Volume-15 October -2015 Pages 1-21

SBS Wiki

monthly e-Journal

For Private circulation only

By

SBS and Company LLP
Chartered Accountants

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INCOME TAX

A BRIEF ABOUT BLACK MONEY LAW (BML)

Contributed by CA Ram Prasad

This law applies only to Resident and Ordinarily resident of India (ROR). The objective of the law is to bring back into India, the money held abroad by Indian residents. It is applicable from 01-07-2015.

BML applies only to foreign sourced income and assets which are liable to Indian Tax but have not been disclosed in the Income tax return filed in India.

If the source of investment in foreign asset is explained to the satisfaction, it is not an undisclosed asset located outside India.

Undisclosed foreign income is taxable in the relevant previous year to which it pertains and undisclosed foreign asset is taxable in the year in which comes to the notice of income tax authority.

Undisclosed foreign income and asset (cost or FMV, on valuation whichever is higher) is taxable @30% (No surcharge and cess). No exemption, deduction will be allowed.

Penalty @300% of amount tax will be levied for concealment of foreign income or asset. A penalty of Rs. 10,00,000/- will be levied for failure to furnish tax return before end of the relevant assessment year in relation to foreign income and asset.

No penalty will be levied if foreign asset comprises of bank accounts, where in aggregate balance does not exceed Rs. 5,00,000/- at any time during the financial year. In addition to penalty, interest as per Income tax act will be levied.

Exchange rate for converting the value in foreign currency in to Indian rupee is RBI reference rate on the date of valuation. Valuation date is 1st April of previous year in which asset comes to the notice of assessing officer.

Voluntary Compliance:

Any person can file a declaration at any time between 1st July, 2015 and 30th September, 2015 in form no.6 declaring undisclosed assets acquired from income chargeable to tax in India for any year prior to financial year 2015-16.

If declaration is accepted the declarant has to pay tax @30% of value of asset and equal amount of penalty to be paid by 31st December, 2015.

If a person uses the one time compliance window, such a person will get immunity from prosecution proceedings under specified statutes (such as the Income tax Act, 1961, Wealth Tax Act, 1957, Foreign Exchange Management Act, 1999, Companies Act, 2013, Custom Act, 1962, Prevention of Money Laundering Act, 2002)

Key issues[1] - Clarifications (CBDT circular)

- Where assets are acquired by a resident taxpayer out of foreign income on which taxes have been paid in a foreign jurisdiction and no taxes were paid though chargeable in India, the taxpayer will be entitled to declare such undisclosed assets under the Scheme. However, no credit for foreign taxes paid, if any, will be available to the taxpayer.

- No part of income which is not taxable in India either on account of non-resident (NR) status as per Indian Tax Laws (ITL) or as per the applicable tax treaty will be regarded as undisclosed foreign income/asset.

- In case where declaration is made by the company/firm under the Scheme, all the directors of the company/partners of firm would enjoy immunity.

- If taxpayer has disclosed his/her own bank account out of which transfers made to spouse/child account, then spouse/child liable to declare only accretion, if any.

- E-wallet/virtual cards are similar to bank accounts. Disclosure is required only in those cases where e-wallets and virtual cards are maintained online on a website hosted in a foreign country which was initially funded by income chargeable to tax and on which taxes has not been paid.

- Where undisclosed assets are acquired and disposed of in the past (viz., prior to 1 July 2015), the same can be declared under the Scheme since there is no requirement under the Scheme that the assets should be held on the date of declaration.

[1] Few clarifications are included..

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INCOME TAX

REQUIREMENT FOR TP ADJUSTMENTS IN COMPUTATION OF ARM'S LENGTH PRICE:

Contributed by CA Mithilesh

Rule 10B(1)(e)(iii) provides that an adjustment should be made to the profit margin of independent comparable companies to take into account the differences in functions and risks. International commentaries on transfer pricing also recognize that controlled and uncontrolled transactions are comparable only when adjustments with respect to significant differences between them in the risks assumed is made. Therefore, in no event can unadjusted industry average returns themselves establish arm's length conditions.

Thus, the objective of comparability analysis is to find more reliable comparables after acknowledging limitations in availability of information. Therefore, comparability adjustment would be warranted where reliability of results can be increased. The factors to be considered for comparability adjustments include:

- The quality of data being adjusted;
- The purpose of adjustment performed;
- The reliability of adjustment performed;

Whether functionally comparable companies which differ on account of other factors such as volume of operations, risk assumed should be accepted as comparables? How to eliminate the impact of such differences?

