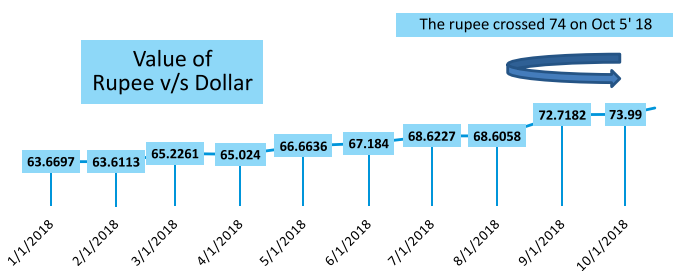


The Economy

Rupee Dollar Movement

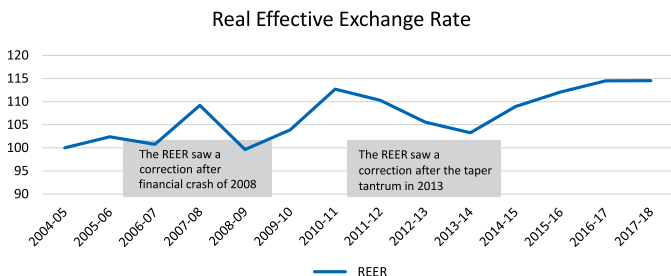
There has been a lot happening on the Rupee Dollar front since the beginning of the year especially over the last few months. This note attempts to analyze the developments on this score and how it is impacting the economy. It also makes some recommendations on the way forward.



At the current stage, the rupee has depreciated Vis a Vis the US dollar by 16.2 % since January 2018.

REER

- The real effective exchange rate (REER) is a measure of the value of a currency against the currencies of major trading partners, and adjusted for inflation. The index of Real Effective Exchange Rate (REER) for the month of August 2018 stands at 114.54 which means that the rupee is overvalued.



REASONS FOR DEPRECIATION OF THE RUPEE AND ITS IMPACT

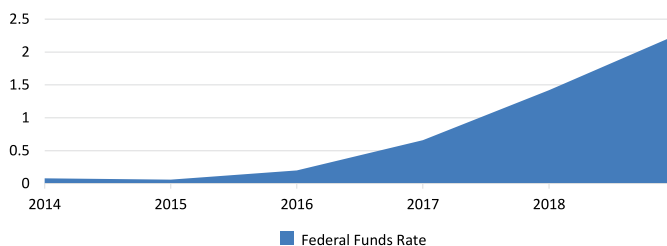
- The US central bank, the Federal Reserve hiked the interest rates to 2.25% in the month of September 2018 and is expected to keep raising it this year and into 2019, as quoted by Federal Reserve chair Jerome Powell.

Impact:

- Billions of dollars invested in Indian stocks and bonds begin to make their way back to the US, where they can once again earn a decent return in deposit accounts without taking any risks. Foreign portfolio investors have

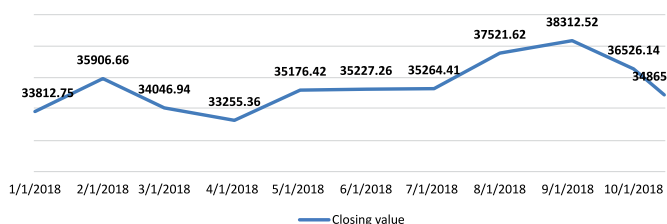
pulled out over Rs 9,200 crores from equities and Rs 46,510 crores from the debt markets this year.

Us Federal Fund Rates



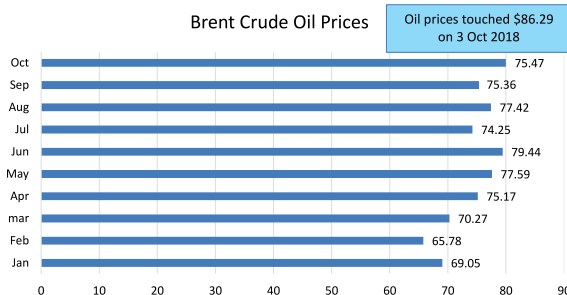
- The benchmark BSE Sensex has lost over 4000 points over the last two months.

