

**2014  
FEBRUARY**

**P. K. LUHARUKA & CO.**  
CHARTERED ACCOUNTANTS  
MONTHLY NEWSLETTER  
[www.pkluharukaco.com](http://www.pkluharukaco.com)



**THIS ISSUE GIVES AN UPDATE ON ASPECTS ON WHICH THE CBDT, CBEC, RBI AND MINISTRY OF CORPORATE AFFAIRS THINKS NEED CHANGES OR CLARIFICATIONS, A FEW RELEVANT CASE LAWS RELATING TO INCOME TAX, AN ANNOUNCEMENT BY THE ICAI RELATING TO EMPANELMENT OF PRACTICING MEMBERS AND A DUE DATES CALENDAR FOR THE MONTH OF FEBRUARY.**

INFORMATION PUBLISHED IN THE NEWSLETTER ARE TAKEN FROM PUBLICLY AVAILABLE SOURCES AND BELIEVED TO BE ACCURATE. P. K. LUHARUKA & CO., CHARTERED ACCOUNTANTS TAKES NO RESPONSIBILITY OF ACCURACY & RELIABILITY OF INFORMATION PUBLISHED IN THE NEWSLETTER. NO PART OF THIS NEWSLETTER MAY BE REPRODUCED, STORED IN A RETRIEVAL SYSTEM, OR TRANSMITTED IN ANY FORM OR BY ANY MEANS – ELECTRONIC, MECHANICAL, PHOTOCOPYING, RECORDING OR OTHERWISE WITHOUT OUR PERMISSION.

### DIRECT TAXES

- a. The Central Board of Direct Taxes has decided that whenever in terms of the agreement/contract between the payer and the payee, the service tax component comprised in the amount payable to a **resident** is indicated **separately**, tax shall be deducted at source (TDS) under Chapter XVII-B of the Act on the amount paid/payable without including such service tax component. (Circular dated 13.01.2014 attached)
- b. CBDT releases Explanatory Notes to the Provisions of the Finance Act, 2013. Clarification is on changes in the definitions, insertion of new sections like 32AC, 43CA, 80EE, 87A, 194IA etc. and also other changes made in the act. (Circular dated 24.01.2014 can be downloaded from the link [http://law.incometaxindia.gov.in/DIT/File\\_opener.aspx?page=CIR&schT=&csId=56770eb7-c3a2-4d47-9c5e-8bdb132bd1d9&crn=&yr=ALL&sch=&title=Taxmann%20-%20Direct%20Tax%20Laws](http://law.incometaxindia.gov.in/DIT/File_opener.aspx?page=CIR&schT=&csId=56770eb7-c3a2-4d47-9c5e-8bdb132bd1d9&crn=&yr=ALL&sch=&title=Taxmann%20-%20Direct%20Tax%20Laws))
- c. The CBDT has decided to keep in abeyance the decision to change the procedure for PAN Allotment. The change was earlier going to be effective from 03.02.2014. After the changes are made effective, along with the proof of identity and proof of address, Date of Birth Documents are also required and also only after the original copies are verified at the PAN facilitation centers, the procedure for issuance will be complete. (Circular dated 24.01.2014 & 30.01.2014 attached)

### INDIRECT TAXES

- a. CBEC issues clarification regarding issue of Discharge Certificate under VCES and availment of CENVAT Credit. Through this circular CBEC has reiterated the answer to question No. 22 of FAQ issued by CBEC dated 08.08.2013, that for eligibility of CENVAT credit attention is invited to Rule 9(1)(bb) and Rule 9(1)(e) respectively of the CENVAT Credit rules, 2004. (Circular dated 20.01.2014 attached)
- b. CBEC, through a circular, has clarified certain doubts raised on the Levy of Service Tax provided by a Resident Welfare Association (RWA) to its own members. The clarifications are related to the doubts raised post negative list approach, which includes levy of service tax on monthly contribution collected for making payments to third parties in respect of commonly used services or goods, availability of threshold exemption of ₹ 10.00 Lacs, payments made as pure agents and availability of CENVAT credit to RWA. (Circular dated 10.01.2014 attached)

### COMPANY LAW

The Ministry of Corporate affairs has changed the layout of its website in which the various options and facilities relating to company formation are arranged in an improved manner. Some of the frequently asked questions relating to how to register a company, change company information, compliance related filing, how to close a company are provided on the face of the website, which makes the website more user friendly.

