

*Welcome to Tax Alert, KPMG's Knowledge Management Team's update on tax, corporate and allied laws. This newsletter updates you with the important and latest notifications/ circulars and decisions of Courts and Tribunals.*

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*We look forward to receiving your valuable feedback about the newsletter at [mknowledge@in.kpmg.com](mailto:mknowledge@in.kpmg.com) and we shall be happy to respond to your queries concerning the information provided here.*

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## **Disclaimer**

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<sup>1</sup> Intangibles were introduced as a separate block of asset from 1 April 1999.

## **Notifications/ Circulars/ Press release**

### **Direct Tax**

#### **Guidelines for notification of Zero Coupon Bonds issued**

The Central Board of Direct Taxes ('the CBDT') has issued guidelines for the notification of zero coupon bonds and for the computation of pro-rata discount on such bonds, which are effective from 1 April 2006. These guidelines are mentioned in Rules 8B and 8C of the Income-tax Rules, 1962. For the highlights of the Notification please refer to our Flash News of 19 May 2006 available on

[http://www.in.kpmg.com/Flash\\_News/flash\\_news.asp](http://www.in.kpmg.com/Flash_News/flash_news.asp)

*Source: Notification No. 93/2006 dated 30 March 2006 issued by CBDT*

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#### **Draft instructions on test to be applied for shares held as stock-in-trade vis-à-vis shares held as investment**

The CBDT, in its instruction no. 1827 dated 31 August 1989, had laid down certain tests to distinguish between shares held as stock-in-trade and shares held as investment. Now the CBDT has issued draft instructions seeking comments from all stakeholders on the supplementary test to be applied for determining whether a person is a trader in stocks or an investor in stocks. The Assessing Officers are also advised that no single criterion listed in the instructions is decisive and total effect of all the criteria should be considered to determine the nature of activity. For a detailed discussion on the above topic please refer to our Flash News of 17 May 2006 available at [http://www.in.kpmg.com/Flash\\_News/flash\\_news.asp](http://www.in.kpmg.com/Flash_News/flash_news.asp).

In our comments to the CBDT on the implications of the draft instructions to Foreign Institutional Investors (FIIs), the way forward suggested was, to make FII activity of purchase and sale of securities, an exception to the test for determining whether a person is a trader in stocks or an investor in stocks, in view of the legislative history and the introduction of a self contained code of taxation (section 115AD) to treat FIIs as investors, in the final instruction that will be issued by the CBDT.

*Source: F.No. 149/287/2005 – TPL from CBDT*

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#### **The benefit of section 80HHC cannot be denied to an assessee claiming refund of the duty drawback under Duty Drawback Rules, 1995<sup>2</sup>**

Section 80HHC of the Income-tax Act, 1961, provides for deduction from the total income in respect of profits derived from the export of goods or merchandise, which are realized in convertible foreign exchange.

The first proviso to section 80-HHC (3) stipulates that the profits computed under sub-section (3) of section 80-HHC shall be further increased by a proportionate amount of the sums of export benefits referred to in section 28 (iiia) (not being profits on sale of a licence acquired from any other person), section 28 (iiib) and 28 (iiic).

Clause (iiic) to section 28 refers to any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971.

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<sup>2</sup> This clarification will apply to assessment years 1996-97 and subsequent assessment years

Customs and Central Excise Duties Drawback Rules, 1971 was replaced by Customs and Central Excise Duties Drawback Rules, 1995 vide notification No.37/95-Cus. and C.E. dated 26.5.1995. However, no corresponding changes were made in the Income-tax Act.

References have been received by the Board indicating that the assessing officers are denying the claim of deduction under section 80HHC on account of duty drawback granted to the assessee in accordance with Customs and Central Excise Duties Drawback Rules, 1995 as clause (iiic) of section 28 refers to Customs and Central Excise Duty Drawback Rules, 1971.

The CBDT has clarified that by virtue of provisions of Section 8 of General Clauses Act, 1897, read with Rule 18 of the Customs and Central Excise Duties Drawback Rules, 1995, which provides for repeals and savings of the 1971 Rules, the benefit of section 80HHC cannot be denied to an assessee claiming refund of the duty drawback under Duty Drawback Rules, 1995. However, the claim of deduction has to be allowed subject to fulfillment of all other conditions provided under section 80HHC.

*Source: CBDT Circular No. 5 dated 15 May 2006*

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### **Amendment in Quarterly Salary TDS Statement**

The CBDT has issued a notification amending Income-tax Rules, 1962 with a view to modify and simplify the quarterly TDS statement in Form No. 24Q used for tax deduction at source from 'Salaries'.

