *NTPC v. Singer* arose as to the application of Part I where the parties had specified that the laws of India would be the substantive laws applicable to any dispute. The jurisdiction of Indian Courts to review an award passed by the International Chamber of Commerce in London was questioned in the same case. It was held by the Court that the principle of party autonomy should be deferred to and parties should be free to choose their choice of forum, seat of arbitration and the applicable procedural and substantive laws to a dispute.)

34. As interpreted by *Bhatia International*, this presumption is now limited to cases where the seat of arbitration has been chosen by the parties (see generally R.S. Bachawat, Law of Arbitration and Conciliation, Vol 2 (LexisNexis Butterworths Wadhwa Nagpur, 5th edn., 2010), p. 2245).

35. *INDTEL Technical Services Pvt. Ltd.* v. *W.S. Atkins PLC.* MANU/SC/3778/2008: (2008) 10 SCC 308.

36. *Hardly Oil and Gas Limited* v. *Hindustan Oil Exploration Company Ltd.*, (2006) 1 GLR 658.

37. *Venture Global Engineering* v. *Satyam Computer Services Ltd. and Another* MANU/SC/0333/2008: AIR 2008 SC 1061.

38. Pawan Agarwal, *Interim Measures of Protection in Arbitration- An Analysis,* The Chartered Accountant, December 2004, available at http://icai.org/resource_file/10962dec04p715-722.pdf.

39. 2009 (5) UJ 2066 (SC) (The facts of the case were that In 2004, an Indian company, Citation Infowares Ltd., entered into an agreement in India with a U.S. company, Equinox Corporation. This agreement was replaced by a new agreement in January 2007, which was also executed in India. Both agreements contained a dispute resolution clause, but the second agreement provided that the agreement "shall be governed by and interpreted in accordance with the laws of California, USA and matters of dispute, if any, relating to this agreement or its subject matter shall be referred for arbitration to a mutually agreed arbitrator." Equinox did not appoint an arbitrator within the 30 day period as required, under Section 11(5) of the Arbitration Act, and Citation then petitioned the Supreme Court of India for the appointment of an arbitrator.)

40. The preamble of Arbitration and Conciliation Act clearly states that "in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice" and since the "Model Law and Rules make significant contribution to the establishment of a unified legal framework for the fair and efficient settlement of disputes arising in international commercial relations", the said Arbitration and Conciliation Act was passed by the Parliament. (*See generally* the Arbitration and Conciliation Act, 1996.)

Dividend under Tax Treaties: Article 10

Rani N.R.*

This article examines the provisions for treatment and taxation of cross-border dividend income under double taxation avoidance agreements (tax treaties). The tax treaties give primary rights to tax the dividend income to the country of residence of the shareholder and limited taxing rights to the country of source of dividend, i.e. the country where the company which distributes dividend is situated. Tax treaties also provide for special treatment of the dividend received by a permanent establishment of a non-resident shareholder situated in the country of source.

Introduction

Cross-border dividend income arises when a resident of country R derives dividend income from another country (country S), i.e. country in which the company making distribution of dividend is resident. In the case of cross-border dividend income, the country S taxes the dividend in the hands of the non-resident taxpayer in accordance with its domestic tax law. This dividend may also be taxed country R i.e. (taxpayer's country of residence) if country R taxes the worldwide income of resident taxpayers as per its domestic tax law. Hence, the dividend income derived by non-resident taxpayer from country S is subject to double taxation. So the taxpayer may claim benefits of the tax treaty between country R and county S to curb the impact of double taxation of dividend. Typically such a tax treaty would limit the amount of tax that country S may impose on dividend income to an amount less than that imposed under country S' domestic law.

In India, under Section 115-O of the Income Tax Act, company declaring dividend has to pay dividend distribution tax. Hence, the dividend which is covered by Section 115-O is not taxable in the hands of the shareholder. So in the hands of non-resident shareholders, the dividends which are subjected to dividend distribution tax are not subjected to double taxation.

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Definition of Dividend under Tax Treaties

Article 10(3) of both the OECD Model Tax Treaty and the UN Model Tax Treaty states that the term "dividend" as used in this article means "income from":

- shares
- "*jouissance*" shares or "*jouissance*" rights
- mining shares
- founders' shares or other rights
- other corporate rights which are subjected to the same taxation treatment as income from shares

  by the domestic tax laws of country S.

Furthermore, Article 10(3) makes it clear that dividend must arise from equity participation in a company's profits and not from rights that constitute debt claims. (Income that arises from debt claims constitutes "interest", which is dealt with under Article 11.)

Taxing Rights under Tax Treaties

Article 10(1) of both OECD model as well as UN model Tax Treaty states that "dividend" paid by a company which is resident of country S to a resident of country R *may be* taxed in country R.

This means that if under its domestic law, country R taxes foreign dividend derived by its resident shareholders, the tax treaty between country R and country S is not going to stop country R from doing so.

Article 10(2) of the *OECD model* provides that dividend *may* also be taxed in country S according to the laws of county S. But if the beneficial owner of dividend is a resident of country R, then the tax so charged shall not exceed:

a. 5 per cent of the gross amount of dividend if the beneficial owner of the dividend is a company which holds directly at least 25 per cent of the capital of the company paying dividend;

b. 15 per cent of the gross amount of the dividend in all other cases.

Article 10(2) of the *UN model* provides that dividend *may* also be taxed in country S according to the laws of county S. But if the beneficial owner of dividend is a resident of country R, then the tax so charged shall not exceed:

a. the percentage to be established through negotiations between the countries of the gross amount of dividend if the beneficial owner of the dividend is a company which holds directly at least 10 per cent of the capital of the company paying dividend;

b. the percentage to be established through negotiations between the countries of the gross amount of the dividend in all other cases.

Again, country S, i.e. country of source does not have to tax the dividend but *may* do so if it wishes. However, if it does so, its tax levy is subject to the limitation in Article 10(2) as discussed above.

For the purpose of determination of the taxing rights of a source country, Article 10(2) of both the OECD Model Tax Treaty and the UN Model Tax Treaty distinguishes between participation investment dividend and portfolio investment dividend.

Participation Dividend

Article 10(2)(*a*) of the OECD Model Tax Treaty states that a company that directly holds at least 25 per cent of the capital of company which distributes dividend is treated as having a participation interest in the latter company, i.e. the investee company and qualifies for the concessional 5 per cent tax impost in the source country. The minimum shareholding threshold is 10 per cent in the UN Model Tax Treaty.

Portfolio Dividend

Article 10(2)(*b*) addresses portfolio dividend. Generally, the dividend other than participation dividend is classified as portfolio dividend. The rate of tax impost on portfolio dividend in the source country is higher than that applicable for participation dividend.

Dividend Received by a Permanent Establishment (PE)

Article 10(4) states that if the dividend is effectively connected with shareholding of a permanent establishment of a company which is resident of country R, carrying on business in country S through such PE then the dividends are to be treated as *Business profits* (Article 7) of the permanent establishment under OECD Model Tax Treaty. (*Income from independent personal services* (Article 14) as per UN Model Tax Treaty).

Depending upon the location of the PE, the taxation of dividend varies as described below:

Scenarios	*Location of PE*	*Taxation under tax treaties*
Situation 1	PE of company R is in country R which is the resident country of its parent company, and dividend is received from company S situated in country S	Dividend will be taxed as dividend and not as business profits since PE is not situated in country S, i.e. source country.
Situation 2	PE of company R is in country S and dividend is received from company S situated in country S.	Dividend will be taxed as business profits since PE is situated in country S, i.e. source country
Situation 3	PE of company R is in country T and dividend is received from company S situated in country S.	Dividend will be taxed as dividend and not as business profits since PE is not situated in country S, i.e. source country
Situation 4	PE of company R is in country S and dividend is received from company T situated in country T.	Dividend will be taxed as dividend and not as business profits since PE is not situated in the country from which dividends are derived. Here the source country is country T.

Forming an Opinion and Reporting on Financial Statements (Standard on Auditing (SA) 700 (Revised) – A Paradigm Shift)

Dr. A.L. Saini*

As the trade and commerce grew extensively globally, the involvement of public money therein also increased manifolds. This in turn created a demand from the investors to have the accounts of the business ventures examined by a person independent of the owners and management of the business to ensure that they were correct and reliable. Such a demand laid down the foundation for the profession of auditing. The extent of reliance placed by the public on the auditors has increased so much with time that it is, unreasonably of course, felt by the public that nothing can go wrong with an organisation which has been audited. This article discusses important improvements from existing SA 700 to revised SA 700.

Introduction

Though the fact that an audit has been carried out is not a guarantee as to the future viability of an enterprise, it is extremely important that the auditors carry out their assignments with utmost professional care and sincerity, to uphold the faith posed by the public in them.

International Response to Auditing Needs

The International Federation of Accountants (IFAC) was established in 1973 with the objective of "worldwide development and enhancement of the accountancy profession .... of high quality in the public interest". The International Auditing and Assurance Standards Board (IAASB), earlier known as the International Auditing Practices Committee of the IFAC, was established to "improve the quality and uniformity of practice throughout the world", by, *inter alia*, issuing International Standards on Auditing (ISAs) and guidance on the application of the ISAs.

India's Response to Auditing Needs

The Institute of Chartered Accountants of India was set up in 1949 to regulate the profession of chartered accountancy in India. Since its establishment, the Institute has taken numerous steps to ensure that its members discharge their duties with due professional care, competence and sincerity. One of the steps is the establishment of the Auditing Practices Committee, or the Auditing and Assurance Standards Board. One of the main objectives of the Board is to issue auditing standards. Accordingly, the Board issues Statements on Standard Auditing Practices and Auditing and Assurance Standards under the authority of the Council.

* The author is a chartered accountant.

Rationale of Auditing Standards

In simplest possible terms, auditing standards represent a codification of the best practices of the profession, which are already existing. Auditing standards help the members in proper and optimum discharge of their profession duties. Auditing standards also promote uniformity in practice as also comparability.

Auditing Standards-setting in India

As mentioned earlier, the Auditing and Assurance Standards Board of the Institute formulates the auditing standards. Broadly, following is the procedure for formulating auditing standards:

1. The Auditing and Assurance Standards Board identifies the areas where auditing standards need to be formulated and the priority in regard to their selection.
2. In the preparation of the auditing standards, the Board is normally assisted by study groups comprising of a cross-section of members of the Institute.
3. On the basis of the work of the study groups, an Exposure Draft of the proposed auditing standard is prepared by the Board and issued for comments of the members.
4. After taking into the comments received, the draft of the proposed auditing standard is finalised by the Board and submitted to the Council of the Institute.
5. The Council considers the final draft of the proposed auditing standard and, if necessary, modifies the same in consultation with the Board. The auditing standard is then issued under the authority of the Council. While formulating the auditing standards, the Board also takes into consideration the applicable laws, customs, usages and business environment in the country.

International Harmonisation of Auditing Standards

The Institute of Chartered Accountants of India is a member of the International Federation of Accountants. Therefore, as a matter of policy, the auditing standards issued by the ICAI are in harmony with the International Standards on Auditing.

Important Changes from Existing Standard (SA 700) to SA 700 (Revised)

1. The existing standard (SA 700) deals with all auditors' reports, including for general purpose financial statements and special purpose financial statements. Whereas SA 700 (Revised), 705 and 706 deal only with auditors reports on general-purpose financial statements and a separate SA 800 issued by the ICAI which deals with the special considerations to be considered for auditor's reports on audits of financial statements prepared in accordance with special purpose frameworks.

2. There is currently no standard that deals with auditor's reports on the special considerations relevant to an audit of a single financial statement or of a specific element, account or item of a financial statement. The existing standard (SA700) says that its standards may be "adapted" to auditor's reports on financial information other than financial statements. To overcome this problem, the ICAI issued SA 805 (ED) which deals with the special considerations relevant to an audit of a single financial statement or of a specific element, account or item of a financial statement.

Also, there is currently no standard that deals with auditor's reports on summary financial statements; to fill this gap the ICAI issued SA 810 (ED), which deals with auditor's report on summary financial statements.

3. In the existing SA 700 the title paragraph is written as "Auditor's Report" whereas revised SA 700 requires the title to indicate that this is the report of the independent auditor as opposed to other types of auditors. Consequently, the title is "Independent Auditor's Report"

4. The existing standard provides an illustrative report for audits under the Companies Act framework. This illustration mixes up several reporting issues – for example, it firstly talks about the financial statement audit, then it refers to CARO reporting, then it goes to the specific matters required to be reported on under the Companies Act (like books of account, qualifications of directors as per Section 274(1)(*g*) of the Companies Act), and then it reverts back to the true and fair Opinion on the financial statement audit.

Whereas in the revised standard [SA 700 (R)], the opinion paragraph is strictly restricted to the audit of the financial statements as performed under a fair presentation framework or a compliance framework. All other matters that law or regulation requires to be part of the auditor's report are put in a separate section of the report below the opinion paragraph (see illustrative report on separate financial statements under the Companies Act framework).

The logic is that the true and fair part of the report is governed by the procedures performed by the auditor as per the auditing standards insofar as they pertain to audits of general-purpose financial statements. For instance, those audit procedures are designed to evaluate whether the financial statements are prepared in accordance with the stated financial reporting framework and are not materially misstated due to fraud or error.

When we report on CARO, for example, we are responding to specific queries under the said order. The CARO report is a report on specific financial information that may or may not be contained in the financial statements and should, therefore, not be intermingled with the opinion on the financial statements because completely different audit procedures are applied to provide a CARO report as versus the procedures used to give a report on the financial statements.

Likewise, when we report on books of account, or agreement of financial statements with books of account, or on qualification of directors, we are reporting on matters that are not really covered by our opinion on the financial statements.

5. The existing standard (SA700) is on "Auditor's Report on Financial Statements". It does not elaborate on how the auditor's opinion is to be

formed. Whereas the revised SA 700 is on "Forming an Opinion and Reporting on Financial Statements". The standard elaborates on the requisites for an auditor to form an opinion as follows.

First, the auditor concludes on whether or not he has obtained sufficient appropriate audit evidence as per SA 330. Second, he concludes on whether or not uncorrected misstatements, individually or in the aggregate, are material as per SA 450. Third, he evaluates whether the financial statements are prepared, in all material respects, as per the applicable financial reporting framework, including its qualitative aspects and freedom from judgement bias. Fourthly, he evaluates whether:

(*a*) accounting policies are appropriately disclosed, consistently applied and are appropriate;

(*b*) estimates are reasonable;

(*c*) information presented is relevant, reliable, comparable and understandable, and terminology used is appropriate;

(*d*) disclosures are adequate to enable users to clearly understand the material transactions and events.

Where the reporting is under a fair presentation framework, he also evaluates whether the financial statements achieve a fair presentation based on the overall presentation, structure and contents, and whether they represent the underlying transactions and events in a befitting manner. And, he also sees whether the financial reporting framework used is adequately referred to. Based on these conclusions/evaluations, the Auditor finally concludes whether the financial statements, as a whole, are free from material misstatement due to fraud or error.

6. Under the existing SA 700, there is no definition of "general purpose financial statements". Whereas the revised SA 700, the general-purpose financial statements are those prepared as per a general-purpose framework. A general-purpose framework can be either a fair presentation framework or a compliance framework.

The key difference between these is that a compliance framework only complies with the framework (no true and fair opinion) but a fair presentation framework complies with the framework as well as includes additional disclosures (or may exclude some disclosures in rare cases) to achieve a fair presentation.

In the Indian context, an audit under the Companies Act would be under a fair presentation framework while a tax audit (where regular statutory audit is separately done) would be under a compliance framework.

7. The existing standard SA 700 implied that "financial statements" mean the balance sheet and profit and loss account. Later, a footnote was added to include the cash flow statement.

Whereas the revised SA 700 does not name any financial statements but instead says that when the term "financial statements" is used, it means a complete set of general purpose financial statements *including significant accounting policies and related notes,* and adds that the financial reporting framework would determine what constitutes a complete set of financial statements.

With India's convergence with IFRS, several new financial statements will get added to a complete set of general purpose financial statements, and existing ones will get new names, such as statement of financial position (balance sheet), income statement (profit and loss account), statement of comprehensive income or statement of other comprehensive income, statement of changes in equity, and cash flow statement.

Conclusion

The revised SA 700 distinguishes, opinion paragraph from report on other legal and regulatory requirements. This is really a paradigm shift, because in old standard all the requirements were mixed up. New standard clearly says that the auditor does not give a true and fair opinion on the report on other legal and regulatory requirements.

Therefore, the revised SA 700 brought a lot of changes, and as a result of these changes, the quality of "Independent Auditor's Report" will improve.

Control on Inflation by the Reserve Bank of India

Sunaina Basera*

The aim of this paper is to discuss in detail the role of Reserve Bank of India as Apex Monetary Institution in controlling the inflation in our Country.

The Reserve Bank of India

The Reserve Bank of India (RBI) is India's Central Bank. It is the apex monetary institution which supervises, regulates, controls and develops the monetary and financial system of the country. It was established on April 1st, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934. The Central Office of the RBI was initially established in Calcutta but was moved to Mumbai in 1937. It was originally privately owned but nationalised in 1949.

Inflation

Inflation is the supply of excess money and credit relative to the goods and services produced, resulting in increased prices in the economy. As the layman understands it, inflation results in the increase in the price of goods and services in a given economy over a period of time. It is measured as the percentage rate of change of a price index. Inflation in India is a grave issue of concern, given the vast disparity between the rich and the poor or the rural and the urban. The fruits of the much talked about economic growth have not reached large sections, especially in the rural areas in the country.

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Under extant conditions, the benefit of high prices paid by consumers does not flow back to primary producers, but is eaten away by middlemen and spectaculars that enjoy a free run in the economy. With production trailing demand in recent years, shortages of essential commodities have widened. Imports have become expensive because of high global market prices.

It is important to mention that inflation is not an overnight phenomenon. The opening up of the economy after the 1990s increased India's industrial output, which in turn raised the inflation rate in India significantly. The stupendous growth rate of industrial output and employment created an enormous pressure on the inflation rate and also pushed it further.

The main cause of rise in the rate of inflation in India has been the disparity in pricing of agricultural products between the producers and the consumers in the Indian economy. Moreover, the skyrocketing of prices of food products, manufacturing products and essential commodities also contribute to inflation rate in the Indian economy.

In India, the burden to control the situation of inflation is on the Reserve Bank of India. It controls the rate of inflation through its Monetary Policy.

Monetary Policy

The Monetary Policy is the policy statement, traditionally announced twice a year – a slack season policy (April–September) and a busy season policy (October–March) in accordance with agricultural cycles. It is through this policy that the RBI seeks to ensure price stability. The policy has become dynamic in nature as the RBI reserves its right to alter it from time to time, depending on the state of the economy.

The Monetary Policy regulates the supply of money and the cost and availability of credit in the economy. It deals with both the lending and borrowing rates of interest for commercial banks. It aims to maintain price stability, full employment and economic growth. Monetary Policy brings about a change in the economy by changing money supply and interest rate.

There are quantitative and qualitative tools through which the RBI plays its role in controlling inflation.

QUANTITATIVE TOOLS

These are the most important tools which the RBI uses in order to control inflation. These are used when inflation is present in general. These tools are as follows:

Bank Rate

It is the rate at which the RBI gives loans to the other banks. It can be called the interest rate. The RBI advances loan to the member banks against approved securities or rediscounts the eligible bills of exchange and other papers.

Bank Rate is considered as a pace – setter in the money market. Changes in the bank rate influence the entire interest rate structure, i.e. short term as well as long-term interest rates. A rise in the bank rate leads to a rise in the other market interest rates, which implies a dear money policy increasing the cost of borrowing. Similarly, a fall in the other market rates implies a cheap money policy reducing the cost of borrowing.

In order to control the inflation, the RBI increases the Bank Rate. If the bank rate is increased the commercial banks will take less money from the RBI and will have lesser amount with them to advance as loans to the members of trade and public and thus, lesser money will enter the market. Even if the banks continue taking the same amount from the RBI, then after the increased bank rate, they will also increase their rate of interest at which they advance loans which will lead the members of trade and public to take lesser loan from the banks and also then lesser money will enter the market and the situation of inflation can be controlled.

The RBI has altered the bank rate from time to time to meet the changing conditions of the economy:

Years		*Bank rate*
1.	1950	3.00%
2.	Nov 1951	3.50%
3.	Jan 1963	4.00%
4.	Sep 1964	5.00%
5.	Feb 1965	6.00%
6.	Mar 1968	5.00%
7.	May 1974	7.00%
8.	July 1974	9.00%
9.	July 1981	10.00%
10.	July 1991	11.00%
11.	Oct 1991	12.00%
12.	Apr 1998	9.00%
13.	June 1997	10.00%
14.	Oct 1997	9.00%
15.	Mar 1999	8.00%
16.	Apr 2000	7.00%
17.	Oct 2001	6.50%
18.	Oct 2002	6.25%
19.	Apr 2003	6.00%
20.	Oct 2004	6.00%
21.	Apr 2005	6.00%
22.	July 2006	Bank rate: 6%; repo rate: 7%
23.	July 2007	Bank rate: 6%; repo rate: 7%
24.	2008	6.00%
25.	Apr 2009	Bank rate: 6%; repo rate: 3.25%
26.	July, 2009	Bank rate; 6%; repo rate: 4%

Repo rate is the rate at which the commercial banks borrow from the RBI at short term. The difference between the Bank and Repo rates is that the Bank rate is the rate at which the banks borrow from the RBI at long term.

CRR (Cash Reserve Ratio)

Cash Reserve Ratio means a certain amount that the commercial banks have to keep with the RBI. The RBI is the banker of banks and it gives the guidelines as to the amount that the banks are required to keep with the RBI. It can change the cash reserve requirement of the bank in order to affect their credit creation capacity. An increase in the CRR reduces the excess reserve of the bank and a decrease in the CRR increases their excess reserves. In the situation of inflation, the RBI increases the CRR. If the CRR increases then the banks will have to keep greater amount with the RBI and will have lesser amount with them which they can advance as loan to the members of trade and public and, thus, lesser amount will enter the market and the situation of inflation can be controlled.

Originally, the RBI Act, 1934, required the commercial banks to keep with the RBI a minimum cash reserve of 5 per cent of their demand liabilities and 2 per cent of time liabilities. The amendment of the Act in 1956 empowered the RBI to use the CRR as an instrument of credit control by varying them between 2 and 20 per cent on the demand liabilities and between 2 and 8 per cent on the time liabilities. Further amendment of the Act in 1962 removes the distinction between demand and time deposits and authorises the RBI to change CRR between 3 and 15 per cent.

The RBI used the technique of variable CRR for the first time in June 1973 when it raised the ratio from 3 to 5 per cent and further to 7 per cent in September 1973. Thereafter, the RBI has changed the CRR from time to time to meet the changing conditions of the economy:

Year	*CRR*
1. Oct 1992	15%
2. Apr 1993	14.50%
3. May 1993	14.00%
4. June 1994	14.50%
5. Aug 1994	15.00%
6. Nov 1995	14.50%
7. Apr 1996	13.50%
8. July 1996	12%
9. Nov 1996	11%
10. Jan 1997	10.50%
11. Nov 1997	9.75%
12. Jan 1998	10.50%
13. Apr 1998	10.00%
14. Aug 1998	11%
15. May 1999	10.00%
16. Nov 1999	9.00%
17. Apr 2000	8.00%
18. Feb 2001	8.25%

Year	*CRR*
19. May 2001	7.50%
20. Dec 2001	5.50%
21. Nov 2002	4.75%
22. June 2003	4.50%
23. Sep 2004	4.75%
24. Oct 2004	5.00%
25. Dec 2006	5.50%
26. Mar 2007	6.00%
27. Apr 2007	6.50%
28. Nov 2007	7.50%
29. May 2008	8.00%
30. July 2008	8.75%
31. Aug 2008	9.00%
32. Oct 2008	6.50%
33. Nov 2008	5.50%
34. Jan 2009	5.00%
35. July 2009	5.00%

The Narsimham Committee, in its report submitted in November 1991, was of the view that a high CRR adversely affects the bank profitability and thus puts pressure on banks to charge high interest rates on their commercial sector advances. The Government therefore decided to reduce the CRR over a four-year period to a level below 10 per cent.

In few countries such as Canada, Mexico, New Zealand, Sweden and the UK, the required CRR is nil.

SLR (Statutory Liquidity Ratio)

Statutory liquidity ratio is the amount a commercial bank needs to maintain in the form of cash, gold or government approved securities (bonds) before providing credit to its customers. SLR is determined and maintained by the RBI in order to control the expansion of bank credit. SLR is determined as the percentage of total demand and percentage of time liabilities. Time liabilities are the liabilities a commercial bank is liable to pay to the customers on any time demand. With SLR, the RBI can ensure the solvency of a commercial bank. It is also helpful in controlling the expansion of bank credits. By changing the SLR rates, the RBI can increase or decrease bank credit expansion. Also, through SLR the RBI compels the commercial banks to invest in government securities like government bonds.

During the inflation, the RBI increases the SLR where the banks will have to maintain a greater amount in the form of cash, gold or government-approved securities and thus they will have lesser amount with them to advance as loans to the members of trade and public. Thus, lesser money will enter the market and the problem of inflation can be tackled.

Under the original Banking Regulation Act, 1949, banks were required to maintain liquid assets in the form of cash, gold, government-approved securities equal to not less than 25 per cent of their total demand and time deposit liabilities. This minimum SLR is in addition to the statutory cash reserve ratio. The RBI has been empowered to change the minimum liquidity ratio.

