

# NEWSLETTER

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# FEMA

## ➤ Transfer of funds from NRO account to NRE account:

Hitherto, transfer of funds from NRO account to NRE account was not permitted by RBI. Now, RBI has allowed NRIs/PIOs to transfer funds from their NRO account to NRE account subject to following conditions:

1. Such transfer is permitted subject to payment of applicable income tax. ( i.e. As if the funds were to be remitted abroad)
2. Such transfer of funds shall be within overall limit of US\$ 1 million per financial year.
3. Such transfer of funds shall be considered as “eligible credit” in NRE account.

## ➤ Release of foreign exchange for Miscellaneous Remittances:

Hitherto, Authorised Dealers were allowed release an amount up to US \$ 5,000 or its equivalent for all permissible transactions on the basis of a simple letter from the applicant containing the basic information like name and address of the applicant and the beneficiary, amount to be remitted and purpose of remittance. It was also insisted that the Authorised Dealers should not insist on submission of Form A2 in such cases.

The above limit has now been raised by The RBI to US \$ 25,000. It is also clarified that the above remittance can be made for any current account transaction (not included in Schedules I and II on Current Account Transactions).

## ➤ Exchange Earner’s Foreign Currency (EEFC) Account:

All foreign exchange earners were permitted to retain 100% of their forex earning in EEFC account with any AD in India. The RBI has now decided as follows:

1. 50% of the balance in EEFC account shall be converted into Rupee balances and credited to their Rupee account.

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2. The facility of EEFC scheme is to enable the exchange earners to save on conversion/transaction cost while undertaking forex transactions. EEFC account holders will now be permitted to access forex market for purchasing foreign exchange only after they have fully utilized balance available in EEFC account.
3. These rules will also apply to Residence Foreign Currency (RFC) account and Diamond Dollar Account (DDA).

## ➤ External Commercial Borrowing (ECB) Policy ? Proceeds for Rupee expenditure

As per the existing ECB guidelines, the proceeds of ECB for rupee expenditure such as local sourcing of capital goods, on-lending to self help groups etc. were brought into India immediately in their Rupee account.

The borrowers are now required at the time of availing Loan Registration Number (LRN) itself to provide bifurcation of utilisation of ECB proceeds towards foreign currency and Rupee expenditure.

RBI has further clarified that it is primary responsibility of the borrower to ensure that the ECB proceeds meant for Rupee expenditure are brought into India for credit to their Rupee account immediately.



*Compiled by Malay Damania*



# DIRECT TAX

## Roxar Maximum Reservoir (Authority for Advance Ruling)

### Facts:

- A tender was floated by ONGC.
- The Assessee was successful bidder and entered into a Contract with ONGC for Supply, installation and commissioning of certain plant and equipment.

### Contention of the Company:

- The contract was an offshore supply contract. The title of the goods passed to ONGC offshore, the payment was received by the Company offshore and therefore the tax authority had no jurisdiction to tax such transaction in its entirety.
- Reliance was placed on Supreme Court decision on Ishikawajima-Harima.

### AAR Ruling:

- The AAR observed that in the case of Vodafone International, Supreme Court laid down that what is needed is to consider the transaction in its entirety and look at the transaction as a whole and not adopt a dissecting approach. A transaction must be "looked at" and not "looked through".
- The purpose for which the contract is entered into has to be seen from the terms of the contract. In this case the contract was for "supply, installation and commissioning of the plant/equipment."
- The contract was clearly not for sale of equipment. Nor was it for a mere erection. It was a composite contract for supply and erection at a site within the territory of India. The payment was received by the Company for the performance of contract as a whole in India. Therefore, the income to the Company accrues in India.
- Accordingly, it held that the payment towards the supply of equipment cannot be considered divorced from the payment received towards performance of the entire contract. Therefore entire income would be taxable in India.

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## **CIT vs. De Beers India (Karnataka High Court)**

### **Sub: High Court explains "Make Available" concept**

The High Court explained the meaning of the term "Make Available" specified in Article 12 on "Fees for Technical Services" in some of the tax treaties.

- Fees for technical services means payments of any kind to any person in consideration for services of technical nature if such services make available technical knowledge, experience, skill, know-how or process, which enables the person acquiring the service to apply such technology contained therein independently.
- The question is, after rendering of such technical service by the service provider, whether the recipient is able to use the technology which the service provider has used.
- The technical knowledge, skills etc. must remain with the recipient of such service even after the particular contract comes to an end.
- The technical knowledge or skills of the service provider should be imparted to and absorbed by the service receiver so that the receiver can deploy the technology or technique in the future without depending upon the service provider.
- Once the technology is made available, it is open to the service recipient to make use of such technology. The tax is not then dependent on the actual use of the technology by the recipient.
- In the case concerned, the High Court observed that, Furgo ( the service provider) had given data, photographs, maps but they had not made available technical expertise, skill or knowledge in respect of such collection or processing of data to the assessee, which the assessee could apply independently and without assistance and undertake such survey independently excluding Furgo in future.
- Also, the contract with Furgo was for providing of service and not for supply of technical design or plan. The reports and maps provided by Furgo was only a mode of representation of data and not technical plan or design.