After these amendments to Rules, there will be only two Annexures to Form No. 24Q. Annexure-I will be required to be furnished with each quarterly statement containing details relevant to the quarter. Modified Annexure-II will be required to be furnished with the last quarterly statement of the financial year containing details for the whole of the financial year. Annexure-III has been omitted.

*Source: PIB Press Release dated 18 May 2006*

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### **Comments sought regarding removal or continuance of exemptions and deductions under the Income Tax Act, 1961**

The Central Government of India is committed to simplify the tax laws, minimize the distortions within the tax structure and broaden the tax base. In this context, tax incentives in the form of various exemptions and deductions are being reviewed. Government is keen to involve all stakeholders in this exercise.

Any comments, with supporting rationale, for the removal or continuance of the exemptions and deductions under the Act, may be sent to us or may be e-mailed or posted by 5<sup>th</sup> July, 2006 to:

Ms. Anita Kapur, Joint Secretary, TPL-I, Room No. 147-B/I, North Block, New Delhi.  
e-mail: jstpl1@nic.in OR

Ms. Monica Bhatia, Director, TPL-I, Room No. 147-D, North Block, New Delhi.  
e-mail: dirtpl1@nic.in OR

Ms. Pragya S. Saxena, Director, TPL-II, Room No. 147-E, North Block, New Delhi.  
e-mail: dirtpl2@nic.in

*Source: incometaxindia.gov.in*

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## **Protocol amending DTAC between India and Kuwait**

The Union Cabinet gave its approval to the Protocol amending the Double Taxation Avoidance Convention (DTAC) between India and Kuwait for the prevention of fiscal evasion in respect of taxes on income. The Agreement will stimulate the flow of investment, technology and services from India to Kuwait and vice versa. It will also provide tax stability to the residents of India and Kuwait and facilitate mutual economic co-operation. The notification of the amendments to the DTAC is awaited.

*Source: PIB Press Release dated 5 April 2006*

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## **New Income-tax Return 'Form No. 2F' substitutes Form No. 2E from 1 August 2006. The taxpayer continues to have the option to file Form No. 2D.**

With a view to make return filing easier, the Central Government has notified on 1<sup>st</sup> June, 2006 a new income-tax return form 'Form 2F' for Assessment Year 2006-07. This form is applicable with immediate effect. However, the existing one page Saral Form 2E can also be used by the taxpayers who file their return on or before 31<sup>st</sup> July, 2006.

This form can be used by resident individuals and HUF who do not have –

- profits and gains of business or profession; or
- capital gains; or
- agricultural income; or
- more than one house property; or
- any claim for relief under section 89 in respect of arrears or advance of Salary.

However, Individuals/HUF having long-term capital gains from transactions in securities on which Securities Transaction Tax (STT) has been paid can also use this form.

One of the key features of the form is that it requires a summarised cash flow statement to be attached as a schedule. However for the Assessment Year 2006-07, information required by the schedule is optional.

*Source: incometaxindia.gov.in*

## **Corporate Law**

### **Amendments to the Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions Laws (Amendment) Bill 2005**

The Union Cabinet today gave its approval for carrying out Amendments to the Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions Laws (Amendment) Bill, 2005 with a view to enhance flexibility of the Boards of Directors and improve corporate governance. The Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions Laws (Amendment) Bill, 2005 was introduced in the Lok Sabha on August 16, 2005 and, thereafter, it was referred to the Standing Committee of Parliament on Finance for examination. The Committee has recommended some modifications in the Bill. The Bill will be introduced in Parliament.

The amendment Bill will bring the operations of nationalized banks in tune with the changed scenario and modern business practices.

Source: PIB Press Release dated 18 May 2006

### **SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2006**

The SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2006 further amended the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. The amended regulations would come into force from the date of its publication in the Official Gazette. The key features of these regulations are as follows:

- The definition of ‘promoter’ has been substituted in regulation 2(1)(h).
- The words “Indian promoters” have been substituted with “Qualifying Indian promoters” in item (a) and the words “promoters” have been substituted with “qualifying promoters” in item (b) of Regulation 3(1)(e)(iii).
- The amendment regulations, inter-alia, made changes in regulations 10, 11, 20, and 21.

Source: SEBI Circular S.O. 807(E) dated 26 May 2006

### **Guidelines for “Qualified Institutions Placement”- Amendments to SEBI (Disclosure and Investor Protection) {DIP} Guidelines, 2000**

In order to make Indian markets more competitive and efficient, it has been decided to introduce an additional mode for listed companies to raise funds from domestic market in the form of “Qualified Institutions Placement” (QIP). The amendments made *vide* this circular shall come into force with immediate effect. For a detailed discussion on the above topic please refer to our Flash News of 19 May 2006 available at

[http://www.in.kpmg.com/Flash\\_News/flash\\_news.asp](http://www.in.kpmg.com/Flash_News/flash_news.asp).

