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The Chamber's Journal

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

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RELATED PARTY TRANSACTIONS-VARIETY OF COMPLEXITIES

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INDIRECT TAXES COMMITTEE & INTERNATIONAL TAXATION COMMITTEE

Panel Discussion on Multi-Dimensional Tax Issues held on 1st November, 2014 at M. C. Ghia Hall, Fort, Mumbai

CA Paras K. Savla, President welcoming the delegates. Seen from L to R : CA Vishal Gada, Panelist, CA N. C. Hegde, Panelist, CA A. R. Krishnan, Moderator, CA Pranav Kapadia, Chairman, Indirect Taxes Committee, CA Heetesh Veera, Panelist and CA Parind Mehta, Panelist.

Section of delegates

Panelists

CA A. R. Krishnan
Moderator

CA Heetesh Veera

CA Parind Mehta

CA Vishal Gada

CA N. C. Hegde

CORPORATE MEMBERS COMMITTEE

Half Day Workshop on SEBI/Securities Laws for Chartered Accountants jointly with BCAS held on 17th October, 2014 at 2nd Floor, Babubhai Chinai Hall, IMC.

CA Jayant Thakur addressing the delegates. Seen from L to R : CA Neha Gada, Convenor, CTC, CA Nitin Shinghala, President, BCAS, CA Paras K. Savla, President, CTC, CA Mukesh Trivedi, Treasurer, BCAS.

Faculties

Mr. Sharad Abhyankar,
Advocate

CA Shailesh Bathiya

Mrs. Shailashri Bhaskar,
Company Secretary

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The Chamber's Journal

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Editorial

The passage from the month of October to November has witnessed several new events, important of which are the formation of new governments in the States of Maharashtra and Haryana, expansion and rejig of the Central Cabinet and several trends emerging in the issue of black money. It appears as though the era of coalitions has come to a halt, with a single party winning majority or at least coming close to majority in these two states. Coalition politics of the last two and half decades have not only stopped the growth and development of India, it has in fact, set a negative agenda before it, by way of slicing the society on caste, regional, linguistic and communal lines. I think, the large scale disillusionment that resulted due to these twin results of coalition politics have led to consolidation of public opinion towards keeping these divisions on back burner for the sake of achieving growth and development. I wish the newly formed government at the Centre and States keep this widespread sentiment and hope of people and work towards achieving them. Though there has been lot of talk regarding the lack of political will on the part of the new Central Government as well on unearthing the black money, as a Tax professional well aware of the intricacies of the procedures and machinery involved in the management of public finances, would not like to jump on to that bandwagon as yet. As an eternal optimist, I would rather adopt a wait and watch approach. I hope that the Hon'ble Finance Minister, in his pre-budget interaction would seek the views of professional bodies like the Chamber of Tax Consultants, which are involved in the day-to-day functioning of the tax structure.

The Special Story of this issue of Chamber's Journal is on Related Party Transactions – Various Complexities. Eminent professionals have contributed articles on different aspects of this issue. I personally thank Shri Anup Shah as well as other contributors to this issue for taking out time for the Journal.

K. Gopal
Editor

From the President

Dear Members,

I wish all the readers Happy Vikram Samvat 2071. May this year bring prosperity and happiness!

Prime Minister has launched programme 'Make in India'. It is a major national programme designed to facilitate investment, foster innovation, enhance skill development and build best-in-class manufacturing infrastructure in India. This programme may also aim for collaboration, friendship, discovery and strong strategic partnerships with overseas counterparts. This programme can also reduce costs of manufacturing with the use of foreign partner's technology.

World Bank every year ranks economies on ease of doing business. Recently published data for 2015 places India at 142nd rank (out of 189 economies) as against 140th rank during 2014. The survey on doing business was conducted by Alliance for US India Business a sister concern of the U.S.-India Political Action Committee. In the survey major concern noted were infrastructure issues viz. shortage of power and transportation, unethical business practices and corruption in government departments. Foreign investors also find various concerns relating to huge compliances requirement, both at Central & State levels of Government, multiple regulators etc.

Last year investors lost around ` 5,600 crores in the National Spot Exchange's (NSEL) fraud. Recently, Government in order to recover loss has ordered to merge NSEL with its holding company Financial Technologies (FTIL). Probably this is the first move by the Government forcing merger. Further, as per the news reports, the Government is also planning to takeover full or partial management of FTIL. There cannot be second opinion for saving the interest of the NSEL's investors. The move of the Government has been criticised at various quarters. The merger of a limited liability company with the parent company would set inappropriate example for Corporate India and its repercussion would be felt by FTIL investors and also those who have invested in various other listed companies. Would this not scare the investors? Would this not further concretise the fact that doing business in India is difficult? Further it is required to appreciate that NSEL scam cannot be compared with that of Satyam on various counts.

Post release of World Bank's report on ease of doing business in India, the Department of Industrial Policy and Promotion has asserted that Government is committed to bring India into

top 50. Each one would agree that this would be daunting task for the Government. But it is certainly not impossible. Government's time bound, concrete result oriented, steps would be required. With the expansion of Union Cabinet we may expect many big bang announcements at the beginning of Parliament's winter session later this month.

At Chamber, innovativeness is the key for organising educational programmes. In order to equip members with 360° understanding of tax and regulatory issues on the transaction, unique programme was organised jointly by Indirect Tax Committee and International Tax Committee. Various issues surrounding International tax, Transfer pricing, Indirect tax viz. Customs, Service Tax, Excise, VAT, Foreign trade policy were covered in this programme. Transfer pricing adjustment is the source of huge litigation in India. Considering this International Tax Committee has organised Conference on Transfer Pricing – Mitigation of Litigation. Further considering the fact that we have to unlearn and relearn Companies Act, 2013, Corporate Members and Allied Law Committees have organised a Residential Refresher Conference on Companies Act. Students Committee has planned further study circle events for students. These study circles are planned considering enhancement of the student skill sets required for effective execution of the work during the period of articleship training. Members are requested to encourage their students to join Study Circle. Various other programs have also been planned, members may visit Chamber's website or refer Newsletter for the same. Information Technology Committee has expanded the contents and coverage of the Chamber's E-zine. Members are requested to give feedback on the same.

The Income-tax Department observed 'Vigilance Awareness Week' during last week of October 2014. The objective of the 'Vigilance Awareness Week' was to sensitise its officials to the need for improving quality of public service rendered and mitigating the potential areas of corruption. During this period interactive session between the senior functionaries of the Income-tax Department and various stake holders to mitigate potential area of corruption was held, wherein the Chamber was invited. The Chamber has presented its representation identifying potential areas of corruption along with suggestion to mitigate the same. Procedure for issue of the NIL or lower tax deduction certificate has been time consuming and at times it is prone to unethical practice. Hence the Chamber during the earlier interactive session with the senior functionaries of the Income-tax Department has suggested for developing online platform for applying for such certificate. Online platform would lead to minimal human interface. Pursuant to the representations made, facility for online application for issue such certificate, has been now made available on www.tdsmumbai.in.

The Government is firmly commitment to deliver and this would open windows of opportunities for the each and every countryman who intends to do something. At this juncture I remember words of William Arthur Ward. He said *"Opportunities are like sunrises. If you wait too long, you miss them."*

Paras Savla
President

Chairman's Communication

Dear Esteemed Readers,

From the period of festivities, we now move into the extended busy season of work in the profession. The extension of due date for tax audit and return filing, which though brought about much desired relief, will keep us busy in this month and this will be followed by the pressure of assessments and other time-barring compliances.

The Special Story in this issue deals with one of the most hotly discussed and debated topics in the corporate world today viz. 'Related Parties Transactions'. The transactions amongst related parties have assumed greater significance in all the spheres of businesses – accounting, fiscal laws, and international movement of goods and services and also as a matter of corporate governance. At times, these transactions are viewed with suspicion due to lingering possibilities of profit and base shifting, though there may exist possibilities of creating operational synergies within the group companies. Thus, there has been plethora of legislation and accounting disclosure requirements to regulate and report such transactions. Thus, it becomes essential to look at such transactions from the inception level itself and structuring of the same can be pretty complex exercise.

I am sure you shall enjoy the articles contained in this issue, which have been carefully analysed by the learned authors. I would like to thank Shri Anup P. Shah for the design of the Special Story and the authors Dr. Paritosh Basu, Shri Sandeep Parekh, Shri Vispi T. Patel, Shri Rajiv Shah, Ms. Kejal Visharia, Shri Amitabh Khemka, Shri Jayesh Gandhi and Shri Jayant Thakur for their contributions. Apart from the regular articles, we have also included Case Studies dealing with some of the intricacies under the Corporate Law. I am also thankful to Shri Aditya Gaiha for his article on "Capital Account Convertibility and the Internationalisation of the Indian Rupee".

Sanjeev Lalan
Chairman – Journal Committee

Dr. Paritosh Basu

Evolution of Regulations for RPTs – Impacts on Corporate Governance and Sustainable Growth

Introduction

Syntheses and fusion of popular definitions of corporate governance reveal that it is all about fairness, transparency and accountability while conducting business. It is concerned with corporate policies, systems, processes, and implicit internal rules in compliance with the legislated stipulations and pronouncements by regulators. It evolves with socio-economic and etho-cultural state of affairs of a country in general and the corporate group and/or entity in particular. The extent of its similarity with global best practices depends on the country's synthesis with global economy and the entity's dependence on overseas business stakeholders. Needs to achieve the global standards of corporate governance also emerge from the effects of coupling with business ecosystems of the world as a whole.

Since the first innovation of human civilisation in lighting fire by scratching two stones, all innovations are on the principle that even the best can be improved. Evolution of all rules and procedures related to corporate governance (CG) also follows the same principle. Evolution of regulations related to conducting related party transactions (RPTs) is no exception to it.

Controllers of all the three frameworks of Indian GAAP, viz., Legal, Regulatory and Institutional have from time to time introduced and amended provisions and compliance requirements for conducting RPTs, their accounting and reporting, penal provisions for disobedience, etc. In 2001 the Income-tax Act also brought RPTs with non-residents under its ambit of regulations. Further Income-tax Act has certain provisions which, disallows expenses paid to related parties since long. Thus RPTs are encircled with total regimentations. Provisions of the Companies Act, 2013 and other recent regulatory promulgations are towards ensuring more specificity by minimising ambiguities and more transparency. Plenty of literatures are available on both the subjects. Accordingly the present author proposes to avoid repetition of those.

This paper makes an attempt through a small case study to establish that good CG practices, policies and procedures related to management of RPTs can enormously contribute towards bringing in competitive advantages for an entity. Such transactions help in strategic planning and management of business when conducted and monitored with clearly laid out standards of CG. The ultimate result is enduring corporate performance and sustainable growth.

The case of Tata Motors

Readers are aware of operational and financial performance of Tata Motors (TM) prior to acquisition Jaguar Land Rover (JLR). Without getting into any controversy it may be mentioned that Tata Motor's position in four wheelers market of India before acquiring JLR, including

export performance, was around the third/fourth amongst competitors. It is, therefore, a point of major interest for any one to study the business rationale of behind acquiring JLR. But before that, it will be useful to appreciate their corporate Vision, Mission and Culture. The following have been extracted from their Annual Report of 2012-13

Vision

"Most admired by our customers, employees, business partners and share holders for experience and value they enjoy from being with us."

Mission

"To be passionate in anticipating and providing the best vehicles and experience that excites our customers globally".

Culture

The four deep-rooted and long-nurtured elements of their corporate culture are "Accountability, Customer & Product Focus, Excellence and Speed".

One can clearly make out the following from the above three proclamations of Tata Motors Group:

- The company promises at all times for delivery of values to all stakeholders with speed and excitements through products, the latent demand for which they want to anticipate in advance;
- Like the eye of fish for the great warrior Arjuna, Tata Motor's focus is on customers who consume their products;
- They want to excel in whatever they do with total accountability; and
- The company wants to measure success with the specific test of admiration they receive from all stakeholders for the value and experience they enjoy for being associated with TM.

The author believes that it is acceptable to all, without much analyses and debates, that the House of Tata is by far one of the most globally respected Indian MNCs, including for their self-motivated standards of corporate governance.

The reader should not be surprised if it is concluded towards the end of this brief case study that strategic intents behind acquisition of JLR by TM are to derive benefits through related party transactions and that too cross-border ones. At this stage it will be useful to quote the following from the MD&A section of their annual report of 2012-13.

"Tata Motors Group primarily operates in the automotive segment. The acquisition of JLR re-enabled the company to enter the premium car market. The company continues to focus on profitable growth opportunities in global automotive business, through new products and market expansion. The Company and JLR continue to focus on integration, and synergy through sharing of resources, platforms, facilities for product development and manufacturing, sourcing, strategy, mutual sharing of best practices."

The last sentence of the above excerpt very clearly reveals that Tata Motors and JLR are and will continue to be engaged in related party transactions. The present author's analyses of the above statement with a bent of business strategies bring out the following major areas of trans-national related party transactions between JLR and TM as well as other companies of Tata Group:

- Import large-value cars for high-end customers in India and market those of relatively cheaper varieties from their Indica stable to the low end users in international market, where demands for the same still exist and perhaps will improve.

  This strategy of complementing each other's overseas markets with products also serves another strategy of creating a natural hedge for management of exposures to currency exchange rate risks to a large extent. This part of enterprise risk management will be ensured at ease because the import bills will be met from inward remittances against exports.

- Derive maximum benefits from the long standing strengths, advantages and reputation of JLR in innovative designing of cars, continuous addition of modern technologies and material substitutions for superior performance and thus customers' satisfaction.

  These are some of the critical aspects from which cars of TM are suffering on the face of competition from Maruti-Suzuki and other foreign car manufacturers, who have set up shops in India. For these services JLR will have to raise RPT bills in compliance with regulations of both India and the UK.

- Tata Group will be able export services of TCS to JLR, which has also been mentioned in some other part of the same M&DA in their annual report;

- There are scopes for many competitive synergies and cost savings by using each other's logistics management systems, market knowledge, brand and corporate images.

- The Anglo-Dutch steel maker Corus, which was not doing very well since its acquisition by Tata Group in 2006, will also be benefitted with a ready in-house market for steel to be used for JLR's cars. This may also be complemented by supplies from Tata Steel, India.

Analyses of case from RPT and CG perspectives

Without enlarging the above list and getting into further details, any professional manager can conclude that strategic objectives behind acquisitions of JLR were to derive competitive advantages from each one's strength points of markets and marketing, innovative technology integration, and strategic cost management. These three would automatically bring many more advantages yielding financial gains with in-built measures for enterprise risk management in related areas of business activities. Such thoughts are no-brainers and not much of a complex task for guessing since the factual position has very loudly been pronounced in their MD&A.

One of the major pillars of strength on which these gigantic tasks TM has taken up, in conformity with their business strategies, is essentially their ability to handle RPTs remaining within the strict regulations of all concerned countries. But for their inherent systems and policies, they would have not been able to create competitive advantages from each other's areas of forte. RPTs must have to be there as they form the very rational and basis for such M&A deals.

All these, when analysed on the back drop of their long standing statements of Vision, Mission and Culture, speak volume of confidence the group has on their people, systems and processes in conducting RPTs across multiple group companies with complex holding structures.

The Case on Drawing Board

From a quick research of reported news items it seems that Maruti-Suzuki Group will also use transfer pricing as the strategic tool for removing physical bottlenecks in expanding manufacturing activities at Gurgaon plant and thus continue to lead motor car sector. While debate on the plan for corporate structuring and project financing between Suzuki Motor Corporation (MSC) and MSIL for Suzuki Motor Gujrat Pvt. Ltd. (SMG) is being concluded, it is crystal clear that the prospective operational plan is based on the solid foundation of pricing products to be traded between related entities. It seems that SMG will probably be a wholly owned subsidiary of MSC and MSIL will be the only customer of SMG.

From available news items it is understood that the two entities have received nod to go ahead form their respective Management and major shareholders are in the process being convinced about the strategic plan. Even before the compulsive provision of taking approval, the two companies have also taken approval from internal authorities on the framework for pricing of products to be sold by SMG to MSIL.

It is, therefore, another pronounced case soon to be a ground reality to prove that RPTs, when executed with best corporate governance practices, can be taken as a boon for business and they are not barriers. One has to wait and see what all other financial benefits that will emerge and how enterprise risk management will become more easy to handle. However, the probable plan for pricing of products at cost may have to be thought through. If at individual entity level no margin is left, how SMC will recover their investments in SMG as dividend up streaming will not be possible and the benefits at MSIL will be shared. In that situation how Indian Tax Authorities will react for assessment at the entity level of SMG needs to be watched. The system of pricing at market rate, i. e., with reasonable margin, cannot totally be ruled out. However, this issue will not arise, if SMG produces complete cars. It will be good to wait and watch developments.

Learning Points

People at large outside any business group, irrespective of being stakeholders or not, view RPTs with an inherent negative sense of conjecture and surmise. On the other hand employees of many business organisations consider all regulatory provisions and even mandates from internal governance framework as hurdles in doing business and generate values. The above case study of TM-JLR points out how such regulations can best be utilised to the maximum advantage of a business group. Again the aforesaid plan of Maruti-Suzuki group further strengthens the proposition.

The present author is of the view that more the ambiguities are cleared with detailed regulatory provisions and financial limits for different types of RPTs, to be conducted by entities of different sizes, more will they facilitate the process of using RPTs for minimisation of value destructions. There is no denying of the eternal business practice that profit should not be shared with an external entity, if the concerned goods and services can economically be generated by different entities within the same business group. Strategic planning and management are synonymous to business.

One of the most important codes of conduct here for any business leader is that the relatively stronger party, involved in any RPT, should not exercise its influence and create any position of business advantage because of the other party's dependence to generate business. The cardinal principles for fair distribution of value addition from a segmented set of business activities, conducted by multiple entities within a business group, should be followed. It should be on the principle of equity, i.e., at the proportion of value that is added each one. This principle ultimately becomes transparent and acceptable when tested at the market place or with laid down principles of equity in case the underlying goods or service is of unique nature.

In the quoted case when the strength of JLR in technology and designing capabilities will be shared through services rendered to TM, there will definitely be a huge task of proving to multiple government agencies of both the countries that both costs and profit included in the value of services are justified from all perspectives. TM has not sighed away. Preparation of a worksheet for these for any finance professional is not a big deal. However, there has to be equal involvement of CXOs and their team to provide bases of assumptions, etc. for common cost allocation with operational justifications, validation with market price, and standing the test of transparency.

With thirty-four years' experience of working in corporate sector the present author is of the view that conducting RPTs in total compliance with all regulations, mostly in practice, forms the onerous responsibility of finance team. This cannot be and should not be the situation any further. The above case of TM is a testimony of approaching and handling the subject of RPTs from the perspective of the organisation as a whole. Then and then only RPTs can be used as an effective tool for sustainable growth through value creations to be shared by all stakeholders.

CA Anup P. Shah

Glass Half Empty or Half Full?

Introduction

One of the biggest charges against corporate India has been the preponderance of Related Party Transactions (RPTs) between the companies and their promoters. This often leads to opacity and has been panned as being anti-minority interest. According to some Press Reports, in the Financial Year 2013, India's top 10 business houses reported RPTs worth ` 1 lakh crore. The Companies Act, 1956 contained s.297/s.314 which dealt with this issue. To improve this scenario the Companies Act, 2013 introduced s.188 which introduced significant changes over the earlier s.297.

This section faced sharp criticism from companies which led to some important dilutions by the Ministry of Corporate Affairs (MCA) which in turn, drew the ire of share holder activists! Thus, there has been a constant yo-yo between promoters and minority share holders with each crying foul and each claiming victory. One of the biggest facets of s.188 is its applicability in toto to private companies. These provisions also need to be read in consonance with the provisions of Cl. 49 of the Listing Agreement when it comes to RPTs by listed companies.

Let us examine some salient features of this very important section under the Companies Act, 2013.

Related Party defined

The definition of a related party in relation to a listed company under S.2(76) of the Companies Act, 2013 is given below:

(a) Director or his relative*

(b) Key managerial person (Managing Director, CFO, Company Secretary) or his relative

(c) Firm in which Director / relative is partner

(d) Private company in which Director / relative is Member / Director

(e) Public company in which a Director is a Director or he with his relatives holds >2% capital

(f) Body corporate whose Board / MD is accustomed to act in accordance with instructions of a Director

(g) Holding Company of the Company

(h) Subsidiary of the Company

(i) Associate of the Company

(j) Fellow Subsidiary of the Company

(k) Key managerial person of the Holding company. A close family member of such a person is also included.

* Under the New Companies Act, a relative *qua* an individual means his HUF, spouse, parents, children, siblings and spouses of children. Step-father, step-mother, step-son, step-brother and step-sister are also relatives. Strangely, a step-daughter is not a relative.

It may be noted that the Act does not make any reference to a related party under the Accounting Standards. Hence, there may be a situation where a party is a related party under AS 18 for disclosure purposes but not so under the Companies Act for substantive purposes or vice versa. Recent Press Reports indicate that the MCA is planning to align the requirements of the Act with the Accounting Standards.

Related Party Transaction defined

S.188 of the Act specifies various contracts or arrangements with a related party which constitute a related party transaction. Hence, there is no express definition of the term RPT but only a list of contracts or arrangements which constitute one. It may be noted that the scope of RPTs u/s. 188 is restricted only to the types of contracts or arrangements specified under the section. The contracts or arrangements constituting a related party are as follows:

(a) sale, purchase or supply of any goods or materials;

(b) selling or otherwise disposing of, or buying, property of any kind;

(c) leasing of property of any kind;

(d) availing or rendering of any services;

(e) appointment of any agent for purchase or sale of goods, materials, services or property;

(f) such related party's appointment to any office or place of profit in the company, its subsidiary or associate company; and

(g) underwriting the subscription of any securities or derivatives thereof, of the company.

Further, the Rules treat certain RPTs as prescribed RPTs for which a special resolution of the share holders is required. These are explained below:

(a) Sale, purchase or supply of any goods or materials or appointment of any agent for purchase or sale of goods, materials and of these RPTs, those exceeding:

- 10% of the turnover of the company or
- ` 100 crore.

whichever is lower, are treated as prescribed RPTs.

(b) Selling or disposing of, or buying any property or appointment of any agent for purchase or sale of any property and of these RPTs, those exceeding:

- 10% of the turnover of the company or
- ` 100 crore.

whichever is lower, are treated as prescribed RPTs.

(c) Leasing of property of any kind and of these RPTs, Lease exceeding:

- 10% of net worth of the company or
- 10% of turnover of the company or
- ` 100 crore,

whichever is lower

(d) Availing or rendering of any services or appointment of any agent for services and of these RPTs, those exceeding:

- 10% of the turnover of the company or
- ` 50 crore.

whichever is lower, are treated as prescribed RPTs.

(e) Related party's appointment to any office or place of profit in the company, its subsidiary company or associate company and of these RPTs, such appointment at a monthly remuneration which exceeds ` 2.5 lakhs is treated as prescribed RPT.

(f) Underwriting the subscription of any securities or derivatives thereof, of the company and of these RPTs, if the underwriting is for Remuneration exceeding 1% of the net worth of the company, then it is treated as prescribed RPT.

The Turnover or Net Worth referred to above shall be computed on the basis of the Audited Financial Statement of the preceding Financial Year. Thus, s. 188 of the 2013 Act encompasses both s.297 as well as s.314 of the Companies Act, 1956 since the appointment to office or place of profit is also covered within this section.

The Rules earlier prescribed that a company having a paid-up capital of ` 10 cr. or more shall not enter into any RPT which is not on an ALP and not in the ordinary course of business without a special resolution. However, by virtue of an Amendment, the MCA has removed this clause. Hence, as the Law stands currently, the threshold requirement of ` 10 cr. of capital stands removed to determine whether an RPT requires a special resolution.

Compliances under the Act

Depending upon whether the RPT is in the Ordinary Course of Business and on an arm's length pricing, the compliances required by a private/public company under the Companies Act, 2013 are as follows:

Compliances	***If RPT in Ordinary Course of business and on ALP* basis***	***If RPT not in Ordinary course of business / not on ALP* basis***
Whether Audit Committee's approval required for all RPTs, whether prescribed or not?	Yes. It is required u/s. 177	Yes. It is required u/s. 177
Whether consent of Board of Directors required for all non-prescribed RPTs?	No	Yes
Whether Special resolution required for all non-prescribed RPTs?	No	No
Whether consent of Board of Directors (Not by Circular Resolution) + Special resolution required for prescribed RPTs?	Not required since RPT in ordinary course and on ALP	Yes
Whether RPT to be referred in Directors' Report along with justification for the same?	No	Yes

* ALP = Arm's Length Pricing basis, i.e., an RPT conducted as if it were between unrelated parties so that there is no conflict of interest. To demonstrate that the RPT is on an ALP, the Company may consider comparable uncontrolled prices or such other available illustrations which would demonstrate that the transaction has been carried out on an arm's length price. The concept of ALP is relevant only *qua* the Companies Act since Cl. 49 makes no distinction between an RPT at ALP or otherwise.

* What is an ordinary course of business has not been defined and would have to be ascertained on a case-by-case basis. The Memorandum of Association, Financial Statements, Board Minutes, history of past transactions, etc., could be some of the indicators of what is ordinary for a company. For instance, purchase of shares of the promoter's private company would not be in the ordinary course of business even though it may be on an arm's length pricing. Press reports indicate that the MCA is averse to defining this crucial term and feels that this should be decided on a case-by-case basis and subjective judgment should be applied.

* The twin conditions or ALP and ordinary course of business need to be satisfied for a company to get out of the provisions of s.188(1) of the Act. Compliance with any one is not enough.

Thus, now the triple test for an RPT to go to share holders is all of the following:

(i) Is it in the ordinary course of business;

(ii) Is it an arm's length price; and

(iii) Is it out of the prescribed list of thresholds

If the company ticked yes to all of the above three questions, then congratulations, the RPT does not need a shareholder's approval! However, if the company is a listed company then the parameters of Cl. 49 of the Listing Agreement must also be considered.

Every company must maintain a Register giving details of all RPTs to which s.188 applies.

Voting for RPTs

Share holders' approval is required either under the Companies Act under certain scenarios enumerated above. The provisions / issues in this respect are as follows:

(a) S.188 provides that no member of the company shall vote on any special resolution, to approve any RPT which may be entered into by the company, if such member is also a related party. The MCA issued a clarification in this respect that related party has to be construed with reference to / in the context of the contract or arrangement for which the special resolution is being passed. E.g., a holding company is entering into a transaction with its substantially owned subsidiary, which is now treated as a related party. The promoter director of the holding company is also treated as a related party. However, he can now vote on this transaction since he is not related parties *qua* the arrangement in question.

(b) In the case of an RPT with a wholly owned subsidiary, special resolution passed by the holding company would suffice.

(c) RPTs entered into by companies, after making necessary compliances under section 297 of the Companies Act, 1956, which contracts came into effect before the commencement of section 188 of

the Act, will not require fresh approval under section 188 of the Act till the expiry of the term of original contract. However, if a modification in such contract is made on or after 1st April 2014, then the requirements under section 188 will have to be complied with.

(d) S.188 does not apply to transactions arising out of compromises, amalgamations, arrangements, etc., dealt with under specific provisions of the Companies Act, 1956 or Companies Act, 2013.

(e) For prescribed RPTs, the share holders' resolution must be passed prior to the transaction but in other cases, no such express provision is made. Further, in case of a contract or arrangement entered into by a director / employee without approval of the Board / Company, such contract may be ratified by post-facto consent within 3 months.

(f) The draft Notification issued by the MCA u/s. 462 proposed to exempt all private companies from the purview of s.188. However, the final Notification has still not been issued and hence, the issues for private companies still remain. Hence, if a private company needs to pass a special resolution for a RPT with a member and if all the members are related parties in the context of the RPT been proposed, then it is a moot point how the same would be complied with? One can only hope that this Notification sees the light of the day sooner than later.

Consequences of non-compliance

The Act provides that any RPT which is not in compliance with s.188 may be voidable at the option of the Board. The director or the employee concerned who authorised such contract or arrangement with the related party will be liable to indemnify the company for any loss incurred by it. Further, the company can proceed against such director or employee for recovery of any loss it sustains due to such RPT.

The punishment for non-compliance of s.188 on a director / employee in case of a listed company is imprisonment for a term of up to 1 year and / or fine of ` 25,000 to ` 5 lakhs. In case of an unlisted company the punishment is a fine of ` 25,000 to ` 5 lakhs. Further, a person who has been convicted of an offence u/s. 188 at any time during the last 5 years is not eligible for appointment as a director of a company.

Epilogue

Whether the dilutions by the MCA is a boon or a bane is something which can be debated upon for times to come. Whether the MCA needs to dilute the provisions further for private companies is another factor which needs consideration. We can surely expect more action on this front. One thing is for sure, when it comes to compliance for Related Party Transactions, whether the glass is half empty or half full depends upon which side of the fence you're sitting!

Effective leadership is putting first things first. Effective management is discipline, carrying it out.

Sandeep Parekh, *Advocate*

RPTs under the Listing Agreement

There have been several cases where related party transactions have been undertaken by those in control of companies to obtain significant monetary advantages. This is further amplified in India due to the concentration of ownership and it gravely affects the interests of minority share holders. To tackle this issue, provisions within the Companies Act, 2013, the Listing Agreement and the Accounting Standards provide safeguards against abuse of dominant position held by promoters. This article will focus on the Securities and Exchange Board of India's efforts in curbing RPTs through the Listing Agreement.

The old regime: SEBI had earlier issued a master circular on corporate governance in listed companies on October 29, 2004[1] wherein "related party transaction" had been defined along the lines of Accounting Standard-18. It contained the requirement of making disclosures to the Audit Committee which included a statement in summary form on all transactions with the related parties in the ordinary course of business, all material related party transactions which are not in the normal course of business and all material related party which are not on an arm's length basis along with justifications for undertaking the same. The Audit Committee was then required to review the annual financial statements with respect to the disclosures that were made and also mandatorily review the statement of significant related party transactions which were submitted by the management. Both the quarterly compliance report on corporate governance and the report on corporate governance in the annual report were to contain information regarding related party transactions.

