THE CHAMBER'S JOURNAL DOMESTIC TRANSFER PRICING OCTOBER - 2013 VOL. II | NO. 1

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THE CHAMBER OF TAX CONSULTANTS

# THE CHAMBER'S JOURNAL

OCTOBER - 2013

VOL. II | NO. 1

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

## DOMESTIC TRANSFER PRICING

In October 2010, the Hon'ble Supreme Court in the case of CIT vs. GlaxoSmithKline Asia (P) Ltd., after examining the complications which arise in cases involving determination of FMV, suggested that the Ministry of Finance should consider appropriate provisions in law to make TP regulations applicable to domestic related party transactions/transactions between two businesses/ units of the same taxpayer.

*(Read further from page 17 onwards)*

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International Taxation

Indirect Taxes

Corporate Laws

Other Laws

Best of the Rest

Economy & Finance

Your Questions & Our Answers

The Chamber News

and more

THE CHAMBER OF TAX CONSULTANTS

## STUDY CIRCLE & STUDY GROUP COMMITTEE

**Study Circle Meeting held on 5th September, 2013 on the subject "Practical aspect of new requirement of e-filing of tax audit & other reports".**

CA Avinash Rawani addressing the members.

## INDIRECT TAXES COMMITTEE

**IDT Study Circle Meeting held on 10th September, 2013 on the subject "Applicability of VAT and Service tax on Deemed Sales".**

CA Bharat Shemlani chairing the session.

CA Ankit Chande addressing the members.

## STUDY CIRCLE & STUDY GROUP COMMITTEE

**Study Group Meeting held on 7th October, 2013 on the subject "Recent Decision under Direct Tax".**

CA Anant Pai addressing the members. Seen from L to R : CA Haresh Kenia, Chairman, Shri Jitendra Singh, Faculty, CA Yatin Desai, President, CA Dinesh Shah, Convenor, Paras Savla, Convenor.

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# Editorial

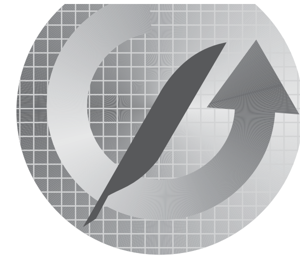
Wish you all Happy Navratri. The month of October brings relief and festivities, especially for the Professionals engaged in audit and filing income tax returns. The Special story for the October issue of the Chamber's Journal is on Domestic Transfer Pricing. The Finance Act, 2012 has introduced a few provisions for Domestic Transfer Pricing for Specified Transactions into the Income-tax Act, 1961. The Executive has responded to the suggestions made by the Apex Court in the case of ***CIT vs. Glaxo Smithkline Asia (P) Ltd. (2010) 236 CTR (Supreme Court) 113***. The Hon'ble Supreme Court observed: "in the case of domestic transactions, the under – invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage: (i) If one of the related companies is loss making and the other is profit making and profit is shifted to the loss making concern; and (ii) If there are different rates for two related units (on account of different status, area based incentives, nature of activity, etc.) and if profit is diverted towards the unit on the lower side of tax arbitrage. For example, sale of goods or services from non-SEZ area (taxable division) to SEZ unit (non-taxable unit) at a price below the market price so that taxable division will have less profit taxable and non-taxable division will have a higher profit exemption. All these complications arise in cases where fair market value is required to be assigned to the transactions between related parties in terms of s. 40A(2). To get over this situation, the matter needs to be examined by CBDT. In order to reduce litigation, certain provisions of the Act, like s. 40A(2) and s. 80-IA(10), need to be amended empowering the AO to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties. The AO may thereafter apply any of the generally accepted methods of determination of arm's length price, including the methods provided under Transfer Pricing Regulations. However, in number of matters, many a times, the AO is constrained by non-maintenance of relevant documents by the taxpayers as, currently, there is no specific requirement for maintenance of documents or getting specific transfer pricing audit done by the taxpayers in respect of domestic transactions between the related parties. One of the suggestions which needs consideration is whether the law should be amended to make it compulsory for the taxpayer to maintain books of account and other documents on the lines prescribed under 10D in respect of such domestic transactions and whether the taxpayer should obtain an audit report from his chartered accountant so that the taxpayer maintains proper documents and requisite books of account reflecting the transactions between related entities as at arm's length price based on generally accepted methods specified under the Transfer Pricing Regulations? The question of amendment, as indicated above, may require consideration expeditiously by the Ministry of Finance. In the meantime, CBDT may also consider issuing appropriate instructions in that regard."

The anxiety of the Hon'ble Court about litigation is well-founded. However, two important aspects with respect to transfer pricing were not brought to the notice of the Hon'ble Supreme Court: (i) The Transfer Pricing provisions with regard to international taxation which have rather contributed to litigation instead of reducing the same (ii) The attitude of the department towards simplification of the statutory provisions which too might lead to increase in the volume of litigation. The Conceptual shift from the fair market price to arm's length price would change the scope of litigation. The focus under the Domestic Transfer pricing regime would shift from expenditure to income. This shall lead to transfer pricing litigation in domestic transactions as well. The Central Board of Direct Taxes should have invited views of professional bodies before introducing such important statutory provisions.

The Executive's response to the Hon'ble Supreme Court's decision in the case of ***Vodafone International Holding B.V. vs. UOI (2012) 341 ITR I (Supreme Court)*** of making retrospective amendments has hurt business sentiment internationally. Foreign investors had been left puzzled and weary of the fiscal policy pursued by the government. As if this is not sufficient, introduction of DomesticTransfer Pricing has been done which would lead to a substantial increase in the compliance cost of assessees and this, again in turn, would dampen the business sentiment in the domestic markets as well. This year assessee would face the music of these provisions. The Hon'ble Court in the case of ***CIT vs. Glaxo Smithkline Asia (P) Ltd. (Supra)*** has specifically indicated the kind of transactions which could be brought under the ambit of Domestic Transfer Pricing . The Executive has not provided those safeguards while introducing the Domestic Transfer Pricing provisions. Thus, it has been left for the Court to deal with litigation and sort out the issues arising out of the same.

I thank all the authors for their contribution to this issue. The Journal Committee acknowledges the support from the President, Vice President and Honourary Secretary, Mr. Hinesh Doshi with thanks and applause.

**K. GOPAL**
*Editor*



## From the President

Dear Members,

One more hectic season of filing Return of Income for assessees covered under various laws is over. However, this year was different from earlier years in the sense that more compliance was introduced in a very short span of time. On the top of it, there were frequent changes in the utilities of filing Tax Audit and other Reports. The Chamber had visualised the difficulty of the Professionals and Tax-filers and filed a representation to extend the due date of filing return of Income, if not, atleast to extend the time for filing Tax Audit Report by a month. Though, the Chamber had filed it long back, the extension as usual came very late leaving no time for the Professionals. That too, with a rider of filing physical report before the due date that negated all the purpose of the extension. Practically, extension remains on paper and is hardly of any use. At the same time frequent crashing of the system on the last day deprived many from filing Returns on the last day. This time again the tax collecting authority failed to provide proper infrastructure before implementing any significant changes. The Chamber has once again represented before the CBDT on the very next day for granting a short extension but till the time I am writing this column, nothing is heard of.

The Gandhi Jayanti was welcomed by the professional brothers as a holiday after burning midnight oil in the month of September. The 144th birth anniversary of the Father of the nation has ceased to raise any enthusiasm to honour the country's idolatry figure. Gandhiji was remembered for his Gandhi topi, which has now become attire for budding politicians. His satyagraha and upvas are used by individuals as tactics to put pressure on the authorities to make them agree to frivolous demands. We are miles away from the simplicity which he preached and practiced throughout his life. Gandhiji has only remained a favourite topic of discussion to impress others and show our pseudo concerns. We require film fraternity to idolise the great immortal Gandhiji. His practice is now known as Gandhigiri which is more of an entertainment to us than a rich legacy to follow.

Gandhiji was instrumental in getting us Independence. India today is the largest Democracy. However, India is in the state of economic paralysis. At the Government level nobody is ready to take any concrete steps to bring it out of the state in which it is. World's another democracy is facing political paralysis. In United States of America, several Federal servants are furloughed

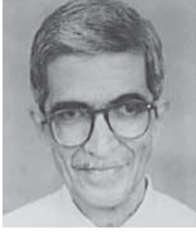
since thirtieth September this year. The United States Constitution requires Government spending be approved in bills passed by the United States Congress. US Federal Government is shutdown due to non-passing of the budget in time in the House of Representatives. Political fights between Democratic President Barack Obama and the Republican-led House have led to a budget impasse. An estimated 800,000 Federal employees are furloughed without pay and about 1.3 million employees are required to work without pay, face uncertain future due to shutdown. More alarming is that there is no certain end to the shutdown. This will not only impact the US but world's economy as the purchasing power of millions of US citizens will come down. Further, due to Social and other benefits available, they do not have saving habits like we Indians have.

One after the other series of festivals continue. Navratri, Sharad Poornima, Vijayadashmi and Dipawali. Each of our festivals has its spiritual significance. One may read a book named Sanskruti-Pujan published by Sat Vichar Darshan for understanding importance of our festivals in a simple language. Navratri is a celebration of Goddess Durga – a form of Power. It has a spiritual significance that Shiva and Parvati (Shakti), the male and female energy of the infinite, one is incomplete without the other. Shiva without Shakti is like Shava. That is the importance our culture has given to females. While Navratri is celebration of Shakti, Dipawali is the "festival of lights"; the most significant spiritual meaning behind it is "the awareness of the inner light". Dipawali is a celebration of the "victory of good over evil". It also refers to the light of higher knowledge dispelling all ignorance. The higher knowledge brings peace.

At Chamber, we try and bring higher knowledge by planning more and more educational activities. As I had mentioned last month, several programmes are announced in the Newsletter including our much awaited Residential Conferences at Pondicherry and 2nd Service Tax Residential Refresher Course at Lonavala. The Chamber's Journal is also coming out with the most topical subject – Domestic Transfer Pricing. On the very same subject Chamber has also arranged a full day programme. I must acknowledge efforts of Mr. Gaurav Shah for preparing a design of the Special Story and Shri Hinesh Doshi, Hon. Joint Secretary for selecting contributors and obtaining articles in record time. The Chamber is also having a unique joint programme with the Indian Merchant's Chamber for the first time on the subject 'Making of the CFO'. By the time this Journal reaches you, the programme would have been concluded. Hope you will all take benefit of the Chambers activities.

I Wish all the readers a very Happy Diwali!

**YATIN DESAI**
*President*



V. H. Patil, *Advocate*

# Ved and Vedanta

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## THE YOGA OF ROYAL SCIENCE AND ROYAL SECRET

Lord Krishna in the last shloka of the last Chapter (Chapter VIII) said that a Real Bhakta totally surrenders, all his actions, works and his life itself to the God and ultimately merges himself with God.

Lord Krishna in this Chapter explains and fully describes the status and the role of God, inside and outside the world and fully explains His role in all activities outside and inside the world.

As per Lord Krishna one, now or later, has to totally merge with the Lord by full devotion and explains the way to totally surrender himself fully along with all his actions, good or not good, to the Lord.

In this Chapter, Lord Krishna through the media of a selfless person Arjuna, advises the whole humanity to try to reach God with a selfless, true and pure love towards God.

The subject matter of this chapter is the knowledge of reaching one's true self through total devotion to the Lord. This knowledge Lord Krishna calls it, a Royal and secret and sacred knowledge, which cannot be fully described in words but it can be realised with one's true experience.

After describing the nature of this Royal and secret knowledge Lord Krishna in shlokas 4 to 7 in a detailed discussion gives the true nature of the Lord, the self in the body of the human body and outside the body and the nature. He says that He pervades the entire universe. This manifested universe in its entirety is pervaded by Him. However though the entire universe is pervaded by him and all beings exist in Him, He does not dwell in any one of them and though He is the cause of all their actions, He does not dwell in them. However ultimately all of them take rest in Him, at the end of a Kalpa (Cosmic Cycle) and all of them come back again to this world, at the start of next 'Kalpa'.

The Vedanta principle that from Brahman the world has come, the word exists in Him and finally reunites back to Him, is reflected in shloka 7 of this Chapter.

Though this Royal and Secret knowledge is difficult to comprehend, it is very easy to practice by a person fully determined to follow it, with one pointed concentrated mind, with full true and pure devotion to the Lord, totally surrendering to the Lord by offering all his actions to The Lord including his Life itself with the full devotion and surrender, one can

reunite ultimately with God his life and living by merging with the Lord.

Apart from being simple and easier to follow, the way of Devotion is available to all and it is not confined to only few high born people like Brahmin. It can be followed even by a 'Sudra' or even by a most wicked person or by a criminal person, if he decides to make an absolute about turn.

Raja Yoga, in a way is fine combination of Karma Yoga and Bhakti Yoga.

Vinoba Bhave summarises all these principles in his talks on Bhagavad Gita as under:

2. What I ain telling here has connection with the Ninth Chapte1-:' 'l fiis Chapter tells about the wonderful greatness of the Lord's Name. It is at the centre of the Gita, which itself is at the centre of the Mahabharata. For many reasons, this Chapter is considered particularly holy. It is said that when Jnanadeva bid farewell to the world and entered into *samadhi*, he was reciting this Chapter. Whenever I think of this Chapter, tears well up in my eyes and my heart dances with divine joy. How great is this gift that Vyasa has given to us! Not only India but all mankind is indebted to Vyasa for this gift. In fact, what the Lord told Arjuna was not something that could be expressed in words; but Vyasa, moved by compassion, put it into Sanskrit verse. He clothed in words the secret wisdom.

3. At the very outset, the Lord says that this unique wisdom is the supreme secret; it is the highest, and the purest. And this is something to be directly experienced. This Chapter describes something that cannot be put into words, but which has stood the test of experience. That is why it has become exceedingly endearing. Saint Tulsidas has said, ' keÀes peevew keÀes peìnw peceHeg keÀes meg Heg Hej -Oeece keÀes, Ieguee efmeefnb yenge Yeuees ueeie le peie peedeve j eceie eguee ece keÀes-" -What is the use of the stories of heaven where one can go after death? Who knows who will go to heaven and who to hell? We are here to live only for a few days. Tulsidas says that he is happy in spending these few days in the service of the Lord. This Chapter describes the beauty and the sweetness of living in the service of the Lord. It tells about things which can be directly experienced in this body, seen directly with the eyes, enjoyed here and now in this life. When one eats jaggery, one can directly experience its sweetness. This_ Chapter gives a taste of sweetness in life' that is totally surrendered to the Lord. It deals with the supreme knowledge that enables us to experience directly the sweetness in the life on this earth. This knowledge is otherwise most difficult to grasp, but the Lord has revealed it here to all, made it accessible and comprehensible to all.

**The easy way**

4. The Gita is the essence of the Vedic religion – the religion that originated from the Vedas. The Vedas are considered to be the oldest among the ancient scriptures in the world. That is why the devout consider them *anadi* (which have no beginning, which have always been in existence). The Vedas are, therefore, held in great reverence. Even from the historical point of view, they are the oldest recorded expression of our ancient social mind. This written record is far more valuable than the copper and stone inscriptions, coins, pots and pans or ani1nal fossils. The Vedas are the oldest historical documents. The religion that was in the form of a seed in the Vedas grew gradually into the tree which finally bore the sweet divine fruit of the Gita. What else can we have from a tree to eat than a fruit? It is only when the tree bears fruit that we can have something to eat. The Gita is the twice-distilled essence of the Vedic religion.

5. The ancient Vedic religion prescribed various rites and rituals, *yajnas*, austerities and penances, different practices and various types of spiritual discipline. All these were not useless, but they called for certain fitness; they were not open to all. Suppose I am hungry, and there is a coconut high up on the tree. How can I get it if I cannot climb the tree, pluck the

coconut and break it open? Can the mere sight of the coconut satisfy my hunger? That coconut is of no use to me until I can have it in my hands. The Vedic rites and rituals were based on subtle and significant ideas. How could the common folk comprehend them? It was laid down that the Vedic path was essential for attaining *moksha* (spiritual liberation), but only a few were entitled to follow it. How could others redeem themselves? That was a predicament.

6. Hence the saints, overflowing with compassion for the masses, came forward and said, "Let us extract the essence of the Vedas and give it to the whole world." That is why Saint Tukaram said, ' Jeo Develbe yeesfueuee ~ DeLe&FlekgeAeef®e meeefOeuee~" – 'There are innumerable teachings in the Vedas. But all that boils down to this.' To what? To the Name of the Lord. That is the essence of the Vedas. The saints proclaimed that the Lord's Name can lead one to *moksha*. The door to *moksha* was thus thrown wide open to all – to the women and the children, the workers and the peasants, the weak and the ignorant, the sick and the handicapped. *Moksha* that lay locked up in the Vedas was brought within the reach of everybody, thanks to the Lord Himself. A simple and easy way became available. Why cannot one's ordinary day-to-day life, what one does as *swadharma*, one's acts of service be infused with the spirit of *yajna*? Where is the need for other complicated and elaborate *yajnas*? Let your daily work itself be a *yajna* – let it be sacrificial in nature.

7. This is the highway. ' 3eeveemLee3e vejes jepevedve HeceefDesle keAefn&ef®eled~ OeeJeefVeceeru3e Jee ve$esve mKeueVe Helesfon ~~" Even if you run on this road with closed eyes, there is no risk of stumbling or falling,' The other way is like the edge of a sharp razor: ' ' #egjm3e Oeeje efveefMelee ogjl3e3ee ~" – The Vedic way is sharper than a sword's edge and is thus extremely arduous. The way of devotion, the way of surrender and service to the Lord is easy. An engineer designs a road to the hilltop in such a way that we have no feeling of having climbed such a height till we reach the top. Therein lies his skill. This highway too is designed with such skill. By this way one can reach God, while remaining where one is, through performing one's *swadharma*.

8. ls God hiding somewhere in a cave or in a river or in heaven? Is He hidden somewhere just as diamonds and gold are in the womb of the earth and pearls are in the depths of the sea? Have we to dig Him up from somewhere? Not at all. All that is around us is nothing but God; He is standing before all of us all the time. Everyone here is His image. The Lord is urging us, "Please do not look down upon My manifestations in human forms." It is the Lord, and the Lord alone, who appears in everything animate and inanimate. Where is then the need for devising artificial methods to seek and find Him? The way is straight and easy. Whatever work you do, do it in the spirit of service and as a service to the Lord. Surrender totally to the Lord and be His devoted and humble servant. The arduous Vedic path with its complex rites and rituals and the numerous *yajnas* will no doubt take us towards *moksha*; but the problem there is that the question of fitness arises there. Let us have none of it. Just dedicate to Him whatever you do. Relate to Him every act of yours. This is what the Ninth Chapter tells us. Hence the *bhaktas* are extremely fond of this Chapter.

## No question of entitlement

9. In the life of Lord Krishna, His childhood is particularly charming. Balkrishna (the child Krishna) has always been the object of special adoration and worship. He would go along with the cowherds to graze cattle; He would eat and laugh and play with them. When they set out to worship Indra, he asked them, "Has anybody seen Indra? What do we owe hin1? On the other hand, this Govardhan hill is here before our eyes. Cows graze on its slopes. Streams flow from it. It is better to worship it. Such things he taught them. To his cowherd companions, to their womenfolk, to the cows and the calves whose company he enjoyed, to them all he opened the door of spiritual liberation. Lord Krishna

has thus shown through His own life an easy way to *moksha*. He moved with cows in His childhood and with horses when He grew up. On hearing the music of His flute, cows would go into raptures. The horses would get thrilled as He stroked their backs. Those cows and horses, belonging to the so-called lower species, would as it were become one with Him and attain spiritual liberation. Lord Krishna has thus shown that such liberation is not a prerogative of human beings only; even the birds and the beasts can attain it. The story of His life is a testimony to this fact.

10. Vyasa too had the sarne experience. In fact, there is an identity between Vyasa and Krishna. The quintessential message of their lives is the sarne. Moksha depends neither on scholarship nor on perf ormance of rites and rituals. Plain, simple devotion is sufficient. Innocent and devout women have surpassed learned egotists - in spiritual progress. If there is pure heart, innocence and faith, *moksha* is not difficult to attain. In the Mahabharata, there is a Chapter narrating a conversation between King Janaka and Sulabha, an ordinary woman. Vyasa has depicted the incident wherein King Janaka goes for Self-knowledge to Sulabha. You may go on discussing whether women have the right to study Vedas or not, but here we find Sulabha, an ordinary woman, imparting the knowledge of the *Brahman* to Janaka, the great Emperor and scholar: Janaka was a learned man, but he was far from securing *moksha*. For that, Vyasa had made him fall at the feet of Sulabha. The story of Tuladhar, the grocer, gives the same message. Jajali, a *Brahmin* goes to him for Self-knowledge. Tuladhar tells him, "All my knowledge consists in holding the scales perfectly even." There is also a story of a hunter who used to kill animals and sell their flesh. That was his way of serving the society. An egoist ascetic was told by his *guru* (teacher) to go to that hunter for Self-knowledge. The ascetic wondered how a hunter could teach him. When he went to the hunter, the latter was busy cutting up meat and cleaning the pieces to be put up for sale. He told the ascetic, "I am doing my best to infuse my work with *dharma* to the extent possible. I pour my soul into this work to the best of my capacity, and also serve my parents." In the form of that hunter, Vyasa has put before us an ideal.

11. The Mahabharata narrates such stories about women and men of humble occupations specifically to make it abundantly clear that the doors of *moksha* are open to all. The Ninth Chapter affirms the same point. The joy in serving the Lord can be found in that hunter's life. Tukaram was a votary of non-violence, but he has fondly described in appreciative terms the story of Sajan who attained *moksha* through his work as a butcher. Elsewhere he has exclaimed with distress, "O God ! What could be the fate of those who kill animals?", but he has also described how the Lord helped Sajan : ′mepeve keÀmee³ee efJekeÀ ueeies ceebme“ The Lord helped Sajan the butcher in selling meat Tukaram is telling that the Lord who honoured Narsi Mehta's *hundi*, who fetched water for Eknath's household, who became an untouchable servant for Damaji, who helped Janabai, the maidservant, in household work, helped Sajan the butcher too with the same love. The moral is that all our activities should be linked to Him, dedicated to Him. Acts of service done with pure heart and noble thoughts are essentially a form of *yajna* .

## Dedication of the fruit of actions to the Lord

12. This is the special teaching of the Ninth Chapter. In this Chapter, there is a fascinating confluence of *karmayoga* and *bhaktiyoga*. *Karmayoga* means doing work and renouncing its fruit. Work should be done with such an ingenuity that the mind remains untouched by attachment to its fruit. It is like planting a walnut tree. The walnut tree takes twenty five years to yield fruit. One who plants it may not be able to eat its fruits. Still one must plant the tree and take care of it lovingly. *Karmayoga* means planting the tree without expecting anything in return. *Bhaktiyoga* means getting attached to

God with love and devotion. *Karmayoga* and *Bhaktiyoga* combine together in *rajayoga*. *Rajayoga* has been defined by different people in different ways. I would like to define it as a beautiful blending of *karmayoga* and *bhaktiyoga*.

Work has to be done, but its fruit is not to be thrown away; it should be dedicated to God. To throw away the fruit would be to reject it. But dedication of the fruit of actions to the Lord is something very different. It indicates an extremely beautiful state of the mind. Even if we renounce the fruit, it is not that nobody will have it; somebody is bound to get it. Questions like the recipient's fitness may then arise. If a beggar comes to our door, we say, "You are strong and stout. It does not behove you to beg. Get lost." We sit in judgment over the justification for his begging. The poor fellow feels ashamed. There is no trace of fellow-feeling in our hardened heart. How can we then have the right judgment about the fellow?

13. When I was a child, I had expressed the same doubt to my mother. Her answer is still ringing in my ears. I had told her about a beggar, "This beggar seems to be strong and stout. To give alms to such a person will encourage indolence and bad habits." I also quoted a verse from the Gita, ''′ O$Mes keÀeues ®e Hee$es ®e ~" She said "That beggar was the Lord Himself. Keep it in mind and then judge His worthiness. Would you rate God as undeserving? In fact, what right have we got to judge his worthiness? I see no need to think any more. To me, he is the Lord and that is all." I have not yet found a fitting reply to what she said.

We judge the worthiness of others when it is a question of feeding others, but when it comes to filling our own bellies, the thought of fitness never crosses our mind. Why should we regard the man coming to our doors as just a wretched beggar? Why should we not look upon him as the Lord Himself ?

14. *Rajayoga* says, "Isn't it true that somebody is bound to enjoy the fruit of your actions? So better offer it to the Lord. Dedicate it to Him." *Rajayoga* points out the proper recipient. Here, there is no negative action of giving up the fruit; and as it has to be dedicated to the Lord, the question of judging the fitness of the recipient is also eliminated. Whatever is offered to the Lord is always pure. Even if your actions have impurities, they will become pure the moment they reach His hands. However hard we try to make our actions perfect, there will still be some flaws. Nevertheless, we should try our best to act with the utmost possible purity. Intellect is God-given. It is our duty to keep it as pure as possible. Not to do so is a crime. So we must judge the fitness of the recipient. But if we look upon the world as a manifestation of God, it is easier to make the right judgment.

15. The fruit of action should be utilised for purifying the mind. Dedicate the actions to God irrespective of their quality, as and when they take place. The mind should thereby be continuously and purified. The fruit of work is not to be thrown away; it should be dedicated to Him. Dedicate to the Lord your desires and longings; even the passions and tendencies like anger that arise in the mind, and then have nothing to do with them. ′ keÀecekeÀeOe DeecneR Jeeefnues efJeÇueeR ~" (we have dedicated to the Lord our passions and anger.') Here is no question of torturing oneself in the fire of self-control; no need for any suppression or straining oneself to the breaking point. Surrender totally and find freedom. Nothing else needs to be done.''′ jeie pee³e OeeWmeeKej W ~ lejer efveye keÀeb efHe³eeJee ~" ('If milk and sugar can cure the disease, why should one take bitter *neem* juice?')

16. The sense organs too are means (for realising Him). Dedicate them to the Lord. People complain that they have no control over what they hear. Should we then refuse to hear anything? Not at all. We must hear. But let us hear only the edifying stories of the Lord. It is difficult to give up hearing altogether, but it is easier, and moreover more desirable and beneficial, to turn the ears to something worth

hearing. Lend your ears to the Lord. Use your mouth to chant His Name. The sense organs are not your enemies. They are good and useful. They possess great capabilities. The best way is to take work from them in a spirit of dedication to the Lord. This is what *rajayoga* means.

## Dedicate all the activities

17. It is not that only some particular actions are to be dedicated to the Lord. All our actions are to be dedicated to Him. Lord Rama gladly accepted the fruits offered by Shabari. One need not retire to a cave to worship the Lord. Whatever you do, wherever you do it, just dedicate that to Him. A mother waiting on her child waits on God. Giving the child a bath is like performing *abhishek* over the Lord. She should regard the child as His gift and bring it up with reverence. Sages and saints like Shuka, Valmiki and Tulsidas consider themselves blessed while portraying how tenderly did Kausalya care for Rama and Yashoda for Krishna. They describe it with fond admiration. Such service by a mother is indeed noble. The child is an image of God. What greater fortune could one have than having an opportunity to serve the Lord in the form of a child? Imagine the transformation that will take place in our actions if we were to serve each other with this attitude! Let each one of us consider the work that has fallen to our lot as service of the Lord Himself.

18. A farmer looks after his bullock. Is that bullock to be despised? No. The bull that sage Vamadeva describes in the Veda as pervading the entire universe in the form of energy, is present in the farmer's bullock too.

' ®elJeeefj Meb|ee $e³ees Dem³e heeoe ë<br>
Üs Meere<ex meHle nmleemees Dem³e<br>
ef$eOee yeOoes Je=<eYees jesKeeeflle<br>
cenes osJees me l³ee¥ Dee eJeJesMe ~"

('The bull which has four horns, three legs, two heads and seven hands and is tied to three posts is roaring. The Great God has pervaded all the mankind in every way.') That greatly effulgent bull, radiating vigour and energy, immanent in all the mortal beings in the universe is roaring. It is the same bull which the farmer worships inwardly while taking care of his bullock. Commentators have interpreted this verse in different ways. This bull is indeed strange. The bull that roars in the sky and causes rainfall, is also present in the farmer's bullock which litters the field with dung and urine and fertilises it to yield abundant crop. If the bullock is looked upon with this feeling, then the ordinary work of taking care of the bullock would become the worship of the Lord.

19. The lady of the house keeps the kitchen spotlessly clean and cooks pure and wholesome food for the family. Her earnest desire is to give nourishment and contentment to all the family-members. All that work of hers is a form of *yajna*. The fire in the kitchen stove is verily the *yajna* fire. Imagine how pure and holy the food will be if it is cooked for the Lord! If the lady has such noble feeling in her mind, she would verily join the august band of the wives of the sages described in the Bhagavata. Many such women must have redeemed themselves through such service, surpassing self-centred scholars.

## The whole life can be infused with God

20. The moments of our daily life may appear commonplace, but they are not really so. They have deep significance. The whole life is like a great *yajna* – a continual sacrificial performance. Your sleep is also a kind of *samadhi* – an experience of oneness with the divine consciousness. If we surrender all that we did and all that we experienced to the Lord before going to sleep, will not that sleep be a kind of *samadhi*? There is a custom of reciting the Purusha-sukta, a Vedic hymn, while taking bath. What is the connection between the bath and the Purusha-sukta? You will discern it if you wish to. What connection does the great, all-pervading *Purusha* (the cosmic Person) having thousand hands and thousand eyes have with your bath?

The connection is that, there are thousands of drops in the water you pour over your head. They wash your head and clean it, ridding it of your sins. They are the Lord's blessing showering on you. The Lord Himself is washing off your sins through those thousands of water drops. Let your bath be infused with such an exalted sentiment; then it will be an altogether different thing. It will then have boundless power.

21. Any work, howsoever ordinary or commonplace, assumes sanctity if performed in the spirit that it is God's work. You can experience it yourself. Just look upon a guest as the Lord Himself and then see the difference it makes. When some distinguished guest is expected in our house, we clean the house thoroughly and prepare special dishes. Imagine the difference it will make if we look upon the guest as the Lord Himself! Saint Kabir was a weaver. While weaving, he would lose himself in spiritual bliss and sing ecstasically. He was as it were weaving the sheets to drape the Lord. The sage in Rigveda says, 'Jeðesle Yeêe meþeAlee JemeÒeë" I am draping the Lord with my hymns.' It is for the Lord that a poet should compose hymns, and it is for Him that a weaver should weave cloth. How stirring the idea is! How purifying and moving the thought is! How pure our life would become if this feeling informs it! A flash of lightning removes darkness in an instant. Is the removal of darkness gradual? The transformation is instantaneous and total. Likewise, life is instantly charged with wonderful energy when every action is linked to the Lord. Every action will then become pure. Life will be full of zest. Today our life is devoid of any zest or purpose. There is no joy, no happiness in it. We are alive only because we are yet to die. But just think of linking your actions to the Lord, and then your life will be full of charm; it will be worthy of veneration.

22. There is no doubt that the Lord's Name brings about instantaneous transformation. Never doubt the efficacy of His Name. Give it a try and see what happens. Suppose a farmer is coming home in the evening and he meets a stranger on the way. Let him say to the stranger, '®eeue leje GYee jenWveeje³eCee" -'O Brother! O Lord! Soon it will be night. So please come and spend the night in my house.' These words will transform the stranger. Even if he were a robber, he would undergo a change and become pure. It is the attitude that makes the difference. It is the attitude that really matters in life. One welcomes a young man and gives him one's daughter in marriage and bows before the bridegroom much younger in age. Why? The act of giving away the daughter is so sacred that the young bridegroom is regarded as the Lord Himself. This very sentiment has to be further developed and elevated.

23. Some may object, "Why make such false assumptions?" But one should not brand anything true or false beforehand. One should first give it a try, see what happens, and only then one would know what is true and what is false. Do not just address the bridegroom as the Lord as a matter of ritual; regard him so in your heart of hearts, and see the difference. That sentiment will bring about a total transformation. Even if the man concerned is not worthy, he will become so. Even if he is evil-minded, he will become good. Did not this happen in the case of Valya Koli? He had never before come across a man with the Lord's Name on his lips while playing veena and remaining not only calm and unruffled even when he (Valya) was about to attack, but also continuing to look at him with love. He had till then seen only two types of people. They would either run away or make counter-attack. But Narada did neither and just stood unperturbed without even blinking his eyes; his singing did not stop for a moment. Valya's axe stopped in the air. Narada asked, "Why has your axe stopped?" Valya replied, "Because you are so calm." Narada brought about transformation in Valya. Was that transformation unreal?

24. After all, who is to decide whether somebody is evil? Even if you come across a wicked man, look upon him as the Lord. That

will transform him into a saint. Do not ask, "Why should we make unreal suppositions?" Who can be certain that the man is really wicked? It is said that 'good men, being good, find goodness everywhere, but that is not true.' Should it then be accepted that only what you see is true? Are we to suppose that only bad men have the means to know the true nature of the creation? Why not say that there is nothing wrong with the world, but it appears bad to you as you yourself are bad? Look, the creation is but a mirror. You will see in it your true image. It is the eye of the beholder that determines the nature of the world. Therefore, look upon the world as good and sacred. Let this attitude inform even your ordinary actions. Then you will witness a miraculous change. This is what the Lord intends to convey : ' peWKeemeer nesÛemeer Osmeer peW peWDee®eefjmeer leHe ~ peWkeÀeðmeRkeÀefjmeer keÀce&leWkeÀjeRcepe DeHe&Ce ~" ('Whatever you do, whatever you eat, whatever you offer as sacrifice or gift, whatever austerity you perform, dedicate all that to Me')

26. The import of all this is that, unusual power is generated when whatever good or bad that we do is dedicted to the Lord. A jowar grain is reddish yellow, but when you parch it, you have a nice pop-corn. Put that white, beautiful and nicely shaped pop-corn near a grain and you will find absolutely no resemblance between them. But there is no doubt that it is the grain that has turned into the pop-corn. It is the fire that brings about such a change. If you grind that hard grain, it will turn into soft flour. Fire turns the grain into popcorn and grinding turns the grain into flour. Likewise, infuse your ordinary and seemingly unimportant actions with the devotion for the Lord and then your actions will be transformed beyond recognition. It is the spirit that enhances the value of actions. Do not consider worthless even the leaves and the flowers; they become sacred when they are offered to the Lord. ' legkeÀe cnCes ®eJeer DeeueW~ peW keÀebefceeÞele efJeÇueW~" ('Tukaram says, whatever is mixed with the Lord becomes delicious.') Add God to everything and experience the outcome. Which spice can equal the Lord in making things delicious? Add this divine spice to every action, and then everything will become good and delicious.

## The Lord's Name destroys the sins

29. Once the sentiment that the Lord is present everywhere is deeply rooted in the mind, we will naturally know how to behave with each other. There will be no need for any rules and canons of ethics. The vices will disappear on their own, sins will flee and the evil would vanish in thin air.

Tukaram has said,

' ®eeue keÀueemeer ceeskeÀUe ~ yeesue efJeÇue JesUesJesUeb
legpe HeeHe ef®e veener Smeb~ veece Iesleebpe JeUeRJemes"

('You are free to do whatever you like. Just chant the Lord's Name again and again. Once you recite His Name, no sin will remain near you.')

Well, you are free to sin now. You can now commit as many sins as you can. Let us see whether you get tired of sinning or the Lord's Nmne gets tired of reducing them to ashes! Is there any evil stubborn and belligerent enough to pit itself against the Lord's name? '' keÀjer legpemeer keÀjJeleer" – Sin as inuch as you can. Let the Lord's Name and your sins fight it out. The Lord's Name is powerful enough to burn down in an instant the sins committed not only in this life but in countless births in the past. A cave may be full of darkness since ages, but the moment you light a candle, darkness disappears. In fact, the older the sins, the more quickly they get destroyed, jnst as old wooden logs are more easily and quickly reduced to ashes.

30. No sin can ever exist in the presence of *Ramanama* (the Lord's Name). Don't the children say, "Ghosts vanish when you take *Ramanama*." In my childhood, we children used to challenge each other to go to the cremation ground at night and drive in a peg there. There used to be snakes and thorns in the way, and darkness all around. Still I would fearlessly go there. I never came across ghosts. Ghosts, after all, are creations of

the mind. How could they appear before us? Wherefrom did a ten-year-old boy gather such courage? From *Rama Rama*. It was the power of the Lord who is Truth. If a man feels that the Lord is ever by his side and surrenders himself to Him, then he will not be afraid even if the whole world turns against him. Which demon can devour him? A demon may destroy the body; but never the truth. No power on earth can destroy the truth. Sin can never stand before the Name of the Lord. Hence seek His grace. Dedicate all actions to Him. Surrender completely to Him and be totally devoted to Him. Let the urge to dedicate all the actions to Him become more and more intense. Then this trivial life will become divine. The soiled life will become beautiful.

## Not what but how you offer is Important

31. 'He$eb HegHeb HeÀueb Iees³eced' – Leaves, flowers, fruits, water, anything can be offered to Him. What is important is that it should be offered with *bhakti*. The spirit and sentiment with which you offer is important. Once I was having a discussion on education with a professor. There was a difference of opinion between us. In order to clinch the issue, he said, "I have been teaching for eighteen years." He should have convinced me of the correctness of his standpoint; he instead flaunted his experience. I said in a lighter vein, "If a bullock pulls an oil *ghani* (oil expeller) for eighteen years, will it become an engineer?" An engineer is an engineer and a bullock is a bullock. An educationist is different from a teacher who goes on doing his job in a routine and mechanical manner. An educationist will gain much more insight and experience in six months than a labourer working for eighteen years. The Professor boasted of his years of experience. But it proves nothing. Likewise, the volume and value of the offering is of no significance. What is important is the spirit in which you make the offering. What is irnportant is not what or how much you offer, but how you offer. The Gita contains only seven hundred verses. There are some other books containing thousands of verses. But a bigger thing need not necessarily be better. You should judge the intrinsic quality, the intrinsic strength in anything. The number of activities in life is not important even a single action with dedication, with surrender to the Lord, will make your life richer. A single sacred moment can give experience that cannot be acquired in years.

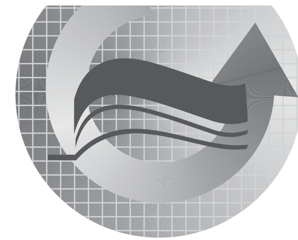
32. Thus, the point is that even the ordinary actions in life should be dedicated to the Lord. The life would then acquire a new vigour. *Moksha* would come within our grasp. *Rajayoga*, which asks us to work and offer its fruit to the Lord instead of giving it up, is a step ahead of *karmayoga*. *Karmayoga* asks you to work without desires and give up the fruit of the work. Here *karmayoga* stops. *Rajayoga* tells, "Do not renounce the fruit of the actions. Dedicate all the actions themselves to the Lord. The actions are a means that help you in making spiritual progress. They are like flowers which should be offered at the feet of the Lord. Conjoin your actions with devotion and go on enriching your life. Do not throw away the fruit dedicate it to the Lord." The fruit that is cut off from the actions in *karmayoga* is linked to the Lord in *rajayoga*. There is a difference between throwing seeds and sowing them. You reap in abundance what you sown what you throw is wasted. The work that is dedicated to the Lord gets sown, and therefore life gets infused with infinite bliss and sanctity.'

*Kim punar brahmanah punya bhakta rajarsayastatha*
*anityam asukham lokamimam prapya bhajasva mam 33*

33. How much more than holy Brahmins and devout royal-sages! Having reached this transient joyless world you worship Me.

*Mammana bhava madbhakto madyaji mam namaskuru*
*mamevaisyasi yuktvaivamatmanam matparayanah 34*

34. Fix your mind on Me, be devoted to Me, sacrifice to Me, bow down to Me; thus uniting yourself to Me, taking Me as the supreme Goal, you shall come to Me.



CA Vispi T. Patel

# Introduction to Domestic Transfer Pricing

## Background and Introduction

The Income-tax Act, 1961 (henceforth, 'the Act'), under section 40A(2) provides for disallowance of expenditure, in respect of which payment is made by the taxpayer to its related party, where such expenditure is, in the opinion of the Assessing Officer (AO) excessive or unreasonable having regard to the fair market value (FMV) of the goods, services or facilities, etc.

Further, the Act also provides for recomputation of profits at FMV, in case of transfer of goods or services between two businesses/ units of the same taxpayer under section 80-IA(8) and in case of business transacted between two closely connected taxpayers under section 80-IA(10), etc.

However, unlike provisions relating to cross-border related party transactions i.e. international transfer pricing (TP) provisions, prior to 2012, the Act did not provide for any mechanism to compute such FMV, thereby leading to arbitrary disallowances in the hands of taxpayers.

In October 2010, the Hon'ble Supreme Court ('SC') in the case of *CIT vs. GlaxoSmithKline Asia (P) Ltd.*,[1] after examining the complications which arise in cases involving determination of FMV, suggested that the Ministry of Finance should consider appropriate provisions in law to make TP regulations applicable to domestic related party transactions/transactions between two businesses/ units of the same taxpayer.

Some of the key observations of the Hon'ble Supreme Court are as under:

- Domestic transactions between related entities will not be revenue neutral if :
  - o Profit is shifted from profitable entity to loss making entity
  - o Tax arbitrage on transactions between related units due to difference in tax rates e.g. shifting of profits from non-SEZ unit to SEZ unit
- Recommended amendments to provisions like 40A(2) and 80-IA(10) of the Act to empower Assessing Officer (AO) to make adjustments to the income having regard to the FMV of the transactions between related parties.
- The AO may thereafter apply one of the generally accepted methods of determination of arm's length price (ALP), including the methods prescribed under TP regulations.

Thus, based on the Hon'ble Supreme Court's observations as aforesaid, the Act was amended prospectively by the Finance Act, 2012 (i.e., with effect from Assessment Year 2013-14), to provide for a mechanism to determine the FMV even in

1 195 Taxman 35 (SC)

cases of transactions of related parties in India. The amendment has been brought in Chapter X of the Act whereby the applicability of international TP provisions has been extended to certain specified domestic transactions between related parties (hereinafter referred to as 'Specified Domestic Transactions' or 'SDT').

## Category of transactions covered under Domestic TP

The newly inserted section 92BA of the Act defines the term 'Specified Domestic Transaction'. It basically refers to any of the following transactions, not being an international transaction, namely:

- Payments to related parties covered under section 40A(2)(b) of the Act;
- Inter-unit transactions of tax holiday eligible units referred to in section 80A(6)/ 80-IA(8) of the Act;
- Any business transacted between tax holiday eligible units with outside parties referred to in section 80-IA(10) of the Act;
- Any transaction referred to in any other Section in Chapter VI-A or Section 10AA to which Section 80-IA(8) or section 80-IA(10) are applicable; and
- Any other transaction to be notified by CBDT[2]

where the aggregate value of such transactions in a previous year exceeds INR 5 crores.

## Compliance requirements

Where Domestic TP applies, a taxpayer would need to comply with the following:

- Maintain and keep information and documents in relation to such transactions as statutorily required[3];
- Obtain and file an accountant's report in respect of such transactions along with his return of income[4];
- All existing TP compliance requirements, mandatory documentation, TP audits (assessments) and penalty provisions would be applicable, though provisions have not yet been legislated for TP audits for SDT.

In June 2013, CBDT *vide* Notification No. 41 dated 10th June, 2013, amended the Income Tax Rules, 1962 (henceforth, 'the Rules') 10A to 10E, thereby including SDT as regards application of various methods, comparability, etc. Further, the Rules now include definition of the terms 'Associated Enterprise' and 'Enterprise' in relation to SDT. For the purposes of SDT, enterprise includes a unit, or an enterprise, or an undertaking or a business of a person who undertakes such transaction. Additionally, the Accountant's Report has also been amended (new Form No. 3CEB) to include SDT.

