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By

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INCOME TAX

FOREIGN TAX CREDIT

Contributed by CA Ram Prasad

Tax Credit refers to granting credit of taxes deducted at source while computing the tax paid by the recipient of income.

The Income Tax Act provides relief mechanism for foreign tax credit for the treaty countries and non –treaty countries separately.

Provisions of section 90(2) provides for foreign tax credit in relation to the assessee to whom such agreement applies.(Bilateral Relief)

Provisions of section 91 provides for foreign tax credit for the resident in India in respect of his income arouse outside India and on which he has paid tax in any country with which no agreement entered under section 90 of the Act.(Unilateral Relief).

The bilateral relief seeks to provide relief by way of (i) Exemption Method; (ii) Credit Method.

Exemption method:

The country of residence has a right to tax its residence and treaties seek to mitigate double taxation in the source taxation. Country of residence can also give up their right to tax the income of its resident earned in foreign country by exempting such foreign sourced income.

It provides for exemption either by way of full exemption or exemption with progression.

Under full exemption method the resident country exclude the income already charged to tax in the source country while computing total income liable to tax.

Under exemption with progression method, the country of residence take into account the exempted income sourced outside India while calculating the rate of tax applicable on the remaining income.

Ex:- Income earned in India Rs. 80,000/- and income earned outside India Rs. 20,000/-. Tax deducted on income earned outside India is Rs. 4000/-. Tax rate in India say 35%.

Tax in India on Global Income = (Rs. 1,00,000 – Rs. 20,000)*35% Rs. 28,000/-.

Tax Relief = Rs. 35,000 (Rs. 1,00,000 * .35) - Rs.28,000/- = Rs. 7,000/-

Credit Method:

Country of residence includes global income in the taxable total income and computes the tax and allows credit of taxes paid in source country from such tax liability.

Tax credit is either full tax credit or ordinary tax credit.

Two more methods tax credits are "Underlying Tax Credit" and "Tax Sparing".

Full tax credit method provides that the country of residence allows tax paid on income earned outside India be reduced from the total tax liability in that country. This is not very commonly used method of granting tax credit.

Ordinary tax credit method provides for deduction of taxes paid in the country of source to the extent of tax paid by the taxpayer in the country of residence in respect of doubly taxed income.

Ex:- Indian income Rs. 80,000/- Foreign Income Rs. 20,000/-. Tax paid on foreign income is Rs. 8,000. Indian tax rate is 35%. (Ordinary tax method)

Tax Liability:

Details	Amount in Rs.	Tax Rate	Tax Amount
Global Income (Indian and Foreign Income)-	1,00,000/-	35%	Rs. 35,000/-
Less: Tax on Foreign Income paid out side India subject to maximum of 35% on such income	20,000/-	40%	Rs. 7,000/- (least of Rs. 8,000/- or Rs. 7,000/-)
Tax liability in India	80,000/-	35%	Rs. 28,000/-

Though tax paid outside India is Rs. 8,000/- maximum credit is limited to the extent of liability @ applicable under domestic law (i.e Rs. 7,000/-) only.

Underlying Tax Credit: India does not provide for Underlying Tax Credit. US, UK and some other countries provide for this credit. Under this method the country of residence provides for credit of taxes paid on dividend income and for corporate taxes paid on underlying profits out of which dividend has been paid.

Ex:- A, Indian company 100% subsidiary of US Holding Co. A Ltd has earned Rs. 1, 00,000/- profit in India. Rate of taxes in India: Corporate tax @ 30% and Dividend distribution tax @ 15%. US Holding company profit is Rs. 2, 00,000/- and rate of tax @ 40%.

Underlying tax credit is computed as follows:

Particulars	Amount in INR	Amount in INR
Profit of subsidiary in India		1,00,000/-
Less: Tax @30%	1,00,000*30/100	30,000/-
Profit after tax		70,000/-
Dividend distributed		70,000/-
Dividend distribution tax	70,000*15/100(ignoring provisions of section 115-O)	10,500/-
Profit of holding company(US)		2,00,000/-
Profit of Indian Subsidiary		1,00,000/-
Total Income		3,00,000/-
Tax @40% on total income	3,00,000*40/100	1,20,000/-
Underlying Tax credit Corporate Dividend tax- Share in Corporate tax paid on underlying profits-	10,500 (A) 1,00,000*30/100 (B)	10,500/- 30,000/-
Total Tax Credit	(A+B)	40,500/-
Tax Payable after credit	1,20,000-40,500	79,500/-

Tax sparing: The Source State generally grants incentives to foreign investors for the purpose of attracting foreign investments which get neutralized if the State of Residence taxes them fully on the basis of no taxation in State of Source.

Tax Sparing is the allowing of relief by State of Residence of those foreign taxes which have been spared under the incentive program of the State of Source.

Under this concept, the country of residence grants credit for the taxes which would have been levied by the country of source had the tax exemption been not granted by it.

Example:

Particulars	No Tax Sparing	Tax Sparing
Income in the country of Residence	Rs. 1,00,000/-	Rs. 1,00,000/-
Income in the country of source (exempt)	Rs. 1,00,000/-	Rs. 1,00,000/-
Total Income for tax in country of residence	Rs. 2,00,000/-	Rs. 2,00,000/-
Tax Rate in the country of Residence	40%	40%
Tax Rate in the country of source	30%	30%
Tax payable in country of residence (A)	Rs. 80,000/-	Rs. 80,000/-
Tax Payable in country of source (B)	-------	-------
Tax credit (Tax exempted on income- country of source) (C)	-------	Rs. 30,000/-
Total Relief (B+C)	-------	Rs. 30,000/-
Tax payable after credit (A-B)	Rs. 80,000/-	Rs. 50,000/-

Unilateral Credit: It is applicable where there is no DTAA with foreign country in which tax is paid or liability incurred. Relief is provided to the extent of lower of Indian Tax Rate or Foreign Tax Rate, whichever is least (Ordinary Tax Method).