BSE Sensex



- Rise in crude oil prices: The Brent Crude oil prices have increased steeply in the recent months.

Brent Crude Oil Prices

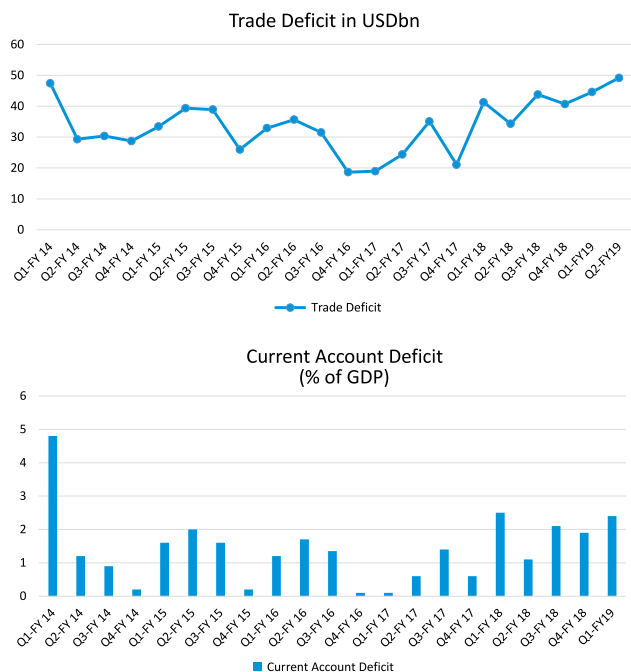


Impact:

- RBI fears inflation pressure in second half of FY19 on the back of MSP price hike, monsoon, and crude oil and HRA allowance under 7th Pay Commission. Headline consumer price index (CPI) inflation is expected at around 5.0 per cent in Q1:2018-19 and thereafter, it is likely to remain below 5.0 per cent till Q4:2018-19.
- This has a negative impact on the CAD (Current Account deficit) as India imports almost 80% of its requirements, resulting in the pressure on rupee. The CAD has widened to USD 15.8 billion or 2.4 percent of the GDP in the first quarter of 2018 from USD 14.9 billion a year earlier (2.5

percent of the GDP). The trade deficit amounted to USD 94.32 billion in April-September 2018 as against USD 76.66 billion during the same period last year.

- However there are opinions that a depreciating rupee will help India's exports. But that would depend on the relative decline in the value of currencies of our competing nations.



3. Global Contagion:

- The Argentinian central bank raised interest rates to 60% in August in an effort to prop up its plunging currency.
- The Turkish lira has fallen to the lowest levels, pushing up borrowing costs
- South Africa unexpectedly plunged into recession in the second quarter of 2018, recording a 0.7% drop in GDP and triggering a sell-off that took the rand to its lowest level in two years.
- The Indonesian central bank has had to raise interest rates to shore up its currency as the rupiah is at a 20-year low.
- Trump's steel tariffs and his threat to force US businesses to bring back production outsourced south of the border hang like a dark cloud over the Mexican economy, putting the peso under pressure.

Country	Currency	Jan, 2018	Oct 19, 2018
Argentina	Peso	19.64	36.54
Brazil	BRL	3.19	3.71
China	CNY	6.29	6.93
India	INR	63.66	74.013
Indonesia	IDR	13386	15187
Turkey	Lira	3.76	5.64
South Africa	Rand	11.85	14.41
Russia	Ruble	56.19	65.46
Mexico	Mexican Peso	18.60	19.28

Impact:

The global economy is so intricately inter connected that anything happening in one country impacts the others.