### RESERVE BANK OF INDIA

- a. Reserve Bank of India has been receiving references from some Indian companies regarding issue of non-convertible/ redeemable bonus preference shares or debentures to non-resident shareholders from the general reserve under a Scheme of Arrangement by a Court, under the provisions of the Companies Act, as applicable. So far, Reserve Bank has been granting permission for such issuances on a case-to-case basis. On a review and with a view to rationalizing and simplifying the procedures, it has been decided that an Indian company may issue non-convertible/redeemable preference shares or debentures to non-resident shareholders, including the depositories that act as trustees for the ADR/GDR holders, by way of distribution as bonus from its general reserves under a Scheme of Arrangement approved by a Court in India under the provisions of the Companies Act, as applicable, subject to no-objection from the Income Tax Authorities.
- b. From April 1, 2014 onwards, the public will be required to approach banks (whether as customer or non customer) for exchanging notes issued prior to 2005. Although, RBI clarified that these notes will continue to be legal tender. The RBI further stated that public can easily identify the notes to be withdrawn as the notes issued before 2005 do not have on them the year of printing on the reverse side. Further, even July 1, 2014 onwards, members of public can exchange any number of these old series notes from the bank branches where they have their accounts. (Press Releases dated 22.01.2014 and 24.01.2014 by RBI attached)
- c. RBI, in its Third Quarter Review of Monetary Policy 2013-2014, **increased** the policy repo rate, rate at which RBI lends to the banks, **by 25 basis points from 7.75% to 8.0%**. Consequently the reverse repo rate under the Liquidity Adjustment Facility (LAF) stands adjusted at 7.0%, and the Marginal Adjustment Facility (MAF) rate and the Bank Rate at 9.0%. The Cash Reserve ratio, however, was kept unchanged at 4.0%. The move is in line with the RBI policy stance to control inflation and stabilize and anchor inflationary expectations. (Notification Dated 28.01.2014 by RBI attached)

### MEMBERS

Applications are invited online from the firms of Chartered Accountants and Chartered Accountants Limited Liability Partnerships (LLPs) who intend to be empanelled with the **OFFICE OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA** for appointment as auditors of Government Companies/Corporations for the year 2014-2015. The format of application will be available on **[www.saiindia.gov.in](http://www.saiindia.gov.in)** from 1st January 2014 to 15th February 2014. Chartered Accountant firms/CA LLPs can apply/update the data showing the status of their firm as on 1st January 2014 and generate online acknowledgement letter for the year. They are also required to submit related documents (to be notified in this office website) to this office by 31st March 2014. Only the Chartered Accountant firms/CA LLPs who have generated online acknowledgment letter for the year 2014-2015 and submitted the required documents before the due date will be considered for empanelment. (This information can be viewed at [http://www.icai.org/new\\_post.html?post\\_id=10092&c\\_id=240](http://www.icai.org/new_post.html?post_id=10092&c_id=240))

### CASE LAWS

a. **January 17, 2014 – CIT vs. Jaipur Vidyut Vitran Nigam Ltd (Rajasthan High Court) –**

Employees' PF/ESI Contribution is also covered by Sec. 43 B and allowable as a deduction u/s 36(1)(va) if paid by the "due date" for filing ROI. In the case, the High Court held that, if the amount has been deposited on or before the due date of filing of return u/s. 139 then the amount cannot be disallowed u/s. 43 B or u/s. 36 (1)(va) of the Act.

**Contrary View –**

**January 13, 2014 – CIT vs. Gujarat State Road Transport Corp (Gujarat High Court) –**

Employees' PF/ESI Contribution is not covered by Sec. 43 B and is only allowable as a deduction u/s 36(1)(va) if paid by the due date prescribed therein. In the case the High Court held that, Sec 43 B permits a deduction for payments made upto the due date for filing the ROI applies only to the **employer's contribution** to the provident fund etc.

b. **January 9, 2014 – Narath Mapila LP School vs. UOI (Kerala High Court) –**

The High Court has granted a stay of proceedings, for a period of two months, on levy of fee of ₹ 200/- for each day's delay in filing the statement of TDS or TCS.