General documents required to claim foreign tax credit:

- Overseas Tax Withholding Certificates;
- Tax Payment Challans;
- Overseas Tax Returns.

This article is contributed by CA Ram Prasad, Partner at SBS and Company LLP, Chartered Accountants. The author can be reached at caram@sbsandco.com

INCOME TAX

IMPORTANT JUDGEMENTS

Contributed by CA Ram Prasad |

Nitin Shantilal Muthiyan Vs Deputy Commissioner of Income-tax Ahmednagar-----
ITAT PUNE

For claiming deduction under section 80E, there is no such stipulation u/s.80E of the I.T. Act that the education should be in India only.

Had there been such an intention by the legislature it would have been definitely and specifically mentioned as had been mentioned in section 11 of the I.T. Act which provides that any income or property held for charitable purposes is exempt from tax u/s.11(1)(a) only to the extent it is applied in India.

Therefore, if the legislature wanted education in India itself for availing of the deduction, the legislature would have specifically stated so in the section itself.

Commissioner of Income-tax-1, Kochi Vs P V S Memorial Hospital Ltd.
High Court of Kerala

The expression "Tax deductible at source under Chapter XVII-B" occurring in section 40(a)(ia) has to be understood as tax deductible under the appropriate provision of Chapter XVII-B. Therefore, if tax is deductible under section 194J but is deducted under section 194C, the requirements of section 40(a)(ia) are not satisfied. A deduction under the wrong provision of law will not save the assessee from disallowance u/s 40(a)(ia).

Prabhat Construction Company Vs Commissioner of Income-tax
ITAT PATNA

The estimation of income upon rejection of the assessee's accounts as not reliable for assessment of income u/s.145(3) is to be made transparently, in two steps. The first being toward assessment of commercial profits, and then again the specific allowances or disallowances that stand to be effected, as u/s.40(a)(ia), an artificial, statutory disallowance.

The assessment of income even under the estimation regime is of the total income under the Act and not of the business profit alone, and which could only be upon considering the applicability or otherwise in the facts of the case of all the relevant provisions of law, to which section 40(a)(ia) is or cannot be any exception.

This article is complied by CA Ram Prasad, Partner at SBS and Company LLP, Chartered Accountants.
The author can be reached at caram@sbsandco.com

SERVICE TAX

CONSTITUTIONAL VALIDITY OF SERVICE TAX ON RESTAURANT SERVICES - AN INCISIVE ANALYSIS

Contributed by CA Manindar |

Introduction:

Ever since the introduction of the service tax levy on Restaurant services (effective from 01.05.2011), its constitutional validity turned out as contentious issues. The reason being that State Governments are imposing VAT on entire consideration received towards food supply over the last two decades by placing reliance on Article 366(29A)(f). All of a sudden Centre has brought service tax levy on a portion of this consideration on the contemplation that this represents service during food supply. In this background, lets have a detailed look into this issue.

Legislative Background that Lead to Article 366(29A)(f):

Prior to insertion of Article 366(29A)(f), there was an attempt in the case of State of Punjab vs. Associated Hotels of India Ltd, 1972 AIR 1131 to levy VAT on a portion of accommodation charges treating it as consideration towards supply of food wherein it was held that the transaction is one essentially of service in the performance of which and as a part of the amenities incidental to that service, the hotelier serves meals at stated hours. Therefore the revenue was not entitled to split up the transaction into two parts as one of service and the other of sale of food stuffs so as to bring the later part under the VAT laws.

Subsequently, another attempt was made by State Governments to levy VAT on supply of food involved in restaurant sales in the case of Northern India Caterers (India) Ltd vs. Lt. Governor of Delhi C 1989 SC1371 (18) on the confrontation that decision of Supreme Court in State of Punjab vs. Association Hotels case (Supra) is applicable only for supply of food in a residential hotel which also provides accommodation but not applicable for the supplies made in restaurants. But the Supreme Court had held that the true essence of transaction involving supply of food in a restaurant is a service to the satisfaction of human need or desire, ministry to a bodily want. A necessary incident of this service or ministry is the consumption of the food required. This consumption involves destruction, and nothing remains of what is consumed to which the right of property can be said to attach. Before consumption title does not pass; after consumption there remains nothing to become the subject of title.

