M V DAMANIA & CO.
CHARTERED ACCOUNTANTS

NEWS LETTER JUNE 2010

Contributors:

1. Malay Damania	-	International Tax
	-	FEMA
2. Bharat Jain	-	IFRS
3. Krishna Kanojia	-	Corporate Law

TABLE OF CONTENTS

1. **International Tax ------------------------------------ Page No. 3 to 4**

    - Airlines Rotables vs. JDIT – UK, (ITAT Mumbai) -------Page No. 3 & 4

2. **Foreign Exchange Management Act ---------------------- Page No. 5**

    - Current Account Transactions – Liberalisation ------- Page No. 5

3. **International Financial Reporting Standards ----------- Page No. 6 to 10**

    - Key Aspect - Financial Instruments ---------------- Page No. 6 to 10

4. **Corporate Law ------------------------------------- Page No. 11 to 14**

    - Corporate Public Deposit ------------ Page No 11 to 14

INTERNATIONAL TAX

- **Airlines Rotables vs. JDIT – UK, (ITAT Mumbai)**

Re: Determination of PE when the stock was held as a Bailee.

Facts of the case:

The Assessee, Airlines Rotables - a UK Company, entered into an Agreement with Jet Airways for providing services in two segments. First, to carry out repairs and overhauling of the aircraft components outside India and second, to provide spares and components while the components were being repaired. To ensure that the spares and components are readily available, the assessee Company kept the stock of spares and components at the operating base of Airline in India. Though the stock was under the direct control of the assessee, the actual possession of the stock was with the Airlines as a Bailee. The AO took the view that since the stock was kept in India with Jet Airways, it constituted an "Agent" and a "Permanent Establishment" in India under Article 5(4)(b) of the Treaty and that 10% of the receipts was liable to be taxed in India. This was upheld by the CIT(Appeals).

The Tribunal Held that:

In order for a PE to come into existence, primarily Three conditions have to be satisfied: (a) Physical criteria ie. Existence of physical location, (b) Subjective criteria ie. Right to use that place and (c) Functional criteria i.e. Actually carrying on business through that place.

It is only when all the above Three conditions are satisfied that a PE can be said to have been constituted to come into existence. The onus is on the Department to prove that the Assessee has a PE.

The Tribunal observed that on the facts of the case, although the stock was kept at the specific location in India that location was not at the disposal of the Assessee. Also the Assessee had no right to carry out its independent business from that place. There was consequently no PE under Article 5(1) of the Treaty.

Further, even if there was a PE, the consideration relatable to the activities done outside India was not "attributable" to the PE. As regards the consideration for the right to use the components, the business element is over as soon as the components

are delivered to the Airline. There is no “carrying on of business” from that location. Consequently, there is no PE under Article 5(1).

The argument of the Department that there is a “Dependent Agent PE” is also incorrect. The rationale of the Dependent Agent is that the foreign Enterprise carries on business through that Dependent Agent. The activity of the Dependent Agent is integrated into the business of the Principal to a substantial extent.

However, on the facts of the case, Jet Airways was neither a Dependent Agent of the Assessee nor the assessee was carrying on any business through Jet Airways. Hence there was no question of PE under Article 5(4) of the Treaty.

- **FEMA ALERT**

Current Account Transactions – Liberalisation

The Reserve Bank of India has liberalised the remittance of foreign exchange for Royalty on sales.

According to Rule 4 of The Foreign Exchange Management (Current Account Transactions) Rules, 2000, any remittance of foreign exchange on technical collaboration agreement for payment of Royalty exceeding 5% on local sales and 8% on export sales and the total lump-sum value exceeding USD 2 million required prior approval of the Government of India.

The Reserve Bank of India, via A.P. (Dir) circular No. 52 dated 13th May 2010 has lifted the entire restriction for payment of such Royalty. Therefore, now onwards for any remittance of foreign exchange on account of Royalty, Central Government permission will not be required.

Compiled By: Malay Damania

INTERNATIONAL FINANCIAL REPORTING STANDARDS

Key Aspect - Financial Instruments As Per International Financial Reporting Standard (Ifrss)

A. Summary of Key differences between IAS 39 and IFRS 9

The ISAB has undertaken a project to replace existing IAS 39 "Financial Instruments-Recognition and Measurement" in order to improve the usefulness of financial statements for user by simplifying the classification and measurement requirements. The replacement process commences with introduction of IFRS 9 "Financial Instruments".