In order to understand the new Form No. 3CEB in-depth, a detailed table having a direct correlation between the clauses in the Act and the clauses in the new Form No. 3CEB is given below as regards SDT:

| | Section 92BA (Specified Domestic Transactions) | New Form No. 3CEB |
|---|---|---|
| (i) | any expenditure in respect of which payment has been made or is to be made to a person referred to in Clause (b) of sub-section (2) of section 40A | Clause (22) Particulars in respect of transactions in the nature of any expenditure |
| (ii) | any transaction referred to in section 80A; | Clause (23) Particulars in respect of transactions in the nature of transfer or acquisition of any goods or services |
| (iii) | any transfer of goods or services referred to in sub-section (8) of section 80-IA | |

2 Central Board of Direct Taxes
3 Section 92D read with Rule 10D
4 Section 92E read with Rule 10E
5 Comparable Uncontrolled Price

| | | |
|---|---|---|
| (iv) | any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable | |
| (v) | any business transacted between the assessee and other person as referred to in sub-section (10) of Section 80-IA | Clause (24) Particulars in respect of specified domestic transaction in the nature of any business transacted |
| (vi) | any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (10) of section 80-IA are applicable | |
| (vii) | any other transaction as may be prescribed | Clause (25) Particulars in respect of any other transactions |

## Key differences in provisions relating to Domestic TP and International TP provisions

- *Types of transactions covered*

International TP *inter alia* covers both income and expense transactions while under Domestic TP i.e. transactions covered u/s 40A(2) of the Act, only expenditure is covered. As regards other transactions specified for Domestic TP purposes i.e. inter-unit transactions covered under section 80A(6)/ 80-IA(8)/80-IA(10)/section 10AA of the Act, both expense/ profits from transactions are covered.

- *Shareholding criteria for applicability of TP provisions*

While international TP provisions *inter alia* prescribe a shareholding criteria of 26% for applicability of TP, as per Explanation to section 40A(2) of the Act, a beneficial owner of shares carrying not less than 20% of voting power/ beneficially entitled to not less than 20% of profits, shall be treated as a person covered u/s 40A(2) of the Act. Thus, TP coverage has increased substantially.

Further, *vide* section 92A(2)(a) of the Act, indirect shareholding is covered under international TP provisions. For example, if A Co holds 100% in B Co and B Co holds 100% in C Co, then A Co and C Co also get covered. However, given the language of section 40A(2) of the Act, it remains unclear whether A Co and C Co would become related for applicability of Domestic TP.

- *FMV vs ALP*

The concept of FMV prevailing in the domestic law has slight nuances as compared to the concept of ALP prevailing internationally. The concept of FMV is probably more akin to the CUP[5] method of arriving at the ALP. However, now there may be more flexibility to arrive at ALP/ FMV as there are other methods specified in section 92C of the Act, now also applicable to SDT.

- *Notional income*

Tax authorities consider international TP as giving them the authority to impute notional income in the hands of a taxpayer for example, provision of corporate guarantee by holding company to its wholly owned subsidiary (WOS) without any consideration. However, given the nature of transactions currently specified under Domestic TP provisions, it appears that application of Domestic TP may at best lead to disallowance of excessive expenditure and/or reduction of quantum of deduction under Chapter VI-A; it cannot lead to imputation of any notional income, as only expenditure is covered under section 40A(2) of the Act.

- *Correlative adjustment*

There is a clear distinction between transfer pricing for SDT and transfer pricing for international

transactions. In case of SDT, there may not be an erosion of the tax base in all the transactions. For example, transactions covered under section 40A(2) of the Act that are undertaken between two resident entities attracting the same rate of taxation.

Article 9 of the OECD[6]/UN[7] Model Convention talks about corresponding adjustment to the income of the counter party to a transaction. Thus, a taxpayer may be able to seek correlative adjustment in respect of adjustment made to an international transaction as per the relevant Article on transfer pricing of the relevant Double Taxation Avoidance Agreement (DTAA), whereas no correlative relief has been provided for in relation to adjustments made to SDT. Thus, under Domestic TP, there could be cases of economic double taxation.

- *Domestic TP may apply even to cross border transactions*

While generally reference is to "domestic" transactions under Domestic TP, it may not always indicate that a SDT should not be a cross border transaction nor does it mean that both parties to the transaction need to be resident. For example,

  - Payment to non-resident director covered u/s 40A(2)
  - I Co making payment to F Co, a foreign company which holds 21% in I Co

- *Safe harbour/Advance Pricing Agreement (APA)*

Safe harbour provisions are not applicable to transactions covered under Domestic TP. Similarly, as per section 92CC of the Act, taxpayers cannot approach the APA authorities for an APA with respect to SDT.

- *Documentation requirements*

Documentation applies to SDT with aggregate value exceeding INR 5 crores whereas for international TP, detailed documentation is not required if aggregate value of transactions is less than INR 1 crore.

## Domestic TP – Key issues

- *Indian company having both SDT as well as international transactions*

When an Indian company is having both international transactions as well as SDT, whether SDT are required to be reported in the following scenarios:

a) When the value of aggregate of international transactions and SDT is less than INR 5 crores

b) When the value of aggregate of international transactions and SDT is more than INR 5 crores, but value of SDT is less than INR 5 crores.

What if, when the value of international transactions as well as value of SDT will be INR 3 crores each? Is the taxpayer required to report the same or obtain an accountant's report for the same? A clarification from the CBDT would give more clarity to the issue; though, on a strict reading of the Act, the taxpayer would need to report only international transactions and not SDT if the aggregate value of SDT is less than INR 5 crores.

- *Benchmarking of Director's remuneration*

Domestic TP provisions cover expenditure under section 40A(2) of the Act, which includes payments to 'any' directors. Fees payable to a director by a company depends on many factors such as the director's role and responsibility, experience, the size and area of operation of the company, performance of the company and performance of the industry. Any kind of payment such as salary, commission, sitting fees, various allowances to any director – be it a comprehensive remuneration package to a chairperson or sitting fees running into a few thousand rupees paid to an independent director — are all covered by Domestic TP provisions. Benchmarking of payments to directors is not an easy task.

The problem arises because TP provisions are based on establishing comparability. To illustrate, remuneration received by Reliance Industries' Chairman Mukesh Ambani is bound to be vastly different from what his counterpart at Wipro,

Azim Premji is paid. It also cannot be compared with director's remuneration paid by a medium-sized private company. Further, the philosophy of two organisations could also differ due to different promoter groups. In case of director's remuneration, thus, there can be no single golden yardstick to evaluate the FMV of such payment.

- *Reference to Transfer Pricing Officer (TPO) with respect to transactions covered under Domestic TP*

In case of international TP, there is a set process for reference to the TPO. However, as stated earlier in this note, there is yet no legislation in relation to Domestic TP.

- *Close connection*

Section 80-IA(10) of the Act provides for applicability of Domestic TP provisions where there is a 'close connection' between the assessee's eligible business and other third party. However, the term 'close connection' has not been defined in the Act, and probably reference may need to be made to section 40A(2)(b)/92A of the Act to understand the same.

## Comments

With the introduction of Domestic TP provisions, TP will not be limited to large groups. Many mid-sized groups, partnership firms, HUFs and even individuals in smaller cities will now have to adhere to TP rules. This will lead to an increase in the administrative and compliance burden for taxpayers in respect of such transactions and a focused examination by the tax authorities.

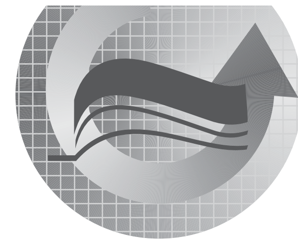
It is pertinent to note that while the Ministry of Finance acted upon the Hon'ble Supreme Court's decision to introduce Domestic TP provisions, it failed to consider the Hon'ble Court's recommendation that such provisions may not be made applicable in cases where transactions are undertaken between two persons attracting the same rate of tax. To clarify, even if a taxpayer incurs any expenditure [covered u/s 40A(2) of the Act] in respect of which payment is made to an entity attracting the same rate of tax as the taxpayer, as per Domestic TP provisions, an adjustment may still be made by the tax authority in the hands of the taxpayer.

The essence of a taxing statute (direct taxes) is to levy and collect tax on the income earned/received/accruing to a taxpayer. Such 'income' which is sought to be brought within the net of tax is real income and not hypothetical or notional income, unless the taxing statute expressly brings to tax such income, which would be the exception and not the rule.

The disallowance sought to be done by section 40A(2), section 80-IA(8) & (10) etc., which are now the focus of Domestic TP, is probably to bring to tax the correct or fair income of the taxpayer. However, when expenditure is aimed to be disallowed from a Domestic TP perspective, the tax administration tends to judge the taxpayer's action on subjective criteria like FMV, legitimate business needs, etc.

The advice of the Hon'ble Supreme Court, on which basis the Government has tried to bring objectivity to the process, by incorporating the principles of international TP for such FMV, etc., philosophically may seem the step in the correct direction, as the aim is to bring objectivity in such evaluation process.

However, one needs to bear in mind that the provisions of Domestic TP will suddenly increase compliance burden, subject the taxpayer to greater scrutiny and hence bring in more stringency in the assessment process. In such circumstance, the tax administration needs to evaluate all this holistically so that the administration is fair and achieves the goal of Domestic TP in a spirit of reasonability. The tax administration also needs to bear in mind that tax has to be levied on 'real income' and hence in Domestic TP where focus in on India, the transactions are emanating and getting concluded in India, the 'tax base' is India, the evaluation of Domestic TP should not lead to economic double taxation as otherwise the sight of the goal posts would be lost. The aim should never be to artificially increase such 'tax bases' in India, but to see only that such 'tax bases' are not reduced artificially by the taxpayer.



CA Milind Kothari & CA Gaurav Shah

# Selection of Transfer Pricing Methods/ Application of CUP and PSM

## 1. Background

Transfer Pricing in respect of specified domestic transactions was introduced in the Indian legislation by the Finance Act, 2012. With the introduction of transfer pricing provisions to such transactions, a structured framework has now been prescribed for determining the correct transaction price for such transactions as against a broad based and open-to-interpretation concept of fair market value. Under the transfer pricing regulations, specified domestic transactions would need to be evaluated against the yardstick of one of the 6 prescribed methods, to be selected as the most appropriate benchmarking method.

Since a formal methodology would now need to be adopted by taxpayers, several existing positions being adopted by taxpayers in justifying the fair market value may now need to be revisited. Some other approaches, however, could also find support under the formal transfer pricing mechanism.

This article seeks to discuss the general guidelines to be adopted while selecting the most appropriate transfer pricing method, and then delves deeper into applicability of two methods – the Comparable Uncontrolled Price Method and the Profit Split Method to specified domestic transactions.

## 2. Overview of selection of Methods

The first issue that arises in several transfer pricing examinations is the selection of appropriate benchmarking methodology, when there are two or more approaches practically available. In such cases, does the taxpayer need to use all such approaches, and demonstrate arm's length under each such approach? Understandably, if the taxpayer were to be expected to use all possible transfer pricing methods to demonstrate arm's length, there would be significant amount of time and energy required to be spent on such exhaustive examination. Even the Indian transfer pricing regulations subscribe to this view and prescribe for the use of the most appropriate method, which is best suited to the facts and circumstances of the particular transaction under consideration.[1]

The next logical question that arises for consideration is how to select this most appropriate method. It is pertinent to note that transfer pricing being a very subjective exercise, it is practically not feasible to provide straitjacket answers for every conceivable

1 Refer Rule 10C(1) of the Income Tax Rules, 1962 (hereinafter referred to as 'Rules')

transaction entered into in every situation. Having said that, the Rules do provide guidance on factors to be considered for selection of most appropriate method.[2] These factors are discussed below:

### 2.1 Nature and class of transactions

The first step in identifying the most appropriate method is to completely understand the nature and class of transaction under consideration. Without a thorough understanding of the transaction, there is an inherent risk of selection of an inappropriate method, and consequent construction of incorrect benchmarks.

Therefore, on several occasions, a robust transfer pricing analysis would be required to be carried out and facts will have to be understood beyond the books of account and financial statements of the Taxpayer.

For instance, consider the example of a taxpayer who is engaged in manufacturing of machine tools. For the purpose of its business, it sub-contracts manufacturing of a small part of the tool to a sister company on a job work basis. Depending on the accounting policy adopted by the taxpayer, the entire payment to such sister company could be categorised as purchases of raw materials, whereas, the essence of the transaction is payment of job-work charges to such job-worker. In case the transaction is understood to be a principal-to-principal purchase / sale transaction even in an economic sense, there is a high possibility of selecting incorrect benchmarks for transfer pricing purposes.

Thus, a thorough understanding of the transaction would involve delving deeper into the commercial rationale and the business perspective for the transaction.

### 2.2 Classes of Associated Enterprises involved and the related FAR analysis[3]

Once the precise nature of the transaction under consideration is understood, the next step is to appropriately classify the parties to the transaction, with the support of a robust FAR analysis. In conducting the FAR analysis, it is not merely relevant to identify the functions, assets and risks involved, it is also equally, if not more, important to identify the relative significance of such functions, assets and risks identified. Practically, this would involve assigning weights to each function, asset and risk identified considering their importance to the transaction under consideration.

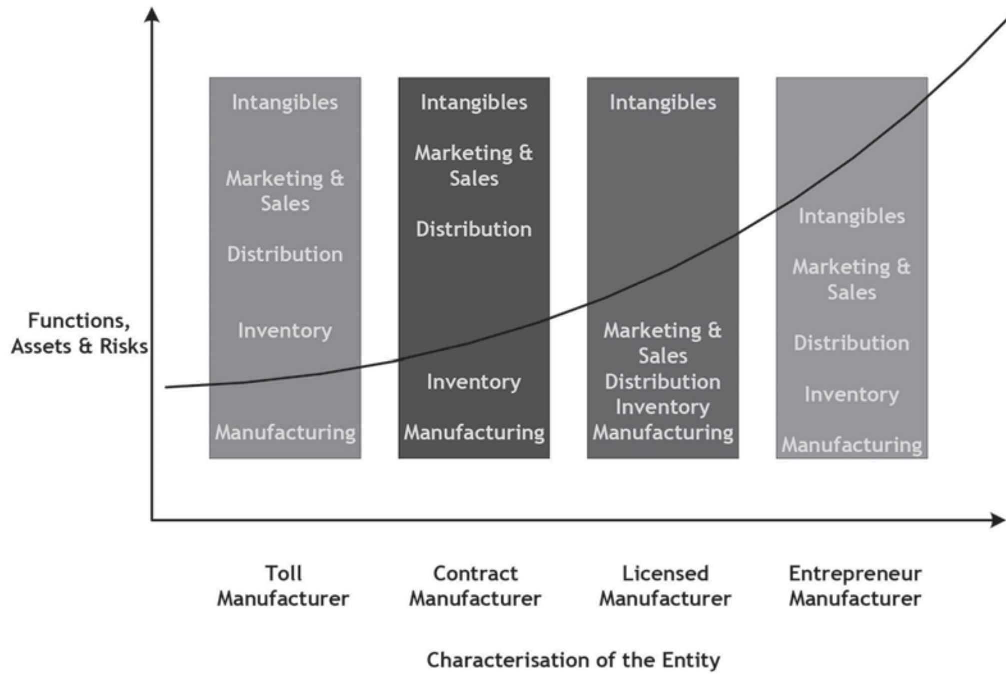
Needless to mention, the weights to be assigned to individual functions, assets and risks could vary significantly depending upon the precise facts of the case. For instance, in case of a manufacturer of wooden doors, the actual manufacturing activity could be the most significant activity, as against the case of a pharma company where R&D and clinical trials could be more important as compared to the manufacturing activity itself. Similarly, a shipping company would assign the most significant value to its tangible assets (namely, ships), as against an engineering company, for which the intangibles in the nature of processes, designs, flowcharts, etc., would be more valuable.

A detailed FAR analysis[4] would not only provide answers to the nature of the parties concerned (say, whether a particular entity is a manufacturer, distributor, service provider, etc.), it would also provide an insight into the exact position of the particular entity in the value chain. For instance, a detailed FAR analysis would identify the precise location of a manufacturer within the following manufacturing value chain:

2 Refer Rule 10C(2) of the Rules

3 FAR analysis refers to an analysis of Functions performed, Assets employed and Risks undertaken by the parties entering into the transaction(s) under consideration, and is considered as one of the most crucial elements of a transfer pricing analysis.

4 A detailed discussion on conducting FAR analysis is beyond the scope of this article.




**2.3 Availability, coverage and reliability of data required for application of the method**

The first two stages dealt with information available from within the taxpayer or the taxpayer group. However, since the basic tenet of a transfer pricing analysis is determining a third party arm's length benchmark, an examination of third party or external data is indispensable in any transfer pricing analysis.

While theoretically, one may be able to conduct a transfer pricing analysis based on the third party data available in public domain, the practical life reality could be vastly different. In real life situations, transfer pricing analysis is constantly constrained by considerations relating to the relevant data. In several cases, third party data being very confidential is not available in public domain. In various other instances, comparable data may be available from unauthentic and unverifiable sources. In such cases, using such incomplete or inaccurate data could distort the results of a transfer pricing analysis.

Conversely, there would be a higher level of comfort with a transfer pricing analysis in a case where the available data is complete and reliable.

**2.4 Comparability standards**

The comparability standards sought under the rules are of two categories, viz, comparability of transactions and comparability of entities involved in the transactions.

It appears logical that a transaction level comparability is inevitable for selection of a given method. For instance, consider a simple example where a manufacturer of automobiles purchases certain types of automobile spares from its sister concern who is a manufacturer of automobile spares. In such a case, an ideal price-based comparable could be an instance where similar types of spares are also sold between third parties. However, in case such a comparable is not available, one may have to look at manufacturers of automobile spares on a broader plane, and use them as comparables by applying a margin-based method.

However, mere transaction level comparability is not enough in a given transfer pricing analysis. The relevant functional characterisation of the entities involved in the controlled transaction also plays an equally important role in selecting the most appropriate method. In the above example, assuming that a comparable price was indeed available, whereby, in a given situation, the automobile manufacturer had to purchase the same spares from a retailer of such auto parts. Here, while the transaction does appear to be comparable (purchase of auto spares), the characterisation of the entities is vastly different. The seller is the manufacturer in the first instance and a retailer in the second. It is not difficult to comprehend that even in an arm's length scenario, the pricing would be significantly different between spares purchased from the manufacturer vis-a-vis those purchased from the retailer.

### 2.5 Reliability and accuracy of adjustments which may need to be made

In an overwhelmingly vast majority of cases, one tends to find that ideal world comparables are difficult, if not impossible, to find. Hence, in almost all cases, it may not be possible to find uncontrolled transactions which completely satisfy comparability standards: at the transaction level and at the entity level. Since there are several market forces affecting any pricing decision or negotiation, there are innumerable factors which affect comparability. These could include the market position enjoyed by the respective parties to a transaction, quality of the products / services under consideration, payment terms, brand value associated with products or services, demand-supply factors, etc.

This imperfection necessitates carrying out adjustments to mitigate differences in comparability standards. For instance, if manufactured apparels are purchased from an affiliate with a 90-day credit period, and apparels of the same characteristics are purchased from a third party wherein, payment is to be made 30 days in advance, other things being equal, an adjustment of imputed interest of 120 days will need to be made to enhance comparability.

As a general rule, if accurate and reliable adjustments can be made to the comparable data for applying a particular method, such method should be selected, and applied after carrying out such adjustments. However, if adjustments for the purposes of applying a particular method cannot be applied, that method ought not to be selected as the most appropriate method.

### 2.6 Nature, extent and reliability of assumptions required to be made

Several assumptions are generally required to be made while selecting a particular method. These could relate to the transaction under consideration, parties involved in the transaction, stage of maturity of the market, economic factors, etc.

If the assumptions relate to crucial comparability or pricing related factors, or if there are several assumptions required to be made for being able to apply a particular method, such method may not be selected as the most appropriate method. A method which requires fewer and non-crucial assumptions should ordinarily be preferred in such cases. Similarly, if the reliability of assumptions used for a particular method is questionable, such method should not ideally be adopted as the most appropriate method.

## 3. Comparable Uncontrolled Price (CUP) Method

CUP Method prescribes for use of the price paid or charges in an uncontrolled transaction, as a benchmark for the transaction under consideration.[5]

5 Refer Rule 10B(1)(a) of the Rules.

CUP Method is considered to be the most direct method of determining transfer pricing benchmarks. Correspondingly, the comparability requirements under the CUP Method are also very strict. CUP Method can normally be used in cases where there are identical third party comparables available in respect of the transaction under consideration. For instance, consider a retail trader of branded cosmetics who buys such goods from wholesalers. Some of these wholesalers are independent third parties, and one wholesaler is a sister concern. In such a case, other things being equal, prices for same goods paid by the retailer to independent wholesalers could be considered as valid comparable benchmarks for the prices paid to the related party wholesaler.

In case there were differences in the terms of business, appropriate adjustments could be made to account for such differences and CUP Method could be used with such adjustments.

The above example considers a case where the comparable data is available from within the group itself. Such comparables are called internal comparables, since they are 'internal' to the group.[6] CUP Method can also be applied in case external comparables are available, i.e., in cases where comparable data is available outside the group. Internal comparables are normally preferred over external comparables.[7]

At this juncture, it would be interesting to discuss the judicial developments in India with respect to the CUP Method, and how such developments would impact applicability of CUP Method to specified domestic transactions.

### 3.1 Quantity related differences

Differences in quantity or volume of purchases in a specified domestic transaction vis-a-vis a comparable transaction should be adjusted for an appropriate application of the CUP Method.[8] Even in third party arm's length scenario, a seller would be willing to provide discounts to a purchaser who buys in a significant volume. For instance, consider a case where the taxpayer purchases goods from a sister concern at a given price, and also purchases goods from a third party vendor at a discount. In the absence of any adjustments, a lower price could be held to be the arm's length price under CUP Method. However, if the taxpayer is able to demonstrate receipt of quantity discount from the third party vendor as against the sister concern, appropriate adjustments should be allowed to the taxpayer.

In doing this analysis, it also needs to be borne in mind that certain risk adjustments may also be necessary, and some of which may nullify the effect of the quantity differences. To illustrate, the sister concern in the above example, may not need to incur marketing costs while selling goods to the taxpayer. Further, the risk associated with default of payments could also be lower, since the sale is made to a related taxpayer. In such cases, the revenue authorities may insist on a risk adjustment, and reduce the arm's length price obtained under the CUP Method.[9]

The manner and quantum of adjustment required to be done would depend on the precise facts of the case.

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6 Transactions between affiliates are normally not considered to be valid internal comparables. Refer Skoda Auto India (P) Ltd. vs. Asst. CIT [2009] 30 SOT 319 (PUNE); DCIT-Mumbai vs. Tech Mahindra Ltd [2011] 12 taxmann.com 132 (Mum.). However, under certain circumstances, even controlled transactions could be considered as valid comparables. Refer Bayer Material Science Pvt Ltd vs. Asst CIT [2011] 11 taxmann.com 330 (Mum), ACIT-Mumbai vs. NGC Network (India) Pvt Ltd [2011] 10 taxmann.com 140 (Mum.)

7 Refer, for instance, Gharda Chemicals Ltd. vs. DCIT, Mumbai [2010] 35 SOT 406 (Mum.)

8 Refer, for instance, Asst.- CIT vs. Dufon Laboratories [2010] 39 SOT 59 (Mum.)

9 Refer, for instance, Dresser-Rand India Pvt Ltd. vs. Addt. CIT, Mumbai [2011] 13 taxmann.com 82 (Mum.)

### 3.2 Characterisation of the entity(ies)

As noted earlier, characterisation of entities is an important factor in selecting the most appropriate method. However, especially, in the case of CUP Method, it is very important to understand the characterisation of entities under consideration, to be able to make appropriate adjustments.

For instance, consider a situation where the taxpayer, being a retailer, buys products from its sister concern. Further, assume that the sister concern has sold similar products to wholesalers and such prices are available. It is common knowledge that prices charged to wholesalers would normally be lower than prices charged to the retailer. Mere price comparison in such cases would not yield the correct result under the CUP Method, without making adjustments for the differences in value chain between the wholesaler and the retailer.

In case where such adjustments cannot be made, CUP Method cannot be selected as the most appropriate method, especially, if some other method can reliably be considered as the most appropriate method.[10]

### 3.3 Geographical differences

There are several decisions in the Indian transfer pricing context, wherein it has been held that geographical differences in the market do affect the selection and application of methods.[11] On the other hand, in a particular case, it has also been held that the customer in USA is not concerned with the economic conditions in the jurisdictions of the vendors (India and China), and therefore, a price comparable available at the US Customer level was held to be a valid comparable under CUP Method.[12]

However, this principle may not be applicable to all cases, especially, if the business model of the taxpayer or the industry is such that geographical differences do not affect the pricing of the products or services.[13]

The decisions noted above are rendered in the context of transfer pricing for international transactions. Accordingly, question arises for consideration whether geographical differences would be material or relevant in the context of specified domestic transactions?

The answer to this question lies in the facts of the case. For some categories of transactions (say, for instance, interest on loans), India could be considered as a unified market-place. However, for some other categories of transactions, especially, in cases involving products from a local industry (for instance, woollen products from Kashmir, spices from South India, milk products from Gujarat etc.), geographical differences may yet become relevant and appropriate adjustments may be required to be made. Other instances could be cases where there are state level differences in applicable taxes, benefits granted to the industry etc. If the taxpayer is able to demonstrate differences due to geographical factors, adjustments for such differences should be permitted even in cases involving specified domestic transactions.[14]

10 Refer, for instance, Gharda Chemicals Ltd. vs. DCIT, Mumbai [2010] 35 SOT 406 (Mum.)
11 Refer for instance, Intervet India (P) Ltd vs. Addt. CIT, Mumbai [2010] 39 SOT 93 (Mum.); Serdia Pharmaceuticals (India) (P.) Ltd. [2011] 44 SOT 391 (Mum.); Welspun Zucchi Texiles Ltd. [2013] 30 taxmann.com 251 (Mumbai - Trib.).
12 Clear Plus India Pvt Ltd vs. Dy CIT, Delhi [2011] 10 taxmann.com 249 (Delhi)
13 Refer, for instance, Asst. CIT vs. Agility Logistics Pvt. Ltd [2013] 36 taxmann.com 556 (Mumbai –Trib.)
14 For discussion on geographical differences within India, refer West Coast Paper Mills Ltd vs. Asst CIT [2006] 103 ITD 19 (Mum.), where, price of electricity in Karnataka and Tamil Nadu was held to be not comparable.

### 3.4 Amounts permissible to be paid under law

There are certain amounts permitted to be paid under law to specified related parties/affiliates. Examples of these include payment of remuneration to Directors[15], and payment of interest and remuneration to Partners of a Partnership firm[16].

Question arises whether the limits prescribed under the law could be considered as permissible limits even for transfer pricing matters as per the CUP Method?

In this regard, reference could possibly be drawn from various decisions pronounced in the case of payment of royalties to overseas affiliates. There are decisions, which have taken support from the fact the royalty payment to overseas affiliate, being approved by the Reserve Bank of India, was considered as a relevant factor in determining arm's length price.[17]

On the other hand, there are another set of decisions, wherein, it has been held that the limits prescribed for payment of royalties to overseas entities as per the Indian Exchange Control Regulations[18], are the upper limits or ceilings on the maximum amount that can be paid, and such ceilings cannot be construed to be the arm's length price.[19]

On a similar ground, a view may be taken by the Revenue Authorities, that in cases where monetary limits are prescribed under various laws, such limits are in the nature of ceilings, rather than prescriptive amounts which should be paid. Further, the objectives of these laws are different as compared to the transfer pricing regulations.

Accordingly, it would augur well for taxpayers to not consider the ceilings prescribed under the tax or company laws as valid comparables under CUP Method, and seek to demonstrate the arm's length price independent of such ceilings.

## 4. Profit Split Method (PSM)

The PSM entails identification of the total profit arising to the group from the transaction under consideration, and splitting that profit to all group entities in an appropriate manner.[20]

There are two approaches to arrive at the arm's length profit split. In the first approach, the entire profit is split between the group entities based on their FAR analysis. In the second approach, there is a two stage profit split, whereby, every entity is provided a basic return based on its FAR analysis, and only the balance is split amongst all group entities.

PSM is ideally suited to cases where both or all parties to a transaction employ unique intangibles.[21] However, there are also other cases, where PSM could be considered as the most appropriate method.

15 5% of net profits for Directors – refer Section 309 of Companies Act, 1956.

16 Refer Section 40(b) of the Income Tax Act, 1961.

17 Refer, for instance, CIT vs. M/s Nestle India Ltd ITA 662/2005 DEL, Abhishek Auto Industries Ltd. vs. DCIT, New Delhi [2011] 9 taxmann.com 27 (Delhi)

18 Refer Foreign Exchange Management (Current Account Transactions) Rules, 2000, under the Foreign Exchange Management Act, 1999

19 Refer, for instance, M/s Syngenta India Limited. vs. The Jt. Commissioner of Income Tax [2013] 37 taxmann.com 165 (Mumbai - Trib.); Cabot India Ltd vs. DCIT, Mumbai [2011] 12 taxmann.com 70 (Mum.),

20 Refer Rule 10B(1)(d) of the Rules.

21 However, it needs to be borne in mind that there is no hierarchy in selection of methods under the Indian transfer pricing regulations. Also refer Circular No. 5 of 2013 dated June 29, 2013 in this regard.

Computation of group level profits is not a very significant challenge, splitting up of the profits amongst various group members does pose practical difficulties.

Globally as well as in India, the PSM has been sparsely used[22], mainly due to two significant challenges associated with the use of PSM. The first challenge relates to computation of group level profits arising from the transaction under consideration, which necessitates reconciliation of differences in the currencies involved as well as in the accounting policies employed. Another significant challenge relates to the subjectivity involved in determining an appropriate profit split between various group entities.

On the other hand, the PSM also has significant advantages, since it primarily considers only the data relating to the group entities, which is supposedly available within the group, and therefore, can be applied in cases where external comparables or benchmarks are not available or not reliable.

Uptill now, the involvement of foreign affiliates used to make it very difficult to practically apply PSM by Indian taxpayers. However, in respect of specified domestic transactions, it could be possible for taxpayers to apply PSM, since the entire group level profitability information could be available in India. Further, a profit split conducted on a scientific basis is less likely to be rejected by the revenue and judicial authorities in India.

Taxpayers entering into specified domestic transactions could consider the possibility of application of PSM considering the precise facts of their case.

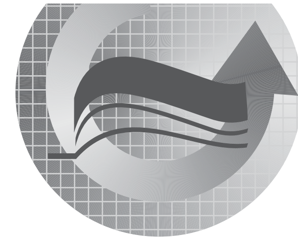
## 5. Conclusion

Selection of the most appropriate transfer pricing method is a very important part of the overall transfer pricing analysis. An appropriate selection of method, backed by a consideration of the relevant factors discussed in the article would go a long way in defending the taxpayer's positions before the revenue and judicial authorities, in case the taxpayer's position were to be challenged.

Taxpayers who were hitherto not subjected to transfer pricing, and are required to comply with the transfer pricing provisions on account of specified domestic transactions entered into by them would need to revisit their justification of the pricing mechanisms employed hitherto. Many approaches being used until now may be required to be amended or replaced with the acceptable transfer pricing methods.

While a discussion on documentation is beyond the purview of this article, the article would be incomplete without mentioning that a thorough documentation of the factors examined, results of the examination, and reasoning for selecting a particular method as the most appropriate method is unavoidable for a robust transfer pricing analysis.

22 The First Report of the Committee to Review Taxation of Development Centres and the IT Sector, formed under the Chairmanship of Mr. N. Rangachary, has observed that the Committee could find only 3 cases pertaining to Contract Development Centres, in which PSM was used: either by the taxpayer or the revenue authorities.



CA Maulk Doshi & CA Lokesh Gupta

# Methods of Arm's Length Pricing – Part II Analysis and details of TNM Method, RP Method and CP Method

Domestic transfer pricing ushers shift from generic fair market value to a concept called Arm's Length Price ('ALP'). This chapter emphasises on determination of arm's length price using Resale Price Method ('RP method'), Cost Plus Method ('CP method') or Transactional Net Margin Method ('TNM method').

## 1. Resale Price Method

RP method is to be used for determining ALP only when goods purchased from an associated enterprise ('AE') are resold to unrelated enterprise. RP method determines the ALP by comparing the gross profit margin earned by the assessee by reselling the goods purchased from a related enterprise with either the gross profit margin earned by the assessee in respect of goods purchased from unrelated enterprise or gross profit margin earned by an independent company performing similar functions and dealing with similar goods. As per Rule 10B(1)(b), following steps needs to be considered in determining ALP using RP method:

| Steps | Amount |
|---|---|
| Resale price charged to unrelated enterprise on sale of the property/service obtained from AE | xxx |
| Less: Normal gross profit margin accruing to enterprise or to an unrelated enterprise for same or similar property/service, in a comparable uncontrolled transaction. | xx |
| Less: Expenses incurred by the enterprise in connection with the purchase of property or obtaining of services | xx |
| Add/Less: Functional and other differences, including differences in accounting practices, if any, between international transaction/specified domestic transaction and the comparable uncontrolled transaction, or between the enterprises entering into such transaction | xx |
| Arm's Length Price | xxx |

RP method is most appropriate in cases involving the purchase and resale of goods where the assessee (buyer/reseller), does not add substantial value to the goods. Under RP method,

comparability is primarily dependent upon the similarity of the functions performed and the risk assumed by the controlled and uncontrolled distributors and is less dependent on the product similarity. Even the OECD Guidelines state that the reason comparability standards are less rigorous under RP method than the CUP method is "because minor product differences are less likely to have as material an effect on profit margins as they do on price."

As mentioned above, the gross margin comparison can be done in two ways:

- The resale price margin of the reseller in the controlled transaction may be determined by reference to the resale price margin that the same reseller earns on items purchased and sold in comparable uncontrolled transactions. This is regarded as internal comparable.
- Alternatively, the resale price margin earned by independent enterprise in a comparable uncontrolled transaction may serve as a guide. These are regarded as external comparables.

## Adjustments required to be made to account for differences include

In order to meet the comparability requirements of RP method, reasonable adjustment for the differences if any between the transactions examined need to be carried out. Such adjustments include adjustments for accounting practices apart from functional and other differences. Differences in accounting practices may be because:

- Sales and purchases have been accounted for inclusive of taxes or exclusive of taxes;
- Method of pricing the goods namely, FOB or CIF;
- Fluctuations in foreign exchange.

Further other adjustments that need to be made while applying RP method include:

- Working Capital: Inventory, debtors and creditors (collection & payment cycle);
- Contractual Terms: Warranties provided, sales or purchase volume, credit terms, transport terms, etc.;
- Differences in functions performed such as the level of marketing activities required and marketing spent required, and any other functional differences.

## Applicability & merits of RP Method

- RP method is most suited in case of distribution of finished products or other goods involving no or little value addition.
- As compared to CUP method, RP method allows broader product differences. The OECD Guidelines provides an example of a distributor reselling toasters can be compared with distributor reselling blenders since gross margin comparison would represent compensation towards the functions performed and a distributor selling toasters or blenders would perform similar functions and thus expect similar returns / gross margins. This level for broader product differences would not be possible in CUP, where the prices of products may be different making comparison difficult.

## Limitation of RP Method

- For sales made to an AE, this method would be inapplicable.
- Difficult to compute gross margins for external comparables since, meaningful and consistently prepared gross margin data is not available, against which the gross margins of assessee company could be compared. Essentially because under the Indian GAAP, there is no statutory necessity to disclose the gross margin in the financial statements of companies.

- RP method may be less reliable when there are differences between controlled and uncontrolled transactions and the parties to those transactions and when such differences have material impact on the margins and it is difficult to ascertain and quantify impact of such material differences. Example of differences between controlled and uncontrolled transaction may include:
  - o Reseller contributing substantially to creating and maintaining IPR of the parent company;
  - o Where the time gap for resale is significantly different;
  - o Where level of activities performed also vary widely. There could be situations where the reseller performs minimum functions like a forwarding agent as compared to reseller which takes full risk and ownership;
  - o Exclusivity in the contract to resale the goods.

## Case study – Resale Price Method

*Facts of the case*

XYZ Co., a wholesaler, purchases finished goods from its AE, A Co. at ` 100 and resells it at ` 110. R Co. also buys same finished goods from third party at ` 200 and sells the same to third party at ` 222.

*Applicability of RP Method*

In the instant case, XYZ acts as a distributor and resells goods purchased from AE. There are also independent distributors available, performing similar functions and dealing in similar goods. Thus, RP Method is the most appropriate method and gross margin earned by R can be used to benchmark gross margin earned by XYZ and consequently, the ALP of purchases can be derived as above.

## Judicial Precedents on RP Method

In the table below, we have summarised few judgments that highlight ideal circumstances in which RP Method can be applied and how the said method should be applied.

| Sr. No. | Case Law | Summary |
|---|---|---|
| 1 | Gharda Chemicals Ltd vs. Dy. CIT [2010] 35 SOT 406 (Mum.-Trib.) | RP Method could not be applied when property is sold by the assessee to its AE in USA. If the situation had been otherwise that the assessee had purchased the goods from its AE situated in USA, then this method could have been invoked for determining the ALP. |
| 2 | Star Diamond Group vs. Dy. DIT (International Taxation) [2011] 9 taxmann.com 311/ 44 SOT 532 (Mum.-Trib.) | The assessee was a trader, without value addition to the goods and hence RP method was the most appropriate method for determining the ALP with respect to AE transaction. |
| 3 | ITO vs. L'Oreal India (P.) Ltd. [2012] 24 taxmann.com 192/ 53 SOT 263 (URO)(Mum.-Trib.) | RP method is the most appropriate method in case of distribution and marketing activities when the goods are purchased from AE which are sold to unrelated parties. |
| 4 | CISCO Systems (India) (P) Ltd vs. Dy. CIT [2011] 16 taxmann.com 128/ [2012] 49 SOT 108 (Bang.-Trib.) | The assessee was only a custodian of the goods imported till these were delivered to the client or customer of its parent company on its direction. The assessee could not be held to be a trader or distributor of the goods and when assessee was not a trader or distributor of the spares parts |

| Sr. No. | Case Law | Summary |
|---|---|---|
| | | it is clear that RP method was not applicable for arriving at ALP. |
| 5 | Mattel Toys (I) Pvt Ltd vs. Dy. Comm. of Income Tax ITA No. 2476/Mum/2008 & ITA No. 2801/Mum/2008 | RP Method is most appropriate method for benchmarking distribution activity. Product similarity is not a vital aspect for RP Method but operational comparability is to be seen. Product differentiation does not materially affect the gross profit margin as it represents gross compensation after cost of sales for specific functions performed. Further, the gross profit margin earned by independent enterprise was a guiding factor in RP Method. |
| 6 | St. Jude Medical India P. Ltd. vs. DCIT ITA No. 1626/Hyd/2010 | In case where entire goods purchased from an AE remained unsold and accordingly the unsold goods cannot be considered in the assessment year in which they remained unsold in order to arrive at ALP. Only goods that have been sold should be considered for determining ALP. |

## 2. Cost Plus Method

The application of CP Method, begins with the identification of the costs that the manufacturer/service provider incurs in the controlled transactions. An appropriate mark-up is then added, based on the functions performed and the market conditions, to these costs so that an appropriate profit level is generated.

Accordingly, under CP Method ALP = Direct cost + Indirect cost of production + Adjusted GP Margin.

As per Rule 10 B(1) (c), following steps needs to be considered in determining ALP using CP method:

| Steps | | Amount |
|---|---|---|
| Direct cost and indirect cost of production in respect of property transferred or service rendered to AE | (A) | xxx |
| Normal gross profit mark-up on cost arising to the enterprise or to an unrelated enterprise in case of transfer/rendition of same or similar property/service, in a comparable uncontrolled transaction | (B) | x% |
| Add/Less: Functional and other differences, if any, between international transaction/specified domestic transaction and the comparable uncontrolled transaction, or between the enterprises entering into such transaction. | (C) | x% |
| Adjusted gross profit mark-up | (D)= (B)+/-(C) | x% |
| Arm's length Gross Margin | (E)= (A)*(D) | xx |
| Arm's length price of the transaction | (A)+(E) | xxx |

CP Method is similar to RP Method, though it applies a reciprocal methodology.

As was the situation under RP Method, comparability is primarily dependent upon the similarity of the functions performed and the risk assumed between the controlled and uncontrolled transactions and is less dependent on the product similarity. As was discussed under RP Method, the comparability requirements under CP Method also are less stringent than those under the CUP Method.

As in case of RP Method, gross margin comparison under CP method can be based on internal comparable or external comparable as given hereinunder:

- The cost plus mark-up of the manufacturer /service provider in a controlled transaction may be determined by reference to the cost plus mark-up that the same manufacturer/service provider earns in comparable uncontrolled transactions. This is regarded as internal comparable.
- Alternatively, the cost plus mark-up earned by independent enterprise in a comparable uncontrolled transaction may serve as a guide. This is regarded as external comparables.

## Adjustments required to be made to account for differences include

In order to meet the comparability requirements of CP Method, reasonable adjustment for the differences if any between the transactions examined need to be carried out. Such adjustments include:

- Contractual terms such as scope and terms of warranties provided, volumes, credit terms, transport terms, etc.;
- Leased assets vs. owned assets;
- Proper and consistent cost base and calculation of gross profit margin.

## Applicability of CP Method

CP Method can be applied in the following cases:

- Sale of semi-finished goods between related parties;
- Associated enterprises have concluded joint facility agreements or long-term buy and supply arrangements;
- Provision of services.

## Limitation of CP Method

- The most important and critical aspect of CP Method is the difficulty in computing gross margins for external comparables since, meaningful and consistently prepared gross margin data is not available, against which the gross margins of assessee company could be compared. Essentially because under the Indian GAAP, there is no statutory necessity to disclose the gross margin in the financial statements of companies. Due to this inherent limitation, in cases where internal comparables are not available, use of CP Method is extremely difficult.
- Determination of direct and indirect cost of production, since the same have not been defined under transfer pricing regulations.
- Challenging to make adjustments for factors which affect indirect costs for example, marketing efforts.

## Case study

*Facts of the case*

- Company A domestic manufacturer of electric heaters sells its finished products exclusively to Company B which is a related party u/s 40A(2)(b).
- Company A earns gross profit margin of 8% while selling the electric heaters to Company B.
- Company X, Y and Z are domestic electric heater manufacturers earning a gross profit margin that range from 6%-8%.
- Company A accounts for selling, general and administrative expenses as expenses not allocated to cost of goods sold to Company B.
- Company X, Y and Z account for selling, general and administrative expenses as a part of their cost of goods sold.

*Applicability of CP Method*

In the instant case, the purchase price paid by Company B can be benchmarked by either considering CUP Method for similar purchases made from unrelated parties if any. Assuming that Company B does not purchase similar products from third parties, it would be appropriate to consider Company A as the tested party Since since Company A is exclusively manufacturing goods for Company B like a contract manufacturer., Thus, CP Method appears to be most appropriate method. For applicability of CP Method, the gross profit margin of company X, Y and Z should be adjusted to provide for accounting inconsistency. Further, depending on whether or not Company A, X, Y and Z purchase raw material or use raw material consigned by Company B or other independent distributors respectively, adjustment for inventory risk needs to be made. If the data is unavailable to determine whether such accounting inconsistencies exist, the reliability of results will decrease..

