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FOREIGN TRADE POLICY

FOREIGN TRADE POLICY VS CUSTOMS LAW – A CASE STUDY

Contributed by CA Sri Harsha |

We all know that Foreign Trade Policy (for brevity 'FTP') is laid down with an intention to encourage the exports and regulate the imports. Apart from such administration of the export and import of goods and services, it also formulates various export incentive schemes to encourage the exports and make India's presence visible in global trade.

The export incentive schemes or exemptions from import duties will generally come with the conditions to be fulfilled for enjoying such incentives or exemptions. Such conditions might be laid down both by the FTP and the relevant statutes as detailed in the following example.

An importer is exempted from the customs duty on import of raw material on a condition that the finished goods manufactured by using such free imported material are exported within a stipulated time. Here, such exemption from import duty might come with conditions to be satisfied in both FTP or Customs law or any one of them.

The point of consideration is in this article is *'whether satisfaction of conditions laid down by the FTP would absolve the assessee from satisfying the conditions laid down in the Customs law to avail the benefits of the scheme'?* In other words, does a customs authority can deny the exemption from the import duty under Customs Law since the assessee has failed to satisfy the conditions laid down in such exemption notification despite of the fact that he has satisfied the conditions laid out in the FTP.

In order to answer such a question, we should touch upon certain basic concepts in the FTP. It is a much known fact that FTP can only formulate the schemes, however the said policy cannot issue exemption notification in relevant statutes like Customs law (as in the above example). That is to say the scheme should be complimented with an exemption notification in the relevant statute separately to avail such benefit laid down by the schemes.

So, from the above, it is evident that FTP can only formulate the schemes but cannot issue exemption notifications in the relevant statutes and the responsibility to lay down such exemption notification rests with Department of Revenue. Now, let us proceed to answer the question raised in the article by taking the ratio of recent Supreme Court judgment in the case of Pennar Industries Limited[1] (for brevity 'Pennar'/'Assessee').

In the Pennar case, they have imported hot rolled non-alloy steel wide coils against advance license issued under the Duty Exemption Entitlement Scheme (for brevity 'DEES'). At the time of importation, Pennar has not paid customs duty in light of the exemption under Notification No 30/1997 – Cus, dated 01.04.1997 which provides exemption to the actual users from the customs duty at the time of import subject to a condition of export of finished goods manufactured using such free imported material.

[1] 2015-TIOL-162-CUS-SC

Pennar has manufactured the finished goods using such duty free raw material but could not export since the quality of the finished goods was not fit for exports. Hence, they have not exported the said finished goods and cleared such goods for home consumption. When the Director General of Foreign Trade (for brevity 'DGFT') has raised query pertaining to the fulfillment of export obligations, Pennar has represented that the said quantity cannot be exported and requested to change the product to be exported and also allow the export obligation to be fulfilled even the said exports was done through supporting exporters (exports made by arranging with other manufacturers or traders to meet export obligation). DGFT has accepted the submissions of Pennar and change the product to be exported and allowed support exports to be deemed as exports done by Pennar. The assessee has met the export obligations vide such permission given by DGFT and was under an impression that the export obligation has been discharged as per the DEES.

However, the customs authorities has demanded the customs duty which is not paid since the assessee has failed to comply with the conditions of Notification No 30/1997-Cus dated 01.04.1997. The grounds of customs authorities were that, the said Notification does not allow any other material to be exported and the actual user of the raw material has to export the finished goods. Both the conditions have not been met by Pennar since the goods exported are not the one which is specified in the Notification and the exports were not actually made by the actual user of the subject imported material since they have been made by support exporters. Since, the conditions have been violated a notice demanding the customs duty on the imported raw material was issued. The assessee has stated that since the DGFT has accepted the exports made by the other persons as exports of the assessee, there cannot be any demand under customs. The supporting exports or 3rd party exports is an accepted concept under DGFT but not under customs especially when the exemption notification specifies that the actual user of raw material has to export and the adjudicating authority has confirmed the demand.

Pennar has approached the tribunal wherein it was held that when DGFT has amended the license to accommodate the products to be exported and support exports, the same amounts to fulfillment of export obligations as per license and hence there cannot be any demand of customs duty and brushed away the order of the adjudicating authority. The authorities have gone for appeal against such order of Tribunal before the Honorable Supreme Court.

The Honorable Supreme court after due considerations made by both the parties has held that when the conditions specified in Notification No 30/1997-Cus has not met, there cannot be any exemption despite of the fact DGFT has amended the terms on which the license is issued. The apex court after taking the ratio laid by the coordinate bench (of apex court) in the case of Sheshank Sea Foods Private Limited vs Union of India & Ors wherein it was held that there is nothing in EXIM policy which prohibits the power of customs to investigate into the matters even the subject belongs of EXIM policy. By adopting such ratio, the apex court has held that the assessee is required to pay customs duty since it has failed to satisfy the conditions laid down vide the Notification No 30/1997-Cus despite of the fact that the assessee has fulfilled the modified conditions given by DGFT.

From the above judgment, it is clear that despite the conditions laid down vide the license has been satisfied, the conditions enshrined in the Customs exemption notification has also to be satisfied. However, the apex court when delivering the above judgment has recommended the Central Government to make necessary amendments to overcome such situations where DGFT has relaxed the conditions, the supporting notification in the statutes should also envisage the same and cannot be in contradiction as after all such notifications under Customs Law are issue to implement and to give effect to the benefits under the foreign trade policy. Hope the DGFT/Department of Revenue comes with necessary amendments to meet the eventualities to avoid unnecessary hardships for bonafide assessees.

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AUDITING

INTERNAL FINANCIAL CONTROLS - A PARADIGM SHIFT IN THE REPORTING REQUIREMENTS UNDER CARO

Contributed by CA Sandeep

Overview:

High-profile corporate disasters in the US made governments, regulators and corporations grasp afresh the significance of internal controls. These disasters were largely attributed to the failure to implement internal controls.Numerous terms are used by globally recognised control frameworks and market regulators - "Internal Control for Financial Reporting" (ICFR) mostly in the US after the Sarbanes Oxley (SOX) Act and "Internal Control" (IC) mostly outside the US.

IC is defined in the three globally recognised frameworks: the Internal Control - Integrated Framework (COSO Framework) developed in the US in 1992, by the Committee of Sponsoring Organisations of the Commission ("COSO") of the Treadway Commission; the Turnbull Guidance for Directors on the UK's Combined Code on Corporate Governance, issued in 1999 by the Institute of Chartered Accountants of England and Wales; and the Board Guidance on Criteria of Control (CoCo) issued in 1995 by the Canadian Institute of Chartered Accountants (CICA). These frameworks not only define internal controls but also break down the controls into components and objectives and elucidate the basis of monitoring, testing, assessment and evaluation of controls. These frameworks serve only as guidance for boards, managements and auditors and have gained global prominence; and advocate a wide approach to internal control, covering objectives such as improving business effectiveness, consideration of significant risks in operations, safeguarding of assets, compliance and financial reporting. The Companies Act 2013 (the Act) created a new term - "Internal Financial Control" (IFC).