MEASURES TAKEN BY THE RBI AND GOVERNMENT TO TACKLE THE RUPEE SLOWDOWN

- Mandatory Currency hedging for infrastructure
- Easier rules for manufacturing entities to raise funds overseas
- Review of debt investment limits for FPI's
- Exemption from withholding tax for masala bonds
- Removal of restriction on Indian banks' market making of masala bonds
- Market Intervention – As the rupee weakened, the central bank intermittently intervened in the market
- India raised import duty on items such as air conditioners, refrigerators, washing machine, footwear, jewellery, furniture etc
- RBI announced open market operation for 36000 crores
- RBI eased the norms on foreign borrowings for Oil Marketing companies
- Foreign Portfolio investors can now invest in corporate bonds
- Manufacturing companies can borrow up to \$50 million with 1 years maturity, instead of 3 years
- Currency Swap Agreement with Japan for US\$ 75 billion

IMPACT OF THE MEASURES

While the above measures have had short term impact on various indices including value of rupee and Sensex, the overall doesn't seem to have changed. The rupee value Vis a Vis US dollar is still around Rs. 74, Sensex is at around 34,000 and trade deficit is high.

RECOMMENDATIONS

Short Term Measures:

- Market Intervention should be done whenever needed
- The country has substantial forex reserves of around \$US 400 billion but NRI bonds can also be used to balance outflow of dollars with maximum inward flows
- It is also essential to build confidence amongst investors, both foreign and domestic on the fact that the Government means business and will do everything to make the environment business friendly
- There should be continuous engagement with the industry on issues of concern and remedial measures initiated
- RBI can buy bonds from oil firms, giving them some other currency in return, that they can use to purchase crude oil from Global Markets.

Long Term measures:

- Although the Government has initiated measures to enhance ease of doing business, this has to be a continuous process to make the industry competitive. This can include:
 - Building the required infrastructure
 - Availability of finance at competitive rates

- Rationalization of labour laws
- Skill development in lines with industry needs
- Inclusion of petroleum products under GST
- Decrease dependence on oil imports to the maximum extent possible with focus on developing alternate sources of energy. As per the current indication, high oil prices are likely to continue
- Encourage domestic production with latest available technologies to leap frog into the next growth stage. Besides, there should be emphasis on encouraging R&D in line with the evolving needs of industry and commerce

Legally Speaking

INSOLVENCY & BANKRUPTCY CODE: IMPACT ON ECONOMY

The Insolvency and Bankruptcy Code 2016 (IBC) has created far reaching ripples within all sectors of our economy. This Code (IBC) is being hailed as the most important legal recourse to recover money from stressed assets. The IBC is an overarching framework of laws for proceedings of winding-up, engineering a turnaround or even an exit. The Insolvency and Bankruptcy Code has ushered an era of swift resolutions and fair decisions for failing/sick companies as it has emerged as a critical safety valve for the Indian Capitalism, with a number of high profile cases and facilitated resolutions being passed in quick succession since the enforcement of the Insolvency and Bankruptcy Code.

As per the last annual report on the banking sector for 2016-17 published by RBI, the central bank observed:

“In India, the extant legal and institutional machinery for dealing with debt default, either through the Indian Contract Act, 1872 or through special laws such as the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 has not been utilised well by banks. Similarly, action through the Sick Industrial Companies (Special Provisions) Act, 1985 and the winding up provisions of the Companies Act, 1956 have neither aided prompt recovery by lenders nor swift restructuring of indebted firms. Empirical evidence shows that a conducive institutional environment and an appropriate insolvency regime are key factors in recovery of stressed assets, apart from loan characteristics....”

Hope is there that the problem of non-performing assets (NPAs) would be tackled in a systematic manner and the banks will be ready for further growth and profitability. Economists feel that the real situation in the country is that when the financial institutions try to get new bidders for the stressed assets, they end up getting the same bidders in a majority of cases. There is often no depth in the bidding process at the NCLT (National Company Law Tribunal) and only few people are available who are really capable of taking up huge projects. As a result, the price of stressed assets stays depressed in many cases. The lenders are required to take a hard stance on these occasions. Whenever the bidders are trying to suppress the price of the asset, banks will prefer to take the company to liquidation rather than sell it off at a huge discount to the

new promoters but ultimately emphasis should be on the fact that payment discipline is sacrosanct.