The total revamp: In order to address the failings of the corporate governance regime, SEBI came out with the Consultative Paper on Corporate Governance norms in India on January 4, 2013[2] discussing various changes that it proposed to make to the Listing Agreement. After analysing the various comments that were received in response, through a circular dated 17 April, 2014[3], SEBI made amendments to Clause 49 of the equity Listing Agreement with a view to align it with the Companies Act, 2013, adopt the best practices on corporate governance and to make the corporate governance framework in the country more effective. While a number of these norms have already been incorporated within the Companies Act, 2013, SEBI has chosen to lay down a more burdensome regime in certain areas. All listed companies are required to be in compliance with Clause 49 from October 1, 2014.

In order to gauge the preparedness of to 500 listed companies by market capitalisation and for ensuring timely compliance with Clause 49, SEBI had sought representations from market participants such as companies and industry associations. These representations highlighted

1 Master Circular on Corporate Governance in listed Companies – Clause 49 of the Listing Agreement, available at http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf

2 Consultative Paper on Review of Corporate Governance Norms in India, available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1357290354602.pdf

3 Corporate Governance in listed entities – Amendments to Clauses 35B and 49 of the Equity Listing Agreement, available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1397734478112.pdf

certain practical roadblocks in ensuring compliance, sought clarifications regarding certain provisions and recommended options to simplify the implementation process. Accordingly, SEBI's circular dated September 15, 2014[4], has further amended Clause 49 and effectively toned down some of the onerous obligations which were prescribed earlier.

The provisions: Apart from being applicable to all future RPTs undertaken by listed companies, Clause 49 will be applicable prospectively to transactions that were initiated earlier but are likely to go beyond March 31, 2015. Therefore, it is important to look at the nature of the requirements that are being implemented.

Related Party: The amended Clause 49 of the listing agreement deals extensively with related party transactions. While the Companies Act, 2013, defines related party transactions, SEBI chose to expand the scope of the kinds of transactions that fall within it by giving a wide definition to the term "related party". It stated that parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. However, on reviewing representations made by various market participants, SEBI has significantly toned down the definition and has aligned it with Section 2(76) of the Companies Act, 2013 and with the applicable accounting standards.

Materiality of RPTs: The revised Clause 49 also creates a materiality threshold in relation to RPTs and all those RPTs which breach the threshold are required to obtain the approval of share holders through a special resolution. The materiality of the transaction in question depends on the related party transaction policy that every company is expected to come out with. However, all transactions with a related party are to be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds five per cent of the annual turnover or twenty per cent of the net worth of the company as per the last audited financial statements of the company, whichever is higher.

The September 15, 2014, circular relaxes the requirement slightly and now states that a transactions shall be considered material if it is entered into individually or taken together with previous transactions during a financial year, exceeds ten per cent of the annual consolidated turnover of the company as per the last audited financial statements of the company. However, it is still unclear if there is any actual relief being provided to listed companies, since certain RPT covered under Section 188 of the Companies Act, 2013 which exceed the threshold prescribed under relevant rules therein, still require prior approval through special resolution. All companies, irrespective of their size, are still required to pass a special resolution in case the transactions being entered into with a related party comes within the ambit of Rule 15(3) of the Companies (Meetings of Board and its Powers) Rules, 2014.

Role of Audit Committee: The revised Clause 49 enhances the role of the audit committee significantly and this includes the responsibility of approving all related party transactions. In a step towards simplifying the approval process, the circular dated September 15, 2014, permits audit committees to grant omnibus approval for all the related party transactions which the company proposes to enter into subject to the criteria laid down for granting the omnibus approval in the company's related party transactions policy. The circular clarified that the omnibus approval can only be availed for the transactions which are repetitive in nature.

In conclusion, while these targeted measures may have toned down the obligation on companies significantly and may address problems specific to the Indian corporate governance model, excessive regulation will impose significant constraints on listed companies. Given that substantive regulation is merely as good as the effectiveness of its enforcement, well-intended but radical norms may affect effective implementation. Through these amendments SEBI has sought to offer the potential for more effective implementation of governance practices by making them more acceptable to companies. However, discrepancies remain in certain aspects which require further clarification for smooth compliance.

4 Corporate Governance in listed entities – Amendments to Clause 49 of the Equity Listing Agreement, available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1410777212906.pdf

CA. Vispi T. Patel, CA. Rajiv Shah and
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Broad Overview of Transfer Pricing Provisions in India and Current Key Issues faced by Tax-payer

INTERNATIONAL TRANSFER PRICING PROVISIONS

Introduction

Transfer pricing ('TP') provisions were introduced in India in the year 2001 (i.e. w.e.f. A.Y. 2002-03) by way of an amendment to the Income-tax Act, 1961 ('the Act'), essentially to put a systematic check on India's tax base erosion on account of dealings/transactions between related parties (i.e. 'associated enterprises' or 'AEs')[1]. The requirements of law being that the transactions between AEs would be a mirror image of transactions between two non-associated enterprises i.e. independent enterprises. The objective is to prevent profit shifting to enterprises situated in jurisdictions with relatively lower tax rates or that are otherwise taxed at lower rates by virtue of exemptions, special deductions, set-off of losses carried forward from previous years, and so forth. The law, thus aims that all controlled transactions should be at arm's length price (ALP).

For example, an Indian company may buy goods at inflated prices from its overseas subsidiary which has a lower tax rate than India to portray higher expenditure and consequently pay lower taxes in India.

Thus, TP provisions were introduced to provide a detailed statutory framework [*vide* Sections 92 to 92F of the Act read with Rules 10A to 10TG of the Income-tax Rules, 1962 (the Rules)] and assist in computation of reasonable, fair and equitable profits and tax in India and resulting tax payments in India, in case of multinational enterprises (MNEs). The basic framework of the provisions has been modelled from the Organization for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

Applicability

Section 92(1) of the Act provides that any income arising from an international transaction shall be computed having regard to the ALP. Further, the Explanation to Section 92(1) clarifies that the allowance for any expense or interest arising from an international transaction shall also be determined having regard to the ALP. Section 92(2) also provides that when two or more AEs enter into any arrangement or agreement for allocation or apportionment of any cost or expenses, the same also need to be apportioned/allocated at ALP. The said arrangement/agreement may be in connection with a benefit, service or facility to be provided to any or all of the enterprises.

International transaction

As per Section 92B(1) of the Act, an international transaction means a transaction between two

1 Refer CBDT Circular No. 14/2003

or more AEs, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more AEs for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

The Finance Act, 2012, inserted an Explanation to Section 92B with retrospective effect from 1 April, 2002, expanded the definition of the term 'international transaction' to include purchase, sale, transfer, lease and use of tangible and intangible property, capital financing (including any type of long-term or short-term borrowing, lending or guarantee, etc., provision of various services and transaction of business restructuring or reorganisation (even though such transaction may not have any bearing on profits, income, losses or assets of the relevant year). Further, the said Finance Act also expanded the definition of the expression 'intangible property' to bring within its ambit almost every kind of intangible property.

Deemed international transaction

Section 92B(2) of the Act provides that a transaction entered into between two unrelated enterprises may also be treated as an international transaction, if such a transaction has been undertaken by virtue of a prior agreement/ understanding between one of such unrelated enterprises and an AE of the other party to the transaction.

Until 2013, taxpayers refuted applicability of TP provisions in such cases if the transaction was between two resident enterprises, based on the proposition that as per Section 92B(1) of the Act, at least one of the parties to the transaction needs to be a non-resident and hence, TP provisions i.e. Section 92B(2) could not be applied in cases where both parties to the transaction were resident enterprises. However, the Finance Act, 2014 has clarified that Section 92B(2) shall apply even if both parties to the transaction are residents.

Associated enterprise/AE

As per sub-section (1) of Section 92A of the Act, two enterprises can be regarded as AE if one enterprise participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or same persons participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of both the enterprises. Sub-section (2) of Section 92A provides a list of cases when the two enterprises shall be deemed to be regarded as AE for the purpose of sub-section (1). The said section uses the criteria of voting power, amount of loan, guarantee provided, dependence on intangible assets, amount of purchase/sale as compared to the total purchase/sale, composition of board of directors etc. for determining participation of control, management or capital between the two enterprises. Even if the relevant criteria are satisfied at any time during the year the enterprises can be regarded as AEs.

The words "at any time during the previous year" used in Section 92A hold significance. It means that even if two enterprises become AEs for even one day in a year, they will be construed as AEs for the full year and transactions undertaken between them during the entire year would need to be benchmarked as per TP provisions of the Act.

Methodology to be followed

Transactions between AEs need to be benchmarked by following the methods specified in the Act, to establish that the controlled transactions are at ALP.

Benchmarking methodologies specified under the Act

Section 92C of the Act specifies six methods that can be applied, depending upon the nature of the transaction, or class of transactions, class of AEs, functions performed by such persons or such other relevant factor as Board may prescribe[2] to justify ALP. The same have been briefly explained as under:

Comparable Uncontrolled Price (CUP) method

CUP method evaluates the 'price' charged in a controlled transaction with reference to the 'price' charged in a comparable uncontrolled transaction(s), which could be identified either through internal or external comparable companies. For example, the same product is being sold by an enterprise to both, its AE as well as third parties (internal comparable) or the same product is freely available in the market of which prices can be compared (external comparable).

Since comparison is done at price level, the CUP method is considered to be the most direct and reliable method for comparison purposes.

Resale Price Method (RPM)

RPM is applicable in a resale situation, where the property or services purchased from an AE are sold to an unrelated enterprise without any value addition. The RPM is applied on either a transactional or a comparable-company basis, and it mostly applies to distributors/ marketers.

Cost Plus Method (CPM)

CPM is generally applied by comparing gross profit mark-up (on direct and indirect costs of production) in relation to supply of products or provision of services to AE. CPM is most useful where semi-finished goods are sold between related parties, where related parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services.

Profit Split Method (PSM)

PSM could be applied mainly in international transactions involving transfer of unique intangibles or in multiple international transactions, which are so interrelated that they cannot be evaluated separately for the purpose of determining the ALP of any one transaction. The PSM is therefore, appropriate for integrated transactions with more than one enterprise.

Transactional Net Margin Method (TNMM)

TNMM is generally appropriate for the provision of services/sale of goods etc., where CPM or RPM cannot be adequately applied. It compares the net level profitability in relation to an appropriate base like sales, costs or assets employed, etc. TNMM is based on the principle that differences in the operating level, capacity etc. get neutralised by the difference in the level of operating expenditure and hence, profitability of companies belonging to the same industry/ category can be compared.

The "Other Method" as prescribed by Rule 10AB (Other Method)

The Other Method refers to "price which has been charged or paid, or would have been charged or paid" for same or similar uncontrolled transactions, with non AEs, under similar circumstances, considering all the relevant facts. This method seems to be akin to the CUP method.

For instance: The "Other Method" may be applicable for transactions which can be benchmarked using "prices" (rather than margins). Also the words "would have been charged or paid" could cover transactions such as valuation of shares, intangible property, etc. It could sanction the use of "quotations" rather than prices "actually" charged or paid.

2 Refer Rule 10B

It is provided that when more than one price is determined by following a method, arithmetical mean of such prices should be regarded as ALP. It is also provided that if the ALP so determined is within the range of the prescribed percentage (i.e. one per cent for wholesale trade and three per cent for others) of the transaction price, the transaction price should be accepted as ALP.

However, in respect of transaction entered into after April 1, 2014, if more than one price is determined by following a method, ALP is required to be computed in a prescribed manner. The manner is yet to be prescribed, it may take into account a concept of range together with use of multiple year data.

Advance Pricing Agreement (APA)

The Finance Act, 2012 introduced provisions relating to Advance Pricing Agreement (APA). The following are the salient features of the APA scheme:

- It is an agreement between a taxpayer and the tax authorities for either specifying ALP or the manner in which the ALP is to be determined in relation to an "international transaction";
- The ALP shall be determined on the basis of prescribed methods or any other method;
- The APA is binding on tax authorities as well as taxpayers unless there is a change in the law or facts of the case.
- Valid for a maximum of consecutive 5 years and preceding 4 years
- In case APA covering a particular year is obtained after filing the return of income, modified return needs to be filed based on the APA and assessment or reassessment to be completed based on such modified return;
- APA to be declared void *ab initio* if obtained by fraud or misrepresentation of facts;
- Rules 10F to 10T governs the detailed procedure for application, annual compliance report, compliance audit etc.

Safe Harbour Rules

Rules 10TA to 10TG were introduced in September 2013 providing rules for Safe Harbour. 'Safe Harbour' means circumstances in which the Income Tax authorities shall accept the transfer price declared by the taxpayer. The Rules among other things provide for the circumstances under which the transfer price declared by the taxpayer (margin declared by the assessee) would be accepted by the authorities for prescribed eligible international transactions i.e. software development services and other IT related services, provision of loans and guarantee, provision of contract research and development services, manufacture and export of core/noncore auto components etc.

Further, following are some of the typical issues faced by the taxpayers as regards the TP provisions in the Act:

Use of TNMM

There seems to be a preference for determining the arm's length nature of international transactions, based upon the overall profitability of an enterprise under the TNMM as opposed to other direct methods, irrespective of whether the international transactions have a bearing on such profitability or not.

For example, a taxpayer may have sold goods to its AE on which it earned a reasonable/ acceptable gross margin, but still suffered a loss at net level on account of higher operating cost that it had to incur to make sales to third party customers, e.g. marketing costs. Such marketing expenditure, though may not be functionally related to the international transaction of sales to AE, often becomes a reason for an adverse TP adjustment in the case of the taxpayer when its net level profitability is compared by the Transfer Pricing Officer (TPO) with its peers. Other examples leading to losses at a net level could include high proportion of bad debts, high employee cost compared to peers, heavy discounts offered to clear stocks at the year-end, etc.

This is one of the most common issues faced by taxpayers in India. While the OECD TP

Guidelines suggest that appropriate adjustments should be made to neutralise the effect of an enterprises' business strategies on its profitability, transfer pricing analysis in India is still in its nascent phase to give due weightage to such aspects.

Characterisation as low-end or high-end service providers

Having regard to the low-cost base of India, it is known that many MNEs have set up back-end centres in India to assist in carrying out routine functions such as accounting, invoicing, payment processing, etc. Such back-end centres are usually remunerated on a cost plus mark-up basis.

One of the most common area of disputes between taxpayers and revenue authorities in such cases is use of appropriate comparable companies for benchmarking the taxpayer's profitability. While taxpayers insist on benchmarking their profits vis-à-vis companies providing routine low-end services, revenue authorities tend to include certain high end service providers in the list of comparables. Obviously, such service providers earn higher margins than routine service providers, due to various economic reasons like established presence in the market, more sophisticated processes, brand value, etc.

Reasons for such disputes in the choice of comparables could be attributed to the difference in the taxpayer's functional, asset and risk (FAR) analysis pertaining to the transaction of provision of services, inappropriate drafting of the relevant agreement for provision of services between the taxpayer and the MNE, non-maintenance of adequate records by the taxpayer to substantiate the routine nature of the services, etc.

Payments for centralised services

MNEs often set up centralised centres in one jurisdiction to carry out certain common services such as IT services, R&D services, etc. for all group members. Further, in many cases, the core function in a MNE viz. conceptualisation, design, product development, marketing strategies, framing of high level business policies, etc. are centralised. The objective may be to establish globally seamless methodology to do business throughout the globe, to achieve economies of scale, to reap benefits of specialisation, etc. Such centralisation ensures standardisation in procedures followed and products/ services provided by all group enterprises globally, ultimately leading to satisfaction of the customer that he will be getting the same product/ service across the globe. MNEs charge out costs incurred for such centralised activities to their group enterprises across the globe, either with or without an administrative mark-up.

The key areas of disputes between taxpayers and TP revenue authorities in such cases are as under:

- Categorisation of costs into stewardship and other allocable costs – division of costs incurred between share holder costs and allocable costs has been a frequent challenge between taxpayers and revenue authorities.

- Substantiation of benefits received by the taxpayer from such services – In many cases, taxpayers are faced with the challenge of putting together tangible evidence for services/ benefits availed. For example a high level management team may have been involved in assisting the taxpayer in negotiating a deal with a customer, in respect of which the MNE may have charged the taxpayer for his time cost. It is likely that in such cases, the taxpayer may not have sufficient evidence to substantiate that services were actually availed by it, if most of the assistance provided by the management committee personnel was through conference calls, etc., and sufficient documentation may not be available. The assistance lent by the AE is intangible in nature as it revolves around the experience and the expert skills of such a team.

Taxpayers are also faced with the challenge of proving that services availed by them from the MNE are not duplicative in nature i.e. they have not availed similar services locally also. The best example for this is IT services where it is likely that the taxpayer avails certain day-to-day services by a local third party service provider while the broad IT framework is provided by the MNE for which a cross-charge is made.

– Arm's length compensation for services – Since such cases mostly involve provision of proprietary services, finding a comparable third party price has always been a challenge.

No rational basis for inclusion/ exclusion of comparable companies

Transfer pricing in India being at a nascent stage, the comparability analysis is more often guided by a company's high/low profitability or loss situation as against its actual functional comparability factors.

Payment towards Royalty

Intra group payment for use of intangibles is always difficult to benchmark. Firstly, the intangible is developed over a period of time and unique to that group. Obviously, such a transaction is never entered into by the company with the outsiders. The revenue authorities generally do not accept the contribution of the intangible in the business of the taxpayer and hence they find it difficult to understand the business rationale for such payment and may view such payment as a tool to shift profits from India.

Capital account transactions

In the recent past, revenue authorities have determined ALP adjustments for typical transactions, such as taxing a transaction of issue of shares by an Indian company to its overseas AE (in the case of Vodafone, Shell, Essar, etc.). It has been alleged that the taxpayer charged a lower price for the shares issued than the ALP for such shares. Further, to the extent of the alleged short receipt of premium, notional interest was also attributed on a deemed loan given by the Indian entity.

One needs to appreciate that the taxpayer, for e.g. instead of issuing 100 shares at a premium of ` 10 could have issued 10 shares at a premium of ` 100. In any case, such a transaction has no bearing on the income or expense of the taxpayer as per Section 92(1) of the Act so as to attract TP provisions.

Recently, the Hon'ble Bombay High Court (HC) in the case of Vodafone India Services Pvt Ltd.[3] held that the transaction of issue of shares at a premium by the assessee to its non-resident holding company, does not give rise to any income from international transaction, and hence is not covered under the TP provisions.

Others

Tax authorities have also been imputing notional income in cases of guarantees provided by Indian MNEs on behalf of their overseas subsidiaries/AEs free of cost, interest free loans provided to its subsidiaries, etc. While taxpayers contend such activities to be in the nature of share holder functions not warranting any considerations, tax authorities tend to ignore the business rationale and by treating both entities as independent enterprises, impute notional income in the hands of the taxpayer.

Domestic transfer pricing provisions

The Finance Ministry has, *vide* Finance Act, 2012, extended the applicability of TP provisions to specified local transactions executed between related parties. These provisions became effective from A.Y. 2013-14 for transactions exceeding an aggregate value of ` 50 million.

3. *Vodafone India Services Pvt. Ltd. v. Union of India, Addl. CIT, Dy. CIT, DRP-III* [Writ Petition No. 871 of 2014]

The genesis of the above amendment i.e. extending applicability of TP to specified domestic transactions lies in the Hon'ble Supreme Court's observation in the case of GlaxoSmithKline wherein the Hon'ble Supreme Court suggested to the Ministry of Finance to consider making TP provisions applicable to domestic related party transactions involving determination of "fair market value". For example, transactions covered under Section 40A(2), Section 80-IA(8)/ (10) etc. Consequent to the above amendment, the following transactions are covered within the ambit of domestic transfer pricing (DTP) regulations:

- Expenditure under Section 40A(2) paid to specified persons;
- Transfer of goods and services between the tax holiday undertaking and other undertakings of the taxpayer;
- Business transacted between the tax holiday undertaking and other 'closely connected entities'; Any other notified transaction.

Clause (b) of Section 40A(2) list various persons that can be regarded as related party with reference to a particular assessee i.e. when the assessee is an individual, Hindu Undivided Family (HUF), Firm, Company etc. Generally, it covers relatives of the individual, member of the HUF, partner of the firm, director of the company, relatives of member, partner, director, various concerns in which said persons have substantial interest etc.

Some of the key issues of domestic transfer pricing provisions are listed below:

- ***Meaning/coverage of beneficial ownership for purposes of Section 40A(2)***

  Whether indirect holding is covered by Section 40A(2) i.e. whether beneficial ownership covers indirect ownership? For example, if A Co. holds more than 50% in B Co. and B Co. holds more than 50% in D Co, can A Co. be regarded as having substantial interest in D Co.?

- ***Benchmarking requirement for Remuneration / other payments to Director / Chairman / Key management personnel***

  In case of a company, specified person as per Section 40A(2)(b) includes directors, key management personnel and their relatives. It will be very difficult for the companies / groups to benchmark the payment made to their directors / chairman.

Concluding remarks

The assessment after the introduction of the DTP provisions will commence in 2016. The taxpayer will eagerly look forward to how the revenue authorities deal with the audit report while completing the assessment. For the revenue authorities also this is going to pose a challenge considering their staff strength and infrastructure.

The OECD is currently working on a Base Erosion and Profit Shifting (BEPS) project. It has recently finalised its guidance on documentation on transfer pricing. It has suggested three tiered approach to the documentation i.e. a master file, a local file and country by country report. This will significantly change the way currently MNEs prepare their transfer pricing documentation and the content and information of the document. OECD is also working on the transfer pricing aspect of the intangibles. Although a significant progress has been made, some of the aspects especially the ownership of the intangibles and transactions relating to the development, enhancement, maintenance, exploitation, protection, etc. of the intangibles has not been finalised because of its close link to the BEPS project. The development in this front and other action points of the BEPS project when implemented is aimed at reducing the compliance cost of the taxpayer and help the revenue authorities in their TP audit. The same should hence reduce the litigation in TP matters.

CA. Amitabh Khemka*

Legal Provisions under Central Excise, Customs and Service Tax Laws

Central Excise Duty

Under the Central Excise law, Central Excise Duty is payable[1] basis the 'transaction value' for each removal of goods (i.e. each removal is treated as separate transaction), if the following conditions are satisfied:

- the goods are sold by the assessee at the time and place of removal
- the assesse and the buyer of goods are not related
- price is the sold consideration for the sale

Hence, where the assessee (the manufacturer) and the buyer are related, then the value (assessable value) on which Central Excise Duty is payable (where such duty is payable *ad valorem*) would not be the 'transaction value'. The determination of value in such cases[2] is prescribed under the 'CE Valuation Rules'[3].

Central Excise Duty is payable at the stage of manufacturing and once the goods are removed from the place of removal, no Central Excise Duty is payable on further sales made after such removal. To reduce excise burden, the manufacturer (A) may sell goods to a person who is related (B), say for ` 100 and thereafter, such related person may sell the goods to the customers (unrelated persons) at higher price, say ` 150. On sale made by the related person to unrelated persons, no Central Excise Duty is payable. If A and B were not related, the assessable value for the purpose of Central Excise Duty would be ` 100 (ie transaction value). However, due to their relationship, the assessable value would not be such transaction value (` 100) but would be one as prescribed in the CE Valuation Rules.

Under the CE Valuation Rules[4], if the goods are sold, whole or part[5], by the manufacturer (assessee) to or through a person who is related, the assessable value would be the 'normal transaction value' at which the related buyer sells the goods to unrelated buyers. In the given example, the assessable value would be ` 150.

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1 Section 4(1)(a) of the Central Excise Act, 1944

2 Section 4(1)(b) of the Central Excise Act, 1944

3 Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000

4 Rule 9 and Rule 10 of the CE Valuation Rules

5 Prior to November 22, 2013, part sale of goods through related person was not covered under Rule 9 and Rule 10 of the CE Valuation Rules; Rule 4 of the CE Valuation Rules would apply then [ie 'transaction value' would apply and not 'normal transaction value'] – as also held in Aquamall Water Solutions vs. CCE 2003 (153) ELT 428 (Tribunal), not interfered by Apex Court on appeal [2003 (158) ELT A182 (SC)]

'Normal transaction value' is defined[6] to mean the transaction value at which the greatest aggregate quantity of goods are sold. For example, on a particular day, the related persons sells 20 units at ` 160, 35 units at ` 150 and 45 units at ` 145, then the greatest aggregate quantity of goods sold on that day is 45 units which is sold for ` 145. Hence, ` 145 would be considered as the 'normal transaction value' and would be the assessable value for the manufacturer, who sold the goods to such related person[7].

If the sale is made through the related person, and such related person sells goods from his depot, then the price relevant for the manufacturer to determine his assessable value would be the depot price of the related person .

It may so happen that the manufacturer sells goods to a related person and the related person may use or consume such goods captively for further production or manufacturing of other goods. The assessable value in such cases for the manufacturer would be[8] 110 per cent of the cost of production of his goods[9].

For this purpose, the persons are deemed[10] to be related, if

(i) they are inter-connected undertakings; or

(ii) they are relatives; or

(iii) amongst them the buyer is a relative and a distributor of the assessee or a sub-distributor of such distributor; or

(iv) they are so associated that they have interest, direct or indirectly, in the business of each other.

Inter-connected undertakings is defined[11] in quite detail. However, in CE Valuation Rules[12], if the goods are sold, whole or part, by the manufacturer (assessee) to or through an inter-connected undertaking, then the value is to be determined as required to be done for a sale to or through a related person. This is to be done only if the undertakings are so connected that they are also related in terms of clause (ii) or (iii) or (iv) stated above, or the buyer is a holding company or subsidiary company of the manufacturer. The detailed definition of inter-connected undertaking, hence, has got diluted to a large extent and accordingly it is not being discussed in detail. The 'holding company' or 'subsidiary company' for this purpose, is to have the meaning as in the Companies Act, 1956.

'Relative' for this purpose means as defined in the Companies Act, 1956. It is defined as (a) a member of HUF; or (b) husband and wife; or (c) relationships indicated in Schedule 1A of the Companies Act. The Schedule contains relations of only a living person ie a natural person (such as father, mother, daughter, brother, etc. etc.). Hence, for this purpose only a living person can be 'relative' of another. A company, firm, body corporate, being not a living person, cannot be a 'relative' of the other.

In clause (iii), the term 'relative and distributor' should ideally mean 'distributor who is a relative' of the manufacturer / assessee. Distributor, generally, is one distributes goods as agent of manufacturer. Hence, if the relation between the manufacturer and distributor is of principal-to-principal and the buyers buys goods in his own name, the buyer should not be considered as 'distributor', even if he is named so in the agreement. Basis the earlier discussion, the relative is only a living ie a natural person, hence the distributor should be such a natural person.

6 Rule 2(b) of the CE Valuation Rules
7 CCE vs. Pepsi Foods Ltd. 2011 (260) ELT 481 (SC)
8 Rule 9 read with Rule 8 of the CE Valuation Rules
9 Ucal Machine Tools vs. CCE 2008 (223) ELT 647 (Tribunal)
10 Section 4(3)(b) of the Central Excise Act, 1944
11 Explanation to Section 4(3)(b) of the Central Excise Act, 1944
12 Rule 10 of the CE Valuation Rules

If the manufacturer and the buyer are so associated that they have interest, direct or indirectly, in the business of each other, then only they are deemed to be related persons. Hence, both of them should have interest in the business of each other. If only the manufacturer has interest in the business of buyer or only the buyer has interest in the business of the manufacturer, they would not be related persons[13]. The interest has to be financial or managerial interest; a mere connection between two parties would not mean interest in business of each other[14]. Hence, the interest should be of the nature having right to participate in the profit / share in profits.

Though, the legal principles are discussed above, the courts may decide to pierce the corporate veil if the arrangement is such that it appears to bogus / sham.

Customs Duty

Article 1 of WTO Valuation Guidelines[15] states:

1. ***The customs value of imported goods shall be the transaction value,*** *that is the price actually paid or payable for the goods when sold for export to the country of importation adjusted in accordance with the provisions of Article 8,* ***provided****:*

   (a) ….

   (d) ***that the buyer and seller are not related, or where the buyer and seller are related, that the transaction value is acceptable for customs purposes under the provisions of paragraph 2.***

2. *(a)* *In determining whether the transaction value is acceptable for the purposes of paragraph 1,* ***the fact that the buyer and the seller are related within the meaning of Article 15 shall not in itself be grounds for regarding the transaction value as unacceptable.*** *In such case* ***the circumstances surrounding the sale shall be examined and the transaction value shall be accepted provided that the relationship did not influence the price.*** *If, in the light of information provided by the importer or otherwise,* ***the customs administration has grounds for considering that the*** *relationship influenced the price, it* ***shall communicate its grounds to the importer and the importer shall be given a reasonable opportunity to respond.*** *If the importer so requests, the communication of the grounds shall be in writing.*

   (b) ***In a sale between related persons, the transaction value shall be accepted and the goods valued in accordance with the provisions of paragraph 1 whenever the importer demonstrates that such value closely approximates to one of the following*** *occurring at or about the same time:*

   (i) *the transaction value in sales to unrelated buyers of identical or similar goods for export to the same country of importation;*

   (ii) *the customs value of identical or similar goods as determined under the provisions of Article 5;*

   (iii) *the customs value of identical or similar goods as determined under the provisions of Article 6;*

13 Atic Industries Ltd. vs. UOI 1984 (17) ELT 323 (SC)

14 Tungabhadra Industries Ltd. vs. CCE 1995 (75) ELT 95 (Tribunal)

15 Uruguay Round Agreement - Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 - Part I: Rules on Customs Valuation

In applying the foregoing tests, due account shall be taken of demonstrated differences in commercial levels, quantity levels, the elements enumerated in Article 8 and costs incurred by the seller in sales in which the seller and the buyer are not related that are not incurred by the seller in sales in which the seller and the buyer are related.