---

**P. K. Luharuka & Co., Chartered Accountants**

**Due Dates Calendar**

01 February 2014 – 28 February 2014

---

**February 2014**

M T W T F S S

---

					1	2
3	4	<u>5</u>	<u>6</u>	<u>7</u>	8	9
<u>10</u>	11	12	13	14	<u>15</u>	16
17	18	19	20	<u>21</u>	22	23
24	25	26	27	28		

---

Details

---

**05 February 2014**



**Subject** Due Date of payment of Central Excise Duties for the previous month -  
For non SSI Units - GAR-7 Challan

---



**Subject** Due Date of payment of Service Tax for services deemed to be  
provided as per rules in the month of January in case of assesseees,  
other than individual or proprietorship firm or partnership firm (if not  
paid electronically) (GAR 7 Challan)

---

**06 February 2014**



**Subject** Due Date of payment (latest by 8 P.M.) of Service Tax for services  
deemed to be provided as per rules in the month of January in case of  
assesseees, other than individual or proprietorship firm or partnership  
firm (if paid electronically) (GAR 7 Challan)

---



**Subject** Due Date of payment of Central Excise Duties for the previous month -  
For non SSI Units (if paid electronically) - GAR-7 Challan

---

---

**07 February 2014**

**Subject** Due Date of deposit of TDS where income or amount is paid or credited in the month of January (Challan No./ ITNS. 281)



**Subject** Due Date of Monthly payment of TCS in January u/s 206C



**Subject** Submission of copy of declaration forms (Form 15G and form 15H) received for non deduction of TDS under section 197A before the Chief Commissioner or Commissioner

---

**10 February 2014**

**Subject** Due Date of ER-1 for Non-SSI assesseees and ER-2 for EOU units for the month of January

---

**15 February 2014**

**Subject** Due Date of Payment of PF for the month of January (plus grace period of 5 days)

---

**21 February 2014**

**Subject** Due Date of Payment of ESI for the month of January

---

**CHAPTER XVII-B OF THE INCOME-TAX ACT, 1961 - COLLECTION AND RECOVERY OF  
TAX - DEDUCTION AT SOURCE - CLARIFICATION REGARDING TDS UNDER CHAPTER  
XVII-B ON SERVICE TAX COMPONENT COMPRISED OF PAYMENTS MADE TO  
RESIDENTS**

**CIRCULAR NO. 1/2014 [F.NO.275/59/2012-IT(B)], DATED 13-1-2014**

The Board had issued a Circular No.4/2008 dated 28-04-2008 wherein it was clarified that tax is to be deducted at source under section 194-I of the Income-tax Act, 1961 (hereafter referred to as 'the Act'), on the amount of rent paid/payable without including the service tax component. Representations/letters has been received seeking clarification whether such principle can be extended to other provisions of the Act also.

2. Attention of CBDT has also been drawn to the judgement of the Hon'ble Rajasthan High Court dated 1-7-2013, in the case of *CIT (TDS) Jaipur v. Rajasthan Urban Infrastructure* (Income-tax Appeal No.235, 222, 238 and 239/2011), holding that if as per the terms of the agreement between the payer and the payee, the amount of service tax is to be paid separately and was not included in the fees for professional services or technical services, no TDS is required to be made on the service tax component u/s 194J of the Act.

3. The matter has been examined afresh. In exercise of the powers conferred under section 119 of the Act, the Board has decided that wherever in terms of the agreement/contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source under Chapter XVII-B of the Act on the amount paid/payable without including such service tax component.

4. This circular may be brought to the notice of all officer for compliance.

■ ■

**Government of India  
Ministry of Finance  
Department of Revenue  
Central Board of Direct Taxes**

**Dated 24<sup>th</sup> January, 2013**

**Press Release**

The procedure for PAN allotment process will undergo a change w.e.f. 03.02.2014. From this date onwards, every PAN applicant has to submit self-attested copies of Proof of Identity (POI), Proof of Address (POA) and Date of Birth (DOB) documents and also produce original documents of such POI/POA/DOB documents, for verification at the counter of PAN Facilitation Centres. The copies of Proof of Identity (POI), Proof of Address (POA) and Date of Birth (DOB) documents attached with PAN application form, will be verified vis a vis their original documents at the time of submission of PAN application at PAN Facilitation Centre. Original documents shall not be retained by the PAN Facilitation Centres and will be returned back to the applicant after verification.