Section 143(3)(i) of the CompaniesAct 2013 now requires statutory auditors to state in his /her reportwhether acompany hasadequate internal financial controls systems in place and the operating effectiveness of such controls. This requirement is in addition to the existing audit opinion on financial statements. Originally this requirement was applicable to the financial year ending 31 March 2015, due to lack of guidance this requirement was postponed tothe year ending 31 March,2016 by virtue of insertion of Rule 10A of Companies (Audit and Auditors) Rules, 2014.The auditor can report such ICFR for the year ending 31 March, 2015 on a voluntary basis. This requirement is applicable to all companies including One Person Company and Small Company. Consequently reporting requirement pertaining to internal control under the Companies (Auditor's Report) Order, 2015(CARO) was retained by Ministry of Corporate Affairs (MCA) for certain areas.

In clause (e), sub-section (5) of Section 134 of the Act, IFC to include policies and procedures adopted by the company for ensuring orderly and efficient conduct of it business, accuracy and completeness of the accounting records and timely preparation of reliable financial information.

The absence of standards will make certification of the adequacy and operational effectiveness of a company's IFC by the auditors difficult. Even the Companies (Auditor's Report) Order (CARO), 2003, which statutory auditors have been following, required auditors to comment upon the adequacy of the internal control system, only with reference to the purchase of inventory and fixed assets and for the sale of goods and services and not specifically on the operating effectiveness of such controls. It is precisely for this reason that the US Securities Exchange Commission (SEC) used the term ICFR in its Rules for Section 404 of the SOX Act. ICFR is specific. It addresses only a subset of internal controls of the COSO Framework pertaining to financial reporting objectives and deliberately leaves out elements that relate to the effectiveness and efficiency of a company's operations and a company's compliance with applicable laws and regulations except financial reporting.

For companies to maintain the effective IFC necessary criteria has been provided in the ICAI "Guidance Note on Audit of Internal Financial Controls over Financial Reporting" (guidance note). Definition of the term ICFR has been reproduced in the guidance note from the US Auditing Standard (AS) 5 – An audit of Internal Control Over Financial Reportingand it is integrated with an Audit ofFinancial Statements issued by PCAOB – A process designed to provide reasonable assurance regarding thereliability of financial reporting and the preparation of financial statements for external purposes in accordance with generallyaccepted accounting principles. A Company's internal financial control over financial reporting includes those policies and procedures (i) pertains to maintenance of records that, in detail, accurately and fairly reflect the transaction and disposition of the asset of the company; (ii) provide reasonable assurance that transaction are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company and (iii) provide reasonable assurance regarding the prevention or timely detection of unauthorised acquisition, use, or disposition of the company's assets that could have material effect on the financial statements.

Criteria to be considered for developing, establishing and reporting on IFC

As such theguidance note does not provide any particular framework for IFC instead it states that a benchmark system internal control, based on suitable criteria, is essential to enable the management and auditors to assess and state the adequacy and compliance of the system of internal controls. The guidance note explains that for auditor's reporting, the term IFC is restricted within the context of the audit of financial statement and relates to internal control over financial reporting (ICFR) and this is in line with the international practice.

Necessary criteria for IFC over financial reporting for the companies has been provided in " Internal Control Components" of Standards on Auditing (SA) 315 " Identifying and Assessing the Risks of Material Misstatement through Understanding the entity and environment" issued by ICAI. SA 315 explains the five components of any internal control as they relate to a financial statement audit. The five components are:

- Control environment
- Entity risk assessment process
- Control activities
- Information system and communication
- Monitoring of controls

Management's responsibility

The 2013 Act has radically expanded the scope of internal controls to be considered by the management of companies to cover all aspects of the operations of the company.

- Boards of directors of the listedcompanies are required to affirm in the Directors' Responsibility Statements in Annual Reports that IFC systems in the companies are adequate and operationally effective as required under Section 134(5)(e) of the 2013 Act.

- Rule 8(5)(viii) of the Companies (Accounts) Rules,2014 requires the Board of Directors report of all companies to state the details in respect of adequacy of internal financial controls with reference to the financial statements.

The inclusion of the matters relating to internal financial controls in the directors' responsibility statement is in addition to the requirement for the directors to state that they have taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the 2013 Act, for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

Auditor's responsibility

The auditor's objective in an audit of internal financial controls over financial reporting is to express an opinion on the effectiveness of the company's internal financial controls over financial reporting and the procedures in respect thereof are carried out along with an audit of the financial statements.

The auditor must plan and perform the audit to obtain sufficient appropriate evidence to obtain reasonable assurance about whether material weakness exists as of the date specified in management's assessment. Company's internal controls cannot be considered effective if one or more material weakness exists. A material weakness in internal financial controls may exist even when the financial statements are not materially misstated. SA 200 - Overall objectives of the Independence Auditor and the Conduct of an Audit in Accordance with Standards on Auditing, issued by ICAI, states that the auditor's opinion on the financial statements does not assure the future viability of the entity nor the efficiency or effectiveness with which the management conducted the affairs of the entity.

Globally, auditor's reporting on internal controls is together with the reporting on the financial statements and such internal controls reported upon relate to only internal controls over financial reporting. For example, in USA, Section 404 of the Sarbanes Oxley Act of 2002, prescribes that the registered public accounting firm (auditor) of the specified class of issuers (companies) shall, in addition to the attestation of the financial statements, also attest the internal controls over financial reporting. The Companies Act, 2013 specifies the auditor's reporting on internal financial controls only in the context of audit of financial statements. Consistent with the practice prevailing internationally, the term 'internal financial controls' stated in Clause (i) of Sub- section 3 of Section 143 would relate to 'internal financial controls over financial reporting' in accordance with the objectives of an audit stated in SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with

Standards on Auditing", issued by ICAI.Further, Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 requires the Board of Directors' report of all the companies to state the details in respect of adequacy of internal financial controls with reference to the "financial statements" only.

Audit of IFC

The guidance note provides procedures that would need to be considered by the auditor for planning, performing and reporting in an audit of IFC under section 143(3)(i) of 2013 Act. The guidance note specifically states that since the audit of IFC is in connection with financial reporting, the concept of materiality will be applicable even in such audits. In planning the audit of internal financial controls over financial reporting, the auditor should use the same materiality considerations he or she would use in planning the audit of the company's annual financial statements as provided in SA 320 "Materiality in Planning and Performing an Audit", issued by ICAI.

Audit procedures mentioned in the guidance note have been framed for an auditor; these procedures could also be used by the companies to perform a self – evaluation. Following steps are included in the audit procedures.

Planning Step 1 → Design and Implementation Step 2 → Operating effectiveness Step 3 → Reporting Step 4

Planning– The planning stage involves identification of significant account balances, disclosures items, identification and understanding significant flow of transactions, identification of Risk of Material Misstatement, and identification of controls. The auditor is required to establish an overall audit strategy which sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

Design and Implementation- The auditor should test the design effectiveness of controls by determining whether the company's control, if they are operated as prescribed by persons posessing the necessary authority and competence to perform the controls effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements. The auditors should obtain understanding of the entity's flow of transactions and identify controls that are relevant to the audit and gain an understanding of those controls.