(c) The tests set forth in paragraph 2(b) are to be used at the initiative of the importer and only for comparison purposes. Substitute values may not be established under the provisions of paragraph 2(b).

The Customs law on related party is based on WTO Guidelines. Customs Act on 'valuation of goods' provides[16] that –

(1) For the purposes of the Customs Tariff Act, 1975, or any other law for the time being in force, ***the value of the imported goods and export goods shall be the transaction value of such goods, that is to say, the price actually paid or payable for the goods when sold for export to India for delivery at the time and place of importation,*** *or as the case may be, for export from India for delivery at the time and place of exportation,* ***where the buyer and seller of the goods are not related*** *and price is the sole consideration for the sale subject to such other conditions as may be specified in the rules made in this behalf:*

Provided that …..

Provided further ***that the rules made in this behalf may provide*** *for,-*

(i) the ***circumstances in which the buyer and the seller shall be deemed to be related;***

(ii) the ***manner of determination of value in respect of goods when there is no sale, or the buyer and the seller are related,*** *or price is not the sole consideration for the sale or in any other case;*

(iii) the ***manner of acceptance or rejection of value declared by the importer or exporter, as the case may be, where the proper officer has reason to doubt the truth or accuracy of such value, and determination of value for the purposes of this section :***

Provided also that …..

WTO Valuation Guidelines, defines[17] 'related person' as:

4. For the purposes of this Agreement, persons shall be deemed to be related only if:

(a) they are officers or directors of one another's businesses;

(b) they are legally recognized partners in business;

(c) they are employer and employee;

(d) any person directly or indirectly owns, controls or holds 5 per cent or more of the outstanding voting stock or shares of both of them;

(e) one of them directly or indirectly controls the other;

(f) both of them are directly or indirectly controlled by a third person;

(g) together they directly or indirectly control a third person; or

(h) they are members of the same family.

5. Persons who are associated in business with one another in that one is the sole agent, sole distributor or sole concessionaire, however described, of the other shall be deemed to be related for the purposes of this Agreement if they fall within the criteria of paragraph 4.

16 Section 14 of the Customs Act, 1962

17 Article 15 Uruguay Round Agreement - Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 - Part I: Rules on Customs Valuation

Customs Valuation Rules[18] defines[19] 'related person' verbatim as done in the WTO Valuation Guidelines, with addition of Explanation - The term "person" also includes legal persons. Interpretative Notes[20] in this regards clarify that one person is deemed to control the other when the former is legally or operationally in a position to exercise restraint or direction over the latter. Thus, even operation control is enough for persons to be related.

Customs Valuation Rules also provides[21] that where the buyer and the seller are related, the circumstances surrounding the sale shall be examined and the transaction value shall be accepted as the value of imported goods provided that the relationship did not influence the price. It is not intended that there should be an examination of the circumstances in all cases where the buyer and the seller are related. Such examination will only be required where there are doubts about the acceptability of the price. Where the proper officer of customs has no doubts about the acceptability of the price, it should be accepted without requesting further information from the importer. For example, the proper officer of customs may have previously examined the relationship, or he may already have detailed information concerning the buyer and the seller, and may already be satisfied from such examination or information that the relationship did not influence the price. Where the proper officer of customs is unable to accept the transaction value without further inquiry, he should give the importer an opportunity to supply such further detailed information as may be necessary to enable him to examine the circumstances surrounding the sale. In this context, the proper officer of customs should be prepared to examine relevant aspects of the transaction, including the way in which the buyer and seller organize their commercial relations and the way in which the price in question was arrived at, in order to determine whether the relationship influenced the price. Where it can be shown that the buyer and seller, although related under Rule 2, buy from and sell to each other as if they were not related, this would demonstrate that the price had not been influenced by the relationship. As an example of this, if the price had been settled in a manner consistent with the normal pricing practices of the industry in question or with the way the seller settles prices for sales to buyers who are not related to him, this would demonstrate that the price had not been influenced by the relationship. As a further example, where it is shown that the price is adequate to ensure recovery of all costs plus a profit which is representative of the firm's overall profit realised over a representative period of time (e.g. on an annual basis) in sales of goods of the same class or kind, this would demonstrate that the price had not been influenced.

The courts have also held[22] that even if the buyers and seller are related person, the invoice price should be accepted if the relationship has not affected the invoice price and the price is the same as the price sold to other independent buyers. If the relationship between the buyer and seller did not influence the price, invoice value has to be transaction value[23].

For examination, investigation and seeking information in cases of import of goods where the buyer and seller are related, Special Valuation Branches (SVB) have been set up as part of Customs administration. All the cases

18 Customs Valuation (Determination of Value of Imported Goods) Rules, 2007

19 Rule 2 of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007

20 Schedule to the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 read with Rule 13 of the said Rules

21 Rule 3(3)(a) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 read with concerned Interpretative Notes

22 Siemens Ltd. vs. CCE 2000 (126) ELT 1134 (Tribunal)

23 Thermon Heat Tracers Ltd. vs. CC 2006 (198) ELT 37 (Tribunal)

that are registered with SVB, the imports are assessed provisionally with Revenue Deposit of one per cent and where the importer fails to furnish the required information within the stipulated period, the Revenue Deposit is increased to five per cent. Generally, the order issued by SVB is in operation for three years. If there is any change during this period in the terms and conditions of the agreement of supply, the same needs to be specifically stated by the importer.

The Customs Valuation Rules provide[24] that –

In a sale between related persons, the transaction value shall be accepted, whenever the importer demonstrates that the declared value of the goods being valued, closely approximates to one of the following values ascertained at or about the same time.

(i) the transaction value of identical goods, or of similar goods, in sales to unrelated buyers in India;

(ii) the deductive value for identical goods or similar goods;

(iii) the computed value for identical goods or similar goods:

The Interpretative Note in this regards states that an opportunity for the importer to demonstrate that the transaction value closely approximates to a "test" value previously accepted by the proper officer of customs and is therefore acceptable under Rule 3. Where a test under rule 3(3)(b) is met, it is not necessary to examine the question of influence under rule 3(3)(a). If the proper officer of customs has already sufficient information to be satisfied, without further detailed inquiries, that one of the tests provided in rule 3(3)(b) has been met, there is no reason for him to require the importer to demonstrate that the test can be met. In Rule 3(3)(b) the term "unrelated buyers" means buyers who are not related to the seller in any particular case. A number of factors must be taken into consideration in determining whether one value "closely approximates" to another value. These factors include the nature of the imported goods, the nature of the industry itself, the season in which the goods are imported, and whether the difference in values is commercially significant. Since these factors may vary from case to case, it would be impossible to apply a uniform standard such as a fixed percentage, in each case. For example, a small difference in value in a case involving one type of goods could be unacceptable while a large difference in a case involving another type of goods might be acceptable in determining whether the transaction value closely approximates to the "test" values set forth in Rule 3(3)(b).

Though, the legal principles are discussed above, the onground experiences with respect to imports from related buyers does add to the issues involved in ease of doing business.

Service Tax

Service Tax law has specific provision for payment[25] of service tax in respect of specified transaction with related parties. Under the reverse charge mechanism[26], where service tax is payable[27] by the recipient of service, the 'point of taxation'[28] is generally the date on which payment is made to the service provider. However, in respect of 'associated enterprises',

24 Rule 3(3)(b) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 read with concerned Interpretative Notes

25 Point of Taxation Rule, 2011

26 Section 68(2) of Chapter V of the Finance Act, 1994 read with Rule 2(1)(d) of the Service Tax Rules, 1994 read with Notification No. 30/2012-Service Tax, dated June 20, 2012, as amended

27 Rule 7 of the Point of Taxation Rule, 2011

28 Defined to mean 'the point in time when a service shall be deemed to have been provided' in Rule 2(e) of the Point of Taxation Rule, 2011

where the provider of service is located outside India, the point of taxation is the date of debit in the books of account of service receiver or date of making the payment, whichever is earlier. 'Associated enterprise' is defined[29] to 'have the meaning assigned to it in section 92A of the Income-tax Act, 1961'.

Service tax is payable on taxable service with reference to its value, wherein such value, is the 'gross amount charged' by the service provider where the provision of service is for consideration of money[30].

'***Gross amount charged' includes*** *payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and book adjustment,* ***and any amount credited or debited, as the case may be, to any account, whether called "Suspense account" or by any other name, in the books of account of a person liable to pay service tax, where the transaction of taxable service is with any associated enterprise.***[31]

At the time of introduction of these provisions in the definition of 'gross amount charged' it was clarified[32] by Tax Research Unit, as follows, which is self-explanatory -

"…. As per rule 6 of the Service Tax Rules, 1994, service tax is required to be paid only after receipt of the payment. It has been brought to the notice that the provision requiring payment of service tax after receipt of payment are used for tax avoidance especially when the transaction is between associated enterprises. There have been instances wherein service tax has not been paid on the ground of non-receipt of payment even though the transaction has been recognized as revenue/expenditure in the statement of profit and loss account for the purpose of determining corporate tax liability. As an anti-avoidance measure, it is proposed to clarify that service tax is leviable on taxable services provided by the person liable to pay service tax even if the amount is not actually received, but the amount is credited or debited in the books of account of the service provider. In other words, service tax is required to be paid after receipt of payment or crediting/debiting of the amount in the books of accounts, whichever is earlier. However, this provision is restricted to transaction between associated enterprises. This provision shall also apply to service tax payable under reverse charge method (Section 66A) as taxable services received from associated enterprises."

The entry should, obviously, be made in the books of the person liable to pay service tax. Entry in other person's books would not create the liability.

Incidentally, there is no provision under the Service Tax law, with respect to specific valuation, as under Central Excise law and Customs law, in respect of transactions between related parties.

Views expressed are personal.

29 Section 65B(13) of Chapter V of the Finance Act, 1994

30 Section 67 of Chapter V of the Finance Act, 1994

31 Explanation to Section 67 of Chapter V of the Finance Act, 1994

32 Para 6 of the Letter D.O.F No. 334 / 1/ 2008-TRU dated February 29, 2008

CA. Jayesh Gandhi

Accounting and Auditing Aspect

Preamble

Transactions with Related Party (RPT) is gaining lot of focus and attention in recent times. It is perceived that higher related party transactions means lack of Governance and it may not be in the interest of the organisation. In my view, quality of management and governance standards get reflected in the way RPT is conducted and reported rather than merely by volume of transactions.

Accounting Framework

There are four key elements in dealing with RPT:

- Identification of Related Parties
- Identification of transactions with such parties
- Approval process adopted by the management
- Disclosures to be made in Financial Statements and Annual Report The applicable Regulations for RPT are
- The Companies Act, 2013 (The Act) (w.e.f. 1st April 2014)
- Accounting Standard 18 – Related Party Disclosures (AS-18)
- Clause 49 of Listing Requirements mandated by SEBI, applicable only for companies (with specified exemption for small companies) whose equity securities are listed on any stock exchanges (w.e.f. 1st October, 2014)

In addition to the above, for auditors there is Revised Standard on Auditing – 550 (SA – 550) which deals with responsibilities of auditors so that risk of material misstatement in respect of RPT is addressed adequately.

Identification of Related Parties (RP)

Clause 49 defines the term in a broad manner. It covers all Related Parties under the Act and was also covering Related Party as per IFRS, which included many entities under common control or influence. Fortunately by amendment dated 15th September, 2014, now it is restricted to the parties covered by the Act or as per applicable Accounting Standard (which is AS-18 at present). The said circular also excludes transactions with wholly owned subsidiary, if Consolidated Financial Statements are prepared and presented to the share holders.

The definition of RP under the Act is wider than under AS-18, except that AS explicitly covers JV and Venturer. After considering

final rules and clarifications, following are covered as RP under the Act:

- A director or KMP of the company and the holding company, and their relatives
- A firm in which director, manager or their relative is a partner
- A private company in which a director or a manager is a member or director
- A Public Company in which a director or manager is a director and holds along with his/her relatives, more than 2% of its paid-up share capital
- A body corporate whose board, managing director or manager is accustomed to act in accordance with the advice (other than professional), directions or instructions of a director or manager
- Any person on whose advice (other than professional), directions or instructions, a director or manager of the company is accustomed to act
- Any company which is:
    - A holding, subsidiary or an associate company of such company
    - A subsidiary of a holding company to which it is also a subsidiary (fellow subsidiary)

Identification of Transactions

The companies will need to have robust system to capture all transactions with identified related parties.

Section 188 of the Companies Act covers specified transactions. Whereas Clause 49 covers any transfer of resources, services or obligations, regardless of whether a price is charged, i.e. it covers all types of transactions.

Approval Process

Approval process for RPT has become complex and auditors should examine whether transactions are approved as per the requirements.

Following provisions should be kept in mind for the approval as per the Act:

1) In case of companies mandated to have audit committee, all RPT requires approval by this committee, irrespective of value, arm's length price or whether the transaction is carried out in the ordinary course of business.

2) As per Section 188 of the Act, if the transaction is entered in the ordinary course of business and at arm's length price, neither board nor share holders resolution is required.

3) Certain Specified Transactions, other than covered under (2) above, requires consent of the Board of Directors by resolution at a meeting. It is better to take prior approval, as Section 188(3) provides that if any arrangement is not approved by the Board within 60 days, it is voidable at the option of the Board and concerned director shall indemnify the company for the loss incurred.

4) For transactions covered under (3) above, it also requires approval of share holders by a special resolution, if a company has paid-up share capital of ` 10 crores or more, or if transaction value is above respective threshold limit (as specified in the Rules). Further, related party cannot vote on such special resolution to approve contract or arrangement. This may create certain practical difficulties for companies where all directors or share holders are related to each other.

Approval under Clause 49 of Listing Agreement

- All RPTs require prior approval of the Audit Committee, irrespective of value or materiality. Since it is impracticable to take prior approval for each transaction separately, MCA has provided that for routine and recurring RPTs, omnibus approval can be taken specifying limits.
- It also requires dis-interested shareholders' approval for all material RPT, specified as 10% of consolidated revenue as per the last audited Financial Statements.
- It must be noted that the above is required to be followed irrespective of such transactions being in the ordinary course of business and at arm's length price.
- Clause 49 does not make any reference of the approval by the Board of Directors for any transactions. However, the transactions requiring shareholders' approval may have to be first approved by the BOD by way of Governance.

Listed companies need to comply with the provisions of the Act or Clause 49, whichever is stricter.

Non-Reciprocal Relationship

Identification of related parties under the Act is not based on the principle of reciprocity. It is possible that one company identifies other company as its related party. However, it does not necessarily mean that the second company will also identify the first one as its related party.

Approval requirement for existing continuing transactions

The Act does not require approval for existing transactions at the commencement of the Act. Transactions earlier entered will continue unless modified. While Clause 49 requires approval if existing contract/arrangement is likely to continue beyond 31st March, 2015.

Disclosure Requirements

As per the Act

Section 188(2) of the Act requires that every contract/arrangement entered into under section 188(1) will be referred to in the board report along with the justification. Such RPT may be in the ordinary course of the business and at arm's length price or otherwise (taking clue from the details required to be given in Form AOC-2). MCA needs to clarify the position or amend Form AOC-2.

As per Clause 49

Clause 49 requires the following additional disclosures:

- Policy on dealing with the related parties on its website and in the annual report.
- Details of material related party transactions on a quarterly basis along with the compliance report on Corporate Governance.
- Disclosure by the senior management to the Board of all material financial and commercial transactions where they have a personal interest that may have a potential conflict with the interest of the company.

As per AS-18

AS-18, which is accounting standard dealing with disclosures, requires certain disclosures for RP and transactions with such parties. These disclosures should form part of Financial Statements. AS-18 does not prescribe any approval process. The objective of AS-18 is to substantially improve transparency. However, it provides

exemption from disclosure if it conflicts the enterprise duties of confidentiality and for state controlled enterprises in respect of transactions with other state controlled enterprises.

Following are the disclosure requirements:

– Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between related parties. This disclosure is required because the existence of control relationship may prevent the reporting enterprise from being independent in making its financial and/or operating decisions. This disclosure is required if there is related party relationship any time during the reporting period.

– If there have been transactions between related parties, during the period when related party relationship exists, the reporting enterprise should disclose the following:

  - The name of the transacting related party
  - A description of the relationship between the parties
  - A description of the nature of the transaction
  - Volume of the transactions either as an amount or as an appropriate proportion
  - Any other elements of the related party transactions necessary for an understanding of the financial statements
  - The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts from such parties at that date
  - Amounts written off or written back in the reporting period in respect of debts due from or to related parties

– Items of a similar nature may be disclosed in aggregate by type of related party.

Audit of Related Party Transactions

It is extensively dealt with in SA-550 which is effective since last four years. Related Party Relationships and transactions give rise to higher risk of material misstatement due to the following:

– Likelihood of transaction not at arm's length price.

– Structure of Related Parties may be complex and it may be with the intention to avoid certain reporting of information.

– There may not be proper IT system for identification of transaction with Related Party.

It is the responsibility of the auditor to understand Related Party Transactions for forming its opinion on true and fair presentation of financial statements and to conclude that information provided is not misleading. In the past, large frauds have been detected in which Related Parties were involved. In the many instances, in the past, special purpose entities were formed without substantial ownership in its equity to circumvent the law. In respect of such entities it is important to identify whether there is a control exercised through other means, for example, by way of written or oral understanding. It is, therefore, important for the auditors to plan and perform the audit with professional skepticism.

Risk Assessment Procedures

The auditor needs to identify risk of material misstatement and risks of non-compliance with laws and regulations, which have become stricter in India due to enactment of new companies act and requirements of Listing Agreement. The auditor needs to identify related parties based on the past and current records maintained by the company, some of which may be available in the working papers of the previous audits. Comprehensive list of related parties should be identified at the planning stage so that engagement team is made aware of the same in the beginning. SA 600 provides that the group engagement team shall provide to the component auditor a list of related party, which can act as a good base for the component auditors. The auditor needs to assess adequacy of internal control by the management over related party relationships and transactions. The control can be demonstrated from existence of ethical codes, policies and procedures to disclose interest by the management, oversight framework, approval procedures followed for transactions which may involve conflict of interest, existence of whistle blowing policy, etc. Where such controls are either non-existent or ineffective, the auditor may have to consider modification of its audit report. During the audit, the auditor may inspect records, documents that may indicate related party relationships and transactions which are not in normal course of business. It shall then inquire with the management about the nature of such transaction.

Identification and Assessment of Risk

Domination of management by single or small group of persons may increase fraud risk. Dominance influence can be identified by conduct of the management in their approval process with related party. If such risks are identified, the nature, timing and extent of audit procedures need to be modified. It should also apply substantive audit procedures to confirm specific aspects of the transaction with external evidence and can also go through financial statements of related parties, if available, to ascertain purpose behind the transaction.

Response to Risk of Material Misstatement

The auditor needs to adequately respond to the risk of material misstatement. If the auditor identifies related parties or RPT that management has not previously identified or disclosed to the auditor, it should inquire reason for failure of entity's control to identify the same. In such circumstances the auditor needs to perform further audit procedures and reconsider the risk of non-identification by the management. In case non-disclosure by management appears intentional, the auditor may also consider whether it is necessary to re-evaluate management's response to various inquiries made by the auditor.

When significant related party transactions outside the entity's normal course of business is identified, the auditor should evaluate the business rationale behind the same. When it finds that the transaction is unusual or lacks an apparent logical business reason, it should inquire intention behind the same. It may also understand the business rationale of such transaction from the related parties' perspective. It should also look at authorisation and approval process for such transactions which may provide audit evidence for appropriate reflection of terms and conditions in the financial statements. One should keep in mind that authorisation and approval alone may not be sufficient to conclude fraud risk because the process of approval may be ineffective due to collusion between the related parties or due to dominant influence of related party.

The auditor also needs to assess whether transactions with related party are at arm's length. For this purpose it should look at comparative price between unrelated parties and also look at the effect of the other terms and conditions such as credit terms, other contingencies, etc. Management is responsible for the substantiation of an assertion that RPT was conducted on terms equivalent to those prevailing in an arm's length transaction. The auditor should look at internal or external data which supports the said assertion of the management.

Evaluating Accounting and Disclosures

In forming an opinion the auditor should evaluate:

- Whether identified related party relationships and transactions are appropriately accounted for and disclosed as required by the financial reporting framework
- Whether the effects of such relationships and transactions prevent fair presentation or result in the financial statements being misleading.

SA 450 requires the auditor to consider both the size and nature of the misstatement and circumstances of its occurrence when evaluating whether the misstatement is material. Auditor should also evaluate whether the facts and circumstances of the RPT have been appropriately summarised and presented so that such disclosures are understandable to the reader of financial statements.

Communication with those Charged with Governance

The auditor should obtain written representations from the management and where appropriate, from those charged with governance in respect of the following:

- They have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware of, and
- They have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirement of the framework.

When auditors come across major non-compliance with the applicable laws or disagreement with the management regarding RPT, it should communicate with those charged with governance.

Conclusion

Related party transactions are now subject to more scrutiny and disclosures. If the same are not conducted as per the requirement of the law or other regulations, it creates doubt on the corporate governance of the entity. Non-compliance may lead to substantial penal action against the promoters and management, involved in the transaction and may also affect business prospects of the entity. In view of this, auditor also needs to be vigilant in performance of their duties to avoid charge of negligence against them. In conclusion, all related party transactions need to have proper business rationale, necessary approvals to substantiate arm's length and appropriate disclosures in the financial statements and annual reports.

CA Jayant Thakur

Related Parties Transactions and Corporate Law – Case Studies (Companies Act, 2013 and Clause 49)

Background

Under the Companies Act, 1956 ("the 1956 Act"), provisions relating to related parties transactions were scattered over various provisions. Many related party transactions as well as related parties were excluded. Certain transactions required approval of Central Government. A much broader category of transactions required disclosure in Board Meeting. The relevant Accounting Standard 18 provided, and continues to provide, for disclosures. However, the provisions of the Companies Act, 2013 ("the 2013 Act"), and the new Clause 49(VII) of the Listing Agreement ("Clause 49") now provide far broader and more comprehensive set of provisions. While most of the provisions restrict transactions by requiring approval of Board/Audit Committee/share holders in certain cases, a few transactions like loans are more severally restricted. A detailed discussion of the new law relating to related party transactions is already the subject of other articles in this issue. This article will focus on presenting Case Studies of practical situations in which it will be seen how these provisions will apply. The emphasis is also on highlighting the fact that now several set of laws, not necessarily harmonised or compatible with each other, deal with related party transactions. It may happen that in some cases, the provisions of the 2013 Act would not apply but the provisions of the Clause 49 would apply or apply differently and vice versa. And as we venture into other laws such as direct and indirect taxes, the matter would become even more complex as the provisions apply even more differently. This only shows how many hurdles even regular commercially justifiable transactions with related parties will have to pass.

The first set of case studies by me will focus on the provisions of 2013 Act and Clause 49. Case studies dealing with provisions of direct and indirect laws form a separate section by other learned authors.

Considering that the provisions are relatively new, case studies have been made to draw attention to the fundamental principles and provisions and thereafter highlighting some interesting issues.

Section 188 of the 2013 Act primarily deals with related party transactions. In practice, however, depending upon facts, other provisions may also apply (an example of this is section 185/186 to which one case study makes reference). The case studies and their suggested answers focus only on the applicability or otherwise of section 188 and rules made thereunder. Similarly, as regards Clause 49, the applicability of the provisions of sections VII and VIII(A) have only been considered here.

Case Study 1

Facts of the case

1) A Private Limited is a company engaged in the business of manufacturing auto ancillaries.

2) There are there directors in A – viz., Mr. D, Mr. B and Mr. C.

3) Mr. D is the Managing Director of A. Mr. B and Mr. C are Technical Director and Marketing Director, respectively.

4) Mr. and Mrs. D together hold 60% of the total paid-up share capital of the Company of ` 1 crore. The rest of the shares are held by Mr. B and Mr. C.

5) A does not have any borrowings, whether from banks, financial institutions or any other person.

6) Ms. X is the 26 years old daughter of Mr. & Mrs. D who is qualified as a B. E. from a leading engineering college in India.

7) D has been given powers under his terms of appointment as MD to appoint and remove any person at any level in the company at such terms as he deems fit.

8) A needed a helping hand in operations to share the requirements of the growing activities of the company. Considering the qualifications of X and requirements of the company, X was felt to be a fit person to be given charge of operations reporting to D.

9) X was thus appointed by D as Vice-President in charge of Operations of the company and works full time with the company.

10) X was given a consolidated salary of ` 15 lakhs per annum.

11) Has the company violated the provisions of section 188 of the 2013 Act in the following alternative situations:-

    a) The company could have got a similar person of almost identical or better qualifications at half the salary?

    b) The company could have got a similar person of almost identical qualifications at similar salary levels and other terms of appointment?

Suggested answer

X being the daughter of Mr. D is clearly a related party since the definition of related party in section 2(76) states that it includes a relative of a director.

Section 188(1) requires that related party transactions as specified therein shall require compliance of various provisions as stated therein under certain circumstances. Appointment of X as Vice-President (Operations) is covered by section 188(1)(f) which includes appointment of a related party to any office or place of profit in the company. The third proviso to section 188(1) states that the sub-section shall not apply if the transaction was entered into in ordinary course of business and was at arm's length.

It appears that considering the needs of the Company, X's appointment was in ordinary course of business. However, it appears that, in situation (a), an alternative equally qualified person was available at half the salary. Other things remaining equal, the appointment was clearly not at arm's length.

Section 188(1) requires that in such cases, the appointment should be approved by a Board resolution at a meeting of the Board. This was not done. Thus, in case of situation (a), the provisions of section 188 were not complied with. In case of situation (b), of course, the provisions of section 188(1) would not apply since the appointment was in the ordinary course of business and at arm's length.

The provisions and features of section 188 that get highlighted from this Case Study are as follows:-

1) Section 188 applies to any company, public or private.

2) The section would apply even if the company was closely held and did not have any borrowings.

3) Section 188(1) will not apply if the related party transaction was in the ordinary course of business and at arm's length.

4) If the transaction was not in ordinary course of business or was not at arm's length, then in a situation like the present case, the requirement is that the company should pass a Board resolution at a Board meeting after making the prescribed disclosures.

5) In conclusion, the requirement is, in practice for a closely held company, largely procedural, assuming the directors are in agreement to make such appointment at such terms.

Case Study 2

Consider the same facts as in Case Study 1 with the following changes:-

Instead of being appointed at a salary of ` 15 lakhs per annum, the salary is ` 40 lakhs per annum.

Whether there is due compliance of section 188?

Suggested answer

As discussed under suggested answer to Case Study 1, the provisions of section 188(1) will not apply if the transaction with the related party was in ordinary course of business and at arm's length.

In the present case, the transaction was not at arm's length. Hence, the Company would have to comply with the provisions of Section 188(1). Approval by way of Board resolution as explained earlier would have to be obtained in the manner discussed. However, since the salary is ` 40 lakhs, a further requirement as specified in Section 188 (1) read with Rule 15(3) of the Companies (Meetings of Board and its Powers) Rules, 2014 would be attracted. Clause (b) of that Rule requires that if the related party transaction concerns an appointment to an office/place of profit carrying monthly remuneration exceeding ` 2.5 lakhs, then prior approval by way of a special resolution is also required.

Further, in the voting for such special resolution, the second proviso to Section 188(1) requires that a member, who is "a related party" shall not vote. The question is whether Mr. and Mrs. D who are also related parties and hence cannot vote. The MCA has clarified *vide* its circular dated 17th July, 2014 "that 'related party' referred to in the second proviso has to be construed with reference only to the contract or arrangement for which the said special resolution is being passed".

The meaning of this clarification is not wholly clear. Does it mean that only the specific related party with whom the transaction is being proposed cannot vote. Or is it that the parties who are related to such specific related party cannot also vote? Or is it that all related parties cannot vote?

It is clear that the contracting related party itself cannot vote. Considering the apparent intention, though two views are still possible, the better view seems to be that parties related to such related party ought not also vote. In other words, Mr./ Mrs. D in the present case ought not vote.

The other share holders, B and C, ought to be able to vote.

Taking this view into account, Mr. and Mrs. D will not be able to vote at the special resolution. Thus, only if the remaining share holders pass with requisite majority, the special resolution would be deemed to have been passed.

However, it is better if Ministry of Company Affairs clarifies further on this. This is more so since the definition of related party is quite wide and at times even parties not related to each other or distantly related would find that their voting rights are suppressed.

This also highlights further the implications for private companies. And a further concern – if, as often happens, only Mr. and Mrs. D were share holders, then can the resolution be passed at all?

Case Study 3

Same facts as in Case Study 2 except that the Company is a listed company having net worth of ` 30 crores.

Suggested answer

The compliance requirements under the Companies Act, 2013 will remain the same as discussed in the Suggested Answer for Case Study 2.

We have to consider additional requirements under Clause 49. Clause 49 requires all related party transactions to have prior approval of the Audit Committee. Hence, this requirement would have to be complied and hence there is a violation to that extent. Incidentally, Section 177 also implicitly requires such approval by Audit Committee.

Note that no exceptions are made whether the transaction is in the ordinary course of business/at arm's length under Clause 49/Section 177. Hence, in both the situations described in the Case Study, such prior approval of the Audit Committee is required.

Case Study 4

Facts of the Case

1) Company X is a private limited company having equity share capital of ` 25 crores and annual turnover of ` 80 crores.

2) It has granted a loan of ` 10 crores to a private limited company in which a director of X is also a director.

3) The loan is granted at an interest of 6% per annum. Admittedly, this interest rate is much below the market rate and the Company could have earned higher interest even on bank deposits. There are no other commercial reasons why such loan should have been given at a lower rate of interest.

The question is whether there is any violation of Section 188?

Suggested answer

Section 188 lists specifically those related party transactions to which the provisions would apply. Grant of loans is not one of those transactions. Hence, whether the transactions were or were not in the ordinary course of business or whether the terms were arm's length, the provisions of Section 188 would not apply. The provisions of Section 188 are not violated by such transaction though it is a loan to a related party and at concessional terms without commercial justification.