Scope of Article 366(29A)(f):

Consequent to these judgments of Supreme Court, with a view to extend to State Governments the power to levy/sales tax on transactions involving supply of food along with other similar potential sale transactions, the definition of 'Sale' as appearing in Article 366(29A) has been amended to include these transactions as deemed sales. Accordingly, Article 366(29A)(f) is introduced which is reproduced as follows;

"a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration, and such transfer,

delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made"

Subsequently, the issue of requirement of valuation rules in order to exclude the value attributable towards service portion involved in supply of food in restaurants and hotels from the gross amount charged for the purpose of levy of VAT was considered by Supreme Court in the case of K. Damodarasamy Naidu vs. State of Tamil Nadu & Others AIR 1999 SC 3909 wherein with respect to supplies at restaurants it was held vide para 9 as follows;

"The provisions of Sub-clause (f) of Clause (29A) of Article 366 need to be analysed. Sub-clause (f) permits the States to impose a tax on the supply of food and drink. The supply can be by way of a service or as part of a service or it can be in any other manner whatsoever. The supply or service can be for cash or deferred payment or other valuable consideration. The words of Sub-clause (i) have found place in the Sales Tax Acts of most States and, as we have seen, they have been used in the said Tamil Nadu Act. The tax, therefore, is on the supply of food or drink and it is not of relevance that the supply is by way of a service or as part of a service. In our view, therefore, the price that the customer pays for the supply of food in a restaurant cannot be split up as suggested by learned Counsel. The supply of food by the restaurant owner to the customer, though it may be a part of the service that he renders by providing good furniture, furnishing and fixtures, linen, crockery and cutlery, music, a dance floor and a floor show, is what is the subject of the levy." (Para 9)

Thus the Supreme Court had interpreted the language of Article 366(29A)(f) and held that supply of food in a restaurant is part of a service and States can impose tax on the entire transaction value of restaurant sales. Further quoted an example that the patron of a fancy restaurant who orders a plate of cheese sandwiches whose price is shown to be Rs. 50 on the bill of fare knows very well that the innate cost of the bread, butter, mustard and cheese in the plate is very much less, but he orders it all the same. He pays Rs. 50 for its supply and it is on Rs. 50 that the restaurant owner must be taxed. The said example is very even in today's business environment also, as there is no difference or negligible difference in restaurant charges for take aways and in-house consumptions.

With respect to food supplies in residential hotel accommodations, it was vehemently pleaded by petitioners that residential hotels may provide only lodging or lodging and boarding involving breakfast alone, breakfast, lunch and dinner or breakfast and one meal. Tax could not be levied on these composite transactions involving boarding and lodging unless the State make Rules which set down formulae for determining that component of the composite charge which was exigible to the tax on food and drink.

The important point to notice here is that the Learned Counsel for the States had not put forward any argument that entire value of composite charge would be subject to VAT. It was only argued that no rules were necessary for assessment as the officers would undertake assessments depending upon the facts of each individual case. But the Supreme Court ordered the State Governments for Rules to be prescribed for separation of the value of services from food supply in composite charge made by residential hotels with the reasoning that it is impossible to carry out assessments of several thousands of assessees by considering facts of each case and further it would lead to arbitrariness.

Thus Supreme Court had made a clear distinction between supply of food at restaurants and that supplied by residential hotels. After 46th amendment, It appears to have laid out or at least agreed to the principle that State Governments can levy Sales Tax on the entire transaction value in case of restaurants though services are also involved in such supply in view of the clear provisions of Article 366(29A)(f) i.e. a tax on the supply, by way of or as part of any service or in any other manner whatsoever. Wherever separate discernable services (which can be provided independently also without food supply) are involved along with food supply like lodging/accommodation services, Sales Tax is restricted to the value of food supply involved in such transaction.

Constitutional Validity of Service Tax Levy on Outdoor Catering Services:

The other service which involves food supply is 'Outdoor Catering Services'. When Service Tax levy was brought into effect in the year 2004 on these services, the issue of Constitutional Validity had arisen in the case of Tamil Nadu Kalyana Mandapam Owners' Association vs. Union of India & Others, 2004-TIOL-36-SC-ST, wherein it was held that Article 366(29A)(f) only permits the State to impose a tax on supply of food and drinks by whatever mode it may be made which does not conceptually include the supply to services within sale or purchase of goods.

Upheld Constitutional Validity by stating the fact that tax on the sale of goods involved in the said service can be levied does not mean that a service tax cannot be levied on the service aspect of catering. In the process, circumvent the K. Damodarasamy Naidu case by distinguishing catering services from restaurant services stating that in the case of outdoor catering service, the food/ eatables / drinks are the choice of the person who partakes the services. He is free to choose the kind, quantum and manner in which the food is to be served. But in the case of restaurant, the customer's choice of foods is limited to the menu card. Again in the case of outdoor catering, customer is at liberty to choose the time and place where the food is to be served. Outdoor catering has an element of personalized service provided to the customer. Clearly the service elements are more weighty, visible and predominant in the case of outdoor catering. It cannot be considered as a case of sale of food and drink as in restaurant."

Kerala High Court Decision on Constitutional Validity:

After introduction of levy of service tax on service portion involved in restaurant supplies, the issue Constitutional validity was initially considered by the single member bench of the Kerala High Court in the case of Kerala Classified Hotels and Resorts Association vs. UOI, 2013-TIOL-533-HC-Kerala-ST wherein the above discussed Supreme Court judgments of K. Damodarasamy Naidu case(Supra) & Tamil Nadu Kalyana Mandapam(Supra) are considered. The Court relied on K. Damodarasamy Naidu case (Supra) as it is more appropriate to restaurant services and held that levy of service tax on services involved in restaurants is constitutionally invalid.

Bombay High Court Decision on Constitutional Validity:

Recently, this issue is again considered by the Bombay High Court in the case of Indian Hotels& Restaurant Association vs. UOI, 2014-TIOL-498-HC-MUM-ST wherein the Constitutional validity of levy of Service Tax on restaurant services is upheld mainly on three findingswhich are summarizedas follows;

- ❖ Stated that the Supreme Court decision in K. Damodarasamy Naidu case(Supra) cannot be relied upon because while selling, supply thereof is contemplated and covered by Article 366(29A)(f) of the Constitution of India. It does not mean that the service during the course of or while supplying the goods the goods is taxed but the tax is and remains on the sale of goods. That is why the State Legislatures were held to be empowered to impose, levy, assess and recover a tax on sale of articles of food and drink which have been termed as "goods" (Para 45).