Year	*SLR*
1. Nov 1972	30%
2. 1973	32%
3. Oct 1981	35%
4. Sep 1984	36%
5. Jan 1988	38%
6. Sep 1990	38.50%

Year	*SLR*
7. Dec 1996	27%
8. 2004	25%
9. 2007	25%
10. 2008	24%
11. 2009	24%

QUALITATIVE TOOLS

These tools play a significant role when inflation occurs in some specific sector or few sectors. These are three kinds of tools:

Marginal Requirement of Loans

Every commercial bank has some marginal requirement of loans. If this marginal requirement is decreased, then the members of trade and public will be encouraged to take loans, and if marginal requirement is increased by the banks, then the members of trade and public will avoid taking loans.

Example: If a person wants to take loan of Rs. 2 lac and the marginal requirement of loan by the bank is worth Rs. 3 lac, then the person will have to pledge the property worth Rs. 5 lac.

During the inflation, the RBI guides or instructs the commercial banks to increase the marginal requirement of loans, as a result of which the members of trade and public will hesitate in taking loans and thus lesser amount of money will enter the market and the problem of inflation can be handled.

Rationing of Credit

It means that the Reserve Bank of India guides the commercial banks to keep lesser amount as loan for some particular sectors as compared to the other sectors and *vice versa*. Thus, if inflation occurs in some particular sector, then as per the instructions of the RBI, the commercial banks advance lesser loans for that sector and lesser amount of money will enter that sector and the problem of inflation can be tackled.

Strict Direct Disciplinary Action

The RBI may take disciplinary action against any bank that does not comply with its instructions or guidelines. The consequences will have to be faced by that bank. For example, the RBI may reduce its aid to that bank which does not abide by its guidelines or stop aiding that bank completely. It may also take away the membership of that bank. All of us know that no bank can work without the aid of the RBI and thus all the banks abide by the guidelines of the RBI.

Drawbacks in the Policy

Monetary tools have proved more effective in economies with greater financial inclusion. They are less effective in economies such as India's, where a large population still has no access to the banks, and those with access barely have the resources to open bank accounts. The increasing cost of funds and rising interest rates are of little consequence in the economic life of a financially excluded population. The impact will be critical on smaller segments and will take a while to yield results for the economy.

To cite Mr. V. Leeladhar: "Compared to the developed world, the coverage of our financial services is quite low. As per a survey of the British Bankers' Association, 92–94 per cent of the population of the UK has either a current or a savings bank account". This contrasts poorly with India, where the ratio of deposit accounts to total adult population is approximately 59 per cent. Most account holders are urban centric, leaving a large population with no access to banks or the means to save or borrow.

Secondly, the impact of CRR hike will not distinguish as between productive credit and credit meant for consumption. This will hurt growth and the creation of assets in the economy. Farmers today keep several acres of land uncultivated as the financial returns are not commensurate with the expenses incurred for cultivation. Irrespective of the increasing cost of funds, large segments of the borrowing public, especially the small, medium and large farmers, have no option but to approach the commercial and cooperative banks, or the multitude of unregulated moneylenders at the beginning of every crop cycle.

Conclusion

No doubt, the RBI is the only authority which is empowered as well as capable to handle the situation of inflation. It is also not disputed that the inflation has been controlled to a great extent at various occasions and that the monetary policy is important to fight inflation but the point is, is it enough?

The RBI seems to concentrate only on the demand end of inflation during the inflation; as a result, the entire perspective of supply is completely ignored. Inflation may also be curtailed if the supply is bolstered to meet the demands of the people in Indian economy. With the increase in supply, prices would inevitably come down and thus inflation may be controlled.

Granted, the supply side would not strengthen so easily, as it would require planning, infrastructure development, large-scale investments etc. However, this is where our central bank could play an extremely important role.

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Division One

Legal Update

Direct Taxes

A. STATUTES

A1. *Notification* – Raman Centre for Applied and Interdisciplinary Sciences, Kolkata approved to be in the category of 'Other Institution' partly engaged in research activities under Section 35(1)(*ii*) of the Income-tax Act, 1961 – No. 83/2010, dated 01.11.2010

It is hereby notified for general information that the organization Raman Centre for Applied and Interdisciplinary Sciences, Kolkata has been approved by the Central Government for the purpose of clause (*ii*) of sub-section (1) of section 35 of the Income-tax Act, 1961 (said Act), read with Rules 5C and 5E of the Income-tax Rules, 1962 (said Rules), w.e.f. 1.4.2008 (Assessment Year 2009-10) onwards in the category of 'Other Institution", partly engaged in research activities subject to the following conditions, namely:-

(*i*) The sums paid to the approved organization shall be utilized for scientific research;

(*ii*) The approved organization shall carry out scientific research through its faculty members or its enrolled students;

(*iii*) The approved organization shall maintain separate books of accounts in respect of the sums received by it for scientific research, reflect therein the amounts used for carrying out research, get such books audited by an accountant as defined in the explanation to sub-section (2) of section 288 of the said Act and furnish the report of such audit duly signed and verified by such accountant to the Commissioner of Income-tax or the Director of Income-tax having jurisdiction over the case, by the due date of furnishing the return of income under sub-section (1) of section 139 of the said Act;

(*iv*) The approved organization shall maintain a separate statement of donations received and amounts applied for scientific research and a copy of such statement duly certified by the auditor shall accompany the report of audit referred to above.

2. The Central Government shall withdraw the approval if the approved organization:

(*a*) fails to maintain separate books of accounts referred to in sub-paragraph (*iii*) of paragraph I; or

(*b*) fails to furnish its audit report referred to in sub-paragraph (*iii*) of paragraph 1; or

(*c*) fails to furnish its statement of the donations received and sums applied for scientific research referred to in sub-paragraph (*iv*) of paragraph I; or (*d*) ceases to carry on its research activities or its research activities are not found to be genuine: or

(*e*) ceases to conform to and comply with the provisions of clause (*ii*) of sub-section (1) of section 35 of the said Act read with rules 5C and 5E of the said Rules.

A2. *Notification* – Organization Centre for the Study of Developing Societies, New Delhi approved to be in the category of 'Other Institution' partly engaged in research activities under Section 35(1)(*iii*) of the Income-tax Act, 1961 – No. 82/2010, dated 28.10.2010

It is hereby notified for general information that the organization Centre for the Study of Developing Societies, New Delhi has been approved by the Central Government for the purpose of clause (*iii*) of sub-section (1) of section 35 of the Income-tax Act, 1961 (Said Act), read with rules 5C and 5E of the Income-tax Rules, 1962 (said Rules) from Assessment year 2010-2011 onwards in the category of 'Other Institution' partly engaged in research activities subject to the following conditions, namely-

(*i*) The sums paid to the approved organization shall be utilized for research in social sciences;

(*ii*) The approved organization shall carry out research in social science or statistical research through its faculty members or its enrolled students;

(*iii*) The approved organization shall maintain separate books of accounts in respect of the sums received by it for scientific research, reflect therein the amounts used for carrying out research, gel such books audited by an accountant as defined in the explanation to sub-section (2) of section 288 of the said Act and furnish the report of such audit duly signed and verified by such accountant to the Commissioner of Income-tax or the Director of Income-tax having jurisdiction over the case, by the due date of furnishing the return of income under sub-section (1) of section 139 of the said Act.

(*iv*) The approved organization shall maintain a separate statement of donations received and amounts applied for research in social sciences and a copy of such statement duly certified by the auditor shall accompany the report of audit referred to above.

2. The Central Government shall withdraw the approval if the approved organization:-

(*a*) fails to maintain separate books of accounts referred to in sub-paragraph (*iii*) of paragraph I; or

(*b*) fails to famish its audit report referred to in sub-paragraph (*iii*) of paragraph 1; or

(*c*) fails to furnish its statement of the donations received and sums applied for research in social sciences or statistical research referred to in sub-paragraph (*iv*) of paragraph I; or (*d*) ceases to carry on its research activities or its research activities are not found to be genuine; or

(*e*) ceases to conform to and comply with the provisions of clause (*iii*) of sub-section (I) of section 35 of the said Act, read with rules 5C and 5E of the said Rules.

A3. *Notification* – M/s. Nodia Cyber Park Private Limited, New Delhi notified as an undertaking for development and maintenance of industrial park – No. 81/2010, dated 26.10.2010

WHEREAS the Central Government in exercise of the powers conferred by clause (*iii*) of sub-section (4) of section 80-IA of the Income-tax Act, 1961 (43 of 1961) (hereinafter referred to as the said Act), has framed and notified a scheme for industrial park, by the notification of the Government of India in the Ministry of Finance (Department of Revenue, Central Board of Direct Taxes) published in the Gazette of India, Part-II, Section 3, sub-section (*ii*) vide number S.O. 51(E), dated the 8th January, 2008 and amended vide number S.O. 1605(E), dated the 2nd July, 2008, for the period beginning on the 1st day of April, 2006 and ending on the 31st day of March, 2009;

AND WHEREAS, M/s. Noida Cyber Park Private Limited, having its registered address at 18, Rouse Avenue, Kotla Lane, New Delhi - 110002, had developed an Industrial Park at Plot Nos. C-28 and C-29, Sector-62, Noida, Gautam Budh Nagar, Uttar Pradesh - 201301;

NOW, THEREFORE, in exercise of the powers conferred by clause (*iii*) of sub-section (4) of section 80-IA of the said Act read with Rule 18C of the Income-tax Rules, 1962, and subject to the provisions of Industrial Park Scheme, 2008, the Central Government hereby notifies M/s. Nodia Cyber Park Private Limited, New Delhi, as an undertaking and the project at C-28 and C-29, Sector-62, Noida, Gautam Budh Nagar, Uttar Pradesh - 201301, being developed and being maintained and operated by the said undertaking, as an industrial park for the purposes of the said clause.

2. The aforesaid Industrial Park shall be deemed to have been developed on and from the 11th June, 2010.

3. This notification shall not be applicable if it is for a location of the Industrial Park for which notification has already been issued in the name of any other undertaking.

4. No amendment of the project plan shall be made without the approval of the Central Government.

B. IMPORTANT CASES

Transfer Pricing Regulations

Sections 40A(2) and 80-IA(10) of the Income Tax Act, 1961

***Commr. of Income Tax-IV, Delhi and Anr.* v.**
Glaxo Smithkline Asia (P) Ltd. (Supreme Court)
Decided on 26.10.2010, MANU/SC/0938/2010

TO AVOID MULTIPLICITY OF LITIGATION, ISSUE OF EXTENDING TRANSFER PRICING REGULATIONS TO DOMESTIC TRANSACTIONS REQUIRES EXPEDITIOUS CONSIDERATION BY THE MINISTRY OF FINANCE AND CENTRAL BOARD OF DIRECT TAXES.

Assessment Year: 2001-2002

Disposition: Petition dismissed.

Facts: In the present case, authorities below have recorded a concurrent finding that Assessee company and its service provider are not related companies in terms of Section 40A(2) of the Income-Tax Act, 1961. Thus, present special leave petitions filed at the instance of the Department.

Issue: Whether Transfer Pricing Regulations should be limited to cross-border transactions or whether the Transfer Pricing Regulations be extended to domestic transactions?

Holding: In the case of domestic transactions, the underinvoicing of sales and overinvoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage, i.e. (1) if one of the related companies is loss making and the other is profit making and profit is shifted to the loss-making concern; (2) if there are different rates for two related units and if profit is diverted towards the unit on the lower side of tax arbitrage. Central Board of Direct Taxes also viewed that complications arise in cases where fair market value is required to be assigned to the transactions between related parties in terms of Section 40A(2) of the Income Tax Act, 1961 and hence amendments would be required to the provisions of the Act if such Transfer Pricing Regulations are required to be applied to domestic. Normally, present Court does not make recommendations or suggestions transactions between related parties under Section 40A(2) of the Act but in order to avoid litigation, certain provisions of the Act, like Sections 40A(2) and 80-IA(10), need to be considered by the Ministry of Finance for amendments, so as to empower the Assessing Officer to make adjustments to the income declared by the Assessee, having regard to the fair market value of the transactions between the related parties. In the present case, no interference is called for as the entire exercise is a revenue neutral exercise. Hence, Special Leave Petition is dismissed.

Assessment

Section 147 of the Income Tax Act, 1961

Sarthak Securities Co. Pvt. Ltd.* v. *Income Tax Officer (Delhi High Court)
Decided on 18.10. 2010, MANU/DE/2733/2010

INITIATION OF PROCEEDINGS UNDER SECTION 147 IS JUSTIFIED ONLY WHEN COGENT MATERIAL IS AVAILABLE BEFORE THE ASSESSING OFFICER SO AS TO REASONABLY BELIEVE THAT INCOME HAD ESCAPED ASSESSMENT. MERE DIRECTIONS FROM SUPERIOR OFFICER WITHOUT APPLICATION OF MIND BY ASSESSING OFFICER DOES NOT JUSTIFY REOPENING OF ASSESSMENT

Assessment year: 2003-04

Disposition: Appeal dismissed

Facts: Assessee-Petitioner filed its return for the relevant assessment year declaring an income and intimation under Section 143(1) was issued by the department accepting the return. A notice under Section 148 was issued by the Respondent No.1 (Income Tax Officer) to the Petitioner alleging that he had reason to believe that the income chargeable to tax for relevant assessment year had escaped assessment within the meaning of Section 147 and, accordingly, directed the Petitioner to file the return for the said assessment year. Assessee raised objections to the initiation of the proceedings under Section 147 on the foundation that the same had not been initiated in accordance with law. Hence, in the present writ petition, Assessee-Petitioner has prayed for issue of a writ of *certiorari* for quashment of the notice, issued under Section 148 of the Income Tax Act, 1961, pertaining to relevant assessment year by the Respondent No.1-Income Tax Officer.

Issue: Whether in the present case, the initiation of proceedings under Section 147 is justified in law or not.

Holding: The apex court in *Assistant Commissioner of Income Tax v. Rajesh Jhaveri Stock Brokers P. Ltd.* made it absolutely clear that before an Assessing Officer issues a notice under Section 148, thereby reopening the assessment under Section 147, he must have formed a belief that income had escaped assessment. There must be some material before the Assessing Officer so as to arrive at such a belief in order that the expression “reason to believe” is triggered. Such a belief and the basis of such belief could be discerned from the material on record which was available with the Assessing Officer. The Assessing Officer had not applied his mind to the information and he did not independently arrive at a belief that on the basis of the material which he had before him, income had escaped assessment. He has merely acted on the directions of the Deputy Director of Income Tax (Investigation) and the Additional Commissioner of Income Tax. Thus, the initiation of proceedings under Section 147 is not justified.

Disallowance of Interest

Section 14A of the Income Tax Act, 1961

M/s. Mazda Colours Ltd* v. *ACIT (ITAT Mumbai)
Decided on 4.11. 2010, MANU/IU/0612/2010

WHERE THE ASSESSEE HAS NOT INVESTED ANY BORROWED FUNDS IN SHARES IN THE RELEVANT ASSESSEMENT YEAR, THEN DISALLOWANCE OF INTEREST UNDER SECTION 36(1)(*iii*)/14A DOES NOT ARISE.

Assessment year: 2004-05

Facts: Assessee was in the business of manufacturing pigments and chemicals. Assessing Officer found that the Assessee made an investment which was slightly reduced from that what was at the beginning of the year. Assessing Officer disallowed an amount of 2,01,718 out of the total claim of interest charges. Before CIT(A), it was contended that the Assessee has not borrowed any funds for the purpose of investment in shares and the disallowance of interest under Section 14A does not arise. On appeal, CIT(A) confirmed the disallowance by giving a finding that there has been fresh investment during the year of more than 1 crore, which is out of borrowed funds, confirmed the disallowance. On appeal, the findings of CIT (A) were confirmed by the ITAT. Hence present appeal.

Issue: Whether disallowance of interest under Section 14A is justified in the present case.

Holding: In the present case, it is an admitted fact that during the year the Assessee has not invested any fresh funds and even the Assessing Officer gave a finding that the investment has come down from the beginning of the year to the end of the year and has taken the average investment for consideration in the assessment order. When this fact is very clear in the order of the Assessing Officer as well in the balance sheet and the enclosures, CIT(A) is not justified in coming to the conclusion that Assessee has invested during the year more than 1 crore out of the borrowed funds. Records indicate that the Assessee has invested in earlier years in various concerns and public limited companies and there is a finding by the ITAT in earlier years, following the finding of the CIT(A) in those years, that the Assessee has not invested any borrowed funds in shares and accordingly the disallowance of interest under Section 36(1)(*iii*)/14A does not arise. During the present assessment year, the Assessing Officer has not considered any other expenditure except the interest for disallowance under Section 14A consequent to the finding giving in earlier years and on the fact that no fresh investments have been made during the year, the disallowance cannot be upheld. To that extent, the orders of the CIT(A) are to be reversed. The Assessing Officer is directed to allow the amounts.

Speculation income

Explanation to Section 73 of the Income Tax Act, 1961

Nine International Securities Pvt. Ltd.* v. *The Income-tax (ITAT Mumbai)
Decided on 10.11.2010, MANU/IU/0648/2010

EXPLANATION TO SECTION 73 APPLIES TO A BUSINESS CARRIED OF FOR PURCHASE AND SALE OF SHARES AND THEREFORE BOTH PROFIT AS WELL AS LOSS IN SUCH BUSINESS HAVE TO BE TREATED AS SPECULATIVE INCOME OR LOSS.

Assessment Year: 2001-02

Facts: Assessee is engaged in the business of trading in shares and securities and had purchased and sold shares during the previous year. Assessee had taken and given delivery in respect of purchase and sale of some of the shares but in respect of some of the shares, there was no delivery either at the time of purchase or at the time of sale. Assessing Officer held that transactions were speculative transactions and he, therefore, did not allow set off of the aforesaid loss against the profit which the Assessee had earned in purchase and sale of shares where there was actual delivery. The Assessee submitted that in view of Explanation to Section 73 of the Act, the entire business of purchase and sale of shares has to be considered as a composite business and further segregation as trading in shares and speculation in shares could not be made. Assessing Officer, therefore, did not allow the set off as claimed by the Assessee and the speculation loss was added to the total income of the Assessee. Assessing Officer also disallowed the professional fees for the purpose of taking professional advise as to whether the Assessee can enter into the business of real estate on the grounds that expenses was not in relation to the business of the Assessee. On appeal by the Assessee the CIT (A) confirmed the order of the Assessing Officer. Hence present appeal by Assessee.

Issues: **(1)** Whether CIT (A) has erred in holding that Assessing Officer has rightly invoked provisions of explanation to Sections 73 and 43(5) and whether CIT (A) has failed to appreciate that entire business was composite business and cannot be segregated as trading and speculation as per provision of law.

(2) Whether CIT (A) has erred in disallowing professional fees for the purpose of taking professional advise as to whether the Assessee can enter into the business of real estate or not.

Holdings: **(1)** In the present case, claim of the Assessee is allowed on relying on the decision of the Bombay High Court in the case of *CIT* v. *Lokmat Newspapers Pvt. Ltd,* wherein similar issue was in consideration and a set off claim was allowed holding that Explanation to Section 73 applies to a business carried on by an Assessee which is in purchase and sale of shares and therefore both profit as well as loss in such business have to be treated as speculative income or loss. Hence CIT (A) erred in disallowing the claim of Assessee.

(2) Assessee failed to bring any material on record to show that it had an intention to do real estate business. Thus, CIT (A) is correct and does not call for any interference.

Profits chargeable to tax

Section 41(1)(a) of the Income Tax Act, 1961

Sulzer India Ltd.* v. *Jt. CIT (ITAT Mumbai)
Decided on 10.11.2010, MANU/IU/0642/2010

WHERE A DEFERRED SALES TAX OR FUTURE LIABILITY IS DISCHARGED IN FULL BY PAYMENT OF ITS NET PRESENT VALUE, NO BENEFIT CAN BE SAID TO HAVE BEEN OBTAINED AND THUS, IT CANNOT BE CLASSIFIED AS REMISSION OR CESSATION OF THE LIABILITY SO AS TO ATTRACT THE PROVISIONS OF SECTION 41(1)(*a*) OF THE INCOME TAX ACT, 1961

Assessment Year: 2003-2004

Facts: Assessee company had opted "sales-tax deferral schemes of 1983 and 1988" of Government of Maharashtra, according to which sales tax was to be deferred and payable after 12 years in six equal instalments. Later on, the State Industrial and Investment Corporation of Maharashtra Ltd. (SICOM) being the Implementing Agency under 1979/1983/1988 Scheme offered to the Assessee an option for the settlement of the deferred sales-tax liability by an immediate one-time payment at net present value (NPV). Assessee paid an amount of Rs. 3,37,13,393 as NPV. The difference between the deferred sales-tax and its present value amounting to Rs. 4,14,87,795 was treated as capital receipt and was credited in the books of account of the Assessee to the capital reserve account. Assessing Officer brought to tax the difference of Rs. 4,14,87,985 under Section 41(1) of the Act on the grounds that since the sales-tax liability has been allowed as a deduction under Section 43B of the Act from the business income of the assessee in the earlier years, therefore, as per provision of Section 41(1) if a trading liability is deducted from the business income and the same is remitted wholly or partly, the remission of sales tax liability is to be added to the income of the Assessee as business income. On Appeal, CIT(A) upheld the addition made by the Assessing Officer. Hence present appeal before the Special Bench.

Issue: Whether the sum of Rs.4,14,87,985 being the difference between the payment of NPV of Rs.3,37,13,393 against the future liability of Rs.7,52,01,378 has rightly been charged to tax under Section 41(1) of the Act.

Holding: For applicability of Section 41(1), the essentials are is that the Assessee must have subsequently (*i*) obtained any amount in respect of such loss and expenditure or (*ii*) obtained any benefit in respect of such trading liabilities by way of remission or cessation thereof. In the present case, earlier State Government provided sales-tax deferral schemes to the Assessee by which amount has to be paid in 12 instalments but later on the State Government came with a scheme by which Assessee was given option to pay the future liability at a discounted value or what we may call net present value immediately. It cannot be construed as remission of liability because the Sate Government has not waived any of the liability. Had the State Government accepted lesser amount after 12 years or reduced such instalments, then it could have been a case of remission or cessation. But in the present case, the State Government has chosen to receive the money immediately which was receivable in future. Thus, it does not satisfy the condition of actual remission *in praesenti*. Present case is a simple case of collecting the amount at net present value which is due later on and even the formula for collecting the net present value was also given by the SICOM and the amounts have been paid as per that formula. Therefore, such payment of net present value of the future liability cannot be classified as remission or cessation of the liability so as to attract the provisions of Section 41(1)(*a*) of the Income Tax Act, 1961. Thus, the deferred sales-tax liability Rs.4,14,87,984 being the difference between the payment of net present value Rs.3,37,13,393 against the future liability of Rs.7,52,01,378 credited by the Assessee under the capital reserve account in its books of account is a capital receipt and cannot be termed as remission/cessation of liability and consequently no benefit has arisen to the Assessee in terms of Section 41(1)(*a*) of the Act.

Disallowance

Section 14A of the Income Tax Act, 1961

Unichem Laboratories Ltd.* v. *DCIT (ITAT Mumbai)
Decided on 10.11.2010, MANU/IU/0650/2010

WHERE THERE IS ONLY REPLACEMENT OF THE PART OF MACHINERY, WHICH ITSELF CANNOT FUNCTION AS PLANT AND MACHINERY, THEN THE SAME CANNOT BE SAID TO BE INSTALLATION OF A NEW ASSET OR ENHANCEMENT OF ANY CAPITAL ASSET TO GIVE ANY ENDURING BENEFIT TO THE ASSESSEE AND, THUS, DISALLOWANCE ON THE SAME IS ALLOWABLE AS REVENUE EXPENDITURE

Assessment year: 2001-02

Facts: The Assessee claimed deduction on amount spent on repairs to plant and machinery. Assessing Officer (AO) made disallowance of repairs and maintenance expenses by treating the same as capital expenditure. Assessing Officer also made disallowance under Section 14A. On appeal, CIT(A) confirmed the addition made by the AO by treating repairs and maintenance expenses incurred for plant and machinery as capital expenditure and also upheld disallowance under Section 14A. Hence present appeal.

Issues: **(1)** Whether CIT(A) has erred in facts and in law and facts in confirming the addition made by the AO by treating repairs and maintenance expenses incurred for plant and machinery as capital expenditure instead of revenue expenditure.

(2) Whether CIT(A) has erred in law and in facts in confirming the disallowance made by the AO under Section 14A of the Act being proportionate interest expense relatable to the investments made by the Appellant and whether the interest expenditure is not allowable under any provisions of the Act.

(3) Whether CIT(A) has erred in law and in facts in levying interest under Section 234D of the Act.

Holdings: **(1)** In the present case, neither the Assessing Officer nor the CIT(A) has examined present issue in respect of the replacement of the plant or of machinery or the nature of installation of the machinery. Where there is only replacement of the part of machinery which itself cannot function as plant and machinery, then the same cannot be said to be installation of a new asset or enhancing any manufacturing capacity of the Assessee. Also, when the Explanation to Section 31 is not applicable for the assessment year under consideration, then even if any capital expenditure is incurred for the purposes of the repairs and maintenance, the same is allowable if the entire expenditure falls under the current repairs. In the present case, though it is not current repairs but replacement of part of the machinery is because of accumulated repairs over the years and, therefore, the same is allowance as revenue expenditure because it is not enhancement of any capital asset or giving any enduring benefit to the Assessee. Therefore, the disallowance made by the lower authorities on this account is not justified. Accordingly, the claim of the Assessee on account of the said repairs and maintenance was allowed being business expenditure under Section 37(1). Orders of the lower authorities were set aside.

(2) In the present case, it is clear from the record that the Asseseee has not established the availability of its own fund for utilising for investment in shares, units and mutual funds. Moreover, the Aseseee has used the interest-bearing funds for investment and disallowed interest expenditure on its own under Section 14A and has not clearly established that the interest bearing funds was used only for purchase of plant and machinery and working capital used for the business activities, then the apportionment of the expenditure is permitted under section 14A. Matter is remitted back to Assessing Officer to examine and verify the issue in light of decision in *Godrej & Boyce Mfg.Co.Ltd. Mumbai*v. *Dy. Commissioner of Income Tax*.