Needless to emphasise, the provisions of Sections 185/186 would be attracted and the Company seems to be in violation.

Case Study 5

Same facts as in Case Study 4 except the following:–

1) X is a listed company.

2) The loan is granted at interest of 14%.

Suggested answer

The position under Section 188 remains the same as per suggested answer under Case Study 4. Further, it also appears that since minimum rate of interest chargeable under Sections 185/186 is charged (though these are variable rates and should be confirmed in each case), the absolute bar under those sections may not apply. The other provisions of these and other sections (including Section 177) in any case should be complied as applicable.

As far as Clause 49 is concerned, the definition of related party transactions is wider. Any "transfer of resources" is covered. Grant of loans is clearly a transfer of resources. Hence, it would be a transaction that would have to require compliance of Clause 49.

Thus, firstly, prior approval of the Audit Committee would be required. Further, since the amount of the loan, being more than 10% of its annual turnover, is a material transaction, it would also require approval of the share holders by a

special resolution. The related parties shall not vote at such special resolution.

The scheme of the Companies Act, 2013 is different from the scheme of Clause 49. Hence, there can be situations under which differing criteria would apply. In the present case, the transaction would not attract the provisions of Section 188 at all. If there is due of Clause 49 then the transaction can be carried out.

Case Study 6

Facts of the case

1) A is a private limited company with a net worth of ` 30 crores.

2) A had entered into an agreement with a related party X under which it had taken its property on rent of ` 3 lakhs per month.

3) The agreement was entered into on 1st January, 2014 after due compliance of provisions of the Companies Act, 1956, and other provisions.

4) The term of agreement was 10 years at the end of which the parties can renew on mutually agreed terms.

5) The terms of agreement require payment of rent in the first week of every month.

6) A regularly pays such rent.

Is the Company in compliance of the provisions of Section 188?

Suggested answer

Considering the wording and intent of the provisions, Section 188 is clearly prospective in nature. It applies to contracts/arrangements entered into after 1st April, 2014 when it has come into effect. Having entered into a valid agreement duly in accordance with the law prevailing on 1st January, 2014 for rent, the actual payment of rent every month, it is submitted, not a fresh contract or arrangement.

The MCA has also clarified in its circular dated 17th July, 2014 that contracts entered into after making necessary compliances under Section 297 of the Companies Act, 1956, will not require approval under Section 188 till the expiry of the term of such contracts.

Incidentally, under the corresponding Section 297 of the Companies Act, 1956, the department's view also was that the said section would not apply to contracts already entered into by companies before the date when the said section came into force. (Letter No. 3/2/75-Clause-XIV, dated 9th July, 1975).

Hence, it is submitted that the provisions of Section 188 shall not apply to such payments.

Case Study 7

Same facts as in Case Study 6 except that the A is a listed company.

Suggested answer

The applicability of the provisions of Section 188 has been discussed above and would remain unchanged.

SEBI's circular dated April 17, 2014 amending Clause 49, however, requires as follows:-

"All existing material related party contracts or arrangements as on the date of this circular which are likely to continue beyond March 31, 2015 shall be placed for approval of the share holders in the first General Meeting subsequent to October 1, 2014…"

The transaction is not a material related party contract as defined. Hence, though the contract would continue beyond March 31, 2015, the above requirement would not apply.

Had the transaction been a material one, then, even though Section 188 may not apply, the approval of the share holders would have to be obtained in the manner provided therein.

Case Study 8

Facts of the case

1) A is a listed company having a net worth of ` 30 crores.

2) One of the directors of A, Mr. X, is a senior lawyer having professional expertise in law relating intellectual property rights.

3) The Company faced a complex legal issue concerning IPRs. The Managing Director sought the professional advice of X and accordingly sent the necessary request in writing with necessary papers, information, etc.

4) Mr. X considered the issue and gave his professional opinion in writing. He sent his bill for professional services, which was duly paid by A, on approval granted by the MD.

Is the payment of professional services to Mr. X in accordance with the provisions of Section 188/Clause 49?

Suggested answer

The provisions of Section 188 apply to "any contract or arrangement with a related party with respect to…availing or rendering of any services". X is clearly a related party. The professional advice sought is also under a contract/arrangement. Thus, the provisions of Section 188 are prima facie attracted. It would have to be seen whether the transaction is in the ordinary course of business under terms that are arm's length. If yes, then it would be covered by the exception as provided in the third proviso to Section 188(1) and hence the said sub-section will not apply.

Interestingly, the department had given a clarification (*vide* Circular dated 5th June, 1975) in context of Section 297 of the Companies Act, 1956, that Section 297 will not apply to services rendered by legal practitioners. The reasoning was that such services "are not obtained on the basis of lowest tender but on account of their professional expertise irrespective of the cost involved. Such services cannot be bracketed with a contract of supply of goods or materials..".

It is submitted that the validity of the views of the Department is questionable in view of clear provisions of Section 297. In any case, the context of Section 297 is different. Under Section 297, under certain situations, such contracts would have required the approval of the Central Government. Hence, a clarification from the department could also be taken as the views of the Central Government whose approval was to be sought. In case of Section 188, there is no role of the Central Government. The approval of the Board/Audit Committee and, under certain circumstances, of the share holders by way of special resolution may be required. Hence, it is submitted that this clarification from the Central Government should not be held to be applicable to Section 188.

Under Clause 49(VII) (and Section 177 of the 2013 Act), such services would also require the prior approval of the Audit Committee. In the present case, the size of such contract would not make it a material contract, but in case it is so, the approval of the Company by way of special resolution would have to be obtained in the manner laid down.

In passing, since lawyers, CAs, are often on the Board of listed companies as Independent Directors, and professional advice is often sought, it is worth reviewing a few other provisions of Clause 49.

Clause 49(II)(C) places another condition for payment of "fees/compensation to non-executive directors, including independent directors". Such shall require previous approval of share holders in general meeting. In absence of any other qualifying factor, this approval would be required for any fees/compensation paid to such directors.

There are also concerns relating to independence on account of such services. A person who has a material pecuniary relationship with the Company is deemed not to be an Independent Director. The term material has not been defined. Even the

term "relationship" is not defined. Nevertheless, this condition would have to be borne in mind. Another condition is that the legal or consulting firm should not have had "any transaction with the company…amounting to ten per cent or more of the gross turnover of such firm.". If such condition is violated, the person also would be deemed to be not a Independent Director. Yet another condition is that the person whose "independence" is being tested should not be a "material supplier".

Curiously, Section 149(6)(c) of the Companies Act, 2013, states that Independent Director would be one who "has or had no pecuniary relationship with the company…during the current financial year". Unlike Clause 49, there is no qualifying word "material" preceding the words "pecuniary relationship". Hence, a person who has any pecuniary relationship with the Company would not be able to be an Independent Director.

Case Study 9

Facts of the case

1) Company A is a listed company.

2) Company A had a turnover of ` 1,000 crores in preceding financial year and a net worth of ` 100 crores at end of such preceding financial year.

3) There are two Promoter Group in A – P who holds 20% and Q who holds 40%.

4) Company B is a private company in which a P is a share holder.

5) Company A proposes to acquire plant and machinery from B for a consideration of ` 25 crores.

6) Questions:

   a) Would a special resolution be required to be passed under Section 188/ Clause 49?

   b) Would Q be able to vote at such resolution?

Suggested answer

B is a related party in view of the provisions of Section 2(76)(iv). Since Clause 49 applies the provisions of Section 2(76) in its definition of related party, B is a related party for both the provisions of law.

Section 188 read with Rules made thereunder require that where property exceeding 10% of the net worth of the Company is sought to be purchased, approval of the share holders by way of special resolution would be required.

Clause 49, in contrast requires material related party transactions to be approved by share holders by way of special resolution. For this purpose, a related party transaction is material if it exceeds 10% of the annual consolidated turnover as per last audited financial statements. In the present case, this condition is not fulfilled. Hence, the provisions of Clause 49 requiring approval by way of special resolution do not apply.

Hence, approval by way of special resolution would be required in accordance with the provisions of Section 188 read with Rules.

The Rules read with Circular dated 17th July, 2014 provide that related parties in the context of the proposed transaction should not vote. While P is the related party in context of such transaction, Q is not. Hence, P will not be able to vote, while Q can. (See detailed discussion on this issue earlier).

In contrast, were the provisions of Clause 49 also applicable, neither P nor Q would have been able to vote. Explanation (ii) to Clause 49(VII)(E) provides that "all entities falling under the definition of related parties shall abstain from voting irrespective of whether the entity is a party to the particular transaction or not".

Aditya Gaiha[1]

Capital Account Convertibility and the Internationalization of the Indian Rupee

Exchange controls have always been the subject for active debate both amongst academic researchers as well as policy makers and government authorities. While India has moved from a largely closed economy to a largely open economy as on date, the management of the external sector using exchange controls continues to be an area of active debate. Public policy in India has been broadly guided by a series of high level committee reports *(Rangarajan Committee (1993), Tarapore Committees (1997, 2006), Mistry Committee (2007), Rajan Committee (2008)* and *The Sinha Committee (2010)).* However there is a need to rework India's practical roadmap for fuller capital account convertibility and internationalisation of the INR.

Historical background

Exchange controls in India were first introduced during the Second World War (1942) under the Defence of India Rules. After independence exchange controls were formally reaffirmed in the form of the first Foreign Exchange Regulation Act in 1949. This was followed by FERA, 1973.

The general thrust of these exchange controls was the conservation of foreign exchange. However, the 1970s and 1980s saw the emergence of large external sector imbalances created on account of a persistent and increasing adverse balance of payments situation. On the capital account side there were negligible private capital inflows into India and there was over dependence on official foreign aid.

This balance of payments crisis (in 1990-91) triggered the first wave of economic liberalisation policies. These policies were aimed at creating an environment for more private capital inflows. The domestic capital market was opened to Foreign Institutional Investors (FIIs). This was followed by the liberalisation of the FDI policy to encourage stable private capital inflows. The Indian Rupee became market determined in 1993 and India became fully convertible on the current account in August 1994.

After nearly a decade of various external sector liberalisation measures, FERA, 1973 was replaced by the Foreign Exchange Management Act (FEMA) in 1999. The stated objective of FEMA, 1999 was 'facilitating external trade and payments...' and not conservation of foreign exchange resources.

Exchange controls – Current context

The present framework of exchange controls in India, consist of the basic legislation (FEMA,

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1999) and Regulations, Rules and Circulars issued under the Act. Since India is fully convertible on the current account, all current account transactions (barring a small list of restricted items) are allowed through the normal banking channels. In the case of capital account transactions, only transactions which are explicitly enabled under the guidelines are allowed, while the remaining require specific approvals, under FEMA.

The Reserve Bank and the Government have been following a calibrated approach of moving towards fuller capital account convertibility. In general counter cyclic measures are taken to mitigate the ill effects of either excessive or deficient capital flows to the country. In the Indian context a large and persistent current account deficit (CAD) has ensured that exchange rate policies and capital controls have tended to work towards creating an investment climate that is conducive for more stable and sustained capital inflows.

In the last eight years, India has witnessed the vagaries of international capital flows. The period 2006-08 saw a period of copious capital inflows. This was followed by the collapse of the Lehman Brothers in late 2008 and this period witnessed a reversal of capital flows in 2008-09. This was again followed by a benign period of capital inflows, on account of the quantitative easing policies of the central banks in the US and Euro zones. In August-September, 2013 there was again reversal of capital flows on account of developments in both domestic as well international economic scenario. The public policy response to these developments, have been largely reactive. The policy of sterilisation of capital inflows was followed during 1998-2003, however it could not be continued on account of the increasing cost. During the period 2006-08 the authorities took various measures to manage the huge amount of capital inflows by encouraging capital outflows as well as by tightening the norms for debt capital inflows. Subsequently during the period of dwindling capital flows to India steps were taken to encourage capital inflows by liberalising the FDI policy norms for various sectors; creation of a new categories of foreign portfolio investors, namely qualified foreign investors (QFIs) and long-term non-resident investors such as foreign central banks, multilateral agencies, sovereign wealth funds, endowment funds, pension funds and insurance funds as a new category of foreign portfolio investor.

Exchange controls – Capital Account Convertibility and Internationalisation of the INR

External sector vulnerabilities in India have reiterated the need to move towards capital account convertibility and to further rationalise the exchange controls framework in India. However capital account convertibility requires certain prerequisites. According to some economists, there is a need to bring the combined fiscal deficit (Centre and State) within 3% of the GDP; dampen the prices of real estate; monetise the gold with the public and discourage import of gold. Some economists argue that India needs to build a level of self-insurance to face future global financial crisis. This should include a minimum level of foreign exchange reserves (built up in times of plenty), strengthening the domestic financial markets and building up of a vibrant domestic corporate debt market.

Various studies on financial globalisation conclude that while there are possible significant gains to be accrued to the domestic economy on account of greater financial globalisation, full capital account convertibility requires the existence of certain supporting conditions to ensure that an economy is less vulnerable to sudden stops of capital flows.

Ideally there is a need to look at capital account convertibility not as an end in it itself but as a means to achieve more fundamental macroeconomic objectives. In the case of India more capital account convertibility is possible

since it has managed exchange rates and monetary policy in tandem. Areas such as small business transactions, portfolio and direct investment could be easily liberalised whereas liberalising areas such as debt capital flows would depend on the risks of pro-cyclic capital flows.

Some of the benefits of capital account liberalization may not be direct but more indirect such as development of financial markets and better financial intermediation. While capital account liberalisation is not the best policy option for all countries, nevertheless, it may be difficult for any country to insulate itself from movements in international capital flows. It is preferable that public policy is geared up to strategise the further opening up of the economy to cross border capital flows rather than reacting to the whims of international investors.

There is also a need to encourage the gradual internationalisation of the INR. The internationalisation of any currency has three basic concomitants – economic size of the home economy, confidence in the currency and depth of the financial markets. More usage of INR in cross border transactions would help to provide greater strength to the external sector and the currency, by making it more resilient to the vagaries of external economic events. The benefits accruing to the domestic economy, on account of internationalisation of the domestic currency, include insulating the domestic entities and individuals from exchange rate risk while conducting cross border transactions, increased ability of domestic authorities to run huge deficits funded by public debt and an increase in business for domestic banks and financial institutions.

A case in the point (for internationalisation of the INR) is the example of the US Dollar, which is today the *de facto* currency for most international / cross border transactions. The US Dollar is also the most preferred reserve currency for economies across the world. This fuels a widespread demand for US Dollars which is largely insulated from the performance of the domestic US economy or other major economic events across the globe. It also allows the US monetary authorities to chart a reasonably independent monetary policy based purely on its domestic economic requirements. Interestingly China, which is yet not convertible on the capital account, has already begun chartering a course for wider usage of the Yuan as an international currency for international / cross border transactions.

The Roadmap for more capital account convertibility and internationalisation of the INR

Currency markets – There is an urgent need to reduce the possibilities of excessive volatility in the foreign exchange markets in India. One of ways to ensure a stable exchange rate is by increasing market participation which would also increase the market turnover. Under the present complex rule based framework, most genuine currency risk hedgers find it very difficult to hedge their currency risk exposure onshore on account of two major bottlenecks – one, the restrictions for participation in the exchange traded currency futures and options segment of the currency markets; and two, the onerous procedural and documentary complexity in the over the counter (OTC) segment of the currency markets in India. Some studies have analysed the inter-linkages between the offshore INR Non Deliverable Forward (NDF) market and the onshore Indian Rupee market. They find that both these markets co-move in the long run and that the introduction of restrictions on the onshore markets tends to encourage the trading volumes in the offshore NDF market. Some of the urgent changes that should be actively considered to rationalise this area are as follows :

- Allow all non-residents who have INR related currency risk to hedge themselves in both the OTC and the exchange traded segments of the currency markets in India

based on self declarations to AD banks in India, without any quantitative limits and without the insistence on submission of any documentary evidence.

- Formally allow trading of INR on platforms outside India with the explicit permission of the Indian authorities as well under the aegis of formal co-operation agreements with overseas financial sector regulators. This will reduce the trading in the informal NDF market for INR and thereby reducing the ill effects of the same on the formal (both onshore and offshore) INR currency markets.

Foreign Direct Investment (FDI) – Theoretically FDI is the most preferred form of foreign capital inflow into a country. Not only is it perceived to be of long-term in nature it also provides positive spillovers to the domestic economy. Despite a reasonably liberal FDI policy India has failed to attract substantial amounts of FDI. There is an urgent need to attract FDI by removing all exchange control barriers to such investment in India by simplifying the framework as well as bringing it in line with the internationally accepted definition of FDI. Some measures towards this end could be as follows :

- FDI should be enabled by way of investment in all equity like instruments including equity shares, fully convertible debentures, fully convertible preference shares, warrants, partly paid shares, instruments with put/call options etc., provided that all such instruments can be demonstrated to be compulsorily convertible to equity shares in a fixed and predetermined period of time as well as long as they are not redeemable at the instance of the investor within a minimum lock in period of say 3 years.

- FDI should include all financial commitments (such as guarantees, loans, issue of debt instruments, creation of charge on movable and immovable assets including pledge, mortgage, hypothecation etc..) by existing non-resident equity share holders to an Indian company as part of FDI without any additional terms and conditions. Incidentally the extant Overseas Direct Investment guidelines (ODI from India) allow all such financial commitments as part of ODI itself.

- Remove all sectoral caps and conditions in the FDI policy except for a very small negative list of activities for FDI.

- FDI investors should be allowed to open and maintain non interest bearing INR and foreign currency accounts with banks in India for the purpose of their FDI into India. At a future date, perhaps interest rates at par with interest rates payable in NRE and FCNR accounts could also be considered to be paid for the balances in these accounts.

Portfolio and other forms of foreign investment – Under the extant exchange control regime there are various categories of portfolio investors (such as Foreign Institutional Investors (FIIs), Qualified Foreign Investors (QFIs), Foreign Venture Capital Investors (FVCIs) and Non Resident Indians (NRIs)) who have different rights and obligations making the framework extremely tedious, complicated as well as irrational. There is a need to simply the current regulatory framework and rationalise the same. Some studies find that there is a high level of correlation between FII investments and the stock market indices in India. Thus FIIs have a significant influence on the stock markets in India and they are the market leaders and the dominant non-promoter share holders in the domestic stock markets. FII flows into India have also been characterised by higher volatility and sudden reversals. Thus foreign portfolio flows have a significant impact on domestic capital market movements and in turn these capital flows also have implications for domestic financial stability. A significant measure which could help in this process would be to amalgamate all classes of foreign portfolio

investors (NRIs, FVCIs etc.) into one single portfolio investor class. This unified investor class of portfolio investors should have the permission to invest in all equity linked and debt linked securities in India as are allowed to FIIs today. This will simplify the extant foreign portfolio investment regulations in India. This will help to widen this investor class increasing their quantity as well as make these capital flows less volatile.

Deposits – Under the extant regulatory framework this route for attracting foreign investment in India has been restricted to the NRIs/PIOs only. It is time to expand the facility available for NRI/PIOs to all foreign investors who fulfil the basic KYC/AML guidelines and come from FATF compliant jurisdictions. This will ensure a steady source of counter-cyclic capital flows into India which all offset capital outflows in times of volatility in exchange rates and/or capital flows to India. Some immediate measures that can be considered in this area are as follows :

- All non-residents from FATF compliant jurisdictions (who fulfil the KYC/AML guidelines) should be allowed to open and maintain NRE and FCNR accounts in India with all terms and conditions (including payment of interest) applicable for NRIs maintaining these accounts being applicable *mutatis mutandis* to the same.
- All exporters and importers (to/from India) who fulfil the KYC/AML guidelines, should be allowed to open and maintain NRE and FCNR accounts in India with all terms and conditions (including payment of interest) applicable for NRIs maintaining these accounts being applicable *mutatis mutandis* to the same. This will also encourage INR denominated invoicing as well as settlement of trade transactions in INR. This would be a significant step towards the internationalisation of the INR.

Currency arrangements and other measures

The Government should actively consider entering into currency arrangements with traditional trading partners and neighbouring countries (such as SAARC countries, South East Asian Countries, Myanmar) to promote INR denominated invoicing and settlement of trade transactions with these countries.

Indian companies should be allowed to issue, transfer and list INR denominated equity and debt instruments outside India. This will ensure that the currency risk is borne by the foreign investors while Indian entrepreneurs and industry have an easy access to equity capital and debt resources at lower costs.

The extant guidelines should be comprehensively reviewed with a view to make them simple, rational and transparent as well as move towards a more principle based rather than rule based regulatory framework.

Conclusion

The above roadmap gives a wide variety of positive measures that can be implemented by the authorities in a time bound manner say over a period of two to three years. The exact timing of these measures can be fine-tuned with other macroeconomic indicators. These measures will help to rationalise and simplify the extant exchange control framework to attract more stable, long-term and counter cyclic foreign exchange flows into the country which can help feed the persistent current account deficit (CAD), provide reserves for buffering the country against reversals in international capital flows and also reduce the possibility of exchange rate volatility in the Indian currency markets. These measures will also lead to the gradual internationalisation of the INR as also achieve fuller capital account convertibility in a calibrated, transparent and non-disruptive manner over a reasonable period of time.

B.V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

National Tax Tribunal Act, 2005 held unconstitutional

Madras Bar Association vs. UOI (Supreme Court – Constitution Bench)

CORAM : A.K. Sikri J., J. Chelameswar J., Jagdish Singh Khehar J., R.F. Nariman J, R.M. Lodha CJI

DATE : September 25, 2014 (Date of pronouncement)

The Full Bench of the Supreme Court had to consider whether the National Tax Tribunals Act, 2005, which sought to take away the jurisdiction of the High Courts in tax matters was constitutional. The Full Bench has struck down the entire Act as being unconstitutional on the ground that though "tribunalization" has been allowed subject to safeguards, the NTT Act "crosses the boundary" and "encroaches the exclusive domain" of the High Courts. In the course of the judgement, the Supreme Court held as under:

"A perusal of the reported judgements shows that while deciding tax related disputes, provisions of different laws on diverse subjects had to be taken into consideration. The Members of the NTT would most definitely be confronted with the legal issues emerging out of Family Law, Hindu Law, Mohammedan Law, Company Law, Law of Partnership, Law related to Territoriality, Law related to Trusts and Societies, Contract Law, Law relating to Transfer of Property, Law relating to Intellectual Property, Interpretation of Statutes, and other Miscellaneous Provisions of Law, from time to time. The NTT besides the aforesaid statutes, will not only have to interpret the provisions of the three statutes, out of which appeals will be heard by it, but will also have to examine a challenge to the vires of statutory amendments made in the said provisions, from time to time. They will also have to determine in some cases, whether the provisions relied upon had a prospective or retrospective applicability. Keeping in mind the fact, that in terms of s. 15 of the NTT Act, the NTT would hear appeals from the Income Tax Appellate Tribunal and the CESTAT only on "substantial questions of law", it is difficult for us to appreciate the propriety of representation, on behalf of a party to an appeal, through either Chartered Accountants or Company Secretaries, before the NTT. The determination at the hands of the NTT is shorn of factual disputes. It has to decide only "substantial questions of law". In our understanding, Chartered Accountants and Company Secretaries would at best be specialists in understanding and explaining issues pertaining to accounts. These issues would, fall purely within the realm of facts. We find it difficult to accept the prayer made by the Company Secretaries to allow them, to represent a party to an appeal before the NTT. Even insofar as the Chartered Accountants are concerned, we are constrained to hold that allowing them to appear on behalf of a party before the NTT, would be unacceptable in law. We accordingly reject the claim of Company Secretaries, to represent a party before the NTT. We simultaneously hold s. 13(1), insofar as it allows Chartered Accountants to represent a party to an appeal before the NTT, as unconstitutional and unsustainable in law."



Ashok Patil, Mandar Vaidya & Priti Shukla
Advocates

DIRECT TAXES
High Court

1] Section 115BB – Prize money won from unsold stock of lottery tickets – to be assessed as income from winning and not business income

J. N. Sharma v. ACIT (2014) 107 DTR (All) 185

The assessee was appointed as a stockist by the Government for the sale of lottery tickets. The assessee was to intimate the Government at the close of the draw date, within 24 hours was to intimate the Government regarding the unsold tickets. In the failure in doing so, it was understood that all unsold tickets were treated as sold. From such tickets the assessee won a lottery, which he showed as business income. The AO held the same to be income from winnings from lottery. The CIT(A) held in favour of the assessee, and the ITAT reversed the said decision. On appeal to the High Court, the Hon'ble court while dismissing the appeal held that the amount of prize money received by the assessee on unsold lottery tickets is income by way of winnings from lottery taxable u/s. 115BB.

2] Section 2(47) – Transfer of ownership vis-à-vis possession – Capital Gains

Chandra Prakash Jain & Ors. v. ACIT (2014) 270 CTR (All) 192

By an agreement dated 4-7-1974, assessee co-owners agreed to transfer the property to four persons and received some advance after handing over possession. Later on co-owners entered into a written agreement dated 7-9-1991 with one AG for transferring the property to them. AO assessed CG in A.Y: 1992-93. CIT(A) upheld AO's order. Tribunal allowed the appeal of assessee and set aside the order of CIT(A). Tribunal held that AO was fully justified in levying the Capital Gain in the A.Y. 1992-93. The assessee preferred Miscellaneous Application for rectification which was dismissed by Tribunal. On appeal in High Court, High Court dismissed the appeal of the assessee and held that section 2(47)(V) was not applicable instead section 2(47)(VI) was applicable in this case since the assessee were full owners of the property and as the ownership was retained by the assessee even after the agreement to sell was executed in 1974, parting of possession in 1974 did not tantamount parting of ownership which remained with the assessee. The court also held that *vide* agreement dated 7-9-1991, the assessee transferred their right of ownership in favour of AG.

3] Section 57(iii) – Interest on borrowed funds for investment in shares –Allowable expenditure u/s 57(iii)

Shri Saytasai Properties & Investment (P) Ltd. v. CIT 270 CTR (Cal.) 210

The question of law before the Hon'ble Court was whether deduction u/s. 57(iii) of IT Act, 1961 in respect of interest incurred on borrowed funds utilised for making investment in shares on which no dividend was received. The court allowed assessee's appeal and held that investment was not for the

purpose of earning dividend. The Court held that what is an income from other sources has not been put into a strait jacket formula. Even the legislature had advisedly expressed "without prejudice to the generality of the provision". Therefore there was no reason why a proper expenditure should not have been disallowed only because the investment was not made for the purpose of making an income. Therefore the Tribunal and AO were wrong in disallowing the expenditure.

4] Section 148 – Material discovered during assessment of subsequent year – Reopening Justified

Debash Services (P) Ltd. v. DCIT (2014) 270 CTR (Bom.) 36

AO during the assessment proceedings for the A.Y. 2010-11 received information. Information so revealed pertained to the A.Ys. to which the impugned notices relate. The High Court dismissed assessee's Writ Petition and held that the said information has direct nexus and/or live link with the tax liability for A.Y. 2006-07 & A.Y. 2008-09. Material in hands constituted *prima facie* sufficient for him to form a belief that income had escaped assessment of the assessment to which the impugned notices relate and therefore reassessment was justified. Issuance of notice was not an outcome of change of opinion of the successor AO but was based on tangible material received by him during the assessment proceedings of the subsequent years. Therefore reopening was sustainable.

5] Section 234D – Any assessment completed after 1-6-2003 – Interest u/s. 234D applicable

CIT v. Gujarat State Financial Services Ltd. & Ors. (2014) 270 CTR (Guj.) 83

Asessee filed Return of Income disclosing certain total income. On processing such return u/s. 143(1) of the Act, the refund order was passed inclusive of interest u/s. 244A of the Act. Assessee filed revised return for wrongly claiming bad debt. On scrutiny, the AO while finalising assessment u/s. 143(3) issued demand notice and also charged interest u/s 234D of the Act. On appeal CIT(A) dismissed the appeal of the assessee relying on *CIT v. Anjum M.H. Ghaswala 252 ITR 1 (SC)* and held that levy of interest is mandatory. On appeal in Tribunal, Tribunal allowed the appeal of the assessee and cancelled interest following assessee's own decision of earlier years. On further appeal in High Court, High Court reversed Tribunal's order and held that Explanation 2 which has been added in 234D w.e.f. 1-6-2003, is declaratory and clarificatory in nature. S. 234D which states that the provision of this section shall also apply to the assessment year commencing before 1-6-2003, if the proceedings in respect of such assessment year is completed after 1-6-2003, regardless of the year of assessment, this provision was made applicable to such assessment year.

6] Section 127 – Transfer of case – Without opportunity of being heard – Breach of principles of natural justice

Sunisha Impex (P) (Ltd. v. CIT & Ors. (2014) 270 CTR (Bom.) 63

Assessee case was transferred from Mumbai to Bengaluru on the alleged ground of co-ordinated investigation and assessment without personal hearing. On writ in High Court, the Hon'ble court allowed the writ of assessee and held that power to transfer proceedings from one place to another u/s. 127 cannot be exercised arbitrarily. In present case, neither any notice was issued to the assessee nor was any personal hearing granted to the assessee before passing the impugned order. The court also held while transferring the case on the ground of co-ordinated investigation and assessment", it is incumbent upon the CIT to indicate the reason why it is necessary to transfer the case for the purposes of co-ordinated investigation. It was not even remotely suggested by the revenue that it was not possible for them to issue notice or grant personal hearing before passing the impugned order. Therefore not giving of notice, not giving personal hearing and passing the order without reasons, impugned order was required to be set aside.