## **Royal Bank of Scotland -**

### **Sub: Interest on Income Tax Refund**

- The assessee bank is entitle to interest under section 244A(1)(b) on excess payment of Self Assessment Tax from the date of payment up to the date the refund is actually granted.

## **Sanghvi Jewellery - Mumbai Tribunal**

### **Sub: Deduction under section 10A**

- If during the course of assessment proceeding, any addition is made to the profit of the business by way of disallowance of expenses, the amount so added will also be available and is to be considered while calculating the deduction under section 10A as per the method prescribed in the section.

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## **Chandabhoy Jasoobhoy - Mumbai Tribunal**

**Facts:** The assessee is a Chartered Accountants' firm which employed 18 consultants. These consultants were prohibited from accepting any other assignments and worked full time for the assessee. During the year, the assessee made consultancy payments to them after deducting tax u/sec. 192 of the Act. After going through the agreement the AO contended that there was no employer-employee relationship and the payments made were in the nature of Professional fees and the tax ought to have been deducted u/sec. 194J. Invoking provisions of section 40a(ia), he disallowed the entire payments made to the consultants.

### **The Tribunal held that:**

- This is not the case where the assessee has not deducted any tax at source.
- The individual assessments of the consultants were made accepting the tax as Salary payments.
- Provisions of section 40a(ia) can be invoked only in the event of non-deduction of tax at source and not for lesser deduction of tax.
- The assessee had indeed deducted tax u/sec. 192 and so the provisions of section 40a(ia) would not apply.



*Compiled by Malay Damania*



# FINANCIAL SERVICES

## Brief Overview of Letter of Credit (LC) Transactions

### I) Letter of Credit

#### A) DEFINITION

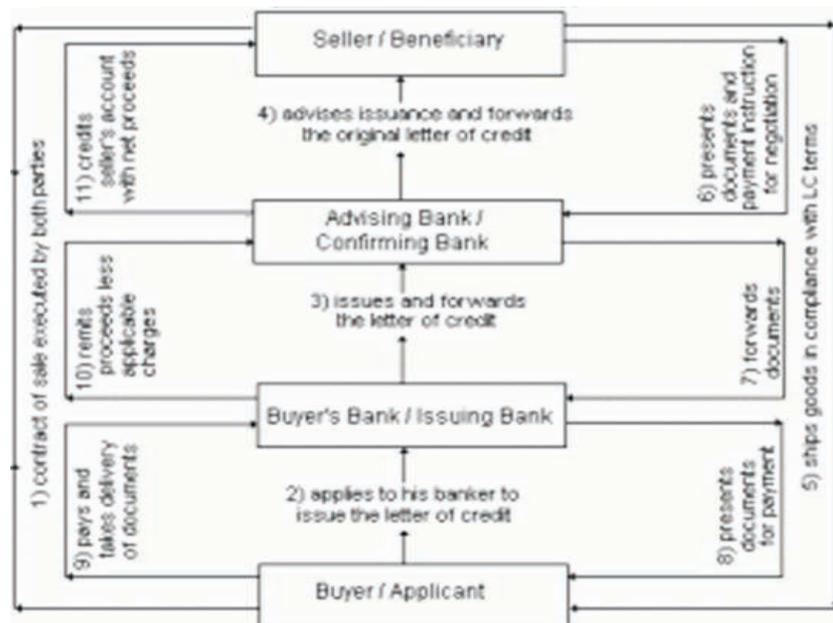
- A letter of credit refers to a document which is issued by financial institutions to offer a binding payment undertaking which is used mainly in trade finance.
- Letter of credit also acts as a method of payment for different transactions. It means that for getting the payment an exporter needs to redeem the letter of credit. In most of the cross border trade transactions between buyers and sellers letter of credit is used. For developing the land, letter of credit are used for ensuring that different services like sidewalks, roads, ponds etc. get completed.
- A letter of credit is a promise to pay. Banks issue letters of credit as a way to ensure sellers that they will get paid as long as they do what they've agreed to do.
- Letters of credit are common in international trade because the bank acts as an uninterested party between buyer and seller. For example, importers and exporters might use letters of credit to protect themselves. In addition, communication can be difficult across thousands of miles and different time zones. A letter of credit spells out the details so that everybody's on the same page.
- Local L/C denominates local currency.