Appropriate comparability adjustments should be carried out to enable comparison between related and uncontrolled transactions

- Eliminate financial impact of differences in risk profile
- Account for extraordinary factors that may influence profitability
- Enhance comparability

Importance of undertaking comparability adjustments is recognized under the Indian transfer pricing regulations. The following are the various TP adjustments that are relevant to the Indian Tested party's:

I. Risk Adjustment:

The provisions of Rule 10B of the Rules prescribe the methods to be used and manner in which it is to be used in determining the ALP relating to any international transaction. In this regard, the provisions of rule 10B(1)(e) of the Rules which states as follows:

10B(1)(e)(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

It should be appreciated that one of the principal elements for a transfer pricing analysis is the analysis of risks assumed by the respective parties. In an open market, theoretically, the assumption of increased risk is normally compensated by an increase in expected return. Accordingly, controlled and uncontrolled transactions are comparable only when adjustments with respect to significant differences between them in the risks assumed is made.

If the Tested Party functions under a limited risk environment vis-à-vis entrepreneurial risk borne by comparable companies who are independent service providers. Accordingly, it is operating under economic circumstances that warrant adjustments to the margins earned by the comparable companies, so as to make the comparison between the margins earned by the comparable companies and the Tested Party appropriate.

The comparables selected for the analysis by the tax office generally include companies, which have fairly diversified areas of specialization, perform additional functions viz., marketing, etc. and bear more risks akin to any third party independent service provider vis-à-vis the Indian Tested Party. The risks such as legal risk, marketing risk, business risk, etc. are normally associated with every independent company, whereas the Indian tested party is generally insulated from these risks. Further, the tested party bears lesser business risk than independent comparable enterprises due to the nature of its revenue model. It is guaranteed profits by way of a mark-up on costs incurred, regardless of its success or failure. As a consequence, the margins earned by the tested party would be comparatively lower to reflect the lower level of business risk. In addition, it may be noted that among other risks the Tested Party does not bear any credit risk.

Where a related party sets prices for intercompany transactions so that the Tested Party receives a specified level of operating profitability, the pricing policy can have the effect of removing virtually all business risk from the controlled entity. When analysing controlled entities that bear such a low level of risk by reference to a set of broadly comparable independent firms, as is the case under TNMM, it is a challenge to identify independent firms that are sufficiently comparable to the controlled entities in terms of risks assumed. In circumstances where the Tested Party has been effectively guaranteed a fixed return, functional similarity does not adequately address this risk differential. In such cases, an adjustment to the comparables for this risk differential seems warranted under the Rules and would provide a more precise pricing of the true risk borne by the Tested Party.

Risk analysis of comparable company's vis-à-vis the Tested Party

Business/market risk

Market risk occurs when a firm is subjected to adverse sales conditions due to either increased competition in the marketplace, adverse demand conditions within the market, the inability to develop markets or position products to service targeted customers or technology obsolescence. The market risks to be considered include, among other things, fluctuations in cost, demand, pricing, and inventory levels. With respect to the services provided by the Tested Party to its AE, there is no specific market risk for the Tested Party as it is not required to penetrate into newer markets or faces competition. The Tested Party does not have any exposure to market risk as it renders all services on a contract basis exclusively to its AE on a revenue model.

In contrast, independent companies bear significant market risks as they are responsible for marketing their services, identifying customers, facing competition and penetrating into the market. Further, slowdown in the IT industry, adverse economic conditions, technology obsolescence, fluctuations in the demand-supply, etc. would have an impact on the margins of the independent companies. Independent companies bear the vagaries of economic and business factors that prevail in the industry and thus, either incur losses or earn profits due to their dealing in market conditions. In case there is a downfall in the market and they are not able to generate sufficient business, independent companies are likely to have low margins or incur losses. However, the Tested Party would still continue to earn a mark-up over its costs.

Further, if the Tested Party is a cost-plus entity and is protected from pricing risk by its AEs, means that it does not take the risk of loss nor is it entitled to any profit/surplus therein, but earns an assured return based on its limited functional and risk profile.

However, in an independent scenario, the comparable companies (that are being considered to determine the ALP) bear the pricing risk, thereby undertake the risk of loss and at the same time also enjoy any profit/surplus therein, therefore substantiating the fundamental principle of economics i.e., the greater the risk, the greater the expected return. In this regard, we wish to emphasize that, since the comparable companies bear the pricing risk and the impact of the same is reflected in the return i.e., net profit/margin it earns, which is not in the case of the Tested Party, a risk adjustment as per Rule10B(1)(e)(iii) for this difference of pricing risk borne by the comparable companies is warranted.