7] Section 201 – TDS – No double recovery once TDS deducted by deductor

CIT v. D. P. Vekaria [2014] 48 taxmann.com 249 (Gujarat)

Assessee made payment for hire of JCB Machine, Roller & Tractors. AO treated the said payment under section 149(1) and raised demand under section 201(1) and interest under section 201(1)(A). On appeal, it was found that concerned deductees already paid the amount of tax on the same. Hence, CIT(A) set aside the order passed under section 201(1). On appeal, the Tribunal dismissed appeals preferred by the revenue. On further appeal by the revenue in High Court the court held that as far as Tax Appeals preferred by revenue are concerned, it is required to be noted that the CIT(A) as well as Tribunal have relied upon the decision of the Supreme Court in the case of *Hindustan Coca-cola Beverage (P.) Ltd. v. CIT [2007] 293 ITR 226* and considering the fact that the concerned deductees had already paid the tax on the same, have set aside the demand raised by the revenue and have quashed and set aside the order passed under section 201(1). In the case of *Hindustan Coca Cola Beverage (P.) Ltd.*, the Supreme Court has specifically observed and held that once tax due has been paid by the deductee, thereafter tax cannot be recovered once again from the assessee. The court was in complete agreement with view taken by the Tribunal. Thus, there was no error committed by the Tribunal in confirming the order passed by the CIT(A) in quashing and setting aside the demand of tax raised against the assessee and quashing and setting aside the order passed under section 201(1) with respect to payment made to hire of JCB Machine, Roller & Tractors.

8] Section 23 – Duty of AO to determine standard rent if it isn't fixed under Rent Control Legislation – House Property

Smt. Kokilaben D. Ambani v. CIT [2014] 49 taxmann.com 371 (Mumbai)

The question of law before Hon'ble High Court was "Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that the annual letting value of the self-occupied flat in Usha Kiran Building has to be the sum equivalent to the standard rent under the Bombay Rent Control Act and not the Municipal Annual Rateable Value in computing the property income u/s. 23 of the Income-tax Act, 1961? ". The Court disposed off the reference by applying the ratio of Tip Top and held that the AO in the cases of properties, which are subject to Rent Control Legislation, cannot ignore the same. If the standard rent has not been fixed under the Rent Control Legislation by the competent authority, it is the duty of the AO to determine the same in terms of the Rent Control Legislation. The law has been crystallised in terms of the decision of the Hon'ble Supreme Court as also the Full Bench of the Delhi High Court. In such circumstances, there was not any basis for an apprehension that the Tribunal would ignore the Rent Control Legislation and prefer some other mode in determining the fair rent or annual letting value of the property under section 23(1)(a). The court further held that the principle cannot be any different for self-occupied properties and in relation to which the exercise must be carried out in terms of the relevant section 23(1) of the I.T. Act.

9] Sec 37(1) – Transport business –secret commission paid – allowable if all details of commission furnished

CIT v. Transport Corporation of India (2014) 110 DTR (AP) 44

In the instant case the AO disallowed the claim of payment of secret commission. The CIT(A) and Tribunal allowed the same. The contention of the Department before the High Court Held that on the very description of the amount claimed as a deduction is opposed to the law and the same should not be allowed. The Hon'ble High Court while dismissing the appeal of the Department held that secret commission paid to persons who provide business to the assessee is allowable if the details of commissions are furnished and if a plea is raised to the satisfaction of the AO that the disclosure of the names of the receipients is dertrimental to the interest of the assessee.

10] Addition ground – can be raised when the matter is set aside to be heard on merits from the High Court to the Tribunal

Lekshmi Traders v. CIT [2014] 367 ITR 551 (Ker)

In the instant case in an appeal before the tribunal in a block assessment proceedings, a legal issued was raised before the tribunal on legality of the issue of notice, which was allowed by the tribunal. The High Court allowed the appeal filed by the Department and set aside the matter to the tribunal to be heard on merits. In the set aside proceedings before the tribunal, the assessee raised an additional grounds on the basis of a Supreme Court Judgement. The Tribunal did not admit the additional ground of appeal, on the grounds that the tribunal was confined to the order of the High Court, which was to decide the matter on merits. On appeal to the High Court, the High Court held that assessee can raise an additional ground, when the matter was remanded to the tribunal to be heard on merits.

Unreported

11] Section 271(1)(c) – Penalty for failure to explain source – Voluntary offer of income for taxation

Jai Palace v. CIT – Income Tax Appeal No. 206 of 2005. Order dated 17th September, 2014 (Allahabad High Court).

There were cash deposits in the bank account of the assessee to the tune of ` 1,47,000/-. When confronted with this, the assessee offered this amount to buy peace. The A.O. levied penalty u/s. 271(1)(c) which was confirmed up to the Tribunal. Before the High Court the assessee argued that the amount represented a deposit obtained from 7 persons and each deposit was less than ` 20,000/- and that the assessee offered the amount to buy peace and avoid litigation. The Revenue relied upon the decision of the Hon'ble Apex Court in *CIT v. MAK Data Ltd. 358 ITR 593 (SC).* The High Court held .that individually the amounts were meagre viz. less than ` 20,000/- and hence a lenient view was warranted. Hence the Hon'ble High Court deleted the penalty. *CIT v. MAK Data Ltd.* decision distinguished.-

12] Secs. 3; 28-43D – Business Expenditure – Setting up of business

CAREFOUR WCANDC (I) Pvt Ltd v. DCIT. ITA/42/2014 dated 22nd September 2014 (Delhi High Court).

The assessee company was incorporated on September 19, 2007, to carry on trading activities which primarily included wholesale trading of all kinds of consumer goods durables, articles and products. The Asst. Yr. 2008-09 was the first year of assessment for which the assessee company filed an E-Return. The assessee claimed expenses amounting to ` 9,03,03,547/- and claimed a business loss of ` 8,64,07,610/- The learned AO disallowed the loss/expenditure on the ground that the assessee's business had not commenced and hence the assessee was not entitled to claim the loss viz. the loss/expenditure was incurred prior to commencement of business as it was not fully set up. The learned AO observed that if the assessee were a manufacturing concern, it could be said to be set up only when it was ready for effecting production. However since the case of assessee was that of a trader, the Assessing Officer was of the view that the business could be said to be set up only when the stocks are available to be sold. The assessee failed up to the Tribunal. The High Court noted certain undisputed facts. The assessee company was incorporated on September 19, 2007. Even before the incorporation, correspondence had been made with well known companies like Nestle, Cadbury, Nivea India Pvt. Ltd., Pepsi, Coalgate, Uniliver etc. It rented out the office premises in the month of October, 2007. Bank account was opened on October 4, 2007. Employees were also appointed during the said period. TDS deduction for the said employees was also placed on record. Registration under the Shops and Establishment Act was also effected. These activities are the first stage activities which would lay foundation for placing orders for procuring the stock and storing them in a warehouse/shop followed by the third stage of marketing them viz. these were preparatory activities ; an entity cannot commence business without establishing itself under the local laws, appointing personnel,

identifying the prospective manufacturers, clients etc. obtaining storage facilities followed by stock-in-trade. It was observed that the expenses during the preparatory stage were also permissible in the light of the decision of the Hon'ble Apex Court in *Sarabhai Mgmt. Corporation 192 ITR 151 (SC).* Hence it was held that the assessee's business was "set up" and the assessee was entitled for to claim the loss & expenditure.

13] Sections 28; 29 – Business Loss – Abandoned Project

M/s Asia Projects Pvt. Ltd. (Formerly Ansaldo Services (P) Ltd.) ITA No. 481/2008 dated 5th August, 2014 {Karnataka High Court}.

The assessee company was awarded a contract by Madhya Pradesh Electricity Board (MPEB). An amount of ` 9,29,20,000/- was paid as advance and the assessee gave a bank guarantee for the said amount. The assessee commenced the work and incurred expenditure to the tune of ` 6,64,01,149/- on the project. The said contract was terminated by the Board. The assessee contended that MPEB arbitrarily terminated the contract and invoked the bank guarantee. The assessee invoked the arbitration clause and put forth a claim. The amount of ` 6,64,01,149/- included money spent on raw materials like tubes and pressure parts, consumables, freight and carriage and also bank charges, professional charges etc., in addition to the expenses on personnel, transport and communication and administrative expenses. The assessee debited the said amount being the cost of abandoned project towards the profit and loss account. In the notes appended, it was stated that the said amount had been charged as expenditure on abandoned project. The assessee also mentioned that the assessee had contested the invocation of bank guarantee by the MPEB before the court of Jabalpur. On the date of assessment order the arbitration award also had been passed on 23-9-2004 under which the assessee was granted substantial damages for the illegal invocation of the bank guarantee, cancellation of the contract etc. However, no amount had been paid by MPEB in terms of the award as they were contesting the award in an appeal before the court of Jabalpur. The AO was of the view that as and when any expenditure was incurred on a contract, it should either result in corresponding receipts from the contract or it should be represented as WIP. The assessee had neither received any amount from MPEB nor was showing any WIP. The expenditure on a particular project cannot be merely allowed as an expenditure unless there is a corresponding credit in the form of contract receipt or work-in-progress. The assessee was claiming the entire expenditure as deductible expenditure since the contract had been abandoned. Although the assessee had abandoned the contract, the fact remains that they had made a claim in arbitration in respect of the expenditure incurred and had also claimed damages for the termination of the contract. This being the case, it cannot be said that the assessee was not entitled for any amount from MPEB. The assessee failed up to the Tribunal.

On appeal, the High Court observed that a claim was put forth before the arbitrator. But in the near future there was no chance of getting any amount and in that particular previous year, the amount paid had been taken away. Therefore, the assessee in that previous year has shown the entire amount incurred as expenditure and sought for writing off as business expenditure. If the assessee incurs a liability (viz. in terms of expenditure incurred on the contract) and when the contract under which that liability was incurred was terminated and when no amounts under the contract or in pursuance of a claim is receivable, he is entitled to claim the said amount incurred as expenditure in implementing the contract as a set off u/s 37(1) r/w 28 of the Act. In view of the aforesaid provision, though the assessee has incurred expenditure, he has not received any amount as against the expenditure. As and when he receives the money in pursuance of the award which is already passed, if it is upheld by the High Court, the said amount is chargeable to income tax as the income of that previous year in which he receives the said amount whether the business in respect of which the deduction has been made is in existence in that year or not. Therefore, the interest of the revenue is fully protected. And hence the assessee's loss was allowable as business loss.


Jitendra Singh & Sameer Dalal
Advocates

DIRECT TAXES
Tribunal

REPORTED

1. Appeal to the Tribunal – Section 253 of the Income-tax Act, 1961 – Tax effect less than 4 lakhs – Appeal by revenue not maintainable – CBDT Instruction No. 5 of 2014 dated 10-7-2014 applicable to pending appeals also. A.Y. 2007-08

ITO vs. Smt. Arati Jana – [2014] 109 DTR (Kol.) (Tribunal) 228

The present appeal before the Hon'ble Appellate Tribunal was filed by the department revenue challenging the order passed by Learned CIT(A). Before the Hon'ble Appellate Tribunal, the assessee contended that the tax effect in the present appeal is below the monetary limit provided by CDBT under Instruction No. 5 of 2014 dated 10-7-2014. The Hon'ble Appellate Tribunal was pleased to dismiss the appeal filed by the department by observing that instructions revising the monetary limit to ` 4 lakh for filing appeal before the Tribunal on income-tax matters, as issued *vide* CBDT Instructions No. 5 of 2014 dated 10-7-2014 applies to pending appeals also. Thus, the instant appeal being a low tax effect case not covered by any of the exceptions as provided in the said instructions is dismissed in limine.

2. Stay of demand – Section 254 of the Income-tax Act, 1961 – Collection of tax in spite of stay granted by the Tribunal – Legally not permissible. A.Y. 2009-10

Johnson & Johnson Ltd. vs. Addl. CIT [2014] 51 taxmann.com 1 (Mumbai - Trib.).

In the present case the A.O. raised a demand of ` 116.27 crores after passing the order. The assessee preferred a stay application on 19-2-2014 and contended that most of the issues are covered in favour of the assessee and hence, it is a fit case for granting stay. The Hon'ble Mumbai Appellate Tribunal after considering the facts and circumstances of the case, granted stay of demand. However, despite a specific direction by the Bench the A.O. decided to adopt an innovative method of collecting the revenue by utter disregard of the Tribunal order and obtained a consent letter from the assessee and collected a sum of ` 16.64 crores during the subsistence of the said order. Thus, the amount outstanding has been further reduced. Though the case was posted from time to time, the same was adjourned at the request of the learned D.R. or for want of time, and hence the assessee had to file a fresh stay application for extension of the stay. During the course of hearing before the Hon'ble Mumbai Appellate Tribunal the assessee brought to the light that the A.O. has followed an innovative method of collecting taxes despite specific directions of the Bench. The Appellate Tribunal stayed the recovery of demand for a further period of six months and also directed the A.O. to refund the amount collected contrary to the order passed by it in earlier stay application along with interest within 15 days.

UNREPORTED

1. Cash credits – Section 68 of the Income-tax Act, 1961 – Assessing Officer treated certain sundry creditors as non-genuine as the assessee was able to file any details or no explanation – Held, that creditors existed in balance sheet of assessee and there was no write off made by assessee thus, the liability existed in the books of account and the same could not be added as assessee's income.

Disallowance – Section 40A(3) of the Income-tax Act, 1961 – Once books of account of the assessee are rejected and profit is estimated – No further disallowance can be made by invoking provisions of section 40A(3) of the Act. A.Y. 2006-07

Sadananda Singha vs. ITO - [I.T.A. No.: 1881 / Kol / 2009; Order dated: 13-8-2014; Kolkata Bench]

During the course of assessment proceedings the Assessing Officer treated certain sundry creditors as non-genuine, as the assessee was not able to file any details nor any explanation was offered by the assessee for the same. The action was confirmed by the CIT(A). On appeal the Tribunal held that the creditors exist in the Balance Sheet of the assessee and there is no write off made by the assessee or no claim made by the assessee. Thus, under these circumstance liability still existed and could not be added to the income of the assessee.

During the course of assessment proceedings, the AO noted that the assessee had made payment on account of purchases exceeding a sum of ` 20,000/- otherwise than by crossed bank cheque or crossed bank draft. The A.O. accordingly, disallowed 20% of the sum under section 40A(3) of the Act. Further, during the course of assessment proceedings A.O. also rejected the book results by invoking the provisions of section 145(3) of the Act and estimated the profits. The disallowance made by the A.O under section 40A(3) of the Act was confirmed by the CIT(A). On appeal the Tribunal held that once the books of account are rejected and profit is estimated, no further disallowance can be made by invoking the provisions of section 40A(3) of the Act.

2. Search assessment – Section 153A of the Income-tax Act, 1961 – Assessments for the year under consideration concluded – Addition made by the Assessing Officer in his order passed under section 143(3) read with 153A of the Act not based on any incriminating material found during the course of search – The Tribunal deleting the addition held, while framing assessment under section 153A the A.O. could make addition in the case of concluded assessments only on the basis of incriminating materials found during the course of search. A.Ys. 2003-04 & 2005-06

Mrs. Raksha Chhadwa vs. Asstt. CIT - [I.T.A. Nos.: 8576 & 8577 / Mum / 2010; Order dated 17-10-2014; Mumbai Bench]

In consequence to search action conducted at the residence of the assessee, the AO completed assessment of both the years under section 143(3) read with section 153A of the Act. In A.Y. 2003-04 A.O. treated an amount received as gift by the assessee as unexplained cash credit and in A.Y. 2005-06 treated long-term capital gain as unexplained cash credit. Original assessment for both the years were concluded accepting the return filed by the assessee without issue of notice under section 143(2) of the Act. The CIT(A) confirmed the additions made by the A.O. in both the years though it was contended before him that additions in the assessment were not based on any incriminating material found during the search action.

On appeal, the Tribunal observed that for both the assessment years the assessments were concluded. Further, the additions made by the A.O. in his impugned order passed under section 143(3) read with section 153A of the Act were not based upon

any incriminating material found during the course of search. Accordingly, the additions were liable to be to be deleted in both the years.

3. Charitable or Religious trust – Section 12A of the Income-tax Act, 1961 – Commissioner's action of rejecting assessee's claim for registration under section 12AA only on ground that trust deed did not contain mandatory clauses for audit as required under section 12A(b) held not justified. A.Y. 2014-15

Kasargod District Health & Family Welfare Society Kanhangad vs. CIT - [I.T.A. No. 133 / Coch/ 2014; Order dated 14-8-2014; Kochi Bench]

The assessee, society was established with an object of assisting the district health administration. The Commissioner rejected the assessee's application for registration under section 12AA of the Act only on the ground that the deed does not contain the mandatory clauses for audit as required under section 12A(b) of the Act.

On appeal the Tribunal held that the Act does not require any mandatory clause either in the trust deed or in the bye-laws of the society for the purpose of grant of registration under the Act. The Commissioner has to examine the application of the assessee as provided in section 12AA(1) read with section 2(15) of the Act and satisfy himself about the genuineness of the activity of the object of the trust. Thus, the application for registration under section 12A of the Act cannot be rejected merely on the ground that the mandatory clause for audit was not incorporated in the bye laws.

Note: Similarly, Chennai Tribunal in the case of, *Disha Trust vs. DIT (E) - [(2014) 31 ITR (Trib.) 154 (Chennai)]* held that application for registration under section 12AA could not be rejected by the Commissioner merely on ground that assessee had not started its activities or the trust has mixed objects that is, religious as well as charitable objects.

4. Notice – Section 159 of the Income-tax Act, 1961 – Notice issued on a dead person as well as assessment framed on a dead person – Held to be nullity in the eyes of law – Further, notice under section 143 (2) of the Act served on the assessee by affixture by the Inspector in the presence of another Inspector and not in the presence of any other independent witness – Held to not valid. A.Y. 2006-07 and 2007-08

Asstt. CIT vs. Late Dayaram Dharmashi Madan; Through L/H Shri Kantilal Narshibhai Mandan & Anr. – [I.T.A. Nos.: 5576 & 5577 / Mum / 2012; Order dated 17-10-2014; Mumbai Bench]

The return of income for both the assessment years were filed on 6-11-2006 and 31-7-2007 respectively. Thereafter, the assessee expired on 20-8-2007. The Assessing Officer issued notice under section 143(2) of the Act for A.Y. 2006-07 on 24-10-2007, which was served by affixture on 30-10-2007. Similarly, the notice under section 143(2) of the Act for A.Y. 2007-08 was issued on 8-9-2008, which was also was served by affixture on 30-9-2008. Thereafter, the A.O. completed the assessment for both the years under section 144 of the Act in the name of, 'Late Shri Dayaram Dharmashi Mandan Through Legal Heir'.

On appeal the Tribunal relying upon section 159(2) of the Act held that as the Revenue authorities were not able to demonstrate that the assessment order was passed after issuing any notice to the legal representative of deceased individual, assessment order passed by the A.O. under section 144 of the Act without bring on record the legal representatives was nullity in the eyes of law and liable to be quashed.

Further, the notices issued under section 143(2) of the Act for both the years had been served by affixture. The notices were served by affixture by the inspector in the presence of another inspector and not in the presence of any other independent witness who was able to identify the place of the assessee. Thus, in the absence of any independent who could identify the assessee's place of business at the time of service under section 143(2) of the Act by affixture, service of such notice by affixture was also treated as invalid service.

CA Sunil K. Jain

DIRECT TAXES

Statutes, Circulars & Notifications

NOTIFICATIONS

Section 35CCC of the Income-tax Act, 1961 – Expenditure on agricultural extension project – Notified eligible agricultural extension project

The Central Board of Direct Taxes has notified following eligible agricultural extension projects for the purpose of section 35CCC of the Income tax Act subject to conditions mentioned in Form 3CP provided in the respective notifications :

(Notification No(s) 37-38/2014, dated 27-8-2014, and 39-40 41/2014 dated 29-8-2014 respectively)

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

- Bhutan
- Poland

(Notification(s) No. 42 - 47/2014 dated 5-9-2014 and 24-9-2014 respectively)

Income-tax (Eighth Amendment) Rules, 2014 – Amendment in new Appendix-I relating to Tangible Assets

The Central Board of Direct Taxes made the rules further to amend the Income-tax Rules, 1962, called the Income-tax (8th Amendment) Rules, 2014 and shall come into force on the date of their publication in the Official Gazette; wherein in the New Appendix I, in Part-A relating to Tangible Assets, under the heading III. Machinery and Plant, in item (8), in sub-item (xiii), in clauses (1) and (m) date of installation "on or after the 1st day of April, 2014" from the earlier "31st day of March, 2012", has been substituted.

(Notification No. 43/2014 dated 16-9-2014)

Section 92C of the Income-tax Act, 1961 – Transfer Pricing – Computation of arm's length price – Notified tolerable limit for determination of ALP

The Central Government notified that where the variation between the arm's length price determined under section 92C and the price of which the international transaction or specified domestic transaction has actually been undertaken does not exceed one per cent of the latter in respect of wholesale trading and three per cent of the latter. In all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed

to be the arm's length price for assessment year 2014-15.

For the purposes of this notification, "wholesale trading" means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions, namely :—

(i) purchase cost of finished goods is eighty per cent or more of the total cost pertaining to such trading activities; and

(ii) average monthly closing inventory of such goods is ten per cent or less of sales pertaining to such trading activities.

(Notification No. 45/2014, dated 23-9-2014)

Income-tax (Ninth Amendment) Rules, 2014 – Amendment in Rule 28AA and Substitution of Form No. 13

The Central Board of Direct Taxes made the following rules further to amend the Income-tax Rules, 1962, namely called the Income-tax (9th Amendment) Rules, 2014 and shall come into force on the date of their publication in the Official Gazette. In the Income-tax Rules, 1962, in rule 28AA, for sub-rule (4) and sub-rule (5), the following sub-rules have been substituted:

- The certificate for no deduction of tax shall be valid only with regard to the person responsible for deducting the tax and named therein.
- The certificate referred to in sub-rule (4) shall be issued direct to the person responsible for deducting the tax under advice to the person who made an application for issue of such certificate.
- The certificate for deduction of tax at lower rate shall be issued to the person who made an application for issue of such certificate, authorising him to receive income or sum after deduction of tax at lower rate, and
- In Appendix-II, for Form No. 13, regarding Application by a person for a certificate under sections 197 and/or 206C (9) of the Income-tax Act, 1961, for no deduction/collection of tax or deduction/collection of tax at a lower rate has been substituted.

(Notification No. 46/2014, dated 24-9-2014)

Income-tax (Tenth Amendment) Rules, 2014 – Insertion of Rule 12D

The Central Board of Direct Taxes hereby makes the following rules further to amend the Income-tax Rules, 1962, namely the Income-tax (10th Amendment) Rules, 2014 which shall come into force on the date of their publication in the Official Gazette. In the Income-tax Rules, 1962 after rule 12C, the following rule hasbeen inserted, about prescribed authority under section 133C.

The prescribed authority under section 133C shall be the Principal Director General or Director General or Principal Director or Director, as the case may be. For the purposes of this rule, "Principal Director General or Director General or Principal Director or Director" means the Principal Director General of Income-tax or the Director General of Income-tax or the Principal Director of Income-tax or the Director of Income-tax to whom the Central Board of Direct Taxes may authorise to act as prescribed authority for the purposes of section 133C.

(Notification No. 48/2014, dated 30-9-2014)

CIRCULARS

Section 10A, read with section 10AA of the Income-tax Act, 1961 – Free Trade Zone – Clarification on allowability of deduction under

section 10A/10AA on transfer of technical manpower in case of software industry

CBDT had issued Circular No. 12/2014 dated 18th July, 2014 to clarify that mere transfer or re-deployment of existing technical manpower from an existing unit to a new SEZ unit in the first year of commencement of business will not be construed as splitting up or reconstruction of an existing business, provided the number of technical manpower so transferred does not exceed 20 per cent of the total technical manpower actually engaged in developing software at any point of time in the given year in the new unit. After considering representations, it has now been decided that the transfer or re-deployment of technical manpower from existing unit(s) to a new unit located in SEZ, in the first year of commencement of business, shall not be construed as splitting up or reconstruction of an existing business, provided the number of technical manpower so transferred as at the end of the financial year does not exceed 50 per cent of the total technical manpower actually engaged in development of software or IT enabled products in the new unit.

Further, in the alternative, if the assessee (enterprise) is able to demonstrate that the net addition of the new technical manpower in all units of the assessee (enterprise) is at least equal to the number that represents 50% of the total technical manpower of the new SEZ unit during such previous year, deduction under section 10A/10AA would not be denied provided the other prescribed conditions are also satisfied.

It is also stated that the assessee will have a choice of complying with any one of the two alternatives given in paras 3 and 4 above.

It is also clarified that this Circular shall be applicable only in the case of assessees engaged in the development of software or in providing IT Enabled Services in SEZ units eligible for deduction u/s. 10A or u/s. 10AA of the Act.

This Circular shall not apply to the assessments which have already been completed. Further, no appeal shall be filed by the Department in cases where the issue is decided by an appellate authority in consonance with this Circular.

(Circular No. 14/2014, dated 8-10-2014)

Section 194LC of the Income-tax Act, 1961 – Income by way of interest from Indian company – Approval of long- term bonds and rate of interest for the purpose of section 194LC

Section 194LC of the Income-tax Act, 1961, introduced by the Finance Act, 2102, provided for lower withholding tax at the rate of 5% on the interest payments by Indian companies on borrowings made in foreign currency by such companies from a source outside India.

The Central Board of Direct Taxes now conveyed the approval of the Central Government for the purposes of section 194LC in respect of the issue of long-term bond including long-term infrastructure bond by Indian companies which satisfy the following conditions:

The bond issue is at any time on or after 1st day of October, 2014 but before the 1st day of July, 2017; should comply with clause (d) of sub section (3) of section 6 of the Foreign Exchange Management Act, 1999; should have a loan Registration Number issued by the Reserve Bank of India (RBI); and that the bond to be issued should have original maturity term of three years or more.

(Circular No. 15/2014 – dated 17-10-2014)

INSTRUCTIONS

Section 143 of the Income-tax Act, 1961 – Assessment – General – Compulsory manual selection of cases for scrutiny during financial year 2014-15

In supersession of earlier Instructions on the above subject, the Board has laid down the procedure and criteria for manual selection of returns/cases for scrutiny during the financial-year 2014-15.

(Instruction No. 6/2014, dated 2-9-2014)

Section 143, read with section 142 of the Income-tax Act, 1961 – Assessment – Scope of enquiry in cases selected for scrutiny during financial year 2014-15 on basis of AIR/CIB/26 as mismatch

It has come to the notice of the Board that during the scrutiny assessment proceedings some of the AOs are routinely calling for information which is not relevant, for enquiry into the issues to be considered. This has been causing undue harassment to the taxpayers and has also drawn adverse criticism from several quarters. Further, feedback and analysis of such orders indicates that many a times the core issues, which formed the basis of selection of the case for scrutiny were not examined properly. Such instances primarily occurred in cases selected for scrutiny under Computer Aided Scrutiny Selection ('CASS') for verification of specific information obtained from third party sources which apparently did not match with the details submitted by the taxpayer in the return-of-income.

Therefore, the cases selected for scrutiny during the financial year 2014-20 (15 under CASS, on the basis of either AIR data or CIB information or for non re-conciliation with 26AS data, the scope of enquiry should be limited to verification of these particular aspects only. Therefore, in such cases, an Assessing Officer shall confine the questionnaire and subsequent enquiry or verification only to the specific point(s) on the basis of which the particular return has been selected for scrutiny.

In case, during the course of assessment proceedings, it is found that there is potential escapement of income exceeding ` 10 lakhs (for non-metro charges, the monetary limit shall be ` 5 lakhs) on any other issue(s) apart from the AIR/CIB/26AS information based on which the case was selected under CASS requiring substantial verification, the case may be taken up for comprehensive scrutiny with the approval of the Pr. CIT/DIT concerned. However, such an approval shall be accorded by the Pr. CIT/DIT in writing after being satisfied about merits of the issue(s) necessitating wider and detailed scrutiny in the case. Cases so taken up for detailed scrutiny shall be monitored by the Jt. CIT/Addl. CIT concerned.

(Instruction No. 7/2014, dated 26-9-2014)

Section 143 of the Income-tax Act, 1961 – Assessment – General – Cases recommended by CPC for scrutiny

Queries have been received from field formations regarding cases visible under the Path AST —> Processing —> CPC Interface —> List of ITRs recommended by CPC for scrutiny. It has been reported that assessing officers are facing problem in generation of notice through system in respect of some such cases. CBDT desires that the assessing officers may issue manual notices under section 143(2) and this instruction shall be deemed to be the necessary approval. The functionality in the ITD will be developed later to flag this selection in AST. All efforts must be made by the assessing officers to serve notices by today.

In cases where notice under section 143(2) could not be served in spite of best efforts, the issue flagged by CPC may be examined for suitable action under section 147 of the IT Act.

(AST Instruction No. 130 dated 30-9-2014)

PRESS RELEASES

Extension of the due date of deposit of Tax Deducted/Collected at Source during the month of September, 2014

Considering the consecutive holidays owing to the festive season and weekend during the first week in the month of October, 2014, the Central Board of Direct Taxes has issued an order to extend the last date of deposit of tax deducted at source/tax collected at source during the month of September, 2014 from 7th October, 2014 to 10th October, 2014 without entailing any consequential interest. The due date for filing of TDS/TCS statements for the 2nd Quarter of the F.Y. 2014-15 shall remain the same.

(Press Release, dated 1-10-2014)

Expeditious process for refunds claims of taxpayers residing in State of Jammu & Kashmir – Where refund cheques could not be delivered at address indicated by tax payers in their returns due to dislocation caused by floods to update their address for delivery of their refund cheques

In view of the large devastation caused by the recent floods in Jammu & Kashmir, the Income Tax Department is taking necessary steps to process expeditiously the refund claims of the taxpayers residing in the State of Jammu & Kashmir who have submitted their returns through electronic mode. Instances have come to notice where the refund cheques could not be delivered at the address indicated by the taxpayers in their returns due to dislocation caused by floods.

Non-Corporate taxpayers of Jammu and Kashmir, who desire to provide a new address for delivery of their refund cheques, may log in to the e-filing site https://incometaxindiaefiling.gov.in, and update their address through the path Profile Setting – My Profile – Address. Alternatively, the taxpayers can contact the helpdesk at Centralised Processing Centre (CPC), Bengaluru at 1800 425 2229 and provide the updated address.