**(Rekha Shukla)  
Commissioner of Income Tax (M&TP)  
Official Spokesperson, CBDT**



**Government of India  
Ministry of Finance  
Department of Revenue  
Central Board of Direct Taxes**

**Dated 30<sup>th</sup> January, 2013**

**Press Release**

The CBDT has decided to keep in abeyance the decision to change the procedure for PAN allotment till further orders. Accordingly the operation of circular No. 11 dated 16.01.2014 issued to PAN service providers has been directed to be put on hold till further orders. In the meantime the old procedure of PAN application and allotment shall continue.

**(Rekha Shukla)  
Commissioner of Income Tax (M&TP)  
Official Spokesperson, CBDT**

**Circular No. 176/2/2014 - ST**

F. No. B1/19/2013-TRU (Pt)  
Government of India

Ministry of Finance

Department of Revenue

Central Board of Excise and Customs

Tax Research Unit

\*\*\*\*\*

New Delhi, dated the 20<sup>th</sup> January, 2014

To,  
Chief Commissioners of Central Excise and Customs (All),  
Director General (Service Tax), Director General (Systems),  
Director General (Central Excise Intelligence), Director General (Audit),  
Commissioners of Service Tax (All),  
Commissioners of Central Excise (All),  
Commissioners of Central Excise and Customs (All)

Madam/Sir,

**Subject: Clarification regarding issue of Discharge Certificate under VCES and availment of CENVAT credit - regarding.**

Trade and Industry has sought clarification as to whether the first installment of tax dues paid under Voluntary Compliance Encouragement Scheme (VCES), 2013 would be available as Cenvat Credit immediately after payment or Cenvat credit can be availed only after payment of tax dues in full and receipt of Acknowledgement of Discharge in form VCES-3.

2. The issue has been examined. As per VCES, under Section 108 (2) of the Finance Act, 2013, a declaration made under Section 107 (1) shall become conclusive only upon issuance of acknowledgement of discharge under Section 107 (7). Further, in terms of Rule 7 of the Service Tax VCES Rules 2013, the acknowledgement of discharge in form VCES-3 shall be issued within a period of 7 working days from the date of furnishing of details of payment of tax dues in full along with interest, if any, by the declarant.

3. It would be in the interest of VCES declarants to make payment of the entire service tax dues at the earliest and obtain the discharge certificate within 7 days of furnishing the details of payment. As already clarified in the answer to question No.22 of FAQ issued by CBEC dated 08.08.2013, eligibility of CENVAT credit would be governed by the CENVAT Credit Rules, 2004.

4. Chief Commissioners are also advised that upon payment of the tax dues in full, along with interest, if any, they should ensure that discharge certificate is issued promptly and not later than the stipulated period of seven days.

Yours sincerely,

(S. Jayaprahasam)  
Technical Officer, TRU  
Tel: 011-2309 2037

**Circular No.175 /01 /2014 – ST**

F. No.354/237/2013-TRU  
 Government of India  
 Ministry of Finance  
 Department of Revenue  
 Central Board of Excise & Customs  
 Tax Research Unit

North Block, New Delhi  
 10<sup>th</sup> January, 2014

To

Chief Commissioners of Central Excise and Service Tax (All), Director General (Service Tax), Director General (Central Excise Intelligence), Director General (Audit), Commissioners of Service Tax (All), Commissioners of Central Excise and Service Tax (All).

Madam/Sir,

**Subject: Levy of service tax on services provided by a Resident Welfare Association (RWA) to its own members – regarding.**

Service tax on 'club or association service' which covers Resident Welfare Association (RWA) was introduced with effect from 16.06.2005, vide section 65(105)(zzze) read with section 65(25a)[(25a) was later renumbered as (25aa)]. Under the positive list approach which was followed prior to 1<sup>st</sup> July 2012, exemption was available under notification No. 8/2007-ST dated 01.03.2007, if the total consideration received from an individual member by the RWA for the services does not exceed three thousand rupees per month. This notification was rescinded vide notification No. 34/2012-ST dated 20<sup>th</sup> June 2012, with effect from 1<sup>st</sup> July, 2012.

