

CORPORATE UPDATE

FOR CLIENT CIRCULATION ONLY

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INCOME TAX

I. DTAA between India & Armenia

Double Taxation Avoidance Agreement (DTAA) between India and Armenia for avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income has been notified on 08.12.2004 under section 90 of the Income Tax Act, 1961 vide notification no. 292/2004.

The provisions of the treaty shall have effect in India in respect of income derived in the Financial Year from 01.04.2005.

II. Electronic Furnishing of Return of Income

The CBDT, in super session of the 'Electronic furnishing of Return of Income Scheme, 2003' notified on 25th July, 2003

2003 [Notification No. S.O. 856(E)], has notified new 'Electronic Furnishing of Return of Income Scheme, 2004'. [Notification No. S.O. 1073(E), dated 30.09.2004].

The new scheme is applicable to all persons who have been allotted PAN and who are assessed / assessable to tax in any of the specified cities (List of specified cities is annexed on page no. 7). The earlier scheme was applicable only to individuals having income under the head "Salaries" and not having income under the head "Profits and gains from business or profession" who had been allotted a PAN and were assessed / assessable to tax at Ahmedabad, Bangalore, Chennai, Delhi, Hyderabad, Kolkatta & Mumbai.

III. Furnishing of Return of Income on Internet

'Furnishing of Return of Income on Internet Scheme, 2004' has been notified by CBDT vide Notification no. SO 1074(E), dated 30.09.2004. This scheme is applicable to an individual who has been allotted PAN and has income under the head 'Salaries' but does not have any income under the head "Profit and gains from business or profession" and is assessed or assessable to tax in any of the specified cities.

IV. Taxation of Business Process Outsourcing Units in India

A. The CBDT has withdrawn its Circular No. 1/2004 dated 02.01.2004 containing clarification on the taxability of Business Process Outsourcing Units in India. This circular was published in the January, 2004 issue of Corporate Update.

B. The salient features of the new Circular are:

- (a) Determination of the profits attributable to an IT enabled BPO unit constituting a PE, shall be based on "Arm's length principle", as defined u/s 92F (iii) of the Income Tax Act, 1961 for purposes of transfer pricing.

(b) In determining the profits of PE, there shall be allowed as deductions, expenses which are incurred for the purpose of PE, including executive and general administrative expenses so incurred, whether in the state in which PE is situated or elsewhere.

(c) The expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income Tax Act, 1961.

C. Circular No. 5 /2004 dated the 28th September , 2004 is reproduced below:-

Subject: Taxation of IT enabled Business Process Outsourcing Units in India.

1. A non-resident entity may outsource certain services to a resident Indian entity. If there is no business connection between the two, the resident entity may not be a Permanent Establishment of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the non-resident entity will not be liable under the Income Tax Act, 1961.
2. However, it is possible that the non-resident entity may have a business connection with the resident Indian entity. In such a case, the resident Indian entity could be treated as the Permanent Establishment of the non-resident entity. The tax treatment of the Permanent Establishment in such a case is under consideration in this circular.