Operating effectiveness - Testing operating effectiveness involves planning and nature, timing and extent of procedures to be performed, assessing findings and concluding on operating effectiveness. Operating effectiveness of a control is tested by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively. In some instances, when the auditor is testing controls, the walkthrough procedures may be used to obtain evidence about the operating effectiveness of a control. In performing a walkthrough, the auditor generally follows a single transaction from its origination through the procedures or steps in the process to the transaction's ultimate recording in the general ledger or its sub-ledgers.

Reporting - Where there are deficiencies that, individually or in combination, result in one or more material weakness, the auditor should evaluate the need to express a modified opinion (qualified or adverse on the company's IFC) unless there is a restriction on the scope of the engagement in which case the auditors should either disclaim the opinion or withdraw from the engagement. As per the guidance note, auditors will have to issue a qualified or an adverse opinion on ICFR if 'material weaknesses' in the company's ICFR are identified as part of their audit.

The auditor shall modify the opinion in the auditor's report on internal financial controls over financial reporting when: (i) The auditor concludes that, based on the audit evidence obtained, the internal financial controls over financial reporting is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct material misstatements in the financial statements on a timely basis; or the control is missing; or (ii) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the internal financial controls over financial reporting is adequate and / or operating effectively to provide reasonable assurance that it is designed, implemented or operated in such a way that it is able to prevent, or detect and correct material misstatements in the financial statements on a timely basis.

IFC reporting on Consolidated Financial Statements (CFS)

Section 129(4) of the 2013 Act states the provisions of the 2013 Act applies to the preparation, adoption and audit of the financial statement of a holding company shall, mutatis mutandis, apply to the CFS. With regard to the consolidated financial statements, the financial reporting process would include understanding the procedures for:

I) Identification of subsidiaries, associates and joint ventures that would form part of the consolidation process;
ii) Identification of inter-company transactions for elimination and elimination of any unrealized profits on such transactions;
iii) Identification and quantification of minority interest;
iv) Ensuring consistency of accounting policies amongst the consolidating entities; e) ensuring consistency of the classification of account balances amongst the consolidating entities;
v) Recording recurring and non-recurring adjustments to the annual and quarterly consolidated financial statements; and
vi) Ensuring appropriate disclosures in the consolidated financial statements.

IFC reporting on interim financial statements

Auditor reporting on IFC is a requirement specified in the 2013 Act, and therefore will apply only in a case of reportingon financial statements prepared under the 2013 Act and reported under section 143 of the 2013 Act.Accordingly, reporting on IFC will not be applicable with respect to interim financial statements, such as quarterly or half yearly financial statements, unless such reporting is required under any other law or regulations.

Integrated Audit - Combined audit of internal financial controls over financial reporting and financial statements

(1) Corporates and auditors in India will need to come to terms with the concept of a combined or an integrated audit, which includes an audit of internal control over financial reporting and financial statements.In a combined audit of internal financial controls over financial reporting and financial statements, the auditor should design his or her testing of controls to accomplish the objectives of both audits simultaneously. In a combined audit of internal controls over financial reporting and financial statements, the auditor expresses opinion on the following aspects:

(i) Opinion on internal control over financial reporting, which requires:

- Evaluating and opining on management's assessment of the effectiveness of internal financial controls (In Japan based on the requirements of the Financial Instruments and Exchange Act).
- Evaluating and opining on the effectiveness of internal controls over financial reporting (In USA based on the requirements of Section 404 of the Sarbanes – Oxley Act).

(ii) Opinion on the financial statements.

(2) While the objectives of the audit of internal controls over financial reporting and audit of financial statements are not identical, the auditor plans and performs the work to achieve the objectives of both the audits in an integrated manner. Therefore, in a combined audit of internal financial controls over financial reporting and financial statements, the auditor should design his or her testing of controls to accomplish the objectives of both audits simultaneously

(3) In such an audit, the auditor plans and conducts the audit:

- To obtain sufficient evidence to support the auditor's opinion on the internal financial controls as of the year-end, and
- To obtain sufficient evidence to support the auditor's control risk assessments for purposes of the audit of the financial statements

Specified date for reporting on the adequacy and operating effectiveness of IFC

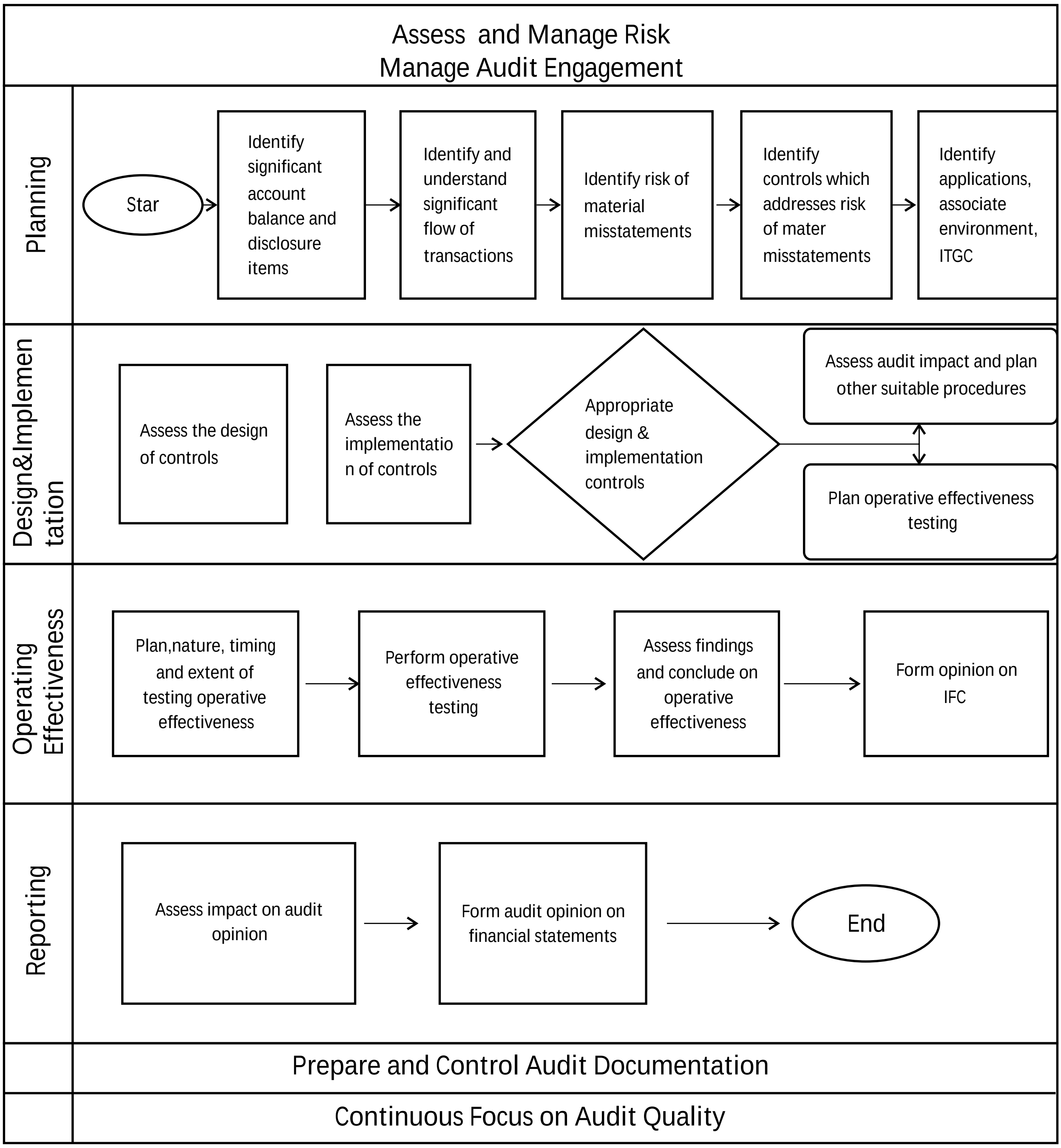
Another aspect which required clarification was whether the comments in the auditor's report should describe the existence and effective operation of ICFR during the period under reporting of the financial statements or as at the balance sheet date. Section 143(3)(i) of the 2013 Act does not specify whether the auditor's report should state if IFC existed and operated effectively during the period under reporting of the financial statements or at the balance sheet date up to which the financial statements are prepared.The guidance note clarifies that auditors will have to report whether a company has an adequate ICFR system in place and whether the same was operating effectively as at the balance sheet date of 31 March 2016. In practice, this will mean that when forming its audit opinion on ICFR, the auditor will surely test transactions during the financial year ending 31 March 2016 and not just as at the balance sheet date, though the extent of testing at or near the balance sheet date may be higher.If control issues or deficiencies are identified during the interim period and are remediated before the balance sheet date, then the auditor may still be able to express an unqualified opinion on the ICFR. For example, if deficiencies are discovered, the management may have the opportunity to correct and address these deficiencies by implementing new controls before the reporting date. However, sufficient time will need to be allowed to evaluate and test controls, which will again depend on the nature of the control and how frequently it operates. This will be a matter of professional judgment.