Contract/service liability risk

Risks associated with service failures, including not meeting the generally accepted/ regulatory standards influences the price charged in a particular transaction. This could result in product recalls and possible injuries to end users resulting in compensation claims.

If the Tested Party acts as service provider for its AE and provides services based on the directions received from them. The Tested Party does not have any contractual liability for losses or damages for service failures and the cost of rework (if any) would be recoverable from its AE on a cost plus basis. Accordingly, in economic substance, the Tested Party does not bear any service liability risk. Furthermore, any rework if required will be reimbursed by AEs on a cost plus mark-up basis and hence, risk/cost of rework also resides with AEs and not with the Tested Party. On the other hand, independent third party service providers undertaking marketing and rendering services directly to customers are exposed to service failures and accordingly bear the service liability risk.

Technology risk

This risk arises if the market in which the company operates in sensitive to introduction of new products and technologies. In such a case, business enterprises may face loss of potential revenues due to inefficiencies arising from obsolete infrastructure and tools as well as obsolescence of production processes.

Most of the Indian Tested Party may not bear any risk on this account because they operates as a contract service provider, on a cost plus mark-up basis. On the contrary, independent service providers need to regularly invest in up-gradation of technology to provide new offering/services to the customers. Therefore, any risk arising out of technology obsolescence is considered for the pricing of the services.

Credit and collection risk

The credit and collection risks arise when an enterprise supplies products or services to a customer in advance of the payment. In such a scenario the firm runs the risk that the customer will fail to make payment.

If the Tested Party provides services only to its AE, it does not bear any credit and collection risks. Presuming, in an event where any cost is borne for receiving the delayed payment that cost also shall be reimbursed to the Tested Party on a cost plus mark-up basis. However, independent third party service providers bear substantial credit and collection risks.

Support from Indian judicial precedents

Several courts have recognized the importance of undertaking a risk adjustment to increase the reliability of comparability analysis. Some of these decisions are discussed as under:

- Intellinet Technologies India Private Limited (ITA No. 1237/BANG/2010)
- Mentor Graphics Noida Private Limited (ITA No. 1969/Del/2006)
- Sony India Private Limited (I.T.A. No. 4008(Del)/2010)

II. Working Capital Adjustment:

The adjustment resulting from the different levels of accounts receivable and accounts payable between the tested party and the comparable companies can be calculated, as described below.

- First, determining the difference between the tested party's ratio of accounts receivable to total cost and the corresponding ratio of accounts receivable to total cost of each comparable. This difference represents the "excess" or "shortage" of accounts receivable, held by the tested party relative to the comparable companies.

- Next, multiplying the above difference by an interest rate benchmarked in order to arrive at a figure representing the implicit interest expense or benefit to the comparable due to its different accounts receivable carrying costs.

- Similar adjustments were made to determine the interest carrying costs associated with different levels of inventory and accounts payable between the tested party and each of the comparable companies.

- Lastly, the adjustments on account of difference in levels of accounts receivable are added to the unadjusted operating revenue of the comparable companies, and the adjustments on account of difference in levels of inventory and accounts payable are reduced from the operating costs.

Based on such adjusted operating revenues and operating costs for the comparables, the operating margin, that the comparable would have earned had it been operating with similar working capital position as the tested party, is computed.

The formula used to calculate the adjusted operating margin is

$$\frac{\text{Adjusted Operating Profit}}{\text{Adjusted Operating Revenue}}$$

where

Adjusted Operating Profit = Adjusted Operating Revenue – Adjusted Operating Cost

$$\text{Adjusted Operating Revenue} = \text{Operating Revenue}^{C} + \left[\frac{\text{Accounts Receivable}^{TP}}{\text{Operating Cost}^{TP}} - \frac{\text{Accounts Receivable}^{C}}{\text{Operating Cost}^{C}}\right] a$$

$$\text{Adjusted Operating Cost} = \text{Operating Cost}^{C} + \left[\frac{\text{Accounts Payable}^{TP}}{\text{Operating Cost}^{TP}} - \frac{\text{Accounts Payable}^{C}}{\text{Operating Cost}^{C}}\right] a$$

C is the comparable company;

TP is the tested party;

$\alpha = \frac{\beta}{\beta + 1}$; and? is the interest rate.

III. Capacity utilization/ idle capacity adjustment in case of start-up phase:

To improve the quality of comparables, one might need to calculate an economic/comparability adjustment for the differences in the level of capacity utilization by the comparables and the tested party. The need for a capacity utilization adjustment becomes more acute in cases where the tested party is in a start-up phase or is going through a phase of slow business growth/demand for its products and such situation is not faced by the competitors in the market, or where an eventuality such as a strike or lock-out at a factory results in a significant decline in production.