(Press Release, dated 15-10-2014)

Last date of filing of TDS/TCS Statements for 2nd quarter of financial year 2014-15 for deductors/collectors in States of Andhra Pradesh, Jammu & Kashmir, Odisha & Telangana extended

In view of the recent natural calamities in the States of Andhra Pradesh, Jammu & Kashmir, Odisha & Telangana, the Central Board of Direct Taxes has issued an order extending the due date for filing the TDS/TCS Statements for the 2nd Quarter of financial year 2014-15 by the deductors/collectors in these States. In case of Government deductors/collectors that are mapped to a valid AIN, the due date is extended from 31st October, 2014 to 7th November, 2014. In case of all other deductors/collectors, the due date is extended from 15th October, 2014 to 31st October, 2014.

(Press Release, dated 17-10-2014)


CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A] HIGH COURT JUDGMENTS

I. Issue of shares at premium does not give rise to any 'Income' from an International Transaction, absent which, provisions of Chapter X of the Income-tax Act, 1961 cannot be invoked. Chapter X not a charging section but merely a machinery provision

Vodafone India Services Pvt. Ltd. v. Union of India & Ors. [WP No. 871 of 2014] [Bombay High Court] – Assessment Year: 2009-10

Facts

1. The petitioner, Vodafone India Services Pvt. Ltd., issued 2,89,224 equity shares of the face value of ` 10/- each at a premium of ` 8,509/- per share to its holding company. However, according to the Assessing Officer ('AO') and Transfer Pricing Officer ('TPO'), the Petitioner ought to have valued each equity share at ` 53,775/-, being value after considering the transfer pricing adjustment for assessment 2007-08 and 2008-09, as against the aforesaid valuation carried out by it. By invoking provisions of Chapter X of the Income-tax Act 1961, (the Act), the AO/TPO treated the shortfall in premium as income and accordingly brought to tax a total amount of ` 1308.91 crores. The aforesaid deficit was further treated as loan, extended by the petitioner to its holding company and periodical interest thereon was held to be chargeable to tax as interest income. Accordingly, ` 88 crores was treated as income in the hands of the petitioner.

Writ Petition was filed before the Hon'ble Bombay High Court, which held that:

(a) A plain reading of section 92(1) of the Act very clearly brings out that income arising from an International Transaction was a condition precedent for application of Chapter X of the Act.

(b) Chapter X was introduced to ensure that the transaction was charged to tax only on working out the income after arriving at the ALP of the transaction. This was only to ensure that there was no manipulation of prices/consideration. The entire consideration received would not be a subject-matter of taxation.

(c) If it was income which is chargeable to tax under the normal provisions of the Act, then alone Chapter X of the Act could be invoked. Sections 4 and 5 of the Act brings/charges to tax total income of the previous year and for the meaning of the word 'income' under the Act, section 2(24) of the Act was to be resorted to. The amounts received on issue of shares was admittedly a capital account transaction

not separately brought within the definition of 'Income', except in cases covered by section 56(2)(viib) of the Act.

(d) The definition of income under section 2(24)(xvi) included within its scope the provisions of section 56(2)(viib) of the Act, which indicated the intent of the Parliament to tax issue of shares to a resident, when the issue price was above its fair market value. In the instant case, the Revenue's case was that the issue price of equity share was below the fair market value of the shares issued to a non-resident. Thus Parliament has consciously not brought to tax amounts received from a non-resident for issue of shares, as it would discourage capital inflow from abroad.

(e) Provisions of section 56(1) of the Act were not applicable since chargeability to tax arose only when there was 'income' which was accrued/deem to have accrued to the assessee and the issue of shares was a capital account transaction, and did not give rise to any 'income'.

(f) A charge to tax must be found specifically mentioned in the Act and in the absence of there being a charging section in Chapter X of the Act, it was not possible to read a charging provision into Chapter X. Further, the said Chapter was a machinery provision to arrive at the ALP of a transaction and even income arising from International Transaction must satisfy the test of 'income' under the Act and must find its home in the charging provisions of the Act.

(g) Consequently, the issue of shares at a premium by the petitioner to its non-resident holding company did not give rise to any income from an International Transaction. Thus, no occasion to apply Chapter X of the Act can arise in such a case.

II. Payments made by resident agents to residents by way of advertising and publicity charges not an international transaction under section 92B. Mere fact that foreign principals also benefited from such charges does not entail the right to deny deduction under section 37(1)

CIT v. NGC Networks (India) Private Limited (50 taxmann.com 240) (Bombay High Court) – Assessment Year: 2005-06

Facts

The assessee a company incorporated in India and engaged in the business of distribution of T.V. channels popularly known as National Geographic and History Channel and also acts as airtime advertising Sales Representative for its principals NGC Network Asi a LLC ("NGC Asia") which operates the National Geographic Channel and Fox International Channels (US) Inc. ("FOX") which owns and operates "the History channel". Under Advertisement-sales agreements, the respondent assessee would solicit advertisers, who wish to advertise "on air" during the telecast of the aforesaid channels in their capacity as agents of the principals, namely, NGC Asia and FOX. By way of agency commission the assessee would earn 15% of the net billed advertising charges collected by the Respondent and balance 85% was remitted by the assessee to the foreign principals.

The AO noted that the assessee had claimed expenses towards head advertising and publicity under section 37(1) of the Income-tax Act, 1961 ('Act'), which benefited not only itself but also the foreign principals i.e. "NGC Asia" and "FOX". Accordingly, only 33.33% of the total amount was held to be allowable under section 37(1) of the Act.

Judgment

The Hon'ble Bombay High Court dismissed the appeal of the Revenue and held that:

(a) The foreign principle, admittedly having the assessee as its agent, would naturally benefit from advertising carried on by agent in India.

However, these benefits were not ascertainable nor taxable in view of extra territory.

(b) The assessee had not suppressed any information and had offered to tax its income from both business, namely, distribution business as well as advertisement and promotion business.

(c) Following the decision of Sassoon J. David (supra), the High Court held that the mere fact that foreign principals also benefited did not entail the right to deny deduction under section 37(1).

(d) It was also not necessary that the foreign enterprises must compensate the Indian agent for the benefit it received or it may receive from the advertisement and promotion of its channels by agent in India. The agent in India earned commission from ad-sales and distribution revenue, both of which have sufficiently compensated the assessee.

B) Tribunal Decisions

I. Supervisory PE – whether the supervisory activities carried out in India by the employees of a German company (assessee) in relation to the projects carried out in India, constitutes a Permanent establishment (PE) for assessee in India – Held : No – both under the Indian Income-tax Act as well as the India-Germany DTAA

M/s. GFA Anlagenbau Gmbh vs. ADIT [TS-383-ITAT-2014(HYD)] – Assessment Years : 2005-06 to 2009-10

Facts

Assessee, a company incorporated in Germany, is engaged in the activity of supervision, erection, and commissioning of plant and machinery of steel and allied plants in India. During the relevant tax year, F Co rendered technical and supervisory services to various Indian Companies. Assessee engaged experienced foreign technicians at the work sites and other places in India to carry out technical and supervisory activities and the receipts from such contracts were categorised as FTS. Period of stay of the technicians deputed for supervising one of the projects in India exceeded 183 days during the relevant tax year. The Tax Officer contended that since assessee's activities in India continued for a period exceeding six months, Assessee has a PE in India under India-Germany DTAA. Further, services rendered in the nature of FTS were also effectively connected to the PE constituted and, hence, income from such services was taxable as business profits.

Decision

(a) Supervisory activities carried out by the technicians in India are taxable as FTS under the ITL. Further, the supervisory activities carried out at project sites in India would not constitute a fixed place PE under the provisions of the ITL as assessee does not have the right to operate such sites independently.

(b) Assessee carries out supervision of projects of I Co, and it does not have any fixed place of business in India.

(c) Supervisory activities by themselves cannot constitute a PE and it should be in connection with a building/construction site of assessee. In the present case, assessee merely provides supervisory activities and does not have a building or construction site or a fixed place at its disposal.

(d) Merely because the technicians stayed in India while supervising the work of assessee in India cannot be considered that their place of stay can be regarded as "fixed place of business" for assessee. Thus, the activities being technical in nature clearly falls under the FTS definition of the India-Germany DTAA and the same is not effectively connected to a PE as assessee does not have a fixed place of business through which its activities are carried out.

(e) Contracts in India cannot be aggregated in absence of any link between them and should be individually assessed for the duration test.

II. Tax Rate on Royalty – whether benefit of lower rate of tax, as provided in India-UK Double Taxation Avoidance Agreement (DTAA), is available on royalty paid to a resident of UK (who is not the beneficial owner), where however, the beneficial owner of such royalty, is also a resident of UK – Held : Yes – in assessee's favour.

JC Bamford Investments Rocester v. DDIT [2014] 47 taxmann.com 283 (Delhi - Trib.) Assessment Year 2008-09

Facts

The assessee is a company incorporated in the UK, and is also a tax resident of UK. JC Bamford Excavators Ltd., UK (JCBE UK) was a group company of the assessee, and was also incorporated as well as a tax resident of UK.

JCBE UK entered into a Technology Transfer Agreement (Agreement) with another group company incorporated and a tax resident of India, JC Bamford India Ltd. (JCBI). Under the Agreement, JCBE UK granted licence for the know how and related technical documents consisting of all drawings and designs [intellectual property (IP)] with an exclusive right to manufacture and market excavator loaders in the territory of India. The consideration towards exploitation of IP was paid by JCBI to JCBE UK, and was characterised as royalty.

Subsequently, JCBE UK, JCBI and the assessee entered into a tripartite agreement (TA) pursuant to which IP was sub-licenced to the assessee subject to right of JCBI to continue to exploit IP. As a result, JCBI started paying royalty to the assessee. The assessee, in turn, paid 99.50% of the royalty received from JCBI to JCBE UK, while retaining 0.50% as its income.

The assessee invoked the DTAA which provides that royalties will be taxable in India at the rate of 15% if the beneficial owner of such royalties is a resident of the UK. The assessee, accordingly, applied 15% rate on the royalty income received from JCBI. The Tax Officer, however, denied DTAA benefit and instead, applied the rate of 20% as provided under the Indian Tax Laws (ITL). The core contention of the Tax Officer was that the assessee was not "beneficial owner" of the royalty, as it was merely acting as a conduit since it subsequently passed on such income to JCBE UK after retaining 0.5%. In other words, as JCBE UK was the "beneficial owner" of the royalty received from JCBI, and not the Assessee, which was a mere conduit, the benefit of 15% tax rate was inapplicable.

Decision:

The Tribunal held that –

(a) In terms of the ITL, the provisions of either the ITL or the DTAA, whichever is beneficial to assessee, shall apply. In the present case, the DTAA rate of tax (i.e., 15% as compared to 20% provided in the ITL) is beneficial to the assessee, and accordingly, the DTAA rate should apply. The applicability of the lower rate is subject to the satisfaction of the requisites of being a "resident" of either India or UK, and the "beneficial owner" thereof.

(b) The DTAA applies to persons who are "residents" of either India or UK or both the States. As such, benefits of the DTAA are meant to be given only to residents of either India or UK, and not to residents of any third State. In certain circumstances, formal recipient of income may be resident of one of the States but the beneficial owner of such income may be the resident of a third State and *vice versa*. Tax relief in the source State (i.e., India) depends on whether the beneficial owner, not the formal recipient of the amount, is a resident of the other State (i.e., UK).

(c) Applying this principle, the benefit of the lower rate of DTAA is not available if the "beneficial owner" of the royalty is not a resident of UK. The Tax officer's contention that DTAA benefit is not applicable as recipient is not the "beneficial owner" of the royalty is not valid. The requirement for applicability of lower rate of DTAA is that the "beneficial owner" should be the "resident" of UK. It is not that if the formal recipient, a resident of UK, is not the beneficial owner, then the benefit is lost, notwithstanding the fact that the beneficial owner is also the resident of UK.

III. Whether the entire profits on freight income, which also comprised slot charter arrangement with third party feeder vessels, is covered under Article 8 of the India–Malaysia DTAA – Held : Yes – in assessee's favour:

M/s. MISC Berhad vs. ADIT TS-418-ITAT-2014(Mum) – Assessment Year: 2004-05

Facts

The assessee is a tax resident of Malaysia. The assessee is engaged in the business of shipping in international traffic. The assessee operates ships that are either owned by it or taken on lease.

In so far as the shipping business from India is concerned, the assessee books cargo from shippers/customers in India up to the final destination port, with all risks and responsibility. The bill of lading is issued for the entire voyage.

The assessee, under a slot charter arrangement, arranges for transport of cargo from the Indian port to the hub port, using the service of feeder vessels which are owned by a third party. From the hub port, the assessee's containers are transhipped on the mother vessel, which are owned/leased by the assessee, and from the hub port it is carried to the final destination port.

Decision

The Tribunal held that –

(a) The activity of "operation of ships" carried on by a person cannot be understood merely as a person who operates the ships. It has to be understood in the broader sense of carrying out shipping activity. Carrying out of shipping activity could be as an owner or as a lessee or as a charterer of a ship. Where the word "owner" has to be inferred as a person who owns a ship and the word "lessee" as one who owns a ship for a given lease period, the word "charterer" has to be understood as a person who charters/hires a ship for a voyage.

(b) Transportation of cargo in the container belonging to the assessee from the Indian port i.e., the port of booking to the hub port through feeder vessel by way of space charter/slot charter arrangement falls within the ambit of the word "charterer". This component cannot be segregated form the scope of "operation of ships" as defined in Article 8 of the Malaysia DTAA.

(c) The voyage between the Indian port to the hub port through feeder vessel and from the hub port to the final destination port through mother vessel owned/leased by the assessee are inextricably linked and there is complete linkage of the voyage. Therefore, the entire profits derived from the transportation of goods carried on by the assessee is to be treated as profits from operation of ships and, therefore, the benefit of Article 8 cannot be denied to the assessee on the part of the freight from voyage by the feeder vessels.


CA Rajkamal Shah & CA Naresh Sheth

INDIRECT TAXES

Service Tax – Statute Update

1. Extension of Due date for submission of Service Tax Returns

The Due Date for submission of Service Tax Returns (Form ST-3) for half year ended on 30th September, 2014 has been extended from 25th October, 2014 to 14th November, 2014.

(Order No. 2/2014–Service Tax dated 24th October, 2014)

2. Levy of Service Tax on inward remittances from abroad to beneficiaries through Money Transfer Service Operator (MTSO)

Earlier Circular No. 163/14/2012–ST, dated 10th July, 2012, was clarifying the Service Tax implications of the activities involved in the inward remittance from abroad. The said circular is now superseded by Circular No. 180/06/2014-ST dated 14-10-2014.

The entire sequence of the in remittances of money from overseas through the Money Transfer Service Operator (MTSO) route is as under:

- Remitter located outside India (say 'A') approaches MTSO/BANK (say B) located outside India for remitting the money to a beneficiary in India. 'B' charges a fee from 'A'.
- B' avails the services of an Indian entity (agent i.e. 'C') for delivery of money to the ultimate recipient of money in India (say 'E'); 'C' is paid a commission/fee by 'B'.
- 'C' may avail service of a sub-agent (D). 'D' charges fee/commission from 'C'.
- 'C' or 'D', as the case may be, delivers the money to 'E' and may charge a fee from 'E'.

Service Tax implications of above referred transactions are clarified by CBEC as under:

Sr. No.	*Issues*	*Clarification*
1	Whether service tax is payable on remittance received in India from abroad?	No service tax is payable *per se* on the amount of foreign currency remitted to India from overseas. As the remittance comprises money, it does not in itself constitute any service in terms of the definition of 'service' as contained in clause (44) of section 65B of the Finance Act, 1994.

2	Whether the service of an agent or the representation service provided by an Indian entity/bank to a foreign money transfer service operator (MTSO) in relation to money transfer falls in the category of intermediary service?	Yes. The Indian bank or other entity acting as an agent to MTSO in relation to money transfer, facilitates in the delivery of the remittance to the beneficiary in India. In performing this service, the Indian Bank/entity facilitates the provision of Money Transfer Service by the MTSO to a beneficiary in India. For their service, agent receives commission or fee. Hence, the agent falls in the category of intermediary as defined in rule 2(f) of the Place of Provision of Service Rules, 2012.
3	Whether service tax is leviable on the service provided, as mentioned in point 2 above, by an intermediary/agent located in India (in taxable territory) to MTSOs located outside India?	Service provided by an intermediary is covered by rule 9 (c) of the Place of Provision of Service Rules, 2012. As per this rule, the place of provision of service is the location of service provider. Hence, service provided by an agent, located in India (in taxable territory), to MTSO is liable to service tax. The value of intermediary service provided by the agent to MTSO is the commission or fee or any similar amount, by whatever name called, received by it from MTSO and service tax is payable on such commission or fee.
4.	Whether service tax would apply on the amount charged separately, if any, by the Indian bank/entity/agent/sub-agent from the person who receives remittance in the taxable territory, for the service provided by such Indian bank/entity/agent/sub-agent	Yes. As the service is provided by Indian bank/entity/agent/sub-agent to a person located in taxable territory, the Place of Provision is in the taxable territory. Therefore, service tax is payable on amount charged separately, if any.
5.	Whether service tax would apply on the services provided by way of currency conversion by a bank /entity located in India (in the taxable territory) to the recipient of remittance in India?	Any activity of money changing comprises an independent taxable activity. Therefore, service tax applies on currency conversion in such cases in terms of the Service Tax (Determination of Value) Rules. Service provider has an option to pay service tax at prescribed rates in terms of Rule 6(7B) of the Service Tax Rules, 1994.
6.	Whether services provided by sub-agents to such Indian bank/entity located in the taxable territory in relation to money transfer is leviable to service tax?	Sub-agents also fall in the category of intermediary. Therefore, service tax is payable on commission received by sub-agents from Indian bank/entity.

(Circular No. 180/06/2014–ST dated 14th October, 2014)

3. Changes in Jurisdiction of Service Tax, Mumbai Commissionerate w.e.f. 15-10-2014

Under each of Mumbai Commissionerate, 10 (Ten) Divisions have been created and under each Division, 4 (Four) Ranges have been created for the convenience of trade and industry. The jurisdiction of the said Divisions and Ranges are based on alphabetical and some Special Groups of "Taxable Service". A person is primarily providing specific service namely Banking Service, General Insurance Service, Life Insurance Service, Telecommunication Services, Broadcasting Services or Airlines Services, they would be placed under a specified Division and Range irrespective of their names commencing with a particular alphabet. Further, to decide whether a particular assessee is providing a specified service, the main service provided by them in terms of revenue would be the determining factor. To illustrate, if a person is providing six services, but if their main service is General Insurance Service in terms of revenue, in that case that assessee should be treated as providing General Insurance Service for the purpose of taking registration with a particular Division.

TRADE NOTICE No. 06/ST-2014-15
JURISDICTION OF SERVICE TAX-I MUMBAI COMMISSIONERATE

Service Tax—I, Mumbai Comrnissionerate **Office Address:** 5th Floor, Central Excise Building, 115, M.K. Road, Churchgate, Mumbai — 400 020	Areas 'A' Ward of the Municipal Corporation of Greater Mumbai of the State of Maharashtra comprising postal Pin Code Nos. 400 001, 400 005, 400 021, 400 023, 400 038 and 400 039 (excluding the areas covered under Pin Code No. 400 020 of the said Ward 'A') and in the areas in the Continental Shelf, or as the case may be in the exclusive economic zone of India declared as designated areas by the Central Government from time to time.

Address of all Divisions under Service Tax — I Mumbai Commissionerate - 1st Floor, Construction House, Walchand Hirachand Marg, Ballard Estate, Mumbai-400 001

TRADE NOTICE No. 07/ST-2014-15
JURISDICTION OF SERVICE TAX-II MUMBAI COMMISSIONERATE

Service Tax—II, Mumbai Comrnissionerate **Office Address:** 5th Floor, Central Excise Building, 115, M.K. Road, Churchgate, Mumbai — 400 020.	Areas 'A' Ward of the Municipal Corporation of Greater Mumbai of the State of Maharashtra comprising postal Pin Code No. 400020 (excluding Pin Codes 400 001, 400 005, 400 021, 400 023, 400 038 and 400 039 of the said Ward 'A') along with wards 'B' 'C' 'D' 'E' 'F' (North)and 'F; (South) of the Municipal Corporation of Greater Mumbai in the State of Maharashtra.

Address of all Divisions under Service Tax — II Mumbai Commissionerate - 1st Floor, Old Custom House, S. B. Marg, Fort, Mumbai – 400 023.

TRADE NOTICE No. 08/ST-2014-15
JURISDICTION OF SERVICE TAX-Ill MUMBAI COMMISSIONERATE

Service Tax – III, Mumbai Commissionerate **Office Address**: 2nd Floor, Madhu Industrial Estate, P.B. Marg, Worli, Mumbai – 400 013.	Areas in Wards G (North) and G (South) of the Municipal Corporation of Greater Mumbai in the State of Maharashtra.

Address of Divisions under Service Tax – III Mumbai Commissionerate - 2nd Floor, Madhu Industrial Estate, P.B. Marg, Worli, Mumbai- 400 013.

TRADE NOTICE No. 9/ST-2014-15
JURISDICTION OF SERVICE TAX-IV MUMBA1 COMMISSIONERATE

Service Tax – IV, Mumbai Commissionerate **Office Address:** 2nd Floor, Madhu Industrial Estate, P.B. Marg, Worli, Mumbai – 400 013.	Areas in Wards H (East) and H (West), of the Municipal Corporation of Greater Mumbai in the State of Maharashtra.

Address of Divisions under Service Tax – IV Mumbai Commissionerate – 2nd Floor, Madhu Industrial Estate, P.B. Marg, Worli, Mumbai- 400 013.

TRADE NOTICE No. 10/ST-2014-15
JURISDICTION OF SERVICE TAX-V MUMBAI COMMISSIONERATE

Service Tax – V, Mumbai Commissionerate **Office Address:** Utpad Shulk Bhavan, Bandra Kurla Complex, Bandra East, Mumbai – 400 051.	Areas comprising in the K (East) Ward of Municipal Corporation of Greater Mumbai in the State of Maharashtra.

Address of Divisions under Service Tax – V Mumbai Commissionerate – 2nd Floor, Madhu Industrial Estate, P.B. Marg, Worli, Mumbai- 400 013.

GUIDELINES FOR EXISTING ASSESSEES

Updation in the ACES to incorporate new jurisdiction of all assessees may take some time. However the assessees would be able to file their Service Tax Returns, make payments of Service Tax, or carryout any other activity with the ACES or through the banks with the existing jurisdiction

details only. It is clarified that till updation in the ACES is carried out, assessees would be able to carry out all their key business process based on the present jurisdiction. Once the ACES system is updated, the necessary migration of the assessees to their new jurisdiction would be completed by the department.

A list of all existing registered assessees showing their present jurisdiction and new jurisdiction is being placed on the website http://www.servicetaxmumbai.gov.in . All the assessees are requested to verify their new Commissionerate, Division and Range by logging to the said website. Query, if any, may please be emailed to helpdesk.st-mum@nic.in immediately for taking corrective action.

In order to facilitate the transition, a helpline No. 022-2261 1241 would be available between 10.00 hrs and 18.00 hrs. up to 31st October, 2014.

The jurisdiction in the case of an assessee who has obtained a centralised registration for more than one premises in terms of Rule 4 of Service Tax Rules, 1994 shall also extend to the jurisdiction of such other Principal Commissioner of Service Tax or Commissioner of Service Tax, in whose jurisdiction, the other premises of the said assessee are located.

PROCEDURE FOR APPLYING FOR NEW REGISTRATION

The procedure for obtaining new registration after 15th October, 2014, has been detailed in Para 6 of the Trade Notice No. 1/2014-ST dated 7-10-2014, issued by Chief Commissioner of Central. Excise and Service Tax, Mumbai Zone-I.

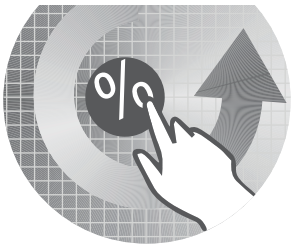
(F.No V./ST-I/HQ/Tech/Trade Notice (NC)/153/2014-15
Mumbai, October, 2014).

There is to be found in every religion the manifestation of the struggle toward freedom. It is the groundwork of all morality, of unselfishness, which means getting rid of the idea that human beings are the same as this little body.

— *Swami Vivekananda*

This life is a hard fact; work your way through it boldly, though it may be adamantine; no matter, the soul is stronger.

— *Swami Vivekananda*



CA Bharat Shemlani

INDIRECT TAXES

Service Tax – Case Law Update

1. Services

Information Technology Software Service

1.1 Tech Mahindra Ltd. vs. CCE, Pune-III 2014 (35) STR 241 (Mum.)

In this case the subsidiary of the appellant incorporated in USA acted as sub-contractor and provided software and related services. Subsidiary company was to provide personnel, but overall responsibility of service was with the appellant. The High Court held that, the appellant company could not derive any advantage by bifurcation and arrangement between them and their American subsidiary. Provider of services was Indian subsidiary outside India and its recipient was also outside India, hence activity of the appellant could not be termed as export of service from India in terms of rule 3(2) of ESR, 2005 as they existed at the relevant time i.e. up to 27-2-2010.

It is further held that, since the refund claim as made neither invoking any specific provision nor in prescribed format and time hence, such claim is not sustainable as it has to be decided in accordance with legal provisions and compliance with procedural formalities set out therein.

Business Auxiliary Service

1.2 Provincial Life Style Retail Services vs. CCE, Nagpur 2014 (36) STR 305 (Tri.-Mumbai)

In present case, the appellant claimed benefit of Notification No. 13/2003-ST available to commission agent. The Tribunal observed that, the appellant has undertaken various other functions not envisaged in the said Notification such as display and sale of stock, design, maintenance of showrooms, appointing additional agents and bearing expense of running showrooms on behalf of principal for which management fees is received on turnover achieved. Further receipts/cash memos indicated sales tax registration of principal's name. In view of the same, it is held that appellant is not eligible for benefit of Notification No. 13/2003-ST.

1.3 CCE, Kanpur vs. Shri Shanker Engg. Works 2014 (36) STR 436 (Tri.-Del.)

The department in this case sought to tax fabrication, erection and installation of steel storage tanks, dozers, settlers etc. under BAS. The Tribunal held that, ground of appeal failed to mention specific clause of definition of BAS. Fabrication of steel storage tanks and structures amounts to manufacture and erection or installation is not covered under BAS.

1.4 Alpine Modular Interiors (P) Ltd. vs. CST (Adj.) New Delhi 2014 (36) STR 454 (Tri.-Del.)

The appellant in this case provided services to customer in Hong Kong which were utilised

abroad and consideration thereon is received in CFE. It is held that, transactions fall within the ambit of ESR, 2005 as concluded in *Paul Merchants Ltd. 2013 (29) STR 257 (Tri.).*

1.5 Vishal Packaging vs. CCE, Raipur 2014 (36) STR 465 (Tri.-Del.)

The Tribunal in this case held that, process of making of corrugated boxed from craft paper on job work basis amounts to manufacture and therefore not liable to service tax under BAS.

1.6 Deshmukh Services vs. CCE, ST&C, Nagpur 2014 (36) STR 100 (Tri.-Mumbai)

The Tribunal in this case held that, multi-piece packaging done on soaps already packed amounts to repacking and accordingly covered under definition of manufacture under section 2(f)(iii) of CEA, 1944. It is also held that, Notification No. 8/2005-ST applicable as goods returned to supplier after undertaking job work for further manufacture.

1.7 TCS E-Serve Ltd. vs. CST, Mumbai-II 2014 (36) STR 132 (Tri.-Mumbai)

The appellant in this case provided computerised data processing services in relation to banking and financial services to clients' group entities. The Tribunal held that, since services provided are in relation to Banking and Financial Services, the question of providing services incidental or ancillary to any customer care services does not arise. Further, services are included under ITSS, therefore specifically excluded from BAS.

Intellectual Property Service

1.8 Thermax Ltd. vs. CCE, Pune-I 2014 (36) STR 318 (Tri.-Mumbai)

The appellant in this case due to out of court settlement became co-owner of IPR i.e. trade secrets or confidential information. The department sought to tax them under IPR service. The Tribunal held that, there is no law relating to trade secrets or confidential information in India as such they are not IPR as defined in FA, 1994. Further in OIO there is no mention of type of IPR acquired. In view of the same the OIO imposing demand is unsustainable.

Banking & Other Financial Service

1.9 Vidarbha Iron & Steel Coporation Ltd. vs. CCE, Nagpur 2014 (36) STR 324 (Tri.-Mumbai)

The department in this case sought to tax lease agreement for land, plant and machinery under BFS. The Tribunal held that, the assessee is neither bank nor NBFC nor non-banking institution. Further, leasing activity cannot fall under BFS, if no transfer of assets at the end of lease term and no transfer of risks and rewards incidental to ownership is there. In view of the same, the OIA is not sustainable.

Management Consultancy Service

1.10 GlaxoSmithKline Pharmaceuticals Ltd. vs. CST, Mumbai-I 2014 (36) STR 349 (Tri.-Mumbai)

The appellant in this case engaged in activity of jointly carrying of day-to-day functions of business of companies as per agreement of merger between them. The department construed the said agreement as Management Consultancy Service. The Tribunal observed that, nothing in said agreement relates or refers to management consultancy services and terms and conditions relating to rendering of executory services and sharing of cost proportionately for same in said agreement. It is held that, there is no evidence produced by the department of rendering of any consultancy in field of management by assessee and hence OIO is required to be set aside.

Consulting Engineer's Service

1.11 Crompton Greaves Ltd. vs. CCE, Mumbai-III 2014 (36) STR 358 (Tri.-Mumbai)

The appellant in this case rendered services as sub-contractor for the period prior to

1-5-2006. The Tribunal held that issue is settled by various Tribunal decisions and Board Circular dated 4-7-1997 wherein it was clarified that, sub-consultant is not liable to pay Service Tax where services rendered to prime consultant, hence the impugned is not sustainable.