Comparison with International practice

It is interesting to note that the guidance note has similarities with PCAOB Auditing Standard No. 5, which is applied by auditors in the context of SOX reporting in the US. For example, various paragraphs from the US auditing standard have been inserted within the guidance note, including definitions such as significant deficiency and material weakness related to internal controls. Also, in India, auditors are not required to report on the management's assertion of effectiveness on IFC. Reporting under the act will be an independent assessment and assertion by the auditor on the adequacy and effectiveness of the entity's ICFR.

The guidance note is a fairly comprehensive document , with detailed guidance in several areas related to ICFR, such as the internal control components, entity-level controls, information technology controls, understanding and documentation of process flows, including flow charts, use of service organisations and sampling. Both the management and auditors will have to quickly familiarise themselves with and decipher the details of this guidance note in order to gear up for the year-end reporting on IFC.

Flowchart Illustrating Typical Flow of Audit of Internal Financial Controls Over Financial Reporting



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LABOUR LAWS

REGISTRATION AND RECOGNITION OF THE TRADE UNIONS

Contributed by SV Ramachandra Rao |

Trade Union Act was amended in the year 2001 which came into effect from 9th January 2002 and there has been a change in the requirements for registration of a trade union.

According to the new provisions of the Act, no trade union of workmen shall be registered unless at least 10% or 100 of the workmen, whichever is less, further subject to minimum of seven workmen, engaged or employed in the establishment or industry with which it is connected are members of such Trade Union on the date of making the application.

The application for registration should accompany the details of members such as (1) Name (2) occupation (3) address of place of work of the member.

After making the application and before the registration, if 50% or more workmen withdrawn from the membership, the Union cannot be registered.

Registered Trade Union of workmen shall at all times continue to have not less than 10% or 100 of the workmen, whichever is less, subject to minimum of seven, engaged or employed in an establishment or industry with which it is connected, as its members.

Thus whenever the Labour Department conducts the verification of membership among the registered trade unions, it is the responsibility of the Registrar of Trade Unions to cancel the registration of a Trade Union which has membership of less than 10% or 100 of the workmen as the case may be.

The Act has also prohibited persons holding an office of profit and also the council of ministers to be the executive and or office bearers of a Trade Union. An office of profit means a position that brings to the person holding it some financial gain or advantage or benefit and the quantum of such gain or remuneration is immaterial.

The Act also disqualifies a member of the union to be the office-bearer or executive of the union if he has been convicted by a Court in India of any offence involving moral turpitude and sentenced to imprisonment. Such person can only become an executive or office bearer of a union only after completion of 5 years period after his release.

The Madras High Court (2010) in the matter of M LakshmananVs ICICI Bank Employees Union held that conviction and sentence imposed on an employee of the Bank under section 138 of Negotiable Instruments Act can be considered as an offence involving moral turpitude and there by not entitled to hold the post of General Secretary of the Union.

The Trade Union members or the office bearers do not enjoy any immunity if they indulge in acts which constitute misconduct. Leadership has no right to indulge in acts which are oppose to law and they are liable for punishment under general law as well.

The Madras High Court in the matter of Indian Bank Vs Federation of Indian Bank Employees held that all workmen, guilty of wrongfully restraining any person belonging to the management or wrongfully confining him during a gherao are guilty under Section 339 or 340 of Indian Penal Code and have committed cognizable offences, for which they are liable to be arrested without warrant and punishable under Section 120A of IPC and is not saved by Section 17 of the Trade Union Act.

The Supreme Court in the matter of UshaBrecoMazdoorSanghVsUshaBreco Ltd [Air 2009 994] held that a union leader has no immunity from misconduct since he is also bound to be disciplined.

The management has every right to debar the entry of a trade union leader who is preaching violence either among the workmen or against the management. The Bombay High Court in the matter of Pudumjee Pulp & Paper Mills KamgarSanghVsPudumjee Pulp & Paper Mills [2008 LLR 860] confirmed this proposition.

The free ingress and egress of men and materials is a fundamental right of the owner of the property and hence the Unions or the workmen have no right to obstruct such movement to conduct its business. The Rajasthan High Court in the matter of Ajmer District Forest Department Asst Employees Union Vs State of Rajasthan [2006 LLR 283] held that a Trade Union has no right to cause obstruction to ingress or egress by staging demonstration since for redressal of grievances, they have the forum as under the law.

The union office bearers are workmen first and the role and responsibility of the management of the union is next to his primary duty of performing the work at the factory. Hence all the rules, regulations and responsibilities of a workman are applicable to them as well. The Himachal Pradesh High Court in the matter of Mohan Meakins Ltd Vs President Mohan Meakins Staff Union [2012 LLR 1040] held that the President of the Union cannot avoid transfer and he is required to report to duty at the new place of work. The Trade Union Act has not given any authority or powers to the executive or the office bearer of a trade union to conduct trade union activities while on duty within the premises of the factory. The trade union activities are to be conducted outside the working hours and not during the working hours. The Andhra Pradesh High Court in the matter of Singareni Collieries Vs Industrial Tribunal [2012 LLR 1162] held that Trade Union activities are not justified while on duty.