2. Under the negative list approach, with effect from 1<sup>st</sup> July, 2012, notification No.25/2012-ST [sl.no.28 (c)] provides for exemption to service by a RWA to its own members by way of reimbursement of charges or share of contribution up to five thousand rupees per month per member for sourcing of goods or services from a third person for the common use of its members.

Certain doubts have been raised regarding the scope of the present exemption extended to RWAs under the negative list approach. These doubts have been examined and clarifications are given below:

Sl. No.	Doubt	Clarification
1.	<p>(i) In a residential complex, monthly contribution collected from members is used by the RWA for the purpose of making payments to the third parties, in respect of commonly used services or goods [Example: for providing security service for the residential complex, maintenance or upkeep of common area and common facilities like lift, water sump, health and fitness centre, swimming pool, payment of electricity Bill for the common area and lift, etc.]. Is service tax leviable?</p> <p>(ii) If the contribution of a member/s of a RWA exceeds five thousand rupees per month, how should the service tax liability be calculated?</p>	<p>Exemption at Sl. No. 28 (c) in notification No. 25/2012-ST is provided specifically with reference to service provided by an unincorporated body or a non-profit entity registered under any law for the time being in force such as RWAs, to its own members.</p> <p>However, a monetary ceiling has been prescribed for this exemption, calculated in the form of five thousand rupees per month per member contribution to the RWA, for sourcing of goods or services from third person for the common use of its members.</p> <p>If per month per member contribution of any or some members of a RWA exceeds five thousand rupees, the entire contribution of such members whose per month contribution exceeds five thousand rupees would be ineligible for the exemption under the said notification. Service tax would then be leviable on the aggregate amount of monthly contribution of such members.</p>

2.	<p>(i) Is threshold exemption under notification No. 33/2012-ST available to RWA?</p> <p>(ii) Does 'aggregate value' for the purpose of threshold exemption, include the value of exempt service?</p>	<p>Threshold exemption available under notification No. 33/2012-ST is applicable to a RWA, subject to conditions prescribed in the notification. Under this notification, taxable services of aggregate value not exceeding ten lakh rupees in any financial year is exempted from service tax. As per the definition of 'aggregate value' provided in Explanation B of the notification, aggregate value does not include the value of services which are exempt from service tax.</p>
3.	<p>If a RWA provides certain services such as payment of electricity or water bill issued by third person, in the name of its members, acting as a 'pure agent' of its members, is exclusion from value of taxable service available for the purposes of exemptions provided in Notification 33/2012-ST or 25/2012-ST ?</p>	<p>In Rule 5(2) of the Service Tax (Determination of Value) Rules, 2006, it is provided that expenditure or costs incurred by a service provider as a pure agent of the recipient of service shall be excluded from the value of taxable service, subject to the conditions specified in the Rule.</p> <p>For illustration, where the payment for an electricity bill raised by an electricity transmission or distribution utility in the name of the owner of an apartment in respect of electricity consumed thereon, is collected and paid by the RWA to the utility, without charging any commission or a consideration by any other name, the RWA is acting as a pure agent and hence exclusion from the value of taxable service would be available. However, in the case of electricity bills issued in the name of RWA, in respect of electricity consumed for common use of lifts, motor pumps for water supply, lights in common area, etc., since there is no agent involved in these transactions, the exclusion from the value of taxable service would not be available.</p>
4.	<p>Is CENVAT credit available to RWA for payment of service tax?</p>	<p>RWA may avail cenvat credit and use the same for payment of service tax, in accordance with the Cenvat Credit Rules.</p>

3. Trade Notice/ Public Notice to be issued. Hindi version to follow.

[Raj Kumar Digvijay]  
Under Secretary to the Government of India



**भारतीय रिज़र्व बैंक**

**RESERVE BANK OF INDIA**

वेबसाइट : [www.rbi.org.in/hindi](http://www.rbi.org.in/hindi)

Website : [www.rbi.org.in](http://www.rbi.org.in)

इ-मेल email: [helpdoc@rbi.org.in](mailto:helpdoc@rbi.org.in)