- ❖ Distinguished the Kerala High Court decision stating that after referring the various judgments of Supreme Court, there was no categorical finding that the tax in question is covered by entry 54 of State List. (Para 53).

- ❖ Relied on the reasoning adopted by Supreme Court in Tamil Nadu KalyanaMandapam case(Supra) while upholding the levy of Service Tax on Catering services.(Para 44 & 45)

However, on a careful study of these judgments, it can be said that the conclusions of Mumbai High Court are not on sound reasoning and are dubious. As discussed above, there is a clear finding by Supreme Court in K. Damodarasamy Naidu case(Supra) that the entire value in restaurant sales is subject to VAT and it cannot be splitup. Further, the distinguishing view adopted by the Supreme Court with respect to residential hotels providing lodging and boarding when compared to restaurants is totally ignored.

The Mumbai High Court refusal to place any reliance in the single member bench decision of Kerala High Court in the case of Kerala Classified Hotels and Resorts Association (Supra) stating that there was no categorical finding that Service Tax on restaurants is covered by entry 54 of State List is devoid of any merit as the Kerala High Court vide para 19 has expressly stated that When food is supplied or alcoholic beverages are supplied as part of any service, such transfer is deemed to be a sale permitting the State Government to impose a tax on such transfer and there cannot be a different component of service on which service tax is payable under the residuary power of the Central Government vide Entry 97 of List I of the Constitution of India.Thus once there is a clear finding that levy is not covered by residuary entry of List I, there is a clear indirect finding by Kerala High Court that the question of levy is covered by Entry 54 of State List.

Further, there is a complete reliance on the reasoning adopted by Supreme Court in the Tamil Nadu KalyanaMandapam case(Supra) in upholding the levy of Service Tax on Catering services by totally ignoring the distinction adopted by the Supreme Court between Restaurant services and Catering services in the said case.

Two Member Bench of Kerala High Court Upheld the view of Single Member:

Keeping aside the legal soundness of the judgment, this decision of Bombay High Court made the industry to lose hope on the issue of service tax levy being unconstitutional.But recently the two member bench of Kerala High Court has considered the Revenue Appeal against the Single Member decision in the case of UOI vs. Kerala Bar Hotels & Otrs,2014-TIOL-1913-HC-Kerala-ST. It has upheld the view of the single member judgment and struck down the levy. Held that after Constitution (Forty Sixth Amendment) Act, as far as supply of food and beverages at a restaurant is concerned, tax could imposed and levied by the State for the whole of the amount of consideration. So it cannot be treated as service for levy of service tax.

In doing so, the two member bench of Kerala High Court has distinguished the judgment of Bombay High Court (supra) vide para 15 and held that no service element exists.

Conclusion:

Thus there are two conflicting views taken by two high courts. However, in the opinion of paper writer, the reasoning adopted by Mumbai High Court is not convincing and is some way or the other conflicts with the propositions laid down in several judgments of Supreme Court. It is for those reasons, the Divisional bench of Kerala High Court has distinguished this judgment and held that levy of service tax is unconstitutional. However, the industry is short sighted of these developments and is continuing to charge service tax to save their skin. It requires one last punch (Supreme Court's decision) to put an end to this issue of double taxation.

This article is contributed by CA Manindar. The author can be reached at manindar@sbsandco.com

INCOME TAX

TRANSFER PRICING ASSESSMENT – A PRACTICAL VIEWPOINT

Contributed by CA Mithilesh |

1. Section 92CA of the Indian Income Tax Act provides that an Assessing Officer may make a reference to a Transfer Pricing Officer (TPO) for computation of arm's length price (ALP). In India, TP audits are conducted by specialist officers notified as Transfer Pricing Officers ('TPO') by the CBDT. The DGIT (International Taxation) and DIT(TP) distribute the work among the TPOs stationed at various cities across India.

   TPO has been defined in the said section to mean a Joint Commissioner or Deputy Commissioner or Assistant Commissioner who is authorised by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D of the Income-tax Act. The determination of arm's length price in several cases is done by the TPO.

2. Across the world (mainly in the developed countries), cases are referred for audit after a detailed risk assessment and generally high risk transactions are focussed to ensure effective use of resources at tax office. The commonly risk indicators include:

- Consistent and continued losses;
- Transactions with related parties in countries with lower effective/marginal tax rates, especially secrecy jurisdictions;
- Local low profit or loss making companies with material cross-border transactions with related parties offshore, where the offshore part of the group is relatively much more profitable;
- The existence of centralised supply chain companies in favourable tax jurisdictions i.e. centralised sourcing or marketing companies located in jurisdictions with low or no tax regimes and which are not located in the same country/region as the group's main customers and/or suppliers.
- Material commercial relationships with related parties in jurisdictions with aggressive/strict transfer pricing rules – the corporate group may be more likely to set transfer prices in favour of the more aggressive jurisdiction at the cost of the less aggressive jurisdiction, due to the higher likelihood of intense scrutiny in the first jurisdiction.
- Similar considerations apply where there are material commercial relationships with companies in jurisdictions that employ safe harbours or similar rules that do not always align to the arm's length principle.