Source: SEBI circular No. SEBI/CFD/DIL/DIP/22 dated 8 May 2006

## **International Taxation**

### **UK Tax Authority clarifies notification obligations imposed on certain Non-UK Pension Schemes**

H.M. Revenue and Customs (HMRC) in the United Kingdom has provided clarification on how certain Non-UK Pension Plans may be relieved of ongoing reporting obligations in respect of plan members who have worked in the UK but have subsequently departed. For a detailed discussion on the above topic please visit

[http://www.in.kpmg.com/Flash\\_News/flash\\_news.asp](http://www.in.kpmg.com/Flash_News/flash_news.asp).

Source: Flash International Executive Alert 2006-099

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### **EU principle of freedom of establishment does not preclude an EU Member State’s Controlled Foreign Companies (CFC) legislation**

In the case pending before the European Court of Justice (ECJ) between Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd and the UK Tax Authorities, Advocate General (AG) Léger issued his opinion on 2 May 2006. The AG concluded that the EU principle of freedom of establishment does not preclude an EU Member State’s Controlled Foreign Companies (CFC) legislation if that legislation applies only to wholly artificial arrangements intended to circumvent national law. Such legislation must enable the taxpayer to be

exempted by providing proof that the controlled subsidiary is genuinely established in the state of establishment and that the transactions which have resulted in a reduction in the taxation of the parent company reflect services which were actually carried out in that state and were not devoid of economic purpose with regard to that company's activities.

For a detailed discussion on the above topic please visit [http://www.in.kpmg.com/Flash\\_News/flash\\_news.asp](http://www.in.kpmg.com/Flash_News/flash_news.asp)

Source: *Euro Tax Flash* of 3 May 2006

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## Decisions Direct Tax

### Tribunals

#### **Depreciation not allowable on Membership Card of the Bombay Stock Exchange (BSE) prior to AY 1999-2000<sup>3</sup>**

The Mumbai Tribunal in the case of a broking Company held that depreciation is not allowable on BSE Membership Card for the assessment year 1998-99 as stock exchange membership card was an intangible asset, and depreciation on intangible assets are allowable only from the assessment year 1999-2000. It may be noted that the Mumbai Tribunal, in the case of *Techno Shares & Stocks Ltd. v. ITO [2006] 101 TTJ 349*, has held that depreciation is allowable in respect of BSE Membership Card as intangible asset. For a detailed analysis of the decision please refer to our Flash News of 12 May 2006 available on our website at:

[http://www.in.kpmg.com/Flash\\_News/flash\\_news.asp](http://www.in.kpmg.com/Flash_News/flash_news.asp).

Source: *M/s Vyomit Shares, Stocks & Investments Pvt. Ltd. v. D.C.I.T ITA 5098/Mum/2000 (unreported)*

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#### **A Foreign company can avail the benefits of the Act or the Treaty whichever is more beneficial.**

The taxpayer, a company incorporated in USA, earned income from capital gains, dividend and interest during the financial year ended 31 March 1998. In the return of income, it claimed the benefit of Double Taxation Avoidance Agreement (DTAA) between India and USA on the interest income and offered to tax capital gains and dividend income as per the domestic tax law. While completing the assessment, the Assessing Officer ('AO') calculated tax on interest at the rate of 20% against 15% as provided in Article 11 of the India-USA DTAA. The Commissioner of Income-tax (Appeals) ['CIT (A)'] upheld the order of the AO, holding that the company has to apply either the rates prescribed in the Income-tax Act or in the DTAA for all sources of income. The company cannot opt to the 'pick and choose policy' to pay the tax.

The Income-tax Appellate Tribunal ('ITAT') held that in the case of dividend income, the local rate of tax was applicable subject to maximum 25% as per Article 10. In case of interest income, the local rate of tax was applicable subject to maximum 15% as per Article 11. Since the local rate as per section 115AD is 20%, it cannot exceed 15% as per the DTAA. For capital gains, no rate or ceiling is provided in Article 13 hence, only local rate is applicable. The company has not adopted pick and choose policy for applying the tax rate. The rates are applied as per combined reading of the Income-tax Act, 1961 and DTAA. Therefore the company is liable to

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<sup>3</sup> Intangibles were introduced as a separate block of asset from 1 April 1999.

pay tax at the rate of 15% on interest income being the maximum rate provided in Article 11.  
*Source: Morgan Stanley Asset Management Inc. v. JCIT ITA No. 4274/Mum/2002 (Lexsite website)*