1.12 ACC Ltd. vs. CST, Mumbai 2014 (36) STR 405 (Tri.-Mumbai)

The Tribunal in this case held that, burden to produce documents for claiming non-taxability lies on the appellant. In absence of evidence, presumption goes against appellant and the order in appeal cannot be questioned. Further, the appellant did not disclose receipt of consideration for services rendered, which clearly amounts to wilful misstatement of facts.

Business Support Service

1.13 Agricultural Produce Market Committee vs. CCE, Nagpur 2014 (36) STR 382 (Tri.-Mumbai)

The appellant in this case collected market fees from farmers for providing infrastructural support and other facilities. The department sought to tax them under BSS. The Tribunal held that, CBEC Circular No. 157/8/2012-ST dated 27-4-2012 clarified that APMC is not rendering any service to licensees and market fees is not in the nature of consideration for such service. APMC provided basic facilities to farmers, purchasers and others and such services are classifiable as BAS and covered by exemption Notification No. 14/2004-ST.

1.14 JM Financial Services Pvt. Ltd. vs. CST, Mumbai-I 2014 (36) STR 151 (Tri.-Mumbai)

The Tribunal in this case held as under:

- IPO financing received from NBFC is not liable to service tax under BAS.
- Reimbursement received of common expenses such as electricity and other expenses is just share of expenses and not liable under BSS as infrastructural support service.

Health & Fitness Service

1.15 Manav Sansadhan Vikas ani Sansodhan Manch vs. CCE, Pune-III 2014 (36) STR 385 (Tri.-Mumbai)

The appellant in this case engaged in treatment of ailments by combination of yoga and medicine. They have booklet named 'Lifesaver' providing names of 20 asanas taught in institution. The Tribunal observed that, the appellant is trust registered to teach yoga and yoga is therapeutic and restorative, therefore services provided by them are covered under Health & Fitness Service.

Storage & Warehousing Service

1.16 Inox Air Products Ltd. vs. CCE, Raigad 2014 (36) STR 391 (Tri.-Mumbai)

The appellant imported helium in tanks and paid rent on insulted tanks in which helium imported. The Tribunal held that, CBEC Circular No. B11/1/2002-TRU dated 1-8-2002 clarified that mere renting of space not to be in nature of service provided for storage and warehousing of goods. The essential test is whether storage keeper provides for security of goods, stacking, loading/unloading of goods etc. Since exporter of helium is not having control over tanks, service tax is not applicable on the said services.

Conmmercial//Industrial Construction Service

1.17 Sunil Hitech Engineers Ltd. vs. CCE, Nagpur 2014 (36) STR 408 (Tri.-Mumbai)

The appellant in this case contended that, since main contractor has discharged service tax liability on value inclusive of value of services rendered by sub-contractor they are not liable to pay service tax. The Tribunal held that, sub-contractor was not exempt from payment of service tax and was still liable to pay it. The various circulars issued by the CBEC were service specific and no general proposition had

been laid therein. It is further held that, since suppression of facts have been proved against assessee and therefore extended period of time found to be invocable for demand. It is also held that, *mens rea* is not required for penalty under sections 76 and 77.

Manpower Recruitment or Supply Agency Service

1.18 Samarth Devabhavi Trust vs. CCE Aurangabad 2014 (36) STR 83 (Tri.-Mumbai)

The department in this case sought to demand tax on harvesting and transportation of sugarcane from farmers' field to sugar factory. The Tribunal observed that, agreement is not for supply of labour and consideration is paid on the basis of sugarcane tonnage supplied hence, it is held that activity does not amount to manpower supply.

2. Interest/Penalties/Others

2.1 IFGL Exports Ltd. vs. CCE & ST, Rajkot 2014 (36) STR 311 (Tri.-Ahmd.)

In this case the Tribunal rejected refund application filed under Notification Nos. 9/2009-ST and 17/2011-ST as the appellant failed to submit certain documents as the requirement of the said Notifications has not been complied with.

2.2 Neel Sidhi Enterprises vs. CST, Mumbai-II 2014 (36) STR 346 (Tri.-Mumbai)

The appellant a builder, collected amount as 'contingent liability' from buyers of flats as per Circular issued by DGST dated 16-2-2006 stating service tax liability arising under Works Contract Service. Thereafter returned the said amounts after issuance of CBEC Circular No. 108/2/2009 dated 29-1-2009 clarifying that amount is not required to be collected by builder. The Tribunal held that, as such amount was not collect as 'service tax' but as 'contingent liability' by way of precaution and as per DGST Circular dated 16-2-2006, provision of section 73A(2) of FA, 1994 is not attracted to facts of the case.

2.3 CCEC&ST, Visakhapatnam-I vs. Divis Laboratories Ltd. 2014 (36) STR 398 (Tri.-Bang.)

The appellant in this case paid service tax on CHA service and filed refund claim under Notification No. 9/2009-ST after 2 years which was allowed by Commissioner (Appeals). The department filed appeal against the same. The Tribunal held that, according to clause 2(f) of Notification No. 9/2009-ST claim for refund shall be filed within six months or such extended period as AC/DC may permit. Since the assessee eligible for refund and this was initial period of implementation of new procedure, observations of Commissioner (A) are valid and in accordance with law in condoning delay.

2.4 CST, Mumbai vs. Union Bank of India 2014 (36) STR 470 (Tri.-Mumbai)

The Tribunal in this case held that, taxable event is the rendering of services and demand raised based on rate of tax applicable on date of receipt of payment is not sustainable.

2.5 Sadguru Construction Co. vs. UOI 2014 (36) STR 3 (Guj.)

The High Court in this case held that, the CBEC Circular No. 170/5/2013-ST dated 8-8-2013 clarifying at point No. 8 that person who has made payment of tax dues before STVCE Scheme is notified i.e. before 10-5-2013 and later on made declaration under the scheme was not entitled for immunity from interest and penalty was counter to statutory provisions. The Scheme permits a person to declare his tax dues, even amount deposited before 10-5-2013, as long as same was done after 1-3-2013. If concept of making a declaration under Scheme which cannot be done till Scheme is formulated is brought into operation, it would run contrary to clarification to point No. 4 that party against whom inquiry/investigation/audit had been initiated after 1-3-2013 could make declaration under the scheme.

2.6 Infinity Infotech Parks Ltd. vs. UOI 2014 (36) STR 37 (Cal.)

The High Court in this case held that, CERA team of CAG of India can inspect records lying at premises of Government company or a company which received any grant/loans/ aid from the Government or any Government undertaking, or when there is a request for the same from President of India or Governor of State. On facts, the audit of the appellant company by CERA team is illegal and unsustainable.

2.7 CST, Mumbai vs. Diotech India Ltd. 2014 (36) STR 96 (Tri.-Mumbai)

The Tribunal in this case held that, adjustment of non-refundable registration fees towards first purchase made by clients ought to be added to gross value of taxable service.

2.8 Ador Fontech Ltd. vs. CCE, Nagpur 2014 (36) STR 146 (Tri.-Mumbai)

The appellant in this case claimed deduction under Notification No. 12/2003-ST for value of material and consumables used for rebuilding old worn out rollers, liners etc. as they have paid appropriate VAT on the same. The Tribunal observed that, the goods have been cleared under consolidated invoice and no separate invoice is raised regarding sale of goods and materials. The ratio of Tribunal decision in *Wipro GE Medical Systems Pvt. Ltd. 2009 (14) STR 43 (Tri.)* is not applicable as materials used for repairs and not as spare parts.

3. CENVAT Credit

3.1 Market Creators Ltd. vs. CCE&ST, Vadodara 2014 (36) STR 386 (Tri.-Ahmd.)

The Tribunal in this case held that, appellant cannot take credit on the basis of documents issued by the premises not registered as an Input Service Distributor under CCR, 2004. Further, extended period of limitation is invocable as it is never brought to the knowledge of department that CENVAT credit is taken on documents issued by unregistered ISD.

3.2 Saboo Coatings Ltd. vs. CCE, Chandigarh 2014 (36) STR 447 (Tri.-Del.)

The appellant in this case availed CENVAT credit of service tax on digital photographs required for brochure/catalogue for sales promotion. The department denied credit on the ground that appellant did not disclose in returns that credit has been availed in respect of digital photographs. The Tribunal held that, there is no column in return to show the nature of input service and non disclosure of facts not required to be disclosed in law cannot attribute suppression. It is further held that, when credit is denied on photographs used for brochure meant for sale, production of brochure before Commissioner (A) cannot be held additional evidence.

3.3 Venus Wire Industries Pvt. Ltd. vs. CCE, Mumbai-III 2014 (36) STR 475 (Tri.-Mumbai)

The Tribunal in this case allowed CENVAT credit of service tax paid on fumigation expenses considering them as in the nature of packing expenses.

3.4 CCE, Surat vs. Remi Metals Gujarat Ltd. 2014 (36) STR 158 (Tri.-Ahmd.)

The Tribunal in this case held that, commission paid for selling activity is a part of sales promotion and credit of the same is admissible as category of sale promotion specifically covered under definition of input service.

3.5 CCE, Vadodara-II vs. Siemens Healthcare Diagnostic Ltd. 2014 (36) STR 192 (Tri.-Ahmd.)

The Tribunal in this case after relying on High Court decisions held that, CENVAT credit of service tax paid on rent, security and maintenance service is admissible even though the said services are rendered beyond the place of manufacture.

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Company Law Update

Case Law No. 1

[2014] 186 Comp Cas 290 (CLB) – [Before the Company Law Board – Mumbai Bench] – Nitin Mukund Sahasrabhojanee and Another v. Venus Automation P. Ltd and Others

The CLB has power under section 402 of the Companies Act, 1956 to provide relief from compliances of provisions and procedure under section 77A related to buy-back of shares and Rules made thereunder if it is not going to be prejudice the interest of anybody and there is no loan from bank which restrict the reduction of capital.

Brief Facts

The Petitioner has filed the petition under sections 397 and 398 read with section 402 of the Companies Act, 1956 ("Act") before the Hon'ble Company Law Board, Western Region, Mumbai Bench ("CLB"). The petition is related to oppression and mismanagement purportedly committed by the respondents.

The petitioner has also filed an application for direction to be given to the respondent company to file Form 32 for the removal of petitioner as director.

During the course of negotiation and settlement, the parties have arrived at mutual settlement. Both the parties have filed an application with consent sheet giving the consent terms. The parties have sought for certain relaxation for procedural compliances under section 77A of the Act and the Private Limited Company and Unlisted Public Limited Company (Buy-Back of Securities) Rules, 1999 ("Rules") related to buy-back of shares. The relaxations sought are as follows.

1. To buy back shares in excess of 25% of total paid-up capital and free reserves.
2. No requirement of passing a special resolution.
3. To complete buy- back in next one year and not to observe the requirement of maintaining debt-equity ratio.
4. No requirement to deposit the buy-back money into separate bank account.
5. No requirement to pay the money within 7 days to those share holders, whose offer has been accepted.

The query raised is whether the CLB has power under section 402 of the Act to pass an order to relax the compliance of the provisions of section 77A of the Act.

From the petitioner side, it is submitted that CLB under section 402 has power to exempt the company from the compliance of section 77A of the Act and rules made therein. In its submission, reliance was placed on various judgments of Company Law Board have been referred as to the power of CLB under section 402 of the Act.

The said judgments are in case of *(1) Gurmit Singh v. Polymer Papers Ltd. [2005] 123 Comp Cas 486 (CLB); (2) Debi Jhora Tea Co. Ltd. v. Barendra Krishna Bhowmick [1980] 50 Comp Cas 771(Cal)* and *(3) Cosmosteels P. Ltd v. Jairam Das Gupta [1977] (CC2) GJX 0073 (SC); [1978] Comp Cas 213 (SC).*

Judgment and reasoning

CLB has allowed the reliefs sought by the parties as mentioned above relaxing certain compliances under the provisions of section 77A of the Act read with rules made thereunder. CLB has considered the submission made by the petitioner along with the judgments referred therein. It has also considered the decision in *(1) Rajahmundry Electric Supply Corporation Ltd. v. A. Nageswara Rao [1956] 26 Comp Cas (AP) and (2) Harikumar Rajah v. Sovereign Dairy Industries Ltd. [2001] 106 Comp Cas 191 (CLB); [2001] CLC 1162 (CLB).* The CLB has noted that if exemption is granted, it is not going to be prejudice the interest of anybody. Further, it has also noted that company does not have any term loan from banks and has no restriction on the reduction of capital.

Case Law No. 2

*[2014] 186 Comp Cas 193 (Mad) – [In the Madras High Court] – T. Kannan and Others v. Shapre Infotech India Ltd. and anot*her.

Under section 237 of the Companies Act, 1956, the investigation of a company can be carried out in two circumstances. First, when a special resolution to that effect is passed or court order for investigation and secondly, at the discretion of the Central Government when the circumstances as mentioned in section are exists.

Brief facts

The petitioner has filed this petition under section 237(a)(ii) of the Companies Act, 1956 ("Act") read with rule 11(9) of the Companies (Court) Rules, 1959 ("Rules"). The petitioner has prayed that to declare that the affairs of the first respondent company ought to be investigated by the Central Government.

The petitioner is a share holder of Shapre Infotech India Ltd (First respondent company or "Company"). The petitioner has submitted as follows.

1. He has subscribed to the shares of the company based on the promise that shares would be listed on other stock exchanges apart from Madras, Bangalore and Hyderabad stock exchanges.
2. He was assured that his Investment in shares will give him the good returns.
3. From beginning, petitioner has not received any notice for any share holders meeting conducted by the company. Even though company was involved in various activities like amalgamation, listing, delisting, etc.
4. A notice was sent to the second respondent and copy to RoC on non - receipt of balance sheet and accounts and annual general meeting.
5. RoC has sought a clarification on the said letters.
6. The petitioner has also received the letter from second respondent that

company is in process to get listed its shares on NSE and BSE.

7. That company has passed a resolution long back for delisting of its shares.
8. Necessary communication were made with Madras Stock Exchange and he was informed that trading in the shares of the company has been suspended due to non-compliances of the listing agreement.
9. Company is getting various offshore projects and has increased its foreign earnings as claimed in director's report and also obtained bank loans, no dividend has been declared till date.

In response, the company has submitted its counter arguments. Based on which, court has noted that ordering investigation would have serious consequences and hence order for verification of company's accounts by a Chartered Accountant. The company then made various petitions for objecting any such verification of accounts on various grounds. The division bench has rejected the objection and concluded that various items and information called by Chartered Accountant does not amount to investigation and rejected the objection of the company.

Judgments and reasoning

The Court has allowed the petition and directed the Central Government to investigate the affairs of the company and to submit report to the court. The court has perused the provisions of section 237 of the Act. Court has observed that said section allows the investigation of a company in two circumstances. First, when a special resolution to that effect is passed or court order for investigation. Secondly, section gives discretion to the Central Government is to whether investigation is called for and only after considering the circumstances as mentioned in sub-clauses (i), (ii) and (iii). Court has observed that company has not taken any steps to list its stock on NSE/ BSE. The respondent has also not provided any evidence as to whether it has complied with the listing agreement and suspension of trading in shares has been revoked. The allegation of de-listing of shares is also not opposed by the company. Court also noted that Chartered Accountant appointed by it for the verification of accounts of the company also has conveyed its inability to express any opinion on verification of accounts due to non- submission of information and documents by the company. Based on the above facts, the court has concluded that the conduct of the business of the company is oppressive to its members and non cooperation of the company with the court appointed chartered accountant shows that it intends to thwart the attempts of the court to do substantial justice to both the parties.

We cannot see outside what we are not inside. The universe is to us what the huge engine is to the miniature engine; and indication of any error in the tiny engine leads us to imagine trouble in the huge one.

— *Swami Vivekananda*

CA Mayur Nayak, CA Natwar Thakrar &
CA Pankaj Bhuta

OTHER LAWS
FEMA Update

In this article, we have discussed recent amendments to FEMA through Circulars issued by RBI and Press Release by Government of India:-

1. Memorandum of Instructions for Opening and Maintenance of Rupee / Foreign Currency Vostro Accounts of Non-resident Exchange Houses

RBI *vide* A.P. (DIR Series) Circular No. 28 [A. P. (FL/RL Series) Circular No. 02] dated February 6, 2008 issued Memorandum of Instructions for opening and maintenance of rupee / foreign currency Vostro accounts of non-resident Exchange Houses, as amended from time to time and also provided a list of permitted items for Rupee Drawing Arrangements with Exchange Houses in the Annex (Last updated *vide* A.P. (DIR Series) Circular No 88 dated January 9, 2014). RBI had specified that Drawing arrangements with Exchange Houses are primarily designed to channel inward personal remittances and under no circumstances, donations / contributions to charitable institutions should be routed through the Exchange Houses.

The RBI has made following changes in the policy for Rupee Drawing Arrangements with Exchange Houses –

- Increase in the limit for Trade transactions from up to ` 2 lakhs up to ` 5 lakhs per transaction (Modification of Entry 10 in the Annex)
- Remittances to the Prime Minister's National Relief Fund through the Exchange Houses subject to the condition that the remittances are directly credited to the Fund by the banks and the banks maintain full details of the remitters. (New Entry No. 14 in the Annex)

All other instructions issued *vide* A.P. (DIR Series) Circular No. 28 [A.P.(FL/RL Series) Circular No. 02] dated February 6, 2008, as amended from time to time, shall remain unchanged.

(A.P. (DIR Series) Circular No. 35 dated 9th October, 2014)

(This is a welcome move to attract inflow of funds from non-resident donors at the time of national calamities. Increase in limit for trade transaction will also help reduce transaction cost.)

2. Foreign Exchange Management Act, 1999 (FEMA) Foreign Exchange (Compounding Proceedings) Rules,

2000 (the Rules) – Compounding of Contraventions under FEMA, 1999

Earlier, RBI *vide* A.P. (DIR Series) Circular no. 117 dated April 4, 2014 has delegated certain powers to the Regional Officers of the RBI to compound the contraventions of FEMA under the Foreign Exchange (Compounding Proceedings) Rules, 2000 notified by the Government of India *vide* G.S.R. No.383 (E) dated 3rd May, 2000, as amended from time to time.

RBI has now decided to delegate further powers to Regional Offices as under:

Sr. No.	*FEMA Regulation*	*Brief Description of Contravention*
1	Regulation 10 A (b)(i) read with paragraph 10 of Schedule I to FEMA 20/2000-RB dated May 3, 2000	Delay in submission of Form FC-TRS on transfer of shares from Resident to Non-Resident.
2	Regulation 10 B(2) read with paragraph 10 of Schedule I to FEMA 20/2000-RB dated May 3, 2000	Delay in submission of Form FC-TRS on transfer of shares from Non-Resident to Resident.
3	Regulation 4 of FEMA 20/2000-RB dated May 3, 2000	Taking on record transfer of shares by investee company, in the absence of certified Form FC-TRS.

Further, with effect from July 15, 2014, the work of three divisions of Foreign Investment Division (FID) viz. Liaison/ Branch/ Project Office(LO/BO/PO) division, Non-Resident Foreign Account Division (NRFAD) and Immovable Property (IP) Division has been transferred to FED, CO Cell, Reserve Bank of India, 6, Sansad Marg, New Delhi – 110 001. Accordingly, the officers attached to the FED, CO Cell, New Delhi office are now authorised to compound the contraventions as under:

Sr. No.	*FEMA Notification*	*Brief Description of Contravention*
1	FEMA 7/2000-RB, dated 3-5-2000	Contraventions relating to acquisition and transfer of immovable property outside India
2	FEMA 21/2000-RB, dated 3-5-2000	Contraventions relating to acquisition and transfer of immovable property in India
3	FEMA 22/2000-RB, dated 3-5-2000	Contraventions relating to establishment in India of Branch Office, Liaison Office or Project Office
4	FEMA 5/2000-RB, dated 3-5-2000	Contraventions falling under Foreign Exchange Management (Deposit) Regulations , 2000

The powers to compound the contraventions at Paragraph 2 and Paragraph 3 above have been delegated to all Regional Offices (except Kochi and Panaji) and FED, CO Cell, New Delhi respectively without any limit on the amount of contravention. Kochi and Panaji Regional offices can compound the above contraventions for amount of contravention below ` 1 cr. The contraventions of ` 1 cr. or more under the jurisdiction of Panaji and Kochi Regional Offices and all other contraventions of FEMA will continue to be compounded at Cell for Effective Implementation of FEMA (CEFA), Mumbai, as hitherto.

Accordingly, applications for compounding the above contraventions as at Paragraph 2 and Paragraph 3 above, up to the amount of contravention stated therein shall be submitted by the concerned entities to the respective Regional Offices under whose jurisdiction they fall or to FED, CO Cell, New Delhi respectively. For all other contraventions, applications may continue to be submitted to CEFA, Foreign Exchange Department, 5th Floor, Amar Building, Sir P.M. Road, Fort, Mumbai – 400 001.

(A.P. (DIR Series) Circular No. 36 dated 16th October, 2014)

(The decentralisation of compounding is a welcome trend. This will reduce pressure on the central office as the number of compounding applications has substantially increased resulting in RBI being unable to process the applications within the statutory time line. The delegation will make the compounding process more accessible and logistically convenient for applicants who are spread out across the country. This would also lead to a lower transaction cost for the applicants.)

3. Print Release – Review of Foreign Direct Investment Policy on the Construction & Development Sector

The Union Cabinet on 29th October, 2014 approved a comprehensive proposal for attracting overseas investment in Construction and Development Sector.

The salient features of the amendments are as follows:

- No minimum land requirements for serviced plots against the requirement of minimum 10 hectares of land. The Indian investee company will be permitted to sell only developed plots and shall also be responsible for obtaining all necessary approvals including those of the building/layout plans, developing internal and peripheral areas and other infrastructure facilities, payment of development, external development and other charges and complying with all other requirements as prescribed under applicable rules/bye-laws/regulations of the State Government/Municipal/Local Body concerned. Investor is no longer liable for such approvals. The State Government/Municipal /Local Body concerned, which approves the building/ development plans, will monitor compliance of the above conditions by the developer.
- The minimum area for construction-development projects has been reduced from 50,000 square metres of 'built-up' area to 20,000 square metres of 'floor area'. The floor 'Floor area' will be defined as per the local laws/regulations of the respective State Governments/Union Territories. Indian company, which is the recipient of FDI, shall procure a certificate from an architect empanelled by any Authority authorised to sanction building plan to the effect that the minimum floor area requirement has been fulfilled.
- The minimum FDI requirement is halved to $ 5 million from existing $ 10 million which is to be brought in within the period of six months from the date of commencement of the project. The commencement of the project will be reckoned from the date of approval of the building plan/lay out plan by the relevant statutory authority.
- The conditions of minimum area (Clause A) and minimum FDI requirement of $ 5 million (Clause B) will not apply to the investee/joint venture companies which commit at least 30 per cent of the total project cost for low cost affordable housing. Projects using at least 60 per cent of the FAR/FSI for dwelling units of Carpet Area and not more than 60 sqm. will be considered as Affordable Housing Projects. In addition, 35 per cent of the total number of dwelling units constructed should be of carpet area 21-27 sqm. for EWS category. Such projects can have a mix of EWS/LIG/Higher Category DUs and commercial units. Provision of servant's quarter along with the main dwelling unit will not be counted as dwelling units for EWS/LIG under Affordable Housing (AH) project.

- The conditions pertaining to minimum area (Clause A), minimum FDI requirement of $ 5 million (Clause B) and early exit (Clause C) will not apply to Hotels and Tourist Resorts, Hospitals, Special Economic Zones (SEZs), Educational institutions, Old Age Homes and Investment by NRIs.

- The investor will be permitted to exit on completion of the project or after three years from the date of final investment, subject to development of trunk infrastructure.

- The Government may, in view of facts and circumstances of a case, permit repatriation of FDI or transfer of stake by one non-resident investor to another non-resident investor, before the completion of the project. These proposals will be considered by FIPB on case to case basis.

- Subsequent tranches of FDI can be brought in till the period of ten years from the commencement of the project or before the completion of the project, whichever is earlier. No such provision was there under earlier policy. Completion of the project will be determined as per the local bye-laws/ rules and other regulations of State Governments.

- The Indian investee company will be permitted to sell only developed plots. For the purposes of this policy "developed plots" will mean plots where trunk infrastructure including roads, water supply, street lighting, drainage and sewerage, have been made a vailable.

- 100 per cent FDI under the automatic route is permitted in completed projects for operation and management of townships, malls/ shopping complexes and business centres.

(These are most practical, long awaited and most welcome amendments in the FDI Policy relating to Construction / Development Sector. With the earlier policy, it was almost impossible to find large pocket of areas which could meet either land requirement of 10 hectares or constructed are consisting of 50,000 sq. metres, especially in the metropolitan regions which needed huge investments in the infrastructure sector. Three year lock-in period also acted as dampener These measures are expected to result in enhanced inflows into the Construction Development sector consequent to easing of sectoral conditions and clarification of terms used in the Policy. It is likely to attract investments in new areas and encourage development of plots for serviced housing given the shortage of land in and around urban agglomerations as well as the high cost of land. The measure is also expected to result in creation of much needed low cost affordable housing in the country and development of smart cities. Press release does not clarify meaning of "trunk infrastructure" and hence some clarification in this regard will be necessary).

The wind of divine grace is blowing on for ever and ever. Do you spread your sail. Whenever you do anything, do it with your whole heart concentrated on it.

— *Swami Vivekananda*


Ajay Singh & Suchitra Kamble, *Advocates*

BEST OF THE REST

1. Damages for default in paying contribution – Liability to pay in case of transfer of establishment – Both erstwhile and transferee employers are jointly and severally liable – Act applies to establishment not to its owner – Covenant in contract of transfer does not insulate transferee employer from liability to pay damages. Employees' Provident Fund and Miscellaneous Provisions Act, 1952, S. 14B

The Supreme Court held that in case of transfer of establishment the liability to pay damages for default of erstwhile employer in paying contribution lies jointly and severally on erstwhile and transferee employer. The Act is made applicable to the factory in contradistinction to its owner. Once this rationale is applied it becomes apparent that the *inter se* covenants between the transferee employer and the erstwhile owners would not insulate the former from the rigours of damages imposed by the Act. The submission of the transferee employer that the liability was of the erstwhile management and since the petitioner was not the "employer" at the relevant time, default much less deliberate and wilful default on the part of the petitioner was absent has no substance. There is no gain saying that criminal liability remains steadfastly fastened to the actual perpetrator and cannot be transferred by any compact between persons or even by statute. But this incontrovertible legal principle does not support or validate the submission of transferee employer that damages levied in terms of Section 14B of the EPF Act cannot be foisted on transferee employer. Sections 14, 14A, 14AA, 14AB and 14AC of the EPF Act are the provisions postulating prosecution; in contradistinction Section 14B contemplates the power to "recover from the employer by way of penalty such damages, not exceeding the amount of arrears, as may be specified in the Scheme". It is true that it is not a river but a mere rivulet that segregates and distinguishes the legal concepts of damages or exemplary damages or deterrent damages or punitive damages or retributory damages. That modern jurisprudence recognises that the imposition of punitive damages, quintessentially quasi-criminal in character, can be resorted to even in civil proceedings to deter wilful wrongdoing by making an admonished example of the wrongdoer. This is the essential purpose, of Section 14B of the EPF Act and an imposition within its confines does not assume criminal prosecution so

as to stand proscribed in so far as transfer of establishment from one management/ employer to its successor is concerned.

Section 17B does not help the transferee employer it specifically speaks of "the contributions and other sums due from the employer under any provision of this Act or the Scheme". The proviso to Section 17B indeed clarifies the position in as much as it restricts and/or limits the liability of the transferee up to the date of the transfer to the value of the assets obtained by him through such transfer. Thus the Commissioner has specifically recorded that he has taken a lenient view in the matter and has eschewed imposition of damages to the extent of 100 per cent of the arrears even though this is envisaged by the EPF Act and appellant petitioner has rightly been burdened with the payment of interest under Section 7Q of the EPF Act. Thus the appeal was dismissed.

Mcleod Russel India Limited v. Reg. Provident Fund Commissioner, Jalpaiguri & Ors. AIR 2014 Supreme Court 2573.

2. Hindu Law – Joint family property – Claim of joint possession and ownership – Has to be pleaded and proved – Khasara entries – Do not convey title – Entries are only relevant for purposes of paying land revenue and has nothing to do with ownership- Evidence Act, Sec 35

The Supreme Court held that the Trial Court on appreciation of the entries and its genuineness which is to be presumed under the provisions of Section 117 of the Madhya Pradesh Land Revenue Code, came to a definite conclusion that the entries were made with different ink and hand-writing and compliance of the order by any competent officer is not mentioned in the *khasara*. In fact in cross-examination also there was some doubt about the entries in some of the khasara placed by the plaintiff. There were errors and omissions found in the *khasara* entries produced by the paintiffs. Hence the Trial Court doubted the correctness of those khasaras. In case of *Smt. Sawarni v. Smt. Inder Kaur & Ors. 1996(6) SCC 223*, the Supreme Court held that mutation of a property in the revenue record does not create or extinguish title nor has it any presumptive value on title. It only enables the person in whose favour mutation is ordered to pay the land revenue in question.

Thus the Supreme Court held that the reasoned judgment and decree passed by the trial Court was based on the settled law that *khasara* entries do not convey title of the suit property as the same is only relevant for the purposes of paying land revenue and it has nothing to do with ownership. The High Court has not taken into consideration all these factors and the Supreme Court therefore, allowed the appeal of the Municipal Corporation.