3. Cases for Compulsory TP Scrutiny in India:

   While the above factors are also relevant and considered by the tax authorities during the assessments in India, the selection of cases for TP auditsin India are primarily based on materiality of the value of the international transaction. As per the CBDT instructions, the following categories of cases/returns are compulsorily selected for TP audit:

- Cases where value of the international transactions exceed Rs 15 crores; (From FY 14-15, in the scrutiny guidelines, the CBDT has excluded this criteria and hence only the cases which satisfy the below criteria would only be subjected to compulsory scrutiny from TP perspective)

- Cases involving addition in an earlier year on the issue of TP in excess of Rs 10 Cr, which is confirmed in appeal or pending before an appellate authority.

  Further, the AO scrutinising a return of an Assessee having international transactions with AEs, can refer the case for TP audit, if he considers it necessary or expedient, with the approval of the Jurisdictional Commissioner.

4. Synopsis of TP Audits in India:

Financial Year	Number of TP Audits Completed	Number of Adjustment Cases	% of Adjustment Cases	Amount of Adjustment (in INR crore)
2005-06	1,061	239	23	1,220
2006-07	1,501	337	22	1,287
2007-08	1,768	471	27	3,432
2008-09	1,945	754	39	7,754
2009-10	1,830	813	44	10,908
2010-11	2,301	1,138	49	23,237
2011-12	2,638	1,343	52	44,531
2012-13	3,171	1,686	53	70,016
2013-14	3,617	1,920	53	59,602
2014-15	4,300	NA	NA	47,000

5. Information Request by the TPO:

The Tax authorities are already in possession of certain information before starting a TP audit. These include (i) tax returns filed; (ii) financial statements attached to the tax returns; (iii) Form 3CEB ('TP certificate'). These form important basic data for a transfer pricing audit.

The first step in a TP audit is the gathering of information that the TPO consider necessary to decide whether to accept tax returns as filed or to propose TP adjustments. The TPO rely primarily on the taxpayer to provide that information. The principal means for the TPO to collect the necessary information is the written information request. A TPO's initial notice generally includes request for the following information/documents:

- All information and documents request to be maintained as prescribed in Rule 10D ('TP documentation' or 'TP study report');

  It is important to note that the Indian TP regulations require maintenance of contemporaneous TP documentation. The contemporaneous documentation the taxpayer has prepared will be an important document for the TPO and will be one of the first documents they request. This represents the first opportunity for the taxpayer to persuade the TPO that the transfer pricing is appropriate.

- A reconciliation of the amount of related party transactions disclosed in the financial statements, Form 3CEB and the TP documentation;
- Annual report (standalone and consolidated) of the Assessee for the relevant year, prior two years and subsequent two years;
- Annual report (standalone and consolidated) of the AEs for the relevant year, prior two years and subsequent two years;
- Annual report of all the comparables selected in the TP study;
- Copies of all Inter-company Agreement with Aes;
- Other supporting documents of the transactions with AEs viz., invoices, ledger account copies, etc;
- Details of all international transactions not reported in Form 3CEB, with particular reference to transaction which fall within the amended definition of international transaction;
- Information of comparable transactions with Non-AEs;
- Details of top non-AE customers and top non-AE suppliers;
- Break-up of the receivables outstanding and details of credit period granted to Aes;
- Any other evidence or documents, the Assessee may want to rely on to substantiate the arm's length nature of its transactions with Aes.

This is particular relevant in the cases relating to payments for intra-group services and intangibles, wherein the TPO expect the Assessee to produce documents to substantial actual receipt of services or intangibles and the benefit therefrom.

6. The Taxpayer is required to furnish the TP documentation within 30 days from the date of receipt of notice from the TPO. The TPO may on an application made by the Assessee extend the period of 30 days by a further period not exceeding 30 days.

7. Penalties for not submitting/ not cooperating in the TP Assessments:

   The Act provides for stringent penalty for non-compliance with the TP provisions relating to maintenance of TP documentation. The penal provisions are summarised below:

Non-compliances	Penalty
Failure to keep and maintain TP documentation or failure to report or furnishing of incorrect information/document relating to international transactions with AEs	2% of the value of each international transaction
Failure to furnish TP documentation	2% of the value of each international transaction

8. As the TP examination progresses, based on the nature of the international transactions, many more questions will arise in the minds of the TPO, and accordingly supplemental information requests are likely to be issued by the TPO. The time given for responding is usually a few weeks unless the taxpayer is expected to take a longer time to obtain and/or prepare the required information. It should be noted that a problem often seen are the challenges in enforcing an information request, which seeks a document or information not held by the taxpayer but held by a related party outside the country. Hence, it is important all relevant information/document related to pricing of the international transaction be obtained by the Assessee well in advance.

   If the contents of information requested by the TPO are confidential to the business of the Taxpayer, the Taxpayer may take precautions in disclosing such information by appropriately requesting the TPO to maintain confidentiality of such information.

9. The TPO also collate necessary information from other sources in public domain such as the taxpayer's website, the taxpayer's submission of periodic financial data to the securities regulatory agency (if the taxpayer's shares are listed on a stock exchange), business journals, other tax filings (related and unrelated to the taxpayer), or any other information that is publicly available.

10. It should be noted that the taxpayer's cooperation in providing the required data is essential in a TP audit. Taxpayers are expected to cooperate with the TPO in providing the necessary data, and a cooperative atmosphere during transfer pricing audits is desirable. It is necessary to create documents or to put necessary data in an orderly form so as to enable the TPO to understand the business operations and to proceed to the analytical stage.