## Judicial Precedents on CP Method

In the table below, we have summarized few judgments that highlight ideal circumstances in which CP Method can be applied and how the said method should be applied.

| Sr. No. | Case Law | Summary |
|---|---|---|
| 1 | Wrigley India (P.) Ltd. vs. ACIT [2011] 14 taxmann. com 91/48 SOT 53 (URO) (Delhi - Trib.) | Although CP method is most appropriate in cases involving sale of semi-finished goods to the AE. However, it is not necessary that CP Method cannot be applied where finished products are sold to the AE. These finished goods sold to its AEs were manufactured in the same factory where goods sold to unrelated parties were manufactured using the same raw material. These goods were manufactured with mostly unrelated cost base and CP Method was held to be the most appropriate method to determine the ALP. |
| 2 | Drilbits International P. Ltd. vs. DCIT, Circle 1 (ITA No. 1361/PN/2010) | For determining the mark-up, the gross margin in export segment cannot be compared with the gross margins in the domestic segment. There are various differences in the functions performed and the risk assumed in these two segments and therefore the same cannot be considered as comparable cases for determining the ALP. There are no marketing risk, no risk of bad debts and no product liability risk in export segments whereas the assessee has to bear all these risks in the domestic segment. The contractual statements also differ in the domestic segment vis-a-vis export segments. There are different characteristics and contractual terms in the two segments and further geographical and market differences are also present. Thus, it is very difficult to make suitable adjustments for these differences. |
| 3 | Cherokee India (P.) Ltd. vs. ITO [2011] 12 taxmann. com 324/47 SOT 12 (URO) (Mum. - Trib.) | In case of a contract manufacturer CP Method is the most appropriate method for testing ALP. Further, under CP Method, mark-up has to be on actual cost and not on the estimated cost. |
| 4 | ACIT vs. Tara Ultimo (P.) Ltd. [2011] 13 Taxmann. com 184/47 SOT 401 (Mum. - Trib.) | While setting the benchmark for CP Method, one can take into account several transactions with the unrelated enterprise on what can be termed as 'global basis' essentially in respect of same or similar property or service. Application of CP Method |

| Sr. No. | Case Law | Summary |
|---|---|---|
| | | has to be on transaction basis rather than on global basis. For example, average mark-up to unrelated enterprise is 20% and mark-up to AE is 2% in one transaction to the AE and 38% in other transaction to the AE. Both the transaction by applying mark-up on a global basis will meet ALP, however specially in case of mark-up of 2%, arm's length test is not met. Further, in the instant case, PLI used was gross profit on sales; however, it was held that the mark-up should be mark-up on cost. Mark-up on cost with the AE should be compared with the mark-up on cost with the non-AE. |
| 5 | M/s Convergys Information Management (India) (P) Ltd. vs. DCIT, Hyderabad, ITA No. 229/H/2009 | The cost for the purpose of this method would be the cost incurred after the date of agreement and not pre-agreement costs, since no customer would pay mark-up before entering into the agreement. |
| 6 | Reliance Industries Ltd. vs. ACIT Range 3(3) (2012) taxmann.com 189 (Mum) | To arrive at the correct cost for the purpose of this method, actuals have to be taken. Cost cannot be taken as a percentage of total cost. This method does not contemplate estimation of cost. |

## 3. Transactional Net Margin Method

TNM method evaluates the profit margin relative to an appropriate base, such as costs, turnover, assets, etc, that a taxpayer earns from a controlled transaction(s). TNM Method is similar to CP Method or RP Method, except that CP and RP Methods are based on gross margins whereas TNM method is based on net margins. As per Rule 10B(1)(e), following steps needs to be considered in determining ALP using TNM Method:

| Steps | | Amount |
|---|---|---|
| Net profit margin realised by an enterprise from international transaction / SDT entered into with an AE in relation to cost incurred or sales effected or assets employed or any other base (PLI) | (A) | xx% |
| Net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base | (B) | xx% |
| Add/Less: Adjustment for differences between point B and point A | (C) | x% |
| Adjusted Net Margins (%) – Arm's length net margin which should be greater than or equal to margins in 'A' above | (D)=(B)+/-(C) | xx% |
| Appropriate base – E.g. sales, cost, asset | (E) | xxx |
| Arm's Length Price | (E)*(D) | xxx |

Under TNM Method, for determination of net margins only following items should be considered:

(a) Items that are directly or indirectly related to the controlled transaction at hand and

(b) Items that are of operating nature

Under TNM Method, cost and revenue that are not related to the controlled transaction under review should be excluded where they materially affect comparability with uncontrolled transaction. Further, non-operating items such as interest income and expenses and income taxes, dividend, income and expense derived from activities not being tested by this method, or extraordinary gains and losses that do not relate to the continuing operations of the assessee company should be excluded from the net margins.

The comparison of net margins under TNM Method can be based on internal comparable or external comparable as given hereinunder:

- The net margins of the assessee company in a controlled transaction may be determined by reference to the net margins of the same assessee company in comparable uncontrolled transactions. This is regarded as internal comparable.
- Alternatively, the net margins earned by independent enterprise in a comparable uncontrolled transaction may serve as a guide. These are regarded as external comparables.

## Adjustments that need to be made to account for differences include

- Working Capital: Inventory, debtors and creditors (collection cycle);
- Cost of capital: Manner of funding such as preference and equity, etc.;
- Assets employed: Difference in assets employed and method of providing for depreciation;
- Assured or risk bearing business: Difference in the customer/revenue model of the assessee vis-à-vis the comparables;
- Transaction level differences may exist and the same may be adjusted if requisite information is available. Some of the common transaction level differences include free gifts, extended warranty (in addition to the normal), marketing risks, quantity discount, etc.

TNM method determines an arm's length operating incomes based on most appropriate "profit level indicators" (PLI). The PLI could be the ratio of operating profits to operating assets, operating profits to net sales or gross profits to operating expenses or based on some other financial ratio that is more appropriate to the facts and circumstances of a specific case.

The comparability required for TNM Method is less strict than for traditional transactional methods, with significant product diversity and some functional diversity acceptable.

The OECD Guidelines recognize that TNM Method can be particularly attractive in situations where one of the parties to the associated transaction is complex and has many inter-related activities, or when it is difficult to obtain reliable information about one of the parties.

TNM Method in practice is widely used because it is difficult to evaluate the comparability of gross margins, while use of net profit indicators may avoid the problem. It is usually only information on operating income that can be appropriately determined from publicly-available information.

TNM Method is regarded as a last resort for determining the ALP. It is invoked only when the other methods of determining the ALP cannot be applied.

## Applicability of TNM Method

- Provision of services;
- Distribution of finished products where Resale Price Method cannot be adequately applied;
- Transfer of semi finished goods where cost plus cannot be adequately applied;

- Transactions involving intangibles where Profit Split Method cannot be applied.

## Limitations of TNM Method

- Net profit may be influenced by some factors that have less or no effect on the price or gross margin
- Net profit may be affected by varying cost structures, business experience, management efficiency, etc.

## Judicial precedents on TNM Method

In the table below, we have summarised few judgments that highlight ideal circumstances in which TNM Method can be applied and how the said method should be applied.

| Sr. No. | Case Law | Summary |
|---|---|---|
| 1 | E-Gain Communication (P.) Ltd. vs. ITO [2008] 23 SOT 385/[2009] 118 ITD 243 (Pune - Trib.) | Any difference which materially affects the market value is to be given a serious consideration. The degree of comparability between the tested party and the uncontrolled tax payer with parameters like nature or line of business product or service market; the composition employed; the size and scope of operation; the stage of business or product cycle are required to be seen. The OECD Guidelines on application of TNM Method lays down the same principles as are reflected in rule 10D. |
| 2 | Vedaris Technology (P.) Ltd. vs. ACIT [2011] 44 SOT 316 (Delhi-Trib.) | Net profit margin worked out under TNM method is to be adjusted to take into account the differences between international transactions, which could materially affect the amount of net profit margin in the open market. Availability of funds without stipulation of interest does make difference in the rate of net profit. |
| 3 | Ranbaxy Laboratories Ltd. vs. Addl. CIT [2008] 167 Taxman 306 (Mag.)/110 ITD 428 (delhi-Trib.) | For applicability of TNM Method, not only comparability of transactions is to be kept in view but FAR analysis is also to be considered in evaluation. Hence clubbing "fundamentally separate & independent transactions" carried at different times & relating to different parties situated in different continents for determining ALP was held incorrect. |
| 4 | UCB India (P.) Ltd. vs. Asstt. CIT [2009] 121 ITD 131/30 SOT 95 (Mum.-Trib.) | TNM Method compares net margins of uncontrolled transactions between independent entities, with net margins in controlled transactions between related parties. Futher rule 10B(1)(e) read with section 92C deals with TNM Method, and it refers to only "net profit margins" realized by an enterprise from an international transaction or a class of such transactions, but not operational margins of enterprises as a whole." |
| 5 | Dy. CIT vs. Ankit Diamonds [2011] 9 taxman.com 37/43 SOT 523 (Mum.-Trib.) | Under TNM Method it would be illegal & against law to apply gross margin or net margin of "enterprises as a whole" and suggested additions based on the variations in the gross profit earned by various enterprises of the |

| Sr. No. | Case Law | Summary |
|---|---|---|
| | | same capacity. Under Chapter X of Income-tax Act, the determination of ALP of an international transactions has to be only at the transaction level or at the level of a class of transactions. Law does not permit determination of ALP of international transactions, by comparing operating margins at entity level, or by taking overall industry level averages. |
| 6 | Asstt. CIT vs. Schlafhorst Marketing Co. Ltd. [2011] 13 taxmann.com 104/47 SOT 120 (URO) (Mum.-Trib.) | It is said that TNM Method is more tolerant to variation in comparability and is more suitable when there is no high degree of comparability between the transactions. |
| 7 | GE India Technology Centre P. Ltd vs. DDIT [TS-768-ITAT-2012(Bang)-TP] | Both guidelines advocate that under TNM Method, only broad functional and product comparability is to be considered, as net margins are less influenced by differences in products and functions. Hence, it would be possible to use 'imperfect' comparables, e.g. comparables from another industry sector, possibly adjusted to eliminate or reduce difference. |

## 4. Choice of Profit Level Indicators in each of the above methods discussed

For each of the methods discussed above the profit level indicator of the tested party (assessee) would be worked out and compared to the external comparables used. Accordingly, following are the method wise profit level indicators:

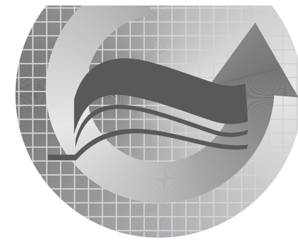
| Method | PLI | Formula | Typically used for |
|---|---|---|---|
| Resale price method | Gross margin | GP/ Sales | Distributor |
| Cost Plus Method | Gross margin on costs | GP/Cost of production | Manufacturer/service provider |
| Transactional Net Margin Method | Return on total costs | Operating Profit (OP)/ Total cost | Contract or toll manufacturer/service provider |
| | Return on sales | OP/sales | Manufacture/ Distributor |
| | Return on assets | OP/Operating assets | Manufacturer/asset intensive business |
| | Return on capital employed | OP/Capital employed | Financial transactions |
| | Return on value added expenses | OP/Value added expenses | Agents |

**5. Conclusion**

The table below summarises the 3 methods discussed above:

| Method | Product / service comparability | Functions, Asset and Risk comparability | Typical circumstances for applicability |
|---|---|---|---|
| Resale Price Method | Not wholly reliant on product/ service similarity. Broad similarity between tested party and comparables is required. | Highly dependent on functions performed and risks assumed by tested party and by comparables. Difficult to apply RP Method in case of transfer of intangibles. | Distribution of finished goods involving no or little value addition. |
| Cost Plus Method | Not wholly reliant on product/service similarity. Broad similarity between tested party and comparables is required. | Highly dependent on functions performed and risks assumed by tested party and by comparables. Difficult to apply RP Method in case of transfer of intangibles. | • Provision of services;<br>• Transfer of semi-finished goods;<br>• Long-term buy and sell arrangements. |
| Transactional Net Margin Method | Produc / service comparability not important. | Functions performed and risks assumed should be broadly similar between tested party and comparables. Transfer of intangibles can be possibly tested using TNM Method. | • Provision of services;<br>• Distribution of finished products where RP method cannot be adequately applied;<br>• Transfer of semi finished goods where cost plus cannot be adequately applied;<br>• Transactions involving intangibles where profit Split Method cannot be applied. |

The applicability of each of the above discussed methods should be done on case to case basis based on facts of the case, applicability and limitation of each method, comparability analysis including functional analysis of the parties to the transaction and availability and reliability of comparable data.



CA Ameya Kunte

# Use of sixth method for Domestic Transfer Pricing

**The computation of arm's length price (ALP) in** relation to "specified domestic transaction" (SDT) needs to be determined by any of the prescribed 6 methods. Section 92C of Income-tax Act, 1961 specifically provides 5 methods and Rule 10B elaborates on each of the methods. The section further states that ALP can also be determined by applying "such other method as may be prescribed by the Board". This is also known as a residuary method. Almost 10 years after the introduction of Transfer Pricing law in India, the Government in 2012 notified the sixth method by amending Rule 10B from AY 2012-13. The sixth method has been specified in Rule 10AB under the heading "Other method of determination of arm's length price".

The Rule 10AB reads as below:

For the purposes of clause (f) of sub-section (1) of section 92C, the other method for determination of the arm's length price in relation to an international transaction or a specified domestic transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

The rule was amended in 2013 to allow application of residuary method to specified domestic transactions with effect from AY 2013-14.

## Analysis of the sixth method

A break-up of the definition of the sixth method shows following aspects:

| Definition | Comments |
|---|---|
| any method | No specific methodology (unlike CUP, RPM, TNMM) has been specified. The sixth method appears to be broad and could cover any method to determine ALP. |
| which takes into account the price which has been charged or paid, or would have been charged or paid, | Specifically, the sixth method provides taking into account the "price". It does not use the words 'profit margin'. Thus, use of profit margin based benchmarking approach, is not be covered under the sixth method.<br>Further, the sixth method refers to "price which has been charged or paid". This would mean it covers prices with reference to actual transaction.<br>It also refers to the "price which would have been charged or paid". This would even mean that a price not arising out of an |

| | |
|---|---|
| | actual concluded transaction, could also be taken as a benchmark. It thus seems to recognise a hypothetical arm's length test.<br>All other 5 methods (especially CUP) refer to "actual transaction price" as a benchmark, unlike in the sixth method. |
| for the same or similar uncontrolled transaction, | This appears to be in line with conventional transfer pricing comparability rule, that transactions should be uncontrolled[1] and should be same or similar. In earlier chapters, the aspects on "same or similar transaction" and "uncontrolled transaction" have been discussed extensively. These aspects would equally be relevant in selection of sixth method[2]. |
| with or between non-associated enterprises, | In order to determine ALP, the uncontrolled transaction could be with non-associated enterprise (s) or could be between non-associated enterprises. As discussed earlier, the price that would have been payable in an uncontrolled transaction with non-associated enterprises can also be covered under the sixth method. |
| under similar circumstances, considering all the relevant facts. | The definition again provides comparability of the circumstances and relevant facts in benchmarking. |

## Sixth method vs CUP

Thus, the sixth method appears to be an extension of Comparable Uncontrolled Price (CUP) method, with following 2 clear distinctions –

- Sixth method considers price that would have been payable unlike CUP which only refers to price charged or paid.
- CUP applies to property transferred or services provided, whereas the sixth method is applicable to any international transaction.

## Most Appropriate Method principles

As specified in Rule 10C, the Most Appropriate Method shall be the method which is best suited to the facts and circumstances of each particular international transaction or specified domestic transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction or the specified domestic transaction, as the case may be. Thus, selection of the sixth method for Domestic Transfer Pricing benchmarking needs to satisfy other criteria provided in Rule 10C.

## Residuary method under OECD TP Guidelines

In this regard, a useful reference could be made to the guidance provided under OECD's (2010) Transfer Pricing Guidelines. Para 2.9 of the 2010 Guidelines states that "Moreover, MNE groups retain the freedom to apply methods not described in these Guidelines (hereafter "other methods") to establish prices provided those prices satisfy the arm's length principle in accordance with these Guidelines. Such other methods should however not be used in substitution for OECD-recognised methods where the latter are more appropriate to the facts and circumstances of the case. In cases where other methods are used, their selection should be supported by an explanation of why OECD-recognised methods were regarded as less appropriate or non-workable in the circumstances of the case and of the reason why the selected other method was regarded as providing a better solution. A taxpayer should maintain and be prepared to provide documentation regarding how

1 Rule 10B(3) states that an uncontrolled transaction shall be comparable to a specified domestic transaction if- (i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or (ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

2 The comparability factors have not been discussed again in this chapter.

its transfer prices were established."

Thus, while selecting the sixth method for SDT, benchmarking exercise needs to be documented appropriately including justification as to why the other methods cannot be applied.

## Sixth method – type of transactions and comparability

On the suitability of the sixth method, the Guidance Note[3] issued by ICAI on "Report Under Section 92E of the Income-tax Act, 1961" states that "The wide coverage of the Other Method would provide flexibility in establishing arm's length prices, particularly in cases where the application of the five specific methods is not possible due to reasons such as difficulties in obtaining comparable data due to uniqueness of transactions such as intangibles or business transfers, transfer of unlisted shares, sale of fixed assets, revenue allocation/ splitting, guarantees provided and received, etc."

The Guidance Note further provides examples of various data which can be used for comparability under the sixth method:

- Third party quotations;
- Valuation reports;
- Tender / Bid documents;
- Documents relating to the negotiations;
- Standard rate cards;
- Commercial & economic business models; etc.

It may be noted that even prior to introduction of the sixth method, valuation methods such as 'excess earning method' and 'discounted cash flow method' have been used for valuation of intangibles and shares.[4] Thus, valuation guidelines prescribed under other laws, such as FEMA and CCI, may be considered under the sixth method. In addition, pricing accepted by the Indirect tax authorities can also be considered under the sixth method, especially where it considers principles of fair value pricing. Use of such data for the purpose CUP has been a subject matter of litigation.[5] However, application under this method stands on a better footing.

It may be noted that, as clarified by the Revenue in various public meetings, percentages notified under Safe Harbour Rules[6] cannot be considered as ALP for the purpose of benchmarking. Hence, the price - based benchmark notified under Safe Harbour Rules for loan and guarantees, cannot be considered under the sixth method for Domestic Transfer pricing benchmarking.

## Benchmarking SDT

Specifically in the context of domestic transfer pricing, a few examples of transactions that could be benchmarked under the sixth method are discussed below.

### 1) Payment of director's remuneration covered by Sec 40A(2)(b)

Director's remuneration would be covered under sec 40A(2)(b) and hence is subject to Domestic Transfer Pricing. It would not be possible to benchmark director's remuneration applying CUP, since it will be impossible to obtain data on comparable salaries. Further, margin based methods will not be suitable to benchmark director's remuneration, unless covered under TNMM.

In such case, the sixth method could be adopted for benchmarking. The Company law provides limits on the director's remuneration. If the payment to director is within the limits prescribed by the company law and approved by the Board of Directors, it could be considered as a benchmark under the sixth method. Where the remuneration (in public limited companies) is approved by the Company law administration, then the same would further substantiate arm's length nature of the transaction.

In addition, one may consider obtaining external compensation benchmark studies based on job

3 Edition Revised in August 2013

4 See ITAT decisions in Tally Solutions and Ascendas India.

5 Different benches of ITAT have taken opposite stands on the use of customs data for determining ALP under transfer pricing provisions. See decisions in Serdia Pharmaceuticals (Mumbai ITAT) and Coastal Energy (Chennai ITAT).

6 Final Safe Harbour Rules were notified on September 18, 2013.

profile, skill set and qualifications of the directors. Such external benchmark report would qualify under the sixth method.

**2) Cost allocation**

***a) Allocation between head office and units as per Sec. 80IA(8) -***

Sec 80IA(8) applies to transfer of goods or services. Thus, there is a view that Sec 80IA(8) is not applicable to cost allocations between head office and units, absent any transfer of goods or services. However, if an assessee considers benchmarking of common head-office expenses, allocation key (which strictly may not be covered under CUP) and cost allocation working could be justified using the sixth method. The allocation key could be sales, number of employees, area, number of units produced, etc.

***b) Allocation between Group entities***

Common cost allocation between group entities would be covered under Sec 40A(2)(b) on expenditure side. Further, Sec 80IA(10) could apply to cost allocations on income as well as expense side. Addition of mark-up on these allocations is an area which requires close examination depending upon whether the allocation is for mere "pass-through" costs or there is a service element involved.

While CUP can also be considered for benchmarking, absent relevant comparable data, cost allocation benchmarking could be justified using sixth method. Cost allocation of third party costs without mark-up would be covered under the sixth method. This would again entail use of cost allocation keys or external studies on the costs, etc.

**3) Asset / Intangible Property transfers which attract Sec 80IA(10)**

Provisions of Sec 80IA(10) may apply for transfer of assets or intangible property within group entities. Such transfers could be substantiated based on 'external expert valuation certificate' for the assets. This should be covered under the sixth method.

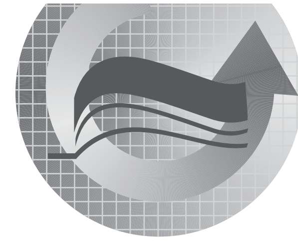
## Use of internal negotiations on pricing?

As discussed in the beginning, the sixth method refers to "any method' and "which takes into account the price which has been charged or paid, or would have been charged or paid". On many occasions, various divisions/associate companies within Group, provide standard pricing guidelines for inter-company transactions. While setting up the internal pricing guidelines, factors such as cost of production/providing of service, market rates, etc. are considered. Even if such internal standards are not set, each division could function as a separate profit centre and would negotiate with other division on the pricing and terms of the transaction. Such negotiations would also involve review of the external pricing, etc.

If a company is maintaining robust documentation of setting up of prices for such inter-company transactions, it could also be considered for benchmarking applying the sixth method. Thus, where behaviour within related entities is demonstrated to be of the nature similar to "uncontrolled transaction with or between non-associated enterprises", the same could be adopted for the purpose of benchmarking applying the sixth method. This could be further supported by data used for the purpose of Cost Audit purposes (wherever applicable) or fair value data maintained under the new Company law provisions.

## Conclusion

AY 2013-14 will be the first year in which sixth method as well as SDT will be implemented for the first time. Unlike International Transfer pricing, the sixth method is available as one of the methods for determination of ALP from the first year of Domestic Transfer Pricing. It augurs well, especially for taxpayers, given relatively wide and open scope available for benchmarking using the sixth method. It however adds an extra burden on taxpayers as well as Revenue, to justify use of the sixth method discarding the conventional five methods available.



CA Karishma R. Phatarphekar and CA Gaurav Jain

# Concept of benchmarking study and guidance on selecting benchmarks for 40A(2) cases – including case law analysis

## A. Introduction

The Finance Bill, 2012 extended the scope of Indian Transfer Pricing regulations by including "Specified Domestic Transaction ('SDT')". The new section 92BA was notified in the Income-tax Act, 1961 ("the Act"), which mentions the nature of the transactions to be covered under SDT.

Section 92BA of the Act covers the following transactions, namely:

- any expenditure in respect of which payment has been made or is to be made a person referred to in section 40A(2)(b) of the Act (hereinafter referred to as 'specified persons' or 'related persons');
- any transaction referred to in section 80A of the Act;
- any transfer of goods or services referred to in section 80-IA(8) of the Act;
- business transacted between the taxpayer and the closely associated persons as referred to in Section 80-IA(10) of the Act;
- any other transaction, referred to in any other section under Chapter VI-A or section 10AA (a undertaking in an SEZ claiming tax holiday), to which the provisions of sections 80-IA(8) and 80-IA(10) of the Act; and
- any other transaction that may be prescribed.

Further, above transactions will be subject to arm's length pricing where the aggregate of such transactions entered into by the taxpayer in the previous year exceeds a sum of five crore rupees.

This article aims to present the approach and guidance for specified domestic transactions covered under section 40A(2) only in an objective and comprehensive manner and provides guidance for benchmarking with help of case studies.

## B. Conditions for applicability of SDT under section 40A(2)

For the applicability of section 92BA(i) of the Act following conditions needs to be satisfied:

- Taxpayer should have incurred an expenditure as defined under section 40A(2) [1],

1. The guidance note on " Report under section 92E of the Income-tax Act, 1961" issued by The Institute of Chartered Accountants of India ('ICAI') (referred to as Revised ICAI guidance note) clarifies that section 92 BA(i) of the Act covers transactions mentioned in section 40A(2)(a) of the Act with persons specified in section 40A(2)(b) of the Act.

- Expenditure should be with the related parties mentioned section 40A(2)(b) and
- The aggregate of SDT should exceed INR 5 crores

If all the above-mentioned conditions are satisfied the assessee is required to demonstrate that these transactions are in accordance with the arm's length principal defined in section 92F of the Act and consequently required to comply with the Indian Transfer Pricing provisions.

## C. Transactions mentioned under section 40A(2)(a)

***Expenditures*:** The provision of section 40A(2) of the Act and consequently section 92BA(i) covers expenditures claimed as deduction while calculating the income under the head 'Profits and gains from business and profession' and 'Income from other sources' are required to comply with the provision of SDT. The recipient of these payments are not required to comply with SDT provisions as per section 92BA(i).

***Actual movement of cash is not important:*** The word 'expenditure' has not been defined in the Act and therefore reliance can be placed on the definition given in Black Law's Dictionary and various relevant case laws. On the basis of this the 'expenditure' as mentioned in section 40A would mean that all outgoing but actual movement of cash is not important.

***Revenue and capital expenditures***[2] : Expenditure would include both capital and revenue expenditure.

Illustrative lists of transactions/expenditures which are covered under the ambit of section 40A(2) of the Act are as under:

- Purchase of goods and services
- Interest expenses for a loan taken from related parties
- Remuneration paid to managerial personnel
- Reimbursement expense
- Purchase of fixed assets
- Shared services
- Rent expenses
- Corporate guarantee charges
- Maintenance and administrative charges
- ESOPs / other benefits to KMP

***Is deprecation covered?*** [2] Capital expenditure in respect of which deduction claimed by way of depreciation under section 32 of the Act will not be covered by section 40A since depreciation is not an expense for which the assessee is liable to some payment and hence will not be covered under SDT. Capital expenditure on which deduction is claimed other than by way of depreciation would be covered under section 92BA(i).

## D. Persons mentioned in section 40A(2)(b)

The second condition for the applicability of SDT is that the assessee must have entered into a transaction with its AEs. AEs for the purpose of section 92BA(i) have been defined under section 40A(2)(b) of the Act.

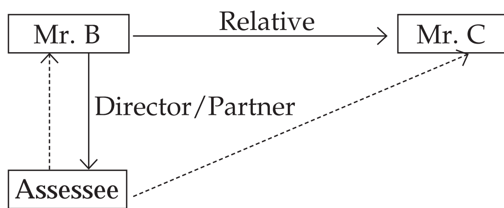
| ·······→ | AEs as per section 40A(2)(b) |
|---|---|
| ——→ | Relation between the parties |

2. ICAI guidance note on Report under section 92E of the Income-tax Act, 1961 – relevant extract – "4 A.11 These provisions are also applicable to expenditures which are in capital in nature and fully claimed as deduction under other provisions since any expenditure is covered under the scope of sec 40A (2)(b)".

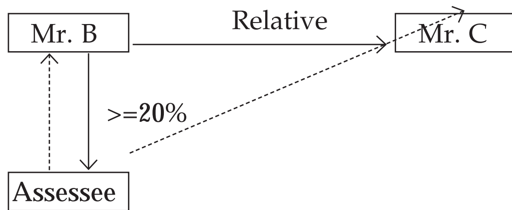
*The ensuing section explains each sub-clause of 40A(2)(b):*

**40A(2)(b)(i):–** *"Where asseesee is an individual : Relative of the assessee"*

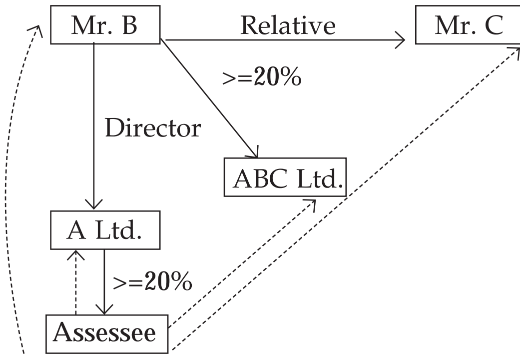
**40A(2)(b)(ii):–** *"Where assessee is a company, firm, association of person or Hindu undivided family- any director of the company, partner of the firm or member of the association or family, or any relative of such director, partner or member"*



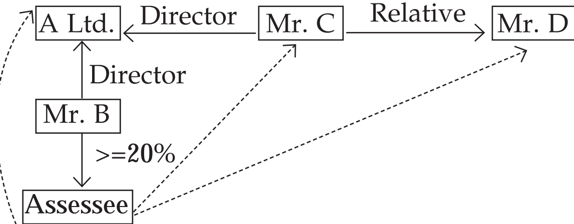

**40A(2)(b)(iii):–** *"any individual who has a substantial interest* in the business or profession of the assessee, or any relative of such individual"*




**40A(2)(b)(iv):–** *"a company, firm, association of persons or Hindu undivided family having a substantial interest* in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member [or any other company carrying on business or profession in which the first mentioned company has substantial interest*]"*

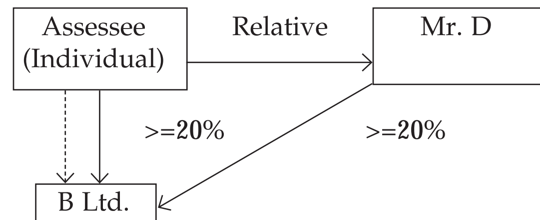



**40A(2)(b)(v):–** *"a company, firm, association of persons or Hindu undivided family of which a director, partner or member, as the case may be, has a substantial interest* in the business or profession of the assessee; or any director, partner or member of such company, firm, association or family or any relative of such director, partner or member;"*



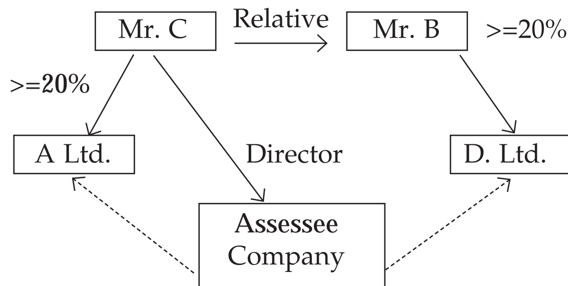

**40A(2)(b)(vi):–** *"any person who carries on a business or profession,—*

*(A) where the assessee being an individual, or any relative of such assessee, has a substantial interest* in the business or profession of that person;"*




*"(B) where the assessee being a company, firm, association of persons or Hindu undivided family, or any director of such company, partner of such firm or member of the association or family, or any*

***relative of such director, partner or member, has a substantial interest* in the business or profession of that person."***




*Substantial Interest means:

- In case of a company – a person who at any time during the previous year is the beneficial owner of share carrying not less 20% of the voting power.
- In any other case a person who is beneficially entitled to not less than 20% of profits or losses of the assessee.

**Does Substantial interest include indirect holding**

As in the case of sections 92A(2) (a) and (b) (which defines the term 'associated enterprise' for the purposes of international transactions) the phrase "directly or indirectly" is not used in section 40A(2)(b).

However, in this regard, references are generally made to the Central Board of Direct Taxes' **Circular number 6-P dated 6 July, 1968** explaining the then newly inserted provisions in section 40A(2). This circular sets out the categories of the persons, payments to whom fall within the purview of section 40A(2). It mentions that such persons would include *inter alia* –

> *"(c) persons in whose business or profession the taxpayer has a substantial interest directly or indirectly".*

Mooting the section 40A(2) of the Act, one would still not find any reference of the circular quoted above. *Now the question arises that in such a scenario what would prevail the Act or a circular?* This could have wide connotation in common parlance and would therefore require clarifications. To go to the root of the matter it is quintessential to interpret the nature of the circulars and the implications of the same on the assessee as well as revenue.

It is well laid out principle by the apex court in the celebrated case of *Navnital C. Javeri (1965) 56 ITR 198 (SC)* that board circulars do not bind the assessee's. However, a circular diluting the stringent requirements of the Act and beneficial to the assessee would be binding on the revenue. This view has been augmented by a division bench of the apex court in the case of *Ellerman Lines (1971) 82 ITR 913 (SC)*and various other benches of the apex court. Based on these judicial precedents it can be concluded that while circulars do not have the power to make the requirements of the Act more stringent for the assessee, they certainly can dilute the requirements of the Act and would be binding on the revenue. Thus after comprehending the nature of circulars the view can be taken that the board circular explaining the provisions of section 40A(2) does not override the Income-tax Act and does not bind the assessee's. If the view expressed by the circular is taken and indirect holding is included to determine the substantial interest there would be additional burden on the assessee's as it would extend the scope of specified persons as defined in section 40A(2) of the Act. This is against the very nature of the circulars as discussed in the preceding paragraph.

Thus it can be concluded that with the absence of any judicial precedent on the issue, substantial interest would arise only in the case of direct holding. Indirect holding by a person in the capital of the taxpayer will not give rise

to the substantial interest in the business of the taxpayer. This view has also been endorsed by the revised ICAI guidance note.

## E. Why benchmarking and what does benchmarking study comprise?

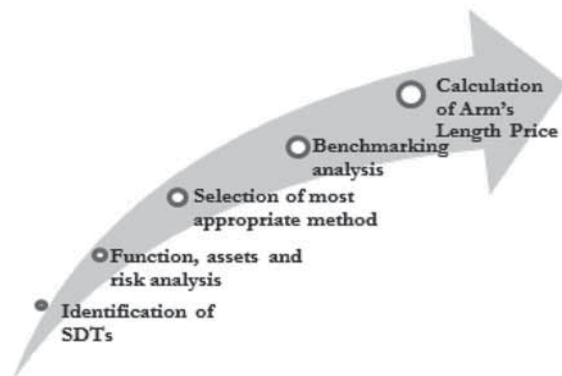
Transfer pricing regulations provides for computation of the notified controlled transactions to be at an arm's length price (ALP). The ALP has been defined in section 92F of the Act which means that the price charged for a transaction between AEs shall be the same that would be charged had the transaction been between two unrelated parties. The arm's length price of a transaction is determined through **a methodical exercise based on meticulous collation and analysis of data** by applying any of the six methods that have been prescribed in the Act. The notified transaction (transfer price) is then benchmarked against the ALP. The process of finding data/transactions comparable to the controlled transaction to determine arm's length price of the transaction is referred to as the **"benchmarking process"**.

Benchmarking process is different for different transactions. In the event of variation between ALP and transfer price, a required adjustment is made to the taxable income.

The six methods notified in the Act to determine the arm's length price of a transaction are as under:

- **Comparable Uncontrolled Price method ('CUP'):** Comparison of price charged to a related party with **price** charged to independent third parties or price charged between two independent parties under similar circumstances.
- **Resale Price Method ('RPM'):** This method is generally used in case of **distributor/re-seller** model with reference to gross profit earned from such transactions.
- **Cost Plus Method ('CPM'):** CPM used for examining transaction comprising **provision of services or manufacturing** activities with reference to **gross profit** earned from such transactions.
- **Profit Spilt Method ('PSM'):** It is used where transaction involves intangibles or transaction is complex. In the Indian context, the use of this method is very limited.
- **Transactional Net Margin Method ('TNMM'):** The method examines **net profit margin** relative to an appropriate base that a taxpayer realises from a transaction with related party. This method is widely used and most preferred method.
- **Any Other Method:** It can be any method which can help in determining the arm's length price of the transaction.

**Determination of Arm's Length Price – the approach**




**Measures for comparing a controlled transaction with an uncontrolled transaction:** Rule 10B of the Income Tax Rules, 1962 ('the Rules') list down the following criteria that should be considered for comparing a controlled transactions with an uncontrolled transactions:

**Specific characteristics of property transferred or services provided**

- Quality of product/services

- Value of the transactions
- Presence of intangibles like brand name, trademarks, etc.
- Material or physical features

**Functions performed taking into account assets employed/to be employed**

- Only the material or important functions are considered
- Not the number but criticality of functions relevant
- Some of the important functions are Manufacturing, Warehousing, Sales and distribution, Technical services

**Risks assumed**

- Financial risk
- Product/service risk
- Market risk
- Entrepreneurial risk

**Contractual terms of the transaction**

- Term of delivery
- CIF, C&F, FOB, etc.
- Terms of payment
- Discount policy
- Credit period
- Warranty period
- Installation services

**Market conditions**

- Geographical location and size
- Regulatory laws and governmental orders
- Level of competition
- Nature of market whether wholesale/retail
- Overall economic development

***Internal comparables vs External comparables***

The comparable uncontrolled data needs to be identified which may be available either in the form of:

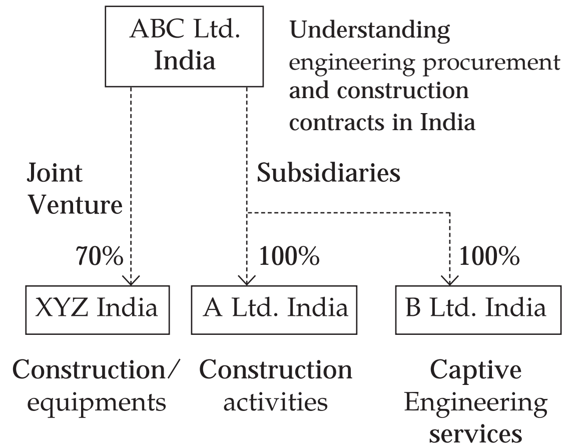
- ➢ Internal comparable or
- ➢ External comparable

Internal comparables are more reliable but it is subject to availability of relevant data. Therefore, in the absence of internal comparable data one needs to search for external comparables using external databases and other sources.

***Databases*** There are various databases available in the market for various transactions. The following are illustrative:

- ➢ Indian Databases:
  - Prowess
  - Capitaline
- ➢ Foreign Databases
  - BVD
  - OneSource
  - Compustat
- ➢ Royalty Transactions
  - Royalty Stat
  - Royalty Source
- ➢ Financial Transaction
  - Bloomberg
  - Moody's risk calculator

*Example*: Following example explains the benchmarking approach in brief:




Following are the transactions entered by ABC Ltd.:

- ABC & XYZ purchase cement from A
- ABC subcontracts engineering to B
- Purchase of construction equipment by ABC Ltd. from XYZ Ltd.

The tables below provides illustrative approach for SDT analysis

| Transaction | Analysis | Indicative Benchmarking g approach | Recommended documentation |
|---|---|---|---|
| Purchase of cement from A Ltd. Expenditure for ABC and XYZ | • A sells to third party<br>• ABC or XYZ purchases from third party | Following methods can be used:<br>• Internal CUP<br>• In case, perfect comparables are not available Internal TNMM can be applied. | • Contemporaneous third party sales details / invoices and benchmarking with sales to group companies |
| Sub-contracting work by ABC Ltd. to B Ltd. | • Captive<br>• No internal data<br>• Would have to benchmark with external data | • External TNMM<br>• Benchmark with technical engineering companies on external database | • Inter-company sub-contracting agreement |
| Purchase of equipment by ABC Ltd. from XYZ Ltd. | • This would not be covered by SDT if ABC Limited claims depreciation on the equipment. | | |

## F. Case Studies on benchmarking of Specified Domestic Transactions

**Case Study I:**

X Ltd. owns 50% voting power in Y Ltd.

X Ltd. is in the distributor of material used for manufacturing of metal and glass products and sells its products only to Y Ltd. who is manufacturer of glass and metal products.

**Controlled Transaction:** Purchase of metal and glass products by Y Ltd. from its holding company

**Selection of Method**: TNMM

We test X Ltd. (assuming least complex entity) which is a distributor.

Due to lack of internal comparable data, external benchmarking in the database needs to be performed.

To search for comparable companies i.e. distributor in the database(s) following keywords would be applied:

a) Distributor

b) Metal products

c) Brass products

d) Stainless steel products

e) Glassware products

To short list the comparable companies from the above search results certain quantitative filters would be applied to eliminate dissimilar companies:

**Elimination process**

- Reject companies with no financial information
- Reject companies with turnover less than INR 1 crore
- Reject companies with net worth less than zero :
- Reject companies with Trading income to total income less than 75%

| | **A Ltd.** | **Third Party Customers** | |
|---|---|---|---|
| Quantity | 150,000 | 50,000 | |
| Price | INR 36 (FOB) | INR 40+2 (CIF) | Freight and insurance INR 2 |
| Quantity discount | Yes | No | 10% discount to B Ltd. for bulk purchases |

After quantitative analysis, the remaining companies would be analysed on qualitative aspects and companies in similar business would be shortlisted. After undertaking above steps one company i.e. ABC Ltd. was found to comparable to X Ltd.

| **Particulars** | **X Ltd. (in crores)** | **ABC Ltd. (in crores)** |
|---|---|---|
| Sales | 52.00 | 59.50 |
| Other Income | 0.85 | 0.90 |
| Total Income | 52.85 | 60.40 |
| **Expenses** | | |
| Operating Expenses | 45.00 | 50.00 |
| Interest | 1.00 | 1.50 |
| Loss on sale of investment | 0.11 | 0.00 |
| Depreciation | 0.50 | 1.00 |
| Total expenses | 46.61 | 52.50 |
| **Net Profit** | **5.39** | **7.00** |

Calculation of Operating Margin

| **Particulars** | **X Ltd. (in crores)** | **ABC Ltd. (in crores)** |
|---|---|---|
| Trading Income | 52.00 | 59.50 |
| Total Income | 52.00 | **59.50** |
| Operating Expenses | 45.00 | 50.00 |
| Depreciation | 0.50 | 1.00 |
| Operating Cost (TC) | 45.50 | **51.00** |
| Operating Profits (OP) | 6.50 | 8.50 |
| OP/TC | 13% | **14%** |

Since the margins earned by X Ltd. on its sales to Y Ltd. (related party) is less than that earned by comparable company, therefore the purchase transaction from a Y Ltd. perspective can be said to be at arm's length.

**Case Study-II:** A Ltd. is in the business of manufacturing of plastic products, it has its manufacturing unit in Haryana. B Ltd. is a wholly owned subsidiary of A Ltd. and is in the business of trading of plastics in raw form with its warehouse in Delhi. During F.Y. 2012-13 A Ltd. purchased plastic raw material from B Ltd. of INR. 5.40 crores. B Ltd. has supplied similar products to third party customers.

**Controlled Transaction:** Purchase of raw material

Now, the three conditions for the applicability of SDT provisions on A Ltd. are satisfied:

As per section 40A(2)(b)(iv) B Ltd. is a related party of A Ltd.

A Ltd. is liable to make payment to B Ltd. for the expenditure incurred for the purpose of business

The amount of transaction exceeds INR 5 crores

To benchmark the transaction following points needs to be analysed:

**Selection of Method:** CUP

To determine the arm's length price of the purchase transaction, it would be appropriate to benchmark the transaction with internal comparables considering that B Ltd also supplies similar products to third party customers.

| Particulars | Amount (INR) |
|---|---|
| Price charged from A Ltd. (FOB) | 36 |
| **Comparability adjustment:** | |
| Add: Freight and insurance charges | 2 |
| Add: Quantity discount (10% of 40 the third party price) | 4 |
| Arm's length price | 42 |

Since the price charged by B Ltd from related party (i.e., A Ltd.) and third party customer is same the transaction can be said to be at arm's length.

**Case Study III:** On 1st April, 2012, ABC Ltd. took a loan of INR 60 crores @ 9% p.a for 5 years from its holding company XYZ Ltd.

**Controlled Transaction:** Payment of interest of INR 5.2 crores to XYZ Ltd.

**Selection of Method:** Any other Method – as the comparable used in the case is a quotation from a bank.

To benchmark this transaction we would first need to analyse the terms and conditions of loan agreement. Also, the interest paid by ABC Ltd. could be compared with the interest rate quotes of bank(s) across India on the date on which such loan was taken.

**The interest rate quote offered by leading bank as on 1st April, 2013 – 10.5%.** Hence, the interest paid as per quote rate should have been INR 6.30 crores.

Since the rate at which interest is paid by ABC Ltd. to its related party is less than the prevailing bank rate the interest transaction is at arm's length.

**Case Study IV:** During the year the CO A has purchased telecommunications rights from CO B for INR 20 crores for 10 years. As per section 35 ABB the CO A would claim an equal amount of deduction in its return of income as under:

The amount deduction is in the nature of capital expenditure.

The AO is empowered to disallow this deduction if it is found that the purchase cost of the rights is excessive or unreasonable under section 40A.

Since the transaction is covered under section 40A same would fall in the ambit of section 92BA(i) if such rights are purchased from person referred under section 40A(2)(b) and arm's length price such rights needs to be determined.

To benchmark the purchase cost of the telecommunication rights any other method can be applied. A report from an independent valuer on the purchase cost of the rights can be used to justify the arm's length price of the transaction.

**Case Study V:** Managerial Remuneration

Owing to the amendments made *vide* Finance Act, 2012, the existing transfer pricing regulations have been made applicable to expenditure incurred or payments made towards persons specified under section 40A(2)(b) of Income-tax Act, 1961 (the IT Act), and this includes payment to or expenditure towards a director, which in turn, quite clearly includes remuneration to directors.