The only differentiation between a workman and the executive or office bearer of a trade union has been made in the Industrial Disputes Act under certain circumstances for a limited number of trade union office bearers, who are known as ‘protected workman’. The Industrial Disputes Act has provided protection from discharge or dismissal of the executive or other office bearer of a registered trade union who are declared as protected workman. During the pendency of an industrial dispute before conciliation or tribunal or labour court, the employer should not discharge or dismissal a protected workmen without permission from authority before whom the dispute is pending.

However, an office bearer or an executive of a registered trade union will not become a protected workman automatically. The registered trade union has to follow the procedure laid down under the Act. In accordance with the ID Rules, every registered trade union is required to submit the list of name of the executive or office bearers of the union who should be considered as protected workman on or before 30th April every year. Within fifteen days of receipt of the request from the union, the employer has to communicate the approved list of protected workman and it shall be valid for a period of twelve months from the date of communication. The number of protected workman shall be one percent of the workmen strength subject to a minimum of five and maximum of one hundred. Where there are more than one registered trade union in an industrial establishment, the protected workman for each of the registered trade union shall be in accordance with the membership of that union.

It has been the most common experience of the managements that soon after the registration of a trade union, most of the leaders will come up with a plan to hoist a flag in or near the factory premises. The Kerala High Court in the matter of Kerafibertex International P Ltd VsKerafibertex Employees Association [2009 LLR 985] held that Trade Unions have no right to hoist flags in the property of the Management. If the flag is hoisted outside the property of the Management, then the flag is said to have hoisted in a public place where the District Collector and the police will have authority not to permit such unauthorized activities.

The Trade Union Act 1926, deals only with the registration of Trade Unions. The Act has not provided any provisions with regard to the recognition of a trade union or declaring a trade union as a sole bargaining agent. However some State Governments such as Madhya Pradesh, Maharastra and West Bengal made certain amendments to recognize the union as a sole bargaining agent. In the State of Andhra Pradesh and Telangana there is no such provision and hence the recognition of the union is based on the acceptance of the code of discipline by the registered trade unions and verification of membership by the Labour Department.

At the central level, the 16th session of the Indian Labour Conference held at Nainital in May 1958 adopted the following set of criteria under the Code of Discipline for the recognition of trade unions:

1. Where there is more than one union, a union claiming recognition should have been functioning for at least one year after registration. Where there is only one union, this condition would not apply.
2. The membership of the union should cover at least 15 per cent of the workers in the establishment concerned. Membership would be counted only those who had paid their subscriptions for atleast three months during the period of six months immediately preceding the reckoning.
3. A union may claim to be recognized as a representative union for an industry in a local area if it has a membership of at least 25 percent of the workers of that industry in that area.
4. When a union has been recognized, there should be no change in its position for a period of two years.
5. In case of several unions in an industry or establishment, the one with the largest membership should be recognized.
6. A representative union for an industry in an area should have the right to represent the workers in all the establishments in the industry, but if a union of workers in a particular establishment has a membership of 50 percent or more of the workers of that establishment, it should have the right to deal with matters of purely local interests, such as, for instance, the handling of grievances pertaining to its own members. All other workers who are not members of that union might either operate through the representative union for the industry or seek redress directly.
7. In the case of trade union federations not affiliated with any of the four central labour organizations, the question of recognition would have to be dealt with separately.
8. Only unions which observed the Code of Discipline would be entitled to recognition.

In accordance with the code of discipline the verification of membership of all the registered trade unions in an establishment is being conducted by the Labour Department authorities and the trade union which has the highest membership is declared as the recognized union for a period of two years.

In accordance with the provisions of the Act, in an industrial establishment, there can be many registered trade unions. The Supreme Court has time and again examined the matter and held that the rights and privileges vested in a non-recognized association are limited to espousing the grievances of individual members relating to their service conditions and representing them in domestic or departmental enquiries held by the employer and not proceeding before the conciliation officer, labour court, industrial tribunal or arbitrator. There is no right in the non-recognized union to participate in discussions relating to general issues concerning all workmen. [Chairman SBI Vs All Orissa S B Officers Association, AIR 2002 SC 2279]

Once there is a representative union, which in the present case, is the Labour Union, it is difficult to see the role of the Workers' Union. If there are number of trade unions registered under the Trade Union Act, not entitled to be registered as "representative unions" and they raise disputes, industrial peace would be a far cry. [National Engg Industries Ltd Vs State of Rajasthan AIR 2000 SC 469].

Today most of the industrial establishment has multiplicity of the unions and hence the management should in their own interest provide the rightful place to the recognized union and should not encourage minority or unrecognized unions. Dealing with unrecognized unions will create more unions and the entire process of employee relations will be more complex and difficult to achieve the organizational objectives.

TRANSFER PRICING

BACKGROUND AND INITIATIVE STEPS TAKEN BY OECD AND G20 & INDIA CONTRIBUTION, INVOLVEMENT

Contributed by CA Mithilesh |

OECD is an international economic organisation of 34 countries, founded in 1961 to stimulate economic progress and world trade. It is a forum of countries describing themselves as committed to democracy and the market economy, providing a platform to compare policy experiences, seeking answers to common problems, identify good practices and coordinate domestic and international policies of its members.

The G20 is made up of the finance ministers and central bank governors of 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States of America.

The remaining seat is held by the European Union, which is represented by the rotating Council presidency and the European Central Bank.

India not a member of OECD, but actively engaged in taxation work of OECD. Since 2006, India been accorded the status of "Participant" / "Observer"of OECD and G20 countries working on equal footing on the BEPS project. Recommendations under BEPS Project made on basis of consensus arrived by 34 OECD Countries and 8 non-OECD G20 countries

India as an non-OECD G20 country, is an active participant in the BEPS project. As member of "Bureau Plus", participated in the decision making process. India obliged to act on BEPS recommendations. We Can expect BEPS related changes as early in the forthcoming 2016 Budget.

What is BEPS?

The term Base Erosion and Profit Shifting (BEPS) refers to tax avoidance strategies which, by exploiting gaps and mismatches in tax rules, shift profits of Multinational Enterprise ('MNE') Groups to low or no tax locations where there is little or no real activity.

What causes BEPS?

The interaction of domestic tax systems in cross border transactions may result in double taxation of same income / leave gaps, resulting in double non-taxation of income.BEPS strategies take advantage of these gaps between tax systems in order to achieve double non-taxation.

Impact:

Global corporate income tax (CIT) revenue losses estimated between 4% and 10% of global CIT revenues, i.e. USD 100 to 240 billion annually. Given developing countries' greater reliance on CIT revenues, estimates of the impact on developing countries, as a percentage of GDP, are higher than for developed countries.

The Organisation for Economic Co-operation and Development (OECD) has published 'Action Plans' on BEPS as an initiative aimed at curbing such strategies. The Action Plans are built around three pillars viz. Coherence, Substance and Transparency. The final reports on the 15 Actions differ in timing of impact and further steps are needed. Some measures may have (almost) immediate effect in a number of countries; others require treaty based action or legislative action by countries. The OECD also has announced plans for additional work on some Actions.