(3) As laid down by the apex court in *Ekta Promotors Private Limited*'s case that the provisions of Section 234D are applicable with effect from the date of its amendment in the statute. Therefore, the same is not applicable for the assessment year under consideration.

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Indirect Taxes

SERVICE TAX

A. IMPORTANT CASES

Input Service

Rule 2(l) of CENVAT Credit Rules, 2004

CCE, Nagpur* v. *M/s. Ultratech Cement Ltd. and Ors.
(Bombay High Court)
Decided on 25.10.2010, MANU/MH/1408/2010

IT IS MANDATORILY REQUIRED UNDER THE PROVISIONS OF THE FACTORIES ACT, 1948 TO PROVIDE CANTEEN FACILITIES TO THE WORKERS.

Facts: Respondent-Assessee is engaged in the manufacture of cement, which is excisable under Chapter 25 of the Central Excise Tariff Act, 1985. During the period 2004-08, the Assessee had availed credit of service tax paid on outdoor catering services under the provisions of CENVAT Credit Rules, 2004 (in short, "the 2004 Rules") and utilised the same in paying Excise Duty, that is, central value added tax on clearance of cement manufactured by the Assessee. The Assistant Commissioner, Central Excise, was of the opinion that outdoor catering services was not a "Input service" under Rule 2(l) of the 2004 Rules and therefore, the Assessee was not entitled to take credit of service tax paid on outdoor catering services and Show Cause Notices were issued for the same.

It was contended that, in order to comply with the aforesaid statutory requirement, the Assessee had engaged the services of M/s. Shrikrishna Catering Services. Since the cost of food including service tax paid thereon by the Caterer was reimbursed by the Assessee, the Assessee was entitled to take credit of the said service tax and utilise the same in paying the Excise Duty i.e. Central Value Added Tax (CENVAT) on the cement manufactured by the Assessee.

Rejecting the contention of the Assessee, the Assessing Officer held that the service tax paid by the outdoor caterer would not qualify as "Input Service" under Rule 2(l) of the 2004 Rules. Accordingly, the Assessing Officer confirmed disallowance of the CENVAT credit as well as the credit of education cess/ Secondary and Higher Secondary Education Cess taken by the Assessee on outdoor catering services and demanded the same with interest and penalty under Rules 14 and 15 of the 2004 Rules read with Section 11(A)(B) of the Central Excise Act, 1944 and Section 75 of the Finance Act, 1994. Hence the present appeal.

Issue: Whether service of an outdoor caterer used by Assessee is an 'input service' used in the manufacture of impugned goods?

Holding: Services having nexus or integral connection with the manufacture of final products as well as the business of manufacture of final product would qualify to be input service under Rule 2(l). Assessee employed more than 250 workers. It is mandatorily required under the provisions of the Factories Act, 1948 to provide canteen facilities to the workers. Failure to do so entails penal consequences under the Factories Act, 1948. Use of the services of an outdoor caterer has nexus or integral connection with the business of manufacturing the final product. Assessee is entitled to the credit of service tax paid on outdoor catering service. Appeal is disposed of.

Credit

Section 78 of the Finance Act, 1994

Glory Digital Photo Station* v. *CCE, Surat-I (CESTAT Ahmedabad)
Decided on 08.10.2010, MANU/CS/0195/2010

IN THE SELF-ASSESSMENT PROCEDURE, ASSESSEE IS FREE TO UTILISE THE CREDIT AND IF DEPARTMENT CAN TAKE ACTION IF THERE IS ANY PROBLEM

Disposal: Assessee's appeal allowed

Facts: The Appellant was engaged in providing photography services. The Service Tax of was demanded on the ground that the Appellant had not paid the full amount due. Interest and penalty was also imposed under Section 78 of Finance Act, 1994. Learned Chartered Accountant, appearing on behalf of the Appellant submitted that the Appellant had surrendered the registration certificate. A search of the Appellant firm was conducted and certain records were seized and consequent to adjudication after completion of proceedings, the above amount has been demanded. Learned Chartered Accountant submitted that he is not in a position to challenge the Service Tax amount demanded since all the records which were seized are no longer available and the Appellant also does not have any record other than copies of Service Tax returns. The Appellant had actually debited the CENVAT Credit. But, the Department, while working out the Service Tax amount due, has not taken this into account. The Additional Commissioner, the original Adjudicating Authority, in his order, has observed that the amount paid by the Appellant is appropriated. It is his submission that the claim made by them before the original Adjudicating Authority as well as before Commissioner (Appeals) that the amount of CENVAT Credit debited by them also should be treated as payment, has not been considered. The original Adjudicating Authority rejected this claim. Hence the present appeal.

Issues: Whether amount of CENVAT credit debited by Appellant should be treated as payment towards service tax ?

Holding: Debit of CENVAT credit made has to be accepted by department in view of the fact that the same has not been challenged. According to the law, in the self-assessment procedure, Assessee is free to utilise the credit and if department can take action if there is any problem. Having failed to take any action or in the absence of any evidence for such action, impugned order can be said to have held that reversal of CENVAT credit was to be taken as payment towards service tax and other dues confirmed against Appellant – Appeal allowed.

CUSTOMS

A. STATUTES

A1. *Notification* – Exemption on customs duty levied on Crude Petroleum oils and oils obtained from bituminous minerals imported into India from Brunei Darussalam – No. 116/2010, dated 01.11.2010

In exercise of the powers conferred by sub-section (1) of section 25 of the Customs Act, 1962 (52 of 1962), the Central Government, being satisfied that it is necessary in the public interest so to do, hereby exempts Crude Petroleum oils and oils obtained from bituminous minerals falling under the tariff item 2709 00 00 of the First Schedule to the Customs Tariff Act, 1975 (51 of 1975), when imported into India from Brunei Darussalam, from so much of the duty of customs leviable thereon as is in excess of the amount calculated at the rate of 3% ad valorem:

Provided that the importer proves to the satisfaction of the Deputy Commissioner of Customs or Assistant Commissioner of Customs, as the case may be, that the goods in respect of which the benefit of this exemption is claimed are of the origin of Brunei Darussalam, in accordance with provisions of the Customs Tariff [Determination of Origin of Goods under the Preferential Trade Agreement between the Governments of Member States of the Association of Southeast Asian Nations (ASEAN) and the Republic of India] Rules, 2009, published in the notification of the Government of India in the Ministry of Finance (Department of Revenue), No. 189/2009-Customs (N.T.), dated the 31st December 2009.

A2. *Notification* – Amendment to Notification No. 153/2009-Customs, dated the 31.12.2009 where new entry "Brunei Darussalam" inserted in Serial No.7 to Appendix I – No. 115/2010, dated 01.11.2010

In exercise of the powers conferred by sub-section (1) of section 25 of the Customs Act, 1962 (52 of 1962), the Central Government, on being satisfied that it is necessary in the public interest so to do, hereby makes the following further amendments in the notification of the Government of India, in the Ministry of Finance (Department of Revenue), No. 153/2009-Customs, dated the 31st December, 2009 which was published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (*i*) vide number G.S.R. 944 (E), dated the 31st December, 2009, namely:-

In the said notification, in the Appendix I, after serial number 6 and the entries relating thereto, the following serial number and entry shall be inserted, namely:-

S. No.	Name of the country
"7	Brunei Darussalam"

A3. *Notification* – Amendment to the Notification No. 23/2006 where "21st day of June, 2011" to be substituted for the figures, letters and word "10th day of November, 2010" – No. 114/2010, dated 01.11.2010

Whereas, the designated authority vide notification No. 15/16/2009-DGAD, dated the 22nd June, 2010, published in the Gazette of India, Extraordinary, Part I, Section 1 dated the 22nd June, 2010, had initiated review in terms of sub-section (5) of section 9A of the Customs Tariff Act, 1975 (51 of 1975) (hereinafter referred to as the said Customs Tariff Act) and in pursuance of rule 23 of the Customs Tariff (Identification, Assessment and Collection of Anti-dumping Duty on Dumped Articles and for Determination of Injury) Rules, 1995 (hereinafter referred to as the said rules), in the matter of continuation of anti-dumping duty on imports of Sodium Formaldehyde Sulphoxylate (SFS), falling under sub heading 2831 10 20 of the First Schedule to the Customs Tariff Act, 1975 (51 of 1975), originating in, or exported from, People's Republic of China imposed vide notification of the Government of India, in the Ministry of Finance (Department of Revenue), No. 23/2006-Customs, dated the 6th March, 2006, published in the Gazette of India, Extraordinary, Part II, Section 3, Subsection (*i*) vide number G.S.R.139 (E), dated the 6th March, 2006, and had recommended for extension of antidumping duty, in terms of sub-section (5) of section 9A of the said Customs Tariff Act;

Now, therefore, in exercise of the powers conferred by sub-sections (*i*) and (5) of section 9A of the said Customs Tariff Act and in pursuance of rule 23 of the said rules, the Central Government hereby makes the following amendment in the notification of the Government of India, in the Ministry of Finance (Department of Revenue), No. 23/2006-Customs, dated the 6th March, 2006, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (*i*) vide number G.S.R. 139 (E), dated the 6th March, 2006, namely:–

In the said notification, in paragraph 2, for the figures, letters and word "10th day of November, 2010, the figures, letters and word "21st day of June, 2011" shall be substituted.

A.4 *Notification* – Rescission of Notification No. 105/2008-Customs, dated the 18.09.2008 under section 9A of the Customs Tariff Act 1975 – No. 113/2010, dated 01.11.2010

In exercise of the powers conferred by sub-sections (1) and (5) of section 9A of the Customs Tariff Act, 1975 (51 of 1975) read with rules 18 and 20 of the Customs Tariff (Identification, Assessment and Collection of Antidumping Duty on Dumped Articles and for Determination of Injury) Rules, 1995, the Central Government hereby rescinds the notification of the Government of India in the Ministry of Finance (Department of Revenue), No. 105/2008-

Customs, dated the 18th September, 2008, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (*i*), vide number G.S.R. 659 (E), dated the 18th September, 2008, except as respects things done or omitted to be done before such rescission.

A5. *Notification* – Amendment to Notification No. 36/2001-Cus (N. T.) dated 03.08.2001 where Description of goods provided with new Tariff value US $(Per Metric Tonne) – No. 97/2010 Customs (N.T.), dated 15.11.2010

In exercise of the powers conferred by sub-section (2) of section 14 of the Customs Act, 1962 (52 of 1962), the Board, being satisfied that it is necessary and expedient so to do, hereby makes the following further amendment in the notification of the Government of India in the Ministry of Finance (Department of Revenue), No. 36/2001-Cus (N. T.), dated, the 3rd August 2001, namely:–

In the said notification, for the Table, the following Table shall be substituted namely:-

"TABLE

S.No.	*Chapter/heading/ sub-heading/ tariff item*	*Description of goods*	*Tariff value US $ (Per Metric Tonne)*
(1)	(2)	(3)	(4)
1	1511 10 00	Crude Palm Oil	447 (i.e. no change)
2	1511 90 10	RBD Palm Oil	476 (i.e. no change)
3	1511 90 90	Others – Palm Oil	462 (i.e. no change)
4	1511 10 00	Crude Palmolein	481 (i.e. no change)
5	1511 90 20	RBD Palmolein	484 (i.e. no change)
6	1511 90 90	Others – Palmolein	483 (i.e. no change)
7	1507 10 00	Crude Soyabean Oil	580 (i.e. no change)
8	7404 00 22	Brass Scrap (all grades)	4241
9	1207 91 00	Poppy seeds	3061

A6. *Notification* – Handling of Cargo in Customs Areas Amendment Regulations, 2010 – No. 96/2010 Customs (N.T.), dated 12.11.2010

In exercise of the powers conferred by sub-section (2) of section 141 read with section 157 of the Customs Act, 1962 (52 of 1962), the Central Board of Excise and Customs hereby makes the following regulations further to amend the Handling of Cargo in Customs Areas Regulations, 2009, namely:-

1. (1) These regulations may be called the Handling of Cargo in Customs Areas Amendment Regulations, 2010.

(2) They shall come into force on the date of their publication in the Official Gazette.

2. In the Handling of Cargo in Customs Areas Regulations, 2009, (hereinafter referred to as the said regulations),-

(*a*) for regulation 5, the following regulation shall be substituted, namely–

"5. Conditions to be fulfilled by Customs Cargo Service provider – The Customs Cargo Service provider for custody of imported goods or export goods and for handling of such goods in a customs area shall fulfill the following conditions, namely:- (1) Provide the following to the satisfaction of the Commissioner of Customs, namely:

(*i*) Infrastructure, equipment and adequate manpower for loading, unloading, stacking, handling, stuffing and de-stuffing of containers, storage, dispatch and delivery of containers and cargo etc., including:-

(*a*) standard pavement for heavy duty equipment for use in the operational and stacking area;

(*b*) free of cost or rent fully furnished office accommodation for Customs, Customs Electronic Data Interchange (EDI) Service Centre, with required amenities and facilities and residential accommodation and transportation facilities for customs staff;

(*c*) premises for user agencies with basic amenities and facilities;

(*d*) storage facility, separately for imported, export and transshipment goods;

(*e*) gate complex with separate entry and exit;

(*f*) adequate parking space for vehicles;

(*g*) boundary wall;

(*h*) internal service roads;

(*i*) electronic weigh-bridge and other weighing and measuring devices;

(*j*) computerized system for location and accountal of goods, and processing of documents;

(*k*) adequate air-conditioned space and power back up, hardware, networking and other equipment for secure connectivity with the Customs Automated system; and for exchange of information between Customs Community partners;

(*l*) facilities for auction, including by e-auction, for disposal of uncleared, unclaimed or abandoned cargo;

(*m*) facilities for installation of scanning equipment;

(*n*) security and access control to prohibit unauthorized access into the premises, and

(*o*) such other facilities as the Commissioner of Customs may specify having regard to the custody and handling of imported or export goods in a customs area;

(*ii*) safe, secure and spacious premises for loading, unloading, handling and storing of the cargo for the projected capacity and for the examination and other operations as may be required in compliance with any law for the time being in force;

(*iii*) insurance for an amount equal to the average value of goods likely to be stored in the customs area based on the projected capacity, and for an amount as the Commissioner of Customs may specify having regard to the goods which have already been insured by the importers or exporters.

(2) Undertake to bear the cost of the Customs officers posted, at such customs area, on cost recovery basis, by the Commissioner and shall make payments at such rates and in the manner prescribed, unless specifically exempted by an order of the Government of India in the Ministry of Finance;

(3) Execute a bond equal to the average amount of duty involved on the imported goods and ten per cent of value of export goods likely to be stored in the customs area during a period of thirty days and furnish a bank guarantee or cash deposit equivalent to ten per cent of such duty:

Provided that the condition of furnishing of Bank guarantee or cash deposit shall not be applicable to ports notified under the Major Ports Act, 1962 (38 of 1963) or to the Central Government or State Governments or their undertakings;

(4) Execute a separate bond for an amount equal to ten percent of value of export goods with a bank guarantee for an amount equal to ten percent of the value of the bond, towards the export goods transported from the customs area to any other customs area for export or transshipment, as the case may be;

(5) Undertake to comply with the provisions and abide by all the provisions of the Act and the rules, regulations, notifications and orders issued thereunder

(6) Undertake to indemnify the Commissioner of Customs from any liability arising on account of damages caused or loss suffered on imported or export goods, due to accident, damage, deterioration, destruction or any other unnatural cause during their receipt, storage, delivery, dispatch or otherwise handling.

(*b*) in regulation 6, in sub-regulation (3), after the words "publish and display", the words "at prominent places including website or webpage of the Customs Cargo Service provider" shall be inserted.

A7. *Notification* – Amendment to Notification No.15/2002-Customs (N.T.), dated the 07.03.2002 relating to jurisdiction of the officers specified in column (3) of the Table – No. 95/2010 Customs (N.T.), dated 12.11.2010

In exercise of powers conferred by sub-section (1) of section 4 of the Customs Act, 1962 (52 of 1962), the Central Board of Excise and Customs hereby makes the following further amendment in the notification of the Government of India in the Ministry of Finance, Department of Revenue number 15/2002-Customs (N.T.), dated the 7th March, 2002, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (*i*), vide number G.S.R 171 (E), dated the 7th March, 2002, namely:-

In the said notification, after the Table, the following shall be inserted, namely:

"2. Notwithstanding anything contained in the said notification, the officers specified in column (3) of the Table shall have jurisdiction over the whole of India for the purpose of adjudicating the cases as assigned to them by the Board."

A8. *Notification* – Customs Tariff [Determination of Origin of Goods under the Preferential Trade Agreement between the Governments of Member States of the Association of Southeast Asian Nations (ASEAN) and the Republic of India] Fourth Amendment Rules, 2010 – No. 94/2010 Customs (N.T.), dated 03.11.2010

In exercise of the powers conferred by sub-section (1) of section 5 of the Customs Tariff Act, 1975 (51 of 1975), the Central Government hereby makes the following rules further to amend the Customs Tariff [Determination of Origin of Goods under the Preferential Trade Agreement between the Governments of Member States of the Association of Southeast Asian Nations (ASEAN) and the Republic of India] Rules, 2009, namely:-

1. These rules may be called the Customs Tariff [Determination of Origin of Goods under the Preferential Trade Agreement between the Governments of Member States of the Association of Southeast Asian Nations (ASEAN) and the Republic of India] Fourth Amendment Rules, 2010.

2. In the Customs Tariff [Determination of Origin of Goods under the Preferential Trade Agreement between the Governments of Member States of the Association of Southeast Asian Nations (ASEAN) and the Republic of India] Rules, 2009, in Annexure IV, after S.No. 6, the following S. No. and entry shall be inserted, namely:-

S. No.	*Name of the country*
"7	Brunei Darussalam"

A9. *Notification* – "Unloading of imported goods and the loading of export goods or any class of such goods." to be substituted from the existing entries in column (4) of table specified under Notification No. 61/1994-Customs-N.T. dated 21.11.1994 – No. 93/2010 Customs (N.T.), dated 01.11.2010

In exercise of the powers conferred by clause (a) of sub-section (1) of section 7 of the Customs Act, 1962 (52 of 1962), the Central Board of Excise & Customs hereby makes the following further amendment in the notification of the Government of India in the Ministry of Finance (Department of Revenue), No. 61/1994-Customs-N.T. dated the 21st November, 1994, namely:-

In the said notification in the Table, against serial number 15 relating to State of Tamil Nadu, against item (c) occurring in column (3), relating to Tiruchirapalli, for the existing entries in column (4), the following entries shall be substituted, namely:-

1	2	3	4
			"Unloading of imported goods and the loading of export goods or any class of such goods."

A10. *Notification* – Substitution of old table specified in Notification No. 36/2001-Cus (N.T.), dated 03.08.2001 with new table consisting specified goods with Tariff value and respective Tariff item – No. 92/2010 Customs (N.T.), dated 29.10.2010

In exercise of the powers conferred by sub-section (2) of section 14 of the Customs Act, 1962 (52 of 1962), the Board, being satisfied that it is necessary and expedient so to do, hereby makes the following further amendment in the notification of the Government of India in the Ministry of Finance (Department of Revenue), No. 36/2001-Cus (N. T.), dated, the 3rd August 2001, namely:–

In the said notification, for the Table, the following Table shall be substituted namely:-

"TABLE

S.No.	*Chapter/heading/ sub-heading/ tariff item*	*Description of goods*	*Tariff value US $ (Per Metric Tonne)*
(1)	(2)	(3)	(4)
1	1511 10 00	Crude Palm Oil	447 (i.e. no change)
2	1511 90 10	RBD Palm Oil	476 (i.e. no change)
3	1511 90 90	Others – Palm Oil	462 (i.e. no change)
4	1511 10 00	Crude Palmolein	481 (i.e. no change)
5	1511 90 20	RBD Palmolein	484 (i.e. no change)
6	1511 90 90	Others – Palmolein	483 (i.e. no change)
7	1507 10 00	Crude Soyabean Oil	580 (i.e. no change)
8	7404 00 22	Brass Scrap (all grades)	4194
9	1207 91 00	Poppy seeds	2751 (i.e. no change)

A11. *Circular* – Enclosure of detailed statutory measures (Phytosanitary requirement) for import of food grains before release of consignments by the Customs authorities – No. 41/2010, dated 03.11.2010

The import of food grains to India is regulated under the Destructive Insects and Pests Act, 1914 and Plant Quarantine (Regulation of Import into India) Order, 2003 issued thereunder. As per this Order, it is mandatory to conduct the pest risk analysis of each commodity before allowing clearance into the country. The import consignments of food grains are required to comply with certain phytosanitary norms as prescribed under Plant Quarantine (Regulation of Import into India) Order, 2003.

2. Instances have come to notice of the Board where phytosanitary requirements are not being implemented properly in respect of import of food grains into India by field formations. The matter was also taken up with Ministry of Agriculture and Food Safety and Standards Authority of India (FSSAI) in order to put in place various statutory standards and also ways to enforce them strictly and more effectively.

3. In this regard, detailed statutory phytosanitary requirements for import of food grains are enclosed as Annexure A to this Circular. The process of phytosanitary inspection and release of consignments are also detailed in the Annexure.

4. Board desires that these requirements should be scrupulously implemented by the field formations. All consignments of food grains may be referred to Plant Quarantine authorities at respective point of entry for phytosanitary inspection before release by Customs. These consignments of food grains will be allowed clearance only after getting NOC from Plant Quarantine Authorities.

5. Suitable instructions may be issued to the field formation for strict compliance.

6. Difficulty faced, if any, may be brought to the notice of the Board.

SEBI & Corporate Laws

CORPORATE LAWS

A. STATUTES

A1. *Notification* – Amendments to Notification No. GSR 555(E) dated 26.07.2001 under Companies Act, 1956 – No. GSR881(E), dated 03.11.2010

In exercise of the powers conferred by sub-section (1) of Section 637A of the Companies Act, 1956(1 of 1956), the Central Government hereby makes the following amendments in the notification of the Government of India, erstwhile Ministry of Law, Justice and Company Affairs (Department of Company Affairs) No. GSR 555(E), dated 26-7-2001, and published in the Gazette of India, in Part II, Section 3, sub-section (*i*), dated the 26th July, 2001, namely:—

In the said notification, in clause (1),—

(*i*) in sub-clause (*d*),—

(*a*) in item (*i*), for the first proviso, the following Proviso shall be substituted, namely:—

"Provided in the case of Nidhi incorporated on or before the 26th July, 2001 having deposits in excess of the aforesaid limits, the same shall be brought to the specified limit by increasing the Net Owned Fund position or alternatively by reducing the deposit according to the time table given below:

Ratio of Net Owned Fund to Deposits (as on 31-3-2010)	*Date by which the company has to achieve prescribed ceiling of 1:20*
(1)	*(2)*
(*a*) More than 1 : 20 but up to 1 : 25	By 31-3-2011
(*b*) More than 1 : 25 but up to 1 : 30	By 31-3-2012
(*c*) More than 1 : 30 but up to 1 : 40	By 31-3-2013
(*d*) More than 1 : 40 but up to 1 : 45	By 31-3-2014
(*e*) More than 1 : 45 but up to 1 : 50	By 31-3-2015";

(*b*) "in item (*ii*),—

1. in sub-item (*A*), For the figures and words "12 months", the figures and words "06 months" shall be substituted;
2. in sub-item (*C*), For the figures "20,000", the figures "50,000" shall be substituted;

(*ii*) in sub-clause (*h*), in item (*ii*), for the words "five percent", the words "seven and half percent", shall be substituted.

A2. *Notification* – Amendments to Notification No. G.S.R. 309(E), dated 30.04.2002 – No. GSR880(E), dated 03.11.2010

In exercise of the powers conferred by sub-section (1) of Section 637A of the Companies Act, 1956 (1 of 1956), the Central Government hereby makes the following amendments in the notification of: the Government of India erstwhile Ministry of Law, Justice and Company Affairs (Department of Company Affairs) No. G.S.R. 309(E); dated the 30th April, 2002, and published in the Gazette of India, in Part II; Section 3; Sub-section (*i*), dated the 30th April, 2002, namely:—

In the said notification, in clause (1) in sub-clause (*ii*), in item (*a*),—

(*i*) after the Table and before the Explanation, the following Note shall be inserted, namely :—

"Note: The estimated realisable value of the collateral security to which such Nidhi or the mutual benefit society has valid recourse may be reduced from the aggregate outstanding amount if the proceedings for sale of mortgaged property have been initiated in a court of law within the previous two years of the interest, income or instalment remaining unrealised";.

(*ii*) For the Table occurring after Explanation, the following Table shall be substituted, namely:—

TABLE

For the period ended	Extent of Provision
31-3-2010	
31-3-2011	
31-3-2012	Un provided balance on an equal basis over the 5 years.
34-3-2013	
33-3-2014	
31-3-2015	

(*iii*) below the Table as so substituted, after the second proviso, the following proviso shall be inserted, namely:—

Provided also that the outstanding Non-performing assets as at 31-3-2010 would be worked out and provided according to the note under the clause (*ii*)(*a*) on equal installments till 31-3-2015.

A3. *Press Release* – Indian Accounting Standards converged with IFRS implementation drawn up with a clear roadmap to be followed by Phase-I companies with effect from 01.04.2011 – No. 8/2010, dated 04.11.2010

Ministry of Corporate Affairs, after wide consultations with all stakeholders and regulators, has drawn up a clear roadmap for implementation of Indian Accounting Standards converged with IFRS. Converged Standards will have to be followed by Phase-I companies w.e.f. 01.04.2011. The Phase I group excludes banks, insurance companies and smaller companies. National

Advisory Committee on Accounting Standards (NACAS) has almost finalized drafting of the converged accounting standards. Under the Converged Accounting Standards, the Schedule VI will have two parts viz. Part-A and Part-B. Part-A will be as per the existing notified accounting standards and Part-B will be based on converged accounting standards. The NACAS has also finalized and recommended Part-A and Part-B of the Schedule-VI.