#### B) MODUS OPERANDI

- A beneficiary who deserves the money, an advising bank with which the beneficiary has an account and the issuing bank with which the applicant has a bank account, are the parties which are involved in a letter of credit. Most of the letters of credit cannot be cancelled until an agreement is made between the beneficiary, the advising bank and the issuing bank. In order to get payment through a letter of credit, a person needs to present documents like bill of lading, commercial invoice and insurance papers testifying that the goods are insured against any damage or loss in transit.

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## Brief Overview of Letter of Credit (LC) Transactions



### C) DOCUMENTATION

- There are different documents which are called for under a letter of credit. Financial documents which include bill of exchange, commercial documents like packing list and invoices, official documents which include license, inspection cert etc., transport documents, insurance documents and shipping documents like insurance certificate are those documents which are called for under a letter of credit. One should also know that any type of charges which are to be paid for getting the letter of credit issued, reimbursement etc. are to be paid by the applicant or according to the terms and conditions mentioned clearly in the letter of credit.

### D) RISK

- You should also make yourself aware about different risk situations related to the use of letters of credit. Several fraud risks are associated with letters of credit. For instance, forging of credit may take place. Risks which are taken by the applicant of a letter of credit include damage of goods in transit, short shipment, bad quality of goods, no delivery of goods etc. It is true that each party which is involved in a letter of credit bears some risk. However, a letter of credit is widely used for trade transactions between different parties in different countries.

## II) LC DISCOUNTING : Overview

- The Letter of Credit from the prime banks or financial institutions is considered as a complete security. A borrower can offer the LC to the lender and get the loan sanctioned. The loan amount may be up to 100% of the LC value. Once the Letter of Credit is executed the amount against LC is settled by the lender against the loan disbursed to the borrower.
- Letter Of Credit Discounting helps the businesspersons to raise finance quickly for a shorter period of time.
- A Bank has Confirmed an irrevocable LC (180 days tenor). Upon checking of documents they found it to be discrepant and listed the discrepancies to the beneficiary. Meanwhile beneficiary has sent the scanned copies of documents to the applicant.

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## Brief Overview of Letter of Credit (LC) Transactions

- The very next day Issuing Bank sent MT799 to the Confirming Bank saying 'applicant has received copies of documents and they agree to accept the discrepancies in it (issuing bank has not mentioned the discrepancies in MT799) and we authorize you to negotiate the documents.
- Now Beneficiary wants the Confirming Bank to discount and credit their account. A confirming bank never sought for waiver /authorization from the issuing bank. it would suggest confirming bank to quote all the discrepancies they have noted and seek authorization from the issuing bank before negotiating.
- No notice of refusal sent by the issuing Bank. If issuing Bank fails to provide discrepant notice within the time frame of 5 banking days then CB can go for the negotiation the L/C.
- Since it will not be sufficient so the confirming bank should just reply to the issuing bank referring to such applicant agreement and requesting further confirmation from the issuing bank concerning all the discrepancies in the shipping documents and only if the issuing bank replied with acceptance and waiving all the stated discrepancies in the confirming bank go forth with the negotiation resting assure that every thing is in order.
- The practice as described is perhaps not that uncommon, and is likely to have arisen as a result of an urgent need of the goods and a desire by the issuing bank to act in its customers best interest.
- However, the better practice would have been for the issuing bank to be absolutely clear in its instructions to the nominated bank. So, for example, it might have stated: "we authorise you to negotiate documents notwithstanding any discrepancies which you may find", or "we authorise you to accept documents as presented, and negotiate accordingly".
- From the nominated bank's point of view (whether confirmed or not), the first option does away with the need to refer discrepancies to the issuing bank, and the second option, provides for the nominated bank not to even be required to examine the document, and therefore, even if the LC is confirmed, the beneficiary cannot compel the bank to discount the proceeds, or compel it to incur a deferred payment obligation.
- The nominated bank must be careful that even if it chooses to discount, since neither the issuing bank, nor the nominated bank will have acted in accordance with UCP articles, the articles will not automatically provide protection to the nominated bank in respect of loss of documents (Art 35), nor beneficiary fraud (sub-art 7C).
- For protection, the nominated bank should ensure that the issuing bank follows the process as under Art. 16, or otherwise, ensure that it specifically invokes the relevant UCP articles when providing the authority to accept the documents.