Coherence	Substance	Transparency
Action 2: Hybrid mismatch arrangements	Action 6: Preventing tax treaty abuse	Action 11: Methodologies and data analysis
Action 3: CFC rules	Action 7: Avoidance of PE status	Action 12: Disclosure rules
Action 4: Interest deduction	Action 8: TP aspects of intangibles	Action 13: TP documentation
Action 5: Harmful tax practices	Action 9: TP risk and capital	Action 14: Dispute resolutions
	Action 10: High risk transactions	

Other Action points (1 is pertaining to concerns on the business involving Digital economy and the harmful tax planning's and the solutions and 15 is pertaining to multilateral instrument relating to one common document to be signed by the countries accepting the changes that the BEPS action plans are suggesting.)

The Action points pertaining to Transfer Pricing (8-10 and 13) are of immediate impact on the global tax economies including India. In the following paragraphs, we have provided a brief overview of the Action points 8-10, transfer pricing aspects (Intangibles, risk allocation and High value Intra group transactions):

Actions 8-10 – Transfer pricing aspects:

The OECD has included its updated transfer pricing guidance in one report under Actions 8-10, covering: amended guidance on applying the arm's length principle (revisions to section D of chapter I of the OECD Transfer Pricing Guidelines), notably providing guidance on the identification of the actual transaction undertaken, on what is meant by control of a risk, and on the circumstances in which the actual transaction undertaken may be disregarded for transfer pricing purposes.

Guidance on comparability factors in transfer pricing, including location savings, assembled workforce, and MNE group synergies (additions to chapter I of the OECD Transfer Pricing Guidelines). This guidance remains unchanged from the guidance issued as part of the 2014 report on transfer pricing for intangibles New guidance on transfer pricing for commodity transactions (additions to chapter II of the OECD Transfer Pricing Guidelines). A new version of chapter VI of the OECD Transfer Pricing Guidelines addressing intangibles, including new guidance on the return to funding activities and on hard-to -value intangibles. New guidance on low-value adding intragroup services (revisions to chapter VII of the OECD Transfer Pricing Guidelines).

An entirely new version of chapter VIII of the OECD Transfer Pricing Guidelines, covering cost contribution arrangements In addition, the Actions 8-10 package describes additional work to be conducted by the OECD to produce new guidance on the application of the transactional profit split method. The aim is to produce a discussion draft in 2016 and final guidance during the first half of 2017.

Intangibles:

The intangibles final report consists of a new version of chapter VI, which builds on the version issued in September 2014.10 The structure of the final report is the same, containing four sections providing guidance on: (i) identifying intangibles for transfer pricing purposes, including adefinition of intangibles for transfer pricing purposes; (ii) identifying and characterizing transactions involving intangibles, including the determination of which entity or entities should share in the costs and risks of intangible development and the economic returns from the intangibles; (iii) identifying types of transactions involving intangibles; and (iv) determining arm's length conditions and pricing in cases involving intangibles, in particular addressing intangible valuation, and arm's length conditions for hard-to-value intangibles.

The key features of the final report, and key differences from earlier reports on intangibles, are:

- Guidance on which entity or entities are entitled to share in the economic return from exploiting intangibles. The final report clarifies and confirms previous work, stating that mere legal ownership of an intangible does not confer any right to the return from its exploitation. Instead, the economic return from intangibles will accrue to the entities that perform the important value creating functions of developing, enhancing, maintaining, protecting and exploiting the intangible, and that assume and manage the risk associated with those functions.

- New guidance on determining the arm's length return for providing funding for intangible development. Where the entity providing the funding exercises control over the financial risk assumed, that entity is entitled to an expected rate of return commensurate with the risk (for example, based on the rate of return that might be achieved by investing in comparable alternative investments). Where the entity does not exercise control over the financial risk, it is entitled to (no more than) a risk free return only.

- Guidance on valuation methods. The final report confirms that database comparables are seldom appropriate for pricing intangible transactions, and provides guidance on the use of other valuation techniques that may be more applicable.

- Guidance on hard-to-value intangibles. Where intangibles are transferred or licensed in development or where their value is highly uncertain, the tax administration is entitled to use the ex post evidence about financial outcomes to inform the determination of the arm's length pricing arrangements, including any contingent pricing arrangements, that would have been made between independent enterprises at the time of the transaction. The taxpayer can prove the original pricing was based on reasonable forecasts taking into account all reasonably foreseeable eventualities. There are some similarities with the US "Commensurate with Income"standard. The guidance on intangibles is effectively final, although one small section within part D on the application of the transactional profit split method for pricing intangibles transactions is likely to be revised when the OECD completes its new guidance on this transfer pricing method.

Cost contribution arrangements

The section on cost contribution arrangements (CCAs) replaces existing chapter VIII of the OECD Transfer Pricing Guidelines in it sentirety. The objective of the final report is to align the guidance on CCAs with the new guidance elsewhere in the final report on control of risk and on intangibles transactions.

The guidance contained in the final report is similar to the guidance in the discussion draft issued in April 2015.11 although some aspects have been refined in light of the OECD consultations with business representatives.

The key points contained in the final report are:

- CCAs are contractual arrangements among business enterprises for sharing contributions and risks associated with the joint development, production or obtaining of intangibles, tangible assets or services, in the expectation of mutual benefit from the pooling of resources and skills.

- The expectation of mutual benefit is a pre-requisite for participating in a CCA. Participants must expect to benefit from the output of the CCA, for example by being able to exploit the rights acquired or services developed in their own businesses.

- Control is a pre-requisite to be considered as a participant in a CCA. Participants must have the functional capacity to exercise control over the risks taken in the CCA. This means they must be capable of making the decision to take on the initial financial risk of participation in the CCA, and must have the ongoing decision-making capacity to decide on whether or how to respond to the risks associated with the CCA.

- The value of the contributions made by CCA participants must be in proportion to their reasonably anticipated benefits from the CCA. Where contributions are not in proportion to reasonably anticipated benefits, true-up payments may be required.

- The value of each participant's contribution should be determined in line with the value that would be placed on it by independent enterprises in comparable circumstances. While contributions should be measured based on value, the final report recognizes that it maybe more practical for taxpayers to compensate current contributions at cost. However, this approach may not be appropriate where the contribution of different participants differ in nature (for instance, where some participants contribute services and others provide intangibles or other assets).

Hard-to-value intangible

The final report contains a specific transfer pricing approach with respect to hard-to-value intangibles (HTVI). The guidance finalizes an earlier discussion draft released June 2015.12 HTVI are defined as intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises, (i) no reliable comparables exist; and (ii) at the time the transactions was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer.

The approach is intended to ensure that tax administrations can determine in which situations the pricing arrangements with respect to a HTVI as set by the taxpayers are at arm's length and are based on an appropriate weighting of the foreseeable developments or events that are relevant for the valuation of certain HTVI and in which situations this is not the case. Under this approach, ex post evidence provides presumptive evidence as to the existence of uncertainties at the time of the transaction, whether the taxpayer appropriately took into account reasonably foreseeable developments or events at the time of the transaction, and there liability of the information used ex ante in determining the transfer price for the transfer of such intangibles or rights in intangibles.