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई-400001

DEPARTMENT OF COMMUNICATION, Central Office, S.B.S.Marg, Mumbai-400001

फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 22660358

January 22, 2014

### **Banknotes issued prior to 2005 to be withdrawn: RBI Advisory**

The Reserve Bank of India has today advised that after March 31, 2014, it will completely withdraw from circulation all banknotes issued prior to 2005. From April 1, 2014, the public will be required to approach banks for exchanging these notes. Banks will provide exchange facility for these notes until further communication. The Reserve Bank further stated that public can easily identify the notes to be withdrawn as the notes issued before 2005 do not have on them the year of printing on the reverse side. (Please see illustration below)

The Reserve Bank has also clarified that the notes issued before 2005 will continue to be legal tender. This would mean that banks are required to exchange the notes for their customers as well as for non-customers. From July 01, 2014, however, to exchange more than 10 pieces of ₹500 and ₹1000 notes, non-customers will have to furnish proof of identity and residence to the bank branch in which she/he wants to exchange the notes.

The Reserve Bank has appealed to the public not to panic. They are requested to actively co-operate in the withdrawal process.

**Press Release : 2013-2014/1472**

**Ajit Prasad**  
Assistant General Manager

## Illustration



**Figure 1: Banknote on which the year of printing is not indicated and will be WITHDRAWN after March 31, 2014**



**Figure 2: Banknote on which the year of printing is indicated and will therefore not be withdrawn**

प्रेस प्रकाशनी PRESS RELEASE



भारतीय रिज़र्व बैंक  
RESERVE BANK OF INDIA

वेबसाइट : [www.rbi.org.in/hindi](http://www.rbi.org.in/hindi)  
Website : [www.rbi.org.in](http://www.rbi.org.in)  
ई-मेल email: [helpdoc@rbi.org.in](mailto:helpdoc@rbi.org.in)

संचार विभाग, केन्द्रीय कार्यालय, एच.सी.एल.मार्ग, मुंबई 400001

DEPARTMENT OF COMMUNICATION, Central Office, S.B.S. Marg, Mumbai 400001  
फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 2270 3279

Date : 24 Jan 2014

### Banknotes issued prior to 2005 to be withdrawn – RBI Clarification

Further to our [Press Release](#) dated January 22, 2014 on the subject and in response to the queries raised, the Reserve Bank of India (RBI) clarifies that the rationale behind its move to withdraw banknotes printed prior to 2005 is to remove these banknotes from the market because they have fewer security features compared to banknotes printed after 2005. It is standard international practice to withdraw old series notes.

The RBI has already been withdrawing these bank notes from the market in a routine manner through banks. In Reserve Bank's view, the volume of the banknotes printed prior to 2005 today, still in circulation, is not significant enough to impact the general public in a large way.

However, it advises that the members of public may initiate the process of exchanging notes at bank branches at their convenience. Further, even July 1, 2014 onwards, members of public can exchange any number of these old series notes from the bank branches where they have their accounts.

The RBI assures that it will continue to monitor and review the process of withdrawal of old series notes so that the public is not inconvenienced in any manner.

Regardless of the above, the RBI reiterates that the notes printed prior to 2005 will continue to be legal tender.

Alpana Killawala  
Principal Chief General Manager

Press Release: 2013-2014/1491

## **Reserve Bank of India**

### **Third Quarter Review of Monetary Policy 2013-14**

On the basis of an assessment of the current and evolving macroeconomic situation, it has been decided to:

- increase the policy repo rate under the liquidity adjustment facility (LAF) by 25 basis points from 7.75 per cent to 8.0 per cent; and
- keep the cash reserve ratio (CRR) of scheduled banks unchanged at 4.0 per cent of net demand and time liability (NDTL).

Consequently, the reverse repo rate under the LAF stands adjusted at 7.0 per cent, and the marginal standing facility (MSF) rate and the Bank Rate at 9.0 per cent.

#### **Assessment**

2. Since the Mid-Quarter Review of December 2013, the global recovery is gaining traction, led by the strengthening of the US economy, but it is still uneven and subdued in the Euro area and Japan, and a slowdown in China seems to be underway. Notwithstanding the boost from stronger external demand, uncertainty continues to surround the prospects for some emerging economies, with domestic fragilities getting accentuated. Financial market contagion is a clear potential risk.