### III) STAND BY LETTER OF CREDIT (SBLC) = MT760

- An SBLC is a Stand By Letter of Credit. It has nothing to do with the classical documentary Letter of Credit, which is used for international trading purposes. AN SBLC is the USA form of the well known . The Swift code for an SBLC is MT760.
- SBLC's (and BG's) can be used to enhance your ability to apply for a line of credit with your bank; in other words, it can be used as collateral when your bank is asking for additional comfort when you ask them to fund your project.
- The SBLC's we deal in are genuinely 100% cash-backed and therefore usable as collateral. This guarantees world wide acceptance of your SBLC.
- These SBLC's are generated by "someone" blocking their funds on your behalf, so IT speak of a "leased" SBLC. In other words the SBLC is owned by the issuer and other one is the beneficiary.

## Brief Overview of Letter of Credit (LC) Transactions

- The SBLC is generally issued for 1 year and 1 day, but can easily be extended up to 5 years. (It is possible to get an SBLC for only 6 months). Once issued the SBLC is transferred to your bank via the Swift protocol of MT760.
- Of course, Leasing of an SBLC comes at a cost. And to be very honest: at a high cost. Financing your project by using an SBLC is very expensive. First you need to pay money to the issuer of the SBLC plus commission to the consultants facilitating the process, Then you need to give the SBLC to your bank, who are providing a Line of Credit against the SBLC, which may only be up to 90% LTV or less. And usually, your bank will charge a one off fee to “monetise” the instrument and also charge interest on the drawn down loan amount.
- To successfully apply for an SBLC you need to be aware of four vital points:
  - a) You need to have a good project
  - b) You need to have a bank funding your project based on the supporting collateral of an issued SBLC
  - c) You need to have the money to pay for the leasing of the SBLC
  - d) You need to have a believable and realistic exit strategy to repay the loan and return the SBLC at the end of the term
- All the SBLC's we deal with are callable, assignable, fully transferable and lien able.
- It is also not possible to use an SBLC to secure a commodity trade and pay for the SBLC out of the profits from the transaction.
- When paid for and used correctly, these instruments provide numerous lucrative options. V-funding can provide BG's, SBLC's and CD's, which can be blocked or delivered via SWIFT.

## IV) SBLC TOOL AS COLLATERAL LOAN

- SBLC Financing offers “The Collateral Loan Program”, commonly called the “CD PROGRAM”, is an established system of financing that uses the traditional banking mechanisms as its fundamental components. The result is a stable structure that procures 100% monetary instrument collateral for project financing. Using a well-calculated and balanced approach, the program provides highly competitive benefits and profits to all participants.
- A CD/MTN (Certificate of Deposit/ Medium Term Note) is merely a financial instrument that is backed by cash, and is freely transferable. The general structure of using the as a collateral instrument has existed for 50 years.
- The primary function of the structure is to procure collateral from a third party at a "discount", and arrange for it to be paid for by the Borrower Company from the loan funds at the time of closing.
- The collateral program is for projects that require a long start up period before launching.
- This program offers a deferment period ranging from 1-3 years. During the period of deferment, the Borrower/Company does not have to pay any interest or minimum payments. This is true even if your project is capable of repaying the loan (of any amount) in full within 3-4 years after launching.
- The result of the structure is that Borrower receives a net amount of capital that it needs to implement its project at a cost lower than a traditional loan, the Depositor receives immediate repayment of the collateral plus profits, and the bank receives full collateral backing of the total principal amount of the loan.
- The ability of the structure to reliably generate a "win-win-win" transaction for all participants is made possible by the fact that the CD/MTN instrument used as collateral doubles in value over a 10 year period. This increase in value from maturity of the CD/MTN makes it possible to provide real and tangible benefits for all parties to the transaction.
- All other expenses related to structuring the loan and procuring the collateral are added to the amount of the loan, to ensure that they are paid from the loan at closing.
- Depositors are multinational corporations and consortiums of trusts and pension funds, which have billions of

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# FINANCIAL SERVICES *(cont.)*

## Brief Overview of Letter of Credit (LC) Transactions

dollars in liquid assets. They have contractual and legal obligations to make these funds work for maximum profits. For such capital resources, direct investment in projects is too "high risk", too "low return", and too much time to wait. Accordingly, they categorically refuse to finance actual projects or invest funds directly, as a matter of principle and policy.

- Instead, Depositors accomplish their goals through purchasing collateral for use in loan transactions. Within about 24 hours, with no risk whatsoever, the Depositor receives 50% of its money back in "cash", plus the "interest certificates" of the CD/MTN as repayment of the other 50%, which Depositor then sells to a pre-arranged "exit purchaser" for a profit.



*Compiled by Rajesh Shah*