Applying the arm's length principle to director remuneration poses a challenge because remuneration to directors would vary across companies and would depend upon a combination of various factors. These factors could include: role and functions of a particular director; each company's ability and capacity to pay; specific business needs of each company; etc. Further, the importance of these factors itself would differ in every company.

The Companies Act, 1956 (Co's Act) contains various provisions relating to managerial remuneration, including remuneration to directors. Compliance with these provisions could be the starting point to defend Managerial remuneration.

**In case of a Public Co.**

If remuneration is paid according to the Co's Act/Bill then it will be at ALP supported by documentation of other factors and considerations, including internal company policy), qualitative background and profile of the KMP

**In case of a Private Co.**

If remuneration is paid in accordance to the Act then it will be at ALP subject to underlying computation to be demonstrated and documented). Also need to ensure documentation of other factors and considerations, necessarily including company's internal policy. If also not paid according to the Act then also can be concluded at ALP if documentation of other factors and considerations, necessarily including company's internal policy, is ensured.

In both the cases for private limited co. a corroborative analysis, may also consider information in public domain on remuneration paid to directors by competitors, etc. – essentially from financial statements, i.e. disclosure u/s 217(2a) of Co's Act and RPT schedule. Since this information may be insufficient/incomplete, it may be used only as an indicator. If director has shareholding then ALP can be proved in line with an External benchmark from a human resource firm/recruitment agency.

## G. Conclusion

Benchmarking under 40A(2) cases cover only expenditures and the general principals of international transfer pricing need to be applied as explained under the various case studies above. The six methods as available under the Act need to be applied.

The documentation needs to be from the perspective of the purchaser and therefore if the price paid by the purchaser is lower than the uncontrolled price it would mean that purchaser's price is not excessive or unreasonable and therefore comply with the arm's length perspective. Further, if profitability of the purchaser is benchmarked then this needs to be higher than comparables. However, if the tested party is the supplier then the margins earned by the supplier need to be equal to or lower than the comparables.

***(The views in this chapter are personal views of the author and they were assisted by CA Vandana Jain)***

CA Manisha Gupta & CA Setu Mankad

# Benchmarking – Guidance on benchmarking analysis for SDT in respect of 10A/80-IA cases

In addition to the payments made to persons covered under section 40A(2)(b) of the Income-tax Act, 1961 ('the Act'), the applicability of domestic transfer pricing provisions has been extended to:

i. transactions referred to in section 80A;

ii. transfer of goods or services referred to in sub-section (8) of section 80-IA;

iii. business transacted between the assessee and any other persons as referred to in sub-section (10) of section 80-IA;

iv. any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable.

The objective of introducing transfer pricing provisions for Specified Domestic Transactions (SDT) in respect of tax holiday units dealt with in Part C of Chapter VI-A and Chapter III (section 10AA) is to restrict the assessee from claiming inflated profits and to bring certainty in determining the market value of the goods and services. Accordingly, the taxpayer needs to demonstrate that the profits eligible for claiming such deductions, is not inflated through inter-unit or inter-company dealings of the eligible unit/enterprise.

Prior to the introduction of SDT provisions by Finance Act, 2012, such anti-abuse provisions already existed albeit using the concept of "market value" which was defined to mean the price such goods or services would fetch if they were sold/acquired from the open market. Further, section 80-IA(10) previously empowered the Assessing Officer ('AO') to re-compute eligible profit in case where the profits earned by the assessee was 'more than ordinary' profit due to close connection with any other person or due to any other reason. This has now been substituted with "arm's length price" as provided under section 92 of the Act.

Now, with the introduction of domestic transfer pricing, where the aggregate value of transactions defined under section 92BA of the Act exceeds ` 5 crores (including transactions referred to in section 80-IA(8)/(10)), the same is subject to domestic transfer pricing provisions which requires adherence to 'arm's length' principle in respect of inter-unit/inter-company dealings. What is pertinent to note here is with the introduction of provisions relating to SDT, the concept of 'market value' shifts to a more systematic and methodical approach of 'arm's length value'. 'Arm's length' price is a price which is applied or proposed to be applied in an uncontrolled transaction.

Section 80A is a general provision under Chapter VI-A laying down various principles based on

which deduction under this chapter is allowable. 80A(6) provides one of the principles that ALP is to be substituted in place of recorded values in certain cases. Many of the deductions under Chapter VI-A are now not available. Accordingly, it only applies to section 10AA, section 80-IA, section 80-IAB, section 80-IB, section 80-IC, section 80-ID, section 80-IE, section 80-JJA, section 80LA and section 80P.

Typical transactions undertaken by eligible units/enterprise that could get covered under the provisions of domestic transfer pricing include sale or purchase of goods an services, tools & spares, material, sale or purchase of capital goods, supply of power through captive power plants; providing and availing of various services; allocation of common costs, financial transactions such as loans and guarantees (in certain circumstances).

Having determined applicability of SDT with reference to provisions of Chapter VI-A of the Act, the next step is as mentioned in Section 92(2A) of the Act is that any allowance for expense, income, interest or allocation of cost in relation to the SDT shall be computed having regard to the 'arm's length price'. The arm's length price is computed based on various transfer pricing methods prescribed in section 92C of the Act read with Rule 10C of the Rules.

## Transfer Pricing Methods

The transfer pricing methods prescribed in section 92C of the Act for determining arm's length price of an international transaction is equally applicable for determining arm's length price of SDT including SDT referred to in sections 80-IA(8), 80-IA(10), 10AA, etc. Section 92C prescribes following methods for determination of the arm's length price:

(a) Comparable Uncontrolled Price (CUP);

(b) Resale Price Method (RPM);

(c) Cost Plus Method (CPM);

(d) Profit Split Method (PSM);

(e) Transactional Net Margin Method (TNMM);

(f) Such other method as may be prescribed by the Board. The Board has notified this *vide* Rule 10AB

CUP, PSM and RPM are price based method and also known as "traditional methods" whereas CPM and TNMM are profit based methods known as "transactional method". The arm's length price is required to be determined by selecting the 'most appropriate method' out of the above-mentioned methods. It is mandatory for the assessee to determine arm's length price of the international transaction or SDT by adopting any one of the above methods. While selecting the most appropriate method, various factors as given by section 92C(1) read with Rule 10C(2) of the Income-tax Rules, 1962 are required to be considered such as nature of transactions, nature of class of transactions, nature of class of associated enterprises, functions performed and other factors as may be prescribed by the Board. The Indian transfer pricing regulations does not provide any hierarchy or order of preference in applying the transfer pricing method but requires the assessee to select the most appropriate method on a sound and rational basis considering the facts of the case.

After selecting the most appropriate method, the next step is to apply the selected method in determining the arm's length price. Rule 10C(1) provided guidance on how each of the above method is required to be applied.

### *Comparable Uncontrolled Price Method*

CUP is a price based method which compares prices charged for property or services transferred in a controlled transaction to the prices charged for the property or services in a comparable uncontrolled transaction. CUP is considered as the most direct method since it deals with the prices of produce and services. CUP finds its applicability largely in transactions relating to sale or purchase of goods, availing or

rendering of services, financial transactions such as loan and guarantee, etc.

The comparable uncontrolled price can either be an internal price i.e. "internal CUP" or third party prices i.e. "external CUP". The example of internal price is the price at which eligible unit is supplying similar product to third party customers. Since the CUP method compares price of a product or services under controlled and uncontrolled transactions, high level of product similarity is of utmost important. If the product sold or services rendered under uncontrolled transaction is materially different then the controlled transaction, CUP method may not be suitable.

***Resale Price Method***

Under RPM, arm's length price of the international transaction or SDT is determined with reference to the gross profit margin. The RPM is most useful in selling and distribution operations wherein the reseller or distributor does not add substantial value to the product through use of tangible or intangible assets. The RPM begins with the price at which a product is resold in a comparable uncontrolled transaction. This price is then reduced by an appropriate gross margin from which the reseller would seek to cover its operating expenses and make an appropriate profit.

This method requires similarity in the functions and contractual terms although the similarity in the product under consideration is less important.

***Cost Plus Method***

CPM determines arm's length of a transfer price in a controlled transaction with reference to the markup realised in a comparable uncontrolled transaction. Unlike RPM, the CPM is generally appropriate where the enterprise is engaged in significant value adding activities. The CPM is typically applied in service transactions, transfer of semi-finished goods, long term buying and selling arrangements, etc.

Under cost plus method, direct and indirect costs incurred by the supplier or service provider. Since the CPM focuses on cost plus profit margins comparison, availability of cost base, reliable data, accounting consistency, etc., needs to be ensured for reliable application of CPM.

***Profit Split Method***

PSM evaluates whether the allocation of the combined profit or loss attributable to one or more controlled transactions is arm's length by reference to the relative value of each contribution to that combined profit or loss. The profit split methods are designed to be applied where transactions are very interrelated and cannot be reliably evaluated on a separate basis using one of the transactional methods. Profit split methods are particularly relevant when each party to the transaction has significant intangible assets and/or the operations of the parties to the transaction are highly integrated and cannot be evaluated on a separate basis.

PSM finds its applicability mainly in case of the transactions which involve transfer of unique intangibles or in case of multiple transactions which are so interrelated that they cannot be evaluated separately.

***Transactional Net Margin Method***

TNMM examines the net profit margin relative to an appropriate base (e.g., costs, sales, and assets) realised on the transaction. For example, return on capital employed, or the ratio of operating income to operating assets. While applying TNMM, the net margin (or other relevant base) earned under controlled transaction is compared with comparable uncontrolled transactions. Under the TNMM, it is essential that the comparables are broadly similar. Significant product diversity and some functional diversity between the controlled and uncontrolled transaction are generally acceptable.

***Other method***

In practice, establishing the arm's length principle in certain unique transactions, or

transactions where commercial arrangements between the parties play a significant role, becomes difficult. The CBDT notified a sixth method vide Rule 10AB allowing use of "any method". The sixth method allows use of "any method" which takes into account (i) the price that has been charged or paid or (ii) would have been charged or paid for the same or similar uncontrolled transaction, with or between third parties, under similar circumstances, considering all the relevant facts to determine arm's length price of the transaction.

The broad base of the sixth method would provide flexibility to the assessee in establishing arm's length prices, particularly in cases where strict application of the other five methods fails due to varied reasons including inherent difficulties in obtaining comparable data of actual transaction; uniqueness of transactions (such as transactions relating to business transfer, intangibles, commodities); transactions where independent valuation is the key; financial transactions; and transactions regulated by government.

***Comparability adjustments***

In applying each of the above referred method, comparability analysis is one of the key factors. Rule 10B(2) provides that while undertaking comparability analysis in application of the most appropriate method, the controlled transaction is compared to the uncontrolled transactions with reference to various factors such as character of property transferred or services provided, functions performed, risks assumed or assets employed, contractual terms, market conditions, geographical locations, market size, overall economic development of market, risk adjustment, working capital adjustment, etc. The uncontrolled transaction can be compared with the controlled transaction if either none of the above differences exists or an accurate/ reliable adjustment can be made for the above difference.

Based on the overview of applicability of the various methods discussed above, certain typical scenarios / transactions which may be covered under SDT are discussed herein below.

## Certain transactions and related issues

***Power sector – supply of power***

Many companies in India have set up captive power plants/wind mills to meet their internal power requirements. Typically, the power generating unit of the assessee supplies power for captive consumption to other units of the assessee. Power generating units claim tax holiday under section 80-IA. Many a times, if power generated by the unit is in excess of its requirements, the surplus power is sold in open market or to the State Electricity Board. Similarly, if power generated by the unit is not adequate to meet requirements of other units, then the other units would procure electricity from the State Electricity Board.

The transaction of supply of power by a power generating unit which is eligible for claiming tax holiday under section 80-IA to other units would be considered as a SDT if the value (along with the company's other SDT transactions) exceed ` 5 crores and would accordingly be required to meet the arm's length standard. The arm's length price is computed based on the six methods prescribed under section 92C of the Act.

In this case, various transfer prices could be involved namely, price at which power generating unit supplies electricity to other units of the assessee; price at which power generating units supplies surplus electricity in the open market or to the State Electricity Board, if any, price at which other units of the assessee obtain electricity from the State Electricity Board, if any, etc. Since various internal and external prices are available, the assessee may evaluate application of CUP method as the most appropriate method.

However, in the past tax authorities and the assessee have disagreed on the value at which power generating unit should supply power for the captive consumption. The dispute mainly

arises as to whether the price at which the non-qualifying units purchase power from the State electricity board can be considered as CUP and similar price can be charged by the qualifying captive power plant. Alternatively, whether the excess power sold by the captive power plant to State Electricity Board can be adopted as the market value.

There are number of judicial pronouncements which have upheld that the prices at which assessee purchases from the State Electricity Board can be considered as the market value for the purposes of section 80-IA(8)[1].

Further, the external CUP may also be available based on the prices of India Energy Exchange (IEX) since Electricity Act, 2003 permits sell of excess power on IEX from June 2007. However, if the prices quoted on IEX cannot be reasonably adjusted for the differences if any, then the same may not be accepted as appropriate CUP.

Another related issue faced by the industry is inclusion or exclusion of various taxes and duties in particular Electricity Duty while determining 'market value'. In the past there have been contradicting judgments[2] on this issue.

Additionally, TNMM method could also be adopted as a corroborative method whereby the profit of the captive power unit can also be benchmarked to demonstrate that it is earning an arm's length margin.

Thus, determining arm's length price for supply of power by power generating unit (claiming deduction under section 80-IA) to other units for captive consumption is a fact sensitive exercise and would depend on the facts and circumstances of each case.

*Inter-unit sale of goods and services*

One of the common transactions envisaged under section 80-IA(8) is inter unit transfer of goods and services from eligible units to other units of the assessee and vice versa. The pre-requisite is that there should actual transfer of goods and services. As held in *Cadila Healthcare Ltd. vs. ACIT [2012] (21 taxmann.com 483 – Ahd),* provisions of section 80-IA(8) cannot be applied assuming notional transfer of goods or services between units. Commonly in the manufacturing industry, the goods manufactured by one unit are transferred either as input material, semi-finished goods or finished goods for other unit. In such cases, the transfer price of such material, semi-finished goods or finished goods as the case may be is required to be justified from an arm's length perspective under SDT provisions.

The above transactions need to be analysed for applicability of the most appropriate method under section 92C read with Rule 10C of the Act. In case the similar material or goods is supplied or procured by eligible unit to or from third parties then CUP may be considered as an appropriate method subject to comparability criterion.

A cost plus method may also be explored since it has been experienced that the manufactured goods are generally transferred at the manufacturing cost plus markup basis. However, the availability of reliable data for applicability of cost plus method may pose constrain.

In this context, reference may be drawn from Rule 8 of the Customs Valuation Rules that where the excisable goods are not sold by the assessee but are used for captive consumption or on his behalf in the production or manufacture of other articles, the value of such goods shall be considered as cost plus 10% markup.

1 *Eveready Spinning Mills (P) Ltd. vs. ACIT [2012] (17 taxmann.com 254-Chennai); DCW Ltd., Mumbai vs. Department of Income Tax (2010 Mum) (37 SOT 322); Sri Matha Spinning Mills Ltd. vs. DCIT [2013] (21 taxmann.com.13-Chennai); ACIT vs. Jindal Steel and Power Ltd. [2007](16 SOT 509-Delhi); Alembic Ltd. in ITA No. 3594/Ahd/2007; West Coast Paper Mills Ltd. vs. ACIT 103 ITD 19 (ITAT Mumbai), Godavari power & Ispat Ltd. 16 taxmann.com 82 (ITAT Bilaspur); Sri Velayudhswamy Spinning Mills (P.) Ltd. vs. DCIT 19 taxmann.com 28, etc.*

2 *CIT vs. Shah Alloys Tax Appeal No. 2092 of 2010 (Gujarat HC); CIT vs. Pragati Glass Works Pvt. Ltd. in Tax Appeal No. 1646 of 2010 (Gujarat HC).*

If CUP or any other method is not applicable, then TNMM could be considered as the most appropriate method. Under TNMM, net level profitability in respect of transaction of eligible unit can be compared with net level profitability of broadly similar comparable companies available in the public domain. The comparable companies are selected using publicaly available databases and following methodical search process. Such comparable companies are selected through applying various quantitative and qualitative selection criterion. For example, as the eligible unit is supplying goods to another unit in India, then appropriate filters should be applied to select companies which are predominantly supplying in the domestic market and not to foreign markets. Drawing experience from the international transfer pricing, selection of comparable companies may be one of the key areas of dispute with the tax authorities in the future.

*Allocation of common overhead costs*

The transaction here is the allocation of common overhead costs like accounting, administration, human resources, legal, etc., incurred by the head office to the qualifying units in view of domestic transfer pricing provisions.

The issue which arises for consideration is whether this transactions would at all be covered under section 80-IA(8) or 80-IA(10) of the Act.

One school of thought is that under sections 80A(6) and 80-IA(8), the scope of the section is limited to 'transfer of goods or services held for the purposes of' qualifying unit to or from any other 'business' carried on by the taxpayer. Further, CBDT Circular No. 14 of 2001 explaining the object of the amendment to section 80-IA(8) to include 'services' in the Finance Act, 2001 clarifies that it is intended to cover services of 'marketable nature'. Therefore, allocation of common headquarter charges may not satisfy the test of transfer of goods or services.

However, based on various Tribunal judgments[3], it has been held that such costs are required to anyways otherwise be considered on general accounting principles while computing the profits of a tax holiday qualifying unit independent of Section 80A(6) or Section 80-IA(8) or 80-IA(10).

Where such common overhead costs are allocated to qualifying units the benchmarking methodology and analysis, there are no explicit guidelines under the Indian transfer pricing regulations which lays down how to determine arm's length of cost allocation. Reliance is therefore placed on OECD Guidelines and tribunal judgments in the case of international transactions which provides certain guidelines on factors that should be considered while determining arm's length nature of intra-group charges or cost allocation. Mainly, these factors are (a) determine whether the services were required or are duplicative or shareholders activity in nature; (b) demonstrate that the services have actually been received; (c) demonstrate with adequate documentary evidence/quantification as to whether the recipient is benefited by availing the services; and (d) determine the basis of cost allocation i.e. allocation keys and where there is a mark-up, benchmark with other comparable companies to determine that the mark-up is comparable.

***Has an intra/inter-group service been provided***

Understanding and documenting the nature of the service is the first step in supporting that the transaction has actually occurred.

Evidentiary support of the services may be in the form of internal correspondence i.e. emails and notes of meetings with visiting personnel, any internal documents that have been prepared and shared with the service recipient such as manuals, guides, templates, policies.

3 *Wipro GE Medical Systems Ltd. vs. DCIT (2003) 81 TTJ 455 (Bang), ACIT vs. Asea Brown Boveri Ltd. (2007) 110 TTJ 502 Mum), Nahar Spinning Mills vs. JCIT ( ITA No.64/Chd/2011)*

*Identifying the benefits*

A benefit tends to be considered in terms of having an economic or commercial value, where an independent enterprise would expect to pay to receive it or be paid for supplying it. Thus, benefits can be considered with reduction in external costs or increase in revenue or profits or reduction in attrition levels for HR services.

There may be situations where activities have been performed that are not beneficial to or needed by the service recipient i.e. for which a third party arguably would not pay for such service. Such activities are —

*Shareholder activities* – These are activities that are performed solely for shareholder's benefits i.e. consolidation of accounts, shareholder meeting expenses, etc.

*Duplicative activities* – This is where a company/unit that has its own personnel or receives third party support also receives similar services from its group company/head quarter.

*Determining the cost base and allocation of costs*

The costs should include both direct and indirect costs. A direct cost is usually the salaries of the service providing personnel and any specific costs incurred by the service provider for the service recipient. Indirect costs are overhead expenses that can be allocated to the relevant personnel providing the services.

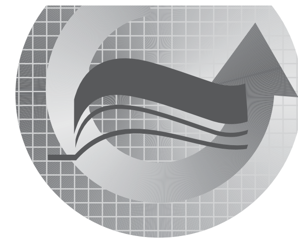
The selection of an appropriate allocation key will depend on the nature of the service. Types of allocation keys include revenue, head count, IT desks, units produced, capital invested. The allocation key used should be appropriate to the costs to be allocated and should be clearly documented i.e. HR costs should typically be allocate based on headcount, IT costs on IT desks, etc.

*Financial transactions – loan and guarantee*

Another typical transaction is where one company provides a loan to its group company which is claiming 80-IA deduction. The issue which needs to be determined is whether the 80-IA availing Company is paying arm's length interest as if it pays lesser interest it would result in more than ordinary profits under section 80-IA(10). Benchmarking of financial transactions for international transactions is one of the most litigious issues in the current Indian transfer pricing environment.

Rate of interest is generally benchmarking considering CUP as the most appropriate method wherein rate of interest on loan given by the lender or rate of interest on loan obtained by the borrower from third parties, could be considered as internal CUP for comparability analysis. In absence of internal CUP, the assessee may also consider external CUP of interest rates available in the public domain. While rate of interest in the international transaction is usually judged with reference to LIBOR plus basis points, for SDT, Prime Lending Rate (PLR) could be potential external CUP.

However, where CUP is to be used there are many factors which could determine the comparable rate of interest such as financial strength of the borrower, contractual terms of the loan, purpose of the loan, repayment period and terms, security, prevailing market conditions, etc.. All these factors need to be considered and suitable adjustment should be made (if required) to arrive at comparable uncontrolled rate of interest.



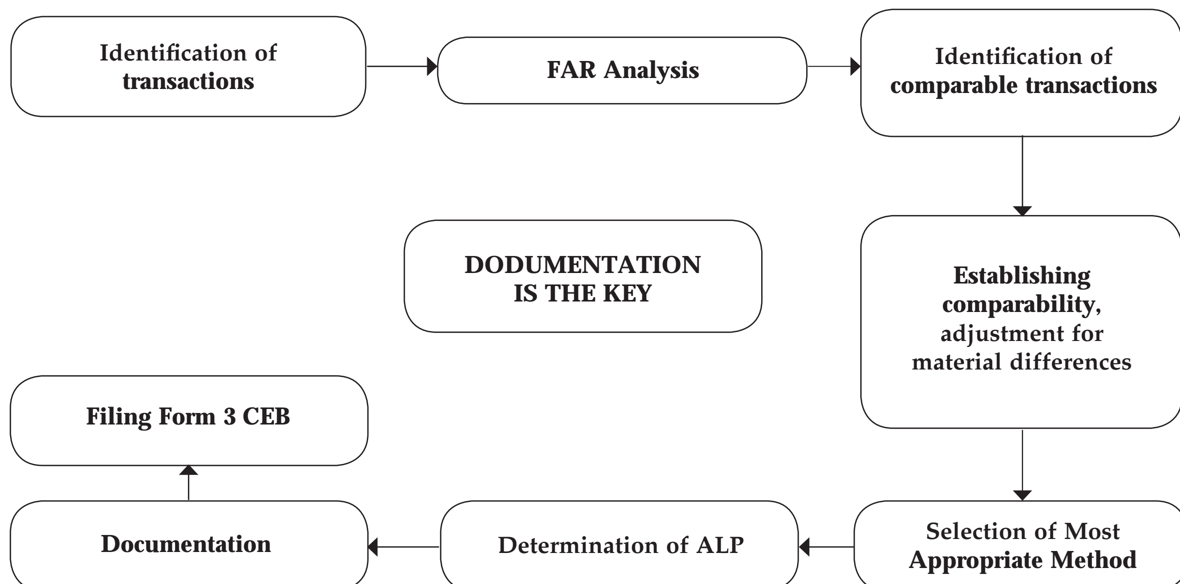
CA Sudhir Nayak

# Documentation and Certification

## I. Background

By virtue of Finance Act, 2012, the gamut of Transfer Pricing (TP) gets extended to certain Specified Domestic Transaction (SDT) with effect from financial year 2012-13. The apex court by landmark judgment in case of Glaxo SmithKline recommended introduction of such provisions. It is pertinent to note that domestic transfer pricing is only applicable if aggregate value of specified domestic transaction exceeds ` 50 million.

Transfer pricing process can be summarised as below:




## II. Documentation

Section 92D read with Rule 10D of Income Tax Rules obligates taxpayer to maintain contemporaneous documentation for a period of 8 years from the end of relevant assessment year.

Every person who has entered into SDT shall keep and maintain the following documents:

| Entity related | Transaction related | Price related | Supporting documents |
|---|---|---|---|
| • Description of the ownership structure<br>• Profile of group<br>• Broad description of the business and industry<br>• Profile of related parties | • Nature and terms of transactions<br>• FAR analysis<br>• Record relating to economic analyses, market analyses, forecasts, budgets, etc.<br>• Record relating to uncontrolled transactions | • Description of the methods considered<br>• Assumptions, policies and price negotiations<br>• Details of adjustments | • Official publications, reports by government, institutions of repute, stock exchanges<br>• Financial statements |

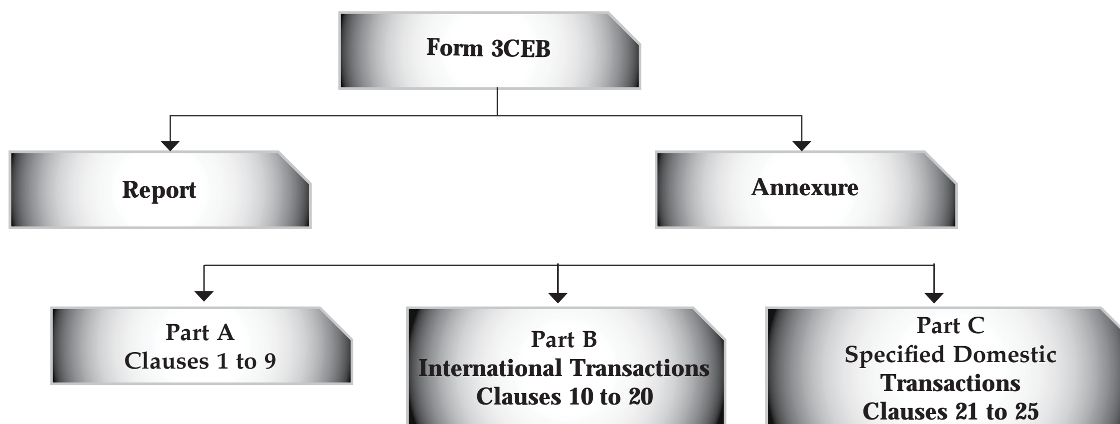
Illustrative list of documents that needs to be maintained for transactions:

| Transactions entered | Documents to be maintained | |
|---|---|---|
| Purchase/Sale of raw material/goods | – Invoices<br>– Purchase/Sale order<br>– Product Details<br>– Sale details if 3rd Party sales | – Pricing strategy<br>– Proof of price negotiations<br>– Quotes from competitors<br>– Terms of payment |
| Corporate cost sharing | – Nature of expenses<br>– Auditor's certificate allocating the expenses – Cost benefit analysis | – Basis of allocation between the companies<br>– Proof of usage (rendering) of services |
| Remuneration to Directors | – Qualification<br>– Work Experience & Profile<br>– Minutes of Meeting authorizing the director's remuneration | – Data from HR firms for Directors in the same line of business<br>– Basis of determination of such amount |
| Rent paid towards use of premises | – Rent receipts<br>– Documents suggesting the rent of the surrounding area | – Rental agreement<br>– Fair market value of the property (municipal valuation, only if higher than actual rent paid) |
| Reimbursement of expenses | – Nature of expenses with detailed break-up<br>– Reason of expenses incurred for | – Employee details<br>– Actual invoices of the expense |
| Interest on loan (non-financial services company) | – Basis of determination of interest rate<br>– Interest Rate Card for the period of loan | – Loan agreement<br>– Basis on which the interest rate is pegged above standard rate |

***Failure to maintain proper documents will attract penalty at 2% of the value of specified domestic transactions.***

## III. Accountants Report to be furnished under section 92E

Section 92E read with Rule 10E binds the person who has entered into international transactions and SDT to obtain the report of a chartered accountant in the prescribed format (Form 3CEB). This form is the basis of reporting the transactions within the purview of TP and the same needs to be filed with the tax authorities by way e-filling[1]. The broad portrait of Form 3CEB can be depicted by the following format:




### Clause 21: List of associated enterprises with whom the taxpayer has entered into specified domestic transactions

The taxpayer is required to furnish complete details in respect of associated enterprises with whom the company has transacted during the previous year. In addition to this, the clause requires mentioning the nature of relationship i.e. under which section and relevant clauses are the entities related. The taxpayer also needs to obtain PAN and business description of such entities. Further, since the completeness of identification of associated enterprises is the responsibility of the taxpayer, the accountant should obtain suitable representation from the management.

### Clause 22: Transaction in nature of payment of any expenditure to person referred to in section 40A(2)(b)

Any dealings with parties covered under section 40A(2)(b) needs to be reported under this clause. It is important to note that only expenditure or payments are considered under this clause. The expenditure referred above includes all types of revenue transactions with related persons. Accountant may refer to or rely on AS 18 or reporting under section 40A(2)(b) Form 3CD (Tax Audit report).

### Clause 23(A) – Transfer/rendition of any goods or services from/by eligible business of the taxpayer to any other business

Clause 23(A) requires taxpayer to report of details transfer of good and services by any eligible business unit claiming benefits under sections 80A(6), 80-IA(8) and 10AA to any other business carried on by the taxpayer.

### Clause 23(B) – Acquisition/availment of any goods or services by eligible business of the taxpayer from another business of the taxpayer

Similar to clause 23(A), taxpayer have to report particulars relating to acquisition of goods

1 CBDT via Notification 34/2013 dated 1-5-2013 made mandatory online filing of Form 3CEB

and services by eligible business unit claiming benefits under sections 80A(6), 80-IA(8) and 10AA to any other business carried on by the taxpayer under this clause.

## Clause 24 – Any business transacted by an eligible business

Any business transacted between the eligible unit and any other unit of the taxpayer that resulted in "more than ordinary profit" to eligible unit needs to be reported under this clause.

## Clause 25 – Any other transaction

This clause requires the accountant to report any other specified domestic transaction not covered under any other clause.

***Failure to furnish accountant's report will result in penalty of ` 100,000/-***

## IV. E-filing

Pursuant to amendment in Rule 12 of Income Tax Rules, by notification 42/2013 dated 11-6-2013, the following proviso has been inserted in sub-rule (2) of rule 12:

"**Provided that** where an assessee is required to furnish a report of audit specified under sub-clauses (iv), (v), (vi) or (via) of clause (23C) of section 10, section 10A, clause (b) of sub-section (1) of section 12A, section 44AB, section 80-IA, section 80-IB, section 80-IC, section 80-ID, section 80JJAA, section 80LA, section 92E or section 115JB of the Act, he shall furnish the same electronically."

*Procedure to be followed:*

**Phase 1: CA needs to obtain CA login and get registered on Income tax website**

- Every CA/ partner in a firm needs to register himself on the Income tax site
- Select "Tax professional" > "Chartered Accountant" and get registered

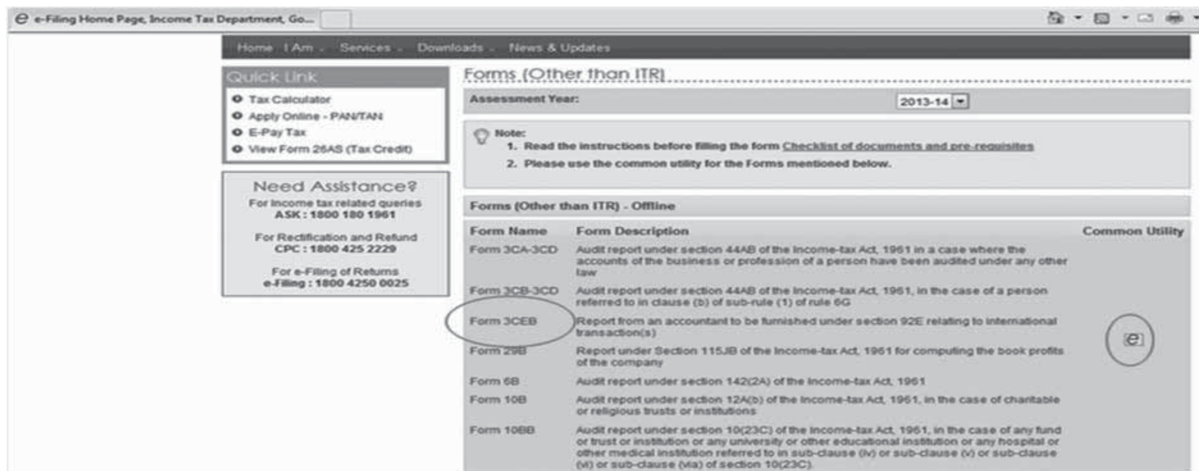
**Phase 2: Taxpayer needs to add CA to his profile**

- Taxpayer needs to add CA for each form/ certificate that needs to be uploaded
- Without "adding CA" by taxpayer, the CA cannot upload Form 3CEB and hence taxpayer cannot approve the same
- This can be done by taxpayer by login to his account > my account > add CA

**Phase 3: Downloading, preparing Form 3CEB report utility (this can be done offline) and generating XML file**

*Preparing & Uploading of Report:*

1. Utility can be downloaded from the link: https://incometaxindiaefiling.gov.in/



2. Open the utility and click on : File>New Form>Form3CEB

3. Fill the basic details

Instructions | Form - 3CEB | Annexure PART A | Annexure PART B (International Transactions) | PART C (Specified domestic transaction)

**FORM 3CEB**

**[See rule 10E]**

**Report from an accountant to be furnished under section 92E relating to international transaction(s) and specified domestic transaction(s)**

1 * Select have examined the accounts and records of * Name

* Address

* PAN

relating to the international transaction(s) and specified domestic transaction(s) entered into by the assessee during the previous year ending on 31st March, * Select

2 In opinion proper information and documents as are prescribed have been kept by the assessee in respect of the international transaction(s) and the specified domestic transaction(s) entered into so far as appears from examination of the records of the assessee.

3 The particulars required to be furnished under section 92E are given in the Annexure to this Form. In opinion and to the best of information and according to the explanations given to , the particulars given in the Annexure are true and correct.

Name : *

Address: *

4. Fill the details of taxpayer in Part A

5. Fill the details of international transaction in Part B

6. Fill the details of Specified domestic transactions in Part C

7. After completing the Form 3CEB, click on "Validate" option on top

8. Validation errors are displayed on right side of the screen:

e-Filing | Open Draft | Save Draft | Validate | Generate XML | Previous | Next | Form 3CEB (Page 5 of 5)

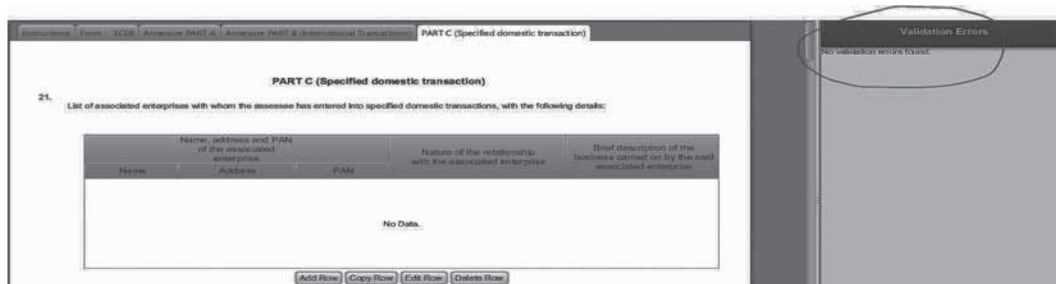
No Data

Validation Errors

Please select I/We from the drop down option in Point 1.
Please enter Name in Point 1.
Please enter Address in Point 1.
Please enter PAN in Point 1.
Previous Year in point 1 is mandatory.
Please enter the name of the CA or the name of the signing ...
Please enter the address of the firm
Please enter Membership no. of the CA signing the report
Please enter the place of signing of the report
Please enter a valid date of signing of the report
Please select Status from drop down option in point 5, Part A
Please select Nature of business or activities in point 4
Please enter aggregate value of international transactions as...
Please enter Aggregate value of specified domestic transacti...
Point 22 is compulsory in Part C. If there is no information to...

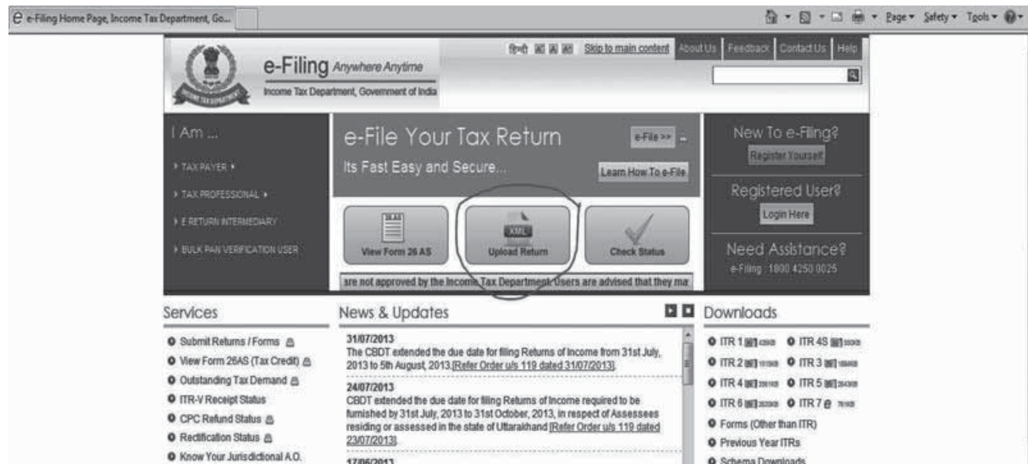
9. If the amount of SDT is 0, then no need to fill clauses 21-25

10. No validation error> then proceed with generating XML, Click on "Generate XML"




11. XML generated at desired location

12. Upload the file on “https://incometaxindiaefiling.gov.in/e-Filing/”




### Phase 4: Taxpayer needs to approve the Form uploaded by the CA

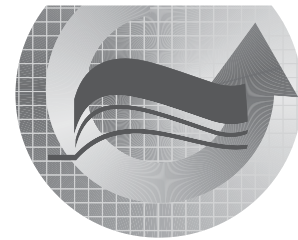
- Taxpayer will have to check in “work list”
- List of forms uploaded by CA will appear
- Select the form that needs to be approved
- Approve or reject
  - To approve : Affix digital signature
  - To reject : Mention the reason for rejection

Wherever I found a living creature, there I found the will to power.

*— Nietzsche*

The great artists of the world are never Puritans, and seldom even ordinarily respectable.

*— H. L. Mencen*



CA Nihar Jambusaria

# Guidance Note issued by the ICAI – and accounting issues

## Overview

Transfer pricing (referred to as TP) regulations introduced in India in 2001, previously covered only cross border related party transactions. The Indian Transfer Pricing Regulations (Indian TP Regulations) comprise of sections 92 to 92F of the Income-tax Act, 1961 (Act) and Rules 10A to 10T of the Income Tax Rules, 1962 (Rules) which guide computation of the transfer price and suggest detailed documentation procedures.

The Finance Act, 2012 has extended its scope to cover certain domestic transactions with related parties within India, defined as 'Specified Domestic Transactions' (referred to as SDT) by insertion of section 92BA in the Act. The Indian TP Regulations are applicable to SDTs from 1st April, 2012.

By extending TP provisions to SDT, pricing of these transactions will need to be determined with regard to arm's length principles using methods prescribed under Indian TP regulations.

The ICAI has issued a 'Guidance note on report under section 92E of the Act (Transfer Pricing)' last revised in August, 2013. The said Guidance note analyses the provisions of SDT of the Act. This article discusses the contents of the Guidance note and related issues.

Section 92BA of the Act provides the transactions which will be covered within the ambit of SDT if the aggregate value of such transactions exceeds a threshold of Rs 5crore in aggregate during a financial year:

i. *any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;*

ii. *any transaction referred to in section 80A;*

iii. *any transfer of goods or services referred to in sub-section (8) of section 80-IA;*

iv. *any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;*

v. *any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or*

vi. *any other transaction as may be prescribed*

## ➢ Threshold Limit

- *Threshold not applicable internally for each limb of the definition*
  All the transactions covered under the six limbs will be considered as SDT **only if the aggregate value of all transactions** exceeds threshold of ` 5 crore. If the threshold limit is crossed, the taxpayer will be required to comply with TP requirements with reference to all

the transactions regardless of the fact that the value of transactions under one of the limbs may be less than ` 5 Crores.

- *Computation of threshold limit*
  The threshold limit is required to be examined by adopting values as reported by the assessee on the basis of entries in his books of account.

  The method of accounting regularly followed by the assesse would determine the basis of computing the threshold. If the assessee is availing credit of indirect taxes, the threshold limit for SDT can be computed on net basis (i.e., without including indirect tax levies like service tax, VAT, etc.). However, if the assessee is not availing credit of indirect taxes, the threshold limit can be computed on gross basis.

- *Comparison with threshold limit required to be done on a year on year basis*
  The comparison with threshold is required to be done on a year on year basis. It is possible that SDT may not apply in a particular year since the aggregate value of all transactions does not exceed ` 5 crore whereas it may apply in subsequent year on account of crossing the threshold limit.

## ➢ Expenditure in respect of payments made to persons referred to in section 40A(2)(b) of the Act

Section 40A(2)(a) of the Act states the following:

*'Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-section, and the Assessing Officer is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction.'*

The following proviso has been inserted in sub-section (2)(a) of section 40A by the Finance Act, 2012, w.e.f. 1-4-2013 :

*'Provided that no disallowance, on account of any expenditure being excessive or unreasonable having regard to the fair market value, shall be made in respect of a specified domestic transaction referred to in section 92BA, if such transaction is at arm's length price as defined in clause (ii) of section 92F.'*

- *Transactions in the nature of 'income' not covered?*
  This provision includes only the expenditure side and would not have any impact in the hands of the recipients of such payments. The persons/ entities receiving such income will not be subject to SDT under this provision.

  Therefore, only the persons/ entities incurring such expenditure would be subject to SDT and would be required to comply with the relevant transfer pricing provisions.

- *Expenditure claimed as deduction under 'income from other sources' also covered*
  Section 58(2) of the Act states that provisions of section 40A of the Act are also applicable for computation of taxable income under 'income from other sources'.

  Section 58(2) of the Act states the following:

  *The provisions of section 40A shall, so far as may be, apply in computing the income chargeable under the head 'Income from other*

*sources' as they apply in computing the income chargeable under the head 'Profits and gains of business or profession'.*

Hence, the said provisions are applicable to expenditure claimed as deduction under the head 'income from other sources' on account of specific direction in section 58(2) of the Act.

- *Only certain types of capital expenditure covered*
The said provisions are applicable only to that capital expenditure which has been fully claimed as deduction under other provisions.

For example –

i. Deduction claimed under section 35(2AB) of the Act on expenditure on know-how;

ii. Deduction claimed under section 35 of the Act on expenditure on scientific research;

iii. Deduction claimed under section 35AD of the Act on expenditure on specified business.

> *The Finance Act, 2012 has amended the list of specified persons to include transactions between persons/ companies wherein another person/ company has substantial interest in both such transacting persons/ companies.*

- *What is substantial interest?*
The explanation to section 40A(2)(b) of the Act states that a person shall be deemed to have a substantial interest in a business or profession,

if,—

a) *in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) carrying not less than twenty per cent of the voting power; and*

b) in any other case, such person is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the profits of such business or profession.

Based on the above, the threshold for substantial interest to qualify as 'specified persons' is twenty per cent or more. However, as per section 92A(2) of the Act, the term associated entities is clearly defined to include an enterprise holding directly or indirectly shares carrying not less than twenty six per cent of the voting power in the other enterprise.

Accordingly, if I $Co_1$ purchases goods from I $Co_2$ in which it has a 24% equity stake at any time during the previous year, such an expenditure transaction will qualify as a specified domestic transaction. I $Co_1$ would be subject to SDT and would be required to comply with the relevant transfer pricing compliances.

- *Exclusion of international transaction from scope of SDT does not imply that all transactions with non-residents are not subject to SDT*
The Guidance note does not specifically discuss this issue. There could be a SDT which may be cross border and either or both parties to the transaction could be a non-resident as the threshold trigger for SDT and international transfer pricing differs.