One of the issues raised by stakeholders is the tax implications in following converged standards. ICAI had set up a Group for identifying tax issues arising on convergence. The group includes nominees from Ministry of Finance. The Group has prepared a draft report identifying certain options which could be adopted to achieve tax neutrality. Secretary, MCA held a meeting with members of the Group, and instructed it to come up in a time bound manner with a specific proposal which will be revenue neutral and acceptable to the Ministry of Finance, while also compatible with IFRS and meeting the needs of the Corporate sector. The implementation of converged accounting standards with IFRS will go on as per schedule.

PRESS RELEASE 0-8/2010,

No. 1/1/2009-IFRS, dated the 4th November, 2010,

Ministry of Corporate Affairs

The Press Information Officer, Press Information Bureau, Ministry of Information and Broadcasting, with the request that the above mentioned Press Note may be given wide publicity.

A4. *Notification* – Companies (Amendment) Regulations, 2010 – Notification No. GSR886(E), dated 29.10.2010

In exercise of the powers conferred by sub-sections (1), (2), (5) and (8) of Section 25 and sub-section (2) of Section 609 of the Companies Act, 1956 (1 of 1956), the Central Government hereby makes the following regulations further to amend the Companies Regulations, 1956, namely :—

1. (1) These Regulations may be called the Companies (Amendment) Regulations, 2010.

(2) They shall come into force on the date of their publication in the Official Gazette.

2. In the Companies Regulations, 1956, regulation 2, for clause (*d*), the following clause shall be substituted, namely:—

"(*d*) "Regional Director" means the person appointed by the Central Government in the Ministry of Corporate Affairs as a Regional Director for the respective regions as under:-

(1)	(2)	(3)
(*i*) Regional Director	North Region Directorate Headquarter at Noida (Gautam Budh Nagar)	States of Jammu and Kashmir, Punjab, Himachal Pradesh, Haryana, National Capital Territory of Delhi, Uttar Pradesh, Uttarakhand and Union Territory of Chandigarh.

(*ii*) Regional Director	Southern Region Directorate Headquarter at Chennai	States of Andhra Pradesh, Karnataka, Tamil Nadu, Kerala and Union Territory of Lakshadweep, Union Territory of Andaman and Nicobar Islands and Puducherry.
(*iii*) Regional Director	Eastern Region Directorate Headquarter at Kolkata	States of Bihar, Jharkhand, Orissa, West Bengal.
(*iv*) Regional Director	Western Region Directorate Headquarter at Mumbai	States of Maharashtra, Goa and Union Territory of Dadra and Nagar Haveli and Daman and Diu.
(*v*) Regional Director	North Western Region Directorate Headquarter at Ahmedabad	States of Gujarat, Rajasthan, Madhya Pradesh and Chattisgarh.
(*vi*) Regional Director	North Eastern Region Directorate Headquarter at Guwahati	States of Meghalaya, Assam, Arunachal Pradesh, Nagaland, Mizoram, Manipur and Tripura."

A5. *Notification* – Competition Commission of India (General) Amendment Regulations, 2010 – No. L-3(2)/Regln-Gen.(Amdt)/2009-10/CCI, dated 20.10.2010

In exercise of the powers conferred by Section 64 of the Competition Act, 2002 (12 of 2003), the Competition Commission of India hereby makes the following regulations further to amend the Competition Commission of India (General) Regulations, 2009, namely:—

1. (1) These regulations may be called the Competition Commission of India (General) Amendment Regulations, 2010.

(2) They shall come into force on the date of their publication in the Official Gazette.

2. In the Competition Commission of India (General) Regulations, 2009,—
(1) in regulation 18, in sub-regulation (1),—

(*a*) after the words "the directions of the Commission", the words "within seven days," shall be inserted;

(*b*) the words "and furnish a report to the Commission on or before the date specified therein" shall be omitted;

(2) in regulation 20, in sub-regulation (2),—

(*i*) (*a*) for the words "as is reasonable", the words as may be specified by the Commission which ordinarily shall not exceed sixty days from the date of receipt of the directions of the Commission" shall be substituted;

(*b*) the words "to collect relevant data, record statements, afford opportunity for cross examination of witnesses and to carry out other necessary analysis in the circumstances of the particular case" shall be omitted;

(*ii*) in sub-regulation (3),—

(*a*) after the words "Director General", the words "giving sufficient reasons," shall be inserted;

(*b*) after the words "extend the time for submission of the report", the words "by such period as it may consider reasonable" shall be inserted;

(*iii*) in sub-regulation (6), for the words "a reasonable time to be specified in its direction", the words "such time as may be specified by the Commission but ordinarily not later than forty-five days" shall be substituted;

(3) in regulation 21,—

(*i*) in sub-regulation (1), after the words "before the Commission", the words "within seven days," shall be inserted;

(*ii*) in sub-regulation (2),—

(*a*) after the words "the Secretary shall", the words ", within seven days," shall be inserted;

(*b*) after the words "inviting objections or suggestions", the words ", to be filed within fifteen days," shall be inserted;

(*iii*) in sub-regulation (4), after the words "the Secretary shall", the words ", within seven days," shall be inserted;

(*iv*) in sub-regulation (6), for the words "fix the meeting of the Commission for the consideration thereof, the words ", with the approval of the Chairperson, fix the meeting of the Commission within seven days for consideration thereof shall be substituted.

(4) in regulation 31, after sub-regulation (2), the following sub-regulation shall be inserted, namely:—

"(3) Where in a case an interim order under Section 33 of the Act has been passed, a final order, as far as possible, shall be passed by the Commission, within ninety days from the date of interim order".

A6. *Notification* – Companies (Director Identification Number) Rules 2006, (Amendment), 2010 to be effective from 05.12.2010

– No. GSR849(E), dated 15.10.2010

In exercise of the powers conferred by clauses (*a*) and (*b*) of sub-section (1) of Section 642 read with Sections 266A, 266B and 266E of the Companies Act, 1956 (1 of 1956) the Central Government hereby makes the following rules further to amend the Companies (Director Identification Number) Rules 2006, namely:—

1. (1) These rules may be called the Companies (Director Identification Number) Rules 2006, (Amendment), 2010.

(2) These rules shall come into force on the 5th day of December, 2010.

2. In the Companies (Director Identification Number) Rules 2006,—

(*i*) in Form DIN-1, in the declaration, at the bottom of serial number 14, the following declarations shall be inserted namely:—

"*I also confirm that I am not restrained/disqualified/removed of, for being appointed as Director of a company under the provisions of the Companies Act, 1956 including Sections 203, 274 and 388E of the said Act.

* I further confirm that I have not been declared as proclaimed offender by any Economic Offence Court or Judicial Magistrate Court or High Court or any other Court".

(*ii*) in Form DIN-3, under Verification, the following Verifications shall be added namely:—

"It is hereby confirmed that the appointed Directors) whose particulars are given above, has given declaration to the company that he/she is not restrained/disqualified/removed of, for being appointed as Director of a company under the provisions of the Companies Act, 1956 including Sections 203, 274 and 388E of the said Act.

It is also confirmed that the appointed Director(s) whose particulars are given above, has given a declaration to the company that he/she has not been declared as proclaimed offender by any Economic Offence Court or Judicial Magistrate Court or High Court or any other Court".

A7. *Notification* – Companies (Central Government's) General Rules and Forms (Third Amendment), 2010 to be effective from 05.12.2010 – No. GSR848(E), dated 15.10.2010

In exercise of the powers conferred by sub-section (1) of Section 642 read with Section 610B of the Companies Act, 1956, the Central Government hereby makes the following rules further to amend the Companies (Central Government's) General Rules and Forms, 1956, namely:—

1. (1) These rules may be called the Companies (Central Government's) General Rules and Forms (Third Amendment), 2010.

(2) These rules shall come into force on the 5th day of December, 2010.

2. In the Companies (Central Government's) General Rules and Forms, 1956, in Annexurer 'A',—

(*i*) in Form No. 1,—

(*a*) in serial number 8, under the heading, Particulars of Promoters (first subscribers to the MOA), at the bottom after the entry Name of the company, the following shall be inserted, namely:—

"Whether the subscriber has been convicted by any court for any offence involving moral turpitude or economic or criminal offences or for any offences in connection with the promotion, formation or management of a company Yes NO If yes, provide details."

(*b*) in Declaration, after serial number (*vi*), the following Declarations as serial numbers (*vii* and *viii*) shall be inserted, namely:—

"(*vii*) That the subscribers have given declaration of details of his/her conviction by any court for any offences involving moral turpitude or economic or criminal offence or for any offences in connection with the promotion, formation or management of a company;

(*viii*) That the subscribers have given declaration that he/she has not been declared as proclaimed offender by any Economic Offence Court or Judicial Magistrate Court or High Court or any other Court."

(*ii*) In form No. 32,—

(*a*) in Verification I, after serial number 3, the following Verification as serial number 4, shall be inserted namely:—

"4. It is also confirmed that the appointed directors) whose particulars are given above, has given a declaration to the company that he/she has not been declared as proclaimed offender by any Economic Offence Court or Judicial Magistrate Court or High Court or any other Court."

B. IMPORTANT CASE

Arrangement

Sections 391 and 394 of the Companies Act, 1956

Chaturanan Industries Limited v.
Kamdhenu Enterprises Limited (Delhi High Court)
Decided on 29.10.2010, MANU/DE/2857/2010

THE TRANSFEROR COMPANY SINCE DOES NOT HAVE SECURED CREDITOR NO MEETING OF THE SECURED CREDIT REQUIRED TO BE HELD.

Facts: Present petition under Sections 391 and 394 of the Companies Act, 1956 is filed for sanction of the scheme of arrangement filed by the transferor company Nos. 1 and 2 respectively and the transferee company. Along with the application, the three companies have enclosed copy of the Resolutions passed by the Board of Directors approving the scheme of arrangement. Also, the two transferor companies and the transferee company have filed their audit report and profit and loss accounts for the year ending 31^{st} March, 2010.

Issues: Whether meeting of the secured creditor is required to be held for sanctioning the scheme of arrangement ?

Holding: The transferor company No. 1 and the transferee company are public limited listed companies and meetings of their shareholders are required to be held. The transferor company No. 2 has 16 shareholders, which have given their consent/no objection certificates, thus the meetings of the shareholders of the transferor company No. 2 are dispensed with. Chairman and Alternate Chairman of the meetings were appointed which will ensure that the notices to the shareholders are sent under certificate of posting in their presence at the respective post offices. The minimum coram for the meeting of the shareholders of the transferor company No. 1 and the transferee company will be 10 in number and 25 per cent in value terms. The transferor company No. 1 and transferor company No. 2 do not have any secured creditor and, therefore, no meeting of the secured creditor is required to be held. No proceedings under Sections 235 to 251 of the Companies Act, 1956, are pending against the two transferor companies and the transferee company. The share exchange ratio is not being examined at this stage and will be examined at the time of second motion.

SECURITIES LAWS

A. STATUTES

A1. *Circular* – Clarification on Trading Rules and shareholding in dematerialized mode – No. SEBI/Cir/ISD/2/2010, dated 26.10.2010

1. This is further to SEBI circular SEBI/Cir/ISD/1/2010 dated September 02, 2010 regarding Trading Rules and shareholding in dematerialized mode.

2. It is clarified that while computing the requirement of minimum 50% shareholding of non- promoters in demat form in a company, the government holding in non promoter category may be excluded.

3. The Stock Exchanges are advised to:

- put in place the adequate systems and issue the necessary guidelines for implementing the above decision.
- make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision immediately.
- bring the provisions of this circular to the notice of the member brokers of the Exchange and also to disseminate the same on the website.
- communicate to SEBI, the status of the implementation of the provisions of this circular in the Monthly Development Report.

4. This circular is issued in exercise of powers conferred by sub-section (1) of Section 11 of the Securities and Exchange Board of India Act, 1992, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

5. This circular is available on SEBI website at www.sebi.gov.in

A2. *Circular* – Auction of Government of India Dated Securities – No. IDMD/2314/08.02.033/2010-11, dated 15.11.2010

Government of India have offered to sell (re-issue) of (*a*) "7.17 percent Government Stock 2015 " for a notified amount of Rs.4,000 crore (nominal) through a price based auction using uniform price method vide Notification No.4(3)-W&M/2010 dated November 15, 2010 (*b*) "8.08 percent Government Stock 2022" or a notified amount of Rs. 4,000 crore (nominal) through a price based auction using uniform price method vide Notification No.4(3)-W&M/2010(*i*) dated November 15, 2010 and (*c*) "8.26 percent Government Stock 2027" for a notified amount of Rs. 3,000 crore (nominal) through a price based auction using uniform price method vide Notification No.4(3)-W&M/2010(*ii*) dated November 15, 2010. The Reserve Bank of India at Mumbai will conduct the auctions on November 19, 2010. The salient features of the auctions and the terms and conditions governing the issue of the Stocks are given in the Notifications (copies enclosed), which should be read along with the General Notification F. No. 4 (13)-W&M/2008, dated October 8, 2008 issued by Government of India.

2. We wish to draw your attention, in particular, to the following:

(*i*) The Stocks will be issued for a minimum amount of Rs.10,000/- (nominal) and in multiples of Rs.10,000/- thereafter.

(*ii*) In all the auctions, Government Stock up to 5% of the notified amount of sale will be allotted to the eligible individuals and institutions under the Scheme for Non-competitive Bidding Facility in the Auctions of Government Securities (enclosed with the notifications F. No.4 (3)-W&M/2010, F. No.4 (3)-W&M/2010(*i*) and F. No.4 (3)-W&M/2010(*ii*) all dated November 15, 2010). Each bank or PD on the basis of firm orders received from their constituents will submit a single consolidated non-competitive bid on behalf of all its constituents in electronic format on the Negotiated Dealing System (NDS). Allotment under the non-competitive segment to the bank or PD will be at the cut-off price that will emerge in the auction on the basis of the competitive bidding.

(*iii*) Both competitive and non-competitive bids for the auction should be submitted in electronic format on the Negotiated Dealing System (NDS) on November 19, 2010. Bids in physical form will not be accepted except in extraordinary circumstances such as general failure of the NDS system. The non-competitive bids should be submitted between 10.30 a.m. and 11.30 a.m. and the competitive bids should be submitted between 10.30 a.m. and 12.30 p.m.

(*iv*) An investor can submit more than one competitive bid at different prices in electronic format on the Negotiated Dealing System (NDS). However, the aggregate amount of bids submitted by a person in an auction should not exceed the notified amount of auction.

(*v*) On the basis of bids received, the Reserve Bank will determine the minimum price up to which tenders for purchase of Government Stock will be accepted at the auctions. Bids quoted at rates lower than the minimum price determined by the Reserve Bank of India will be rejected. Reserve Bank of India will have the full discretion to accept or reject any or all bids either wholly or partially without assigning any reason.

(*vi*) The result of the auctions will be announced on November 19, 2010 and payment by successful bidders will be on November 22, 2010 (Monday).

(*vii*) The Government Stocks will be issued by credit to Subsidiary General Ledger Account (SGL) of parties maintaining such account with Reserve Bank of India or in the form of Stock Certificate. Interest on the Government Stock will be paid half-yearly.

(*viii*) The Government Stocks will be repaid at par on June 14, 2015, August 2, 2022 and August 2, 2027 respectively.

(*ix*) The Stocks will qualify for the ready forward facility.

(*x*) The Stock will be eligible for “When Issued” trading during the period November 16-19, 2010 in accordance with the guidelines on ‘When Issued’ transactions in Central Government Securities’ issued by the Reserve Bank of India vide circular No. RBI/2006-07/178 dated November 16, 2006 as amended from time to time.

A3. *Circular* – Enhancement of the exposure limits of the standalone Primary Dealers (PDs) to facilitate market making activities in corporate bonds – No. IDMD. PCD.No. 1652/14.03.05/2010-11, dated 11.11.2010

Please refer to our circular IDMD.PDRD.No.19/03.64.00/2010-11 RBI/2010-11/142 dated July 27,2010 wherein standalone Primary Dealers (PDs) were advised to adhere to the exposure limits prescribed in paragraph 18 of the Notification DNBS.193 DG(VL)-2007 dated February 22 , 2007 updated till June 30, 2010 and issued vide the circular RBI/2010-11/18 DNBS (PD) CC No.178/03.02.001/2010-11 dated July 1, 2010 on Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

2. The matter has since been reviewed in the context of the need to further facilitate market making activities of the standalone PDs in corporate bonds. Accordingly, it has been decided to enhance the exposure limits of the standalone PDs from 15 per cent to 25 per cent of their NOF to single borrower and from 25 per cent to 40 per cent of their NOF to group borrowers.

3. The above guidelines are effective from the date of the circular.

A4. *Circular* – Modification to Repo in Corporate Debt Securities (Amendment) Directions 2010 to be effective from 01.12. 2010 – No. IDMD.PCD. 22/11.08.38/2010-11, dated 09.11.2010

As part of the measures to develop the corporate bond market, repo transactions were permitted in corporate debt securities vide the Directions issued through the Notification No IDMD.DOD. 04/11.08.38/2009-10 dated January 8, 2010.

2. As announced in the Second Quarter Review of the Monetary Policy 2010-11 (paragraph 70), the Directions have been reviewed taking into consideration the market feedback and it has been decided as under:

- The repo trades in corporate debt securities are permitted to be settled on T+0 basis in addition to the existing T+1 and T+2 basis under DvP I (gross basis) framework.
- The minimum haircut, applicable on the market value of the corporate debt securities prevailing on the date of trade of 1st leg, which was earlier stipulated as 25 per cent, has been revised as under:

Rating	AAA	AA+	AA
Minimum haircut	10 %	12%	15%

The above haircuts are minimum stipulated haircuts where the repo period is overnight or where the remargining frequency (in case of longer tenor repos) is daily. In all other cases, the participants may adopt appropriate higher haircuts.

The Directions (Repo in Corporate Debt Securities (Amendment) Directions 2010) issued in this regard vide IDMD.PCD.21/11.08.38/2010-11 dated November 9, 2010 are enclosed. The modifications will be effective from December 1, 2010.

Reserve Bank of India, Internal Debt Management Department, 23rd Floor Central Office, Fort Mumbai 400 001,

Mumbai, November 09, 2010

Repo in Corporate Debt Securities (Amendment) Directions, 2010

In exercise of the powers conferred by Section 45 W of the Reserve Bank of India Act, 1934 and in partial modification of the notification No IDMD.DOD. 04/11.08.38/2009-10 dated January 8, 2010, the Reserve Bank hereby makes the following amendments in the Repo in Corporate Debt Securities (Reserve Bank) Directions, 2010 dated 8th January 2010 (hereinafter referred to as the said Directions) namely:

2. (*i*) In Paragraph 8 of the said Directions, for sub paragraph (*a*) the following shall be substituted:

"(*a*) All repo trades in corporate debt securities shall settle on a T+0 or T+1 or T+2 basis under DvP I (gross basis) framework"

(*ii*) In Paragraph 10 of the said Directions, for sub paragraph (*a*) the following shall be substituted:

"(*a*) A rating based haircut as under (or higher as maybe decided by the participants depending on the term of the repo and the remargining frequency) shall be applicable on the market value of the corporate debt security prevailing on the date of trade of 1st leg."

Rating	AAA	AA+	AA
Minimum haircut	10 %	12%	15%

3. These Directions may be referred to as the Repo in Corporate Debt Securities (Amendment) Directions 2010 and the modifications made therein shall be effective from December 01, 2010

A5. *Circular* – Repo in Corporate Debt Securities (Amendment) Directions, 2010 – No. IDMD.PCD 21/11.08.38/2010-11, dated 09.11.2010

In exercise of the powers conferred by Section 45 W of the Reserve Bank of India Act, 1934 and in partial modification of the notification No IDMD.DOD. 04/11.08.38/2009-10 dated January 8, 2010, the Reserve Bank hereby makes the following amendments in the Repo in Corporate Debt Securities (Reserve Bank) Directions, 2010 dated 8th January 2010 (hereinafter referred to as the said Directions) namely:

2. (*i*) In Paragraph 8 of the said Directions, for sub paragraph (*a*) the following shall be substituted:

"(*a*) All repo trades in corporate debt securities shall settle on a T+0 or T+1 or T+2 basis under DvP I (gross basis) framework"

(*ii*) In Paragraph 10 of the said Directions, for sub paragraph (*a*) the following shall be substituted:

"(*a*) A rating based haircut as under (or higher as maybe decided by the participants depending on the term of the repo and the remargining frequency) shall be applicable on the market value of the corporate debt security prevailing on the date of trade of 1st leg."

Rating	AAA	AA+	AA
Minimum haircut	10 %	12%	15%

3. These Directions may be referred to as the Repo in Corporate Debt Securities (Amendment) Directions 2010 and the modifications made therein shall be effective from December 01, 2010

A6. *Circular* – Auction of interest – bearing Government Stock having different maturities – No. IDMD/2208/08.02.033/2010-11, dated 08.11.2010

Government of India have offered to sell (re-issue) of (*a*) "7.99 percent Government Stock 2017" for a notified amount of Rs.4,000 crore (nominal) through a price based auction using uniform price method vide Notification No.4(3)-W&M/2010 dated November 8, 2010, (*b*) "7.80 percent Government Stock 2020 "for a notified amount of Rs 4,000 crore (nominal) through a price based auction using uniform price method vide Notification No.4(3)-W&M/2010(*i*) dated November 8, 2010 and (*c*) "8.30 percent Government Stock 2040" for a notified amount of Rs.3,000 crore (nominal) through a price based auction using uniform price method vide Notification No.4(3)-W&M/2010(*ii*) dated November 8, 2010. The Reserve Bank of India at Mumbai will conduct the auctions on November 12, 2010. The salient features of the auctions and the terms and conditions governing the issue of the Stocks are given in the Notifications (copies enclosed), which should be read along with the General Notification F. No. 4 (13)-W&M/2008, dated October 8, 2008 issued by Government of India.

2. We wish to draw your attention, in particular, to the following:

i. The Stocks will be issued for a minimum amount of Rs.10,000/- (nominal) and in multiples of Rs.10,000/- thereafter.

ii. In all the auctions, Government Stock up to 5% of the notified amount of sale will be allotted to the eligible individuals and institutions under the Scheme for Non-competitive Bidding Facility in the Auctions of Government Securities (enclosed with the notifications F. No.4 (3)-W&M/2010, F. No.4 (3)-W&M/2010(*i*) and F. No.4 (3)-W&M/2010(*ii*) all dated November 8, 2010). Each bank or PD on the basis of firm orders received from their constituents will submit a single consolidated non-competitive bid on behalf of all its constituents in electronic format on the Negotiated

Dealing System (NDS). Allotment under the non-competitive segment to the bank or PD will be at the cut-off price that will emerge in the auction on the basis of the competitive bidding.

iii. Both competitive and non-competitive bids for the auction should be submitted in electronic format on the Negotiated Dealing System (NDS) on November 12, 2010. Bids in physical form will not be accepted except in extraordinary circumstances such as general failure of the NDS system. The non-competitive bids should be submitted between 10.30 a.m. and 11.30 a.m. and the competitive bids should be submitted between 10.30 a.m. and 12.30 p.m.

iv. An investor can submit more than one competitive bids at different prices in electronic format on the Negotiated Dealing System (NDS). However, the aggregate amount of bids submitted by a person in an auction should not exceed the notified amount of auction.

v. On the basis of bids received, the Reserve Bank will determine the minimum price up to which tenders for purchase of Government Stock will be accepted at the auctions. Bids quoted at rates lower than the minimum price determined by the Reserve Bank of India will be rejected. Reserve Bank of India will have the full discretion to accept or reject any or all bids either wholly or partially without assigning any reason.

vi. The result of the auctions will be announced on November 12, 2010 and payment by successful bidders will be on November 15, 2010 (Monday).

vii. The Government Stocks will be issued by credit to Subsidiary General Ledger Account (SGL) of parties maintaining such account with Reserve Bank of India or in the form of Stock Certificate. Interest on the Government Stock will be paid half-yearly.

viii. The Government Stocks will be repaid at par on July 09, 2017, May 3, 2020 and July 2, 2040 respectively.

ix. The Stocks will qualify for the ready forward facility.

x. The Stock will be eligible for “When Issued” trading during the period November 9-12, 2010 in accordance with the guidelines on ‘When Issued’ transactions in Central Government Securities’ issued by the Reserve Bank of India vide circular No. RBI/2006-07/178 dated November 16, 2006 as amended from time to time.

A7. *Circular* –Display of details of Stock Brokers should be prominent as registered with SEBI or using the brand names/ logos of group companies – No. Cir/MIRSD/9/2010, dated 04.11.2010

1. It is observed that a few stock brokers are using brand names/logos of their group companies in their portals, notice/display boards, advertisements, publications, correspondences with outsiders and various documents. They are either not using the names as registered with SEBI or using the brand names/logos of group companies more prominently. This creates confusion in the minds of the investors in the market.

2. In consultation with the Investors Associations and major stock exchanges, it has been decided that while a stock broker may use the brand name/logo of its group companies, it must display more prominently:

(*a*) its name as registered with SEBI, its own logo, if any, its registration number, and its complete address with telephone numbers in its portal/ web site, if any, notice/display boards, advertisements, publications, know your client forms, and member client agreements;

(*b*) its name as registered with SEBI, its own logo, if any, its registration number, and its complete address with telephone numbers, the name of the compliance officer, his telephone number and e-mail address in contract notes, statement of funds and securities, and correspondences with the clients.