Municipal Corporation, Gwalior v. Puran Singh alias Puran Chand and Ors. AIR 2014 Supreme Court 2665

3. Title of Land – Proof – Entries made in Government Land Records maintained under Cantonment Land Manual – Are conclusive proof of title – Plaintiff held said land – But word 'held' does not necessarily mean to own with legal title – Land being 'old grant' resumable by Central Government, plaintiff did not possess it as 'owner' – Therefore suit by plaintiff for permanent injunction restraining Government

from interfering with his possession and title – Held, cannot be decreed – Cantonment Act, 1924, S. 31 – Cantonment Land Manual Rules, R.1

The Supreme Court held that the entries made in the GLR show that it is an old grant and that it is managed by the plaintiff as B3 land. The plaintiff held the land but being an old grant the Central Government has the right of its resumption and therefore it cannot be said that the plaintiff possesses the land as owner. In respect of the old grant tenure, the Government retains the right of resumption. The GLR in unequivocal terms describes the nature of holder's right as "old grant". Thus, the plaintiff has not been able to establish his title over the suit land in question and therefore, the plaintiff deserves to be non-suited on this ground. The GLR maintained under the Cantonment Land Administration Rules supports the defendants' contention that the plaintiff held the land on old grant. The plaintiff, on the other hand, has not produced any document to show the title of his predecessor-in-interest. N*emo dat quid non habet* is the maxim which means no one gives what he does not possess, aptly applies in the case. It needs no emphasis that the successor will not have better title than what his predecessor had. Therefore, the appeal was allowed.

Union of India and Ors. v. Robert Zomawia Street AIR 2014 Supreme Court 2721

4. Retiral benefits – Interest on delayed payment – Pensionary benefits and gratuity amount erroneously withheld by employer – Order of High Court directing employer to pay it without interest, not proper – Interest awarded to employee at rate 9% from the date of entitlement till the date of actual payment. Payment of Gratuity Act, 1972, S. 4 Constitution of India, Article 311

The Supreme Court held that it is undisputed fact that the appellant retired Form service on attaining the age of superannuation and the order of the Single Judge after adverting to the relevant facts and the legal position has given a direction to the employer-respondent to pay the erroneously withheld pensionary benefits and the gratuity amount to the legal representatives of the deceased employee without awarding interest for which the appellant is legally entitled, therefore, Supreme Court has to exercise its appellate jurisdiction as there is a miscarriage of justice in denying the interest to be paid or payable by the employer from the date of entitlement of the deceased employee till the date of payment as per the aforesaid legal principle laid down by Supreme Court in case of *State of Kerala & Ors. v. M. Padmanabhan Nair (1985) 1 SCC 429*. Thus the Supreme Court awarded interest at the rate of 9% per annum both on the amount of pension due and the gratuity amount which are to be paid by the respondent. The Supreme Court held that respondents have erroneously withheld payment of gratuity amount for which the appellants herein are entitled in law for payment of penal amount on the delayed payment of gratuity under the provisions of the Payment of Gratuity Act, 1972. The appeal was allowed.

D. D. Tewari (D) Thr. LRs. v. Uttar Haryana Bijli Vitran Nigam Ltd. & Ors. AIR 2014 Supreme Court 2861

5. Maintenance – Obligation of husband to maintain wife and children – Husband has to maintain

them in same status as they were before –Adjournments – Not to be given in routine manner – Family Judge deals with sensitive matters pertaining to marriage – Any delay in disposal would lead to more family problems and build everlasting bitterness –Criminal Procedure Code, 1974, S. 125

The Supreme Court held that Section 125 was conceived to ameliorate the agony, anguish, financial suffering of a woman who left her matrimonial home for the reasons provided in the provision so that some suitable arrangements can be made by the Court and she can sustain herself and also her children if they are with her. The concept of sustenance does not necessarily mean to lead the life of an animal, feel like an unperson to be thrown away from grace and roam for her basic maintenance somewhere else. She is entitled in law to lead a life in the similar manner as she would have lived in the house of her husband. That is where the status and strata come into play, and that is where the obligations of the husband, in case of a wife, become a prominent one. In a proceeding of this nature, the husband cannot take subterfuges to deprive her of the benefit of living with dignity. Regard being had to the solemn pledge at the time of marriage and also in consonance with the statutory law that governs the field, it is the obligation of the husband to see that the wife does not become a destitute, a beggar. A situation is not to be maladroitly created whereunder she is compelled to resign to her fate and think of life "dust unto dust". It is totally impermissible. In fact, it is the sacrosanct duty to render the financial support even if the husband is required to earn money with physical labour, if he is able bodied. There is no escape route unless there is an order from the Court that the wife is not entitled to get maintenance from the husband on any legally permissible grounds.

The Family Judge is expected to be sensitive to the issues, for he is dealing with extremely delicate and sensitive issues pertaining to the marriage and issues ancillary thereto. That does not mean that the Family Courts should show undue haste or impatience but there is a distinction between impatience and to be wisely anxious and conscious about dealing with a situation. A Family Court Judge should remember that the procrastination is the greatest assassin of the lis before it. It not only gives rise to more family problems but also gradually builds unthinkable and Everlasting bitterness. It leads to the cold refrigeration of the hidden feelings, if still left. The delineation of the lis by the Family Judge must reveal the awareness and balance. Dilatory tactics by any of the parties has to be sternly dealt with, for the Family Court Judge has to be alive to the fact that the lis before him pertains to emotional fragmentation and delay can feed it to grow. The Family Court Judges are expected to decide the matters as expeditiously as possible keeping in view the objects and reasons of the Act and the scheme of various provisions pertaining to grant of maintenance, divorce, custody of child, property disputes, etc. Thus appeal was dismissed.

Bhuwan Mohan Singh v. Meena and Ors. AIR 2014 Supreme Court 2875

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TAX ARTICLES FOR YOUR REFERENCE

Articles published in Taxman, Current Tax Report (CTR), The Tax Referencer (TTR), Sales Tax Review (S. T. Review), The Bombay Chartered Accountant Journal (BCAJ), The Chamber's Journal (CJ), The Chartered Accountant (CAJ), SEBI and Corporate Laws (S & Co Laws), Company Case, Times of India and Economic Times for the period August to September 2014 has been arranged and indexed topic-wise.

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Mindless tinkering of tax rules must stop	Uma Shashikant	Times of India	4/8/2014	10
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Don't switch to balanced funds just for Tax Gains	Madhu T.	Economic Times	18/8/2014	16
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Prepare your will online	Chandralekha Mukherji	Times of India	22-9-2014	20
Will Trust can help safeguard interests of your family members	Tariq Aboobaker	Times of India	30-9-2014	19

Opportunity does not knock, it presents itself when you beat down the door.

CA Rajaram Ajgaonkar

ECONOMY AND FINANCE

A VOLATILE MONTH

The month of October turned out to be very eventful for the global economies. In the first half of the month, the sentiments nosedived as the news of slowdown of Europe trickled in. It created doubts about the recovery of the European economy. The sentiment was further hampered by the expectation of a slowdown in China. The geopolitical risk in the Middle East caused further uncertainty. Aggression of Muslim fundamentalists in their local areas and the fear of the possibility of terrorist attacks further dampened the environment. The geographical reach of the Ebola epidemic increased, thereby causing a global scare. These negative events and risks therefrom were perceived to be so strong that the stock exchanges in many developed markets lost considerable capitalisation. The sentiment, which was strong till September, took a sudden u-turn and the confidence levels depleted. The propagators of doom emerged again and the issue of fragility of the global recovery became a subject of widespread discussion.

While these negatives were weighing heavily on the minds of the investors around the world, certain positive signals remained unnoticed. Since the last couple of months, the global demand of commodities started slowing down. It resulted in reduction of the prices of raw materials across the world. The lowering of the global demand of petroleum products and an increase in domestic supply of gas in the US due to increased availability of shale gas in the country reduced the demand of crude oil. This led to a decrease in the price of crude at a very fast pace. The crude oil, which was at its peak in the month of June 2014, dropped down by more than 25% by the end of October. It resulted in reduction of cost of energy across the world. It also caused a reduction in prices of petroleum derivatives and a host of critical naphtha based raw materials. This positive development was not given adequate importance by the world, which was then reeling under unfavourable news. However, the growth rate in the US, published in the last week of October, became the game changer. The US economy grew at the rate of 3.5% as against the expected rate of 3.1% for the last quarter and it gave the much needed fillip to the economies of the world and especially their stock-markets. It was realised that the reduction in petroleum prices will do a lot of good to the global economies and especially the developing countries. The Chinese data displayed some signs of improvement in the economy. To top the list, on the last working day of the month, the Japanese Government announced economic Quantitative Easing, which not only boosted the Japanese sentiment, but the sentiments across the world. Most of the stockmarkets flared up on that day and posted substantial gains, wiping out the losses faced by the indices in the beginning of the month.

The rebound in the month of October was a positive development, but not everybody is convinced that things are looking good and will

improve further. Undoubtedly, the US economy is on the right path and it may grow further over the next few years. However, the same cannot be said in respect of the Chinese economy, which is struggling and as many believe, will continue to struggle. The Japanese Quantitative Easing may boost the economy of Japan and many other countries in Asia may benefit from the spillover. Still, the exact impact of the same cannot be easily assessed. Though the Japanese sentiment has improved immediately, the percolation of the benefits may take a longer time. The environment in Europe may find it difficult to correct itself easily. Most of the economies in Europe are developed and matured. The demography of many countries in Europe is not conducive for high growth as the working populace is stagnating, though average life expectancy has increased. The Governments have to bear heavy burden of welfare measures and therefore the tax rates are high. These high tax rates deter the private investments in the region and many big groups and high net worth individuals resort to tax planning through tax havens and tax friendly jurisdictions. This results in a loss of revenue for the region, and the Governments are not able to take tax friendly measures as many of the countries are struggling with high debt burden as compared to their Gross Domestic Product (GDP). The environment can only change gradually and even such possibility is laden with uncertainties. Europe may take a longer time to return to sustainable growth. Two of the BRIC countries namely – Brazil and Russia seem to have lost their economic momentum as of now. Brazil is expected to grow at a rate of less than 1% for the current year and the re-elected Government is not likely to be more investor friendly, which can push the GDP growth. Their socialistic approach may hinder the growth of this large country bestowed with great natural resources. Russia continues to remain in substantial uncertainty. In spite of the recent rate hike, the weakening of the rouble continues. The falling oil prices are likely to hurt this economy badly and the turnaround may not happen very easily. Investors should keep in mind that though the US is booming as of now and may continue to boom, the world will take some time to turn around. Sustainable growth will not come easily. Political will needs to be garnered and concerted efforts are needed to return the world to high economic growth.

Fortunately for India, it seems that things are falling in place. The new Government, which has come in power, has made efforts to improve the feel good factor in the economy. There are talks of liberalisation of the economy and changes in laws, and specially those, which are perceived to have been a drag for investment and economic growth of the country. It has been promised that over the next few years doing business in India will become easier. The Prime Minister is marketing India as a future manufacturing hub. Labour laws are likely to be amended to increase the cost efficiency. Though a lot needs to be done, it seems that at least baby steps are being taken in the right direction. If sincere efforts are made to fulfil the promises, India can witness a greatly prosperous era in the near future. Apparently, the new Government is proving to be lucky for the country due to a variety of global factors. The prices of petroleum products have plummeted across the world giving great breathing space for countries like India, which are heavily dependent on imports of these products. The steps taken for eliminating subsidies on petrol and diesel have not impacted the economy negatively due to the reduction in the price of these commodities in the global markets. Easing commodity prices across the globe is also having a positive impact on Indian balance of payment. Due to reduction of subsidies, the fiscal deficit is likely to be bought within the targeted number, if adequate care is taken for curtailing avoidable expenditure. India is likely to remain comfortable vis-a-vis its foreign exchange reserves and also its fiscal deficit; and the current year is likely to achieve much better GDP growth as compared to last year, increasing the confidence of investors as well as the public. The country can get affected with external factors on which it has no control, but the overall situation looks positive for the Indian growth story to unfold. Investors are likely to reap good returns by investing in this economy.

The Indian stockmarkets are likely to continue their well-deserved bull run, not only for months but years to come. Currently, India seems to be very appropriately positioned to escalate its growth rate and become one of the major

contributors to the growth of the world. It has the right demography, inherent talent and fairly abundant natural resources which if harnessed properly can do wonders. There was a need to harness these resources in right earnest and it is likely that the present Government will be able to do the same. No changes are expected overnight but at least the direction seems to be right and the domestic indicators as well as global opinions are vouching for it. The opportunities, especially in the Indian stock markets are going to be ample but the investors need to take a calibrated approach as the markets have already run up fast, purely on expectations. Valuations are not cheap, although potentials are high. Currently, similar opportunities are not available in too many countries in the world and therefore India will be benefitted by increased allocation from the global investors. The global hiccups can create ups and downs in the stockmarkets, but over a period, the bull run is likely to continue and steady investors are likely to gain. Though the stockmarkets have gone up, Investors should not reduce their equity allocation; in fact they need to increase the same at the current juncture. In spite of the expected volatility, this asset class is likely to outperform, over the next few years. The debt market is likely to lose its sheen after initial gains, when the expected rate cut will start happening over the next one year.

It appears that the high rate interest cycle is about to end. Lowered commodity prices and lowering inflation in the economy will pave a way for the RBI Governor to start implementing rate cuts. This will reduce interest rates on deposits including bank deposits. The bond yields to maturity will start reducing and will give some capital appreciation to the investors due to increase in bond prices, but this gain will be available for only a limited period. As signs of a rate cut are imminent and it is only a question of time when it starts getting implemented, high interest rates are likely to be a thing of the past. Investors will do well to lock-in their liquidity in fixed income investments including bonds, for attractive returns over the next few years.

The property market remains listless and the quantum of transactions are not improving. Over a period, interest rate is likely to go down, which may result in the mortgage rates to come down as well, thereby making property investments more lucrative. The revival of this market is probably waiting in the wings but will be triggered only when interest rates start easing. Investors need to be watchful for the opportunities in this asset class as better days are expected to come in the near future. A dampener can be an increase in stamp duty and other levies, which the Government is liberally levying on this sector to recoup every type of deficit. If stamp duty is increased to substitute some other tax levy, it will be detrimental for the industry which is already laden with high transaction cost.

As expected, the crash in the bullion market has come. Gold has receded to ` 26,000/- per 10 grams, which is 20% off its peak. Silver has borne a bigger brunt and is currently hovering at ` 37,000/-, which is about 25% off its peak. Though the bullion prices have depreciated substantially, it may not be an appropriate time to invest in this asset class. The prices may recede further or may stagnate but their chances of appreciation in the near future are not very bright. The precious metals can be brought for consumption but their investment appeal, as of now, remains limited.

The US dollar is appreciating against leading global currencies and on the back of its better outlook; it may continue to appreciate in the near future. This may turn out to be favourable for India as majority of Indian trade is denominated in the US currency. The appreciating dollar can be a great boon for Indian companies engaged in software/ BPO services and exports of products such as pharma and textiles. Indian rupee may depreciate a bit but such depreciation can only be gradual. If inflation is brought under control and reduces below 5%, the rupee can appreciate against many currencies. Though there will be volatility in the global currency market, India is expected to have a comparatively fair regime.

Current times, though uncertain, are quite good for Indian investors to increase their commitments with a long term view. Things are expected to be better for quite a number of years to come.


CA Hinesh R. Doshi, Ajay Singh, *Advocate*
Hon. Jt. Secretaries

The Chamber News

Important events and happenings that took place between 8th October, 2014 to 8th November, 2014 are being reported as under.

I. ADMISSION OF NEW MEMBERS:

1) The following new members were admitted in the Managing Council Meeting held on 29th October, 2014.

LIFE MEMBERSHIP

1	Mr. Mutvalli Aziz Gulamnabi (Tr. Ord to Life)	CA	Mumbai
2	Mrs. Agrawal Swati Sarvesh	CA	Mumbai

ORDINARY MEMBERSHIP

1	Mr. Dusseja Vijay Juriomal (Half Year Oct. 2014 - Mar. 2015)	ITP	Thane
2	Mr. Sanghavi Suresh Nagardas (Half Year Oct. 2014 - Mar. 2015)	ITP	Mumbai
3	Mr. Vaishampayan Mukund Manohar (Half Year Oct. 2014 - Mar. 2015)	CA	Navi Mumbai
4	Mr. Kadrekar Rajendra Vasani (Half Year Oct. 2014 - Mar. 2015)	CA	Mumbai
5	Mrs. Kuwadia Alpa Saurabh (Half Year Oct. 2014 - Mar. 2015)	CA	Mumbai
6	Mr. Agarwal Pradeep Hariprasad (Half Year Oct. 2014 - Mar. 2015)	CA	Mumbai
7	Mr. Parida Pramod Kumar (Half Year Oct. 2014 - Mar. 2015)	Advocate	Mumbai
8	Mrs. Khare Deepa Kiran	CA	Pune
9	Mr. Shah Bipin Bhogilal (Half Year Oct. 2014 - Mar. 2015)	CA	Mumbai
10	Mr. Sejpal Vikas Narendra (Half Year Oct. 2014 - Mar. 2015)	ITP	Thane
11	Mr. Kulkarni Santosh Ambadas	CA	Mumbai
12	Mr. Shetty Praveen Kumar	CA	Mangalore

STUDENT MEMBERSHIP

1	Mr. Chordia Kushal Gumanmal	
2	Mrs. Priya SaratKumar Jain	Law Student

ASSOCIATE MEMBERSHIP

1	Lakshmikumaran & Sridharan	Mumbai

II. Past Programmes

Sr. No.	*Programme Name/ Committee/Venue*	*Date/Subjects*	*Chairman/Speakers*
1.	**Corporate Members Committee**		
	Half Day Workshop on SEBI / Securities Laws for Chartered Accountants (Jointly with Corporate and Securities Laws Committee of BCAS) Venue : 2nd Floor, Babubhai Chinai Hall, Indian Merchant Chamber, Churchgate, Mumbai	**17th October, 2014** **i)** Basic Concepts of Securities Laws ii) Take over and Insider Trading Regulations iii) Clause 49 – Analysis of Important Changes iv) Penalties and Settlement of Violations	CA Jayant Thakur Mr. Sharad Abhyankar, Advocate CA Shailesh Bathiya Mrs. Shailashri Bhaskar, Company Secretary
2.	**Indirect Taxes Committee**		
	Panel Discussion on Multi Dimensional Tax Issues Jointly with International Taxation Committee	**1st November, 2014** (Direct and Indirect Taxes) in Respect of Certain Transactions (in Tangibles, EPC Contracts etc.)	CA A. R. Krishnan CA Heetesh Veera CA Parind Mehta CA Vishal Gada CA N. C. Hegde
3.	**Direct Taxes Committee**		
A.	**Intensive Study Group on Direct Taxes** Venue : CTC Conference Room	**14th October, 2014** Recent Important Decisions under Direct Tax	CA Sanjay Chokshi
B.	**Full Day Seminar on Assessment, Reassessment and Settlement Commission** Venue : M. C. Ghia Hall, Rampart Row, Kalaghoda, Fort, Mumbai – 400 001.	8th November, 2014 i) Current common issues faced during assessment and reassessment proceedings including the following issues • Purchases from suspicious dealers • Share Premium • Section 14A, Rule 8D and its applicability in various situations • Deemed Dividend	CA Reepal Tralshawala

Sr. No.	*Programme Name/ Committee/Venue*	*Date/Subjects*	*Chairman/Speakers*
		• Creditors outstanding for more than 3 years Issues arising in post search assessment ii) Do's and Don'ts during the assessment proceedings and reassessment proceedings with practical examples iii) Law of Evidence – Importance of Evidence and Fundamental Concepts of Reassessment Proceedings iv) Settlement Commission – Scope, Advantages, Limitations and Procedures	CA Atul Bheda Shri K. Gopal Advocate CA Chetan Karia
4.	**International Taxation Committee**		
A.	**Intensive Study Group on International Taxation** Venue : CTC Conference Room.	**11th October, 2014**: i) The taxable residence of Companies ii) Cross border outsourcing	CA Shreyas Shah CA Ramesh Iyer CA Chintan Shah & CA Deven Shah
B.	**Seminar on Current Issues in International Taxation** (Jointly with Bombay Chartered Accountants Society) Venue : Senator Hall, Status Restaurant, Nariman Point, Mumbai – 400 021.	**16th October, 2014** i) The impact of BEPS on tax treaties ii) Current International Tax	Prof. Michal Lang, WV University of Vinna Prof. Kees Vaan Raad, University of Leiden
C.	**Transfer Pricing Study Circle Meeting** Venue : Kilachand Hall, 2nd Floor, IMC	**7th November, 2014** Basic Provisions & Issues in Domestic Transfer Pricing	CA Natwar Thakrar
D.	**FEMA Study Circle Meeting** Venue : CTC Office	**8th October, 2014** Introduction to FEMA	CA Rashmin Sanghvi

Sr. No.	*Programme Name/ Committee/Venue*	*Date/Subjects*	*Chairman/Speakers*
5.	**Study Circle & Study Group Committee**		
A.	**Study Circle on International Taxation Meeting** Venue : Kilachand Hall, 2nd Floor, IMC	**30th October, 2014** Issues in Taxation of Permanent Establishment	CA Bhaumik Gada
B.	**Study Circle Meeting** Venue : Babubhai Chinai Committee Room, IMC	**3rd November, 2014** Issues in Domestic Transfer Pricing including various methods for determining ALP	CA Rakesh Alshi
C.	**Study Group Meeting** Venue : Babubhai Chinai Committee Room, IMC	**6th November, 2014** Recent Judgments under Direct Taxes	Mr. Nitesh Joshi, Advocate

III. Future Programmes

Sr. No.	*Programme Name / Committee/Venue*	*Day & Date*
1.	**Allied Laws Committee**	
A.	**1st RRC on the Companies Act, 2013 with the flavour of LLP Act, 2008** (Jointly with Corporate Members Committee) Venue : Ras Resort Silvassa	**Friday,** **12th December, 2014 to** **Sunday,** **14th December, 2014**
B.	**Study Circle Meeting** (Only for ALC Study Circle Members) Subject : Provisions relating to The Indian Partnership Act, 1932 –An Overview (Part-II) Venue : Kilachand Hall, 2nd Floor, IMC, Mumbai.	**Monday,** **18th November, 2014**
2.	**Direct Taxes Committee**	
	Intensive Study Group on Direct Tax (Only for ISG Members) Subject : Recent Important Decisions under Direct Tax Venue : CTC Conference Room.	**Thursday,** **13th November, 2014**
3.	**Indirect Taxes Committee**	
A.	**Study Circle Meeting** (Only for IDT SC Members) Subject : Recent Updates & Issues in MVAT Audit Venue : Conference Hall, 2nd Floor, All India Local Self Govt., Juhu Lane, Andheri (W), Mumbai – 400 058.	**Tuesday** **2nd December, 2014**

Sr. No.	*Programme Name / Committee/Venue*	*Day & Date*
B.	**3rd Residential Refresher Course on Service Tax** At Fountainhead Leadership centre, Bamansure, Post Kihim, Alibag, Maharashtra – 402 201 Subject : Paper – I - Issues in Place of Provision and Point of Taxation Rules Paper – II - Indirect Tax Issues in Real Estate Industry Paper – III - Case Studies under Service Tax (other than above) Presentation – I - Settlement Commission and Advance Ruling under Service Tax	**Friday, 23rd January, 2015 to Saturday, 25th January, 2015**
4.	**Membership & EOP Committee**	
	Self Awareness Series Subject : Art of Managing – Self and around Venue : CTC Conference Room	**Tuesday** **11th November, 2014**
5.	**International Taxation Committee**	
A.	**Workshop on Taxation of Foreign Remittances** Subject : 1) Law and Procedure applicable to Taxation of Foreign Remittance, applicable Rules, Circulars and Provisions of the Treaty, Law, Procedure of TDS provisions for Non Residents 2) Overview of the DTAA – Application scope, (Articles 1, 2, 3 and 4) and Mechanism of Use of Treaty, Interplay between ITA and Treaty, Priority of Articles, Tax credit mechanism etc. 3) Business profits 4) Taxation of other payments – Artist and Sportsmen, Other Income, Directors Fees and Students Remuneration 5) Income of Non Residents from Shipping and Aircraft Operation 6) Taxation of Interest and Dividend 7) FTS and Royalty 8) Taxation of Capital Gains including indirect transfers 9) Expatriates Taxation – Inbound and Outbound deputation – Payment to Non-Residents for Services in India as well as Outside India 10) Brains' Trust Venue : West End Hotel, New Marine Lines, Mumbai	**Friday** **19th December, 2014** **Saturday** **20th December, 2014**

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Sr. No.	*Programme Name / Committee/Venue*	*Day & Date*
B.	**Conference on Transfer Pricing – Mitigation of Litigation** Subject : 1) Global scenario and India updates 2) Navigating challenges by robust documentation on current controversial issues: i) Issue of Shares, Location Savings, Savings on Development Centres and R&D Centres ii) Management Charges, Marketing Intangibles. 3) Representation before the ITAT/HC on Transfer Pricing Controversies - Practical Experiences 4) Alternate Dispute Resolution Mechanism – APA, MAP, Safe Harbour – Practical experiences 5) BEPS – Country by Country Reporting – Indian perspective 6) Panel Discussion on Effective Handling of TP Litigation Venue : Palladium Hotel, Lower Parel, Mumbai.	**Saturday** **6th December, 2014**
C.	***Publication :*** Transfer Pricing An Industry & Technical Perspective	Special price for Members only ` 1,250/-
6.	**Residential Refresher Course & Public Relations Committee**	
	38th Residential Refresher Course Subject : Paper I – Deeming Provisions under the Income-tax Act. Paper II – Issues in Corporate Taxation including LLP Paper III – Case Studies on Direct Tax Paper for Presentation : Domestic Transfer Pricing Brains' Trust – Direct Tax Venue :At Toshali Sands Resort, Puri, Odisha	**Thursday,** **19th February, 2015 to** **Sunday,** **22nd February, 2015**
7.	**Students Committee**	
	Student Study Circle Meetings Subject : 1) MVAT Audit, 2) Compliance under Companies Act, 2013 3) E-Filing of TDS Return 4) Finance Bill Venue : Maheshwari Bhawan, Chira Bazar, Marine Lines, Mumbai.	**Thursdays** **4th December, 2014** **8th January, 2015** **5th February, 2015** **5th March, 2015**
8.	**Study Circle & Study Group Committee**	
	Study Group Meeting (Only for SG Members) Subject : Recent Judgments under Direct Taxes Venue : Babubhai Chinai Committee Room, IMC	**Thursday** **11th December, 2014**

For Further details of the future events kindly visit our website www.ctconline.org.

The Chamber of Tax Consultants

Vision Statement

The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre–eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.

STUDY CIRCLE & STUDY GROUP COMMITTEE

Study Circle Meeting held on 6th October, 2014 on the subject "Issues in Domestic Transfer Pricing Including Various methods for determining ALP" at IMC.

CA Rakesh Alshi addressing the members.

CA Anand Thacker addressing the members.

INTERNATIONAL TAXATION COMMITTEE

FEMA Study Circle Meeting held on 8th October, 2014 on the subject "Introduction of FEMA" at CTC Conference Room.

CA Rashmin Sanghvi addressing the members.

INDIRECT TAXES COMMITTEE

Indirect Tax Study Circle Meeting held on 8th October, 2014 on the subject "Issues in CENVAT Credit under Service Tax" at IMC.

Mr. Prasad Paranjpe, Advocate chairing the session. Also seen CA Uma Iyer, Group Leader.

DIRECT TAXES COMMITTEE

Intensive Study Group on Direct Taxes Meeting held on 14th October, 2014 on the subject "Recent Important Decisions under Direct Tax" at CTC Conference Room.

CA Sanjay Chokshi addressing the members.

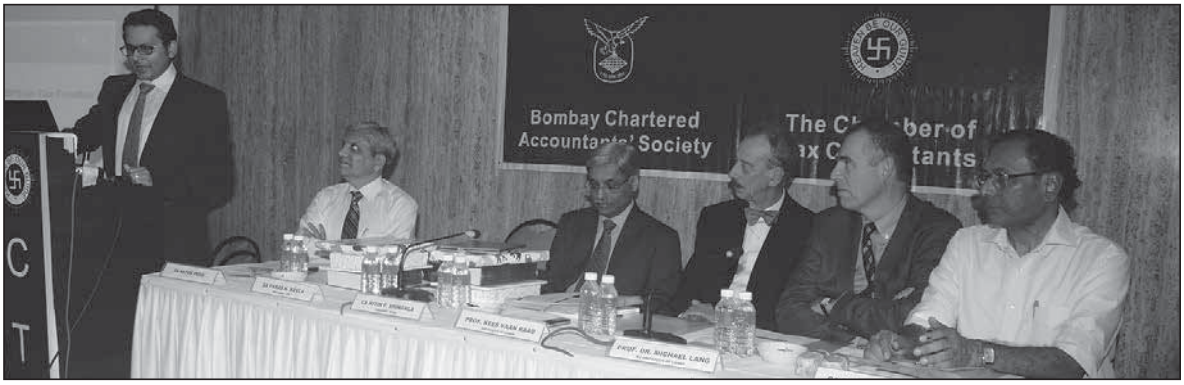
STUDY CIRCLE & STUDY GROUP COMMITTEE

Study Circle on International Taxation Meeting on the subject "Issues in Taxation of Permanent Establishment"held on 30th October, 2014 at Kilachand Hall, IMC.

CA Bhaumik Goda addressing the members.

INTERNATIONAL TAXATION COMMITTEE

Seminar on Current Issues in International Taxation jointly with BCAS held on 16th October, 2014 at Senapati Hall, Status Restaurant, Nariman Point, Mumbai – 400 021.



CA Paras K. Savla, President, CTC addressing the members. Seen from L to R : CA Mayur Desai, BCAS, CA Nitin Shingala, President, BCAS, Prof. Kees Vaan Raad, Facuty, Prof. Michael Lang,Faculty and CA Rashmin Sanghvi, Member.

Prof. Michael Lang, WU University of Vienna addressing the members.

Prof. Kees Vaan Raad, Univerisity of Leiden addressing the members.

Section of delegates.

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