For example – I Co an Indian company may make payment to F Co, a foreign company, which holds 21% in I Co. I Co and F Co are not associated enterprises as threshold of 26% is not met. However,

payment by I Co to F Co is covered under section 40A(2)(b) of the Act and would be subject to SDT provisions.

- *Indirect subsidiaries also to be considered?* The phrase 'directly or indirectly' is not used in sections 40A(2)(b) of the Act as mentioned in section 92A(2)(a) and (b), which defines the term

  'associated enterprise' for the purposes of international transactions.

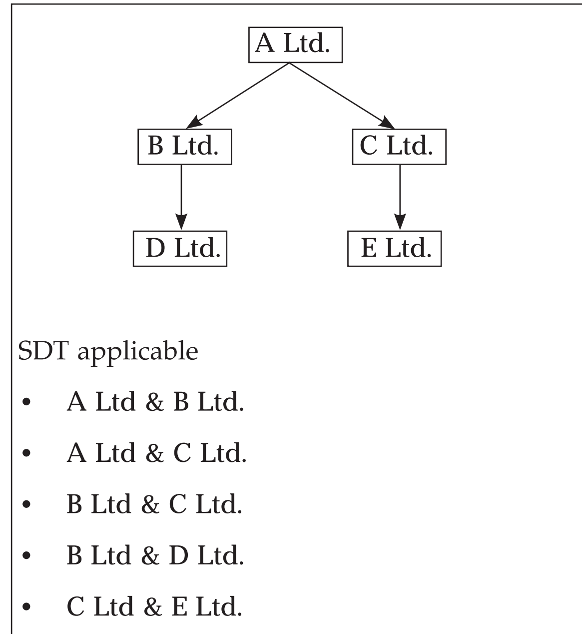
  In this regard, reference should be made to the Central Board of Direct Taxes (CBDT) Circular number 6-P dated 6th July, 1968 explaining the then newly inserted provisions in section 40A(2) of the Act. The circular sets out the categories of the persons and payments to which specified persons would be covered within the provisions of section 40A(2). It states that such persons would include inter alia – "(c) persons in whose business or profession the taxpayer has a substantial interest directly or indirectly".

  However, Explanation to section 40A(2) of the Act deems a person to have substantial interest if such person is 'beneficial owner' of shares carrying not less than twenty per cent of voting power.

  The term 'beneficial ownership' is not defined in the Act. It is to be construed in contrast to 'legal owner' and not in context of determining indirect ownership of shares. Therefore, the emphasis is on covering the real owner of the shares and not the nominal owner.

  This proposition is also supported by legal jurisprudence which states that in a multi-tier structure, a parent cannot be regarded as the beneficial owner of shares in a downstream subsidiary merely because it owns the shares of the intermediate subsidiary companies.

  It is important to respect the fact that the entities are separate legal entities.




## ➢ Transactions covered under section 80A of the Act

The second limb of section 92BA of the Act covers all the transactions referred under section 80A of the Act. Though the reference is given for the transactions referred in section 80A of the Act, on examining it in detail, it covers only those transactions which are referred under section 80A sub-section (6) and not to other sub-sections. The other sub sections do not deal with the fair pricing mechanism.

> *It is pertinent to note that section 40A(2)(b) covers only expenditure transactions. However, the provisions of section 80A(6) covers both income as we as expenditure transactions of the eligible unit.*

The same is also supported by the corresponding amendment made in the Explanation of expression 'market value' of the said section in Finance Act, 2012, which states that in case of the specified domestic transactions, the market value shall be computed at Arm's Length Price as defined under section 92F sub-clause (ii) of the Act.

As per section 80A(6) of the Act, any transfer of goods or services from an eligible undertaking or unit or enterprise to any other business of the assessee or vice versa should be done at market value as on the date of transfer.

Also, if the value of transaction does not cross the threshold limit of ` 5 crore, the same will still be governed by unamended provisions of section 80A(6) of the Act and fair market value will be determined on general principles.

## ➢ Transfers referred to in section 80-IA(8) of the Act

The third limb of section 92BA covers all such transfers of goods or services as referred under section 80-IA(8) of the Act.

This section provides that any transfer of goods or services from one eligible unit to another unit or vice versa of the same assessee, shall be done at market value.

The Finance Act, 2012, amended the explanation to section 80-IA(8) defining 'market value'. Market value shall be computed at arm's length price as defined under section 92F sub-clause (ii) of the Act for all the transactions fall under the purview of SDT.

▪ ***Transactions between two eligible units covered***

The Guidance Note is silent on this issue. The transactions between both the profit linked holiday qualifying units are covered under section 80A(6) and /or section 80-IA (8) of the Act and will fall within the ambit of SDT. The AO is allowed to make TP adjustments to determine the quantum of deduction available in respect of profits of each of the qualifying units. The conservative view is to voluntarily benchmark the transaction at arm's length price and report such transactions.

## ➢ Transfers referred to in section 80-IA(10) of the Act

The forth limb of section 92BA covers all the transactions between the assessee carrying on eligible business under the said section and any other person owing to 'close connection'.

| The term 'close connection' is not defined under the Act. |
|---|

## ➢ Arm's Length Price

Section 92C(1) of the Act stipulates that the arm's length price is to be determined by adopting any one of the following methods, being the most appropriate method:

- Comparable Uncontrolled Price Method (CUP Method)
- Resale Price Method (RPM)
- Cost Plus Method (CPM)
- Profit Split Method (PSM)
- Transactional Net Margin Method (TNMM)
- Other Method (OM) as prescribed by the Board and provided in Rules 10AB and 10B

## ➢ Selection of most suitable method

Rule 10C(1) states that the method to be selected shall be the one that suits the best

as per the facts and circumstances of each transaction and that provides the most reliable measure of the arm's length price. Rule 10C(2) lists the specific factors that should be taken into account in the process of selecting the most appropriate method.

### ➢ Maintenance of information and documents

Rule 10D(1) lays down thirteen different types of information and documents that a person has to keep and maintain.

These information is broadly classified into three types:

a) Enterprise-wise documents

b) Transaction-specific documents

c) Computation related documents

### ➢ Report under section 92E

Every person who has entered into international or specified domestic transaction during a previous year shall obtain a report in Form 3CEB and furnish such report on or before 30th November of the relevant year. The form is required to be duly signed and verified in the prescribed manner by the accountant and setting forth such particulars as may be prescribed.

### ➢ Penalties for non-compliances of Domestic Transfer Pricing provisions

| | | |
|---|---|---|
| 271(1)(c) | In case of an adjustment post assessment, if regarded as concealment of income | 100-300% of the tax leviable on the amount of adjustments |
| 271AA | Failure to maintain TP documentation, failure to report the transaction, maintenance or furnishing of incorrect information/document | 2% of the value of the transactions |
| 271BA | Failure to furnish Form 3CEB | INR 100,000 |
| 271G | Failure to furnish TP documentation with the tax officer | 2% of the value of the transactions |

## Conclusion

SDT will not be limited to large groups. Many mid-sized groups, partnership firms, HUFs and even individuals in smaller cities will now have to adhere to the TP laws. Certain expenses, transfer of goods and services between related parties, extraordinary profits and profits earned by SEZs / tax holiday units will now be liable for scrutiny by TPOs. This will lead to an increase in the administrative and compliance burden for the taxpayer in respect of such transactions. While the Advance Pricing Agreement (APA) regime has been introduced with respect to international transactions, the same benefit has not been extended for domestic transactions.

I thank CA Ms. Akshata Kapadia and CA Kushal Shah for helping me in the research required to be done for this article.

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*Wigley India (P.) Ltd.*

B.V. Jhaveri, *Advocate*

# DIRECT TAXES
## Supreme Court

### Alternate remedy – Notice u/s. 153C – Writ not maintainable

*CIT vs. Vijaybhai N. Chandrani (SC) [(2013) 91 DTR (SC) 202]*

The Respondent had purchased a plot of land in Samutkarsh Co-operative Housing Society which was developed by M/s Savvy Infrastructure Ltd. A search was conducted under section 132 of the I.T. Act at the premises of the Samutkarsh Co-operative Housing Society and Savvy Infrastructure Ltd. in the year 2008. During the course of the search, certain documents pertaining to the Respondent were found and seized. Thereafter, on the basis of these documents notices under section 153C of the Act were issued to the Respondent for assessing his income for six assessment years preceding the assessment year relevant to the previous year in which the search was conducted i.e., from A.Ys 2001-02 to 2006-07.

The Respondent *vide* letter dated 11th November, 2009 requested the petitioner to provide copies of the seized material and also asked for an extension to file the return. In response, the Petitioner supplied copies of three loose sheets of paper seized during the search. The Respondent filed a writ challenging the validity of such notices issued under section 153C of the Act without filing objections for issuance of notices under section 153C of the Act before the Assessing Officer.

The Gujarat High Court allowing the writ petition quashed the said notices issued u/s. 153C of the Act on the ground that documents seized by the petitioner under section 132A did not belong to the Respondent and therefore, the conditions precedent for issuance of the notice under section 153C is not fulfilled.

On appeal, the Supreme Court set aside the decision of the High Court and held as under:

"13. In the instant case, it transpires from the record that the jurisdictional Assessing Authority, upon having a reason to believe that the documents seized indicate escapement of income, has issued Show-Cause Notices under section 153C to the assessee for reassessment of his income during the assessment years 2001-02 to 2006-07. Thereafter, upon request of the assessee, the Assessing Authority has furnished him with the copies of documents seized under Section 132A. The assessee being dissatisfied with the said documents instead of filing his explanation/reply to the Show-Cause Notices, has filed a Writ Petition before the High Court impugning the said notices.

"14. In our considered view, at the said stage of issuance of the notices under section 153C, the assessee could have addressed his grievances and explained his stand to the Assessing Authority by filing an appropriate reply to the said notices instead of filing the Writ Petition

impugning the said notices. It is settled law that when an alternate remedy is available to the aggrieved party, it must exhaust the same before approaching the Writ Court. ….. ."

"17. In view of the above, without expressing any opinion on the correctness or otherwise of the construction that is placed by the High Court on section 153C, we set aside the impugned judgment and order. Further, we grant time to the assessee, if it so desires, to file reply/objections, if any, as contemplated in the said notices within 15 days' time from today. If such reply/objections is/are filed within time granted by this Court, the Assessing Authority shall first consider the said reply/objections and thereafter direct the assessee to file the return for the assessment years in question. We make it clear that while framing the assessment order, the Assessing Authority will not be influenced by any observations made by the High Court while disposing of the Writ Petition. If, for any reason, the assessment order goes against the assessee, he/it shall avail and exhaust the remedies available to him/it under the Act, 1961."

## Right of the shareholder to use and occupy a flat which is allotted by a company through its Article of Association confers ownership rights in the flat and thus entitled to be mortgaged

***Hill Properties Ltd. vs. Union Bank & Others Civil Appeal 7939 of 2013 Judgment dated 11th September, 2013***

Hill Properties Ltd., the appellant company by its Articles of Association had allotted a flat to its shareholder and permitted the shareholder to use and occupy the said flat. The shareholder mortgaged the said flat allotted to him by the appellant company as a security against the loan taken from the Union Bank of India. Thereafter, on default in repayment of the loan, the Debt Recovery Tribunal (DRT) passed an order of attachment of the said flat. The appellant company claimed that it was the owner of the flat and the shareholder had a mere right to use and occupy the flat. Thus, the mortgage of the flat by the shareholder was void. The High Court rejected the contention and held that the shareholder had the right to mortgage the flat. The Supreme Court relying on the decision of *Ramesh Himatlal Shah vs. Harsukh Jadhavji Joshi (1975) 2 SCC 105* dismissed the appeal and held as under:

"The right, title & interest over a flat conveyed is a species of property, whether that right has accrued under the provisions of the Articles of Association of a company or through the bye-laws of a Co-operative Society. Flat owners' right to dispose of its flat is also well recognized, and one can sell, donate, leave by will or let out or hypothecate his right. By purchasing the flat, the purchaser, over and above his species of right over the flat, will also have undivided interest in the common areas and facilities, in the percentage as prescribed. Flat owners will also have the right to use the common areas and facilities in accordance with the purpose for which they are intended. It is too late in the day to contend that flat owners cannot sell, let, hypothecate or mortgage their flat for availing of loan without permission of the builder, Society or the company. The Articles of Association of a company have no force of a statute and the right of the shareholder to mortgage could not have been restricted by the Articles of Association. Neither the Companies Act nor any other statute make any provision prohibiting the transfer of species of interest to third parties or to avail of loan for the flat owners' benefit. A legal bar on the saleability or transferability of such a species of interest will create chaos and confusion. The right or interest to occupy any such flat is a species of property and hence has a stamp of transferability and consequently we find no error with the warrant of attachment issued by DRT."

Ashok Patil, Mandar Vaidya & Priti Shukla
*Advocates*

# DIRECT TAXES
## High Court

### REPORTED

### 1. Section 195A – For grossing up of salary u/s. 195A – only actual reimbursement of tax paid by the employer could be included and not of tax paid by the employee

*CIT vs. Jaydev H. Raja (2013) 261 CTR (Bom.) 408*

Assessee was a resident but not ordinarily resident individual and an employee of a foreign company. He earned salary income. He received ` 77 lakhs in India on which tax payable at maximum rate of 44.8 per cent came to ` 35 lakhs .Assessee included ` 35 lakhs to his salary income of ` 77 lakhs and offered ` 113 lakhs (round figure) to tax. Total tax liability was ` 50 lakhs which assessee paid. Revenue authorities sought to include ` 50 lakhs of total tax with salary income of ` 77 lakhs to arrive at total income. The issue involved was whether tax amounting to ` 15 lakhs paid by assessee which was not reimbursed by company, could not be added to income of assessee. CIT(A) upheld the decision of the AO and held that confusion has arisen because the assessee in his computation had added ` 50 lakhs as income & deducted ` 15 lakhs from the income, when in fact the said amount of ` 15 lakhs was not received from the company but paid out of the salary amount received in India. Though the assessee had paid tax of ` 50 lakhs, the assessee was entitled to reimbursement of ` 35 lakhs from the company, the salary income (` 77 lakhs) received by the assessee had to be enhanced by ` 35 lakhs only & not the balance ` 15 lakhs which is paid by the assessee from the salary income. On further appeal in High Court, High Court upheld the findings of Tribunal and held that the tax amounting to ` 15 lakhs paid by the assessee from the salary income (not reimbursed by the company) could not be added to that income of the assessee.

### 2. Section 17(2)(iv) – Income Tax paid by the employer on behalf of employee is perquisite covered by section 17(2)(iv) and therefore cannot be taken into consideration for computing perquisite value of rent free accommodation

*CIT vs. Telsuo Miter (2013) 261 CTR (Del.) 352*

The question of law considered in this case was whether the tax component paid by the

employer towards and as Income-tax, when an employee is entitled to tax free salary, is a perquisite within the meaning of section 17(2)(iv) of the IT Act. The Court held that payment of Income Tax by the employer on behalf of an employee is payment of an obligation payable by the employee. It will be covered by Section 17(2)(iv) of the IT Act. An employee who has taxable income as an assessee is liable to pay tax. His income is chargeable to tax. It is the obligation of the employee as an assessee to pay Income-tax. In the present case, it was the obligation which was being discharged & paid by the employer. Therefore it would fall within the ambit of section 17(2)(iv) of the act.

### 3. Section 260A – High Court is entitled to frame another question of law during the course of final hearing

*CIT vs.. Indo Gulf Fertilizers (2013) 261 CTR (All.) 206*

In this case the revenue had formulated another question of law at the time of final hearing apart from the two questions of law admitted by the Court. The point of argument during this stage was the admissibility of additional question of law at the time of final hearing. Allowing the contention of the revenue, the Court held that under the proviso of sub-section 4(4) of 260A, the High Court has got ample power to frame new or additional substantial question of law during the course of hearing if it is satisfied on its own or on the reasons recorded. The court further held that it was incorrect to say that the framing of another substantial question of law shall amount to review of earlier order. Deeming provision has been added consciously to confer wide power on the High Court to formulate additional substantial question of law and in case High Court is to do so, the provision contained in sub-section (4) shall not come into the way. Also the court held that the power conferred to the court is judicious power and discretion should be exercised cautiously and judiciously after assigning reasons in terms of the proviso of sub-S(4) of 260A.

### 4. Section 273B – Penalty cannot be imposed where assessee did not mention PAN of deductees on TDS certificates issued by it

*CIT vs. Gail (India) Ltd. [2013] 36 taxmann. com 336 (Allahabad) [2013] 36 taxmann.com 336 (Allahabad)*

The assessee, a public sector undertaking, had deducted income tax at source as per the provisions of sections 194C and 194J on all the payments made to contractors/ professionals during the financial year 2002-03. The tax so deducted was also deposited by it in the government treasury in time. The annual return of TDS as per the provisions of section 203 was also filed in the prescribed 'Form 26C' and TDS certificates were issued to contractors/professionals. However, penalty at the rate of ` 10,000 for each 350 defaults committed by the respondent-assessee was imposed by the revenue on the ground that the respondent-assessee has not mentioned PAN in Form 16A issued to 350 contractors. The Additional Commissioner imposed penalty u/s 272B & 273B of the Act. On appeal, the Commissioner (Appeals) upheld the penalty imposed. However, the Tribunal deleted the penalty, holding that there was reasonable cause for default. On further appeal in High Court, the court upheld the findings of Tribunal and held that considering the provisions of section 272B, 273B and sections 139A (5A) and 139A (5B), a bare reading of the provision itself makes it clear that the penalty under section 272B would not ordinarily be imposed, unless the assessee had either acted deliberately in defiance of law or was

guilty of conduct which is contumacious, dishonest or acted in conscious disregard to its obligation. The penalty under section 272B cannot be imposed merely because it is lawful to do so. It can be imposed for failure to perform statutory obligation. The imposition of penalty for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially, after considering the explanation of reasonable clause submitted by the assessee and on a consideration of all the relevant circumstances. The court also held that there was no revenue loss and mere technical breach, it clearly satisfies the test of reasonable cause under section 273B. In the present case the levy of penalty under section 272B by the assessing authority was fully unjustified.

### 5. Sec. 56(2)(vi) Amount of gift received by assessee on occasion of his daughter's marriage is not exempt from tax u/s. 56(2)(vi) of the Act

*Rajinder Mohanlal vs. DCIT [2013] 36 taxmann. com 250 (Punjab & Haryana)*

During the year, the assessee, an individual, received gifts from relatives and friends on the occasion of his daughter's marriage. He did not admit any tax liability on the amount of gifts. The Assessing Officer added the said amount to the income of the assessee by holding that section 56(2)(vi) did not permit gifts received on account of an assessee's daughter wedding to be exempted. Both the Commissioner (Appeals) and the Tribunal dismissed the appeal of the assessee. The Tribunal held that the gifts received at the time of marriage of the assessee's daughter did not fall within meaning of word 'individual' used in clause (b) of proviso to section 56(2)(vi). Clause (b) of proviso to section 56(2)(vi) would apply to the gifts received on occasion of the marriage of the assessee and not on the gifts received on account of marriage of his daughter. On appeal to High Court affirmed the findings of Tribunal and held that the word 'individual' appearing in clause (b) of proviso to section 56(2)(vi) is preceded by the word 'marriage' and, therefore, relates to the marriage of the individual concerned, i.e., the assessee and not to the marriage of any other person related to him in whatsoever degree, whether as his daughter or son. The expression 'marriage of the individual' is unambiguous in its intent and does not admit to an interpretation that it would include an amount received on the marriage of a daughter. If the legislature had intended that gifts received on the occasion of marriage of the assessee's children should be exempted, nothing prevented the Legislature from adding the words 'or his children' after the words 'marriage of the individual'. Therefore, the addition made to the assessee's income on account of gifts received on the occasion of his daughter's marriage was affirmed.

### 6. Sec 37 – expenditure incurred for restructuring debt is allowable as a revenue expenditure

*DCIT vs. Gujarat Narmada Valley Fertilizers Co. Ltd. 356 ITR 460 (Guj)*

The Hon'ble High Court held that when obtaining a loan is not considered an asset or an advantage of enduring nature, then any expenditure incurred for reducing such loan burden or securing the borrowing, or more advantageous condition, cannot be seen as resulting in a benefit of enduring nature so as to be categorised as a capital expenditure.

### 7. Sec. 50C – Adoption of SVA value – AO has to record reasons for accepting or not

### accepting the SVA valuation as well as registered valuer's report

*CIT vs. Chandra Narain Chaudhari Tax Appeal 287/2011 {Allahabad High Court} Order Dated 29-8-2013*

The property which was transferred by the assessee was subject to tenancy. It is observed by the Hon'ble Allahabad High Court that it was well known that an immovable property may have various attributes, charges, encumbrances, limitations and conditions. The Stamp Valuation Authority (SVA) do not take into consideration the attributes of the property for determining the fair market value in the condition the property is a offered for sale and is purchased. The object of the valuation by the Stamp Valuation Authority is different from the purpose of valuation for section 50C. The question as to whether the assessee filed any objections before the Stamp Valuation Authority is not of any relevance. There may be several reasons for the purchaser to have not filed such objections. A purchaser may not like to go into litigation and may pay stamp duty, as fixed by the Stamp Valuation Authority . Whenever the assessee claims before the Assessing Officer that the value adopted or assessed or assessable by the Stamp Valuation Authority under sub section (1) of Section 50-C exceeds the fair market value of the property as on the date of transfer, the Assessing Officer may refer the valuation of the capital asset to a Departmental Valuation Officer (DVO) and for that purpose, the procedure prescribed under the Wealth Tax Act are to be applied. In case of any such claim, the AO may rely on the report of registered valuer under Section 55-A of the Act and in such case it will not be necessary for him to refer the matter to the DVO. Or the AO may decide to make a reference to the DVO. However, in any event, the AO has to record sufficient reasons. He has to record reasons for accepting the report of the approved valuer submitted by the assessee along with his claim/objection under Section 50 -C (2) of the Act. If he does not accept the report, he has to record the reason for referring the matter to the DVO. The reasons in either case must have nexus with the objection/claim made by the assessee and the objection, which may be raised by the department against the valuation determined in the report of the approved valuer.-

### 8. Section 69 – Addition on the basis of Valuation Report of DVO where books of accounts are not rejected cannot be sustained

*Nirpal Singh vs. CIT ITA/522/2009 (O&M) dated 16th September 2013 {P & H High Court}*

The assessee had made some investments in building a petrol pump which was duly recorded in his books. The AO made a reference to the DVO who enhanced the cost of construction. On the basis of such report, the addition was made u/s. 69. However, the assessee's books were not rejected. It was held, by drawing support from the decision of the Hon'ble Apex Court's decision in Sargam Cinema 328 ITR 513(SC), that addition cannot be sustained where assessee's books are not rejected.

### 9. Section 263 – to exercise Revisionary powers the CIT has to give a definite finding that an order is erroneous cannot be in

*CIT vs. Gupta Spg. Mills Ltd. ITA/410/2013 dated 13th September'2013 {Delhi High Court}.*

The assessee declared income from short term capital gains from some investments

in mutual funds, securities and dividend. The assessee had no other income. The AO had conducted some inquiries and completed the assessment but in the opinion of the CIT, there was a lack of inquiry and further inquiries were imperative. The CIT, accordingly set aside the assessment and directed that the assessment be done afresh. The Hon'ble Delhi Court held that there could be a total lack of inquiry by the Assessing Officer or there could be an inquiry but inadequate inquiry. In the former case, the CIT can invoke section 263 and require the A.O. to redo the assessment since lack of inquiry can itself be an error which can be corrected by the CIT. However, in case of an inquiry made by the Assessing Officer, which according to the CIT is 'inadequate', the jurisdiction u/s. 263 can be exercised validly but the CIT has to go into the merits of the case and arrive at a definite finding that the order is erroneous-'erroneous' means unsustainable in law. Without arriving at a definite finding that the order is 'erroneous', the CIT cannot simply remand the matter to the Assessing Officer for reconsideration. Inadequate inquiry, by itself, will not make the order 'erroneous'. The Hon'ble High Court, accordingly, held that the jurisdiction u/s. 263 was wrongly invoked

### 10. Section 271 (1)(c) – Assessee is liable for penalty, if the 'wrong claim' is impossible to accept or highly unreasonable

*CIT vs. Arcotech Ltd. ITA/71/2013 dated 12th September'2013. {Delhi High Court}*

The assessee had claimed certain capital losses as 'revenue' losses and certain expenditure relating to ESIC, PF which was not allowable u/s. 43B. Further the assessee had also claimed depreciation on 'Plant & Machinery' but there was no manufacturing activity, during that particular year. The original assessment was made u/s.143(1) but the same had been reopened. The assessee did not make any rectifications to its' return/computation while filing return u/s. 147. During the course of the reassessment proceedings, the assessee conceded its' mistake and filed a revised computation. This resulted into a penalty of ` 2,13,75,229/- on account of concealment and/or furnishing of inaccurate particulars. The Tribunal deleted the penalty. The High Court, however, upheld the penalty for wrong claim of revenue loss and deductions u/s. 43B. The Hon'ble High Court observed that the assessee had not rectified its' mistake even while filing the return u/s. 147, the assessee's accounts were subject to audit, the assessee's claims (though legal claims) were highly unreasonable. The principle that there can be no penalty for making wrong claims DOES NOT mean the assessees can claim wrong deductions or claim without any basis or foundation to justify the claim. False, spurious and mendacious claims cannot be insulated from penalty merely because they are 'claims'. It was also observed that the plea that the issue was debatable or there was wrong advice, cannot be stretched beyond the point to believe or accept contentions when the claim itself is impossible to accept and is contrary to fundamentals of tax or accountancy. Income tax returns are mostly accepted without scrutiny or regular assessment. Self and due compliance of tax provisions is required. The High Court, accordingly, upheld the penalty vis-a-vis wrong claim of revenue loss and deductions u/s. 43B.

CA Sunil K. Jain

# DIRECT TAXES
## Statutes, Circulars & Notifications

### Notifications

**Section 35(1)(ii) of the Income-tax Act, 1961 – Scientific research expenditure – Approved scientific research associations/institutions – The Indian Institute of Technology, Gandhi Nagar**

It has been notified that The Indian Institute of Technology, Gandhi Nagar, (PAN-AAAT17352M) has been approved by the Central Government for the purpose of clause (ii) of sub-section (1) of section 35 of the Income-tax Act, 1961 from 1-4-2012 onwards in the category of 'University, College or Other Institution', subject to the conditions mentioned in the said notification.

*(Notification No. 65/2013 dated 22-8-2013)*

**Section 10(46) of the Income-tax Act, 1961 – Exemptions – Statutory body/authority/board/commission – Notified body or authority**

The Central Government notified the Karnataka State AIDS Prevention Society, a body constituted by the Government Karnataka, the Rajasthan Electricity Regulatory Commission, a Commission established by the Government of Rajasthan, the Chandigarh State AIDS Control Society a body established by the Chandigarh Administration and the Meghalaya AIDS Control Society a body constituted by the Government of Meghalaya for the purposes of the clause (46) of section 10 of the Income-tax Act, 1961, in respect of the income(s) mentioned in the respective notification(s) and arising to the said societies. The notification(s) shall be deemed to have been applied for the financial years mentioned therein and shall be applicable for the financial years specified in respective cases. The notification(s) shall be effective subject to the conditions mentioned and that the grants received by the said Societies shall be received and applied in accordance with the prevailing rules and regulations.

*(Notification Nos. 66/2013, 69/2013 77/2013, and 78/2013 dated 29-8-2013, 18-9-2013, 25-9-2013 and 25-9-2013 respectively)*

**Income-tax (Fifteenth Amendment) Rules, 2013 – Insertion of rule 12BA and Form No. 63AA for the statement of income to be distributed by the Securitisation Trust**

The Central Board of Direct Taxes made the rules further to amend the Income-tax Rules, 1962 which shall come into force on the date of their publication in the Official Gazette.

After Rule 12B, the Rule 12BA has been inserted about the statement of income to be

distributed by the Securitisation Trust shall be furnished as provided in sub-rule (2) to (i) the Assessing Officer so designated by the Chief Commissioner or Commissioner of Income-tax, within whose area of jurisdiction, the principal office of the Securitisation Trust is situated; (ii) in any other case, to the Assessing Officer within whose area of jurisdiction, the principal office of the securitisation trust is situated.

The statement of distributed income which is to be furnished under sub-section (3) of section 115TA by the Securitisation Trust shall be in Form No.63AA, duly verified by an accountant in the manner indicated therein."

*(Notification No. 68/2013 dated 4-9-2013)*

## Income-tax (Sixteenth Amendment) Rules, 2013 – insertion of sections 10TA, 10TB, 10TC, 10TD, 10TE, 10TF & 10TG and Form No.3 CEFA regarding the determination of arm's length which is subject to Safe Harbour rules

The Central Board of Direct Taxes made the rules to amend the Income-tax Rules, 1962, which shall come into force from the date of their publication in the Official Gazette. (A) in Part II, in sub-part D relating to special cases, after rule 10T, the rules regarding "Safe Harbour" 10 TA and Rules 10TB to 10 TG have been inserted being the circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee. Form No. 3CEFA has also been newly inserted for the said purpose being the form for Application for Opting for Safe Harbour.

*(Notification No. 73/2013 dated 18-9-2013)*

## Section 90 of the Income-tax Act, 1961 – Double Taxation Agreement – Agreement for avoidance of double taxation and prevention of fiscal evasion with foreign countries – Australia – Amendment in Notification No. GSR 60(E), dated 22-1-1992

The Protocol amending the Agreement between the Government of the Republic of India and the Government of Australia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income has been signed in December, 2011 and shall enter into force from the 2nd day of April, 2013.

Now, the Central Government directed that all the provisions of the protocol annexed thereto shall be given effect to and shall be deemed to have been given effect to in the Union of India in accordance with Article 7 of the said protocol.

*(Notification No.74/2013 dated 20-9-2013)*

## Income-tax (Seventeenth amendment) Rules, 2013 – Insertion of Rules 10U, 10UA, 10UB & 10UC and Form Nos. 3CEG, 3CEH & 3CEI regarding Application of General Anti Avoidance Rule

The Central Board of Direct Taxes made the rules to amend the Income-tax Rules, 1962, which shall come into force on the 1st day of April, 2016.

In the Income-tax Rules, 1962, after Rule 10T, the Rules 10U, 10UA, 10UB & 10UC regarding Application of General Anti Avoidance Rules have been inserted. Further Form 3CEG for making the reference to the Commissioner by the Assessing Officer u/s. 144BA(1), Form 3CEH for returning the reference made under section 144BA and Form 3CEI for recording the satisfaction by the Commissioner before making a reference to the Approving Panel under sub-section (4) of section 144BA, have been inserted.

*(Notification No. 75/2013 dated 23-9-2013)*

### Income-tax (Eighteenth Amendment) Rules, 2013 – Amendment in Rule 44(E) and insertion of Form No. 34EA regarding the application for obtaining an advance ruling

The Central Board of Direct Taxes made the rules further to amend the Income-tax Rules, 1962, which shall come into force on the 1st day of April, 2015.

In the Income-tax Rules, 1962,(i) in Rule 44(E), in sub-rule (1), after item (c), regarding advance ruling and in Appendix-II, after the No. 34E, Form No. 34EA of application for obtaining an advance ruling under section 245Q (1) of the Income-tax Act, 1961 has been inserted.

*(Notification No. 76/2013 dated 24-9-2013)*

## Circulars

### 8% Savings (Taxable) Bonds, 2003 – Premature encashment

The captioned bonds, issued with effect from April 21, 2003, *vide* Government of India dated March 21, 2003 and subsequent Notification dated April 2, 2003, are repayable on the expiry of six years from the date of issue. Premature encashment was not permissible under this scheme.

The Government of India has now *vide* Notifications dated July 29, 2013 and August 16, 2013, decided to provide the facility of premature encashment of these bonds to individual investors in the age group of sixty years and above, after a minimum lock-in period of three years from the date of issue as indicated below:

(a) Lock-in period for investors in the age bracket of 60 to 70 years shall be 5 years from the date of issue.

(b) Lock-in period for investors in the age bracket of 70 to 80 years shall be 4 years from the date of issue.

(c) Lock-in period for investors of the age of 80 years and above shall be 3 years from the date of issue.

An investor, desiring to avail of the facility of premature encashment, will have to submit documentary evidence in support of his/her date of birth to satisfaction of the agency bank besides fulfilment of further details as mentioned in the said circular.

*(Circular DGBA.CDD. No. 1448/13.01.299/2013-14, dated 29-8-2013)*

### Section 245 of the Income-tax Act, 1961 – Refunds – Set Off of refunds against tax remaining payable – Central Action Plan For F.Y. 2013-14 – Pending Refunds for A.Y. 2011-12

It is seen from the data available on AST that refunds for A.Y. 2011-12 are pending. These need to be issued at the earliest. The same had been conveyed during the last video conference on 23-8-2013, but the progress so far has been tardy.

CBDT directed to take necessary action by the Assessing Officers to issue the refunds for A.Y. 2011-12 without further delay. It also directed superiors to personally monitor the progress in the above respect and send a report on the matter by 15-10-2013 with reasons for non-issue of refunds, if any.

*(Letter [F. No. 380/1/2013-IT (B)], dated 20-9-2013)*

### Section 119 of the Income-tax Act, 1961 – Income-tax authorities – Instructions to subordinate authorities – Extension of due date for furnishing of report of audit electronically for A.Y. 2013-14

CBDT has decided to relax the requirement of furnishing the Report of Audit electronically as prescribed under the proviso to sub-rule (2)

of Rule 12 of the IT Rules for the Assessment Year 2013-14 as under:

(a) The assessees, who are presently finding it difficult to upload the prescribed Reports of Audit (as referred to above) in the system electronically may also furnish the same manually before the jurisdictional Assessing Officer within the prescribed due date.

(b) The said Report of Audit should however be furnished electronically on or before 31-10-2013.

*(Order [F. No. 225/117/2013/ITA.II], dated 26-9-2013)*

### Section 119 of the Income-tax Act, 1961 – Income-tax Authorities – Instructions to subordinate authorities – Extension of due date for filing returns of income from 30-9-2013 to 14-10-2013 in case of assessees in the State of Gujarat due to reports of dislocation of general life cause by heavy rains and floods

On consideration of reports of dislocation of general life caused due to recent heavy rains and floods in the State of Gujarat, the Central Board of Direct Taxes, extended the 'due-date' for filing Returns of Income from 30th September, 2013 to 14th October, 2013, in cases of Income-tax assessees in the State of Gujarat, who are liable to file their Income-tax returns by 30th September, 2013.

*(Order [F. No. 225/117/2013/ITA.II], dated 30-9-2013)*

## Instructions

### Section 204 of the Income-tax Act, 1961 – Deduction of tax at source – Furnishing of statement of tax deduction – Action on unmatched challans reflected in Form 26AS – Direction of the Hon'ble Delhi HC in the case *'Court on its own motion vs. UOI & Ors. in WP(C) 2659/2012 & WP(C) 5443/2012' [2013] 31 taxmann.com. 31 (Delhi)*

The Hon'ble Delhi High Court *vide* its judgment in the case *'Court On its Own Motion vs. UOI and Ors' (W.P.) (C) 2659/2012 & W.P. (C) 5443/2012, dated 14-3-2013)* has issued seven mandamuses for necessary action by Income-tax Department, one of which is regarding the issue of 'Unmatched Challans' reflected in Form 26AS where the report by the deductor in the TDS statement are not found available in the OLTAS database resulting in TDS mismatch.

2. The unmatched challans belong to two categories of TDS statements, viz:

(i) Statements pertaining to F.Y. 2011-12 and earlier which have been processed by jurisdictional TDS Assessing Officers [hereinafter AOs (TDS)]

(ii) Statements pertaining to FY 2012-13 onwards, now processed by CPC (TDS)

3. The Hon'ble Delhi High Court (reference: para 42 of the order), has directed that

"...with regard to unverified TDS under the heading 'U' in Form 26AS for verification and correcting unmatched challans within a time period, which should be fixed by the Board keeping in mind the date of filing of return and processing of return by the assessing officer.."

4. In view of the above direction of the Hon'ble High Court, the Board decided that the CPC(TDS)/AOs(TDS) shall immediately issue letters to the deductors, in whose case TDS challans are unmatched, with a view to verify and correct these challans. If necessary, the deductors may be asked to file correction statements, as per the procedure laid down and necessary follow up action be taken. It

is directed that the task should be completed by 31st December, 2013 for FY 2012-13 in the case of CPC (TDS) and FYs 2011-12 & earlier in case of AOs (TDS).

*(Instruction No. 11/2013 [F. No. 275/03/2013-IT (B)], dated 27-8-2013)*

## Section 245 of the Income-tax Act, 1961 – Refunds – Set off of refunds against tax remaining payable – Strict compliance of Section 245 before making any adjustment of refund

Hon'ble Delhi High Court *vide* its judgment in case *Court On Its Own Motion vs. UOI in W.P.(C) 2659/2012,* dated 14-3-2013 has issued seven mandamuses for action by the Income Tax Department. One mandamus is on compliance of section 245 of the Income-tax Act, 1961.

2. The Hon'ble High Court in this context had issued interim directions *vide* its order dated 31-8-2012 as under:

"13. We issue interim direction to the respondents that they shall in future follow the procedure prescribed under section 245 before making any adjustment of refund payable by the CPC at Bengaluru. The assessees must be given an opportunity to file response or reply and the reply will be considered and examined by the Assessing Officer before any direction for adjustment is made. The process of issue of prior intimation and service thereof on the assessee will be as per the law. The assessees will be entitled to file their response before the Assessing Officer mentioned in the prior intimation. The Assessing Officer will thereafter examine the reply and communicate his finding, to the CPC, Bengaluru, who will then process the refund and adjust the demand, if any payable. CBDT can fix a time limit for communication of findings by the Assessing Officer. The final adjustment will also be communicated to the assessees. "

3. In compliance with the above directions of the Hon'ble Court, CPC Instruction No. 1 dated 27-11-2012 was issued explaining the step-by-step procedure for adjustment of refunds to be followed by Assessing Officers and CPC, followed by the DIT (Systems)-III letter dated 30-1-2013.

4. Vide its final order in the writ petition dated 14-3-2013, the Hon'ble High Court in para 24 has confirmed its interim order and issued second mandamus as under:

"24. The said interim order is confirmed. We notice that the respondents have taken remedial steps to ensure compliance of section 245 of the Act as they now give an option to the assessee to approach the Assessing Officer. This is the second mandamus which we have issued. As noticed above, the interim order passed in the writ petition dated 31st August, 2012 has been implemented."

5. In view of the above directions of the Hon'ble High Court, the CBDT directed that the provisions of section 245 of the IT Act be strictly adhered to before making any adjustment of refund. In respect of adjustment of refund payable by the CPC at Bengaluru, and that the procedure detailed in Para 2 above may be complied with. The Assessing Officer, in this regard, has been directed to respond to CPC within 45 days from the date of communication of issuance of notice u/s. 245 by the CPC to the Assessing Officer.

*(Instruction No. 12/2013 [F. NO. 312/55/2013-OT], dated 9-9-2013)*

## Section 143 of the Income-tax Act, 1961 – Assessment – General – Procedure and criteria for selection of scrutiny cases under compulsory manual selection of returns during Financial Year 2013-14 – Amendment in Instruction No. 10/2013, dated 5-8-2013

Instruction No. 10 of 2013, dated 5-8-2013 of CBDT on the above captioned subject is partially modified as under: (j) Cases where registration u/s. 12AA of the IT Act has not been granted or has been cancelled by the CIT/DIT and the assessee has been found claiming tax-exemption under section 11 of the IT Act. However, the cases where such order of CIT/DIT has been reversed/set-aside in appellate proceedings will not be picked up for scrutiny under this clause. (k) Cases where order denying the approval u/s. 10(23C) of the IT Act or withdrawing the approval already granted has been passed by the Competent-Authority and the assessee has been found claiming tax-exemption under the aforesaid provision of the IT Act.

Therefore the above will also be picked up for selection of scrutiny cases for F.Y. 2013-14.

*(Instruction No. 13/2013 [F. No. 225/107/2013/ ITA.II], dated 20-9-2013)*

## Section 142 of the Income-tax Act, 1961 – Procedure for Assessment – Inquiry before assessment – Standard Operating Procedure for cases under Non-filers Monitoring System (NMS)

The CBDT on examining observed that the existing procedure for monitoring cases of 'Non-Filers of IT Returns' as identified by Director General of Income Tax (System) are not being uniformly monitored by the Assessing Officers due to lack of consistency in approach in dealing with such cases. Therefore, in order to streamline processing of such cases and to ensure consistency in monitoring NMS cases by the Assessing Officers, the Board, laid down the following Standard Operating Procedure:

1. The Assessing Officer should issue letter to the assessee within 15 days of the case being assigned in NMS, seeking information about the return of income flagged in NMS. Facility to generate letter has been provided in the NMS module of i-taxnet.

2. If the letter is delivered, the Assessing Officer should capture the delivery date in the NMS module.

3. If the letter is not delivered, the Assessing Officer should issue letter to the alternate addresses of the assessee available in the Online Monitoring System or any other address available with the Assessing Officer through field enquiries or otherwise. All addresses used in IT Return, AIR, CIB databases have been made available to the Assessing Officer in the Online Monitoring System to assist the field formations in identification of current address of the taxpayer.

4. If the return is received, the assessing officer should capture the details in AST within 15 days of filing of the return. If the assessee informs that paper return has already been filed which was not captured in AST, the details of return should be entered in the AST within 15 days of receiving such information. E-filed returns will be automatically pushed to NMS.

5. If no return is required to be filed in the case (non-resident etc.), the Assessing Officer should mark "No return is required" and mention reason for the same in NMS which needs to be confirmed by Range head.

6. If the Assessing Officer is not able to serve the letter and identify the taxpayer, Assessing Officer should mark the assessee "Assessee not traceable" in NMS which needs to be confirmed by Range head.

7. In cases where the assessee has been identified and no return has been filed within 30 days of the time given in the letter, the Assessing Officer should consider initiation of proceedings u/s. 142(1)148 in AST.

8. The cases will be processed every week by the Directorate of Systems and will

be marked as closed in NMS if one of the following actions are taken for A.Y.'s 2010-11, 2011-12 and 2012-13:

*(Instruction No. 14/2013 [F.No.225/153/2013/ ITA.II], dated 23-9-2013)*

## Press Releases

### Income-tax Department sends letters to another batch of 35,000 non-filers to file returns and pay taxes thereon

As part of a massive exercise to identify high risk non-filers of Income Tax returns and ask them to file returns and pay taxes thereon, the Income Tax Department has sent letters to another batch of 35,000 non-filers this week. These persons were part of around 12 lakh non-filers identified by the Department by mining its database. With this latest batch, the Department has now issued letters in 2,45,000 cases.

The Department now also proposes to extend this exercise to persons who have conducted high value transactions during F.Y. 2010-11 and F.Y. 2011-12. It is also developing a dedicated module on the e-filing portal which will give details of returns not filed, ITR-V not submitted, demand not paid etc. to individual taxpayer. The taxpayer can post his comments so that situation on such issues is crystallised. This will be one more step towards greater transparency and minimising the grievance of taxpayers.

*(CBDT Press Release, dated 13-9-2013)*

### Section 2(22AAA) of the Income-tax Act, 1961, read with para 5(a) of the Electoral Trusts Scheme, 2013 – Electoral trust – Extension of date for filing of applications by electoral trusts

The Central Board of Direct Taxes has permitted Electoral Trusts to file their applications upto 30th November, 2013 in respect of assessment year 2014-15 for approval under clause (22AAA) of section 2 of the Income-tax Act, 1961 (read with Para 5(a) of the Electoral Trusts Scheme, 2013).

*(CBDT Press Release, Dated 16-9-2013)*

### Section 90 of the Income-tax Act, 1961 – Double Taxation Agreement – Agreement for Avoidance of Double Taxation and prevention of fiscal evasion with foreign countries – Latvia

The Government of India signed an Agreement and the Agreed Note for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (DTAA) with the Government of Latvia. Latvia is the third Baltic country with which DTAA has been signed by India. Earlier DTAAs have been signed and have come into force with Lithuania and Estonia. The DTAA provides that business profits will be taxable in the source if the activities of an enterprise constitute a permanent establishment (PE) in the source state. The Agreement provides for fixed place PE, building site, construction or assembly PE, service PE, Off-shore exploration/exploitation PE and agency PE.