3. The stock exchanges are directed to bring this to the notice of their members and make necessary amendments to the bye-laws, rules and regulations to implement the above decision. They shall include the compliance of the said circular as part of their inspection and internal audit by stock brokers. They shall also monitor compliance of this circular by stock brokers and send annually a list of stock brokers who have not complied with the circular, while sending report on internal audit of the stock brokers.

4. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

5. This circular shall come into force from the date of this circular.

6. The circular is available on the SEBI website at www.sebi.gov.in under the category 'Legal Framework'.

A8. *Circular* – Code of Conduct for Investor Associations (IAs) – No. Cir/OIAE/IAD/01/2010, dated 01.11.2010

1. In consultation with SEBI recognised Investor Associations, it has been decided that they shall abide by the enclosed code of conduct. It has also been decided that every SEBI recognised Investor Association shall submit a letter of compliance with this code of conduct every year in the first week of April for the preceding financial year and also along with the application for renewal of recognition.

2. A copy the circular is made available on the investor website, www.investor.sebi.gov.in.

3. This circular has been issued in exercise of powers conferred under section 11(1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

A9. *Circular* – Auction of interest – bearing Government Stock having different maturities – No. IDMD/2133/08.02.033/2010-11, dated 01.11.2010

Government of India have offered to sell (re-issue) of (*a*) "7.17 percent Government Stock 2015" for a notified amount of Rs.4,000 crore (nominal) through a price based auction using uniform price method vide Notification No.4(3)-W&M/2010 dated November 1, 2010 (*b*) "8.13 percent Government Stock 2022" or a notified amount of Rs. 5,000 crore (nominal) through a price based auction using uniform price method vide Notification No.4(3)-W&M/2010(*i*) dated November 1, 2010 and (*c*) "8.26 percent Government Stock 2027" for a notified amount of Rs. 2,000 crore (nominal) through a price based auction using uniform price method vide Notification No.4(3)-W&M/2010(*ii*) dated November 1, 2010. The Reserve Bank of India at Mumbai will conduct the auctions on November 4, 2010. The salient features of the auctions and the terms and conditions governing the issue of the Stocks are given in the Notifications (copies enclosed), which should be read along with the General Notification F. No. 4 (13)-W&M/2008, dated October 8, 2008 issued by Government of India.

2. We wish to draw your attention, in particular, to the following:

i. The Stocks will be issued for a minimum amount of Rs.10,000/- (nominal) and in multiples of Rs.10,000/- thereafter.

ii. In all the auctions, Government Stock up to 5% of the notified amount of sale will be allotted to the eligible individuals and institutions under the Scheme for Non-competitive Bidding Facility in the Auctions of Government Securities (enclosed with the notifications F. No.4 (3)-W&M/2010, F. No.4 (3)-W&M/2010(*i*) and F. No.4 (3)-W&M/2010(*ii*) all dated November 1, 2010). Each bank or PD on the basis of firm orders received from their constituents will submit a single consolidated non-competitive bid on behalf of all its constituents in electronic format on the Negotiated Dealing System (NDS). Allotment under the non-competitive segment to the bank or PD will be at the cut-off price that will emerge in the auction on the basis of the competitive bidding.

iii. Both competitive and non-competitive bids for the auction should be submitted in electronic format on the Negotiated Dealing System (NDS) on November 4, 2010. Bids in physical form will not be accepted except in extraordinary circumstances such as general failure of the NDS system. The non-competitive bids should be submitted between 10.30 a.m. and 11.30 a.m. and the competitive bids should be submitted between 10.30 a.m. and 12.30 p.m.

iv. An investor can submit more than one competitive bid at different prices in electronic format on the Negotiated Dealing System (NDS). However, the aggregate amount of bids submitted by a person in an auction should not exceed the notified amount of auction.

v. On the basis of bids received, the Reserve Bank will determine the minimum price up to which tenders for purchase of Government Stock will be accepted at the auctions. Bids quoted at rates lower than the minimum price determined by the Reserve Bank of India will be rejected. Reserve Bank of India will have the full discretion to accept or reject any or all bids either wholly or partially without assigning any reason.

vi. The result of the auctions will be announced on November 4, 2010 and payment by successful bidders will be on November 8, 2010 (Monday).

vii. The Government Stocks will be issued by credit to Subsidiary General Ledger Account (SGL) of parties maintaining such account with Reserve Bank of India or in the form of Stock Certificate. Interest on the Government Stock will be paid half-yearly.

viii. The Government Stocks will be repaid at par on June 14, 2015, September 21, 2022 and August 2, 2027 respectively.

ix. The Stocks will qualify for the ready forward facility.

x. The Stock will be eligible for "When Issued" trading during the period November 2-4, 2010 in accordance with the guidelines on 'When Issued' transactions in Central Government Securities' issued by the Reserve Bank of India vide circular No. RBI/2006-07/178 dated November 16, 2006 as amended from time to time.

INSURANCE LAW

A. STATUTES

A1. *Circular* – Date of grant of 'certificate of registration' in Form IRDA/R3 under IRDA (Registration of Indian Insurance Companies) Regulations, 2000 to be the relevant date for the purpose of computing the first year of commencement of business
– No. IRDA/F&I/CIR/EMT/183/11/2010, dated 18.11.2010

Section 40A of the Insurance Act, 1938 (the Act) lays down the permissible limits for payment of commission or remuneration, in any form, in respect to any policy of life insurance issued in India by an insurer and effected through an insurance agent, in various lines/segments of life insurance business. The proviso to the said section permits life insurers, in the first ten years of business, to pay forty per cent of the first year's premium payable on the policy, towards commission.

2. In the light of the fact that a few life insurance companies are completing ten years of business in the current financial year, it is necessary to clarify the exact relevant date to be reckoned for the purpose.

3. It is hereby, clarified that the date of grant of 'certificate of registration' in Form IRDA/R3 under IRDA (Registration of Indian Insurance Companies) Regulations, 2000, by IRDA shall be the relevant date for the purpose of computing the first year of commencement of business.

4. All life Insurers are directed to take note and ensure compliance.

A2. *Circular* – Additional stipulations issued for compliance to Anti Money Laundering/Counter-Financing of Terrorism (AML/CFT) Guidelines – No. IRDA/F&I/CIR/AML/180/11/2010, dated 12.11.2010

The Authority has reviewed the AML/CFT guidelines to align certain stipulations with that of the 40 +9 Recommendations of the Financial Action Task Force (FATF). Accordingly, the following additional stipulations/ clarifications are issued for compliance:

Sl. No.	*Clause Ref. in Master Circular 2010 on AML/ CFT guidelines*	*Stipulation/Clarification*
i.	Clause 3.1.1	While implementing the KYC norms on legal persons insurers will have to identify and verify their legal status through various documents (indicated, but not limited to, at Annexure I of the guidelines), to be collected in support of • The name, legal form, proof of existence, • Powers that regulate and bind the legal persons, • Address of the registered office/main place of business • The natural persons who have a controlling interest and comprise the mind and management of the legal persons.Systems/processes laid down to meet this requirement may be based on risk perception on the entity (Eg., in case of a public limited company verification and identification of shareholders of that company is not called for)
ii.	Clause 3.1.2 (*i*)(*b*)	Insurers shall pay special attention to money laundering threats that may arise from • Development of new products • New business practices including new delivery mechanisms • Use of new or developing technologies for both new and pre-existing products. Special attention should especially, be paid to the non-face-to-face business relationships brought into effect through these methods. Insurer should lay down systems to prevent their misuse in money laundering schemes. Safeguards will have to be built to manage typical risks associated in these methods like • Ease of access to the facility; • Speed of electronic transactions; • Ease of making multiple fictitious applications without incurring extra cost or the risk of detection; • Absence of physical documents; etc., The extent of verification in respect of such non face-to-face customers will depend on the risk profile of the product and that of the customer.Insurers shall have in place procedures to manage specific increased risks associated with such

		relationships e.g., verification of details of the customer through on-site visits etc.,
iii.	Clause 3.1.3 (*ii*)	Insurers are directed to lay down appropriate on-going risk management procedures for identifying and applying enhanced due diligence measures to PEPs, customers who are close relatives of PEPs. These measures are also to be applied to insurance contracts of which a PEP is the ultimate beneficial owner. If the on-going risk management procedures indicate that the customer or beneficial owner is found to be, or subsequently becomes a PEP, insurers shall obtain senior management approval on this business relationship.
IV.	Clause 3.1.4 (*iv*)	Insurers are directed to apply the AML/CFT requirements effective from 1st January 2011, even in case of 'term life insurance contracts' hitherto exempt from the AML/CFT requirements.For the purposes of risk categorization, however, they may be considered as low risk products, unless the details indicate otherwise.
V.	Clause 3.3 (*iv*)	It is hereby clarified that 'freezing of insurance contracts' would require not-permitting any transaction (financial or otherwise), against the specific contract in question.

2. This circular is being issued in terms of powers under section 14(*l*)(*e*) of the Insurance Regulatory and Development Authority Act, 1999.

3. Insurers shall revise their AML/CFT program in accordance with the above stipulations at the earliest and file a revised Board approved AML/CFT program with the Authority, in any case, not later than 31st December 2010

A3. *Circular* – User manual guide designed for entire process of registration of a Referral Company – No. IRDA/L1FE/CIR/REF/179/11/2010, dated 11.11.2010

The process of seeking grant of approval of Referral Company is stipulated in Regulation 3 of Chapter II of the Regulations. In order to streamline the process and enable better control, a portal has been designed wherein the insurers need to key in the data prior to sending the application for grant of approval of the Referral Company. After uploading the information sought on the portal, you may print Form-A and send the same along with the supporting documents as mentioned in Schedule-I of Form A of the Regulation.

The Entire process of registration of a referral company has been divided in to two stages viz., Application Stage and Agreement stage. User manual which will guide the insurers in this process is placed as an Annexure. This process should be completed by the Compliance Officer who is designated under Regulation 15 of the Regulations. Members' Login and passwords would be communicated to the compliance officers separately. Please note that the insurers who had sent applications earlier also need to upload their data on the Portal and send the hard copies of Form-A generated by it.

A4. *Circular* – "Current liabilities" of the Balance Sheet to be disclosed as a separate line in Schedule 13 for unclaimed Amount of Policyholders – No. IRDA/F&I/CIR/CMP/174/11/2010, dated 04.11.2010

It has been noticed by the Authority that the quantum of the amount lying unclaimed by the policyholders/insureds is accumulating on year on year basis. The unclaimed amounts of the policyholders/Insureds may be on the following account

a. claims settled but not paid to the policyholders/insureds due to any reasons except under litigation from the insured/policyholders

b. sum due to the insured/policyholders on maturity or otherwise

c. Any excess collection of the premium/tax or any other charges which is refundable to the policyholders either as terms of conditions of the policy or as per law or as may be directed by the Authority but not refunded so far

d. Cheques issued by the Insurer for settlement under "A", "B" or "C" above and cheques have not been encashed by the policyholders/insured

Presently, the unclaimed amount is not being disclosed separately. In view of the same, all the insurers are hereby advised that the amount representing the unclaimed sum shall be disclosed as a separate line item in Schedule 13- "current liabilities" of the Balance Sheet. Further, its age-wise analysis will also be disclosed in the enclosed format.

It is further advised that such unclaimed sum will not be appropriated/ written back, in any circumstance, by the insurers.

This circular is issued with the approval of the competent Authority and comes into effect immediately.

A5. *Circular* – Revision of 'Expenses of Management' (EOM) under section 40C of the Insurance Act, 1938 where clarification provided to facilitate uniform approach by all companies – No. IRDA/F&I/CIR/EMT/169/10/2010, dated 22.10.2010

A detailed review of the various elements of the 'Expenses of Management' (EOM) reckoned by non-life insurers for compliance with section 40C of the Insurance Act, 1938 read with Rule 17E of the Insurance Rules 1939 undertaken by the Authority recently has indicated that there are divergent practices in the presentation of details and interpretation of the applicable provisions among the insurers.

2. The issues have been examined and the following clarifications are provided to facilitate a uniform approach by all companies:

Sl. No.	*Proviso reference*	*Particulars*	*Clarification*

1	Rule 17E(3)(*i*) to 17E(3) (*ii*)	Interest earned on paid up capital	It should be based on: a) Yearly mean yield on the interest yielding investments (excluding equity, real estate etc.,) during the year applied on the mean equity capital.Equity capital for this purpose includes: • Share Premium; Reserves & Surplus, shareholders portion of credit balance in Fair Value Change Accountnet of • Debit balances in the Profit and Loss Account, • debit balance in Fair Value Change Account and • Preliminary expenses, if any.b) Profit on sale of investments/ loss on sale of investments should be excluded for the purpose of computation of investment income
2	Explanation (*b*) to section 40C	'Charges' to be included.	All charges levied directly or indirectly in respect of the insurance business but excluding taxes which are charge against profits e.g. income tax, wealth tax. The other taxes like Service Tax borne by the insurer, Fringe Benefit Tax, which are not charge against profits should however, not be excluded.
3	Explanation (*b*)(*iii*) to section 40C of the Insurance Act, 1938	Expenses that can be excluded for the purposes of 'expenses of	Only expenses debited to profit and loss account relating exclusively to the 'management of capital'; 'dealings with shareholders' and a proper share of management'. managerial expenses calculated in such manner as prescribed in Rule 17-FB alone can be excluded for the purpose of EOM. Expenses towards: (*i*) 'Management of Capital' includes fees for increasing authorized capital, issue expense, underwriting fees (if any,), lead managers' fee etc. and expense incurred towards managing capital which includes employee cost involved in the activities of investment of capital, relevant bank charges, demat charges etc. (*ii*) 'Dealings with shareholders' includes expenses for calling and holding meetings of shareholders,

			secretarial expenses, stamp duty incurred in increase/decrease of capital etc., (*iii*) Proper share of managerial expenses to be deducted (Y) shall be computed as under: (15% of C)/P=X Y=R * X Where, C is the Paid-up Capital of the Insurer, P is the gross premium written direct in India, X is the proportion of 15% of C and P R is the total Remuneration of Chief Executive Officer of the insurer (by whatever name called) Y is the deductible proportion of total remuneration received by the Chief Executive Officer of the insurer.

3. The statement of the management expense should be signed by the Managing Director/CEO and certified by at least one of the Statutory Auditors of the insurer.

4. Statement of 'Expenses of Management' shall be submitted annually in the format prescribed at Annexure along with a copy of Annual Report of the insurer submitted to the Authority as advised in IRDA circular Ref: IRDA/F&A/013/2005-06 dated June 9, 2005.

5. This circular is effective from the financial year 2010-11.

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Banks and NBFCs

A. STATUTES

A1. *Circular* – Exclusion of "The Bank of Rajasthan Limited" from the Second Schedule to the Reserve Bank of India Act, 1934 – No. DBOD.Ret..BC. No. 62/12.06.031/2010-11, dated 15.11.2010

We advise that the name of "The Bank of Rajasthan Limited" has been excluded from the Second Schedule to the Reserve Bank of India Act, 1934 by notification DBOD.No.PSBD/2866/16.01.056/2010-11 dated August 18, 2010, published in the Gazette of India (Part III - Section-4) dated September 11, 2010–September 17, 2010.

A2. *Circular* – Guidelines on Fair Practices Code for Lenders – Disclosing all information relating to processing fees/charges for processing the loan application – No. DBOD. Leg. BC. 61/09.07.005/2010-11, dated 12.11.2010

Please refer to our Circular DBOD. No. Leg. BC. 86/09.07.005/2008-09 dated November 25, 2008 containing guidelines on the captioned subject wherein banks were advised to ensure that all information relating to charges/fees for processing are invariably disclosed in the loan application forms and that banks must inform 'all-in-cost' to the customers to enable them to compare the rates charged with other sources of finance.

2. With a view to bringing in fairness and transparency, banks are advised that they must transparently disclose to the borrower all information about fees/charges payable for processing the loan application, the amount of fees refundable if loan amount is not sanctioned/disbursed, pre-payment options and charges, if any, penalty for delayed repayments if any, conversion charges for switching loan from fixed to floating rates or vice versa, existence of any interest reset clause and any other matter which affects the interest of the borrower. Such information should also be displayed in the website of the banks for all categories of loan products.

3. In other words, banks must disclose 'all in cost' inclusive of all such charges involved in processing/sanction of loan application in a transparent manner to enable the customer to compare the rates/charges with other sources of finance. It should also be ensured that such charges/fees are non-discriminatory.

A3. *Circular* – Extension of up to 1.0 per cent of Net Demand and Time Liabilities (NDTL) in avail of Additional Liquidity support under Liquidity Adjustment Facility (LAF) – No. DBOD.No.Ret.BC.60/12.02.001/2010-11, dated 09.11.2010

Please refer to our circular DBOD. No. Ret. BC. 55/12.02.001/2010-11, dated November 01, 2010 on the captioned subject.

2. As stated in the Reserve Bank's press release issued on November 09, 2010, in line with the stance of monetary policy set out in the Second Quarter Review of November 2, 2010 and in order to provide liquidity comfort arising out of frictional liquidity pressure, it has been decided that scheduled commercial banks may avail of additional liquidity support under the Liquidity Adjustment Facility (LAF) to the extent of up to 1.0 per cent of their Net Demand and Time Liabilities (NDTL) as on the reporting Friday of the second preceding fortnight. For any shortfall in maintenance of Statutory Liquidity Ratio (SLR) during November 9–December 16, 2010 arising out of availment of this facility, banks may seek waiver of penal interest purely as an *ad hoc*, temporary measure. The above measure will be in force till December 16, 2010.

A4. *Circular* – Banks advised to start full-fledged test runs to guidelines on management of interest rate risk with effect from 01.01.2011 – No. DBOD. No. BP. BC. 59/21.04.098/2010-11, dated 04.11.2010

Please refer to paragraph 155 of Second Quarter Review of Monetary Policy 2009-10 announced on October 27, 2009 on introduction of Duration Gap Analysis for interest rate risk management. Accordingly, Guidelines on Banks' Asset Liability Management Framework- Interest Rate Risk are furnished in Annex.

2. As banks are aware, interest rate risk is the risk where changes in market interest rates affect a bank's financial position. Changes in interest rates impact a bank's earnings (i.e. reported profits) through changes in its Net Interest Income (NII). Changes in interest rates also impact a bank's Market Value of Equity (MVE) (hereinafter 'equity' would mean 'net worth' unless indicated otherwise) through changes in the economic value of its interest rate sensitive assets, liabilities and off-balance sheet positions. The interest rate risk, when viewed from these two perspectives, is known as 'earnings perspective' and 'economic value perspective', respectively. The earlier guidelines (DBOD. BP. BC. 8/21.04.098/99 dated February 10, 1999) to banks indicated approach to interest rate risk measurement from the 'earnings perspective' using the Traditional Gap Analysis (TGA). To begin with, the TGA was considered as a suitable method to measure Interest Rate Risk. Reserve Bank had also indicated then its intention to move over to modern techniques of Interest Rate Risk measurement like Duration Gap Analysis (DGA), Simulation and Value at Risk over a period of time, when banks acquire sufficient expertise and sophistication in acquiring and handling MIS.

3. In this context, it is clarified that Duration Gap Analysis (DGA) is aimed at providing an indication of the interest rate risk to which the bank is exposed. Accordingly, the estimated drop in MVE as a result of the prescribed shock applied would indicate the economic impact on the banks' equity should the shock scenario materialise but would not be an accounting loss as banking book is not marked to market.

4. The revised guidelines furnished in Annex will be effective from April 1, 2011. However, banks are advised to start full-fledged test runs on these guidelines with effect from January 1, 2011 with a view to enable them to gain more experience in the operation of the revised framework.

5. The salient features of the guidelines furnished in the Annex are

(*i*) Banks shall adopt the DGA for interest rate risk management in addition to the TGA followed presently.

(*ii*) The framework, both DGA and TGA, should be applied to the global position of assets, liabilities and off-balance sheet items of the bank, which are rate sensitive. Banks should compute their interest rate risk position in each currency applying the DGA and TGA to the rate sensitive assets/liabilities/off balance sheet items in that currency, where either the assets, or liabilities are 5 per cent or more of the total of either the bank's global assets or global liabilities. The interest rate risk position in all other residual currencies should be computed separately on an aggregate basis.

(*iii*) Keeping in view the level of computerisation and the current MIS in banks, adoption of a uniform ALM System for all banks may not be feasible. The proposed guidelines have been formulated to serve as a benchmark for banks. Banks which have already adopted more sophisticated systems may continue their existing systems but should also adopt the DGA and TGA as supervisory reporting/disclosure frameworks.

(*iv*) Banks should adopt the modified duration gap approach while applying the DGA to measure interest rate risk in their balance sheets from the economic value perspective. In view of the evolving state of computerisation and MIS in banks, a simplified framework has been suggested, which allows banks to:

A. group rate sensitive assets, liabilities and off balance sheet items under the broad categories indicated in Appendix I under various time buckets; and

B. compute Modified Duration (MD) of these categories of assets/liabilities and off-balance sheet items using the suggested common maturity, coupon and yield parameters.

(*v*) Measurement of interest rate risk with the above method is an approximation. Hence banks which have the capability to compute the weighted average MD of their assets and liabilities based on the MD of each item of Rate Sensitive Asset (RSA)/Rate Sensitive Liability (RSL) may do so.

(*vi*) Each bank should set appropriate internal limits for interest rate risk based on its risk bearing and risk management capacity, with prior approval of its Board/Risk Management Committee of the Board.

(*vii*) Banks should compute the potential decrease in earnings and fall in MVE under various interest rate scenarios.

(*viii*) In addition to extant frequency of supervisory reporting of interest rate sensitivity as per Traditional Gap Analysis (TGA), banks shall submit a report on interest rate sensitivity as per DGA in the stipulated format with effect from June 30, 2011 on a quarterly basis till March 31, 2012 and monthly with effect from April 30, 2012.

6. It is clarified that the framework prescribed in this circular is aimed at determining the impact on the MVE of the bank arising from changes in the value of interest rate sensitive positions across the whole bank i.e. both in the banking and trading books. This requirement is in addition to the existing guidelines for assessing capital adequacy requirement for interest rate sensitive positions in the trading book and banking book (under Pillar II) separately. For the purpose of capital adequacy trading and banking books are treated separately because generally no offset of positions between the banking book and trading book is considered due to different accounting/ valuation norms.

7. After gaining significant experience with the methodology laid down in the circular, banks may consider switching over to this methodology for management of interest rate risk in the banking book under Pillar II.

8. As per extant guidelines on management of interest rate risk in the banking book under Pillar II, banks where the economic value of the banking book declines by more than 20% of the MVE as a result of a standardised interest rate shock of 200 basis points are considered outlier from supervisory perspective. However, no such calibration is envisaged at this stage for decline in the MVE based on the impact of the standardised interest rate shock of 200 basis points on the entire balance sheet, under the guidelines on banks' ALM contained in this circular.

SECOND QUARTER REVIEW OF MONETARY POLICY FOR THE YEAR 2009-10

Introduction of Duration Gap Analysis for Asset Liability Management

155. The Reserve Bank had issued guidelines on asset liability management in February 1999, which, *inter alia*, covered aspects relating to interest rate risk measurement. These guidelines to banks approached interest rate risk measurement from the 'earnings perspective' using the traditional gap analysis (TGA). To begin with, the TGA was considered as a suitable method to measure interest rate risk. The Reserve Bank had, however, indicated its intention to shift to modern techniques of interest rate risk measurement such as duration gap analysis (DGA), simulation and value-at-risk over a period of time, when banks acquire sufficient expertise and sophistication in this regard. Since banks have gained considerable experience in implementation of the TGA and have become familiar with the application of the concept of duration/modified duration while applying standardised duration method for measurement of interest rate risk in the trading book, this is an opportune time for banks to adopt the DGA for management of their interest rate risk. With this move, banks would migrate to the application of the 'economic value perspective' to interest rate risk management. Accordingly, it is proposed:

- to issue detailed guidelines on the use of DGA for management of interest rate risk by end-November 2009.

A5. Circular – Banks advised to follow "Settlement Date" accounting for recording purchase and sale of transactions in Government securities from 1.01.2011 – No. DBOD No. BP.BC. 58/21.04.141/2010-11, dated 04.11.2010

In terms of paragraph 1.1(i)(*d*) of Master Circular No. DBOD. BP. BC.18/21.04.141/2010-11 dated July 1, 2010 on 'Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks' all the transactions put through by a bank, either on outright basis or ready forward basis and whether through the mechanism of Subsidiary General Ledger (SGL) Account or Bank Receipt (BR), should be reflected on the same day in its investment account and, accordingly, for SLR purpose, wherever applicable.

2. In this connection, it has come to our notice that the banks are not following a uniform methodology of accounting for investments in Government securities i.e. they follow either 'Trade Date' or 'Settlement Date' accounting. With a view to bringing in uniformity, it has been decided that banks should follow 'Settlement Date' accounting for recording purchase and sale of transactions in Government securities.

3. It is advised that these instructions will be applicable from January 1, 2011.

A6. *Circular* – State Bank of Indore excluded from the Second Schedule to the Reserve Bank of India Act, 1934 vide Notification DBOD. No. Ret. BC. 37/12.06.004/2010-11 dated 27.08.2010 – No. DBOD. Ret. BC. No. 57/12.06.004/2010-11, dated 03.11.2010

We advise that the name of "State Bank of Indore" has been excluded from the Second Schedule to the Reserve Bank of India Act, 1934 by notification DBOD. No. Ret. BC. 37/12.06.004/2010-11 dated August 27, 2010, published in Gazette of India (Part III - Section 4) dated September 25–October 1, 2010.