Such presumptive evidence may be subject to rebuttal if it can be demonstrated that it does not affect the accurate determination of the arm's length price.

Compared to the discussion draft, the final report provides more detailed exemptions and safe harbours when a transfer does not fall within the rules on HTVI.

Risk & Capital

The final report also contains revisions to Section D of Chapter I of the OECD Transfer Pricing Guidelines following the work under Action 9 (transferring risks or allocating excessive capital) and Action 10 (clarifying circumstances to re-characterize transactions).

More specifically, the revisions include the following main guidance to consider in conducting a transfer pricing analysis:

- The importance of accurately delineating the actual transactions between associated enterprises through analysing the contractual relations between the parties together with evidence of the actual conduct of the parties.

- Detailed guidance on analysing risks as part of a functional analysis, including a six-step analytical framework. This framework considers the identification of the economically significant risks with specificity, the determination of contractual allocation of these risks and the functions relating to these risks.

  For transfer pricing purposes, the associated enterprise assuming a risk should control the risk and have the financial capacity to assume the risk.

- A capital-rich MNE group member without any other relevant economic activities (a "cash box") that provides funding, but cannot control financial risks in relation to the funding, will attain no more than a risk-free return, or less if the transaction is commercially irrational.

- In exceptional circumstances of commercial irrationality, a tax administration may disregard the actual transaction. The main question is whether the actual transaction has the commercial rationality of arrangements that would be agreed between unrelated parties under comparable economic circumstances.

With respect to risk and recharacterization, the final report contains significant changes compared to the discussion draft in December 2014.13 including the inclusion of guidance on risk as an integral part of a functional analysis, the new six-step analytical framework to analyze risk, the inclusion of a materiality threshold by considering economically significant risks with specificity, the importance of financial capacity to assume risk, which was generally ignored in the discussion draft, and elimination of the moral hazard concept.

Low value added services

The guidance on low value adding services under Action 10 finalizes an earlier discussion draft released in November 2014.14 It takes the form of a rewrite of chapter VII of the OECD Transfer Pricing Guidelines on services. The updated guidance has the stated aim of achieving a balance between appropriate charges for low value adding services and head office expenses and the need to protect the tax base of payer countries. Key features of the proposed guidance include:

- A standard definition of low value-adding intra-group services as being supportive in nature, not being part of the MNE's core business, not requiring or creating valuable intangibles and not involving significant risks.

- A list of services that would typically meet the definition. In essence the services listed are back-office services.

- An elective simplified approach to determine arm's length charges for low value-adding services:

- - A process for determining the costs associated with low value adding services
- - Allowing general allocation keys
- - A simplified benefits test
- - A standard 5% mark-up

- Prescriptive guidance on documentation and reporting that should be prepared for the MNE to be able to apply the simplified approach.

- The ability for tax administrations to include a threshold above which the simplified approach may be denied. Further work on the threshold will be performed as part of step two mentioned below.

Implementation will take place in two steps. As step one, a large group of countries has agreed to endorse the elective simplified mechanism by 2018. The second step looks to provide comfort to other countries that the elective simplified mechanism will not lead to base-eroding payments. It will entail further work in relation to a potential threshold above which the elective simplified mechanism will not apply and other implementation issues.

Finally, the revised guidance encourages tax administrations to limit any withholding taxes on low value-adding services to the profit element in the charge only.

Profit split

One of the objectives of Action 10 was to prepare transfer pricing rules or special measures to clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains. In order to determine for which matters additional clarification would be useful, the OECD released a discussion draft in December 2014.15 That discussion draft did not include revised guidance. The final report released in respect of Actions 8-10 includes a "scope of work for guidance on the transactional profit split method" which explains, among others, that the revised and improved guidance should:

- Clarify the circumstances in which transactional profit splits are the most appropriate method for a particular case and describe what approaches can be taken to split profits in a reliable way

- Take into account changes to the transfer pricing guidance in pursuit of other BEPS actions and take into account the conclusions of the Report on Addressing the Tax Challenges of the Digital Economy, developed in relation to BEPS Action 1.

- Reflect further work being undertaken to develop approaches to transfer pricing in situations where the availability of comparables is limited, for example due to the specific features of a controlled transaction, and clarify how in such cases, the most appropriate method should be selected. This scope of work as included in the final report will form the basis for draft guidance to be developed by the OECD during 2016 and expected to be finalized in the first half of 2017. A discussion draft will be released for public comments and a public consultation will be held in May 2016.

Commodities

The new guidance on commodity transactions under Action 10 finalizes an earlier discussion draft released in December 2014.16 and includes additional paragraphs to be inserted immediately following paragraph 2.16 of the OECD Transfer Pricing Guidelines.

The stated aim is an improved framework for the analysis of commodity transactions from a transfer pricing perspective which should lead to greater consistency in the way that tax administrations and taxpayers determine the arm's length price for commodity transactions and should ensure that pricing reflects value creation. The key features of the released guidance on commodity transactions include:

- Clarification of the existing guidance on the application of the comparable uncontrolled price (CUP) method to commodity transactions and the use of publicly quoted prices to apply the CUP.
- Recommendation that taxpayers document their price-setting policy for commodity transactions to assist tax authorities in conducting informed examinations.
- Guidance regarding the adoption of a deemed pricing date for controlled commodity transactions in the absence of evidence of the actual pricing date agreed by the parties to the transactions.

Compared to the discussion draft, the final guidance has minor changes, including a more specific list of the types of adjustments applicable when using a CUP method and clarification that the functions performed, assets used and risk assumed by other entities in the supply chain need to be compensated properly.

In our next Wiki, we would be covering exhaustively on the CBC (country by Country Reporting – Action 13) and its impact on the Indian TP regulations.

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

INCOME TAX

OVERVIEW OF INCOME COMPUTATION & DISCLOSURE STANDARD (ICDS)- III ON CONSTRUCTION CONTRACTS

Contributed by CA Ram Prasad

Brief about ICDS:

The Finance Act (No.2) 2014 provides in Section 145(2)that the Central Government may notify in the Official Gazette from time to time Income Computation and Disclosure Standards(ICDS) to be followed by any class of assessee or in respect of any class of income.

In exercise of the powers conferred by Section 145(2) of the Income Tax Act, 1961 the Central Government has notified ICDS vide notification dated 31-3-2015. These notified ICDS are required to be followed by all assessee's following the mercantile system of accounting for the purpose of computation of income chargeable to income-tax under the head "Profits and Gains of Business or Profession" or "Income from Other Sources". ICDS is not applicable for assessee who are not required to maintain books of accounts as per the Income Tax Act, 1961.

In case of any conflict between The Income Tax Act, 1961 & ICDS, the provisions of the Act will be prevail.

Words and expressions used and not defined in ICDS but defined in the Act shall have the meaning respectively assigned to them in the Act.

ICDS-III:

ICDS-III shall be applied separately to each construction contract. However, where ever it is necessary, ICDS-III should be applied to the separately identifiable components of a Single Contract (Segmentation of Contract) or to a group of contracts (Combination of Contracts) to reflect the substance of a contract or group of contracts.