3. Domestically, some loss of momentum of growth is likely in Q3 of 2013-14, despite a strong pick-up in *rabi* sowing. Industrial activity remains in contractionary mode, mainly on account of manufacturing, which declined for the second month in succession during Q3. Consumption demand continues to weaken and lacklustre capital goods production points to stalled investment demand. Fiscal tightening through Q3 and Q4 is likely to exacerbate the weakness in aggregate demand. Lead indicators of services suggest a subdued outlook, barring some pick-up in transport and communication activity.

4. While retail inflation measured by the consumer price index (CPI) declined significantly on account of the anticipated disinflation in vegetable and fruit prices, it remains elevated at close to double digits. Moreover, inflation excluding food and fuel has also been high, especially in respect of services, indicative of wage pressures and other second round effects. In terms of the wholesale price index (WPI), headline inflation eased to a four-month low with the sharp decline in vegetable and fruit prices. Non-food manufactured products (NFMP) inflation, however, rose in December on an uptick in prices of chemicals, non-metallic minerals and paper products. Hardening prices of services and key intermediates seen in conjunction with rising bank credit, increase in order books, pick-up in capacity utilisation and the decline in inventories of raw materials and finished goods in relation to sales suggests that aggregate demand pressures are still imparting an upside to overall inflation. It is critical to address these risks to the inflation outlook resolutely in order to stabilise and anchor inflation expectations, even while recognising the economy is weak and substantial fiscal tightening is likely in Q4.



5. Liquidity conditions were impacted by the mid-December advance tax outflows. Recourse to the MSF rose from an average of ₹27 billion during the first half of December to an average of ₹250 billion in the second half, and the weighted average call rate moved up to 8.4 per cent from sub-LAF overnight repo rate levels. Although liquidity eased in the first week of January 2014 due to large redemptions by the Government, it started tightening thereafter with the build-up of Government's cash balances with the Reserve Bank. In order to normalise liquidity conditions in the face of these frictional pressures, the Reserve Bank conducted 7-day term repos of ₹100 billion on January 10, followed by 28-day term repos on January 17 and 21 cumulating to ₹300 billion, in addition to the normal liquidity provision of ₹1.4 trillion under overnight, 7-day and 14-day repos, and export credit refinance taken together. After assessing that market liquidity would likely remain tight for a while, and keeping in view the need to accommodate normal credit growth, open market purchase operations of ₹95 billion were conducted on January 22 in order to provide liquidity of a more permanent nature. The weighted average call rate has eased in response to these operations. The Reserve Bank is engaged in active management of liquidity to offset frictional and structural pressures so that there is adequate credit flow to the supply side of the economy.

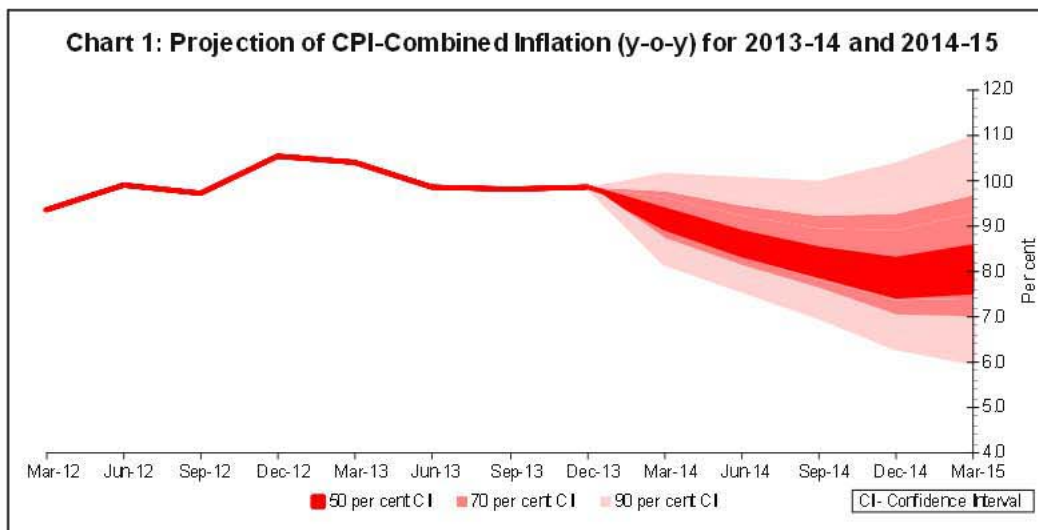
6. For the period April-December 2013, the trade deficit has shrunk by 25 per cent from its level a year ago, with merchandise exports increasing on a y-o-y basis for the sixth consecutive month in December, while non-oil imports have continued to decline. Accordingly, the current account deficit (CAD) for 2013-14 is expected to be below 2.5 per cent of GDP as compared with 4.8 per cent in 2012-13. The recent resumption of portfolio flows, both equity and debt, alongside the pick-up in FDI and external commercial borrowings that is underway should help finance the current account deficit comfortably. Reserves have been rebuilt since September, and oil marketing companies have been buying foreign exchange in the market to repay the Reserve Bank when their swaps come due. Despite a significantly more comfortable external position than in the summer of 2013, both fiscal and monetary authorities need to continue their efforts at macroeconomic stabilisation.