11. Powers of TPO to collect information:

    The TPO's authority for making the information request is based on the general investigation authority provided for in the tax law. Hence, in addition to calling for information by written notice, the TPO's have the following powers:

- Powers u/s 131 of the Income-tax Act, of discovery and inspection of taxpayers, enforcing the attendance of any person and examining him on oath, compelling the production of books of account & other documents and issuing commissions;

- Power u/s 133(6) of the Act, to call from any person, information in relation to such points or matters, that will be useful or relevant for the TP audit; and

- Power of survey u/s 133A of the Act.

    Tax authorities can also utilize the exchange of information provision in an applicable tax treaty for obtaining information.

    Again, while opinion differ on the use of information not available in public domain for the purpose of determination of the ALP of the Assessee's international transactions with AEs (referred to as 'secret comparables'), the Income-tax Appellate Tribunals have upheld the use of such information provided adequate opportunity is provided to the Assessee for cross examination of such information.

12. While the above powers are sparingly used by the TPO's, it is important for Assessee to be aware that, in addition to routinely calling for information from third parties, TPO's have also issued summons to Directors, former employees and also third parties for interviewing and confirming the facts stated in the TP documentation and the Taxpayers records. Hence, it is in the Taxpayers interest that the TP documentation is complete and accurate. In many instances, it may also be in the Taxpayer's interest to arrange a site visit of the TPO to taxpayer's facilities to present the factual portions of the taxpayer's case.

13. The TPO's power of determination of ALP is not restricted to transactions referred to him by the AO or disclosed by the tax payer. He can apply TP provisions to any other international transactions that come to his notice during assessment.

14. The TPO has to determine the ALP of the international transactions after considering and taking into account all evidence or documents produced by the Assessee in addition to the TP documentation and all relevant material gathered by him. Thereafter the TPO is to pass a speaking order after obtaining approval of the DIT(TP). The order contains details of the data used, reasons for arriving at a certain price and the applicability of methods. The TPO sends a copy of his order to the AO and the Assessee.

15. Time limits for TP Assessments:

A TP audit usually takes a longer time than an ordinary tax audit because the scope of the factual matters to be investigated is much broader and the amount of time and effort for TP is much greater. The TP audit is concerned only with transfer pricing aspects of the international transactions of the Assessee with Aes.

Whenever a reference is made by an assessing officer (AO) to a transfer pricing officer (TPO), AO gets an additional time of 12 months to complete a 'draft' assessment order. Then upon reference to DRP, a further time of nine months is allowed to DRP and one month to AO to complete assessment. Thus the assessment procedure takes around 22 extra months.

The TPO is required to pass the order 60 days prior to the period of limitation of passing of the assessment order by the AO. The limitation period for cases referred to the TPO is four years from the end of the relevant financial year. For example: for the FY 2011-12, the limitation period for passing the assessment order is March 31, 2016 and hence the TPO is required to pass his order by January 30, 2016. Thereafter the AO proceeds to compute the total income of the taxpayer in conformity with the ALP determined by the TPO.

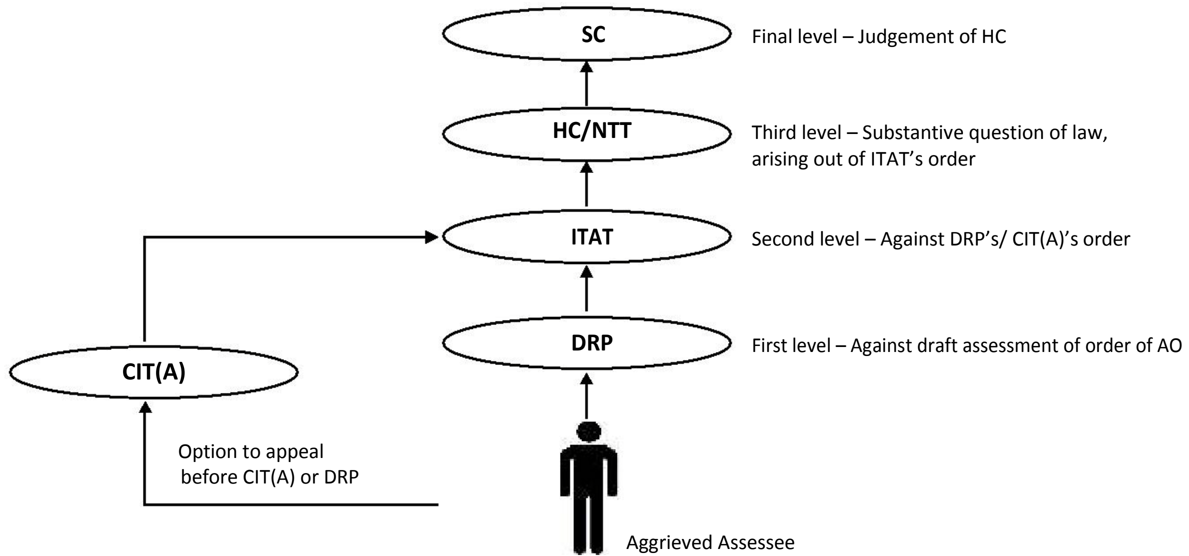
16. The provisions relating to rectification of any apparent mistake apply to the TPO's order. Accordingly, the TPO can amend the TP order to rectify any apparent mistake on his own or which has been bought to notice by the Assessee or AO. The limitation period of amending an order is 4 years from the end of the year in which the TP order is passed.