<p>3. During the last decade or so, India has seen a steady growth of outsourcing of business processes by non-residents or foreign companies to IT enabled entities in India. Such entities are either branches or associated enterprises of the foreign enterprise or an independent Indian enterprise. Their activities range from mere procurement of orders for sale of goods or provision of services and answering sales related queries to the provision of services itself like software maintenance service, debt collection service, software development service, credit card/ mobile telephone related service etc. The non-resident entity or the foreign company will be liable to tax in India only if the IT enabled BPO unit in India constitutes its Permanent Establishment. The extent to which the profits of the non-resident enterprise is to be attributed to the activities of such Permanent Establishment in India has been under consideration of the Board.</p> <p>4. A non-resident or a foreign company is treated as having a Permanent Establishment in India under Article 5 of the Double Taxation Avoidance Agreements entered into by India with different countries, if the said non-resident or foreign company carries on business in India through a branch, sales office etc. or through an agent (other than an independent agent) who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India by the Permanent Establishment becomes taxable in India under Article 7 of the Double Taxation Avoidance Agreements.</p>	<p>5. Paragraph 1 of Article 7 of Double Taxation Avoidance Agreements provides that if a foreign enterprise carries on business in another country through a Permanent Establishment situated therein, the profits of the enterprise may be taxed in the other country but only so much of them as is attributable to the Permanent Establishment. Paragraph 2 of the same Article provides that subject to the provisions of Paragraph 3, there shall in each contracting state be attributed to that Permanent Establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a Permanent Establishment. Paragraph 3 of the Article provides that in determining the profits of a Permanent Establishment there shall be allowed as deductions expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere. What are the expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income Tax Act, 1961.</p> <p>6. Paragraph 2 contains the central directive on which the allocation of profits to a Permanent Establishment is intended to be based. The paragraph incorporates the view that the profits to be attributed to a Permanent Establishment are those which that Permanent Establishment would have made if instead of dealing with its Head office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the "arm's length principle". Paragraph 3 only provides a rule applicable for the determination of the profits of the Permanent Establishment, while paragraph 2 requires that the profits so</p>
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<p>determined correspond to the profit that a separate and independent enterprise would have made. Hence, in determining the profits attributable to an IT enabled BPO unit constituting a Permanent Establishment, it will be necessary to determine the price of the services rendered by the Permanent Establishment to the Head office or by Head office to the Permanent Establishment on the basis of “arm’s length principle”.</p> <p>7. The “arm’s length price” would have the same meaning as in the definition in Section 92F(iii) of the Income Tax Act. The arm’s length price would have to be determined in accordance with the provisions of Section 92 to 92F of the Act.</p> <p>8. The CBDT Circular No.1/2004 dated 2nd January, 2004 is hereby withdrawn with immediate effect.</p> <p style="text-align: center;">*****</p> <p style="text-align: center;">SERVICE TAX</p> <p style="text-align: center;">Issues Pertaining to Levy of Service Tax on Goods Transport Agency</p> <p>1. In the Budget 2004, it was proposed to levy Service Tax on services provided by a goods transport agency in relation to transport of goods by road.</p>	<p>2. As provided in our November, 2004 issue of Corporate Update, Central Govt. had issued Notification no.’s 32/2004 to 34/2004 dated 3rd December, 2004 prescribing the modalities for levy and collection of service tax in respect of transport of goods by road. These notifications are effective from 1st January, 2005.</p> <p>3. Subsequently under Notification no. 35/2004 – Service Tax, dated 3.12.2004, the Govt. has announced certain amendments to the Service Tax Rules. These specify as to who will be liable to pay service tax in relation to taxable service provided by a goods transport agency. The said notification specifies as under:-</p> <p>“(v) in relation to taxable service provided by a goods transport agency, where the consignor or consignee of goods is:-</p> <p>(a) any factory registered under or governed by the Factories Act, 1948 (63 of 1948);</p>
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<p>(b) any company established by or under the Companies Act, 1956 (1 of 1956);</p> <p>(c) any corporation established by or under any law;</p> <p>(d) any society registered under the Societies Registration Act, 1860 (21 of 1860) or under any law corresponding to that Act in force in any part of India;</p> <p>(e) any co-operative society established by or under any law;</p> <p>(f) any dealer of excisable goods, who is registered under the Central Excise Act, 1944 (1 of 1944) or the rules made thereunder; or</p> <p>(g) any body corporate established, or a partnership firm registered, by or under any law.</p> <p>any person who pays or is liable to pay freight either himself or through his agent for the transportation of such goods by road in a goods carriage”.</p> <p style="text-align: center;">FOREIGN DIRECT INVESTMENT</p> <p>The Govt. of India has issued Press note no. 1 on 12th January, 2005 reviewing the guidelines pertaining to approval of foreign/technical collaborations under the automatic route with previous ventures/tie-up in India issued vide</p>	<p>Press note no. 18 dated 14th December, 1998. The said Press note is reproduced below:</p> <p style="text-align: center;">Government of India Ministry of Commerce & Industry Department of Industrial Policy & Promotion Secretariat for Industrial Assistance</p> <p style="text-align: center;">Press Note No. 1 (2005 Series)</p> <p>Subject: Guidelines pertaining to approval of foreign/technical collaborations <u>under the automatic route with previous ventures/tie-up in India.</u></p> <p>1. The Government has reviewed the guidelines notified vide Press Note 18 (1998 series) which stipulated approval of the Government for new proposals for foreign investment/ technical collaboration where the foreign investor has or had any previous joint venture or technology transfer/ trademark agreement in the same or allied field in India.</p> <p>2. New proposals for foreign investment/technical collaboration would henceforth be allowed under the automatic route, subject to sectoral policies, as per the following guidelines:</p> <p>i) Prior approval of the Government would be required only in cases where the foreign investor has an existing joint venture or technology transfer/trademark agreement in the 'same' field. The onus to provide requisite justification as also proof to the satisfaction of the Government that the new proposal would or would not in any way jeopardize the interests of the existing joint venture or technology/ trademark partner or other stakeholders would lie equally</p>
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<p>on the foreign investor/ technology supplier and the Indian partner.</p> <p>ii) Even in cases where the foreign investor has a joint venture or technology transfer/ trademark agreement in the 'same' field prior approval of the Government will not be required in the following cases :</p> <p>a. Investments to be made by Venture Capital Funds registered with the Security and Exchange Board of India (SEBI); or</p> <p>b. where in the existing joint-venture investment by either of the parties is less than 3%; or</p> <p>c. where the existing venture/ collaboration is defunct or sick.</p> <p>iii) In so far as joint ventures to be entered into after the date of this Press Note are concerned, the joint venture agreement may embody a 'conflict of interest' clause to safeguard the interests of joint venture partners in the event of one of the partners desiring to set up another joint venture or a wholly owned subsidiary in the 'same' field of economic activity.</p> <p>3. These guidelines would come into force with immediate effect.</p> <p style="text-align: right;">Sd/- (Umesh Kumar) Joint Secretary to the Government of India</p>	
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Annexure – List of specified cities (Electronic/Furnishing of Return of Income Scheme, 2004)