NOTIFICATION DBOD.No.Ret.BC. 37/12.06.004/2010-11,
dated 27.08.2010

In exercise of the powers conferred under Clause (*b*) of Sub-section (6) of Section 42 of the Reserve Bank of India Act, 1934 (2 of 1934), the Reserve Bank of India hereby directs exclusion of the "State Bank of Indore" from the Second Schedule to the said Act, as the said bank has ceased to carry on banking business with effect from August 26, 2010.

A7. *Circular* – Prudential Norms for Off Balance Sheet Exposure-Bilateral netting of counter party credit exposures – No. DBOD.FID.FIC.No 8/01.02.00/2010-11, dated 02.11.2010

Please find enclosed circular DBOD No. BP .BC .48/21.06.001/2010-11, dated October 1, 2010 on the above subject. In this connection, it is advised that the above guidelines issued to banks, shall *mutatis mutandis* apply to the select All-India Financial Institutions (AIFIs).

A8. *Circular* – 'Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks' to be effective from 01.04.2011 – No. DBOD. No. BP.BC. 56/21.04.141/2010-11, dated 01.11.2010

In terms of our circular No. DBOD.BP.BC. 34/21.04.141/2010-11 dated August 6, 2010 on the captioned subject it was decided that if the value of sales and transfers of securities to/from HTM category exceeds 5 per cent of the book value of investments held in HTM category at the beginning of the year, bank should disclose the market value of the investments held in the HTM category and indicate the excess of book value over market value for which provision is not made.

2. In this connection, we clarify that the one-time transfer of securities to/from HTM category with the approval of Board of Directors permitted to be undertaken by banks at the beginning of the accounting year and sales to the Reserve Bank of India under pre-announced OMO auctions will be excluded from the 5 per cent cap prescribed in the above mentioned circular.

3. It may be mentioned that in terms of para 4.2 of our Master Circular DBOD.No.BP.BC.18/21.04.141/2010-11 dated July 1, 2010 on 'Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks', banks are permitted to undertake repos from any of the three categories of investments, viz., HFT, AFS and HTM.

4. Further, we clarify that these instructions will be effective from April 1, 2011.

A9. *Circular* – LAF auction of four days to be conducted for avail of Additional Liquidity support under Liquidity Adjustment Facility (LAF) – No. DBOD.No.Ret.BC.55/12.02.001/2010-11, dated 01.11.2010

Please refer to our circular DBOD.No.Ret.BC. 54/12.02.001/2010-11 dated October 29, 2010 on the captioned subject.

2. As stated in the Reserve Bank's press release issued on October 31, 2010, in view of likely persistence of frictional liquidity pressures, it has been decided to extend the liquidity easing measures announced on October 29, 2010 on all days during November 1–4, 2010. Accordingly, Scheduled Commercial Banks may avail of additional liquidity support under the Liquidity Adjustment Facility (LAF) to the extent of up to 1.0 per cent of their Net Demand and Time Liabilities (NDTL) as on October 8, 2010. As the LAF auction on November 4, 2010 will be for four days, banks may seek waiver of penal interest for any shortfall in maintenance of Statutory Liquidity Ratio (SLR) arising out of availment of this facility up to November 7, 2010 purely as an *ad hoc*, temporary measure.

A10. *Circular* – Special 2-day repo auction under the LAF conducted for avail of Additional Liquidity support under Liquidity Adjustment Facility (LAF) – No. DBOD.No.Ret.BC. 54/ 12.02.001/2010-11, dated 29.10.2010

As stated in the Reserve Bank's press release issued today, in order to provide liquidity comfort arising out of frictional liquidity pressure, a special 2-day repo auction under the LAF will be conducted at 10.30 a.m. on Saturday, October 30, 2010. Scheduled Commercial Banks may avail of additional liquidity support under the LAF to the extent of up to 1.0 per cent of their net demand and time liabilities (NDTL) as on October 8, 2010. It is advised that for any shortfall in maintenance of statutory liquidity ratio (SLR) on October 30-31, 2010 arising out of availment of this facility, banks may seek waiver of penal interest purely as an ad hoc, temporary measure. This facility will be available only on Saturday, October 30, 2010.

B. IMPORTANT CASES

Redemption

Sections 13 and 17 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)

Ram Murty Pyara Lal and Ors.* v. *Central Bank of India and Ors.
(Delhi High Court)
Decided on 01.11.2010, MANU/DE/2878/2010

ALTHOUGH THE RIGHT OF REDEMPTION IS TO BE ORDINARILY EXERCISED BEFORE THE DATE FIXED FOR SALE OF TRANSFER, HOWEVER, EVEN IF THE AUCTION SALE PROCEEDINGS TAKE PLACE BUT IN CASE THE BORROWER SUCCEEDS IN THE S.A. UNDER SECTION 17, THE AUCTION SALE PROCEEDINGS CAN BE CANCELLED AND SINCE FRESH AUCTION SALE MAY HAVE TO BE CONDUCTED, THE RIGHT OF REDEMPTION CAN AGAIN BE EXERCISED AT THAT STAGE WHEN A FRESH DATE WILL BE FIXED FOR SALE/TRANSFER.

RIGHT OF REDEMPTION HAS TO BE DECIDED IN TERMS OF THE SUCCESS OR FAILURE OF THE PETITIONERS IN THE PROCEEDINGS INITIATED BY THEM UNDER SECTION 17 OF THE SARFAESI ACT.

BEING A SPECIAL LEGISLATION, PROVISIONS OF THE SARFAESI ACT WILL PREVAIL IN CASE OF ANY CONFLICT AND INCONSISTENCY OF ANY PROVISION THEREIN WITH ANY PROVISIONS OF THE TRANSFER OF PROPERTY ACT AND THE CPC.

Facts: Petitioners borrowed financial limits from the Respondent No. 1 bank. On account of default of the Petitioners in payment of the dues, the Respondent No. 1 bank exercised its rights under the SARFAESI Act. Auction of property took place after the Petitioners failed to comply with the notice of demand issued under Section 13(2) of the SARFAESI Act. Subsequently, Petitioner-borrowers sought redemption of the mortgaged property. Debt Recovery Tribunal and Debt Recovery Appellate Tribunal dismissed the petition of the Petitioners. Petitioners, thereafter, filed S.A. under Section 17 of the SARFAESI Act before the DRT and challenged the auction sale proceedings on the grounds of violation of the provisions of SARFAESI Act and the Rules framed thereunder. Petition was dismissed by Debt Recovery Tribunal and appeal to Debt Recovery Appellate Tribunal was preferred. Pending appeal to Debt Recovery Appellate Tribunal, present writ petition was preferred.

Issues: **(1)** Whether in the present case, the right to redemption can be exercised by the Petitioners over the mortgaged property under SARFAESI Act and up to what stage the right of redemption can be exercised.

(2) Whether the provisions of the Transfer of Property Act, including Sections 60 and 69, will apply or whether the provisions of the SARFAESI Act will apply with respect to redemption.

Holdings: **(1)** Under the SARFAESI Act, the right of redemption claimed by the Petitioners will depend upon success of the proceedings initiated by the Petitioners under Section 17 of the SARFAESI Act. In case the Petitioners finally fail, then it will not have a right of redemption; however, in case the Petitioners succeed in the proceedings under Section 17 and orders are passed for setting aside the auction sale in terms of Sub-sections (2)–(4) of Section 17, then in such a case, it will be open to the Petitioners to claim right of redemption. Thus, in the present case, if the borrower succeeds in its petition under Section 17, then the Debt Recovery Tribunal can pass orders under Sub-sections (3) and (4) of Section 17, cancelling the auction sale proceedings and a fresh auction may have to be conducted. In case a fresh auction of the mortgaged property has to be conducted, then a fresh date will be fixed for auction sale and it is at that stage that again Section 13(8) will come into play and at which stage, the borrower can seek to exercise its right of redemption of the mortgaged property. Therefore, everything will turn upon the success or failure of the Petitioners in the petition under Section 17 of the Act when the same reaches finality. Presently, the stage of the proceedings under Section 17 has been dismissed by the Debt Recovery Tribunal and a statutory appeal under Section 18 is pending before the Debt Recovery Appellate Tribunal. Therefore, if the Petitioners succeed in its appeal under Section 18 before the Debt Recovery Appellate Tribunal, the Petitioners can exercise a right of redemption because fresh auction sale proceedings may have to be conducted and when so required to be conducted, once again a date will have to be fixed for sale/transfer/auction and before which date, the Petitioners can seek to pay all the dues of the bank in terms of Section 13(8) of the SARFAESI Act. Orders of the Debt Recovery Tribunal and Debt Recovery Appellate Tribunal were set aside

(2) Yes, the provisions of the SARFAESI Act will apply with respect to redemption because the said Act is a special Act dealing with respective rights and obligations with respect to proceedings to be taken thereunder. It is a special legislation will prevail over a general legislation. The provisions of the SARFAESI Act will therefore prevail in case of any conflict and inconsistency of any provision therein with any provisions of the Transfer of Property Act and the CPC.

Dishonour of cheques

Sections 138 and 141 of the Negotiable Instruments Act

Rajasekar* v. *U.M.S. Radio Factory Limited, a Public Limited Company incorporated under the Companies Act 1956 represented by its Assistant Company Secretary B. Srinivasan (Madras High Court)
Decided on 28.10.2010, MANU/TN/2065/2010

IN CASE OF POST-DATED CHEQUES, UNDER SECTION 141 OF THE NEGOTIABLE INSTRUMENTE (NI) ACT, THE RELEVANT TIME OF COMMISSION OF AN OFFENCE IS THE DATE OF PRESENTATION AND DISHONOUR OF THE CHEQUE AND THUS THE PERSON WHO HAD RESIGNED FROM THE DIRECTORSHIP OF THE COMPANY CANNOT BE HELD RESPONSIBLE UNLESS SPECIFIC ALLEGATIONS ARE MADE THAT THE SAID PERSON WAS IN CHARGE OF AND RESPONSIBLE FOR THE CONDUCT OF THE BUSINESS OF THE COMPANY EVEN AFTER RESIGNATION.

Disposition: Petition allowed

Facts: Debtor company issued two post-dated cheques to the Respondent company. On presentation of the cheque to the bankers, both the cheques were returned with an endorsement "insufficient funds". Respondent company issued legal notice calling upon the debtor company and the directors to make payment of the cheques within 15 days. Since the amount was not repaid, the Respondent had initiated proceedings under Section 138 read with 141 of the NI Act, which was taken on file by the learned Judicial Magistrate No. II. Petitioner Company Secretary filed present petition to quash the proceedings.

Issue: Whether the present proceeding against the Petitioner under Section 138 read with 141 of the NI Act is sustainable.

Holding: Section 141 makes it clear that every person who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence. The above provision makes it clear that the persons who are sought to be made vicariously liable for criminal offence should be at the time the offence was committed was in charge of and was responsible to the company for the conduct of the business of the company. In the case of post-dated cheques, the relevant time of commission of an offence is the date of presentation and dishonour of the cheque. Any person in charge of and responsible for the conduct of the business of the company at this point of time alone are vicariously liable and the person who had resigned from the directorship of the company cannot be held responsible unless specific allegations are made that the said person was in charge of and responsible for the conduct of the business of the company even after resignation. Also, the Petitioner was not the signatory of the cheques. Therefore, the Petitioner cannot be held liable for the dishonour of the cheque. Thus, criminal original petition is allowed.

Foreign Trade & Exchange Laws

EXPORT & IMPORT

A. STATUTES

A1. *Circular* – Processing and Settlement of Export related receipts facilitated by Online Payment Gateways – No. A.P. (DIR Series) Circular No.17, dated 16.11.2010

Of late, Online Payment Gateways have emerged as a popular mode of facilitating e-commerce transactions. Some of these Online Payment Gateway Service Providers (OPGSPs) have also been facilitating cross-border transactions. We have recently reviewed the service model provided by these OPGSPs with reference to the provisions of the Foreign Exchange Management Act (FEMA), 1999. It was observed that a few OPGSPs have not only facilitated conclusion of the transactions but also allowed exporters to retain the export proceeds abroad without repatriation resulting in violation of the provisions of FEMA, 1999. Acknowledging however the importance of the services provided by the OPGSPs to the exporters, particularly in facilitating small value export transactions, it has been considered necessary to issue a set of guidelines to cover such e-commerce arrangements.

2. Accordingly, it has been decided to allow the Authorised Dealer Category-I (AD Category-I) banks to offer the facility of repatriation of export related remittances by entering into standing arrangements with OPGSPs, subject to the following conditions:

(*i*) The AD Category-I banks offering this facility shall carry out the due diligence of the OPGSP.

(*ii*) This facility shall only be available for export of goods and services of value not exceeding USD 500 (US Dollar five hundred).

(*iii*) AD Category-I banks providing such facilities shall open a NOSTRO collection account for receipt of the export related payments facilitated through such arrangements. Where the exporters availing of this facility are required to open notional accounts with the OPGSP, it shall be ensured that no funds are allowed to be retained in such accounts and all receipts should be automatically swept and pooled into the NOSTRO collection account opened by the AD Category-I bank.

(*iv*) A separate NOSTRO collection account may be maintained for each OPGSP or the bank should be able to delineate the transactions in the NOSTRO account of each OPGSP.

(*v*) The following debits will only be permitted to the NOSTRO collection account opened under this arrangement:

(*a*) Repatriation of funds representing export proceeds to India for credit to the exporters' account;

(*b*) Payment of fee/commission to the OPGSP as per the predetermined rates/frequency/arrangement; and

(*c*) Charge back to the importer where the exporter has failed in discharging his obligations under the sale contract.

(*vi*) The balances held in the NOSTRO collection account shall be repatriated and credited to the respective exporter's account with a bank in India immediately on receipt of the confirmation from the importer and, in no case, later than seven days from the date of credit to the NOSTRO collection account.

(*vii*) AD Category-I banks shall satisfy themselves as to the *bona fides* of the transactions and ensure that the purpose codes reported to the Reserve Bank in the online payment gateways are appropriate.

(*viii*) AD Category-I banks shall submit all the relevant information relating to any transaction under this arrangement to the Reserve Bank, as and when advised to do so.

(*ix*) Each NOSTRO collection account should be subject to reconciliation and audit on a quarterly basis.

(*x*) Resolution of all payment related complaints of exporters in India shall remain the responsibility of the OPGSP concerned.

(*xi*) OPGSPs who are already providing such services as per the specific holding-on approvals issued by the Reserve Bank shall open a liaison office in India within three months from the date of this circular, after duly finalizing their arrangement with the AD-Category-I banks and obtaining approval from the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Central Office, Fort, Mumbai 400 001 for this purpose.

In respect of all new arrangements, the OPGSP shall open a liaison office with the approval of the Reserve Bank before operationalising the arrangement.

3. AD Category-I banks desirous of entering into such an arrangement/s should approach the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Central Office, Fort, Mumbai 400 001, for obtaining one time permission in this regard and thereafter report the details of each such arrangement as and when entered into.

4. AD Category-I banks may bring the contents of this circular to the notice of their constituents concerned.

5. The directions contained in the circular have been issued under Section 10(4) and Section 11(1) of the Foreign Exchange Management Act, 1999 (42 of 1999) and are without prejudice to permissions/approvals, if any required under any law.

A2. *Circular* – Reporting Mechanism – Data of Authorised Dealer Category-I Branches – No. A.P. (DIR Series) Circular No.16, dated 16.11.2010

Attention of Authorised Dealer Category-I (AD Category-I) banks is invited to the A.P. (DIR Series) Circular No. 54 dated May 08, 2007.

2. In terms of the extant guidelines, all AD Category-I banks are required to inform any changes in the categorisation of their branches dealing in foreign exchange to:

The Director, Reserve Bank of India, Central Office, Department of Statistics and Information Management Banking Statistics Division, C-9,6th Floor, Bandra-Kurla Complex, Bandra (E), Mumbai 400 051.

The above information should be prepared in Proforma I or II, as specified in RBI circulars DBOD No. BL.BC.92/22.06.001/2004-05 dated May 20, 2005 and DBOD No. BL.BC.55/22.01.001/2005-06 dated January 23, 2006, and a soft copy should be e-mailed. Further, for maintaining the data compatibility, information in Proforma I and II should be prepared using RBIMOF Application package. The RBIMOF Application Software package (RBIMOF.exe) is available on the Reserve Bank's website (www.rbi.org.in).

3. Further, the path to access the directory of the scheduled commercial banks given in Annex-I of the above mentioned circular is changed and therefore, the revised access path to generate the report on the Directory of AD Category branches is given in the Annex-II. The path to access the Application Software package is given in Annex I. In case of any assistance/ clarification, AD banks may communicate by e-mail.

4. All the other instructions contained in A.P. (DIR Series) Circular No. 54 dated May 08, 2007 shall remain unchanged.

5. The directions contained in this Circular have been issued under sections 10(4) and 11(1) of the Foreign Exchange Management Act, 1999 (42 of 1999) and is without prejudice to permissions/approvals, if any, required under any other law.

[Annex-I to A.P. (DIR Series) Circular No.16 dated November 16, 2010]

Path to access the RBIMOF Application Software Package (RBIMOF.exe)

The Application Software package viz. RBIMOF.exe is available on the RBI website (www.rbi.org.in) under Home Page → Notification → FEMA → Electronic Reporting System → Reporting Mechanism → Data of Authorised Dealers Category Branches.

[Annex-II to A.P. (DIR Series) Circular No.16 dated November 16, 2010]

Path to access the information on the category-wise branches of AD Category-I banks (Directory of the Scheduled Commercial Banks)

(*i*) The website address is http://dbie.rbi.org.in/

(*ii*) After logging on the website, either select the tab 'Data Series' or click on the link "To view Data Series - click here".

(*iii*) In order to select the following options, Double click on the same.

Select the option 'Corporate Categories' → Reports → By subject → Financial sector → Money and Banking → Banking. Double click on the report titled **"Directory of AD Category Branches"**.

Select the required Bank name from the list and click on the **'>'** box.

The name of the bank should appear on the right hand panel. Now, click on the button "Run Query".

The list of the AD Category branches pertaining to that particular bank will get generated. Use the navigation keys to go to the next page. In case the file is to be saved, then click on the tab "Document" ? Save report to my computer. The report can be saved either in PDF or in Excel format.

(*iv*) The report can also be seen by selecting the tab 'Data Series' then the tab 'Corporate Categories' → By Frequency → Daily → Financial sector → Banking. Click on the report titled as **"Directory of AD Category Branches"**. Then follow the procedure mentioned in para *iii* above.

(*v*) The report can also be seen under the tab 'Corporate Categories' ? 'For Banks' Use'. Click on the report titled as **"Directory of AD Category Branches"**. Then follow the procedure mentioned in para iii above.

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CAPJ Times

Keep ESI, EPF schemes out of service tax ambit: Labour Ministry

The Labour and Employment Ministry has requested the Finance Ministry to keep Employees' State Insurance (ESI) and Employees' Provident Fund (EPF) schemes out of the ambit of service tax as they are social security schemes.

"If the provisions of service tax are made applicable to the ESI schemes, the cost of insurance will increase to the extend of service tax," Minister of State for Labour and Employment Harish Rawat said on Monday.

He said his Ministry has requested the Finance Ministry to consider "exemption of ESI scheme and EPF scheme from the applicability of service tax".

Mr. Rawat said this to a written question in the Lok Sabha on Monday.

His reply came in the backdrop of the Department of Revenue sending demand-cum-show cause notice to ESI corporation which considered the ESI schemes at par with general insurance business and stated that activities of ESI Corporation are within the ambit of Insurance Act, 1938 and hence service tax provisions are applicable to it.

A similar notice has also been received by the EPFO.

[Source: http://www.thehindu.com, dated 22nd November, 2010]

2G scam: Excerpts from the affidavit

An affidavit on behalf of Prime Minister Manmohan Singh was filed in the Supreme Court today which rejected the charge of inaction on the part of his office in dealing with the request of sanction for prosecution of former Telecom Minister A Raja in the 2G spectrum issue.

In an 11-page affidavit, filed through Director, PMO, V Vidyawati, it was stated that there was no inaction on the part of the PMO on the complaint filed by Janata Party President Subramanian Swamy seeking the sanction for prosecution of Raja.

Here are a few excerpts:

I'm making this affidavit only for the purpose of showing how the various letters received from the petitioner have been duly considered.

On 1st December, 2008, the PM perused the letter (Swamy's letter) and noted "Please examine and let me know the facts of this case." This was marked to the Principal Secretary to the PM who in turn marked it to the Secretary. The Secretary marked it to me as Director in the PMO.

It is specifically mentioned in paragraph 2 of the letter dated 31st October, 2009 of Shri Swamy that an FIR was registered by the CBI and "the substance of the allegation made by me in the above cited letters to you are already under investigation."

On 9th February, 2010, I prepared another note placing on record the advice from the Department of Legal Affairs. I stated that according to the advice, the decision of granting sanction for prosecution may be determined only after perusal of the evidence collected by the investigating agency, the CBI and other materials to be provided to the competent authority.

[Source: http://www.ndtv.com, dated 20th November, 2010]

Four states cut tax on petro products

Only four states have reduced the rate of tax on petroleum, Minister of State for Petroleum and Natural Gas Jitin Prasada said Thursday.

This is despite the petroleum ministry's appeal to state governments to rationalize the tax structure on petro products, the minister said.

In a written reply in the Lok Sabha, Prasada said the central government had asked states to shift from ad-valorem tax rates to specific tax components on the four petro products which are petrol, diesel, kerosene and cooking gas "to provide relief to the consumers".

But the petroleum ministry has not recommended any uniform tax rate to the state governments.

Delhi was the first to reduce the VAT rate on diesel from 20 to 12.5 percent. Bihar cut its VAT on kerosene from 12.5 percent to 4 percent in July.

Goa has made substantial cuts in VAT for petrol and diesel while exempting cooking gas from it entirely. West Bengal removed the sales tax on kerosene in September.

[Source: http://www.indiavision.com, dated 19th November, 2010]

Aviation firms not liable to pay customs duty for imported aircrafts

The Customs, Excise and Service Appellate Tribunal on Thursday ruled that companies that generate revenue from the use of the imported aircraft fall under the category of non scheduled use and would therefore, not be liable to pay customs duty. This ruling is likely to have a bearing on several cases that are either being investigated or are in litigation across the country.

Importers will not have to pay customs duty on aircraft that are brought into the country for non scheduled use, while private use operators will have to.

The difference between non scheduled and private operations is that an aviation company charges clients for using non scheduled services, while private use means companies operating aircraft on their own expenses.

Several companies that imported aircraft under the non schedule use permits, were initially exempted from having to pay customs duty, but were later served show cause notices for the same.

The Customs Department issued the notices on the basis that the companies were using the aircraft for private purposes and were hence, not covered by any exemption under law.

[Source: http://www.livemint.com, dated 18th November, 2010]

MCD to collect service tax from discoms

Looking for ways to increase its revenue, the Municipal Corporation of Delhi (MCD) has decided to collect service tax from power distribution companies, an official said on Friday.

"Discoms should pay service tax to the MCD in effect from today (Friday), which amounts to approximately ₹10 crore annually. The decision was taken in the meeting of municipal property tax officers," said Ved Prakash Gupta, chairman of the special high-powered property tax committee.

He also said that a five-member sub-committee will be constituted to collect the tax.

"They will take care of the issue of payment of arrears of service tax prior to February 2010, and tax on vacant land and that of sub-station areas under discoms," Gupta added.

[Source: http://www.hindustantimes.com, dated 19th November, 2010]

GMADA under Income Tax scanner

The Greater Mohali Area Development Authority (GMADA) came under the scanner of Income Tax (I-T) department on Wednesday. A team of I-T sleuths, headed by Assistant Commissioner Preneet Suri, swooped on the GMADA office at PUDA Bhawan in Sector 62 here around 11 am and took the entire official machinery of the Authority by surprise.

The team, comprising around 10 officials, took stock of the finances, accounts, allotments and development works initiated by the GMADA since its inception in August 2006.

Besides meeting GMADA senior functionaries, the I-T sleuths also went to the offices of GMADA ACA (Finance and Accounts) Rajesh Sodhi, Advisor Projects K.K. Kaul, ACA (Headquarter) Balwinder Singh Multani and Chief Engineer Rajiv Moudgil.

Even though the I-T officials or the GMADA officials were ready to talk on the issue despite repeated attempts, sources revealed that the I-T operation was prompted by the receipt of around ₹9,200 crore on account of earnest money from around 3.22 lakh applicants for GMADA's much-hyped Aerocity project, from which GMADA was earning at least Rs 1.5 crore daily on account of interest.

[Source: http://www.indianexpress.com, dated 19th November, 2010]

Vodafone International Holdings B.V. v. *Union of India and Anr.*

MANU/SC/0978/2010, dated 15.11.2010

The Supreme Court in a petition filed by *Vodafone International Holding B.V.* against the impugned order of Bombay High Court has directed the Petitioners to deposit a sum of ₹2,500 crores in the court registry and the rest to be secured by the Petitioner by giving Bank Guarantee of a Nationalised Bank on terms and conditions fixed by the Registry. Both the Department and Petitioner will give undertaking that in case the Petitioner ultimately succeeds, the Department will pay interest at the rate that may be fixed by this Court at the appropriate time and if the special leave petition/civil appeal is dismissed, the balance amount will be paid by the Petitioner with interest at suchrate as this Court will fix.

[To view the full text of the order log on to www.manupatra.com]

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Division Two

Practice Update

Practice Support

A. PRONOUNCEMENTS & ANNOUNCEMENTS

A1. Revised Guidelines for Training of Articled Assistant outside India - (22-11-2010)

The Institute, while considering the difficulties being faced by overseas members in providing training to articled assistants has issued the revised guidelines and FAQs for training of articled assistant outside India. Please visit the links below for: -

- Revised Guidelines for training of articled assistant outside India
- Form for self declaration in lieu of Annual Report for Imparting Industrial Training outside India
- FAQs on training of articled assistant outside India

Guidelines for Training of Articled Assistants outside India

(*i*) A Chartered Accountant is eligible to train an articled assistant provided his main occupation is the practice of the profession of Accountancy at the time of engaging articled assistants as well as in each of the qualifying years on the basis of which he claims eligibility to train articled assistants.