Thus, it demonstrates that adjustments towards idle time or excess capacity in case of service providers also is necessary and accepted methodology, practiced both by the taxpayer and revenue authorities. The low profit margin earned or loss incurred due to incurrence of high start-up cost and low utilization of capacity is a common phenomenon in case of start-up business. This difference in cost levels of the start-up company vis-a-vis the comparables who might be established players would require an adjustment. The issue of adjustment on account of idle capacity hinges on the concept of the leverage that fixed cost offers to the profitability ratio of business.

The Delhi Tribunal In case of Global Vantedge Point Pvt Ltd wherein, the Tested Party was an information technology enabled ('ITeS') service provider, providing service primarily to its associated enterprise. The Tested Party adopting TNMM method, claimed an adjustment towards its bench strength (ie., idle time of employees) or surplus capacity to the extent of 33.33 % of total capacity. The reason for excess capacity was predicated on the fact that the Tested Party was in its start-up phase and the surplus capacity was carried in anticipation of future growth in business. The Delhi Tribunal held that whenever an entity was established it always carried some surplus capacity vis-à-vis present/projected business operations. Looking into the IT industry which was in a booming stage a surplus capacity to the extent of 1/3rd of the existing capacity is treated as normal in this industry in anticipation of future growth in business. Hence, an adjustment to the profitability of the comparables was allowed to the extent of 33.33 %. Reference could also be drawn in case of *Genisys Integrating Systems India Pvt Ltd[4]*, wherein, the Bangalore Tribunal observed that as per information available in the public domain, the average underutilization of manpower in ITeS industry is 20 %

- Mentor Graphics (Noida) Pvt. Ltd. v. DCIT (109 ITD 101) (Delhi)
- Organisation of Economic Co-operation and Development
- Global Vantedge Point (P) Ltd (37 SOT 1) (Delhi)
- Genisys Integrating Systems (India) Pvt Ltd vs DCIT(2012) (53 SOT 159) (Bang)
- Mando India Steering Systems Pvt Ltd vs ACIT (2014-TS-110-ITAT-CHNY-TP- 2014)
- Global Turbine Services Inc vs ADIT (TS-259-ITAT-DEL-TP-2013)
- Amdocs Business Services Pvt Ltd (54 SOT 46) (Pune)
- Mobis India Ltd(ITA No 2112/Mds/2011)

The rationale for carrying out adjustments to eliminate differences in capacity utilization or idle capacity adjustments is explained in para 2.7 of the OECD Transfer Pricing guidelines. Depending on the facts and circumstances of case and in particular on the proportion of fixed and variable costs, the transactional net margin method ('TNMM') may be more sensitive than the cost plus or resale price methods because differences in the levels of absorption of indirect fixed costs (eg fixed manufacturing costs or fixed distribution costs) would affect the net profit indicator but may not affect the gross margin or gross markup on costs if not reflected in price differences.

IV. Depreciation adjustment:

If Tested Party depreciates the assets on an accelerated basis as compared to the depreciation rates prescribed under the corporate law. Further, based on analysis of annual reports of comparable companies, 60-70% of comparable companies apply the depreciation rates prescribed under the corporate law. Accordingly, the depreciation policy followed by Tested Party and the comparable companies are not similar and hence, requires to be adjusted for such differences while determining arm's length margin of international transactions of Tested Party.

Quantification of depreciation adjustment:

While the Rules provide that appropriate adjustments should be made for arriving at the arms length price, the basis for making such adjustment is not specifically provided by the Indian Transfer Pricing Regulations.

The following cases where the adjustments for such differences have been provided by various Tribunals:

E-gain Communication Pvt. Ltd. v. ITO [2008-TIOL-282-ITAT-PUNE]

SchefenackerMotherson Ltd v. ITO [2009-TIOL-376-ITAT-DEL]

CIT v. Rakhra Technologies Pvt. Ltd. [2011-TII-07-HC-P&H-TP]

Amdocs Business Services Pvt. Ltd. v. DCIT [ITA No. 1412/PN/11]

Qual Core Logic Ltd v. DCIT (ITA No. 893/HYD/2011)

Honeywell Technology Solutions Lab Pvt Ltd v. DCIT (IT(TP)A No. 1344/Bang/2011)

24/7 Customer (P) Ltd. vs. DCIT (ITA No. 227/Bang/2010)