Key differences are as follows:

Particulars	IAS 39	IFRS 9
Applicability	Currently effective	Effective from annual period commencing on or after January 2013. Early Adoption is permitted
Scope	All aspects of Financial assets & Financial Liabilities including hedge accounting	Only Financial assets included. Presently the standard does not include Financial liabilities, derecognition of financial instruments, impairment and hedge accounting
Classification of debt instruments	Fair Value Through Profit & Loss (FVPL) Available-for-sale (AFS) Held-to-maturity (HTM) Loan and Receivable (LAR	Fair Value Through Profit & Loss (FVPL) Amortised Cost (AC)

Particulars	IAS 39	IFRS 9
Classification of equity instruments	Fair Value Through Profit & Loss (FVPL) Available-for-sale (AFS)	Fair Value Through Profit & Loss (FVPL) Fair Value Through Other Comprehensive Income (FVOCI)
Basis of Classification	Intention to hold till maturity, trading for short term profits, derivative, loan or receivable or intentional designation subject to certain restrictions.	Classification based on business model and the contractual cash flow characteristics
Measurement - Debt Instruments	Measured at amortised cost if classified as held-to-maturity or as loan or receivable. Other classifications are measured at fair value.	Measured at amortised cost (AC) if business model objective is to collect the contractual cash flows and the contractual cash flows represent solely payment of principal and interest on the principal amount outstanding. Debt instruments meeting the above criteria can still be measured at fair value through profit or loss (FVPL) if such designation would eliminate or reduce accounting mismatch. If not, measured at fair value through profit or loss (FVPL).
Measurement - Equity Instruments	Measured at fair value. *Exception:* Unquoted equity investments are measured at cost where fair valuation is not sufficiently reliable.	Measured at fair value through profit or loss. An entity can irrevocably designate at initial recognition as fair value through other comprehensive income, provided the

Particulars	IAS 39	IFRS 9
		equity investment is not held for trading.
Fair value option	An entity can designate a financial asset to be measured at fair value on initial recognition. The entity has the freedom to do so and need not satisfy any other criteria.	A financial asset can be designated as FVPL on initial recognition only if that designation eliminates or significantly reduces an accounting mismatch had the financial asset been measured at amortised cost.
Reclassifications **- Debt instruments**	Reclassification between the various four categories allowed under specific circumstances with the gain/loss being treated differently depending upon the movement between the classifications. Reclassification from held-to-maturity (HTM) is viewed seriously if does not fall within the permitted exceptions.	If entity's business model objective changes, reclassification is permitted between FVPL and AC or vice versa. Such changes should be demonstrable to external parties and are expected to be very infrequent.

The standard has given certain transitionary provisions which provide guidance on how companies who are currently following IAS 39 principles can transition to IFRS 9 within the period when the standard is issued and the effective date of application.

The transitionary provision also provides guidance on classification and measurement of financial assets existing on the date of initial application of IFRS 9.

AS 30 "Financial Instruments- Recognition and Measurement "issued by ICAI is based on the IAS 39 and would be mandatory applicable from annual period commencing on or after 1st April 2011. As ISAB is on the project of amending IAS 39, ICAI needs to amend the AS 30 accordingly but the issue would remain for in between period i.e. from 1st April 2011 to 31st December 2012.

B. GUIDING PRINCIPLES -CLASSIFICATION FOR VARIOUS FINANCIAL INTRUMEMTS- EQUITY vis a vis LIABILITY:

The table illustrates the decision process to determine whether an instrument is a financial liability or equity instrument.

Instrument	Cash obligation for principal	Cash obligation for coupon / dividends	Settlement in fixed number of shares	Classification
Ordinary shares	×	×	n/a	Equity
Redeemable preference shares with 5% fixed dividend each year	✓	✓	×	Liability
Redeemable preference shares with discretionary dividends	✓	✓	×	Liability for principal and equity for dividends
Convertible bond which converts into fixed number of shares	✓	✓	✓	Liability for bond and equity for conversion option
Convertible bond which converts into shares to the value of the liability	✓	✓	×	Liability

C. Guiding Principles- Classification For Various Financial Intrumemts Which Linked To Entity's Own Equity:

Derivative contracts that only result in the delivery of a fixed amount of cash or other financial assets for a fixed number of an entity's own equity instruments are classified as equity instruments. All other derivatives on own equity are treated as derivatives and accounted for as such under revised IAS 39. This includes any that can or must be settled on a net basis in cash (or other financial assets) or in shares; may be settled gross by delivery of a variable amount of cash (or other financial assets). Any derivative on own equity which gives either party a choice over how it is settled is a financial asset or liability unless all of the settlement alternatives would result in equity classification. The table opposite illustrates this.

Instrument	Classification	Example
A contract that is a settled by the issuer delivering a fixed number of the issuer's own shares in exchange for a fixed monetary amount of cash or other assets	Equity	A warrant giving the counterparty a right to subscribe for a fixed number of the entity's shares for a fixed amount of cash
A contract that requires an entity to repurchase (redeem) its own shares for cash or other financial assets at a fixed or determinable date or on demand	Liability (redemption amount)	Forward contract to repurchase own shares for cash
An obligation to redeem own shares for cash that is conditional on the counterparty exercising a right to redeem	Liability (redemption amount)	Written option to repurchase own shares for cash
A contract that will be settled in cash or other assets where the amount of cash that will be received or delivered is based on changes in the market price of the entity's own equity	Derivative asset or liability	Net Cash settled share option

Compiled By : Bharat Jain

CORPORATE LAW

• CORPORATE PUBLIC DEPOSIT

The term "Public Deposit" implies any money received by a non- banking company by way of deposit or loan from the public other than in the form of shares and debentures. The term public includes the general public, employees, customer and shareholders of the company.