The Agreement will provide tax stability to the residents of India and Latvia and will facilitate mutual economic co-operation between the two countries. It will also stimulate the flow of investment, technology and services between India and Latvia.

*(Press Release, dated 18-9-2013)*

CA Tarunkumar Singhal & CA Sunil Lala

# INTERNATIONAL TAXATION
## Case Law Update

## A] AUTHORITY OF ADVANCE RULINGS

### I. India-Singapore DTAA – Payments by applicant to INSEAD, a Singapore based educational institution, towards teaching services not taxable as the same falls in the exclusive clause of Article 12(5)(c) of the DTAA

*Eruditus Education Private Ltd. vs. DIT (Int. Tax) [AAR No. 1037 of 2011 dated 20th September, 2013]*

**Facts**

1. The applicant, an Indian Company was engaged in the business of providing high quality executive education programmes to Indian corporates and other participants.

2. It entered into a Programme Partnership Agreement ('the agreement') with INSEAD, a business school registered in Singapore as a Private Education Trust which was engaged in the business of providing various management education programmes globally. The teaching by INSEAD would consist of in-class teaching on INSEAD global campuses in Singapore and France, in-class teaching in India and teaching through telepresence in Singapore.

3. As per the agreement, INSEAD was obliged to conduct teaching intervention while the applicant, was to assist in the marketing, organising, managing and facilitating the conduct of the programme. The applicant would compensate INSEAD the cost involved in teaching the entire programme.

4. The applicant sought ruling on the taxability of the amount paid to INSEAD under the India Singapore Double Tax Avoidance Agreement ('DTAA') and the Income-tax Act, 1961 ('the Act').

**Ruling**

1. The Hon'ble AAR observed that in view of the definition of the curriculum of the programme offered by INSEAD to the applicant, the services rendered involved expertise in or possession of special skill or knowledge that are technical in nature. Thus the payment for the services rendered would qualify as "Fees for Technical Services" under section 9(1)(vii) of the Act as well as Article 12 of the DTAA.

2. The Hon'ble AAR held that the payments made by the applicant to INSEAD for services rendered under the terms of the agreement were not in the nature of "Fees for Technical Services" as it falls under the exclusive clause of Article 12.5(c) of the DTAA even though the payment for the service may be fees for technical services under the provision of Section 9(1)(vii) of the Act.

3. It further held that INSEAD did not have a permanent establishment in India within Article 5(1) or 5(8) of the DTAA in relation to the activity of conducting in-class teachings through telepresence in India.

4. The Hon'ble AAR concluded that since the payments made to INSEAD were not chargeable to tax in India, the applicant was not required to withhold tax under Section 195 of the Act.

## B] HIGH COURT JUDGMENTS

### II. Section 92CA(2A) – A) TPO has inherent jurisdiction to proceed to consider unreported transactions *suo motu* even if the same was not expressly referred to him by Assessing Officer. Section 92CA(2A) amendment is a substantive provision and applicable to proceedings pending before TPO as on June, 1, 2011. B) Writ petition liable to be quashed in case alternate remedies are available to the assessee. C) Mere filing of objections before DRP in pursuance of orders of High Court is not a valid ground to dismiss a writ petition. D) High Court can entertain writ even if the challenged order is merged into another order. E) Whether the sale of call center business is an international transaction is a mixed question of law and fact and to be decided by lower authorities. F) The assignment of call options under framework agreements to be decided by lower authorities after giving effect to Vodafone's Supreme Court ruling and retrospective amendment to section 2(47) relating to transfer.

*M/s. Vodafone India Services Pvt. Ltd. vs. UOI, ACIT – Transfer Pricing-I(5), ACIT-3(3) [2013] 37 taxmann.com 250 (Bombay) Assessment Year: 2008-09*

**Facts**

1. The assessee had filed a writ petition to quash and set aside the order of Transfer Pricing Officer ('TPO') and a Draft Assessment Order to the extent it related to the addition of ` 8,434 crores (approx.) on account of two unreported international transactions.

2. During the transfer pricing proceedings, TPO had determined the arm's length price of the two unreported transactions *suo motu* in exercise of powers under sections 92CA(2A) and/or (2B) and proposed an addition of ` 8,434.39 crores. The two unreported transactions were

- Sale of the call centre business by the assessee to Hutchison Whampoa Properties (India) Private Limited ['HWP (India)'].
- Assignment of call options by the assessee to Vodafone Holdings.

3. The alleged unreported transactions were not referred to TPO by Assessing Officer ('AO').

4. Subsequently, the AO passed a draft assessment order making addition as proposed in TPO's order.

5. The assessee challenged the draft assessment order before Dispute Resolution Panel ('DRP'). In the same month, it also filed a writ petition before High Court. During the pendency of the writ petition, the assessee sought for a stay of proceedings before DRP which was rejected by the High Court. The High Court entertained the writ stating that the assessee could appear before DRP without prejudice to its rights and contentions contained in the writ petition.

6. The DRP in turn passed an order disposing of the assessee's objections and the AO passed the final assessment order in pursuance of directions of DRP. Both the orders were not communicated to the assessee in pursuance of interim order passed by High Court which directed the Revenue to not serve the orders to assessee for a certain period.

7. Before the Hon'ble High Court, the assessee raised following 3 broad issues by a writ:

- TPO cannot *suo motu* take cognizance of transactions without being expressly referred by the AO.
- TPO did not have jurisdiction to get into valuation of the sale of call centre business as the same is domestic transaction and not international transaction.
- Rewriting of call option in new framework agreement did not constitute an assignment of options and thus, it was not an international transaction.

8. The Revenue contended before High Court on following points:

- Since the assessee had alternate remedy under Income-tax Act, the writ petition was not maintainable.
- The petitioner had filed objections and had appeared before DRP and hence, it was not entitled to maintain parallel writ proceedings
- Further, the TPO's order and draft assessment order had merged into DRP's order and final assessment order of the AO and therefore, the assessee's writ against the TPO's order and draft assessment order was not maintainable.

**Judgment**

*A] TPO's power to ta***ke** suo motu *cognizance of transactions not referred to him*

1. The Hon'ble High Court held that sub-section (2A) to section 92CA conferred fresh jurisdiction upon and extended the jurisdiction of TPO. Therefore that amendment inserting Sub-section (2A) was a substantive provision. The contention of assessee that the provisions of Sub-section (2A) would apply to AY after June 1, 2011 was rejected stating that the provision of Section 92CA(2A) was applicable to proceedings pending before TPO as on June 1, 2011 and therefore TPO had jurisdiction to determine ALP of transactions not referred to him or not reported in Form 3CEB.

2. The contention of the assessee that sub-section (2B) applies only in cases where no report is filed by the assessee under section 92E is not well founded. It was held that sub-section (2B) would apply where the assessee has not reported the transaction or transactions in Form 3CEB and the same comes to TPO's notice during the course of proceedings before him.

*B] Maintainability of writ and availability of alternate remedy*

- *Powers of TPO and AO*

3. The Hon'ble High Court observed that AO is not entitled to question or revisit ALP determination by the TPO including the question as to whether the transaction is an international transaction or not. When AO makes a reference u/s. 92CA(1) with approval from CIT, then in such case, the TPO is bound to determine the ALP and is not entitled to reconsider the question as to whether the transaction is an international transaction or not. The remedy of the assessee to question the TPO's decision would be before the Commissioner of Income Tax ('CIT') or DRP.

4. The Hon'ble High Court further observed that the assessee had alternate remedy of challenging all aspects of such a matter before the DRP or CIT (Appeals) as well as before Income Tax Appellate Tribunal ('ITAT').

- *DRP's Powers*

5. The contention of the assessee that DRP is not entitled to consider whether the transaction is international or not was rejected on the ground that the words used in the Sections 144C(6)(a) and (b) uses the expression 'confirm.....variations proposed in draft order' includes the power of not to confirm and power to annul the variations. DRP has power to decide whether the unreported transactions are

international transactions or not or even whether what the TPO considered was a transaction at all. However if DRP concludes that the TPO had no jurisdiction, the proceedings do not end since DRP is bound to consider the entire assessment which comprise of domestic transactions as well.

6. The Hon'ble High Court further observed that if the assessee had approached the court at the earliest before the TPO passes order, the Court would have entertained the writ. It further stated that even if the High Court had come to the conclusion that the TPO lacked inherent jurisdiction on this ground, it would not have entertained the writ for authorities below would have been entitled to set right the defect and conclude the assessment proceedings accordingly.

*C] Effect on maintainability of the Writ Petition on account of the petitioner having filed objections and having appeared before the DRP*

7. The Hon'ble High Court rejected Revenue's argument of dismissing the Writ on the ground that the assessee had appeared before the DRP. It was observed that the petitioner had appeared before the DRP not voluntarily, but without prejudice to its rights and contentions in this Writ Petition. The Hon'ble High Court therefore held that when a litigant appears in such proceedings without prejudice to its rights and contentions and the Court expressly permits him to do so, it would be a travesty of justice for the Court to thereafter refuse to entertain the Writ Petition merely on that ground.

*D] Effect on maintainability of the Writ on account of the merger of the impugned orders of the DRP and the final assessment order of the AO*

8. The Hon'ble High Court held that when an order stands merged in another order, the remedy of a party is to challenge the final order and it cannot do so by challenging the order which stands merged in the final order but that is not an absolute rule. A court exercising jurisdiction under Article 226 would be justified in entertaining a challenge to such an order even if it has merged in another order where the proceedings were pursued without prejudice to the petitioner's rights and/or pursuant to the orders of the Court granting the petitioner liberty to do so.

*E] TPO's jurisdiction regarding transaction of transfer of call centre business*

9. The revenue contended that as per section 92B(2), a transaction between an enterprise and a person other than Associated Enterprise('AE') shall be deemed to be international transaction, if there exists a prior agreement in relation to the relevant transaction between such other person and the AE, or the term of the relevant transaction is determined in substance between such other person and the AE. The High Court observed that the expression 'in relation to' has a very wide meaning and therefore it was sufficient even if some of the terms of relevant transaction were present in prior agreement. So long as the terms of the relevant transaction are determined "in substance" between such other person and the associated enterprise it is sufficient and that such existence of 'substance' would vary according to facts of each case. It further stated that Section 92B(2) would apply even if there was a modification of prior agreement. Also Section 92B(2) does not exclude from its ambit a case where the enterprise was an associated enterprise of more than one entity during the previous year.

10. The Hon'ble High Court stated that provisions of the share purchase agreement ('SPA') *prima facie* foreshadowed the sale of the call centre business by the petitioner to an affiliate of the vendor i.e. Hutchison Telecommunications International Limited ('HTIL'). The SPA had several provisions relating to and in connection with the sale of the call centre business. On perusal of various clauses of Business Transfer Agreement ('BTA') and SPA, it held that BTA/sale of the call centre

business was in relation to the SPA in so far as it concerned the sale of the call centre business.

11. The High Court held that the TPO's lack of jurisdiction to consider the transaction relating to the sale of the call centre business/BTA was not so obvious and clear as to entitle the assessee to invoke the extraordinary writ jurisdiction instead of being compelled to file an appeal before the ITAT.

12. There were numerous issues which required finding of facts which the lower authorities required to consider, and it was not necessary for the court to invoke its extra-ordinary writ jurisdiction to decide the same

**TPO's jurisdiction regarding alleged assignment of call options under framework agreements**

13. The Hon'ble High Court observed that Supreme Court in Vodafone's case had held that the call options are contractual rights and they vested and continue to vest in the assessee and had not been transferred or assigned by the assessee to its AE, viz. Vodafone International Holdings BV ('VIH BV') in pursuance of new framework agreement entered, as stated by the Revenue.

14. The Hon'ble High Court held that since AO's Order & TPO's order was prior to Supreme Court ruling, they did not have occasion to consider the observations of the Supreme Court, including in respect of the Framework Agreements, to their full effect. However it further stated that there was no need to short circuit the proceedings and Hon'ble Tribunal should consider the impact of the ruling.

15. It further stated that Supreme Court ruling in Vodafone considered the term 'transfer' prior to retrospective amendment therein. However, the amended definition was relevant in the present case. The consideration of impact of the amendment and whether the Supreme Court ruling would remain unaffected on the ground that the amendment was only clarificatory nature, were important issues which need not be considered in proceedings under Article 226 bypassing the regular channel provided under IT Act.

## III. Section 271G – Penalty under section 271G is discretionary and not mandatory – Penalty under section 271G cannot be levied when notice under section 92D(3) didn't specify the information or document, which was required to be submitted

*CIT-II vs. M/s. Leroy Somer & Controls (India) Pvt. Ltd. [ITA No. 410/2012 (Delhi High Court) dated 30th August, 2013]*

**Facts**

1. The assessee company had entered into international transactions with its AE's. It claimed that for export sale it had adopted CUP method and for the other transactions it had applied TNMM as the most appropriate method; however, it could not establish the CUP comparability.

2. During the year under consideration, the TPO levied penalty u/ss. 271AA and 271G on the assessee for not maintaining any document under Rule 10D read with section 92D(3). It recorded that all documents had been prepared when the proceedings before TPO recommenced and the TP study was filed late.

3. However, the TPO made no transfer pricing addition as no adverse inference could be drawn in respect of international transactions in view of the functional and economic analysis of the assessee in comparables.

4. The Hon'ble ITAT deleted the penalty u/s. 271G on account of two reasons. Firstly, it noted that the AO had not asked for any specific information or document from the assessee, which was not supplied within the period stated in section 92D(3). Secondly, it observed that the TPO had issued first notice under Sections

92CA(3) and 92D(3) seeking information and evidence by January 10, 2008; however, the date of service of notice was not known and there was no evidence whether or not time was extended. Only in the office note, which was not meant for the assessee, the TPO had recorded that the transfer pricing report was filed late on February 26, 2008. Thus, the TPO only presumed that the assessee was not maintaining any document under Rule 10D read with section 92D(3).

**Judgment**

1. The Hon'ble High Court analyzing the provisions of Section 271G of the Act held that the said levy of penalty was discretionary and not mandatory.

2. It observed that notice under section 92D(3) should specify the information or document, which was required to be submitted and if and when there is a failure or delay in submission of the said documentation or information, penalty can be imposed under section 271G of the Act. In the present case, the AO's order merely recorded that there was failure to file Rule 10D documentation without specifying or stating which document or information was not furnished in spite of notice calling for the said information or document under section 92D(3). It thus held that in absence of the said basic details or facts, the levy of penalty under section 271G cannot be sustained.

3. The Hon'ble High Court observed that since documentation requirement under Rule 10D is voluminous & virtually unlimited, penalty under section 271G is to be interpreted reasonably & in a rational manner.

4. The Hon'ble High Court concluded that for imposing penalty under section 271G, the Revenue was required to first mention the document and information which was required to be furnished but was not furnished by the assessee within the specified time and the documentation/information should be one specified in Rule 10D. Since the Revenue's appeal was misconceived and totally lacking in merit, it dismissed the appeal and deleted the levy of penalty under section 271G.

## C] TRIBUNAL DECISIONS

### IV. India-UK DTAA – Fees for Technical Services – Article 13(4)(c) – Fees for employees training services did not satisfy 'make available' condition and therefore was not taxable in India

*ITO v. Veeda Clinical Research Pvt. Ltd. [2013] 35 taxmann.com 577 (Ahmedabad - Trib.) – Assessment Year : 2008-09*

**Facts**

1. The assessee had made certain payments to Veeda Clinical Research Ltd. UK, for providing 'in-house training of IT staff and medical staff' and to Steve Matheson UK, for providing 'market awareness and development training'. Such training services were provided to the assessee's employees.

2. The assessee claimed that it did not have any obligation to deduct tax at source under section 195 of the Income-tax Act, 1961 (the Act) since such training services did not 'make available' any technical knowledge, experience, skill, knowhow or process, or consist of the development and transfer of a technical plan or design as required under Article 13(4)(c) of India-UK tax treaty (the tax treaty).

3. The Assessing Officer (AO) held that the expression 'make available' also include the cases in which technical services were made accessible to the recipient of services and not necessarily confined to the cases in which the recipient should be made expert in such technical knowledge, etc. Accordingly, the AO treated the training fees paid by the assessee as FTS taxable under Article 13(4)(b) of the tax treaty.

4. The CIT(A) held that Article 13(4)(b) of the tax treaty deals with only technical and consultancy services which 'are ancillary and subsidiary to the enjoyment of the property' referred to in Article 13(3)(b) of the tax treaty, and it is unrelated to the facts of the present case. Hence, the payments were not taxable in India under the tax treaty.

**Decision**

The Tribunal held in assessee's favour as follows:

1. The law is now settled that as a condition precedent for invoking 'make available' clause in the definition of FTS, the services should enable the person acquiring the services to apply technology contained therein. The Tribunal relied on High Court decisions in the case of *DIT vs. Guy Carpenter & Co. Ltd. [2012] 346 ITR 504 (Del)* and *CIT vs. De Beers India Pvt. Ltd. [2012] 346 ITR 467 (Kar.)* in support of this proposition. Further, there was no contrary decision by jurisdictional High Court or by the Supreme Court.

2. Unless there is a transfer of technology involved in technical services extended by the UK based company, the 'make available' clause is not satisfied and therefore, the consideration for such services cannot be taxed under Article 13(4)(c) of the tax treaty.

3. There can be situations in which technical training results in transfer of technology and consideration for rendering of such training services will be covered by the definition of FTS. However, what was really the decisive factor was not the fact of training services *per se* but the training services being of such a nature that results in transfer of technology.

4. In the present case, the training services rendered by the service provider were general in nature as the training was described as 'in house training of IT staff and medical staff' and of 'market awareness and development training' and such training does not involve any transfer of technology.

5. In order to invoke the 'make available' clause in the definition of FTS under the tax treaty, the onus is on the tax authorities to demonstrate that these services do involve transfer of technology. However, in the present case, that onus was not discharged by the AO, or by the tax department.

6. The provisions of the Act apply only when it is more favourable to the assessee as compared to the provisions of the tax treaty. Therefore, when the case of the tax department fails on the tests of the tax treaty provisions, there was no occasion for their leaning upon the provisions of the Act.

## V. India-USA DTAA – Force of Attraction Rule – Indian branch of a foreign company providing pre-sale activities and incidental post-sale support activities for products supplied by the parent and overseas group companies cannot be treated as dependent agent PE and in the absence of PE, the force of attraction rule under relevant tax treaties does not apply – Articles 5 and 7 of the Treaty.

*Varian India Pvt. Ltd. vs. ADIT [2013] 33 taxmann.com 249 (Mumbai-Trib.) – Assessment Years : 2002-03 to 2006-07*

**Facts**

1. The assessee is a branch of Varian India Pvt. Ltd. (VIPL), USA, which in turn is a 100 percent subsidiary of Varian Inc, USA. Varian Inc was engaged in designing, manufacturing and marketing of its technological products such as scientific instruments, vacuum technologies, contract electronics manufacturing and analytical lab instruments.

2. The assessee was engaged in the distribution of products manufactured by Varian Group of companies (VGCs) all over the world.

3. VIPL has entered into Distribution and Representation Agreement (DR Agreement) with VGCs for supply and sale of analytical lab instruments to the Indian customers directly.

4. The assessee carries out two types of sale of Varian products in India i.e. (i) direct sale and (ii) indent sale. In the case of direct sale, the assessee directly imports spare parts from VGCs and sells them to Indian customers directly on its own account on principal-to principal basis. These spare parts are made available at discounted price by various Associates Enterprises (AEs). In the case of indent sale, VGCs sells analytical lab instruments to the Indian customers directly and the assessee carries out pre-sale activities like liaisoning and other incidental post-sale support activities for which it was entitled to commission.

5. In pursuance of the DR Agreement with VGCs in relation to the indent sale, the assessee has earned commission income. The commission income in respect of indent sale and income from direct sales has been fully offered for taxation in India by the assessee.

6. The Assessing Officer (AO) held that the assessee is a dependent agent PE of three companies i.e. Varian USA, Australia and Italy because of "Force of Attraction Rule" under Article 7(1) of the relevant tax treaty. Accordingly, as per Article 7 of the respective tax treaty, dealing with "Force of Attraction Rule", profits of these foreign companies attributable to their business in India are also taxable in the hands of the assessee being PE of three group of companies. Further, in the absence of actual profit attributable to the PE of these three VGCs, the AO applied the provisions of Rule 10 of the Incometax Rules, 1962 (the Rules) and estimated profit attributable to the PE at 10 per cent of the operating profit from the business of these three companies.

7. The CIT(A) upheld the order of the AO.

**Decision**

The Tribunal held in assessee's favour as follows:

1. As per Article 5(4) of the India-USA tax treaty an agent is deemed to be PE if he is not independent and habitually exercise an authority to conclude contracts on behalf of the enterprise; or if he has no such authority, but habitually maintains stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise; or he habitually secures orders solely or almost wholly for the enterprise. If none of these conditions are fulfilled, the agent cannot constitute a PE for the foreign enterprise.

2. On perusal of the DR Agreement, it indicates that the assessee has no authority and also cannot negotiate or conclude contracts on behalf of VGCs. It only provides marketing support liaisoning activity for pre-sale and incidental and ancillary post-sale activities.

3. The title of the goods supplied by VGCs is directly passed on to the customers and the assessee neither undertakes any risk nor title of the product at any point of time.

4. The order relating to indent sale are only introduced and liaised by the assessee and not secured by it and the sale orders are not binding on the VGCs until accepted by them. The assessee has no authority to accept orders on behalf of any of the VGCs. The assessee is providing services to various VGCs and it has not devoted only for one foreign enterprise. Accordingly, the assessee does not fulfil any of the condition enumerated in Article 5(4) of the tax treaty.

5. The language of India-Australia and India-Italy tax treaty is similarly worded. However, there is an additional clause under these tax treaties relating to the activity of manufacturing or processing goods belonging to the foreign enterprise. Since the assessee does not manufacture or process any other products developed or manufactured by VGCs,

the conditions of Article 5(4) of India-Australia and India-Italy tax treaty also not been fulfilled.

6. Further, on reference to DR Agreements, it indicates that none of the risks like market risk, product liability risk, R&D risk, credit risk, price risk, inventory risk or foreign currency risk is undertaken by the assessee. All these risk factors are borne by VGCs.

7. The Tribunal then went on to examine whether the assessee constitutes a PE under Article 5(5) of the tax treaty and observed that an agent can be considered as PE under this Article only if following two conditions are fulfilled:

a) When the activities of such agent are devoted wholly or almost wholly on behalf of that enterprise.

b) The transaction between the agent and enterprise are not made at arm's length price

8. On a perusal of statement of sales it is evident that the percentage of commission income and sales from three VGCs are normal and with regard to Varian Inc USA., the activities of the assessee are between 5 and 7 per cent. Hence, it cannot be said that the assessee is devoted wholly or almost wholly on behalf of any one VGC as per Article 5(5) of the tax treaty.

9. Further, the TPO held that the transactions were at arm's length. Even the AO has also not adversely held that compensation in the form of commission is not at arm's length, thus the second condition is also not satisfied. Thus, as per Article 5(5) of the tax treaty also, the assessee cannot be held to be agent for constituting a PE in India for the various VGCs.

10. Merely because the assessee is a subsidiary of Varian Inc. USA, VIPL or its branch would not constitute PE of Varian Inc. USA under Article 5(6) of the tax treaty. Thus, as per Article 5(6) of the tax treaty it cannot be treated as PE for Varian Inc USA or any other VGCs.

11. In order to tax business profits of the enterprise under Article 7 of the tax treaty two basic conditions needs to be fulfilled i.e. the foreign enterprise should have PE in India for the purpose of selling goods and direct sale by the foreign enterprise is the same or similar kind of goods or merchandise as sold by the PE in India. However, in the present case since the assessee does not fulfil such conditions; the profits of VGCs cannot be taxed.

12. The assessee is showing the entire income as is reasonably attributable to the operations carried out in India as per section 9(1)(i) of the Act in view of the decision of the Supreme Court in the case of Hyundai Heavy Industries Co. Ltd. and therefore, no further profits could be attributed.

13. Since the assessee does not have PE in India, the attribution of 10 per cent profit margin on the basis of global accounts of VGCs, as applied by the AO cannot be made.

14. The Delhi High Court in the case of Rolls Royce Plc has held that the Indian company was 100% subsidiary of Rolls Royce Plc which was held to be PE looking to the functions performed. However, in the present case, the issue is not whether the Indian branch of VIPL is a PE of VIPL or not but whether the VIPL through its Indian branch is a PE of other VGCs. Therefore, the said decision was not applicable on the facts of the present case.

## VI. Salary payments to non-residents to be allowed as a deduction in the previous year in which withholding tax is paid

*Tianjin Tianshi India Pvt. Ltd. vs. ITO [TS-217-ITAT-2013(Del.)] / [2013] 35 taxmann.com 343 (Delhi-Trib.) – Assessment Year : 2007-08*

**Facts:**

1. The assessee made payments of salary to non-resident staff working in India. The tax amount was deducted but was deposited with

the Government after the due date of filing of the tax return under section 139(1) of the Act. The AO disallowed the claim for expenditure.

2. The assessee contended that section 40(a)(iii) of the Act provides for disallowance of salary expenditure where taxes have not been paid or deducted. The section was silent on the time of payment of withholding tax.

3. Section 40(a)(ia) of the Act provides for payment of withholding tax by a specified date to escape disallowance i.e. before the due date of filing the tax return. Since, the two sections are different from each other, no disallowance could be made if the withholding tax was deposited belatedly. In this regard, reference was made to *DCIT vs. Dolphin Drilling Ltd. [2009] 28 SOT 141 (Delhi).*

4. The DRP, however, affirmed the order of the AO. It observed that section 40(a)(iii) of the Act had to be read in harmony with section 40(a)(ia) of the Act and the tax deducted was required to be deposited within the time limit prescribed under section 40(a)(ia) of the Act, i.e. the due date of filing of return of income.

**Decision**

1. The Tribunal held that under section 40(a)(ia) of the Act, the tax was required to be withheld on or before the due date of filing the tax return and where the withholding tax was paid after the due date of filing the tax return, the amount of expenses would be allowed as a deduction in the previous year in which the tax was paid. The Tribunal held that the above position would equally apply to section 40(a)(iii) of the Act, as both the provisions – section 40(a)(ia) and section 40(a)(iii) – were required to be read in harmony with each other.

2. Accordingly the Tribunal allowed the salary expenditure of the assessee if the amount of withholding tax was paid on or before the due date of filing of the tax return. However, where such sum was not paid, then it would be allowed as deduction in computing the income of the previous year in which such withholding tax was paid.

## VII. India-USA DTAA – Payments for training of pilots and other staff abroad are not taxable as Fees for Included Services under Article 12(4)(b) of the tax treaty. Retrospective amendment in section 40(a)(i) of the Act is not applicable to the payment made earlier since the assessee is acted under a *bona fide* belief that tax was not deductible

*United Helicharters Pvt. Ltd. vs. ACIT 2013-TII-161-ITAT-MUM-INTL – Assessment Years: 2006-07 & 2007-08*

**Facts**

1. The assessee was engaged in the business of charter hire of helicopters. The assessee made payment towards training expenses to Bell Helicopter Textron Inc, a US company.

2. The US company is approved by DGCA for providing such training to enable the pilots or engineers to get their respective licences endorsed, to operate/work on respective type of helicopter. On completion of the training the US company provides a certificate based on which the DGCA make endorsed of respective licences.

3. The assessee claimed that these payments are treated as business profits under the tax treaty and in the absence of Permanent Establishments (PE) in India, it was not taxable in India. Accordingly, withholding of tax was not required.

4. The Assessing Officer (AO) held that in view of Explanation 22 to section 9(1)(vii) of the Act, the payments made by the assessee is FTS and therefore the same is liable to be taxed in India. Accordingly, the AO has disallowed the payments under section 40(a)(i) of the Act.

5. The CIT(A) confirmed the disallowance made by the AO relying on the retrospective amendment made by the Finance Act, 2010.

**Decision**

The Tribunal held in assessee's favour as under:

1. The lower authorities have disallowed the payment under the Act without considering the provisions of tax treaty.

2. There is no dispute that prior to the A.Y. 2006-07 there was no disallowance under section 40(a)(i) of the Act. The retrospective amendment brought by the Finance Act, 2010 was not in existence when the assessee made the payments. Therefore, it cannot be ruled out that the assessee has acted under *bona fide* belief that no tax was required to be deducted on such payment.

3. There was no such disallowance prior to A.Y. 2006-07 and it is not the case of the assessment of income in the hands of foreign recipient but it is a case of disallowance of the claim of expenditure claimed by the assessee. At the time of such payment, the provisions relied on by the CIT(A) was not in existence. Thus, the assessee was not expected to do something which was impossible to perform.

4. Relying on the decision of Ahmedabad Tribunal in the case of *Sterling Abrasive Ltd. vs. ACIT [2011] 44 SOT 652 (Ahd.),* it was held that the assessee had acted under *bona fide* belief that no tax was to be deducted on these payments.

5. As per Article 12(4)(b) of the tax treaty FIS means if such services made available technical knowledge, experience, skill, know-how, or processes, or consists of the development and transfer of a technical plan or technical design. The training in the present case was given to the pilots and other staff as per the requirement of the DGCA Rules and therefore, it was only a part of the eligibility of the pilots and other staff for working in the industry of aviation and such training would not fall under the term 'service make available' under the tax treaty.

6. The decisions relied on by the tax department are on the taxability of the income in the hands of the non-resident in view of the retrospective amendment and therefore the said principle cannot be applied while deciding the issue of disallowance under section 40(a)(i) of the Act. Accordingly, the disallowance under Section 40(a)(i) of the Act was deleted.

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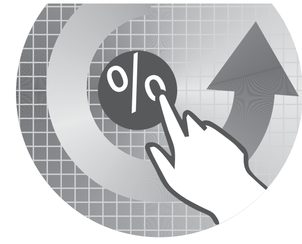


CA. Hasmukh Kamdar

# INDIRECT TAXES

## Central Excise and Customs – Case Law Update

### Demand – Limitation

*Commissioner of Central Excise, Ahmedabad vs. VRW Refractories Pvt. Ltd. [2013 (294) ELT 105 (Tri. Ahmd.)]*

**Facts in this case were as follows**

The manufacturer assessee was recovering transport charges from the customers in addition to the sale price of the goods. The excise duty was paid on the basis of sales price. The Department noticed that during the year 2000-01, the assessee has recovered excess transportation charges to the extent of ` 12,01,402/- from their customers than the actual amount paid by them to the transporters. Therefore demand of duty for ` 1,92,224/- was raised against the assessee by way of issuance of a show cause notice dated 2-2-2005.

The adjudicating authority confirmed the demand along with interest and imposed penalty of identical amount under section 11AC of the Act.

However, on appeal, the Commissioner (Appeals), by following the Hon'ble Supreme Court's decision in the case of *Baroda Electric Meters reported in 1997 (94) E.L.T. 13 (S.C.)* held that since the transportation activity is not connected with the manufacturing activity, the excess recovery of transportation charges from customers cannot be added to the assessable value. He accordingly set aside the impugned order. He also held the demand to be barred by limitation inasmuch as the duty demand for the period 2000-10 was raised by way of issuance of a show cause notice on 2-2-2005. The Commissioner (Appeals) relied upon the Hon'ble Supreme Court's decision in the case of *Padmini Products vs. CCE reported in 1989 (43) E.L.T 195 (S.C),* and observed that mere failure or negligence on the part of the manufacturer in not paying duty does not attract the extended period of limitation unless there is a positive evidence to show that the manufacturer knew the goods were liable to duty. As such by observing that the elements of proviso to section 11(A) relating to wilful misstatement, suppression of facts, fraud and collusion being absent in the facts of the case, the extended period is not be available to the Revenue.

The Department filed an Appeal to the Hon'ble Tribunal against Order of the Commissioner (Appeals). On behalf of the Revenue it was submitted that:

(i) The law declared by the Hon'ble Supreme Court in the case of Baroda Electric Meters cannot be followed in this case inasmuch as another matter relating to the same issue is pending before the Hon'ble Supreme Court in the case of Majestic Auto Ltd.

(ii) The recovery of excess freight charges was not known to the Revenue inasmuch as the respondent never disclosed the said fact to escape his duty liability, the suppression of fact with intent to evade payment of duty was rightly incorporated in the show cause notice.

(iii) The Revenue accordingly prayed for setting aside the impugned order of Commissioner (Appeals).

On behalf of the assessee it was submitted that there is no infirmity in the Order passed by the Commissioner (Appeal ).

The Hon'ble Tribunal observed as follows.

The Supreme Court's judgment in the case of *CCE, Meerut vs. Majestic Auto Ltd. reported in 2005 (184) E.L.T. 130 (S.C.),* we find that it again stands reiterated by the Hon'ble Supreme Court that in view of the earlier decision of in the case of Baroda Electric Meters, the appeal filed by the Revenue is dismissed. However in respect of other appeals a different issue was involved as is clear from paras 5 & 6 of the judgment, wherein they observed that there seems to be some confusion as to the factual and legal basis on which the original order of assessment had been passed. In view of that the appeal gets remanded to the Tribunal for determining the questions so formulated. As is already observed one of the appeals before the Hon'ble Supreme Court stands dismissed in view of the decision of the Hon'ble Supreme Court in the case of Baroda Electric Meters. As such we find no infirmity in the views adopted by Commissioner (Appeals) on merits.

The Hon'ble Tribunal also found favour with the findings arrived at by Commissioner (Appeals) in respect of limitation. Merely because the fact of charging more freight was not being disclosed to the Revenue, by itself cannot be taken as ground for invoking the longer period of limitation unless any evidence to reflect upon the assessee's *mala fide* is brought on record. In the absence of any such evidence, the extended period has been rightly held has not invoked as not against the respondent.

In view of our foregoing observations, the appeal filed by the Revenue was rejected.

## Condonation of delay in filing appeal

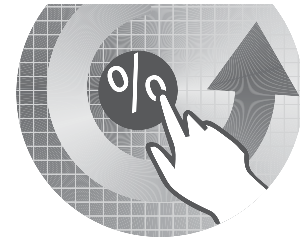
***Cadbury India Ltd vs. Commissioner of C. Ex. Indore [2013 (295) E.L.T. 585 (Tri. - Del.)]***

The appellant had filed an appeal to the Commissioner Appeals after delay of 67 days. The Commissioner Appeals rejected the Appeal as filed beyond limitation period observing that it has been filed beyond the period which could be condoned by exercise of discretions by the appellant authority within the contours of section 35 of the Central Excise Act, 1944.

The appellant preferred this appeal to Hon'ble Tribunal against the Order in Appeal.

The Hon'ble Tribunal observed that admittedly and demonstrably the appeal was filed before the Commissioner (Appeals) with a delay of 67 days beyond the initial period of limitation of 60 days. Section 35 (1) of the Act enacts that a person aggrieved by any decision or order passed under this Act by a Central Excise Officer lower in rank than a Commissioner may appeal to the Commissioner (Appeals) within 60 days from the date of the communication of order. The proviso to section 35 authorities the Commissioner (Appeals), if satisfied that the appellant was prevented by sufficient cause from presenting the appeal within the aforesaid period of sixty days, to present an appeal within a further period of thirty days. No discretion is granted to the Commissioner (Appeals) to condone a delay of 67 days beyond the initial period of limitation of sixty days. This is the reason the impugned order has recorded, for dismissing the appellant's appeal. Dismissal of the appeal is in conformity with the text and context of Section 35 of the Central Excise Act, 1944. The appellant order is impeccable and warrants no interference.

The appeal was considered as misconceived and was accordingly dismissed.



CA. Rajkamal Shah & CA. Naresh Sheth

# INDIRECT TAXES

## Service Tax – Statute update

### 1. Exemption to service provided by National Skill Development Corp and others approved by Sector Skill Council

Clause 9A is inserted in Notification No. 25/2012-ST dated 20-6-2012 for granting exemption to:

(i) The National Skill Development Corporation set up by the Government of India;

(ii) A Sector Skill Council approved by the National Skill Development Corporation;

(iii) An assessment agency approved by the Sector Skill Council or the National Skill Development Corporation;

(iv) A training partner approved by the National Skill Development Corporation or the Sector Skill Council.

For providing services in relation to (a) the National Skill Development Programme implemented by the National Skill Development Corporation; or (b) a vocational skill development course under the National Skill Certification and Monetary Reward Scheme; or (c) any other Scheme implemented by the National Skill Development Corporation.

This exemption is effective from 10-9-2013.

*(Notification No. 13/2013-ST dated 10-9-2013)*

### 2. Exemption to hotel and restaurant services provided in Uttarakhand

Following services provided to any person in the State of Uttarakhand during the period 17-9-2013 to 31-3-2014 is wholly exempted from service tax:

- Renting of a room in a hotel, in guest house, club campsite or other commercial place meant for residential or lodging purpose;
- Serving of food or beverages by a restaurant, eating joint or mess.

The exemption is granted for revival of hospitality industry which was badly affected by recent floods and landslides in the State of Uttarakhand.

*(Exemption Order No. 01/2013 dated 17-9-2013)*

### 3. Auxiliary Education Services

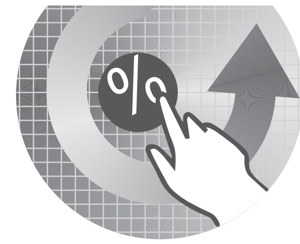
It has been clarified that based on the entry in negative list and exemption under Notification No. 25/2012 – ST all services relating to education are exempt from service tax. In relation to service provided to an Education Institution, the definition of "Auxiliary Education Service" is given in the exemption notification. Examples of such services are hiring of a bus to ferry students to and from the school, hostels, housekeeping, security, canteen, etc.

*(Circular No 172/7/2013 – ST dated 19-9-2013)*

### 4. Guidelines for arrest and bail

CBEC has come out with detailed guidelines for arrest and bail in relation to offences punishable under the Finance Act, 1994 for strict compliance by the field officers. The guidelines covers the types of cases as provided u/ss. 89(1) and 89(2) of the Finance Act and prescribes the conditions precedent for arrest, procedure for arrest, post arrest formalities, reporting system etc. For further details and the text of circular please refer to the Chamber's website.

*(Circular No 171/6/2013 – ST dated 17-9-2013)*



CA. Bharat Shemlani

# INDIRECT TAXES
## Service Tax – Case Law Update

### 1. Services

**Outdoor Catering Service**

*1.1 CST, Bangalore vs. The Grand Ashok 2013 (31) STR 528 (Kar.)*

The High Court in this case held that, outdoor catering consists of articles of food etc., which constitute sales and other part consists of service to bring food to place designated by client, including transportation, which alone is liable to service tax and not the entire cost received from client. It is composite but divisible contract of service under Article 366(29A) (f) of Constitution of India on which State Legislature is competent to levy sales tax on sales aspect only. Hence, sale of goods has to be bifurcated from service provided.

**Manpower supply & Security Service**

*1.2 CCE, Indore vs. International Logistics 2013 (31) STR 563 (Tri-Del.)*

The Tribunal in this case held that, reimbursement of expenses in case of manpower and security services are to be included in assessable value as such expenses are inseparable and integrally connected with performance of taxable service. It is further held that mere filing of balance sheet and returns does not amount to disclosure of facts.

*1.3 Seven Hills Construction vs. CST, Nagpur 2013 (31) STR 611 (Tri-Mumbai)*

In this case, the department sought to tax supply of manpower for running and maintenance of crushing plant, loading crushed stones in various sizes as required by clients under agreement of supply of manpower as per rate contract under Manpower supply service. The Tribunal after following decision in *Divya Enterprises 2010 (19) STR 370 (Tri.),* held that lump sum work given to assessee is not covered under supply of manpower service category.

**Erection, Commissioning and Installation Service**

*1.4 CCE, Rajkot vs. PSL Ltd. 2013 (31) STR 570 (Tri-Ahmd.)*

The assessee in this case engaged in job of laying the coated pipes on behalf of their customers for Government of Gujarat for GWRDC and NWRSDSK projects. The Tribunal held that as per paras 13.2 and 13.4 of Boards Circular No. 80/10/2004-ST dated 17-9-2004 and decision in *Larsen & Toubro Ltd. 2011 (22) STR 459 (Tri.)* service tax is leviable on construction done for commerce or primarily commerce and in the instant case, the supply of water was for the needy citizens of State and therefore, the activity is not chargeable to Service Tax.

**Business Auxiliary Service**

*1.5 Good Wind Travels Pvt. Ltd. vs. CCE, Ahmedabad 2013 (31) STR 598 (Tri-Ahmd.)*

The department in this case sought to tax services provided in the nature of assistance in visa and passport related work under BAS. The Tribunal held that CBEC Circular No. 137/6/2011-ST dated 20-4-2011 covers the issue in favour of the appellant and impugned services are not covered under any category of services leviable to service tax.

*1.6 Katrina R. Turcotte vs. CST, Mumbai-I 2013 (31) STR 670 (Tri-Ahmd.)*

The Appellant in this case paid service tax on various promotion or marketing services through her agent under Advertising Agency Service. The department sought to demand service tax under Business Auxiliary Service. The Tribunal held that, service tax liability discharged by the agent cannot be denied merely on the ground that it has paid service tax under Advertising Agency service. Just by paying the service tax liability under wrong head does not mean that service tax liability has not been discharged. Further the expression "Assessee" under section 65(7) means a person liable to pay tax including his agent.

*1.7 Smart Chip Ltd. vs. CCE, Bhopal 2013 (31) STR 727 (Tri-Del.)*

The Tribunal in this case held that the primary activity of issuance of Smart Card with relatable chip is composite contract to build a system and cannot be conceived to be Business Auxiliary Service.

**Club or Association Service**

*1.8 Sports Club of Gujarat Ltd. vs. UOI 2013 (31) STR 645 (Guj.)*

The High Court after relying on the decision in *Ranchi Club Ltd. 2012 (26) STR 401 (Jhar.)* held that service tax on club rendering services to its members is *ultra vires* and beyond legislative competence of Parliament. There was no loss of mutuality of club members, even if club was incorporated under Companies Act, 1956. The Court also rejected department's plea that, they have not accepted Jharkhand High Court judgment and held that persuasive value of the said judgment was not lost and more so because it has relied on a Full Bench decision of High Court.

**Banking and Financial Service**

*1.9 CST, Delhi vs. Lufthansa Technik Service India P. Ltd. 2013 (31) STR 730 (Tri-Del.)*

The Tribunal in this case held that providing aircrafts parts/equipments to airlines on leas for fixed period on payment of monthly lease charges is not a financial lease but operating lease and not liable to service tax under BFS. It is further held that, in absence of definition, the term or expression to be interpreted in sense in which it is understood in common parlance or trade parlance.

**Télécommunication Service**

*1.10 Vodafone Essar Cellular Ltd. vs. CCE, Pune-III 2013 (31) STR 738 (Tri-Mumbai)*

The appellant in this case, claimed export of telecom services provided in India to International inbound roamers registered with foreign telecom network operators, for which consideration was received in convertible foreign exchange. The Tribunal held that, there is no contract/agreement between assessee and subscriber of foreign telecom operator and therefore foreign telecom service provider is paying for services as recipient of service. Telecom service falls under category III of ESR, 2005 and CBEC in circular No. 111/5/2009-ST dated 24-2-2009 clarified that benefit accruing to foreign service provider as subscriber billed for services rendered. The ratio of Tribunal's decision in *Paul Merchants 2013 (29) STR 257 (Tribunal)* is squarely applicable to the present case and therefore service is qualified as export of service.

## 2. Interest/Penalties/Others

### 2.1 *Chitra Builder's P. Ltd. vs. ADC, CE &ST, Coimbatore 2013 (31) STR 515 (Mad.)*

The department in this case collected ` 2 crores from the petitioner company during search and stated that same has been paid voluntarily. The High Court held that though it is stated that amount has been paid voluntarily, it is not shown by the department that the petitioner was liable to pay service tax relating to the works being carried on by it during the course of its business. No tax can be collected from the assessee, without an appropriate assessment order being passed by the authority concerned and by following the procedures established by law.

### 2.2 *Bhagwati Security Services (Regd.) vs. UOI 2013 (31) STR 537 (All.)*

In this case petitioner provided security services to BSNL under an agreement. The petitioner deposited service tax on reimbursement of expenses and applied for reimbursement of service tax from BSNL, which was denied on the ground that the same was not contemplated in the agreement. The High Court held that Service tax is statutory liability and statute is imposing the tax upon the person to whom the service is being provided and the service provider is merely a collecting agency, therefore the respondent is liable to make reimbursement of service tax to petitioner.