17. Owing to the complexities inherent in TP, a TP audit are becoming unduly complicated and time & resource intensive. It should therefore not to be taken lightly and due consideration should be given to possible complexities and to the amount of tax at risk. An effective representation and submissions during assessment, irrespective of the outcome, helps the Assessee in defending the transfer price before the appellate authorities. The hard work involved in TP assessments also results in significant learning, which also helps in the assessment for the subsequent years. However, currently the return from the extensive TP exercise does not seem to come immediately and are generally resolved at appellate levels.

18. Red flags of TP Assessments in India:

Captive intra group service providers (IT/BPO)	Loss/low-margin companies with significant intercompany transactions	Sales supply chain structures	Financial transactions-intra-group loans, guarantees
Business restructuring	Outstanding receivables	Significant Advertisement, Marketing and Promotion (AMP)expenses	Payment for intra-group service/HQ charges
Activities that result in enhancement/ development of IP	Payments for use of IP	Procurement activities	Comparables Tweaking
Use of adhoc filters	Disregard of adjustments	Disregard of berry ratio	Disregard of broker quotes/CUP's

19. **Hierarchy of Appellate authorities** for perusing the appeal in relation to the TP adjustments proposed by the TPO's:



This article is contributed by CA Mithilesh. The author can be reached at mithileshs@sbsandco.com

ACCOUNTING STANDARDS - IND AS AND IFRS CONCEPTS

Contributed by CA Aruna |

What and Why Ind AS:

To know what and why Ind AS, we need to first understand what and why IFRS:

IFRS (International Financial Reporting Standards)

International Financial Reporting Standards (IFRS): International Financial Reporting Standards (IFRS) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. They are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries.

According to the U.S. Securities and Exchange Commission. IFRS are used in many parts of the world, including the European Union, India, Hong Kong, Australia, Malaysia, Pakistan, and GCC countries, Russia, Chile, South Africa, Singapore and Turkey. As more than 113 countries around the world, including all of Europe, currently require or permit IFRS reporting and 85 require IFRS reporting for all domestic, listed companies

Advantages of IFRS

Most important advantage of presenting financials per IFRS offers comparability. With India being an emerging market, such presentation provides an advantage.

Securities & Exchange Commission (SEC), USA has also permitted filing of IFRS- compliant financial statements without requiring presentation of reconciliation statement between US GAAPs and IFRSs.

Why in India

There has been academic research about the benefits of IFRS to reduce capital costs in Europe. And here, we are speaking about mature economies.

For emerging economies like India, the impact will be even bigger. And that is why countries like Brazil or Korea have decided to adopt IFRS. The Indian stock markets already have a high percentage of foreign owners, that might further increase and the ratios may get better.

If one looks at the extent of foreign institutional investors (FII) and foreign direct investment (FDI) that is coming into the country, today most of them are forced to rely on Indian Generally Accepted Accounting Principles (GAAP) which all of them know are very different from the international standards.

The moment companies start reporting under Ind-AS or IFRS, the overall confidence in the quality of financial reporting will go up significantly and therefore, the risk premium otherwise getting attached or even the discount getting attached to the reported earnings of the companies will go off.

This will ultimately result in lowering the cost of capital.

Road Map for implementation of IFRS

India decided to converge and not adopt IFRS in toto.

Adoption means application of IFRS issued by IASB as it is in toto. Convergence, on the other hand, means using IFRS issued by IASB with some carve in and carve outs.

The IFRS converged standards notified in India are Ind AS (Indian Accounting Standards), which are notified by MCA on 16 Feb 2015.

On 16 Feb 2015, MCA notified 39 Ind AS along with implementation roadmap, which is going to be phase wise as given below.

(a) Early adoption permitted voluntarily from 1 April 2015, with one year comparative.

(b) Phase I applicable from 1st April 2016 onwards to
- Listed & Unlisted Companies having net worth *=> 500 crores
- Holding, Sudsy, JV or Asso of above

(c) Phase 2 applicable from 1st April 2017 onwards to
- Listed companies having net worth* less than 500 cr
- Unlisted companies having net worth*>=250 cr but less than 500 cr
- Holding, Subsy, JV and Associates of above.

For companies covered in the first phase of the roadmap following are the alarming dates:

- Transition date (1st Apr 2015) - Companies have to prepare Opening Balance sheet as per Ind AS.
- Adoption date (1st Apr 2016).
- Reporting Date (31st Mar 2017) - Full-fledged Ind AS financials with comparative needs to be prepared.

Note:

a. Companies have to continue reporting their financials as per existing AS for the year ending 31 Mar 2016.

b. Such companies need to compile their financials as per Ind AS also for year ending 31 Mar 2016 being comparative period for 31 Mar 2017.

** Net worth has same meaning as defined in section 2(57) of companies Act, 2013*

Deliverables in Ind AS regime:

As part of Ind AS transition process, companies covered in first phase will have to prepare:

- Opening Ind AS Balance sheet as at 1st April 2015.
- Equity reconciliation between Ind AS and Indian GAAP on 1stApril 2015 & 31s tMar 2016.
- Income Reconciliation between Ind AS and Indian GAAP for the year ending 31st Mar 2016.
- Ind AS financial statements as at and for the year ending 31st Mar 2016 for comparative.
- Ind AS Financial statements as at and for year ending 31st Mar 2017.

Ind AS financial statements includes following deliverables:

- Balance Sheet
- Statement of profit or loss and other comprehensive Income
- Statement of changes in equity
- Statement of cash flows
- Notes including significant accounting policies and other explanatory information to the accounts.