Some of advantages of public deposits enjoyed by the companies are:

1. Process of inviting deposit is simple and easy.
2. Administrative cost of deposit is lower compared to issue of share and debentures.
3. Interest rate payable on deposit is lower compare to loans from banks and financial institution.
4. No dilution of shareholder's control
5. No need to create mortgage or pledge of security as public deposit is unsecured.

However there are some disadvantages faced by companies are:

1. The maturity period is short enough
2. Limited fund can be obtained from the public deposit.
3. Public deposit is more likely to be affected by uncertain economics conditions.

Experience has shown that in many cases companies has defaulted in refund of deposit, so to control those erroneous companies, Sec 58 A and 58 B were introduce in the Companies Act, which prescribe the limits and the manner of invitation of acceptance of deposits from the public or the members of the Company. In pursuance of these sections Companies (Acceptance of Deposits) Rules 1975 were introduced.

Synopsis of Companies (Acceptance of Deposits) Rules 1975 is as follows:

Rule 2 - defines "Deposits" as – any deposit of money with, and amount borrowed by, a company, but does not include,

i. Any amount received or repayment guaranteed by Central or a State Government or amount received from Local Authority, Foreign Government and any foreign citizen, authority or person.
ii. Any amount received as loan from banking company, State Bank of India or its subsidiaries, nationalized bank or Co-operative societies
iii. Any amount received as loan from notified financial institution, UTI, Insurance Company, etc.
iv. Any amount received by a Company from any other Company.
v. Amount received from employee of the company by way of security deposits.
vi. Amount received as advance or security deposits from any purchasing, selling or other agent during the course of business.
vii. Amount received by way of subscription to any shares, stock, etc.
viii. Amount received in trust or amount in transit.
ix. Amount received by a private company from person who at the time of receipt is director, relative of director or member.
x. Amount raise through issue of bonds or debenture.
xi. Unsecured loan from promoters of company subject to some conditions.

Rule 3 (1) - Acceptance of deposits by Companies:-

(a) No company shall accept deposit maturating within a period of less than 6 months or more than 36 months from the date of acceptance or renewal.

Provided for short term requirement, accept or renew deposit refer in clause (i) of sub-rule (2) for repayment earlier than 6 months subject to condition that such deposit,

i) shall not exceed 10% of aggregate paid-up capital and free reserves and
ii) are repayable not earlier than three months.

(b) Interest rate should not exceed 12.5% p.a at rest which shall not be less than monthly rest.

(c) Brokerage payment to any broker should not exceed as prescribed, however brokerage to be paid only to person authorized by company in writing.

Brokerage Rate	Period of Deposits
1%	Upto 1 Year
1.5%	1 year to 2 year
2%	Exceeding 2 years

(d) Company with net owned fund of less than one crore should not invite public deposit

Rule 3 (2) - No company other than Government company shall accept;

i. Any deposit against unsecured debenture or from shareholders (not being Pvt. Ltd Company) or deposit guaranteed by director, if the amount of deposit outstanding exceeds 10% of aggregate of Equity Capital and Free Reserves

Provided that for calculation of deposit outstanding on the date of acceptance, any deposit guaranteed by person who was managing agent, treasurers or secretaries at the time of giving such guarantees, such deposit should also included.

ii. Any other deposit including above (i) should not exceeds 25% of aggregate of Equity Capital and Free Reserves.

Rule 3 (2A) - No government company shall accept deposit if amount of deposit exceeds 35% of aggregate of Equity Capital and Free Reserves.

Rule 3A – Maintenance of Liquid Assets;

1. Every company shall before 30th April of each year should deposit not less than 15% of deposit maturing in next year, in following manner;

   (a) In current or deposit account with scheduled bank, free of charge or lien
   (b) Unencumbered securities of Central & State Government
   (c) Unencumbered securities of clause (a) to (d) and (ee) of section 20 of Indian Trust Act ,1882 (2 of 1882).
   (d) Unencumbered bonds issued by HDFC.

2. Amount deposited or invested, should be utilized only for payment of maturing deposit, however deposit should not fall below 10% of amount maturing till the 31st March of that year.

Rule 4 - Company can invite deposit only after giving advertisement in leading English newspaper and in one vernacular newspaper circulating in state in which registered office of company is situated.

Rule 7 – Every company shall keep at its registered office one or more Deposit register and same should be preserved for eight calendar years.

Rule 8 – Provision relating to repayment of deposit.

- If repayment is after 12 months but before maturity, the interest payable on such deposit should be less by 1% from the applicable interest rate.

Rule 10 - Return of deposits to be filed with the Registrar.-

Every company shall on or before the 30th day of June, of every year, file with the Registrar, a return in the form annexed to these rules and furnishing the information contained therein as on the 31st day of March of that year duly certified by the Auditor of the Company.

A copy of the return shall also be simultaneously furnished to the Reserve Bank of India.

Complied By : Krishna Kanojia