Assets cannot be given away just because a bidder has the money, it is subject to due diligence and compliance with the provisions of Section 29A of IBC 2016. The source of money is identified, if everything is within the ambit of the law, then the bidder succeeds to acquire the asset.

The RBI in its report on the trend and progress of banking in India mentions:

“An analysis of the transactions under the corporate insolvency resolution process indicates that the pace of admitted cases to the IBC has picked up with time. Another interesting insight is that operational creditors have been the most aggressive in the initiation of corporate insolvency proceedings, though the number of financial creditors approaching the Board for resolution has also been increasing. The IBBI notified the IBBI (Voluntary Liquidation Process) Regulations, 2017 on March 31, 2017 which enable a corporate to liquidate itself voluntarily if it has no debt or if it is able to pay its debt in full from the proceeds of the assets to be sold under the liquidation.

In pursuance of these Regulations, corporates are also tapping this route for voluntary liquidation. The success of the IBC hinges on the development of a supportive environment consisting of trained insolvency professionals. The registration of trained insolvency professionals has gathered pace in the recent period, with the highest registrations being accounted for by the northern region.”

There are only a few business groups who are capable of big project implementation, especially in the power and steel sectors where the projects are mega-sized. In our country, the ground reality is that there are problems in realising receivables on time. Therefore, the lenders should take a flexible approach. The cash flows and payment schedule should be structured in such a way that banks should be prepared for a six-to-eight-month receivable cycle. The promoter needs to bring in a higher margin.

Whenever there is a huge credit expansion, there is a danger of Non-Performing Assets being formed. The slippages cannot be avoided. The effort by some vested interests to stall the process at every stage should not be allowed. For the Committee of Creditors (CoC) to come out with a resolution in 180 days is a tough task but it is considered to be a reasonable period. The US bankruptcy laws also provides the same time frame. Whatever steps that the banks and the adjudicating authority can take, are being addressed. In large cases, there are visible changes in management. When it comes to smaller cases, the possibility of gaming the system is more. In the case of Essar Steel, the Supreme Court has taken note of the fact that there is a delay in completion of the insolvency resolution process. We can expect some pronouncements from the court on the need for speedier resolutions to preserve the value of the asset so that things move fast.

With relation to the effect of the implementation of the Insolvency and Bankruptcy Code, 2016, certain observations can be made to sum up the impact of the Code on our economy as given under:

- It is possible that most of the loans that actually land up for insolvency proceedings are likely to have been already

restructured by the banks in the past.

- Further, the fact that restructuring has failed even after such effort, raises serious questions on the credit-worthiness of the loaners. Hence, barring promoters of such companies is only logical.
- The amended law has created scope for disqualifying an existing promoter or including a rank outsider into the bidding process.
- The Insolvency and Bankruptcy Board of India (IBBI) is a statutory regulator set up under the provisions of the Insolvency and bankruptcy Code. But several advisory committees of IBBI, entrusted with task of conducting the Corporate Insolvency Proceedings, are chaired by several top corporate leaders. This could be a tricky situation with regard to the credibility of the IBC and the recent amendments could be misused to defeat the very objective of penalising the errant promoters.

The government should display greater urgency in tackling systemic issues in different sectors, but there should be no deviation from the IBC path which it has embarked on to fix the banking stress. Optimism is that time is not far off when the Insolvency and Bankruptcy Code will be fully operational and all apparent loop holes will be plugged and the system finally gets secured.

By Mr. P K Malhotra, Senior Legal Consultant, VJA Legal and Former Law Secretary, Govt. of India

Taxation matters

Goods and Services Tax (GST)

- **ITC ineligible on repair, maintenance of employees' residential accommodation, hospitals, guest houses**

Odisha AAR holds that input tax credit cannot be claimed on various inputs received for maintenance and repair work of the townships, guest houses, hospitals etc. Such input services are in the nature of welfare activities and not in course or furtherance of business. Further, services under works contract related to repairs and maintenance of various immovable property and assets, the ITC of which is blocked u/s 17(5) of CGST/SGST Act. Also, the services by way of residential accommodation, alteration or maintenance service of goods or service or goods received does not qualify for ITC in terms of Section 17(2) of CGST/SGST Act. Further, the hospital/ dispensary maintained for the employees and society is covered under the Sr. No. 74, heading 9993 of Notification No. 12/2017- Central Tax (Rate), thereby ITC stands ineligible and cannot be claimed.