Reference can be drawn to the above judicial precedents, wherein any specific approach/method have been provided while adjudicating the depreciation adjustment:

Hon'ble Bangalore Tribunal in the case of 24/7 Customer (P) Ltd. vs. DCIT (ITA No. 227/Bang/2010) – Adjusting the depreciation of comparable companies using the ratio of depreciation to gross block of assets of the tested party. The following are the various steps which are to be followed in computing depreciation adjustment:

- Step 1: Calculate depreciation ratio (Depreciation/ Gross Block) of the Tested Party;
- Step2: Calculate the depreciation amount of the comparable companies on the basis of depreciation ratio as calculated in Step1;
- Step 3: Recalculate the operating cost & operating profit of the comparable companies on the basis of deprecation calculated in Step 2;
- Step 4: Calculate the operating margin (Operating profit/Operating Cost) on the basis of revised operating cost & profit as calculated in step 3 above;
- Step 5: Calculate the ALP (average of the margins of comparable companies as calculated above).

Concluding remarks:

Material differences between comparable companies can render TP analysis inaccurate.The five comparability factors to be kept in mind for TP documentation and analysis include:

- Characteristics of property or services;
- Functions performed taking into account the assets employed and risks;
- Assumed;
- Contractual terms;
- Economic circumstances of the parties; and
- Business strategies pursued.

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ACCOUNTING STANDARDS

WHAT IS CHANGING FROM CURRENT INDIAN GAAP?

Contributed by CA Aruna |

The Famous Five

The volume and breadth of differences between Indian GAAP and Ind AS is enormous. Further, its impact will vary by industry and for each company. Ind AS will cover every area comprising reported revenues, expenses, assets, liabilities and equity. Before we get into the details of the specific differences, we think companies should be familiar with the Famous Five. In our view, companies will have to devote substantial amount of their time especially in these areas while preparing for Ind AS adoption.

We have focused on the Famous Five concepts below.

Revenue Recognition – AS 115

Consolidation – AS 110

Business Acquisition – AS 103

Financials Instruments – AS 109

Taxes – AS 12

Let us Focus on AS 115, Revenue from contracts with Customers:

Let us try to understand:

What has changed Revenue recognition?
Is it for good or bad?
How does it affect my financials and its outlook?

Revenue recognition

Revenue is one of the most important financial statement measures for both preparers and users of the financial statements. It is therefore an accounting topic heavily scrutinized by investors and regulators. Today, Accounting Standard (AS) 9 on Revenue Recognition does not provide comprehensive guidance for certain aspects resulting in diversity in practices under Indian GAAP. Adoption of Ind AS 115, Revenue from Contract with Customers, provides comprehensive principles for recognising revenue, which will affect mostly all entities that apply Ind AS. Companies will be required to closely analyse their business practices within the revenue cycle to identify and evaluate potential GAAP differences.

Some of the changes are discussed below:

Transfer of control

Under Ind AS 115, revenue is recognised when a customer obtains control of a good or service, while under Indian GAAP, revenue is recognised when there is a transfer of risk and rewards. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is neither same as transfer of risks and rewards nor similar to the culmination of an earnings process as understood today. Entities will be required to apply the new guidance to determine whether revenue should be recognised 'over time' or 'at a point in time'. So as the first step, a company will have to first determine whether control is transferred over time. If the answer to this question is negative, only then revenue will be recognised at a point in time, or else it will be recognised over time.

The difference between transfer of control vis-a-vis transfer of risk and reward can sometimes be subtle and at other times be stark requiring a detailed understanding of the accounting standard and customer contractual arrangements.

The five-step control model

The core principle of Ind AS 115 is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. This core principle is described in a five-step model framework:

Step 1: Identify the contract(s) with the customer
Step 2: Identify the separate performance obligations in the contract
Step 3: Determine the transaction price
Step 4: Allocate the transaction price to separate performance obligations
Step 5: Recognise revenue when (or as) each performance obligation is satisfied.

Application of this guidance will depend on the facts and circumstances present in a contract with a customer and will require the exercise of judgment.

Performance obligation

Understanding what a customer expects to receive as a final product is necessary to assess whether goods or services should be combined and accounted as a single performance obligation or separate elements. Some contracts contain a promise to deliver multiple goods or services, but the customer is not purchasing the individual items. Rather, the customer is purchasing the final good or service, which is the aggregate of those individual items. The judgment, based on proper application of the principles envisaged in Ind AS 115, will determine whether a contract involves a single or multiple performance obligations.