Interesting to know:

- The Insurance, Banking and NBFC companies shall not be required to apply Ind AS either voluntarily or mandatorily as per notified roadmap.
- Companies that are listed or in the process of listing in SME exchanges are exempt from implementation roadmap.
- Net worth for the purpose of applicability needs to be checked on Mar 31st, 2014 on the basis of audited standalone financials or after first audited accounting period.
- Ind AS will apply to both Consolidated as well as standalone financials of the company.
- Ind AS once adopted either voluntarily or mandatorily cannot be revoked in prospective years even in case of net worth goes down from specified limit or any other criteria given in roadmap.

Practical issues /FAQ's:

Q. What will be the applicability date if the company has a year ending other than 31st March?

Sol. Ind AS applicability is decided based on the beginning of the financial year and not its end.

Explanation: To comply with the companies Act 2013 requirement concerning uniform financial year, a company prepares 15-month financials starting 1st April 2015 to 31st March 2016. Following table helps to decide the applicability of IND AS.

Year End	Voluntary Phase	Mandatory Phase 1	Mandatory Phase 2
	Ind AS applicability for financial years beginning		
31st December	1st Jan 2016	1st Jan 2017	1st Jan 2018
30th June	1st July 2015	1st July 2016	1st July 2017
30th September	1st Oct 2015	1st October 2016	1st October 2017

Q. Whether IND AS should be applied only to CFS or should it be applied to stand alone financials correspondingly.

Sol. In accordance with the final road map notified under the Companies Act 2013, companies need to apply both at the SFS and CFS level. This will help users understand the financials better. Moreover, Section 129(3) of Companies Act 2013 requires the CFS to be prepared in the same form and manner as company's SFS.

Q. Can a company choose to apply certain standards of IND AS and continue with GAAP with respect to other disclosures?

Sol. No. A company who wishes to voluntarily adopts IND AS, need to apply either adopt IND AS or 2006 AS in its entirety. Companies are not allowed to mix between the two different sets of standards.

Q. Does the requirement to include subsidiaries, JV's for adopting the IND AS extends to Indirect/step-down subsidiaries?

Sol. Yes. The term subsidiary per companies Act 2013 and accounting standards include direct as well as indirect /step down subsidiaries.

Q. Does the requirement to include subsidiaries, JV's for adopting the IND AS extends to Indirect/step-down subsidiaries even when the parent has voluntarily adopted IND AS and not by virtue of applicability criteria i.e., net worth?

Sol. No and Yes. Using the strict definition, its no, since the parent is not required to adopt by virtue of applicability criteria-net worth But from practical stand point, it is required to adopt since, these subsidiaries/JV's need to provide IND AS group reporting package to facilitate preparation of IND AS CFS by the company which has adopted IND AS – even if voluntarily.

Q. Are IND AS applicable to venture capital funds(VCFs) and mutual funds (Mfs)?

Sol. No.

The road map is clear that it applies to companies. For VCFs and MFs the Securities Exchange Board of India (SEBI) will lay down conversion road map separately.

Q. Is interim financial information required to be Ind- AS Compliant?

Sol. Yes.

As per clause 41 of the listing agreement currently requires that quarterly and year to date results should be prepared in accordance with recognition and measurement principles laid down in AS 25 Interim Financials Reporting notified under the Company rules, 2006. Once company starts using IND AS for annual financials statements, it will be expected that the company use same standards for quarterly reporting.

This poses a practical difficulty for the first year of adoption in terms of comparatives. Since the interim financials are prepared in comparison with the previous years financials – which are presented in Indian GAAP, a lot of information and explanations need to be provided to make the numbers comparable.

This article is contributed by CA Aruna. The author can be reached at arunam@sbsandco.com

TECHNICAL SESSIONS:

S.No.	Event	Date	Speaker	Venue
1	Road map for implementing IFRS in India	14/08/2015	CA Aruna	SBS - Hyd
2	Preparation of Financial statements using MS Office	21/08/2015	CA Saran Kumar U	SBS - Hyd
3	Basics in Project Finance	28/08/2015	CA Rajesh	SBS - Hyd
4	Export Benefits under Service Tax	04/09/2015	CA Manindar	SBS - Hyd

Preparation of Director's Report & Annual Return - Companies Act, 2013 - CS Phanindra DVK

Overview of Transfer Pricing - CA Mithilesh Sai

FEMA - NRI Transactions @ ICAI - Ongole - CA Murali Krishna G

FCRA - Procedure & Critical Issues @ ICAI - Hyderabad - CA Murali Krishna G

Overview on GST @ ICAI - Hyderabad - CA Manindar

Updates in Service Tax @ Tax Bar Association - Guntur - CA Sri Harsha

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Hyderabad: 6-3-900/6-9, #103 & 104, Veeru Castle, Durganagar Colony, Panjagutta, Hyderabad, Telangana
Kurnool: No. 302, 3rd Floor, V V Complex, 40/838, R.S. Road, Near SBI Main Branch, Kurnool, Andhra Pradesh
Nellore: 16-6-259, 1st Floor, Near Santi Sweets Opp: SBI ATM, Vijayamahal Centre, SPSR Nellore, Andhra Pradesh
Tada: 8-3-425/2, Flat No. 202, 2nd Floor, Bigsun Avenue, Near SRICITY, TADA, SPSR Nellore Dist, Andhra Pradesh
Visakhapatnam: # 39-20-40/6, Flat No.7, Sai Yasoda Apartments, Madhavadhara,Visakhapatnam (Urban),Vizag, Andhra Pradesh

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