[National Aluminium Company Ltd. – Odisha AAR] (98 taxmann.com 245)

- **Reimbursement by head office (HO) to liason office not liable to GST as no supply**

Tamil Nadu AAR holds that undertaking liason activities between parent company and Indian supplier of goods in line with condition specified by RBI permission letter does not constitute 'supply' under CGST und SGST Act. It is stated that their shall be no consideration from

supplier as well as no such fees/commission or any other remuneration received/income earned by office in India for liason activities/ services. Only the parent company may reimburse expenses incurred for the operations in India which are in nature of salary, rent, security, electricity, travelling etc. and further there is no any other source of income. Also, the liason office shall be restricted to undertake any activity of trading, commercial or industrial nature or entering into any business contracts in own name. With reference to definition of 'supply' given u/s 7 and Schedule I of CGST Act, states that supply of services between related parties or distinct persons constitutes a 'supply' as per Section 25, even without consideration. Tamil Nadu AAR states that undertaking liason activities is not covered under 'supply' definition and hence not required to obtain registration u/s 22 of CGST /SGST Act or pay CGST/SGST or IGST.

[Takko Holding GmbH -Tamil Nadu AAR] (98 taxmann.com 334)

- **'Liquidated damages' awarded pursuant to arbitration constitutes 'supply'**

Maharashtra AAR has held that liquidated damages awarded to the applicant by the International Chamber of Commerce ("ICC") pursuant to arbitration would qualify as 'supply' as per Sr. No. 5(e) of Schedule II of the CGST Act which reads "agreeing to the obligation to refrain from an act or to tolerate an act or a situation or to do an act". In the present case, having presence of clear understanding/ agreement between the parties to foresee and tolerate an act shall be for monetary consideration and in case of change of name such as 'damages' or 'compensation' would not change the nature of contact and thus will be taxable.

Further, in the present case, it is clarified that time of supply shall be determined as per Section 13 of the CGST Act i.e. after the award of arbitration proceedings is given by Arbitration Tribunal as administered by ICC as per Association Agreement by the parties to dispute, in present proceedings. Maharashtra AAR holds that value of supply shall be actual liquidated damages cum consideration as pronounced in award administered by ICC.

[North American Coal Corporation India Private Limited - Maharashtra AAR] (98 taxmann.com 331)

Income Tax

- **Order of Assessing Officer (AO) rejecting the Income Tax Return (ITR) without providing opportunity to rectify defect under Section 139(9) of the Act was liable to be set-aside**

For A.Y. 1998-99, assessee filed its return declaring certain taxable income. Subsequently, assessee filed a revised return under Section 139(5) of the Act within the prescribed time period. AO, however, rejected the revised return at very threshold on the ground that it was not accompanied with tax audit report. The order of AO was upheld by the Tribunal as well. The High Court, however, was of the view that if, in opinion of

AO, return was defective, the procedure contemplated under Section 139(9) of the Act should have been followed. Thus, the High Court concluded that since assessee had not been given an opportunity to rectify defects as contemplated under Section 139(9) of the Act, the impugned order passed by the AO was to be set-aside and matter was to be remanded back for fresh disposal.

[Zeenath International Supplies v. CIT – Madras High Court] (98 taxmann.com 219)

- **Once genuineness, creditworthiness and identity of investors are established, no addition could be made as cash credit on ground that shares were issued at excess premium**

High Court in this case has held that issuing share at a premium is a commercial decision and it is the prerogative of Board of Directors of a company to decide premium amount and it is the wisdom of shareholders whether they want to subscribe shares at such premium or not. High Court further observed that in day-to-day market, unless and until rate is fixed by any Government Authority or unless there is any restriction on amount of share premium under any law, price of shares is decided on mutual understanding of parties concerned. The Court, thus, concluded that once genuineness, creditworthiness and identity of investors are established, revenue should not justifiably put itself in armchair of a businessman or in position of Board of Directors and assume role of ascertaining how much is a reasonable premium having regard to circumstances of the case.