Until now there has been limited guidance in this area of multiple elements or performance obligations under Indian GAAP. Under Ind AS, companies will have to necessarily determine whether there are multiple promises in a contract and whether those promises are distinct. The consideration will then be

allocated to multiple components and revenue recognised when those distinct goods or services are delivered, i.e. when control is transferred.

It is also to be noted that separate performance obligations may be identified based on promises in a contract which may be explicit or implicit including based on past customary business practices. Also, upon transition to Ind AS, certain previously identified multiple elements may no longer be considered as separate promises under the new standard. In our experience, this area can be quite complex. Companies should carefully understand the impact of this, as potentially upon transition some revenue may never be reported and some could be reported twice.

Variable consideration

Entities may agree to provide goods or services for consideration that varies upon certain future events, which may or may not occur. Examples include volume and cash discounts, refund rights, rebates, performance bonuses/incentives, penalties, sales returns, etc. Sometimes this is also driven by past practice of an entity or a particular industry for example a history of giving discounts or concessions after the goods/services are sold. Variable consideration is a wide term and includes all types of positive and negative adjustments to the revenue.

Under the current accounting practice, it is not uncommon to defer the revenue until the contingency is resolved. However under Ind AS, if the consideration is variable, then a company will need to estimate this variability at the inception of the contract subject to certain constraints,that is there should not be a significant revenue reversal in the future, which will be reassessed at each reporting period. Some of these concepts are new for us, as entities will have to estimate not only downward but also upward adjustments to revenue, something we are not used to. Also, this could result in earlier recognition of revenue as compared to current practice. This could affect entities in industries where variable consideration is presently not recorded until all contingencies are resolved. There is a narrow exception for intellectual property (IP) licenses where the variable consideration is a sales-or usage-based royalty, which will continue to be recognised based on sales or usage.

Another significant area of difference from the current practice will be presentation of revenue.

Upon adoption of Ind AS 115, generally all positive and negative adjustments to variable consideration discussed above will be presented as an adjustment to revenue as opposed to costs presently done for certain areas.

Allocation of transaction price based on relative

Standalone selling price

Entities that sell multiple goods or services in a single arrangement (for example, sale of equipment with two year maintenance services contract) may be following different accounting practices under the current Indian GAAP. Under Ind AS 115, these entities must first evaluate whether the sale of equipment and services are two separate performance obligations, and if yes, then allocate the consideration to each of the distinct goods or services based on their relative standalone selling price. This allocation is

based on the price an entity will charge a customer on a standalone basis for each good or service sold separately. In this regard, management will follow a hierarchy to estimate the selling price. Entities will first consider observable data to determine the standalone-selling price. An entity will need to estimate the standalone selling price if such data does not exist (cost plus profit margin is an acceptable approach). Some entities may also need to determine the standalone selling price of goods or services that previously did not required this assessment.

Allocation of the transaction price to multiple performance obligations can be a matter involving significant estimate and judgment. Accordingly, a careful analysis of this aspect is required as a part of the transition to Ind AS.

Licenses

Entities that license their IP to customers will need to determine whether the license transfers to the customer 'over time' or 'at a point in time'. A license that is transferred over time allows a customer access to the entity's IP as it exists throughout the license period–such revenue is recognised over time. License provides right to access IP if all of the following criteria are met:

1) The licensor performs activities that significantly affect the IP.
2) The rights expose the customer to the effects of these activities.
3) The activities are not a separate good or service.

Licenses transferred at a point in time allow the customer the right to use the entity's IP as it exists when the license is granted. The customer must be able to direct the use and obtain substantially all of the remaining benefits from the licensed IP to recognise revenue when the license is granted. The standard includes several examples to assist entities making this assessment. In certain circumstances, this could result in change from current practice.

Time value of money

Some contracts provide the customer or the entity with a significant financing benefit (explicitly or implicitly). This is because performance by an entity and payment by its customer might occur at significantly different times. In such situations, under Ind AS, the entity will have to adjust the transaction price for the time value of money if the contract includes a significant financing component. The standard provides certain exceptions to applying this guidance and a practical expedient which allows entities to ignore time value of money if the time between transfer of goods or services and payment is less than one year.

Presently, under Indian GAAP, such financing benefit is not identified and separated. This aspect will impact entities which have significant advance or deferred payment arrangements.

Contract costs

Entities sometimes incur costs (such as sales commissions or mobilisation activities) to obtain or fulfill a customer contract. Contract costs that meet certain criteria will be capitalised as anasset and get

amortised as revenue is recognised upon adoption of Ind AS. Such capitalised costs will require a periodic review for recoverability and impairment, if applicable. If the contract period is a year or less, then as a practical expedient, such capitalisation may not be required.