### **Policy Stance and Rationale**

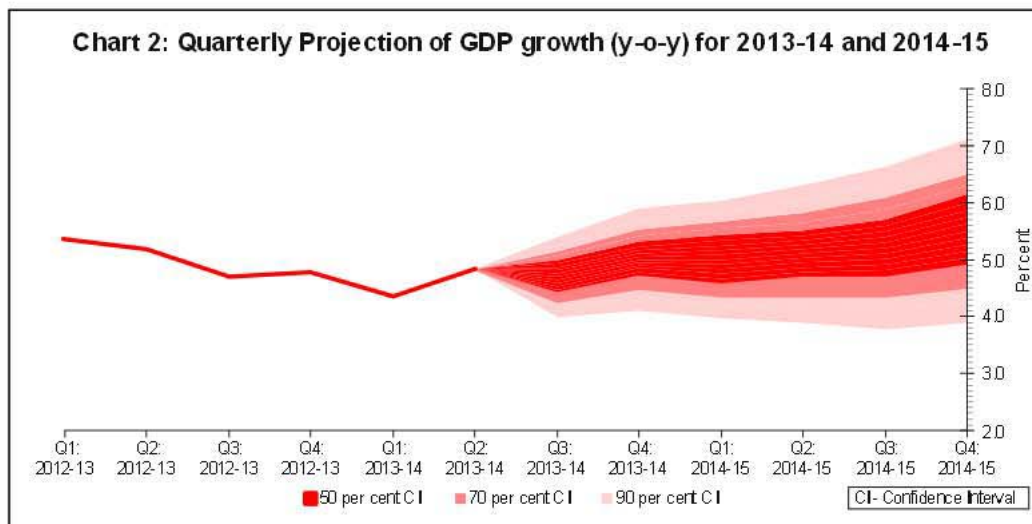
7. In the Mid-Quarter Review on December 18, 2013, the policy decision was to wait for more data before acting. With the subsequent substantial fall in food prices, especially of vegetables, headline inflation has fallen significantly. Some of these effects will continue into the next round of data readings. CPI inflation excluding food and fuel has, however, remained flat and WPI inflation excluding food and fuel has risen.

8. The Dr. Urjit Patel Committee has indicated a "glide path" for disinflation that sets an objective of below 8 per cent CPI inflation by January 2015 and below 6 per cent CPI inflation by January 2016. The Reserve Bank's baseline projections set out in the accompanying Review of Macroeconomic and Monetary Developments for Q3 of 2013-14 indicate that over the ensuing 12-month horizon, and with the current policy stance, there are upside risks to the central forecast of 8 per cent. An increase in the policy rate will not only be consistent with the guidance given in the Mid-Quarter Review but also will set the economy securely on the recommended

disinflationary path. The extent and direction of further policy steps will be data dependent, though if the disinflationary process evolves according to this baseline projection, further policy tightening in the near term is not anticipated at this juncture.



9. If policy actions succeed in delivering the desired inflation outcome, real GDP growth can be expected to firm up from a little below 5 per cent in 2013-14 to a range of 5 to 6 per cent in 2014-15, with risks balanced around the central estimate of 5.5 per cent. A pick-up in investment in an environment in which external demand continues to be supportive of export performance could impart an upside to this forecast.



10. Hereafter, following the recommendation of the Dr. Urjit Patel Committee, monetary policy reviews will ordinarily be undertaken in a two-monthly cycle, consistent with the availability of key macroeconomic and financial data. Accordingly, the next policy review is scheduled on Tuesday, April 1, 2014.