### 2.3 *Elgi Equipment Ltd. vs. CCE, Coimbatore 2013 (31) STR 583 (Tri. - Chennai)*

In this case appellant, applied for refund of amount paid after stipulated period of one year under section 11B on the ground that, mere erroneous deposit of service tax not to be treated as tax and therefore section 11B is not applicable. The Tribunal held that, the Commissioner (A) has rejected refund following Supreme Court decision in *Doaba Co-operative Sugar Mills 1988 (37) ELT 478 (SC)* and powers of Central Excise Officers are confined within statute of Central Excise Act, therefore the rejection of refund is required to be upheld.

### 2.4 *CCE, Daman vs. Asian Plastowares Pvt. Ltd. 2013 (31) STR 594 (Tri.-Ahmd.)*

The department in this case objected for common appeal against two orders sanctioning refund. The Tribunal observed that, two separate numbers were given to two orders and common order not covering both refund claims hence there is no justification for filing common appeal.

### 2.5 *Ultratech Cement Ltd. vs. CCE, Bhavnagar 2013 (31) STR 600 (Tri.-Ahmd.)*

In this case, the refund claim filed under Notification No. 17/2009-ST has been rejected as time barred for failure to file claim within one year from date of export of goods. The Tribunal held that, it is settled law that Notification issued by Government to be considered as part of Statute and the said Notification is self contained providing for exemption by way of refund in respect of exports. Filing of claim within one year from date of exports becomes statutory and substantive requirement. It is further held that, Tribunal being creature of law not to go beyond provision of law and Statute and given relief.

### 2.6 *Prithvi Hotels (Gujarat) Pvt. Ltd. vs. CST, Ahmedabad 2013 (31) STR 612 (Tri.-Ahmd.)*

In this case the appellant received OIO dated 9-4-2010 on 16-4-2010 and filed appeal against the same on 1-6-2011. The Tribunal held that, Commissioner is not empowered to condone delay of 14 months as section 85(3) of FA, 1994 is very clear and provides specific time limit for filing appeal.

### 2.7 *CCE, Mangalore vs. Kudremukh Iron Ore Company Ltd. 2013 (31) STR 633(Tri.-Bang.)*

The Tribunal in this case held that, where the exemption under Notification No. 41/2007-ST

is available for "the whole of Service Tax", the Education Cess also stands to be exempt.

*2.8 CIT (TDS), Jaipur vs. Rajasthan Urban Infrastructure 2013 (31) STR 642 (Raj.)*

The High Court in this case held that, if the agreement stipulating that service tax was to be paid separately and it was not included in fee for professional/technical fees then expression "any sum paid" appearing in section 194J relates to fees for professional or technical services and therefore service tax amount paid separately is not subjected to TDS.

*2.9 Infinity Infotech Parks Ltd. vs. UOI 2013 (31) STR 653(Cal.)*

In this case, pursuant to audit, the SCN dated 18-4-2012 was issued for the financial years 2007-08 to 2010-11alleging that if Audit team had not visited the appellant premises the fact that they were engaged in providing taxable service of Renting of Immovable Property would not have been known to Dept and they had wilfully suppressed the facts within intent to evade service tax. However, Court observed that, records indicate that in response to notice dated 13-4-2009 by jurisdictional authorities' copies of lease agreements etc., have been submitted. The Court held that allegations against the appellant about suppression were vague and the payment of service tax on premium for long term lease was question of interpretation of law.

*2.10 Hari & Co. vs. CCE(ST), Tirunelveli 2013 (31) STR 681 (Tri-Chennai)*

The department in this case rejected refund claim as supporting documents submitted after considerable delay as due to delay in issue of certificate by Port Trust Authorities. The Tribunal held that, assessee not to be penalized and export benefit not to be refused for no fault of theirs. Refund claim filed within the stipulated time though relevant documents submitted later to be treated filed within time and refund to be allowed.

## 3. CENVAT Credit

*3.1 CCE & ST (LTU), Chennai vs. Turbo Energy Ltd. 2013 (31) STR 573 (Tri-Chennai)*

The assessee in this case claimed CENVAT credit of service tax paid on services such as sales promotion, handling, storage, assembly, logistics, quality services, repacking, warehousing, delivery etc. provided by agent located outside India. The department sought to deny the credit. The Tribunal held that, there is no reason to distinguish the services of Commission Agent falling within the ambit of BAS on different footing as compare to other services falling within the scope of same taxing category for the purpose of allowing CENVAT credit.

*3.2 Hindustan Zinc Ltd. vs. CCE, Jaipur 2013 (31) STR 575 (Tri-Del.)*

The Tribunal in this case allowed CENVAT credit of service tax paid on:

- Transportation of employees from residence to factory and back.
- Hiring of ambulance for treatment of employees in case of accident is required to be kept as per the provisions of the Factories Act.
- Transportation of employee's children from the residential colonies to schools as the factory is located at a remote place, and providing a residential colony for staff is essential and providing of transportation for school children is more essential.

*3.3 CCE, Panchkula vs. Jamuna Auto Industries Ltd. 2013 (31) STR 587 (Tri-Del.)*

The Tribunal in this case after relying on CBEC Circular No. 97/8/2007 dated 23-8-2007 allowed CENVAT credit of service tax paid on GTA services for outward transportation of goods beyond place of removal as the freight was part of the price on which duty has been discharged.

*3.4 Jindal Pipes Ltd. vs. CCE, Meerut II 2013 (31) STR 588 (Tri-Del.)*

The Tribunal in this case allowed CENVAT credit of service tax paid on Travel Agent services availed at Head Office by the Company's officers and services of maintenance of Head office.

*3.5 Federal Mogul Goetze (India) Ltd. vs. CCE, Chandigarh-II 2013 (31) STR 628 (Tri-Del.)*

The Tribunal in this case allowed CENVAT credit of service tax paid on insurance premium for protection of plant & machinery from risks and hazards as the same though does not contribute to manufacture directly but manufacture is made with such facility having indirect nexus.

*3.6 United Telecom Ltd. vs. CCE, Bangalore-I 2013 (31) STR 636 (Tri-Bang.)*

The appellant in this case claimed CENVAT credit of service tax paid on stock brokers service used for disposal of shares held by appellant in another company. The Tribunal held that, integral connection between sale of shares and any of the appellant's business activities has not been established and affidavit of Director does not bring out clear picture and therefore credit is inadmissible.

*3.7 Delta Energy Systems Ltd. vs. CCE, Delhi-III 2013 (31) STR 684 (Tri-Del.)*

The Tribunal in this case allowed CENVAT credit of service tax paid on Clearing house agent, erection and commissioning, inward freight, courier service, credit card service, real estate agent and repair and maintenance service are utilised in relation to business hence admissible as input service. It is further held that, CENVAT credit of catering service would be eligible for Cenvat credit only if the assessee is not charging to the employees.

*3.8 J. K. Cement vs. CCE, Jaipur-II 2013 (31) STR 687 (Tri-Del.)*

The Tribunal in this case allowed CENVAT credit of service tax paid on accident insurance policy for workers as insurance for workers even contract workers is required by law and insurance service has to be treated as service in or in relation to manufacture of finished products.

*3.9 MRF Ltd. vs. CCE&ST (LTU), Chennai 2013 (31) STR 689 (Tri-Chennai)*

The appellant in this case claimed service tax paid on security services availed by appellant for guarding the inputs which had been sent to the premises of Job-Worker where the goods were converted into an intermediate product and sent back to the factory of the appellant. The Tribunal held that definition of input service nowhere specifies that the services have to be received and utilised within the factory and therefore there is no reason to deny CENVAT credit on said security services. It is further held that service tax paid on security services availed at the guest house maintained by the appellant near factory is not admissible as the said guest house is used for business process as well as for satisfaction of personal needs.

> Society prepares the crime, the criminal commits it.
>
> — *Buckle*

CA. Mayur Nayak, CA. Natwar Thakrar &
CA. Pankaj Bhuta

# OTHER LAWS
## FEMA Update

In this article, we have discussed recent changes in FEMA through RBI circulars and Press Notes

### A. RBI CIRCULARS

### 1. Overseas Direct Investments – Rationalisation/Clarifications

RBI has clarified that all the financial commitments made on or before August 14, 2013, in compliance with the earlier limit of 400% of the networth of the Indian Party under the automatic route will continue to be allowed. In other words, such investments shall not be subject to any unwinding or approval from the Reserve Bank.

The limit of financial commitments for an Indian Party (presently 100% of its net worth) shall not apply to the financial commitments funded out of EEFC account of the Indian Party or out of funds raised by way of ADR's / GDRs by the Indian Party, as hitherto.

RBI has further decided to retain the limit of 400% of the net worth of the Indian Party for the financial commitments funded by way of eligible External Commercial Borrowing (ECB) raised by the Indian Party as per the extant ECB guidelines issued by the Reserve Bank of India from time-to-time.

Further, the following clarifications on Overseas Direct Investments have been provided by RBI:

An IP can make fresh financial commitments in the existing JV/WOS (including for the purpose of setting up of/acquiring step down subsidiaries outside India) only up to the revised limit of 100%, under the automatic route. Any financial commitment beyond the 100% cap shall require prior approval of the Reserve Bank under the approval route for ODI.

In case of an already contracted/committed financial commitment for an existing JV/WOS, the earlier limit of 400%, under the automatic route, would apply. The onus of ensuring the veracity/authenticity of the contract/ commitment before permitting remittances would lie with the designated AD bank. Such cases would have to be immediately reported *post facto* to RBI by the AD banks.

For setting up or acquiring a new JV / WOS, for which contract / agreement has been put in place on or before August 14, 2013, in this case also the dispensation of the following would apply:

i. Applicability of automatic route up to 400% of net worth and

ii. Post facto reporting of such cases to RBI immediately by the AD banks.

In case of applications received by the Reserve Bank or/and an AD bank on or before August 14, 2013, same would be examined and dealt with by the Reserve Bank or/and an AD bank under the earlier guidelines only, i.e., guidelines prior to August 14, 2013.

For calculating the limit of 100% for JV/WOS, the earlier investments made by the Indian Party will also be reckoned towards this 100%.

Making fresh financial commitment in an existing overseas JV/WOS of another Indian Party (either by way of transfer of existing stake or by way of fresh contribution) would be treated as fresh financial commitment by the new Indian Party and it would have to be within the revised limit of 100%, under the automatic route.

The term 'Government of India' may be considered to read as the 'Competent Authority'. 'Competent Authority', depending on the amount involved, would be (1) Board of Directors of the respective PSU, (2) Empowered Committee of the Secretaries (ECS); and (3) Cabinet Committee on Economic Affairs (CCEA)

*[A.P. (DIR Series) Circular No. 30 dated 4th September, 2013]*

*(It is a welcome clarification from RBI that earlier limit of 400% of net worth shall continue to be applicable to financial commitments already made before 14-8-2013 but wherein remittances towards such financial commitments are to be made in tranches in future. Further, the previous ceiling would also apply in cases whereby applications for overseas direct investments would have been submitted to AD/RBI on or before 14-08-2013. An important change to noted is that the revised limits would not apply to ODI funded out of ECB)*

## 2. External Commercial Borrowings (ECB) from the foreign equity holder

As per the extant ECB policy, borrowings in the form of ECB cannot be utilized for general corporate purpose.

RBI now decided to permit eligible borrowers to avail of ECB under the approval route from their foreign equity holder company with minimum average maturity of 7 years for general corporate purposes subject to the following conditions:

i. Minimum paid-up equity of 25 per cent should be held directly by the lender;

ii. Such ECBs would not be used for any purpose not permitted under the extant ECB guidelines (including on-lending to their group companies / step-down subsidiaries in India); and

iii. Repayment of the principal shall commence only after completion of minimum average maturity of 7 years. No prepayment will be allowed before maturity.

*[A.P. (DIR Series) Circular No. 31 dated 4th September, 2013]*

*(Subject to certain exceptions for specific sectors, under approval route, hitherto, ECB has not been permitted for 'working capital or general corporate purpose or repayment of existing rupee loans'.* Vide *this circular, RBI has allowed ECB for 'general corporate purpose' from foreign equity holder companies under approval route subject to certain conditions although there is a need to define in greater detail what is meant by 'general corporate purpose'.)*

## 3. Liberalised Remittance Scheme – Clarifications

Following clarifications on Liberalised Remittance Scheme (LRS) have been issued by RBI:

i. In terms of the extant FEMA provisions LRS can be used to acquire both listed and unlisted shares of an overseas company.

ii. As per the current guidelines of LRS, only gift and donations by a resident individual have been subsumed under the LRS limit. For all other purposes such as educational and medical expenses the limits of LRS and Schedule III to FEM CAT Rules 2000 are separate, distinct, mutually exclusive and over and above each other respectively.

   In this context, RBI has drawn attention to the following remittances which can be made over and above the annual limit of USD 75,000 permissible under LRS under the extant guidelines under FEMA:

   a. A resident individual can make remittances for meeting expenses for medical treatment abroad up to the estimate from a doctor in India or hospital/ doctor abroad under general permission (without any RBI approval ).

   b. A resident individual can make remittances up to USD 25,000 for maintenance expenses of a patient going abroad for medical treatment or check-up abroad or for accompanying as attendant to a patient going abroad for medical treatment/ check-up (without any RBI approval).

   c. A resident individual can make remittances for studies up to the estimates from the institutions abroad or USD 100,000, whichever is higher (without any RBI approval). This is over and above the remittance limit of USD 75,000 which can be made under the LRS route for the same.

   d. A resident individual can also make all other remittances (other than donation and gifts) as stipulated under Schedules III to FEM CAT Rules, 2000, as amended from time to time.

   e. A resident individual can also carry out other permissible current account transactions (transactions which are not explicitly prohibited under Schedule I, or restricted under Schedules II and III, to FEM CAT Rules, 2000, as amended from time- to-time) without any limits through an AD Bank in India subject to the AD bank verifying the bonafides of the transaction.

   Therefore notwithstanding the revised guidelines and reduction in the LRS limit these guidelines do not affect genuine transactions.

iii. Resident individuals have been permitted to make remittances for acquiring immovable property within the annual limit of USD 75000 for already contracted cases, i.e. only for those contracts which were entered into on or before the date of the circular, i.e., August 14, 2013, subject to satisfaction of the genuineness of the transactions by the AD bank. Such cases would have to be immediately reported post facto to the Reserve Bank of India by the AD banks.

*[A.P. (DIR Series) Circular No. 32 dated 4th September, 2013]*

*(Fresh investments in immovable property abroad had been restricted* vide ***A. P. (DIR Series) Circular*** *No.24 dated August 14, 2013. It a welcome clarification from RBI to allow remittance for immovable properties under previous ceiling of USD 2,00,000 where they had been acquired under instalment basis on or before 14-8-2013.)*

## 4. Deferred Payment Protocols dated April 30, 1981 and December 23, 1985 between Government of India and erstwhile USSR

In terms of A.P. (DIR Series) Circular No. 26 dated August 14, 2013, the Rupee value of the Special Currency Basket was indicated as ` 83.45023 effective from August 12, 2013.

Upon further revision, RBI has fixed the Rupee value of the Special Currency Basket at ` 86.857663 with effect from August 23, 2013.

*[A.P. (DIR Series) Circular No. 33 dated 4th September, 2013]*

## 5. AML Standards/Combating the Financing of Terrorism CFT Standards – Money Changing Activities

Financial Action Task Force (FATF) has updated its Statement on the subject and document 'Improving Global AML/CFT Compliance: on-going process' on June 21, 2013.

*[A.P. (DIR Series) Circular No. 34 dated 4th September, 2013]*

## 6. Anti-Money Laundering (AML) standards/Combating the Financing of Terrorism (CFT) Standards – Cross Border Inward Remittance under Money Transfer Service Scheme

Financial Action Task Force (FATF) has updated its Statement on the subject and document 'Improving Global AML/CFT Compliance: on-going process' on June 21, 2013.

*[A.P. (DIR Series) Circular No. 35 dated 4th September, 2013]*

## 7. Risk Management and Inter Bank Dealings

As per the extant regulations, the facility of cancellation and rebooking is not permitted for forward contracts, involving Rupee as one of the currencies, booked by residents to hedge current and capital account transactions. However, exporters are allowed to cancel and rebook forward contracts to the extent of 25 per cent of the contracts booked in a financial year for hedging their contracted export exposures.

RBI has now decided with a view to providing operational flexibility to exporters and importers to hedge their foreign exchange risk, to:

1) allow exporters to cancel and rebook forward contracts to the extent of 50 per cent of the contracts booked in a financial year for hedging their contracted export exposures, and

2) allow importers to cancel and rebook forward contracts to the extent of 25 per cent of the contracts booked in a financial year for hedging their contracted import exposures.

*[A.P. (DIR Series) Circular No. 36 dated 4th September, 2013]*

*(Enhancement of rebooking limit for exporters and re-initiation of sanction for rebooking of forward contracts for importers will benefit exporters as well as importers to a great extent especially in recent times of forex volatility.)*

## 8. Issue of Bank Guarantee on behalf of person resident outside India for FDI transactions

RBI has now decided to permit AD Category-I bank to issue bank guarantee, without prior approval of the Reserve Bank, on behalf of a non-resident acquiring shares or convertible debentures of an Indian company through open offers/ delisting/exit offers, provided:

a. The transaction is in compliance with the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) [SEBI(SAST)] Regulations;

b. The guarantee given by the AD Category-I bank is covered by a counter guarantee of a bank of international repute.

The guarantee has to be valid for a tenure co-terminus with the offer period as required under the SEBI (SAST) Regulations.

In case of invocation of the guarantee, the AD Category-I bank would be required to submit to the Chief General Manager-in-Charge, Foreign Exchange Department, Reserve Bank of India, Central Office, Mumbai 400 001, a report on the circumstances leading to the invocation of the guarantee.

*[A.P. (DIR Series) Circular No. 37 dated 5th September, 2013]*

*(This move shall afford operational convenience to non-residents acquiring shares/convertible debentures of an Indian company through open offers/delisting/exit offers.)*

## 9. Purchase of shares on the recognised stock exchanges in accordance with SEBI (Substantial Acquisition of Shares and Takeover) Regulations

At present, Foreign Institutional Investors, Qualified Foreign Investors and Non-Resident Indians are eligible to acquire shares on the recognised stock exchanges in compliance with the conditions under Schedules 3, 4, 5 and 8 of Transfer or issue of security by a person resident outside India Regulations. A non-resident is not permitted to acquire shares on stock exchange under FDI scheme.

The issue of acquisition of shares under the FDI Scheme by a non-resident on a recognised stock exchange has been reviewed by RBI and as a further measure of liberalisation, RBI has decided that a non-resident including a Non Resident Indian may acquire shares of a listed Indian company on the stock exchange through a registered broker under FDI scheme provided that:

i. The non-resident investor has already acquired and continues to hold the control in accordance with SEBI (Substantial Acquisition of Shares and Takeover) Regulations;

ii. The amount of consideration for transfer of shares to non-resident consequent to purchase on the stock exchange may be paid as below:

- by way of inward remittance through normal banking channels, or
- by way of debit to the NRE/FCNR account of the person concerned maintained with an authorised dealer/bank;
- by debit to non-interest bearing Escrow account (in Indian Rupees) maintained in India with the AD bank in accordance with Foreign Exchange Management (Deposit) Regulations, 2000;
- the consideration amount may also be paid out of the dividend payable by Indian investee company, in which the said non-resident holds control as (i) above, provided the right to receive dividend is established and the dividend amount has been credited to specially designated non-interest bearing rupee account for acquisition of shares on the floor of stock exchange.

iii. The pricing for subsequent transfer of shares to non-resident shareholder shall be in accordance with the pricing guidelines under FEMA;

iv. The original and resultant investments are in line with the extant FDI policy and FEMA regulations in respect of sectoral cap, entry route, reporting requirement, documentation, etc.

*[A.P. (DIR Series) Circular No. 38 dated 6th September, 2013]*

*(Consequent to issuance of this circular, there would be huge capital gains tax savings for shareholders offering shares towards further acquisition of shares on stock-exchange by non-residents who are in 'control' of investee entities.)*

## 10. Export and Import of Currency

As per extant regulations, any person resident in India can take outside India or having gone out of India on a temporary visit, can bring into India (other than to and from Nepal and Bhutan) currency notes of Government of India and Reserve Bank of India notes up to an amount not exceeding ` 7,500 per person.

As part of providing greater flexibility to the resident individuals travelling abroad, the existing limit, mentioned above, has been enhanced by RBI to ` 10,000 per person.

Accordingly, any person resident in India:

i) May take outside India (other than to Nepal and Bhutan) currency notes of Government of India and Reserve Bank of India notes up to an amount not exceeding `10,000 (Rupees ten thousand only) per person; and

ii) Who had gone out of India on a temporary visit, may bring into India at the time of his return from any place outside India (other than from Nepal and Bhutan), currency notes of Government of India and Reserve Bank of India notes up to an amount not exceeding `10,000 (Rupees ten thousand only) per person.

*[A.P. (DIR Series) Circular No. 39 dated 6th September, 2013]*

## 11. Overseas Foreign Currency Borrowings by Authorised Dealer Banks – Enhancement of limit

All categories of overseas foreign currency borrowings including existing ECBs, loans and overdrafts from their Head Office, overseas branches and correspondents and overdrafts in Nostro accounts (not adjusted within five days) shall not exceed 50 per cent of their unimpaired Tier I capital as at the close of the previous quarter or USD 10 million (or its equivalent), whichever is higher, and overseas borrowings by AD Category-I banks for the purpose of financing export credit in foreign currency, subordinated debt placed by head offices of foreign banks with their branches in India as Tier II capital, capital funds raised/augmented by the issue of innovative perpetual debt instruments and debt capital instruments in foreign currency and any other overseas borrowings with the specific approval of the Reserve Bank would be outside this limit.

RBI has now decided that AD Category-I banks may henceforth borrow funds from their Head Office, overseas branches and correspondents and overdrafts in nostro accounts up to a limit of 100 per cent of their unimpaired Tier I capital as at the close of the previous quarter or USD 10 million (or its equivalent), whichever is higher, as against the existing limit of 50 per cent (excluding borrowings for financing of export credit in foreign currency and capital instruments).

RBI has further decided that AD Category-I banks, at their option, can enter into a swap transaction with RBI in respect of the borrowings raised after the date of this circular. The swaps shall be available at a concessional rate of a hundred basis points below the market rate for all fresh borrowing with a minimum tenor of one year and a maximum tenor of three years, irrespective of whether such borrowings are in excess of fifty per cent of their unimpaired Tier I capital or not. Further, while the swaps shall be for the entire tenor

of the borrowing, the rate shall be reset after every one year from the date of the swap at hundred basis points lower than the market rate prevailing on the date of reset. While the banks are free to borrow in any freely convertible currency, the swap will be available only for conversion of USD equivalent into Rupees and the USD equivalent shall be computed at the relevant cross rate prevailing on the date of the swap. Category-I AD banks may contact the Principal Chief General Manager, Financial Markets Department, Reserve Bank of India, Central Office for availing of the swap facility. The concessional swap window shall be open till November 30, 2013. It may be noted that RBI reserves the right to decline a swap transaction or to withdraw this facility before November 30, 2013 after due notice.

The borrowings beyond the hitherto permitted level of 50 per cent of their unimpaired Tier I capital will have to subject to the following conditions:

i. The bank should have a Board approved policy on overseas borrowings which shall contain the risk management practices that the bank would adhere to while borrowing abroad in foreign currency;

ii. The bank should maintain a CRAR of 12.0 per cent.

iii. The borrowings beyond the existing ceiling shall be with a minimum maturity of three years.

iv. All other existing norms (FEMA regulations, NOPL norms etc.) shall continue to be applicable.

*[A.P. (DIR Series) Circular No. 40 dated 10th September, 2013]*

## 12. Overseas Direct Investment – Amendment

As per the extant regulations, issue of corporate guarantee on behalf of second generation or subsequent level step down operating subsidiaries is considered under the Approval Route, provided the Indian Party directly or indirectly holds 51 per cent or more stake in the overseas subsidiary for which such guarantee is intended to be issued. RBI has decided that issue of corporate guarantee on behalf of second generation or subsequent level step down operating subsidiaries will be considered under the Approval Route, provided the Indian Party indirectly holds 51 per cent or more stake in the overseas subsidiary for which such guarantee is intended to be issued.

*[A.P. (DIR Series) Circular No. 41 dated 10th September, 2013]*

*(It seems that earlier the word 'directly' was inadvertently inserted since the Indian Party would commonly not have any direct equity stake in its step down subsidiary.)*

## 13. Foreign Investment in India – Guidelines for calculation of total foreign investment in Indian companies, transfer of ownership and control of Indian companies and downstream investment by Indian companies

As per the extant regulations, for the purpose of downstream investment, the Indian companies making the downstream investments have to bring in requisite funds from abroad and cannot use funds borrowed in the domestic market. This, however, does not preclude downstream operating companies, from raising debt in the domestic market. Downstream investments through internal accruals are permissible by an Indian company engaged only in activity of investing in the capital of another Indian company/ies.

RBI has now decided that downstream investments through internal accruals are permissible by an Indian company and not necessarily restricted to an Indian company

engaged only in activity of investing in the capital of another Indian company/ies.

*[A.P. (DIR Series) Circular No. 42 dated 12th September, 2013]*

*(Dispensing with the condition of bringing in funds from abroad in case of existence of internal accruals would go a long way in facilitating downstream investments by Indian Companies.)*

## 14. Export of Goods and Services – Simplification and Revision of Declaration Form for Exports of Goods/Softwares

Every exporter of goods or software has to give declaration in one of the forms (GR/PP/SDF/SOFTEX/Bulk SOFTEX) and submit it to the specified authority for certification. In order to simplify the existing form used for declaration of exports of Goods/Softwares, a common form called "Export Declaration Form" (EDF) has been devised to declare all types of export of goods from Non-EDI ports and a common "SOFTEX Form" to declare single as well as bulk software exports. The EDF will replace the existing GR/PP form used for declaration of export of Goods. The procedure relating to the exports of goods through EDI ports will remain the same and SDF form will be applicable as hitherto.

Under the revised procedure, the exporters will have to declare all the export transactions, including those less than US$25000, in the form as applicable.

*[A.P. (DIR Series) Circular No. 43 dated 13th September, 2013]*

## 15. Foreign Direct Investment (FDI) in India – Review of FDI policy – Definition for control and sector specific conditions

Under FDI regulations, description of sectors/activities wherein the entry norms, sectoral cap and other conditions for sectors/activities in which FDI is permitted under Government route and Automatic route are specified.

RBI has decided to revise the definition of the term 'control' as under:

> 'Control' shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.

Government of Himachal Pradesh and Karnataka have given consent to implement the FDI policy on Multi Brand Retail Trading in Himachal Pradesh and Karnataka respectively. As such, the list of States/Union Territories which have conveyed their concurrence would stand modified. Further, the extant policy on FDI caps and routes for various sectors has also been reviewed.

*[A.P. (DIR Series) Circular No. 44 dated 13th September, 2013]*

*(Although the definition of 'control' has been brought in line with such definition as appearing under SEBI Regulations as well as Companies Act 2013, the objective criteria has been transformed into a subjective one which could create problems in inference of existence of control in different situations.)*

## 16. Memorandum of Instructions governing money changing activities – Location of Forex Counters in International Airports in India

RBI has now decided to allow non-residents to carry Indian currency upto a maximum of ` 10,000/- beyond Immigration/Customs desk to the Duty Free Area/Security Hold Area (SHA) in the departure hall in international airports in India for meeting miscellaneous expenditures subject to the condition that non-residents will not be allowed to carry any

Indian Rupee beyond SHA and that they should dispose of Indian currency before boarding the plane.

In order to provide money changing facility to non-residents to convert unspent Indian Rupees with them, Foreign Exchange Counters in the departure halls in international airports in India may be established in the Duty Free Area/SHA beyond the Immigration/ Customs desk. Such Foreign Exchange Counters will however, only buy Indian Rupees from non-residents and sell foreign currency to them subject to usual terms and conditions. Putting up suitable display at these counters, reminding the passengers that the area is the last point for non-residents to possess Indian Rupees (INR) will be the responsibility of the Airport Authorities.

*[A.P. (DIR Series) Circular No. 45 dated 16th September, 2013]*

*(RBI has subsequently also issued Press Release dated 19-09-2013 in response to misreporting in media and clarifying that such restrictions on non-residents pertaining to Indian currency notes were always in place and that this circular has been issued to indeed provide convenience to non-residents to make purchases from Duty Free Area with Indian currency.)*

## 17. Overseas Forex trading through electronic / internet trading portals

RBI has taken note of the fact that some banking customers continue to undertake online trading in foreign exchange on portals / websites offering such schemes wherein they initially remit funds from Indian bank accounts using credit cards or other electronic channels to overseas websites / entities and subsequently receive cash refunds from the same overseas entities into their credit card or bank accounts.

With a view to further strengthening the restrictions on such online activities which are in violation of FEMA, 1999, RBI has directed AD Category-I banks as follows:

All AD Category-I banks who offer credit cards or online banking facilities to their customers should advise their customers that any person resident in India collecting and effecting / remitting payments directly /indirectly outside India in any form towards overseas foreign exchange trading through electronic/internet trading portals would make himself/ herself/ themselves liable to be proceeded against with for contravention of the Foreign Exchange Management Act (FEMA), 1999 besides being liable for violation of regulations relating to Know Your Customer (KYC) norms / Anti Money Laundering (AML) standards.

As and when any AD category-I bank comes across any prohibited transaction undertaken by its credit card or online banking customer the bank will immediately close the card or account of the defaulting customer and report the same to Chief General Manager-in-Charge, Forex Markets Division, Foreign Exchange Department, Reserve Bank of India, Central Office, 5th Floor, Amar Building, P.M. Road, Mumbai – 400001 in the prescribed format.

If it is observed that the concerned AD category- I bank has failed to carry out the measures as outlined above, Reserve Bank of India shall proceed against the defaulting bank under section 11(3) of FEMA, 1999 and take any action as may be deemed necessary.

*[A.P. (DIR Series) Circular No. 46 dated 17th September, 2013]*

*(Although RBI had cautioned earlier against overseas forex trading carried out through electronic/internet trading portals,* vide ***this*** *circular, RBI has put emphasis on transactions taking place through credit cards and/or through proxy bank accounts by placing more responsibility and onus on banks and also card issuing companies.)*

## 18. Deferred Payment Protocols between Government of India and erstwhile USSR

In terms of A.P. (DIR Series) Circular No. 33 dated September 4, 2013, the Rupee value of the Special Currency Basket was indicated as ` 86.857663 effective from August 23, 2013.

Upon further revision, RBI has fixed the Rupee value of the Special Currency Basket at Rs.92.985396 with effect from September 2, 2013.

*[A.P. (DIR Series) Circular No. 47 dated 17th September, 2013]*

## 19. External Commercial Borrowings (ECB) Policy – Liberalisation of definition of Infrastructure Sector

The existing definition of infrastructure sector for the purpose of availing ECB includes: (i) power, (ii) telecommunication, (iii) railways, (iv) road including bridges, (v) sea port and airport (vi) industrial parks (vii) urban infrastructure (water supply, sanitation and sewage projects), (viii) mining, exploration and refining, (ix) cold storage or cold room facility, including farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat.

RBI has decided to expand the existing definition for infrastructure sector for the purpose of availing ECB. The expanded infrastructure sector and sub-sectors for the purpose of ECB include:

a) Energy which will include (i) electricity generation, (ii) electricity transmission, (iii) electricity distribution, (iv) oil pipelines, (v) oil/gas/liquefied natural gas (LNG) storage facility (includes strategic storage of crude oil) and (vi) gas pipelines (includes city gas distribution network);

b) Communication which will include (i) mobile telephony services / companies providing cellular services, (ii) fixed network telecommunication (includes optic fibre / cable networks which provide broadband / internet) and (iii) telecommunication towers;

c) Transport which will include (i) railways (railway track, tunnel, viaduct, bridges and includes supporting terminal infrastructure such as loading / unloading terminals, stations and buildings), (ii) roads and bridges, (iii) ports, (iv) inland waterways, (v) airport and (vi) urban public transport (except rolling stock in case of urban road transport);

d) Water and sanitation which will include (i) water supply pipelines, (ii) solid waste management, (iii) water treatment plants, (iv) sewage projects (sewage collection, treatment and disposal system), (v) irrigation (dams, channels, embankments, etc.) and (vi) storm water drainage system;

e) (i) mining, (ii) exploration and (iii) refining;

f) Social and commercial infrastructure which will include (i) hospitals (capital stock and includes medical colleges and para medical training institutes), (ii) Hotel Sector which will include hotels with fixed capital investment of ` 200 crore and above, convention centres with fixed capital investment of ` 300 crore and above and three star or higher category classified hotels located outside cities with population of more than 1 million (fixed capital investment is excluding of land value), (iii) common infrastructure for industrial parks, SEZs, tourism facilities, (iv) fertilizer (capital investment), (v) post harvest storage infrastructure for agriculture and horticulture produce including cold storage, (vi) soil testing laboratories and (vii) cold chain (includes cold room facility for farm level pre-cooling, for preservation or storage or

agriculture and allied produce, marine products and meat.

*[A.P. (DIR Series) Circular No. 48 dated 18th September, 2013]*

*(It is a welcome move by RBI wherein various sub-sectors within 'Infrastructure Sector' have been exhaustively defined to prevent ambiguity.)*

## 20. Deferred Payment Protocols between Government of India and erstwhile USSR

In terms of A.P. (DIR Series) Circular No. 47 dated September 17, 2013, the Rupee value of the Special Currency Basket was indicated as `92.985396 effective from September 2, 2013.

Upon further revision, RBI has fixed the Rupee value of the Special Currency Basket at `90.052266 with effect from September 04, 2013.

*[A.P. (DIR Series) Circular No. 49 dated 20th September, 2013]*

## 21. Opening of Trading Office / Non-Trading Office / Branch Office/ Representative Office abroad

As per extant guidelines, statement in Form ORA was to be submitted to the Regional Offices of Reserve Bank on half yearly basis instead of on a monthly basis by the Authorized Dealers. RBI has now decided to discontinue the practice of forwarding the statement in Form ORA to the respective Regional Office of Reserve Bank by the Authorized Dealers. Authorised Dealers may, however, continue to maintain the particulars of approvals granted for opening of Trading Office / Non-Trading Office / Branch Office/ Representative Office at their end.

*[A.P. (DIR Series) Circular No. 50 dated 20th September, 2013]*

*(It seems that such deregulation has been effected since Form ORA pertained to essentially only initial expenses and recurring expenses for maintenance of Trading/Non-Trading/Branch/Representative office abroad.)*

## 22. Export of Goods and Services – Project Exports

Memorandum of Instructions on Project and Service Exports (PEM) had been revised by RBI and the time limit to submit Forms DPX 1, PEX-1 and TCS-1 was increased to 30 days of entering contract for grant of post-award approval. RBI has now decided that submission of forms DPX1, PEX-1, TCS-1 and DPX-3, to the Office of the Reserve Bank of India (Foreign Exchange Department) within whose jurisdiction the Head Office of the exporter is situated, by the Approving Authority (AA) such as AD Bank / Exim Bank/ Working Group may be dispensed with. However, submission of these forms to ECGC and Exim Bank where their participatory interests by way of funded / non-funded facilities, insurance /risk cover, etc. are involved may continue.

*[A.P. (DIR Series) Circular No. 51 dated 20th September, 2013]*

## 23. Exim Bank's Line of Credit of USD 22.50 million to the Government of Burkina Faso

The Credit Agreement under the LOC is effective from September 13, 2013 and the date of execution of Agreement is January 18, 2013.

*[A.P. (DIR Series) Circular No. 52 dated 24th September, 2013]*

## 24. Trade Credits for Import into India

AD Category-I banks have been allowed to approve availing of trade credit not exceeding USD 20 million up to a maximum period of five

years (from the date of shipment) for companies in the infrastructure sector, subject to certain terms and conditions stipulated therein. It is also stipulated that AD Category-I banks are not permitted to issue Letters of Credit/ guarantees/Letter of Undertaking (LoU) /Letter of Comfort (LoC) in favour of overseas supplier, bank and financial institution for the extended period beyond three years. No roll-over/ extension is permitted beyond the permissible period.

RBI has now decided to allow companies in all sectors to avail of trade credit not exceeding USD 20 million up to a maximum period of five years for import of capital goods as classified by Director General of Foreign Trade (DGFT). It has also been decided to relax the *ab initio* contract period of 15 (fifteen) months for all trade credits to 6 (six) months.

AD Category-I banks are, however, not permitted to issue Letters of Credit/ guarantees/Letter of Undertaking (LoU) /Letter of Comfort (LoC) in favour of overseas supplier, bank and financial institution for the extended period beyond three years.

*[A.P. (DIR Series) Circular No. 53 dated 24th September, 2013]*

## 25. Overseas Foreign Currency Borrowings by Authorised Dealer Banks – Enhancement of limit

AD Category-I banks were allowed to borrow beyond 50 per cent of their unimpaired Tier I capital subject, *inter alia*, to the condition that the borrowing would have a minimum maturity of three years.

RBI has now decided to lower the requirement of minimum maturity from three years to one year for the aforesaid borrowings made on or before November 30, 2013 for the purpose of availing of the Swap facility from the Reserve Bank of India. It shall also be noted that after the said date, foreign currency borrowing by AD Category-I banks beyond 50 per cent of their Tier I Capital shall have to be of a minimum maturity of three years.

*[A.P. (DIR Series) Circular No. 54 dated 25th September, 2013]*

## 26. Deferred Payment Protocols between Government of India and erstwhile USSR

In terms of A.P. (DIR Series) Circular No. 49 dated September 20, 2013, the Rupee value of the Special Currency Basket was indicated as `90.052266 effective from September 4, 2013.

Upon further revision, RBI has fixed the Rupee value of the Special Currency Basket at `86.903352 with effect from September 13, 2013.

*[A.P. (DIR Series) Circular No. 55 dated 26th September, 2013]*

## 27. Trade Credits for Imports into India – Review of all-in-cost ceiling

On a review, RBI has decided that the all-in-cost ceiling as specified below will continue to be applicable till March 31, 2014 and is subject to review thereafter.

| Maturity period | All-in-cost ceilings over 6 months LIBOR* |
|---|---|
| Up to one year | |
| More than one year and up to three years | 350 basis points |
| More than three years and up to five years | |
| * for the respective currency of credit or applicable benchmark | |

*[A.P. (DIR Series) Circular No. 56 dated 30th September, 2013]*

## 28. External Commercial Borrowings (ECB) Policy – ECB proceeds for acquisition of shares under the Government's disinvestment programme of PSUs – Clarification

ECB proceeds is currently permitted to be used in the first stage acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public under the Government's disinvestment programme of the public sector undertakings (PSUs) shares. RBI has clarified that ECB is now allowed for all subsequent stages of acquisition of shares in the disinvestment process under the Government's disinvestment programme of the PSU shares; in other words, facility of ECB is available for multiple rounds of disinvestment of PSU shares under the Government disinvestment programme.

*[A.P. (DIR Series) Circular No. 57 dated 30th September, 2013]*

## 29. External Commercial Borrowings (ECB) Policy — Review of all-in-cost ceiling

RBI has now decided that the all-in-cost ceiling as specified below will continue to be applicable till March 31, 2014 and subject to review thereafter.

| Average Maturity Period | All-in-cost over 6 month LIBOR* |
|---|---|
| Three years and up to five years | 350 bps |
| More than five years | 500 bps |
| * for the respective currency of borrowing or applicable benchmark | |

*[A.P. (DIR Series) Circular No. 58 dated 30th September, 2013]*

## 30. External Commercial Borrowings (ECB) Policy – Refinancing / Rescheduling of ECB

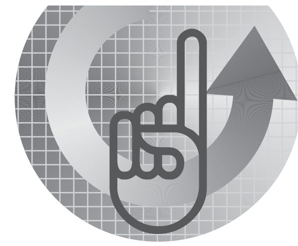
Under the extant regulations, eligible borrowers desirous of refinancing an existing ECB can raise fresh ECB at a higher all-in-cost / reschedule an existing ECB at a higher all-in-cost under the approval route subject to the condition that the enhanced all-in-cost does not exceed the all-in-cost ceiling prescribed as per extant guidelines.

RBI has now decided to discontinue this facility allowing eligible borrowers to raise ECB at a higher all-in-cost to refinance / reschedule an existing ECB with effect from October 1, 2013.

The scheme of refinance of existing ECB by raising fresh ECB at lower all-in-cost, subject to the condition that the outstanding maturity of the original ECB is either maintained or extended, will continue as hitherto under the automatic route and approval route as the case may be.

*[A.P. (DIR Series) Circular No. 59 dated 30th September, 2013]*

*(Refinancing an existing ECB by a fresh ECB had been permitted by RBI to boost inflows in reaction to the temporary decline in Rupee. With the current measure, RBI has prudently stopped refinancing at a higher cost which could have been detrimental to the economy in terms of stoking inflation.)*



Ajay Singh & Suchitra Kamble, *Advocates*

# BEST OF THE REST

**1. Recovery – Taking possession of secured assets – Eviction of tenant – Bank in exercise of its power under the SRFAESI Act, while taking actual possession of mortgaged assets, can evict tenants occupying premises only by taking recourse to provisions of Rent Act and not otherwise: Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, Ss. 13(4), 14, S. 35.**

M/s. J. P. Telecom obtained a cash credit limit and term loan from State Bank of India. Smt. Jaggi Devi was one of the guarantors of the loan. House was mortgaged to the Bank by deposit of title deed. The guarantee agreement was executed. The borrower failed to repay the loan. The State Bank of India initiated proceedings under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 by issuing notice under section 13(2) for recovery of its dues. A notice was also sent to Smt. Jaggi Devi wife of Raja Ram and Ajay Kumar son of Raja Ram, the guarantors. The details of house which was mortgaged was mentioned in Part II of the Notice. The borrower failed to repay the amount within 60 days, hence bank invoked its power under section 13(4) of the 2002 Act. The possession notice was issued. Before issuing the possession notice, the Bank has filed an application under section 14 of the 2002 Act before the District Magistrate for taking possession of the house. The District Magistrate passed an order under section 14 of the 2002 Act for taking possession of mortgaged assets including the said house. The bank took symbolic possession of the house. A notice was also published in the newspapers informing the public in general that possession of the mortgaged assets have been taken and public in general has been cautioned that no transaction (sale/ purchase) be made of the mortgaged assets. M/s. J. P. Telecom was mentioned in notice. The bank after taking symbolic possession, proceeded to auction the House. One Neeraj Kumar purchased the house in auction for the specific amount. The sale was confirmed and the sale certificate was issued to the auction-purchaser. The bank which had taken symbolic possession of the house earlier had written a letter to the Additional City Magistrate-III forwarding copy of the order of the District Magistrate passed under section 14 of the 2002 Act stating that possession of the mortgaged assets was taken on "symbolic possession basis" and no physical possession was taken. The bank

by the said letter requested for taking of possession. The Additional City Magistrate wrote to Station House Officer, Police Station to get the possession of the house transferred in favour of the Bank and police help be provided. Notice was issued in the name of Smt. Jaggi Devi that possession of the house be transferred to the bank failing which police force shall be used. The bank has again written to the Additional City Magistrate for handing over the possession to the Bank. One Vinod Kumar Jaiswal, one of the sons of Smt. Jaggi Devi had filed an appeal under section 17 of the 2002 Act against the auction which appeal was dismissed. Against the order of Debts Recovery Tribunal securitisation appeal was filed by Vinod Kumar Jaiswal which too was dismissed. One Ajai Kumar Jaiswal another son of Smt. Jaggi Devi has also filed an appeal under section 17 of the 2002 Act which was dismissed. The police officials, bank officials and certain persons reached the house and sealed the shops existing the ground floor of the house. Writ Petition was filed by four petitioners in the Allahabad High Court claiming to be tenants of the shop claiming for direction for opening the seal and further direction that respondents may not interfere in the peaceful possession and working of the petitioners over the shops.