(*ii*) Any member engaged in any other business, occupation or holding part time certificate of practice is not entitled to train articled assistant.

(*iii*) Any member employed as a Paid Assistant or engaged as a partner in a foreign firm of Chartered Accountants will also be eligible to train articled assistants at par with the paid assistants with a firm of Chartered Accountants in India. All conditions applicable to the Paid Assistants in India would be applicable to them as well. However, in case of a foreign firm, such a foreign firm shall have at least one partner who is either a member of the Institute or who is eligible to become a member of the Institute, in terms of MRA.

(*iv*) The members shall provide a professional address as envisaged in Regulation 2(1)(*xiii*) as well as an address in India. (As per the said Regulation, professional address means: -

a. an address of the place where the member is carrying on his profession (or where he is carrying on his profession at more than one place, the principal place), or

b. if a member is employed, the place of employment or at his option the place of his residence

c. the place of residence, if the member neither carried on the profession nor is employed.

It may please be noted that an address in India is essential in any of the situation)

(*v*) The terms and conditions that may be made applicable for training articled assistant in India from time to time shall mutates mutandis apply for training of articled assistant abroad.

(*vi*) The period of practical training shall be 3 years or 3½ years, as applicable, under a practising chartered accountant abroad. However, the articled/audit assistants should have an option to undergo industrial training in accordance with the Regulations 51 & 72 of the Chartered Accountants Regulations, 1988 during the last one year of training.

(*vii*) The Industrial Training may be imparted by the Chartered Accountants working abroad in a financial, commercial or industrial undertaking with minimum fixed assets & minimum total turnover or minimum paid up capital as may be specified by the Council (whatever the value specified in terms of Indian currency may be deemed as applicable in foreign countries in their respective currencies) or such other organization or institution approved by the Council. In case of a member employed outside India, and eligible to impart Industrial training outside India, is unable to submit Annual Report/Balance sheet of the corporate/undertaking the member is working with, the member may submit a self declaration about the particulars of the undertaking alongwith the application.

(*viii*) The terms & conditions contained in Regulation 54 and Regulation 54A dealing with secondment shall be applicable to the articled assistants receiving training abroad.

(*ix*) The Principal shall send training reports as prescribed alongwith the service certificate to be issued in Form 109 & 108 as the case may be.

(*x*) The principal shall impart training in accordance with the guidelines contained in Training Guide. He shall maintain a record of practical training imparted by him to the articled assistant and report to the Council in the form prescribed in the training guide.

(*xi*) The rates, terms and conditions of stipend prescribed as payable to the articled assistants receiving training in India shall be applicable to the articled assistants receiving training aboard except that the same rate of stipend in equivalent terms specified in respective national currencies of the countries concerned instead of Indian rupees.

(*xii*) Regulation of training in terms of office hours and working days holidays will be applicable as per local office timings and laws. However, requirements of total training hours will be the same as applicable in India, the terms of which are given hereunder:-

a. The working hours for the articled assistants shall be 35 hours in a week excluding the lunch break.

b. The office hours of the Principal for providing article training to the articled assistant shall not be generally before 9.00 a.m. or after 7.00 p.m.

c. The normal working hours for the articled assistant shall not start after 11.00 a.m. or end before 5.00 p.m.

d. The working hours for the articled assistants should not exceed 35 hours in a week excluding the lunch break and normally an articled assistant be required to work during the normal working hours fixed for articled assistants.

e. In case of exigencies of work with Principal, an article assistant may be required to work beyond his/her normal working hours. However, under such circumstances, the aggregate number of working hours shall not exceed 45 hours per week. The requirement to work beyond 35 hours in a week should not be a practice but only in exceptional circumstances.

Further, where the articled assistant is required to work beyond normal working hours, and aggregate of such hours exceed 35 hours per week, he/she shall be entitled to compensatory leave calculated with reference to number of completed working hours, over and above, 35 hours per week.

Further conduct of training will be regulated as per provisions of the relevant Regulations as follows:-

Regulation 60: Working hours of an Articled Assistant—Subject to such directions as may be issued by the Council, the working hours of an articled assistant shall be 35 hours per week to be regulated by the Principal from time to time.

Regulation 65: Articled assistant not to engage in any other occupation "Without the previous permission of the Council, obtained on application made in the *approved form, no articled assistant shall, during the period of his service as an articled assistant, take any other course of study or training, whether academic or professional, or engage in any business or occupation."

Regulation 66: Enquiries against articled assistant—"(1) Where a complaint or information of any misconduct or breach of Regulation 65 or breach of any of the covenants contained in the articles is received against an articled assistant from his principal or any other person, the President or the Vice-President as the Executive Committee may decide from time to time, may cause an investigation to be made

(2) The Executive Committee may, on a consideration of the report of the investigation and after giving the articled assistant an opportunity of being heard, make any of the following orders, namely;-

i. direct that the papers be filed and the complaint be dismissed, if the Executive Committee finds that the articled assistant is not guilty of any misconduct of breach of Regulation 65 or breach of any of the covenants contained in the articles; or

ii. if the articled assistant is found guilty, reprimand the articled assistant or cancel the registration of articles or direct that any period already served under such articles shall not be reckoned as service for the purpose of the period of practical training specified in Regulation 50.

(3) The articled assistant, the registration of whose articles has been cancelled under this regulation, shall not, except with the permission of the Executive Committee be retained or taken as an articled assistant or audit assistant by any member".

Regulation 67: Complaint against the Principal—(1) Where an articled assistant makes a complaint against his principal on a matter concerning his training as an articled assistant, the President or the Vice-President as the Executive Committee may decide from time to time, may cause an investigation to be made and submit a report to the Executive Committee.

(2) The Executive Committee shall submit the report of the investigation to the Council with its recommendations.

(3) The Council may, on a consideration of the report of the Executive Committee, pass such order as it may consider expedient, including an order withdrawing the entitlement of the principal to train one or more articled assistants either permanently or for a specified period:

(4) The President or the Vice-President as the Executive Committee may decide from time to time, may, pending an investigation of the complaint, either terminate or suspend the articles and allow the articled assistant to be accepted as additional articled assistant by a member, notwithstanding anything contained in Regulation 43.

Form for Self Declaration in lieu of Annual Report for Imparting Industrial Training outside India

(To be typed on Letter Head of the Corporate/Undertaking)

I ____________________ S/o, D/o, W/o ___________________________with Professional Address* of ___________________________ and Resident* of ______________________________ bearing membership no. ___________ employed with the corporate/undertaking _________________________ at the post/designation of ______________ w.e.f ______________ do hereby solemnly affirm and declare as under:

1. That I am an Associate**/ Fellow** member of the Institute w.e.f _______________
2. I am employed with _______________ with its office at _____________ at the post of ________ from a period of ____ years.
3. The paid share capital of the said corporate/undertaking is ______________ (in US Dollars)
4. The total turnover of the corporate/undertaking of immediate previous year (_____) is__________ (in US Dollars)
5. The Fixed Assets of the corporate/undertaking is _________________ (in US Dollars)
6. I hereby verify that the above particulars are true and correct to the best of my knowledge and belief and nothing has been concealed therefrom.

____

Signature

Name: ____________________________

Address: ____________________________

____

____

M.No. __________________

Date: __________________

Place: __________________

Email Id: __________________

Mobile No.: __________________

* As per the revised Guidelines for training of articled assistants outside India an overseas member shall provide a professional address as envisaged in Regulation 2(1)(*xiii*) as well as an address in India.

As per the said Regulation, professional address means:-

a. an address of the place where the member is carrying on his profession (or where he is carrying on his profession at more than one place, the principal place), or

b. if a member is employed, the place of employment or at his option the place of his residence

c. the place of residence, if the member neither carried on the profession nor is employed.

(It may please be noted that an address in India is essential in any of the situation)

** Strike out whichever is not applicable

FAQ's on Training of Articled Assistant outside India

Q. 1 Can a student registered with the Institute get training outside India?

Ans. Yes, a student registered with the Institute is eligible to enroll for training outside India.

Q. 2 Can a Chartered Accountant practicing abroad, train an articled assistant outside India?

Ans. Yes, a Chartered Accountant is eligible to train an articled assistant provided his main occupation is the practice of the profession of accountancy at the time of engaging articled assistants as well as in each of the qualifying years on the basis of which he claims eligibility to train articled assistants. Moreover, the members would be eligible to train articled assistant in accordance with Regulation 43.

Q.3 Is it necessary for a Chartered Accountant training articled assistants outside India to have a professional address in India?

Ans. Till recently, it was mandatory for a member in practice to have a professional address in India in his own charge or in charge of another member. However in terms of the Council decision taken at its 291st meeting held in December 2009, a member shall provide a professional address as envisaged in Regulation 2(1)(xiii) as well as an address in India.

As per the said Regulation, professional address means:–

a. an address of the place where the member is carrying on his profession (or where he is carrying on his profession at more than one place, the principal place), or

b. if a member is employed, the place of employment or at his option the place of his residence

c. the place of residence, if the member neither carried on the profession nor is employed.

(It may please be noted that an address in India is essential in any of the situation)

Q.4 Can a Chartered Accountant working abroad impart Industrial Training to an articled assistant abroad?

Ans. The Industrial Training may be imparted by the Chartered Accountants working abroad in a financial commercial or industrial undertaking with minimum fixed assets & minimum total turnover or minimum paid up capital as specified by the Council (whatever the value specified in terms of Indian currency may be deemed as applicable in foreign countries in their respective currencies) or such other organization or institution approved by the Council. Moreover, the members would be eligible to impart Industrial training in accordance with Regulation 51 and 72. In addition to above, an organization eligible to impart training outside India which is not yet registered with the Institute may submit an application (format of application is available on our website www.icai.org) alongwith a self declaration (in absence of Annual report) regarding minimum fixed assets & minimum total turnover or minimum paid up capital of the organization about the particulars of the undertaking.

Q.5 Can a Chartered Accountant employed as a Paid Assistant or engaged as a partner in a foreign firm of Chartered Accountants eligible to train articled assistant outside India?

Ans. A member employed as a Paid Assistant or engaged as a partner in a foreign firm of Chartered Accountants will also be eligible to train articled assistants at par with the paid assistants with a firm of Chartered Accountants in India. All conditions applicable to the Paid Assistants in India would be applicable to them as well. However, in case of a foreign firm, such a foreign firm shall have at least one partner who is either a member of the Institute or who is eligible to become a member of the Institute, in terms of MRA.

Q.6 What shall be the period of practical training?

Ans. The period of practical training shall be 3 years or 3½ years as applicable, under a practising chartered accountant abroad. However, the articled / audit assistant have an option to undergo Industrial training in accordance with the Regulations 51 & 72 of the Chartered Accountants Regulations, 1988 during the last one year of training.

Q.7 What will be the stipend in respect of articled assistant receiving training abroad?

Ans. The rates, terms and conditions of stipend prescribed as payable to the articled assistants receiving training in India shall be applicable to the articled assistant receiving training abroad except that the same rate of stipend in equivalent terms specified in respective national currencies of the countries concerned instead of Indian rupees.

Q.8 What will be the terms of office hours and working days holidays applicable to articled assistant working abroad?

Ans. Regulation of training in terms of office hours and working days holidays will be applicable as per local office timings and laws. However, requirements of total training hours will be the same as applicable in India which are given hereunder:–

(*a*) The working hours for the articled assistants shall be 35 hours in a week excluding the lunch break.

(*b*) The office hours of the Principal for providing article training to the articled assistant shall not be generally before 9.00 a.m. or after 7.00 p.m.

(*c*) The normal working hours for the articled assistant shall not start after 11.00 a.m. or end before 5.00 p.m.

(*d*) The working hours for the articled assistants should not exceed 35 hours in a week excluding the lunch break and normally the articled assistant be required to work during the normal working hours fixed for articled assistants.

(*e*) In case of exigencies of work with Principal, an article assistant may be required to work beyond his/ her normal working hours. However, under such circumstances, the aggregate number of working hours shall not exceed 45 hours per week. The requirement of work beyond 35 hours in a week should not be a practice but only in exceptional circumstances.

Further, where the articled assistant is required to work beyond normal working hours, and aggregate of such hours exceed 35 hours per week, he / she shall be entitled to compensatory leave calculated with reference to number of completed working hours, over and above 35 hours per week.

Q.9 What are the formalities to be complied by the articled assistant?

Ans. Form 103 for registration of articles should be duly filled and submitted along with such documents as mentioned in the Instruction sheet of Form 103 along with registration fee should reach the respective Institute's office to which the member is attached within 30 days of commencement of training.

Q.10 What is the registration fee applicable to such articled assistant?

Ans. The details of registration fees as applicable for articled assistant is given on link http://www.icai.org/resource_file/14707ipcc_enrolment_feestructure.pdf can be referred. The fee as applicable can be paid by way of Demand Draft drawn in favor of "The Secretary, The Institute of Chartered Accountants of India" payable at the concerned Decentralized office of the Institute.

Q.11 Where are the Forms required to be submitted?

Ans. Form 103 is required to be submitted at the respective Decentralized office of the Institute (i.e. the decentralized office in whose jurisdiction the Indian address of the member falls).

Q.12 Will an articled assistant receiving training abroad be eligible for secondment?

Ans. Yes. The terms and conditions contained in Regulation 54 and Regulation 54A dealing with secondment shall be applicable to the articled assistants receiving training abroad.

Q.12(*a*) Can a Principal depute an articled assistant for training under eligible members of accountancy institutions or bodies outside India (in accordance with Regulation 54A)

Ans. Yes. A principal, with the consent of the articled assistant may depute the latter for training for a period not exceeding 6 months, under a member eligible to engage and train an articled assistant under the bye laws of an institution or body set up in the respective countries.

Q.12(*b*) Will such service be considered as part of practical training? (in accordance with Regulation 54A)

Ans. Such training under members of accountancy institutions or bodies outside India, will be considered as part of practical training.

Q.12(*c*) Is the articled assistant eligible for stipend during such period of training? (in accordance with Regulation 54A)

Ans. No. The provisions of stipend do not apply during such period of training.

Q.12(*d*) Should the articled assistant enter into a Deed of articles for this purpose? (in accordance with Regulation 54A)

Ans. No. There is no need either for execution of deed of articles for such training or for any intimation to the Institute in this regard. However the Principal is required to include the particulars of such training in the report to the Council under Regulation 64.

Q.13 Can a member of the Institute engage and articled assistant under the bye laws of the accountancy institutions or bodies outside India?

Ans. Members entitled to train articled assistants shall not engage any articled assistant or articled assistant or apprentice under the bye laws of any other institutions or society or body unless the person concerned has been registered student with any of the accounting institutions or bodies whose training is recognized by the Council as equivalent to the training prescribed for the members of the Institute.

Q.14 What are the terms and conditions applicable for training articled assistant abroad?

Ans. The principal shall impart training in accordance with the guidelines contained in Training Guide. He shall maintain a record of practical training imparted by him to the articled assistant and report to the Council in the form prescribed in the training guide. Further, the terms and conditions that may be made applicable for training articled assistant in India from time to time shall mutates mutandis apply for training of articled assistant abroad.

In addition to above, the Principal and the articled assistant shall be bound by the provision of Chartered Accountants Act 1949 and Regulations framed thereunder and such other rules and guidelines and directions issued by the Council from time to time.

B. FAQ'S ON STRAIGHT THROUGH PROCESSING

1. What is STP?

Straight-through Processing ("STP") is a mechanism that automates the end-to-end processing of transactions of the financial instruments. It involves use of a single system to process or control all elements of the work-flow of a financial transaction, including what is commonly known as the Front, Middle, and Back office, and General Ledger. In other words, STP can be defined as electronically capturing and processing transactions in one pass, from the point of first 'deal' to final settlement.

2. What is the advantage of using STP over the traditional method?

In the traditional method, each and every transaction involves costly multiple data re-entry from paper documents and other sources which are susceptible to errors, discrepancies, delays and possible fraud. Further, the traditional means and methods of capturing and processing of information such as phone, fax, email etc. requires human intervention which slows the entire cycle, introduces errors and delays settlement. Usage of STP enables orders to be processed, confirmed, cleared and settled in a shorter time period, more cost effectively and with fewer errors. Apart from compressing the clearing and settlement time, STP also provides a flexible, cost-effective infrastructure, which enables e-business expansion through real-time processing and access to enterprise data. STP also streamlines back-office activities, leading to fewer failures, lower risks and drastically reduces costs per transaction. It embraces a set of applications, business processes and standards, which are set to revolutionize the settlement and processing standards within the capital markets industry.

3. What is the status of STP usage in the international scenario?

Internationally, STP can be found in use at the organization level or at the most at the closed group level. However, none of the markets in the world have adopted STP at broader level i.e. STP across the market including participation across the majority of the market participants. As such, no standards for messaging or for interoperability although attempted have been implemented that could be used for adopting STP across the market. The organizations using STP in their own organizational functions are using different messaging standards. Moreover there is STP but only within clients who are networked with one Service Provider. The issue of inter-operability between STP Service Providers has not been resolved. However Internationally it has been accepted that whether it is viewed as an obligation or an opportunity, markets will have no choice but to adopt the system; they will have to spend money to stay in business.

4. What is the current settlement cycle in India?

There has been a move from account settlement period to rolling settlement system. The settlement cycle has been gradually brought down from 15 days to just 2 days thus putting the Indian capital market in the elite group of advanced markets of the world.

5. What are the benefits of adopting STP in India?

1. Facilitates shortening of the settlement cycle.
2. Increases transparency.
3. Avoids costly duplication of work and manual intervention.
4. Reduction in Risks and errors.
5. Faster data capturing, processing and report generation.
6. Increases the overall efficiencies.
7. Makes the market cost effective.
8. Better regulation by systematic audit trial.

6. What is the genesis of STP in India?

The need for STP or any other mean to achieve a quicker, safer, economical and automated system in the Indian capital market was actually felt with the shortening of the settlement cycle, increase in the number of products traded and number of players who participated it the market. Coupled with the technical advancements taking place, the various limitations arising out of the traditional system of trading and settlement, compelled the industry to revisit the viability and feasibility of the systems they had been adopting. Sensing the need of the market, SEBI set up the Committee on 19-February-2002, to assess the feasibility and suitability of introducing STP in Indian markets. The committee was formed to propose a scheme of STP and undertaking a cost-benefit analysis of implementing STP in India. The SEBI Committee for implementation of STP in Indian markets approached the matter under reference through the following steps:

1. Identification of components of the current life-cycle of a trade that involves manual intervention.
2. Identifying and establishing messaging standards for information communication.
3. Identifying options for establishment of a communications backbone that will enable data transfer across participants in a secure and efficient manner.

The committee made a comparison of the various processes involved in the trade cycle (both domestic and international) and identified the following areas which were needed to be automated on a priority basis:

1. Post Trade activities like contract note transfer from broker-dealer to sub-custodian and the mutual fund/FII
2. Pre-match advice to the broker-dealer
3. Domestic Mutual Funds' trade data flow to/from the sub-custodian

In order to implement STP in Indian market, the committee set up by SEBI recommended the following:

1. On-line Connectivity between the depositories to permit easier settlement.
2. Recognition of electronic contract notes as a legal document as an alternative to paper based contract notes.
3. Adoption of ISO 15022 standards for financial messaging with Digital Signature using PKI (Public Key Infrastructure).
4. Encourage multiple STP Service Providers to set-up infrastructure to provide STP to bring in competition for higher efficiency and economy.
5. Amendment to the legal framework (laws/regulations/bye-laws etc.) to provide for recognition of paperless form of data and records. The Committee identified and made a list of bye-laws/regulations etc. that needed to be changed in order to move to a paperless environment.
6. There were certain issues relating to the payment system that needed to be addressed on a priority basis. However, these did not fall under the purview of SEBI and the matter had to be referred to RBI for action at their end. The Committee recommended a strong need to implement Real Time Gross Settlement system. The RBI has already indicated that the RTGS system would be in place by June 2003 (which has later been revised to mid 2004). This would help in creating better synergy between settlement of funds and securities at the same time and true Delivery v/s Payment system can be achieved. Meanwhile, in the interim period, Electronic Funds Transfer (EFT) facility of the RBI was also proposed to be increased in terms of its coverage and the value so that payments may be made faster.

The STP committee also set out the viability and the road map for STP including the following key dependencies/comments:

1. The carrier must be able to deliver a consistent communications platform that meets the security criteria recommended, and offers connectivity to all participants.
2. The carrier must be cost-efficient
3. While there is no constraint on the number of carriers, each carrier must, before launch, establish continuous connectivity with other carriers, so that a participant needs only to sign up to one carrier.

7. What are the circulars regarding STP issued by SEBI?

1	17-Mar-98	L C Gupta Committee on Derivatives
2	30-Jul-98	VARMA COMMITTEE REPORT on risk containment in the derivatives market
3	September-02	SEBI Advisory Committee on Derivatives Report on Development and Regulation of Derivative Markets in India
4	5-Feb-03	Report of the K.R. Ramamoorthy Committee on Participation by Securities Brokers in Commodity Futures Markets
5	5-Oct-04	Market Integrity Related Disclosures

8. On what lines was STP mandated?

SEBI vide letter dated October 03, 2002[1] (Ref: FITTC/FII/19320/2002) mandated introduction of STP for electronic trade processing with a common messaging standard with effect from December 02, 2002 on the following lines:

1. Adoption of ISO 15022 messaging standards by the market participants.
2. Electronic delivery of Contract Notes
3. Connectivity among the market participants and implementation of STP.

9. When was STP first introduced in India?

STP was launched in India on a voluntary basis on November 30, 2002.

10. What were the issues due to which the system could not initially nourish?

1. Lack of Inter-operability between all the STP Service Providers.

1a. Message Handshake Protocols.

1b. Lack of Common Authentication of Digital Signatures across the STP Service Providers.

1c. Lack of end to end compliance to ISO messaging formats from sender to the recipient and absence of standardisation of file formats for client's back office development.

1d. Technological Issues.

2. Absence of a common agreement among the STP Service Providers.
3. Lack of Service Legal Agreement between the STP Service Providers to guarantee delivery of the entire message in a secure and confidential manner.
4. High inter-connectivity charges to interconnect different STP Service Providers.
5. Commercial considerations – bearing of the additional cost of developing and maintaining such interfaces.

11. How was the issue of inter-operability addressed?

To address the issue of inter-operability, a committee consisting of the 4 existing STP Service Providers was formed with NSDL as the convener. The Committee had various deliberations and raised issues of regulatory non-clarity of the issue of electronic contract notes, issues relating to payment of consolidated stamp duty, technological issues, absence of inter-operability between the STP Service Providers due to non-verification of the digital signature of one STP Service Provider (obtained from one Certifying Authority) by another STP Service Provider (who has obtained digital signature from another Certifying Authority), legal and operational issues subsequent to finalization of the operational issues.

NSDL on behalf of the Committee on July 4, 2003, forwarded a consolidated document highlighting the communication protocol & message structure standards/discussions which in their opinion would suit the inter-connectivity between the STP Service Providers through a centralized hub. However one of the STP Service Provider, Financial Technologies had their reservations in adapting the specified customized protocol to suit the inter-operability needs. They preferred adopting the readymade standard messaging platforms.

12. Why was ISP chosen over CUG by the STP Centralised Hub?

There were two options available for the STP centralised hub, one to set it up as a CUG or as an Internet Service Provider (ISP). It was informed that in the current scenario, registering the STP centralised hub as a CUG would necessitate a special permission to waive the inter-connection charges between the STP Service Providers and the STP centralised hub. According to them, the waiver of interconnection charges would take more time. Further, under the existing scenario, CUG networks do not have the flexibility to interconnect to other networks. Compared to this, ISP license has the required flexibility & the following advantages:

1) The STP centralised hub set up as an ISP can be connected by an existing CUG network as a client.
2) The centralized hub could also be connected through a leased line connection or through dial-up connections. However it had been opined that a leased line connection would be a more secure form of connection and the dial-up connectivity should be used as a back-up form of communication.
3) Interconnection to other ISP or any other network including CUG network does not attract any interconnect charges based on the directive issued by TRAI. Only leased line charges based on bandwidth and distance shall be applicable. As such, connectivity of STP centralised hub with any other CUG networks can be achieved without any licensing issues. It has also been confirmed that the STP centralised hub as an ISP would have the flexibility of connecting with any other CUG network like RBI's INFINET CUG network (to facilitate STP for funds).
4) International connectivity is permitted.
5) IP/VPN connection is permitted.
6) Present ISP's license charges applicable are Rs. 1 per annum.
7) No major roll-out obligations. Even one customer with an ISP is regarded as the same having gone live considering the requirement of roll-out within 18 months as per the license requirements.
8) The STP centralised hub as an ISP could also be used for other allied services like a standard communication platform for various exchanges, depositories, and market participants and the STP centralised hub could be made scaleable to include STP among retail clients also.

13. What is the constitution of the STP Centralised Hub?

The STP centralised hub was registered as an Internet Service Provider (ISP) with TRAI. The next issue was the mechanism in which the STP centralised hub would be constituted and owned. After various deliberations, it was agreed that since the exchanges are the originators of trade and the trade gets finally settled with the Clearing Corporation/house associated with the exchange, the exchange and its Clearing Corporation is the focal point for all post trade, pre-settlement and post settlement activities. Hence it would be desirable for the exchanges to constitute the STP centralised hub to bring in the inherent synergies and efficiencies to make the whole framework economically viable. NSE and BSE had shown interest in setting up the STP centralised hub. However setting up two centralized hubs would not solve the issue of inter-operability and would complicate the issue further. BSE endorsed the proposal but desired that the centralized hub be set up as a joint venture between BSE and NSE. NSE also agreed with the proposition of setting up the centralized hub as a joint venture. However NSE recommended implementing the proposed plan in two phases. In Phase I NSE would setup the centralized hub by earmarking some of its existing infrastructure to implement STP for institutional trades where the number of trades is not very large. In Phase II BSE and NSE could jointly develop a project to set up an independent STP centralised hub with an independent system architecture and infrastructure. This plan was accepted by both the exchanges.