[Pr. CIT v. Chain House International (P.) Ltd. – Madhya Pradesh High Court] (98 taxmann.com 47)

- **No addition under Section 68 of the Act if identity of share applicants was clearly revealed**

In the course of assessment, AO noted that assessee was a sick company during the relevant year but has nevertheless collected substantial amounts from two share applicants. AO took a view that identity of shareholders and genuineness of transaction had not been established and accordingly, brought to tax said amount. It was noted by the Tribunal as well as the High Court that identity of share applicants was clearly revealed, but AO did not conduct any enquiry except resting his conclusions on surmises. Accordingly, addition made by the AO was deleted by the Tribunal as well as the High Court. Considering these facts, the SLP filed by Revenue against order of High Court has been dismissed.

[Pr. CIT v. Himachal Fibres Ltd. – Supreme Court] (98 taxmann.com 173)

International Taxation

- **Line Production Services cannot be termed as technical, managerial or consultancy services and brought under the definition of ‘Fee for Technical Services’**

In this case, the Tribunal has concluded that Endemol India was commissioned to produce television series ‘Fear Factor’ for broadcast in India and hired assessee for shooting episodes in South Africa. The Tribunal further observed that assessee was hired for carrying out line production services in South Africa on work-for-hire basis, since various coordination and facilitation services were rendered by assessee. It was taken note of that such services included arranging of locational crew, producer, transportation, paper work for various stunts to be performed and other requirements for setting up and filming series. The Tribunal, thus, on these facts, concluded that such services were in the nature of line production services and cannot be termed as technical managerial or consultancy services. The Tribunal, therefore, concluded that the consideration received by assessee for rendering aforesaid services, which are purely administrative in nature, cannot be brought within the sweep of definition of ‘Fee for Technical Services’, within the meaning of Explanation 2 to Section 9(1)(vii) or Article 12 of India-South Africa tax treaty.

[Endemol South Africa (Proprietary) Ltd. v. DCIT – ITAT Mumbai] (98 taxmann.com 227)

- **Where relevant bad debts related to sales made in earlier years by company acquired by assessee, same could not be added as part of operating cost for computing operating profit of assessee**

Pursuant to global acquisition of HSG group by parent company, HSG business was acquired by assessee during financial year 2001-02. Debts of HSG were taken over by assessee company as part of said acquisition and amount of such debts, to extent could not be recovered was provided for as bad and doubtful debts. Thus, it was observed by the Tribunal that the provision in question made for bad and doubtful debts was not with respect to sales made by assessee company during year under consideration, but same was with respect to sales made during earlier year and that too by HSG, i.e. the company acquired. Therefore, it was concluded that such provision for bad and doubtful debts could not be treated as part of operating cost for the purpose of computing operating profit of assessee company for the year under consideration.

[Philips Medical Systems (P.) Ltd. v. ITO – ITAT Kolkata] (98 taxmann.com 296)

News Round up

Insolvency & Bankruptcy Code

[IBBI needs to have more powers, says NCLAT Chairperson \(Business Standard\)](#)

The Insolvency and Bankruptcy Board needs to be given more powers, NCLAT Chairperson Justice Sudhansu Jyoti Mukhopadhyaya said October 1 and also suggested that there should be regulations for the Committee of Creditors (CoC). The number of cases coming up for resolution under the Insolvency and Bankruptcy Code (IBC) is on the rise, especially against the backdrop of efforts to deal with non-performing assets in the banking system.

Investment - GDP

[Share of investments in GDP to rise to 33% by FY23: RBI working paper](#) (Financial Express)

The share of investments in gross domestic product (GDP) will rise to 33% by FY23 from 31.4% recorded in the last fiscal, a working paper of the Reserve Bank of India (RBI) has forecast, suggesting that the upturn in the current investment cycle that started in FY17 could last for five more years.