Presently, under Indian GAAP, such costs are generally expensed as incurred. This will result in more cost deferral for long-term type of arrangements.

Presentation

Ind AS includes more guidance on gross versus net presentation(including items such as excise duty, other charges, etc). Some of this could change the presentation of revenue upon adoption of Ind AS.

Disclosures

Extensive disclosures are required to provide greater insight into both, revenue that has been recognised and revenue that is expected to be recognised in the future from existing customer contracts. Quantitative and qualitative information will have to be provided about the significant judgments and changes in those judgments made while recording revenue.

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

BASIC PRACTICES

THE ART OF DELEGATION IS FUNDAMENTAL TO GROWTH

Contributed by CA Sandeep |

Delegation is vital for effective leadership. Effective distribution of activities can make better use of restricted time and generate opportunity for development.

Delegation is the assignment of responsibility to another individual for the purpose of carrying out specific activities. Improved time management, increased teamwork and sense of achievements are the key benefits of delegation.

Auditor need to find ways to maximize the available time. Mixture of reduced workforces, greater stakeholder expectations, the productivity and concentration challenges associated with multitasking leave many auditors wishing there are more hours a day. One approach is to delegate activities. Delegation of activities is important for the auditors who are at Supervisory role.

Auditors at time are hesitant to delegate work for reason like "it take less time if I do it myself", such excuses keep auditors from benefiting from one of the best time-management tools. Involving others can help develop their skills and abilities, so next time a similar requirement arises, tasks can be delegated with confidence. Effective time-management requires a lot of candid effort on the part of the delegator. When delegation is approached correctly it allows for the growth of everyone involved in the process.

Delegating can be helpful in the following situations

- When the task offers valuable training to an employee
- When an employee has more knowledge related to the task than delegator
- When the task is recurring and all employees should be prepared or trained
- When the task is of less priority and high priority tasks requires your immediate attention

Describe the Task

It is important to clearly articulate the task to be performed with time lines for completing the activity, clarification for the situation that requires additional effort. Any specific formatting, style or such other criteria to be followed should be recognized at this stage, for this a high –level picture of what "complete" Job shall look like shall be established. Very often auditors go into delegation without giving clear thought to the full scope of the activity and steps to be performed, decreasing the probability that the delegation will be successful.

Skill Identification and select the individual or team

It is important for the delegator to comprehend the necessary skills required to accomplish the task and identify who within the team exhibits those attributes. Adopt an appropriate strategy to delegate the right task to the right people at the right time and in the right way if a task is delegated to a person without adequate skills, it is unlikely the task will be performed adequately and within the expected time frame. Hence the possibility of delegating the similar activities in the future will be reduced. With that in mind, auditors should consider who may be best positioned to complete the activity within the established time frame.

Support and Communicate Expectations

Use a systematic step-by-step approach to brief people on what you want to delegate to them. Clear expectations are not always established and shared with the delegate about the specific tasks to be performed. Communicating the expectations in a clear and precise manner prevents errors caused by miscommunication. Common failures in communicating expectations include:

- Lack of adequate information regarding the task must be performed
- Unclear direction about the way to carry out the task
- Not sharing with the intended audience about purpose of the activity
- Not providing relevant background information
- Not discussing in advance specific formatting, style or other such criteria

Understanding the Task

It is important to ensure that the delegator and the delegate have a mutual understanding of the task. The person who will be performing the task should be encouraged to ask any clarifying questions necessary to better understand the activity, timelines and any other requirements. For clarity the delegator should consider having the delegate repeat back a summary of the activity to provide visibility into any areas in which the expectations may be unclear. Face to face meetings are better suited than email to ensure there is a common understanding; such meeting allows the delegator to read the body language of the delegate to help identify any areas that may be unclear.

Monitor Regular Progress

It is important to set regular checkpoints for all delegated activitieswith the person who will be responsible for completing the task especially those that may span several weeks or months. These checkpoints allow the opportunity for the delegate to ask any clarifying questions that may arise during the course of performing the activity. They also enable the delegator to confirm the task is being performed as intended and it is always better to identify early in the process.

Scope for Improvement

Delegation sometime may be a skirmish and may push delegator and delegate out of their comfort zones, it can give a fresh set of eyes to an activity that has traditionally been performed by one person. This not only maximizes audits limited time, but new insights can create opportunity for improvement all around. Good delegation saves time, develops employees, grooms a successor and motivates.