It was also confirmed that an ISP license taken up by NSE in Phase I could be later reconstituted to enable joint ownership by BSE and NSE in Phase II. Accordingly, NSE made an application for the ISP (for the STP centralised hub) with Department of Telecommunication (DoT) and has procured the necessary registration of the STP centralised hub as an ISP.

14. How was the issue of Electronic Contract Note operationalised by SEBI?

In order to operationalise the issue of an electronic contract note, SEBI had issued a circular no. SMDRP/POLICY/Cir-15/00 dated December 15, 2000 and a clarification vide letter dated SEBI/SMD/SE/15/2003/29/04 dated April 29, 2003 whereby SEBI had permitted the issue of electronic contract notes with digital signature obtained from a valid Certifying Authority provided under the Information Technology Act, 2000 (IT Act). The exchanges were directed to make the necessary amendments to the bye-laws, rules and regulations for the implementation of the same.

15. What was the format prescribed by SEBI in order to streamline the issuance of electronic contract notes as a legal document like the physical contract note?

In order to streamline the issuance of electronic contract notes as a legal document like the physical contract note, SEBI prescribed a format for the electronic contract note and advised the exchanges to implement the following vide SEBI circular no. DNPD/Cir-9/04 dated February 3, 2004:

1) The exchanges would prescribe a standard format for the electronic contract note (based on the prescribed model format prescribed in Annexure A) in its bye-laws, rules and regulations.
2) The exchange bye-laws, rules and regulations for issuance of electronic contract note were amended to include all the standard pre-printed terms and conditions in the physical contract note. The electronic contract note would mention the relevant bye-laws/rules/regulations of the exchange subject to which the said contract note is being issued.
3) The exchanges were also advised to modify/amend other relevant bye-laws, rules and regulations with respect to signing of the electronic contract note with a digital signature so as to make the modified format

of the electronic contract note a valid legal document like the physical contract note.

4) The exchanges were asked to prescribe the mechanism of record keeping of electronic contract notes in a soft non-tamperable form in compliance with the provisions of the IT Act, 2000.

16. When did the mandatory use of STP come into existence?

SEBI decided vide circular no. DNPD/Cir-22/04 dated April 1, 2004 that all the institutional trades executed on the stock exchanges would be mandatorily processed through the STP System w. e. f. July 01, 2004.

17. What was the system flow of transactions in the STP framework as prescribed by SEBI?

In order bring in standardisation and objectivity, SEBI vide circular no. DNPD/Cir- 23/04 dated April 27, 2004[1] prescribed the following system flow of transactions in the STP framework:

(*a*) A STP user intending to send an instruction would send the message to his STP service provider after digitally signing the same.

(*b*) The STP service provider would verify the signature of the STP user and forward it to the:

  (*i*) recipient STP user, if the recipient STP user is availing services of the same STP service provider; or the

  (*ii*) STP centralised hub if the recipient STP user is not with the same STP service provider. In such a case the STP service provider would be required to prepare a message as per the STP centralised hub prescribed message format, enclose the user's message, digitally sign the message and then send it to the STP Centralised Hub.

(*c*) On receipt of the message by the STP centralised hub, the STP Centralised Hub would:

  (*i*) verify the signature of the sending STP service provider only.

  (*ii*) send an acknowledgment to the sending STP service provider.

(*d*) The STP centralised hub would forward the message to the recipient STP service provider after digitally signing on the message.

(*e*) The recipient STP service provider on receipt of the message from the STP centralised hub, shall verify the signature of the STP centralised hub, verify if the recipient STP user is associated with itself and send an appropriate acknowledgment with digital signature to the STP centralised hub. The STP centralised hub would in turn forward the acknowledgment (received from the recipient STP service provider) duly signed to the sending STP service provider.

(*f*) The recipient STP service provider shall forward the message to the recipient STP user. The recipient STP user would receive the message and verify the signature of the recipient STP service provider and sending STP user.

(2) To enable inter-operation, the STP centralised hub would provide a utility/ client software to the STP service provider. The STP service provider's point of interface with the STP centralised hub would be through this utility/

client software. The PKI (Public key infrastructure) system for the interface shall be implemented at a later stage.

The transaction work flow for the STP system as provided by SEBI circular no. DNPD/Cir-25/04 dated June 10, 2004 is as follows:

1. A contract note in electronic form in the prescribed format (IFN 515 messaging format) shall be issued by the broker & sent to the custodian and/or the institutional investor.
2. In case the contract note is processed directly by the institutional investor, the institutional investor shall send the trade confirmation of acceptance or rejection of the contract note to the broker by using the IFN 598 messaging format. The custodian shall also send the confirmation of acceptance or rejection of such contract note to the broker using the messaging standard IFN 548.
3. In case the contract note is processed by the custodian on behalf of the institutional investor, the custodian shall send the confirmation of acceptance or rejection of the contract note to the broker by using the IFN 548 messaging format.
4. The institutional investor shall send settlement instructions to its custodian in IFN 540 to IFN 543 messaging formats to the custodian for the following trade types:
   - *a.* IFN 540: settlement instruction for a clearing house buy trade
   - *b.* IFN 541: settlement instruction for a delivery-v/s-payment (DVP) buy trade
   - *c.* IFN 542: settlement instruction for a clearing house sell trade
   - *d.* IFN 543: settlement instruction for a delivery-v/s-payment (DVP) sell trade
5. The custodian shall confirm/reject the execution of the settlement instructions to the institutional investor in IFN 544 to IFN 547 messaging formats in the following manner:
   - *a.* IFN 544: confirmation/rejection of an instruction received in messaging format IFN 540
   - *b.* IFN 54+D3585: confirmation/rejection of an instruction received in messaging format IFN 541
   - *c.* IFN 546: confirmation/rejection of an instruction received in messaging format IFN 542
   - *d.* IFN 547: confirmation/rejection of an instruction received in messaging format IFN 543
6. It was clarified that if a message (for the activities mentioned above) is sent using the STP centralised hub framework from one user to another user, then the confirmation/rejection for such a message shall also be sent using the STP centralised hub framework.

In order to bring in clarity and better understanding SEBI in consultation with the STP centralised hub, STP service providers and the STP users had also prescribed the messaging standards for IFN 515, IFN 540 to 547, IFN 548 and IFN 598.

18. What are the identification codes as prescribed by SEBI?

1. Brokers: SEBI registration number (until MAPIN ID is available for every broker)
2. Mutual Funds and schemes of Mutual Funds: SEBI registration number for Mutual Funds and Unique client code issued by the exchanges for schemes (until MAPIN ID is available for each scheme of a mutual fund)
3. FIIs and sub-accounts: SEBI registration number for FII and Unique client code issued by the exchanges for sub-account (until MAPIN ID is available for each FII and their sub-accounts)
4. Custodians: SEBI registration number (until MAPIN ID is available for every custodian)
5. STP service providers and STP centralised hub: MAPIN ID
6. Depositories and exchanges/clearing house/clearing corporation: MAPIN ID.
7. Other Institutional Investors like financial institutions, banks etc.: Unique client code issued by the exchanges (until MAPIN ID is available for each Institutional Investor)

19. Which are the four STP Service Providers currently recognized to execute STP in India?

1. BSE
2. NSE.IT
3. NSDL
4. FTIL

International Taxation

International News

California Completes $14.5 Billion in Debt Sales With Tax-Exempt Issuance

California wrapped up the sale of $14.5 billion in short-term notes and longer-maturity securities to finance public works projects, said Tom Dresslar, a spokesman for Treasurer Bill Lockyer.

Today's sale of $1.25 billion in tax-exempt bonds capped a week of offerings that included $10 billion in revenue anticipation notes and $3.275 billion in taxable general- obligation bonds, Dresslar said in an e-mail.

California sold after yields on 10-year AAA tax-exempts fell 2 basis points, or 0.02 percentage point, to 2.98 percent on Nov. 19, the first decrease in more than a week, according to a Bloomberg Fair Market Value index. The stabilization followed a 13 basis point jump on Nov. 18, the biggest one-day surge since April 1994.

"Now we can catch our breath and give the market a breather," Lockyer said in the e-mail.

The extra yield investors demand above top-rated debt for five-year general obligations from California issuers reached 90 basis points on Nov. 19, the most since July 23, Bloomberg Fair Market Value data show.

California, the biggest issuer of debt in the municipal market, is rated A1 by Moody's Investors Service, its fifth- highest grade, and A- by Standard & Poor's, its fourth-lowest level for investment-quality securities.

The most-populous U.S. state sold $2.5 billion of tax- exempts on March 11, with 30-year bonds priced to yield 5.65 percent, or 121 basis points above AAA debt, according to a Bloomberg Fair Market Value index. The so-called spread narrowed to about 89 basis points on Nov. 19.

'Not Struggling'

"We're not struggling," Dresslar said in a statement on Nov. 19. "We're doing a job that's vital to California's fiscal and economic health, and doing it at the best possible price for taxpayers."

The state completed its sale of $3.275 billion of taxable debt on Nov. 19, a day after increasing it almost 20 percent amid demand for yields that exceed those on some lower-rated corporate bonds.

The sale included $3.025 billion of federally subsidized Build America Bonds and $250 million of traditional taxable general-obligation securities. Coupons were set at 3.25 percentage points more than comparable-maturity Treasuries on $2.11 billion of the Build America debt due in 30 years, according to Lockyer's office. That's a yield of about 7.52 percent.

Earlier in the week, California was forced to raise yields on $10 billion of short-term notes it sold and had to offer rates on taxable debt that exceed those on some lower-rated corporate bonds amid the surge in municipal issuance.

"It's interesting to me that an entity with a $25 billion deficit over the next 18 months doesn't pay much of a rate penalty," Jon Schotz, co-managing partner at Saybrook Capital in Santa Monica, California, who oversees more than $300 million in municipal bonds, said in a telephone interview.

[Source: http://www.bloomberg.com, dated 23rd November, 2010]

'Sin Tax,' Currency Levy Could Help Fund Health-Care

Raising taxes on tobacco and alcohol and introducing a levy on foreign exchange transactions could help pay for health-care for millions of people worldwide who can't get or afford it, the World Health Organization said.

Governments worldwide should also increase the proportion of health-care costs they cover to reduce out-of-pocket expenses for patients whose illnesses can subject them to "financial catastrophe," the Geneva-based agency said in its annual World Health Report today. About 100 million people a year are pushed into poverty because of health-care costs, the WHO said.

Aging populations, increasing rates of chronic disease such as cancer and diabetes and more expensive treatments are driving up health care costs globally, the WHO said. Raising more funds, reducing direct payments and improving efficiency would save millions of lives and keep millions more from poverty, it said.

"For many, health services just don't exist, for others they're not affordable," David Evans, the WHO's director of health systems financing, told reporters in a telephone briefing. "You either choose not to use them, or you suffer severe financial hardship for long periods of time because you actually use them and pay for them."

A 50 percent increase in tobacco excise taxes would generate $1.4 billion in 22 low-income countries, and a levy of 0.005 percent on currency transactions in India alone could raise about $370 million a year, the WHO said.

"So-called sin taxes have the advantage of raising funds and improving health at the same time by reducing consumption of harmful products such as tobacco or alcohol," the WHO said.

Between 20 percent and 40 percent of health-care resources globally are wasted through inefficiency, the WHO said.

"Paying too much when you purchase medicines is one of the major causes," Evans said.

[Source: http://www.businessweek.com, dated 22th November, 2010]

Aid will force Ireland to raise corporation tax

Ireland is being forced to increase its corporation tax in return for an 90-billion euro bailout as European Union and IMF officials began work on Friday on rewriting the Irish budget for the next four years.

EU countries have moved to force Ireland to abandon its low corporate tax rate as a condition for aid to solve its debt crisis.

Low taxes, both personal and corporate, are seen by the Irish government as vital to drive the economic growth needed to lift the country out of a deep recession.

Corporate taxation in Ireland is 12.5 per cent, compared to 34 per cent in France, 30 per cent in Germany and 28 per cent in Britain. The cornerstone of Irish economic policy, it is credited with attracting foreign investment and multinational companies.

French and German officials want any EU rescue deal to end the policy, which they see as disadvantaging their own higher-taxation economies.

[Source: http://www.ottawacitizen.com/business, dated 20th November, 2010]

Wesley Snipes ordered to surrender in tax case

A federal judge on Friday ordered actor Wesley Snipes to surrender to authorities so he can begin serving a three-year prison sentence for tax-related crimes.

U.S. District Judge William Terrell Hodges in Florida rejected a request from the actor's attorneys to review Snipes' sentence and grant a new trial. Snipes has been free on bond for more than two years while appealing.

"The defendant Snipes had a fair trial; he has had a full, fair and thorough review of his conviction and sentence. ... The time has come for the judgment to be enforced," the judge wrote in his 16-page decision.

The 48-year-old star of the "Blade" trilogy and Spike Lee's "Jungle Fever" was convicted in 2008 on three misdemeanor counts of willful failure to file his income tax returns. He was acquitted of two more serious felony charges.

Snipes' defense attorney, Daniel Meachum, said in an e-mail to the Associated Press that he planned to appeal to the U.S. Supreme Court.

Meachum said later in an interview that he didn't expect the Bureau of Prisons to take custody of the actor for another five to seven days. Snipes is in Atlanta, preparing to film the movie "Master Daddy."

"Wesley is incredibly calm and positive," Meachum said in the interview in his Atlanta office. "He wasn't angered. He wasn't bitter."

[Source: http://www.latimes.com, dated 20th November, 2010]

House and Senate Democrats plan tax cut votes after Thanksgiving

Democratic leaders in the House and the Senate have decided to move ahead with votes after Thanksgiving to extend the Bush tax cuts for those making $250,000 or less.

These decisions come hours after Democratic leaders met at the White House with President Obama, where several sources say they talked extensively about the tax cuts. Until now, how or whether Democrats would proceed on the thorny issue of extending the Bush era tax cuts was unresolved.

In the House, Majority Leader Steny Hoyer told CNN that Democratic leaders have scheduled a vote. "At least that will be available for members to have a vote on," Hoyer said.

What is still unclear is if that House vote would extend so-called middle class tax cuts permanently, or just on a temporary basis.

In the Senate, Majority Leader Harry Reid said he plans to vote on the middle class tax cut extension most Democrats want, but he will also allow Republicans to hold a vote on what they are demanding: a permanent extension of all Bush-era tax cuts.

[Source: http://ac360.blogs.cnn.com, dated 19th November, 2010]

Noose tightens on tax haven funds

The government is hard on the trail of money allegedly stashed away in secret bank accounts in tax havens. Finance minister Pranab Mukherjee on Friday told delegates at the Hindustan Times Leadership Summit that India has written to 78 countries to amend existing tax treaties, insisting on their adding on Article 26 of the Model Tax Convention of the Organisation for Economic Cooperation and Development (OECD).

"We are regenotiating the double taxation avoidance agreements (DTAAs) with 78 countries," Mukherjee said.

He said the government has also finalised tax information exchange agreements (TIEAs) with eight countries.

"Once this is institutionalised, we can analyse how much the quantum (of black money is stashed away in secret accounts) would be,"" he added.

"I would not know the actual estimation of black money or unaccounted money stored in other countries," he said.

Global Financial Integrity, a Washington-based research group, says India is losing about $16 billion (₹72,496 crore) a year to outflows related to tax avoidance by wealthy individuals and companies, besides money lost to corruption.

It has estimated that India has been drained of $462 billion (over ₹20 lakh crore) between 1948 and 2008 at current prices. This is nearly 40% of India's gross domestic product.

"My department is examining it (the study)," Mukherjee said.

"Adequate measures would be taken to nip it in the bud as soon as possible as it could affect growth. It is definitely a matter of concern," he said.

He said no estimates have been made on the amount of slush funds from India stashed away in Swiss Banks. "It was estimated way back in the mid-1980s, in a government sponsored study," he said.

In August, India and Switzerland inked an amended tax pact.

[Source: http://www.hindustantimes.com, dated 19th November, 2010]

New tax regime irks Pakistan government allies

The Pakistan government is now feeling the heat from its allies on charges of not taking them into confidence on important decisions like imposition of 'reformed' general sales tax (GST) that aims to broaden the tax net and cut down on inflation.

The government has decided to cut down GST from 17 percent earlier to a flat 15 percent. The move is intended to levy it across the board to include sectors that were not being taxed earlier.

However, the decision has drawn huge opposition from political parties and traders alike.

Senator Kamil Ali Agha of the PML (Quaid) said Friday that 'the decision has been taken without consulting the stakeholders and was likely to prove counter-productive'.

MQM legislator and federal minister Farooq Sattar said: 'The government had assured us of not taking a unilateral decision on this subject but it failed to do so.'

Industry associations too criticised the decision.

'The move will derail the industry which is already reeling from the lack of electricity and gas,' said Federation of Pakistan Chambers of Commerce and Industry (FPCCI) chairman Sultan Chawla.

Former FPCCI president Tariq Saeed said: 'We will take to streets if the government does not withdraw this decision.'

Reform in the tax culture of Pakistan is something on top of the agenda of foreign donors backing the country's bid for financial stability.

US Secretary of State Hillary Clinton has said a couple of times that 'Pakistan should broaden the tax net before looking to foreign countries for assistance'.

Representative of International Monetary Fund (IMF) Adnan Mazari, who was recently in Islamabad to attend a development forum, said: 'This GST has to be imposed, otherwise it will be difficult to extend future instalments of (an) agreed loan.'

The GST was first imposed in 1987 during the tenure of former premier Nawaz Sharif. However, there are quite a few industrial and other sectors, including traders, who manage to evade it by operating without proper invoicing.

[Source: http://sify.com/news, dated 19th November, 2010]

Churches and mosques are tax exempt – Government

The government has described as jaundiced journalism reports that it plans to tax churches and mosques as part of the 2011 budget.

A statement issued by the Minister for Information, John Akologu Tia, said claims by the Accra-based the Daily Guide newspaper that the government will impose taxes on religious bodies is mischievous and assured them of their tax free status.

The Daily Guide in its Friday, November 19 edition published the story with the banner headline "Mills Killer Budget….Churches, Mosques Pay Taxes".

"I want to assure adherents of the various religions, including Christians and Muslims, that no tax has been imposed on churches and mosques under next year's budget", the Minister said.

The minister quoted from the budget statement a portion it suspects the Daily Guide may have 'deliberately distorted' and emphasized that it is not correct.

"Madam Speaker, some institutions enjoy tax-free status because of the original non-profit motive that established them. However, in recent times, some of these institutions have expanded their scope of operation to include commercial activities, thereby making substantive profits but not paying taxes on them. Madam Speaker, government will amend the law to allow the Commissioner-General to tax all commercial activities undertaken by the affected institutions."

[Source: http://news.myjoyonline.com, dated 19th November, 2010]

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Important Cases

Deduction

Besix Kier Dabhol, SA* v. *Deputy Director of Income Tax (International Taxation) (ITAT Mumbai)
Decided on 10.11.2010, MANU/IU/0629/2010

EXPLANATION TO SECTION 37 OF THE ACT IS NOT APPLICABLE IN RESPECT OF DEDUCTION ON INTEREST UNDER SECTION 36(1)(*iii*).

WHEN THERE ARE NO THIN CAPITALIZATION RULES *VIS-À-VIS* DOMESTIC THIN CAPITALIZATION SITUATIONS, MERELY BECAUSE IT IS DESIRABLE TO CURB THIN CAPITALIZATION, THE ASSESSING OFFICER CANNOT DISALLOW THE INTEREST PAID ON DEBT CAPITAL IN THE CASES OF THINLY CAPITALIZED COMPANIES.

Assessment year: 2002-03

Disposition: Appeal allowed

Facts: Assessee is a foreign company having a permanent establishment in India and carrying on a sole business to carry out the project of "construction in India". Pursuant to a contract, Assessee raised the capital by borrowings from its two foreign shareholders, which own the equity shares in the ratio of 60:40. Assessee claimed deduction of interest on these borrowings from the shareholders. Assessing Officer held that in terms of the provisions of Article 7(3)(*b*) of India–Belgium Double Taxation Avoidance Agreement, interest payments from branch to head office are not deductible in computation of profits of the permanent establishment. Assessing Officer also held that as per the provisions of Income Tax Act, provisions of the Double Taxation Avoidance Agreement between India and Belgium, and in view of specific guidelines of Reserve Bank of India, the interest paid by the permanent establishment to its head office, which has an effect of reducing the taxable income of the permanent establishment in the source country, cannot be allowed as deduction. On appeal, CIT(A) relying upon restriction placed in Explanation to Section 37 of the Act and on restriction placed in Article 7(3)(*b*) on intra-organisation notional payment of interest on capital upheld the decision of Assessing Officer. Hence present appeal.

Issue: Whether or not the Commissioner (Appeals) was justified in sustaining the disallowance of interest paid by the Assessee to its shareholders.

Holding: When there are no thin capitalization rules *vis-à-vis* domestic thin capitalization situations, and in the light of the Section 90(2) as it exists at present, any attempts to neutralize thin capitalization *vis-à-vis* permanent establishments of Belgian enterprise will be clearly contrary to the scheme of non-discrimination envisaged by Article 24 (5). In the present case, it cannot be open to the revenue authorities to put any limitation on deduction of interest, in respect of funds borrowed by the permanent establishment, while computing income in accordance with the provisions of Article 7 of

Indo Belgium Tax Treaty, when no such limitations are placed on the domestic enterprise. Merely because it is desirable to curb thin capitalization, the Assessing Officer cannot disallow the interest paid on debt capital in the cases of thinly capitalized companies. Assessee is justified in claiming deduction on account of interest paid on borrowings from its shareholders/ joint venture companies.

Learned CIT(A) is also not justified in placing reliance upon the restriction placed in Explanation to Section 37 of the Act as the provision is not applicable in respect of deduction on interest under section 36(1)(*iii*). Also, CIT(A) is also not justified in placing reliance upon Article 7(3)(*b*) of India–Belgium Double Taxation Avoidance Agreement which put restriction on intra organization notional payment of interest on capital as the interest payment in the present case did not constitute an intra organization transaction at all. Even if these interest payments were to be treated as intra-organization transactions by treating the same as payments made to the foreign general enterprise, and not to the joint venture partners, these payments cannot be viewed as notional payments because in such a situation the foreign general enterprise will have corresponding liability to pay the same to the joint venture partners. Thus, impugned disallowance is contrary to the scheme of the law as it exists. Assessing Officer is directed to delete the impugned disallowance.

Capital asset

Sections 2(14), 2(24), 4, 41(2), 143(2) and 260A of the Income Tax Act, 1961

The Commissioner of Income Tax* v. *Late David Lopes Menezes and ITAT, Panaji Bench (Bombay High Court)
Decided on 29.10.2010, MANU/MH/1450/2010

A CASUAL RECEIPT IN THE NATURE OF WINDFALL ARISING OUT OF ONE TIME EVENT OF AFFIRMATIVE VOTING ON A RESOLUTION IS NOT AN INCOME WITHIN THE MEANING OF SECTION 2(24) OF THE INCOME TAX ACT

Disposition: Appeal dismissed

Facts: Respondent-Assessee Menezes family own 58.88 per cent of equity shares in a company Colfax Limited, which was granted right to use and market products under the brand name "Old Spice" by Shulton (GB) Ltd. UK. Procter and Gamble, USA, acquired Shulton Inc. USA and became the holding company of Shulton (GB) Ltd., UK. To confirm from Colfax about its right to exclusively use the trade mark "Old Spice", Procter and Gamble, USA, pay to the Respondents Menezes family a sum of Rs. 3.5 crores in consideration of their casting affirmative vote in favour of the resolution of the transfer of business of marketing the products under the trade name "Old Spice" in favour of Procter and Gamble, USA. The amount was distributed amongst the members of Menezes family in the proportion agreed between them. When members of Menezes family filed their return of income for the assessment year, notices under Section 143(2) of the Income Tax Act, 1961, were issued by the Assessing Officer, holding the amount received by each members of

Menezes family from Procter and Gamble as an income chargeable to tax. On appeal, the CIT(A) confirmed the decision of the Assessing Officer. On further appeal, Tribunal held that the amount received by Respondent Menezes family from Procter and Gamble could not be considered as an income within the meaning of Section 2(24) of the I.T. Act and was therefore not chargeable to tax under Section 4. Hence, present appeal.

Issue: Whether the amount received by the Assessee is revenue income within the meaning of Section 2(24) and taxable under Section 4 of the IT Act, 1961.

Holding: The burden of proving that a receipt is of revenue character initially rests on the revenue and therefore, revenue is required to initially establish that the amount of Rs. 3.5 crores received by the members of Respondent-Assessee Menezes family from Procter and Gamble was of a revenue character. Once receipt is found to be of a revenue character whether it comes under exemption or not, it is for the Assessee to establish. In the present case, Revenue have not discharged that burden. Also, in the present case, the money was paid for casting an affirmative vote by the members of Respondent Menezes family for one resolution namely the resolution recognizing extinction of the marketing rights of Colfax and the voting on the resolutions in a particular manner was not a business of the members of the Menezes family. The money which was received by them was not a business receipt, but received as bounty or windfall for voting affirmatively and supporting the resolution. Also, money was not to be paid to them at any time in part and never intended to be paid in future. Thus, it was not of repetitive character. Thus, it was a casual receipt in the nature of windfall arising out of one time event of affirmative voting on a resolution and not an income within the meaning of Section 2(24) of the I.T. Act.

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