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**The expression ‘Indian Concern’, for the purpose of Section 115A of the Act, shall include Indian branch offices of foreign companies.**

The taxpayer is a non-resident company in liquidation. During the Assessment Year 1998-99, the company received interest on FCNR deposits placed with Bank of Nova Scotia’s Mumbai branch. The company paid tax @ 20% under section 115A of the Income-tax Act, 1961 (‘the Act’). The AO was of the view that section 115A of the Act can only be applied when the interest is earned from an Indian concern and the Indian Branch of a foreign bank i.e. Bank of Nova Scotia cannot be treated as an Indian Concern. He taxed the interest income @ 48%. The CIT (A) upheld the order of the AO.

The Tribunal observed that the expression ‘Indian Concern’ used in Section 115A was not defined anywhere in the Act. A harmonious interpretation would suggest that the meaning of an Indian concern should be taken as a business carried on in India which may essentially include a business carried on in India even by a non-resident.

The CBDT Circular No. 740 dated 17 April 1996, 132 CTR (Statute) 5, clarifies that the branch of a foreign company/ concern in India is a separate entity for the purpose of taxation and interest paid/payable by such branch to its head office or any branch located abroad would be liable to tax in India and would be governed by the provisions of section 115A of the Act. The Tribunal was of the view that this circular also covers the cases in which interest is payable by Indian branches of foreign banks.

Thus, the Tribunal held that the expression ‘Indian concern’ will also include Indian branch offices of foreign companies. The rate of tax applicable on the income earned by the company, by way of interest on foreign currency deposits, will be 20%.

*Source: Joint Official Liquidator of Bank of Credit and Commerce (Overseas) Ltd. v. JCIT ITA No. 4740/Mum/2001 (Lexsite Web site)*

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**Loss arising to a dealer from sale of shares acquired in the primary market is loss in speculation business.**

The Special Bench of the Ahmedabad Tribunal has held in the case of a Company, which is a dealer in shares, that, the loss suffered on sale of shares acquired by allotment was speculation loss covered by the plain, clear and unambiguous statutory language of the provisions of the Explanation to Section 73 of the Act, which required no external aid, like object etc to construe them differently.

For a detailed analysis of the decision please refer to our Flash News of 24 May 2006 available on our website at: [http://www.in.kpmg.com/Flash\\_News/flash\\_news.asp](http://www.in.kpmg.com/Flash_News/flash_news.asp)

*Source: M/s AMP SPG & WVG MILLS PVT LTD . v ITO WARD 1(1) ITA No. 2358/Ahd/2004 (SB) (unreported).*

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**Write off of Bad Debts is sufficient requirement of the amended provision of section 36(1)(vii) of the Act, for allowance as deduction.**

The Special Bench of the Mumbai Tribunal has held in the case of a bank, that the it is not obligatory on the part of the bank to prove that the debt written off is indeed a bad debt for the purpose of allowance under section 36(1)(vii)<sup>4</sup> of the Act.

For a detailed analysis of the decision please refer to our Flash News of 1 June 2006 available on our website at: [http://www.in.kpmg.com/Flash\\_News/flash\\_news.asp](http://www.in.kpmg.com/Flash_News/flash_news.asp)

Source: *DCIT v Oman International Bank SAOG and Spectrum Business Support Ltd v. DCIT (Mum Special Bench)* (unreported).

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**Long-term capital loss can be set off against short term capital gains without disturbing the long-term capital gains, for the assessment years 1988-89 to 2002-03<sup>5</sup>**

The Special Bench of the Mumbai Tribunal has held that the taxpayer has an option to set off long-term capital loss against short-term capital gains without disturbing long-term capital gains for the assessment year 1995-96 as the 'source of income' is every transaction of sale of asset.

For a detailed analysis of the decision please refer to our Flash News of 8 May 2006 available on our website at: [http://www.in.kpmg.com/Flash\\_News/flash\\_news.asp](http://www.in.kpmg.com/Flash_News/flash_news.asp)

Source: *JCIT v Montgomery Emerging Market Fund and JCIT v Morgan Stanley Asset Mgt Inc. (Mumbai Tribunal Special Bench)*(unreported).

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<sup>4</sup> Post the amendment to the section with effect from 1 April 1989.

<sup>5</sup> The Finance Act, 1987 amended section 70 of the Act to provide that where the net result for any assessment year in respect of any source falling under any head of income is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head. The Finance Act, 2002, with effect from 1 April 2003 has amended the provision whereby long-term capital loss can now be set off only against long-term capital gains whereas short-term capital loss can be set off against short-term and long-term capital gains.

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