Telecom

[New policy will take care of telecom industry's concerns](#) (The Economic Times)

The government is aware of the telecom industry's concerns, including those around higher levies and inadequate spectrum, and the new communications policy will address these issues, said telecom Minister Manoj Sinha. Addressing delegates at the India Mobile Congress on Thursday October 25, the Minister assured the industry and spoke about the government's efforts to promote the sector. bottlenecks."

[Net neutrality: Telecom department amends unified licence norms for operators & VNOs](#)

The Department of Telecommunications (DoT) has amended the Unified Licence (UL) norms for telecom operators and virtual network operators (VNOs) to include the regulatory framework for application of net neutrality principles. This means that now operators providing internet services cannot engage in any "discriminatory treatment of content, including based on the sender or receiver, the protocols being used or the user equipment".

Ecommerce

[Developing nations need policy space in ecommerce: India to WTO](#) (The Economic Times)

India has told the World Trade Organization (WTO) that developing countries need to maintain policy space in certain aspects of ecommerce such as ownership and use and flow of data in "sunrise sectors like cloud computing and data storage." Citing gaps in understanding on effects of ecommerce on competition and market structures, India said policy space is needed in the facets related to hosting of servers as well as big data analytics and M2M (machine-to-machine) communication in the era of internet of things.

Energy

[Government to rank oil and gas fields to boost output, promote Competition](#) (The Economic Times)

The Directorate General of Hydrocarbons (DGH) has begun ranking the country's oil and gas fields in a bid to induce competition among its managers and help boost domestic

output stagnant for years now. The ranking is based on a field's performance on 10 key parameters such as output, infusion of new technology, energy efficiency, reduction in flaring, safety standards and financial audit, an official said.

Logistics

[India's logistics industry to be worth \\$215 bn by 2020-21](#) (Business Standard)

The country's logistics industry is projected to be worth \$215 billion by 2020-21, recording a 10 per cent compounded annual growth rate (CAGR) over its approximate size of \$160 billion in 2016-17. The industry's growth will be fuelled by the strides in manufacturing, retail, fast-moving consumer goods and e-commerce sectors. Development of logistics related infrastructure, like dedicated freight corridors, logistics parks, free trade warehousing zones and container freight stations, are expected to improve efficiency, a report by CARE Ratings observed.

Start-ups

[Startups in India see 108% growth in funding in 2018](#) (The Economic Times)

The startups in India saw a 108 per cent growth in total funding from USD two billion in 2017 to USD 4.2 billion this year, National Association of Software and Services Companies said Thursday, October 25. The worrying factor, however, was the decline in funding for companies at the seed stage, NASSCOM said. "India is becoming a startup hub. Opportunity for growth is enormous, which we had never seen in our lifetime. Challenge is how fast a company wants to transform," NASSCOM president Debjani Ghosh said.

International News

[Fed's Powell says U.S. outlook 'remarkably positive'](#) (Reuters)

U.S. Federal Reserve Chairman Jerome Powell on Tuesday, October 10, hailed a "remarkably positive outlook" for the U.S. economy that he feels is on the verge of a "historically rare" era of ultra-low unemployment and tame prices for the foreseeable future.

[Further rise in trade tensions could cause global financial crisis](#) (Business Standard)

The International Monetary Fund (IMF) on Wednesday, October 10, warned that global growth may be significantly harmed with further escalation of trade tension, which is a result of the uneven global economic recovery that has fuelled inward-looking policies and contributed to increased policy uncertainty. A decade since the economic crisis, while there has been an undeniable progress towards a safer global financial system, clouds appear on the horizon, the IMF said in its latest fiscal stability report.

VJA | Legal

17, Babar lane, New Delhi - 110001

Tel.: +91 11 43504546 | E-mail: mail@vjalegal.com

Head Office:

100, Babar Road, Opp. Hotel Lalit, New Delhi - 110001