When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when separate proposals have been submitted for each asset and each asset is subject to separate negotiation. It provides that contractor and customer able to accept or reject that part of contract relating to each asset and cost and revenue of each asset can be identified, such contracts should be treated as separate construction contract.

Where a contract provide for the construction of an additional asset at the option of the customer or is amended to include the construction of an additional asset, the construction of additional asset should be treated as a separate construction contract when the asset differs significantly in design, technology or function from the asset or assets covered by the original contractor the price of the asset is negotiated without having regard to the original contract price.

A group of contracts should be treated as a single construction contract when the group contracts is negotiated as a single package and contracts are so closely interrelated that they are part of single project with an overall profit margin. These contracts are performed concurrently or in a continuous sequence.

Contract for the purpose of this standard includes the following:

i. Construction of an asset or combination of assets
ii. Contract for rendering services which are directly related to (i) above.
iii. Contracts of demolition or destruction of assets in connection to (i) above.

Note:- Taxpayer's who compute their taxable income on presumptive basis i.e 44AD etc are not required to maintain books of accounts for tax purposes if they claim their income in accordance with the provisions of section (i.e., 8% in case of 44AD). As a result ICDS may not be applicable as they are not following mercantile system of accounting.

Contract revenue: It shall be recognized when there is a reasonable ground of certainty for collection of amount which includes the following:

i. agreed price of the contract;
ii. Retentions;[1]
iii. Claims;
iv. Incentives;
v. Variations such as escalation clause.

} Only when measured reliably.

If any amount, in any year during the period of contract was written off due to uncertainty in collection, the same should be SHOWN AS AN EXPENSE, not by way of adjusting to contract revenue. (Finance Act, 2015- Section 36(1)(vii))[2]

Contract costs: Shall include the following:

i. Costs which are directly related and attributed to contract;
ii. Other costs specifically charged under T&C of contracts;
iii. Allocated BORROWED COSTS as per ICDS on BORROWED COSTS.

These costs will be reduced by incidental income(Income which is supplementary to the costs), if any. But, income or revenue shall not comprise, if it is in the nature of:

i. Interest;
ii. Dividend;
iii. Capital gains.

[1]Only the real income should be taxed. Reference should be made to section 4 and 5 to see whether it is a real income.
[2]Where the amount of such debt or part thereof has been taken in to account in computing the income of the assessee of the previous year in which such debt or part thereof become irrecoverable or an earlier previous year on the basis of ICDS without recording the same in the accounts and the same becomes irrecoverable it shall deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purpose of section 36(1)(vii)

Those costs* which are spent for securing a contract shall also be recognized if:

i. They are separately identified;
ii. If it is more likely than not to secure a contract. (Probable).

*If those costs are recognized as an expense in that particular year when they were incurred, then they are not included in contract costs when it is obtained.
Contract costs related to future activity shall be recognized as an asset by showing as the amount due from customer.

Contract costs exclude the following:

i. Costs related to future activity;
ii. Payments to sub – contractors as an advance for work to be done.

Recognition of contract costs & revenue: Shall be recognized by way of stage of completion of contract.

Stage of completion of contract: Shall be determined by any of the following ways:

i. Cost to cost method;
ii. Survey method;
iii. Valuation through valuer - physical proportion of work done.

Change in estimates: For cost to cost method – Cumulative cost is to be applied. If any change in estimates on a reasonable ground, that estimates are to be used for determining the percentage of completion of contract.

Transitional provisions: Contract costs & revenue which are commenced on or before 31st March, 2015 but not completed by the said date, shall be recognized as per this ICDS. The amount of contract revenue, contract costs or expected loss if any, recognised for the said contract for any previous year commencing on or before 01/04/2014 shall be taken into consideration for recognising revenue and cost of the said contract for the previous year commencing 01/04/2015.

Disclosure requirements as per this standard:

i. Type of contract;
ii. Contract revenue & costs recognized for the respective period;
iii. Method used for determining stage of completion of contract;
iv. The amount of advances received;
v. The amount of retentions;

Some Issues:-

Recognition of Retention Money:- AS-7 is silent on treatment of retention money. Various Judicial pronouncements[3] held that retention money accrues only at the time of completion of conditions attached as per the relevant contract. To nullify these judgements ICDS provides for recognition of retention money on Percentage of Completion Method basis. However, this is contrary to the concept of prudence and hence will not recorded in the books of accounts.

If subsequently the amount is not recoverable, taxpayer can't claim this amount as bad debt since the amount is not recorded in the books. To claim non recovery of debt as bad debt it should have been written off in the books of accounts. Since debt was not recorded in the books the question of written off doesn't arise.

To overcome this difficulty Finance Act, 2015 amended section 36(1)(vii) by inserting second proviso with effect from AY 2016-17. It provides that if debt or part thereof has been offered as income in compliance with ICDS and the debt or part becomes irrecoverable it would be allowed as a bad debt deeming that such debt or part thereof been written off as irrecoverable in accounts.

Initial Period of Recognition of Revenue:- AS-7 provides that revenue shall not be recognized during the early stages of contract. What is meant by "early stage" is not clearly defined. To provide certainty ICDS provides that contract revenue and contract cost should not be recognised till the contract reaches 25% stage of completion.

Recognition of Expected Losses:-

ICDS provides that expected losses from the contract are allowed to be recognised as per percentage of completion method. This is contrary to the concept of prudence. Also it would conflict with the provisions of section 28 which provides for allowances of losses in computing the business income. As per AS-7 expected losses to be recognised in full.

[3] CIT VS Simplex Concrete Tiles India Pvt Ltd (179 ITR 8), CIT VS East Coast Construction& Industries Ltd (283 ITR 297), CIT VS Associated Cables Pvt Ltd (286 ITR 596) - Few cases

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

TECHNICAL SESSIONS:

S.No.	Event	Date	Speaker	Venue
1	Changing professional opportunities – What MNCs are expecting	08/01/2016	CA Murali Krishna G	SBS - Hyd
2	Unlocking the Financial Statements with Ratio Analysis	22/01/2016	CA Rajesh	SBS - Hyd
3	Data Modelling with MS Excel-Power Pivot	29/01/2016	CA Saran Kumar U	SBS - Hyd
4	Basics of Foreign Trade Policy	05/02/2016	CA Sri Harsha	SBS - Hyd

Note:

The timings for the above events shall be from 17:30 hrs to 19:30 hrs. We request the recipients of "SBS Wiki" who are interested to attend the above events to send confirmation of your participation 2 days in advance to make appropriate arrangements and sharing of the relevant material, if any.

FEMA-ECB-Overviews & Issues - ICAI - Hyderabad - 22nd December 2015 CA Murali Krishna G

Overview on Working Capital and its management - CA Rajesh D

Valuation under Central Excise- 11th December, 2015 - CA Manindar K

Forensic Accounting and Fruad Detection - ICAI Varanasi - 17th December 2015 - CA Saran Kumar U

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
Bengaluru: B104,RIRCO, Santosh Apartments, Wind Tunnel Road, Murugeshpalya, Old Airport Road, Bangalore – 560017, Karnataka.