The High Court held that the relationship of tenants and landlord is regulated by the statutory schemes as delineated by U.P. Urban Building (Regulation of Letting, Rent and Eviction) Act, 1972. The relationship of landlord and tenant is not contemplated to exist only by registered lease, rather relationship of landlord and tenant may exist without there being any written or registered deed of tenancy. Section 20 of the 1972 Act creates bar of suit for eviction of tenant except on specified grounds. When the right and interest of a borrower or guarantor in a premises is sold in exercise of power under section 13(4) of 2002 Act by the bank, the auction-purchaser steps in the shoes of the owner of the premises and he shall have same right which the borrower or guarantor has prior to sale. Owner of the premises i.e. landlord cannot evict a tenant except on specified grounds as mentioned in section 20 of the 1972 Act or by getting the premises released on an application filed under section 21, the same provision shall also be applicable to auction-purchaser who steps in the shoes of the owner of the premises and the provisions of 1972 Act cannot be said to be diluted for auction-purchaser who purchases a property in auction made by the bank in exercise of powers under section 13(4) of 2002 Act. If, it is held that auction-purchaser who purchases the property by sale made by the Bank under section 13(4) of 2002 Act, shall have also right to evict the tenants, the sale of tenanted building through bank by owners shall become a device of evicting the tenants by creating a security interest in the premises and after default permitting sale of the premises. 2002 Act overrides any other law for the time being in force which is inconsistent with the 2002 Act. No inconsistency can be read between the 2002 Act and 1972 Act, both are the special Acts which operate in different fields. The provisions of 2002 Act cannot be interpreted to mean to override the 1972 Act which operates in different field and which has been enacted for protection of tenants in the State of U. P. and which regulates the relationship of landlord and tenant. The High Court further held that High Court in exercise of writ jurisdiction cannot adjudicate issues of fact specially the claim of petitioners to be tenants prior to date of execution of mortgage when tenancy of petitioners is disputed by other party.

*Ratan Kumar & Ors. vs. State Bank of India & Ors. AIR 2013 Allahabad 115.*

### 2. Conveyance of property by legatee – Validity – Executrix had no say in matter – Conveyance of

**property by legatee or his constituted attorney, not improper. Transfer of Property Act, 1882, S. 54**

One Samshul Haque made and published his last Will and Testament. He died in year 1995. The testator had four daughters, Husna Bano, the plaintiff, Munni Bano, the first defendant, Akhtar Bano, the fourth defendant and Mushtar Bano, the fifth defendant. The fourth and fifth defendants are impleaded as proforma defendants. He had an undivided ½ share in the above property. He left behind one son Md. Farooque, the third defendant to whom he bequeathed his ½ share in the above property. According to the cause title of the plaint, all the children of the testator reside in the United Kingdom. The dispute is with regard to an Indenture executed concerning this property. In this document, Munni Bano is described as the vendor/seller, Md. Farooque as the confirming party/the releaser and the second defendant company, the purchaser. In it a power of attorney executed by Md. Farooque is referred to, whereunder, Munni Bano was empowered to take steps for "release" of the property, execution and registration of a conveyance relating to it. Md. Farooque in that document is said to have relinquished his right, title and interest in the property in favour of his sister Munni Bano. Furthermore, Munni Bano is said to have conveyed and registered the above property in favour of the second defendant at the consideration mentioned therein. Although the testator died a long time ago and probate of the Will was obtained the administration of the estate is not complete. The executrix has not till date executed a deed of assent. The executrix filed a suit before the Calcutta High Court seeking a restraint order on a company which is the second defendant preventing it from selling or otherwise transferring or dealing with the undivided ½ share in the premises as well as the challenging the conveyance.

The High Court held that the executor has the legal title to the property as per section 211 and 213 of the Indian Succession Act, 1925. Section 307 empowers the executor to dispose of the property of the deceased of which he is the legal representative under S. 211 of the said Act. This legal title or interest can be transferred by the executor to the legatee by an assent expressed by him. This assent may also be verbal as per section 333 of the Indian Succession Act, 1925. Section 332 stipulates that the assent of the executor is necessary to complete the legatee's title. Section 104 of the Indian Succession Act, 1925 provides that the legatee has a vested interest in the legacy from the day of the death of the testator. The case of *Hirak Roy vs. S. K. Roy & Ors. reported in (1990) 95 CWN 629* says that without assent, a legatee's title is imperfect the legatee can convey that imperfect title to the purchaser if the estate is free from debts. The High Court is in total agreement to the said case law as stating therein that the facts of the said case and the present are identical and there was no pleading before the High Court to show that the property should be held back to pay out the debt of the estate. Therefore, Md. Farooque, as a legatee or through a power of attorney was in a position to confer an imperfect title of the property on the purchaser. There is no rule of law by which it can be said that a power of attorney for transfer of an immovable property has to be registered. No authority was cited for the proposition that registration was required. It is for the taker of an immovable property to complain about its title or the authority of the executants of the document, conveying it. Here the purchaser is not making any complaint at all. The complaint is coming from the executrix. Having regard to the decision in *Hirak Roy vs. S. K. Roy & Ors.*, a legatee is recognised to be having an imperfect title to an immovable property, in the absence of an assent from the executor or executrix. Furthermore, he has the right to convey the imperfect title. If the title

is imperfect, it is the problem of the taker of the property. By virtue of the above decision the property could have been conveyed by the third defendant or his constituted attorney. The executrix has no say in the matter. The High Court directed that in the event of any transfer or dealing with the property in the present case otherwise than by transfer, the second defendant will state in the recital of the conveyance or in the written document, evidencing transfer or parting with its possession and any transfer or parting with possession of this property can be made only by way of a written document containing the above recital. The application was allowed.

*Husna Bano vs. Munni Bano & Ors. AIR 2013 Calcutta 111*

### 3. Suit by married Hindu female for partition of dwelling house – Substantial portion of suit property was under tenancy of third parties – Embargo of daughter not having right to claim partition, not applicable – Decreeing of suit in favour of married Hindu female, proper : Hindu Succession Act, 1956, S. 23

The Plaintiff/Respondent Nos. 1 and 2 had filed a suit for declaration, injunction, partition and possession in respect of house which was decided by the Civil Judge in favour of the plaintiffs/respondents. The case setup in the plaint was that the aforesaid property belonged to Gopal Devi and her husband, Baboo Ram Sharma (parents of the parties). On account of death of Gopal Devi and Baboo Ram, it is stated that the four sons and two daughters, who were left behind by them, were legally entitled to 1/6th share each in the said property. The respondent Nos. 1 and 2 are the two daughters while as the present appellant Krishan Sharma is the grandson of Gopal Devi. So far as the other sons and daughters are concerned, they are respondents in the present appeal and are represented by their legal heirs. The appellant, who was the defendant No. 7 in the suit, filed his written statement admitting that the suit property belonged to Gopal Devi and that she was survived by four sons and two daughters; however, he resisted the prayer of the respondent Nos. 1 and 2 for partition of the suit property on the ground that the suit property was the only dwelling unit available to the appellant and the other respondents and therefore, by virtue of section 23 of the Hindu Succession Act, the Respondent Nos. 1 and 2, being the daughters could not claim partition and would only have a right of residence. The trial court decided all the issues against the Defendant No. 7/ appellant and in favour of the Plaintiffs/ Respondents 1 and 2 and returned a finding that the property was partly occupied by the tenants. The trial court, accordingly, passed a preliminary decree in favour of Plaintiffs/ Respondent Nos. 1 and 2 and the remaining co-shares in the property as the legal heirs of Gopal Devi. Being aggrieved by the said order of passing preliminary decree the appellant along with Respondent Nos. 10 and 11 preferred an appeal. The Additional District Judge upheld the judgment and the preliminary decree passed by the trial court holding that the plaintiffs/respondent Nos. 1 and 2 were entitled to 1/6th share each in the suit property and directed appointment of a Local Commissioner for the purpose of exploring the modalities of partition by metes and bounds. Still not feeling satisfied, the appellant preferred the Second Appeal.

The High Court held that the embargo of the daughter not being able to claim partition would be applicable only if the house in question was being used as a dwelling unit by the brothers for their residence and not if any portion of the house or substantial portion of the house has been let out to the

tenants, while as in the instant case, this was not in dispute that the substantial portion of the suit property was under tenancy of third parties. Apart from this, by the Act of 39 of 2005, section 23 of the Hindu Succession Act has been deleted with effect from 9-9-2005. The necessary effect of this deletion is that any pending matter which involves a question which was earlier covered by section 23 of Hindu Succession Act would also not be taken as an embargo on the right of the daughter to claim partition in respect of the dwelling unit, meaning thereby that after the amendment, a daughter has been put at par with the brother to claim partition in respect of a property inherited by the siblings of a person. Therefore, there was no infirmity in both, the judgment and the decree passed by the trial court as well as the order passed by the first appellate court. The Appeal was dismissed.

*Krishan Sharma vs. Raj Rani Bhardwaj and Ors. AIR 2013 Delhi 136*

**4. Adverse possession – Claim for – Entry in record of rights and order of Revenue authority showed that defendant was in forceful possession of suit land – Defendant thus had proved his continuous open, undisturbed and animus possession in suit land – Adverse possession of defendant for over 12 years before date of institution of suit in year 1995, proved – Defendant can be said to have become owner of property. Limitation Act, 1963, Articles 64, 65**

Nityanandas Das, the predecessor of the appellants as plaintiff instituted the suit seeking declaration of title and recovery of khas possession of the suit land, described in the schedule of the plaint against Sadhan Ch. Das, the predecessor of the respondents, as defendants. The case of the plaintiff is that the suit land long with other lands was originally settled in the name of his father and the plaintiff inherited the suit property. The defendant was temporarily permitted to construct his dwelling house on the suit land and accordingly the defendant had been residing with his family on the suit land. He was asked by the plaintiff to vacate the land but the defendant did not vacate it. The plaintiff asked the defendant to vacate the suit land but the defendant refused. Thereafter, the plaintiff issued notice through lawyer to hand over vacant possession but the defendant remained silent. The plaintiff, therefore, instituted the suit for declaration of title and recovery of possession. The trial court decided all the issues against the plaintiff and dismissed the suit.

The High Court held that from the pleadings of the parties, it appears that the plaintiff instituted the suit not based on possession but based on title. The period of limitation is 12 years as prescribed in Article 65 of the Schedule annexed to the Limitation Act, 1963. Where a suit is for possession on the basis of the Limitation Act. The case cannot come under the purview of Article 64 of the Limitation Act since there is neither any averment nor any evidence that the plaintiff was ever in possession of the suit land and that he was dispossessed from the suit land. In the present case, admittedly, the defendant is in possession of the suit land. The entry in the record of right (Khatian) is a primary proof in respect of possession which shows that the defendant had/has been in forceful possession of the suit land from 1965. The order of the Revenue authority also makes it clear that the defendant is in continuous possession of the suit land. By "adverse possession" is meant possession which is hostile, under a claim or colour of title, actual, open, uninterrupted, notorious, exclusive and continuous. Adverse possession is made out by the co-existence of two distinct

ingredients: first, such a title as will afford colour, and second, such possession under it as will be adverse to the right of the true owner and title by adverse possession of the trespasser continues uninterruptedly for the full statutory period. Where a plaintiff is suing for possession on the basis of dispossession the burden lies on him to show that the date of his dispossession or discontinuance of possession which give him the cause of action for the suit was within twelve years of the suit, while if the suit is not for possession based on ground of dispossession or discontinuance of possession but is a suit for possession of immovable property or any interest therein barred on title, then Article 65 of Limitation Act would apply and on proof of title the plaintiff's suit cannot be dismissed until the defendant further establishes his adverse possession for more than twelve years. Ordinarily an owner of property is presumed to be in possession of it and such presumption is in his favour where there is nothing to the contrary. It would, therefore, follows that an owner of property starts with the presumption in his favour that he is in possession of his property, but where the plaintiff himself admits or it is proved that he has been dispossessed by the defendant and, therefore, is no longer in proprietary possession of the property in suit, at the time of the institution of the suit, the Court cannot start with the presumption in his favour that the possession of the property was with him. No doubt in many cases the distinction is very fine and the line of demarcation between dispossession and adverse possession is thin but the question in each case is one of burden of proof and it is incumbent on the plaintiff when he has been dispossessed or has discontinued his possession to establish the date of dispossession or discontinuance of possession and to show that it was within twelve years of the institution of the suit. The defendant has proved his continuous open, undisturbed and animus possession in the suit land from the year 1965. Once the adverse possession of the defendant for over 12 years before the date of institution of the suit is established, the suit has to fail, regardless of the consideration whether it is under Article 64 or 65 of the first Schedule to the Limitation Act is applicable. In such a case, it could be said that the defendant has become the owner of the property because of his adverse proprietary possession for more than 12 years. It is also clear that the plaintiff had not been in the possession of the property at any time within 12 years of the date of institution of the suit. Under such facts and circumstances, the decision of the lower courts was upheld and the appeal was dismissed.

*Smt. Tapasi Rani Das v. Sajal Das & Ors. AIR 2013 Guwahati 100*

**5. Deficiently stamped documents – Impounding of – Documents in question were only marked – Documents were not admitted in evidence – Mere marking of documents does not amount to admission of same unless that fact is judicially determined by Court in terms of O. 13, R. 4 of Civil P. C. – Deficiently stamped documents liable to be impounded. Stamp Act, 1899, S. 36 – Civil P. C., 1908, O. 13, R. 4**

The respondent filed Suit before the Junior Civil Judge impleading the petitioners herein as defendants seeking a decree for perpetual injunction restraining them from entering into and interfering with the peaceful possession and enjoyment of the suit schedule property. According to the plaint averments, the respondent-plaintiff is the absolute owner and is in exclusive possession of the said property. His name is also reflected in the revenue

records, including the Pattadar Pass Book. The petitioner – defendants are strangers to the said land and they have no right or interest whatsoever over the said property. The respondent-plaintiff's possession was sought to be disturbed by the petitioners-defendants because he refused to sell the land to them. The 2nd Petitioner-defendant No. 2 filed written statement, *inter alia*, stating that the respondent-plaintiff entered into an agreement of sale of the suit land with the 1st petitioner-defendant No. 1, who is her husband and on payment of the total sale consideration, possession of the suit schedule property was delivered to the 1st petitioner-defendant No. 1, who is her husband, and on payment of the total sale consideration, possession of the suit schedule property was delivered to the 1st petitioner-defendant No. 1. Thereupon he constructed a house after obtaining necessary permission from the Gram Panchayat and thus the petitioners-defendants acquired the right over the suit schedule property and are in enjoyment of the same. After the evidence on behalf of the respondent-plaintiff was closed the 1st petitioner-defendant no. 1 was examined and the document i.e. agreements of sale were marked through him. Later during the course of examination of the 2nd petitioner-defendant No. 2 filed an objection regarding the admissibility of the said documents on the ground that they were deficiently stamped. Considering the said objection, the Court below found that the said documents are deficiently stamped and accordingly passed the impugned order with a direction to the concerned party to take steps for impounding the documents either before the Court or before the concerned authorities.

The High Court held that as per the judgment of the Apex Court in *Shayamal Kumar Roy vs. Sushil Kumar Agarwal, (AIR 2007 SC 637)* and also a judgment of the *Andhra Pradesh High Court, in Akkireddi Nagayamma & Anr. vs. Adhikari Appalanaidu (2011 (2) Andh LD 71)* in support of the proposition that the Court is not competent to reopen the matter and direct for impounding of the document. There cannot be any controversy with regard to the principle laid down by the Apex Court in Shyamal Kumar Roy's case and Akkireddi Nagayamma to the effect that section 36 of the Act would operate after a document is admitted in evidence. But the question that falls for consideration in this case is whether the agreement for sale were admitted in evidence so as to attract the provisions of section 36 of the Act. The said endorsements bear the signatures of the Judge. Whenever documents are admitted in evidence, the procedure prescribed under Order 13, Rule 4, C. P. C. has to be followed. The said provisions postulates that on every document admitted in evidence, particulars, viz., the number and title of the suit, name of the person producing the document, the date on which it was produced, and a statement of its having been so admitted shall be mentioned and the endorsement shall be signed or initialled by the Judge. Therefore, one of the essential requirements under the said provision is that the document should contain a specific statement that it has been admitted in evidence and the endorsement shall be signed or initialled by the Judge. It must be held that the matter had not reached the stage for invoking the provisions of section 36 of the Act. The Court below had rightly held that the documents are liable to be impounded for appropriate steps to be taken by the concerned party. Thus petition was dismissed.

*Athapuram Raghuramaiah and Another vs. Dyava Ramaiah AIR 2013 Andhra Pradesh 83*

CA. Rajaram Ajgaonkar

# ECONOMY AND FINANCE

## NO SIGNS OF REVIVAL

The month of September, 2013 turned out to be a month of uncertainties for the Indian economy. The Indian currency remained very volatile and the economic sentiment fluctuated in tandem with the movement of the currency. The already fragile Rupee weakened further and became more volatile. High fluctuation in the exchange rates developed a fear psyche in the economy and especially with the importers. The greed of the exporters to secure higher exchange rate for their export proceeds resulted in holdback of the supply of US Dollars. The economy became very volatile. The resultant increase in speculative activities in the Indian currency in many offshore markets added fuel to the fire. The new Governor of the Reserve Bank of India (RBI) took charge on the 4th of September, 2013. The Government as well as the people had a lot of expectations from him. The initial steps, which he took to contain the decline of the currency, created good impact on the market. It not only arrested the slide of the Rupee but the currency strengthened by more than 9% from its all time low and stabilised to an extent. This has given respite to the foreign trade of the country and hopefully it will rein the increasing current account deficit to an extent.

The economic numbers published by India still continue to show signs of weakness. A further weakening of the economy cannot be ruled out as yet, though there is hope that the improved US and European economies will help to reverse the process of slowdown in India. A negative impact on Indian economy of the reversal of quantitative easing, which is an inevitable occurrence, cannot be ruled out. The budgetary deadlock in the US economy resulting in Government shutdown can directly affect not only the revival of the US economy but also indirectly impact the developing economies of the world like India.

Considering this fact, it may be premature to state that the Indian economy has taken a U-turn. The Parliamentary elections are less than 9 months away and in such times, the ruling party will tread cautiously taking recourse to populist measures and temporarily suspend the reforms process. Though these steps may be politically correct, they are not good for the economy and especially when it is slowing down. Therefore, the immediate prospects of the revival of the economy do not look great. We can only hope that it will not deteriorate further.

The US economy has been improving over the last few months but the recent action of the US Senate on the budget can create an impasse and stall the US economy, thereby inflicting damage not only on the US economy but also to the ensuing revival of the global economy. The current improvement in the economic prospect of the world is mainly on account of the revival of the US and if the impasse continues for long, it can badly affect the US recovery. Slowing of the US economy will have its own impact on other developed as well as developing economies of the world, which are trying to revive. It is also realised by the world that the negative impact of reversal of quantitative easing can be quite serious on the world and this unavoidable event will create a number of problems, especially in the developing countries. The question is that when and how soon will it happen and how to reduce its impact. The entire developing world should be prepared for this event, so that when it happens, it should not affect them unduly.

The European economy is currently showing some signs of improvement but the progress is gradual and will likely to remain so in the immediate future. The last recession has hit the European economy very badly and even after many years the wounds have not fully healed. The healing will happen only gradually. Europe may get negatively affected, if the US economy suffers any damage due to shutdown of the US Government. Still, it is expected that the worst for the European economy is over and things will be better from here onwards.

The Chinese economy has been showing some improvement over the last month. This is a welcome development for the world. China needs to get its imbalances corrected, which is not an easy task. Further, China has started ageing and the one child policy of the country will make it age faster. It may be high time that the Chinese Government re-considers its one child policy and liberalise the rules to have better age distribution in the demography so that its growth momentum is suddenly not lost. If adequate measures are not taken, China may go the Japanese way after a couple of decades. Japan remains slow, though there has been hopes of emerging growth. Japan will not be able to go on fast track as its ageing population will remain a drag on that country. However, probably the time has come when Japan will get out of its long stagnation and start growing again.

The risks of developing economies across all the continents have increased, of late. The quantitative easing is going to create turmoil in these economies and that day is not probably very far. It is essential for these economies to adopt appropriate measures so that when the D-day arrives, they will be least affected. Appropriate strategies will have to be implemented to tackle the situation emerging out of the impact which is not in control of these economies. When the easing ends, there is going to be a major outflow of foreign currencies from these economies. The investment will suddenly slowdown and liquidity will get tightened. When all these negative things happen together, it is bound to affect the economies. If proper care is not taken in advance, the effect can be severe.

The equity market in India has unexpectedly rallied in the latter part of September and the Sensex crossed the level of 20,000 though, it could not sustain at that level. Though the Sensex is ruling at a high level, the overall market is not looking positive. The risk of the slowing economy very much exists and investors can think of buying stocks only selectively. The rational level of buying may be around 18,000 and investors may get an opportunity to buy stocks at that level over the next few months. Markets are volatile and are oscillating within a range. It may not be desirable for the investors to be aggressive in the stock market but they can do selective investments at lower levels, for short-term

gains. The current timing may not be right for long-term major investment and a wait and watch strategy can be beneficial to the investors. Stocks of banking and finance companies are badly thrashed by the investors and they are available at attractive prices considering their historic prices. Though, the sector looks undervalued going by the long-term prospects, the possibility of its going down further, especially after withdrawal of quantitative easing, very much exists. Investors therefore need to take a cautious approach. Systematic Investment Plan for investing in such sector will be more beneficial to the investors.

Even in the recent RBI policy, the interest rate could not be reduced as the inflation remained stubborn. The RBI Governor has kept inflation control as his economic priority and therefore he will not reduce the rates unless the inflation tapers off. In spite of good monsoon and greater availability of agricultural products, the inflation may remain high due to high petroleum prices and weakening Indian currency. The high interest rates and tight liquidity is likely to continue at least till March, 2014 and therefore investors can take advantage of prevailing high interest rates for at least some more months to come. Investment in debt remains attractive in the current scenario in which the growth is uncertain. Debt oriented mutual fund schemes can give good returns, if they are invested in long-term or even medium term prospects. However, if the horizon of the investment is short-term, these investments may not give very good returns due to volatility. For parking temporary liquidity, liquid schemes of the mutual funds can be very suitable as they can give good returns in the liquidity starved market. It is a good time to take exposure on debt with a horizon of one to three years as interest rates may start tapering off, especially after March, 2014.

Though gold is not strong in the global markets, it has become strong in India over the past few months due to heavy depreciation of the Indian currency. Though gold has dropped from its peak after the decline of the US Dollar from its peak level against the Indian Rupee, it is still ruling at a high price. Gold may decline in the international markets in the near future. However, the movement of gold price in India will be governed by the strength and weakness of the US Dollar against the Indian currency. The Government is discouraging the import of gold, being a non-essential commodity. Import duty on gold has been hiked and that has also strengthened the gold prices in India as the imports have become expensive. Though high duty will prevail and will support the gold price in India, it is expected that gold price will decline over a period of time. Considering the current good rate of return on debt, it may not be advisable for the investors to invest in gold.

Property markets seem to be weakening over the last few months across the country. It is believed that prices are gradually dropping in many of the micro markets. The property market may be heading for a long awaited recession. Even if the prices do not decline, it is likely that they may stagnate for the months to come. Therefore, currently, property investment is not looking attractive. Situation of the commercial properties is worse than the residential properties. Not only are their prices stagnating but their demand has also come down due to slowing economy.

Fortunately, the Rupee has stabilised and so also the fear in the minds of the investors to an extent. Still the micro-economic scenario has not improved in India and the current phase may continue till the new Government is formed after the elections. Therefore, the investment climate is likely to remain subdued till then. Investors need to remain cautious and non-aggressive.

V. H. Patil, *Advocate*

# YOUR QUESTIONS & OUR ANSWERS

## FACTS & QUERY

*Q.1 As per the provisions of S.194-IA, TDS is to be deducted on payments to builders even if the property is under construction. A private limited company has received advances for booking of flats to the tune of ` 1 Cr. and TDS @ 1% has been deducted on it. However, the project has not yet started and no revenue is going to be recognized in F.Y. 2013-14. They wish to know whether they can claim credit of the TDS although no revenue will be recognised from the project?*

**Ans.** In the querist's case as only advances are received but as construction work is yet to be started, there is no income during the year which is taxable for that year. Now TDS is deducted in the respect of the person, in respect of whose income, and if there is no taxable income TDS amount will be returned to person in respect of whose income it is deducted. As such, such TDS amount can be credited to the project account as there is no revenue receipt or income for that year to claim set off of TDS amount against the tax liability for that year.

*Q.2 When a holding company transfers unquoted shares to its wholly owned subsidiary, there is no capital gain tax liability since the transaction is not regarded as transfer by virtue of section 47(iv). However if the unquoted shares are received by the subsidiary for a consideration of less than the fair value as computed in accordance with the provisions of section 56(2)(viib), then whether such receipt by the subsidiary will be chargeable to tax under section 56(2)(viib)?*

**Ans.** Under the provisions of S. 47(iv) any transfer made by a holding company to its subsidiary company is not a transfer irrespective of the fact as to whether such transfer is for no consideration or for consideration.

Now coming to the provision of S. 56(2)(viib), even under these provisions the amount would be taxable if and only if the consideration payable is more than the market value of the asset transferred. As in the case of the querist the asset is transferred for a consideration which is less than the M.V. of the share is transferred, there would be no liability for gift tax under S. 56(2)(viib) of the I.T. Act 1961.

*Q.3 Mr. Mehta is engaged in trading in commodity derivatives. He incurred a loss of ` 100,000 during the year ending 31-3-2013. His income from other sources is ` 400,000. Will he liable to get his accounts audited u/s 44AB r.w.s. 44AD?*

**Ans.** The purpose of the provisions for getting the accounts audited is to see that proper taxes are paid on correct accounts of the taxable profits of that year. However, if in a given case, there is

loss in the business carried on by the assessee, it is not necessary to get the accounts audited. In the case of the querist there is a loss in the business carried on by the querist, as such the accounts of the querist for the year need not be submitted for Audit under S. 44AB of the Act.

*Q.4 A notice u/s 148 has been received by the assessee for A.Y. 2009-10. However, the reasons for assessment have not been given. The assessing officer is insisting that only after the return in response to the 148 notice is filed that the reasons will be issued. Is the stand of the office correct or can the assessee insist on the reasons before complying with the notice?*

**Ans.** Under the provisions of S. 148 read with S. 147, the I.T.O. has to record the reasons for reopening of a completed assessment proceeding. On asking the reasons for reopening he is bound to supply the said reasons recorded for the reopening.

However, the Hon'ble Supreme Court in *259 ITR 19 (SC) - GKN Driveshafts (India) Ld. vs. ITO & Others*, has held that the assessee has to file the return and then only he can ask for the reasons recorded; later on the courts have followed the above ruling of the Supreme Court.

As such in view of the said ruling of the S.C., the querist has to file its return and then only it can ask for the reasons for the reopening. However, the querist may mention to ITO to treat the return filed under regular proceedings as the return for reassessment proceeding and ask for the reasons for the reopening of the assessment proceedings.

*Q.5 (i) The querist is an Individual. He is assessed by Dy. CIT-Circle-1 XYZ. For A.Y. 2003-04, a notice u/s. 148 was issued on 30-3-2010 and served upon the assessee on 9-4-2010. As such case of the assessee was selected for scrutiny for A.Y. 2003-04. Hearing was in progress during financial year 2010-11.*

*(ii) DY. CIT R-1, XYZ has also selected the case of assessee for scrutiny for A.Y. 2009-10 by issue of notice u/s. 143(2) in Aug. 2009. The Dy CIT Circle-1 XYZ has taken the hearing for A.Y.2003-04 and A.Y. 2009-10 simultaneously during financial year 2010-11.*

*(iii) Further, the CIT has assigned the assessment of 2009-10 to the JCIT R-1 XYZ* vide *order u/s. 127 of the I T Act on 7-11-2010.*

*(iv) Even though the case was assigned u/s.127 to JCIT R-1 XYZ, the then A.O. Dy. CIT continues the hearing for A.Y. 2003-04, after 7-11-2010 too. Therefore, Assessee has raised the objection of jurisdiction over the case of the assessee, before the learned A.O i.e Dy. CIT-Cir-1, XYZ A.O* vide *letter 28-11-2011. Dy. CIT Cir-1, XYZ replied that JCIT and Dy. CIT both have concurrent jurisdiction over the case of assessee and eventhough, the case is assigned to JCIT u/s. 127.*

*(v) Both the assessing officer, JCIT and Dy. CIT cited supra were simultaneously taken the hearing during financial year 2010-11.*

*(vi) Dy. CIT has finalized the assessment for A.Y. 2003-04 u/s. 143(3) rws 148 on 16-12-2011 and JCIT has finalised the assessement u/s. 143(3) for A.Y. 2009-10 on 12-12-2011.*

Further, as a result of transfer the case u/s. 127 from one AO to another AO, all proceedings which are pending against the assessee under the Act in respect of the same year as also previous years are meant to be transferred simultaneously and all proceedings under the Act which may be commenced after the date of such transfer in respect of any year whatever are also included therein, so that the AO to whom such case is transferred would be in a position to continue the pending proceedings and also institute further proceedings against the assessee in respect of any year. The proceedings pending at the date of transfer can be thus continued but in the case of such proceedings the provisions in regard to issuance of notices contained in the main body of section 127(2) of the Act would

apply and it would not be necessary to reissue any notice already issued by AO from whom the case is transferred.

Further, Explanation to section 127 of the Act makes it clear that the word "case" in relation to any person whose name is specified in the order of transfer means all proceedings under the Act in respect of any year which may be pending on the date of the transfer, and also includes all proceedings under the Act which may be commenced after the date of transfer in respect of any year. The word "case" is thus used in a comprehensive sense of including both pending proceedings and proceedings to be instituted in the future. Consequently, an order of transfer can be validly made even if there be no proceedings pending for assessment of tax and the purpose of the transfer may simply be that all future proceedings are to take place before the officer to whom the case of the assessee is transferred.

***Q.6 In view of the narrated facts, and considering the order u/s. 127 of the IT Act cited supra, Whether, order passed u/s. 143(3) rws 148 of the IT Act on 16-12-2011 for A.Y. 2003-04 by the Dy. CIT Circle-1, XYZ, is valid order, for want of jurisdiction? Whether, it is bad in law and void*** *ab initio*, ***for want jurisdiction?***

**Ans.** S. 127 of the I.T. Act deals with the powers in the higher tax authorities to transfer cases from one I.T.O. to another I.T.O. the relevant provisions of the said S. 127 are as under:

S. 127(3) Nothing in sub-section (1) or sub-section (2) shall be deemed to require any such opportunity to be given where the transfer is from any Assessing Officer or Assessing Officers (whether with or without concurrent jurisdiction) to any other Assessing Officer or Assessing Officers (whether with or without concurrent jurisdiction) and the offices of all such officers are situated in the same city, locality or place.

(4) The transfer of a case under sub-section (1) or sub-section (2) may be made at any stage of the proceedings, and shall not render necessary the re-issue of any notice already issued by the Assessing Officer or Assessing Officers from whom the case is transferred.

*Explanation.*—In section 120 and this section, the word "case", in relation to any person whose name is specified in any order or direction issued thereunder, means all proceedings under this Act in respect of any year which may be pending on the date of such order or direction or which may have been completed on or before such date, and includes also all proceedings under this Act which may be commenced after the date of such order or direction in respect of any year.

Now explanation to the sec. 127 makes it quite clear, that once a case is transferred from one I.T.O. to another ITO the I.T.O. to where case is transferred will hand over the case, its present, past and the future proceedings. That once a case is transferred to another I.T.O. the I.T.O. from whose jurisdiction case is transferred after such transfer he will have no power to deal with the case even in a case of assessment proceedings already initiated by him.

In this regard useful reference may be made to the following cases.

*38 ITR 325 (Mad) – S. Chattanatha Karayalar vs. ITO*

*51 ITR 596 (Pat) – Raja Bahadur Kamakhya Narain Singh vs. UOI*

*71 ITR 609 (P&H) - S. Ram Singh Uppal vs. CIT.*

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## OUR CONFERENCE (see full programme overleaf)

***In memory of Ms Uma Sathnur, our Executive Secretary, who passed away in June 2013***

Our 19th International Taxation Conference will be held in Mumbai (India) from 5th - 7th December 2013 at the ITC Maratha Hotel, Mumbai, India. The conference theme is **"International Tax and Treaty Conflicts"**. Specific speaker topics include:

**International Tax and Treaty Conflicts: An Overview - Allocation of Taxing Rights under Model Tax Treaties - Permanent Establishment Article under Model Treaties - Double Non-taxation: A Critical Evaluation - Beneficial Ownership under Tax Treaties: Recent Developments - Conflicts under Article 13 of the Model Tax Treaty - Guernsey as Jurisdiction of Choice for Cross-border Investment - Base Erosion and Profit Shifting (BEPS): An International Tax Issue - International Tax Conflicts for Multinational Enterprises under BEPS - Use and Abuse of Tax Treaties - Taxation of Services: OECD v/s UN Model - International Tax Issues in Cloud Computing - International Tax Developments in the US and in the UK - Emerging International Tax Trends in India - Recent Transfer Pricing Developments: OECD & India.**

Our first speaker will be **Porus Kaka** from India, our new President of International Fiscal Association - Worldwide as from September 2013. Our international speakers include **Professor Michael Lang** from Austria, **Professor Jeffrey Owens** (ex head of OECD, Paris) now Director of the Global Tax Policy Center at WU in Vienna; and **Professor Arvid Skaar** from Oslo, a recognised global expert on issues involving taxation of permanent establishments. Our Indian speakers include **Professor Parthasarathi Shome**, Minister of State Finance, and **Mohan Parasaran**, Solicitor General of India. We have also invited **Dr. Sudha Sharma**, Chairman CBDT, and **Mr. N. C. Joshi**, Director General of Income Tax (International) in India to attend and address us at the conference. **Mr. Akhilesh Ranjan**, recently appointed as India's competent authority, has also agreed to speak at the conference.

Like last year, we have a special address by the former **Chief Justice Sarosh Kapadia**. Moreover, **Mr. Sumit Bose**, Revenue Secretary, Ministry of Finance India & **Mr. Marc Hein**, Chairman, Financial Services Commission, Mauritius have agreed to address us at the conference.

Besides around 25 full speakers, this year we have provided for several thought provoking panel discussions with around 50 panel speakers from India and abroad. The topics include:

**Selected Examples of Current Tax and Treaty Conflicts: Treaty Shopping? Double Non-taxation? Use of Domestic Law in Treaty Interpretation? - Base Erosion and Profit Shifting - Should International Taxation be based on "Morality" or " Legality" - Emerging International Tax Trends in India - Current Treaty Conflicts under India/USA Treaty - Emerging Tax Controversies for MNCs in India - Impact of Recent Domestic Tax Changes in India on its Tax Treaty Policy - International Taxation Conflicts in Electronic Commerce - Enhanced Relationship in Developing Countries - Gross Source Withholding Tax v/s Net Residence Credit issue - Framework for New GST Tax in India - Transfer Pricing: a discussion on a wide range of issues.**

As in previous years, we expect over 500 conference delegates from all over the world. As a high level technical conference, it also provides an excellent opportunity for networking and marketing. We look forward to your participation at our 19th Annual Conference in 2013.

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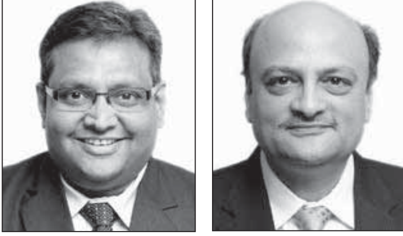

Hitesh R. Shah & Hinesh R. Doshi, *Hon. Jt. Secretaries*

# THE CHAMBER NEWS

Important events and happenings that took place between 8th September, 2013 to 8th October, 2013 are being reported as under.

## I. Admission of New Members

1) The following are the new members, who were admitted in the Managing Council Meeting held on 12th September, 2013.

**Life Membership**

| | | | |
|---|---|---|---|
| 1 | Mrs. Hariharan Janki K.P. | CA | Mumbai |
| 2 | Mr. Pasari Surendra Kumar | CA | Dhanbar |

**Ordinary Membership**

| | | | |
|---|---|---|---|
| 1 | Shri Satra Kewal Harshad | CA | Mumbai |
| 2 | Shri Sanchet Siddharth Santosh | CA | Mumbai |
| 3 | Shri Jakhelia Yashesh Ashok | CA | Mumbai |
| 4 | Shri Avhad Sudhir | CA | Mumbai |
| 5 | Shri Sanghani Mandip Vinodrai | ITP | Mumbai |
| 6 | Shri Rao Ramesh Nilkanth | CA | Pune |
| 7 | Shri Bhavsar Mahesh Purshottam | Advocate | Mumbai |
| 8 | Shri Kumar Chandan Kishorkumar | CA | Mumbai |
| 9 | Shri Gandhy Pradeep Dinesh | Advocate | Mumbai |

**Associate Membership**

| | | |
|---|---|---|
| 1 | Moore Stephens-Jersey | Mumbai |

## II. Past Programmes

Details of programmes conducted by the Chamber are given below:

| Sr. No. | Programme Name / Committee/Venue | Date / Subjects | Speakers |
|---|---|---|---|
| 1 | **Indirect Taxes Committee**<br>Study Circle Meeting | **16th September, 2013:**<br>Applicability of VAT and Service Tax on Deemed Sales | Chairman :<br>CA Bharat Shemlani<br>Group Leader :<br>CA Ankit Chande |
| 2 | **Study Circle & Study Group Committee**<br>Study Group Meeting | **7th Otober, 2013**<br>Recent Judgments under Direct Taxes | CA Anant Pai |

## III. Future Programmes

Future programmes of the Chamber's are as follows:

| Sr. No. | Programme Name / Committee / Venue | Day / Subjects | Speakers |
|---|---|---|---|
| 1 | **Allied Laws Committee**<br>Lecture Meeting at IMC | **22nd October, 2013**<br>Provisions of Stamp Duty Including for Business Restructuring | CA Anup Shah |
| | Half Day Seminar on Labour Laws at Gulmohar Hall, BCAS<br>Jointly with BCAS | **23rd November, 2013**<br>• Employees State Insurance Act, 1948<br>• The Payment of Bonus Act, 1965<br>• The Employees Provident Fund & Miscellaneous Provisions, 1952<br>• The Payment of Gratuity Act, 1972<br>• The Contract Labour and Abolition Act, 1970 | Shri Ramesh Soni, Labour Law Consultant |
| 2 | **Corporate Members Committee:**<br>(Jointly with IMC)<br>A training workshop at IMC | **11th October, 2013 & 12th October, 2013**<br>Making of CFO | Mr. D. D. Rathi, Director, Grasim Industries<br>Mr. Paresh Mehta, CFO Ashoka Buildcon<br>Mr. Ashish Chauhan, MD & CEO, BSE<br>Mr. Anil Rustogi, Sr. President and Deputy CFO of Aditya Birla Group Global Pulp & Fibre Business |

| | | | |
|---|---|---|---|
| | | | Mr. B. R. Jaju, CFO, Welspun Corp. Ltd.<br>CA Amrish Shah, Partner & National Leader, Transaction Tax Ernst & Young Ltd.<br>CA Rajeev Pai, CFO, JSW Steel Ltd.<br>Mr. Yogesh Dhingra, CFO, Blue Dart*<br>Dr. V.R. Narasimhan, Chief of Regulatory Affairs National Stock Exchange of Indian Limited*<br>Mr. Pramod Menon, Director (Finance), JSW Energy Ltd.<br>CA M. M. Chitale, Past President, ICAI<br>Mr. Pradip Shroff, CEO Coach, Member CFI Coaching Network<br>Mr. Sudhir Valia, Director, Sun Pharma Ltd.<br>*( * Subject to Confirmation)* |
| 3 | Direct Taxes Committee<br>4th Intensive Study Group (Direct Tax) Meeting at CTC Office | **15th October, 2013**<br>Recent Important Decisions under Direct Taxes | Mr. Rahul Hakani, Advocate |
| 4 | **Indirect Taxes Committee**<br>2nd Residential Refresher Course on Service Tax<br>At The Lagoona Resort, Lonawala – 410 403. | **3rd January, 2014 to 5th January, 2014**<br>• Paper – I : Service Tax & VAT on Composite Transactions<br>• Paper – II : CENVAT Credit Mechanism for Service Providers<br>• Paper – III : Case Studies under Service Tax<br>• Presentation : Prosecution, Arrest and Recovery provisions under Service Tax Legislations | Mr. P. K. Sahu, Advocate, Delhi<br>Mr. V. Raghuraman, Advocate, Bengaluru<br>CA Parin A. Mehta<br>Mr. V. Sridharan, Advocate |

| | | | |
|---|---|---|---|
| 5 | **Information Technology Committee**<br>Info Tech Update Series Workshop at IMC | **17th October, 2013**<br>Google – Not Just a Search Engine<br>(Effective use of Google in your workspace) | CA Sanjay Chheda<br>CA Samir Kapadia |
| 6 | **International Taxation Committee & Direct Taxes Committee**<br>Domestic Transfer Pricing Conference jointly with Direct Taxes Committee at Maharashtra Chamber of Commerce Hall | **19th October, 2013**<br>The Law of Specified Domestic Transfer Pricing provisions under Income-tax Act, 1961. | Senior Officials from the Tax Department*<br>CA Karishma Phatarphekar<br>CA Nihar Jambusaria<br>CA Sanjay Kapadia<br>CA Pramod Joshi<br>CA Vispi Patel<br>Mr. Ajit Kumar Jain, CIT-DR (TP)<br>CA Rohan Phatarphekar<br>CA Sanjay Tolia<br>Mr. Vineet Agrawal<br>*( * Subject to Confirmation)* |
| | Workshop on Taxation of Foreign Remittances<br>at M. C. Ghia Hall | **13th, 14th, 20th & 21st December, 2013**<br>The workshop will comprise about 13-14 sessions spread over three and half days | Eminent Faculties will address the sessions of Workshop. |
| 7 | **Membership & EOP Committee**<br>Self Awareness Series at CTC Office | **24th October, 2013**<br>Information Technology for Business Innovation & Growth | Mr. Nilay Yajnik, Professor & Chairman Information Systems Area, Narsee Monjee Institute of Management Studies, Mumbai |

| | | | |
|---|---|---|---|
| 8 | **Residential Refresher Course & Public Relations Committee**<br>37th Residential Refresher Course at Anandha Inn Convention Centre & Suites, Pondicherry | **13th February, 2014 to 16th February, 2014**<br>• Reassessments / Revision / Rectification | Paper Writer :<br>CA Mahendra Sanghvi<br>Chairman :<br>Shri Keshav Bhujle, Advocate |
| | | • Case Study under Direct Taxes | Paper Writer :<br>Ms. Anita Sumanth, Advocate (Chennai)<br>Chairman:<br>Shri S. N. Inamdar, Sr. Advocate |
| | | • Case Study in Taxation of Real Estate Transactions [Secs. 2(1A), 2(14), 43CA, 50C, 50D, 56(2)(vii)(b), 145 & TAS and 194IA) | Paper Writer : CA Pradip Kapasi |
| | | • Brains' Trust : Direct Tax | Brains' Trustees :<br>Eminent Faculties |
| 9 | **Study Circle & Study Group Committee**<br>Study Circle on International Taxation Meeting<br>at IMC | **16th October, 2013**<br>Foreign Tax Credit Mechanism | CA Jimit Devani, Senior Manager, Global International Corporate Tax, KPMG |
| | Study Circle Meeting<br>at Jaihind College | **25th October, 2013**<br>Deemed Dividend u/s. 2(22)(e) | CA Mayur B. Desai |

## III. Forthcoming Journal by Journal Committee

The Chamber's Journal for the month of November, 2013 will cover topic on "Estate & Succession Planning".

## IV. Publications for Sale

A) **International Taxation - A Compendium**

Four hardbound volumes set containing approx. 4000 pages.

B) **Study Material – 7th Residential Conference on International Taxation, 2013 held from 20th June, 2013 to 23rd June, 2013 at Bengaluru.**

(For Enrollment and further details of all the Future Events, please refer to the October, 2013 Issue of CITC News or visit the website www.ctconline.org)

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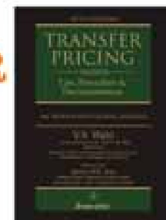


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