Serial Number	City	Serial Number	City
(1)	(2)	(1)	(2)
1.	Agra	28.	Jalpaiguri
2.	Ahmedabad	29.	Jodhpur
3.	Allahabad	30.	Kanpur
4.	Amritsar	31.	Kolhapur
5.	Bangalore	32.	Kolkata
6.	Bareilly	33.	Lucknow
7.	Baroda	34.	Ludhiana
8.	Bhopal	35.	Madurai
9.	Bhubaneshwar	36.	Meerut
10.	Bikaner	37.	Mumbai
11.	Calicut	38.	Muzaffarpur
12.	Chandigarh	39.	Mysore
13.	Chennai	40.	Nagpur
14.	Cochin	41.	Nashik
15.	Coimbatore	42.	Panaji
16.	Delhi	43.	Panchkula
17.	Dhanbad	44.	Patiala
18.	Gandhinagar	45.	Patna
19.	Thane	46.	Pune
20.	Guwahati	47.	Raipur
21.	Gwalior	48.	Rajkot
22.	Hubli	49.	Ranchi
23.	Hyderabad	50.	Rohtak
24.	Indore	51.	Sambalpur
25.	Jabalpur	52.	Shillong
26.	Jaipur	53.	Shimla
27.	Jalandhar	54.	Surat

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Serial Number	City	Serial Number	City
(1)	(2)	(1)	(2)
55.	Trichy		
56.	Trivandrum		
57.	Udaipur		
58.	Varanasi		
59.	Vijayawada		
60.	Vishakhapatnam		