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

INDIRECT TAXES

THE REVENUE'S MISPERCEPTION ON CUM TAX BENEFIT

Contributed by CA Manindar

Introduction:

The provisions regarding Cum Tax/Cum Duty is available both under Central Excise Act, 1944 and Finance Act (Service Tax Law) under Section 4(1) and Section 67(2) respectively. Accordingly, wherever service tax or excise duty is not separately collected, assessee is entitled to compute their tax liability treating the gross amount collected as inclusive of service tax/excise duty.

Though this appears to be simple, straightforward benefit to assessees, but it is not so in reality considering the litigation that took place on this benefit. The vehemence contention of the Revenue is that mere non-collection of service tax/excise duty does not entitle the assessee for this benefit; the invoice should indicate that the amount charged is inclusive of service tax/excise duty. The article aims to demystify the ambiguity surrounded this straightforward benefit.

Is It Possible under Law to Issue an Invoice Inclusive of Taxes?

As stated above, the main contention of the revenue for declining this benefit is that the invoice issued to Service Provider/Customer should indicate that amount charged is inclusive of service tax/excise duty. In this context, it is relevant to examine whether it is legally possible to issue an invoice inclusive of service tax/excise duty or not.

Section 12A of Central Excise Act, 1944 provides that every person who is liable to pay duty of excise on any goods shall at the time of clearance of goods, prominently indicate in all goods relating to assessment, sales invoice, and other like documents, the amount of such duty which will form part of the price at which such goods are sold. The said section is also made applicable to Service Tax law vide Section 83 of the Finance Act, 1994.

This section begins with Non-obstante clause 'Notwithstanding' which means that this section has overriding effect even in case of inconsistency with other provisions of the Act. Thus whenever assessee is of the view that excise duty/service tax is applicable or at least doubtful but decides to collect, then he has to prominently indicate the same in the invoice. Thus in case, he issues invoice as inclusive of excise duty/service tax, then the same is in contravention of this section.

The question of non-collection of excise duty/service tax arises only when the assessee interprets that excise duty/service tax is not applicable on particular goods/services as the case may be. The issue of cum-tax benefit arises in that case only. Section 11D of the Central Excise Act, 1944 assessee should not collect any amount in excess of duty assessed or determined to be payable by representing it towards excise duty. Similarly Finance Act, 1994 contains section 73A.

Thus in a scenario, where assessee is at least doubtful of excise duty/service tax applicability and issues invoices saying price is inclusive of excise duty/service tax and subsequently if he claims that no duty/tax is payable, still he may require to deposit the portion representing excise duty in such inclusive price because this may indirectly tantamount to collection of some portion of price representing excise duty which is not statutorily payable.

Thus it may be practically impossible for an assessee to issue an invoice inclusive excise duty/service tax without contravening the law. Even if he does so and subsequently claims that no excise duty/service tax is payable, he may be required to pay to Government the portion representing excise duty/service tax from such inclusive price in terms of Section 11D/Section 73A as the case may be.

Presumption of Passing the Incidence of Excise duty/Service Tax:

The Cum-Tax provisions of Central Excise & Service Tax law are reproduced as follows;

Central Excise	Service Tax
Expln to Section 4(1): For the removal of doubts, it is hereby declared that the price-cum-duty of the excisable goods sold by the assessee shall be the price actually paid to him for the goods sold and the money value of the additional consideration, if any, flowing directly or indirectly from the buyer to the assessee in connection with the sale of such goods, and such price-cum-duty, excluding sales tax and other taxes, if any, actually paid, shall be deemed to include the duty payable on such goods	Section 67(2): Where the gross amount charged by a service provider, for the service provided or to be provided is inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, is equal to the gross amount charged.

In terms of the above sections, whenever, excise duty/service tax is not separately collected by the assessee as the case may be, then the price of the goods or the gross amount charged for services shall be deemed to include excise duty/service tax as the case may be.

In terms of Section 12B of the Central Excise Act, 1944, there is an irrefutable presumption that every person who is paying excise duty on goods shall be deemed to have passed on the full incidence of such duty to the buyer of such goods. This section is made applicable to service tax also vide Section 83 of the Finance Act, 1994. It is because of this presumption, Revenue proceed to recover tax dues from assessees irrespective of the fact whether excise duty/service tax is collected by them separately from customer or not.

The Supreme Court in the case of Hindustan Sugar Mills vs. State of Rajasthan & Otrs, 1978(4)SCC271 has held that it is only as part of consideration for the sale of the goods that the amount representing excise duty would be payable by the purchaser. There is no other manner of liability, statutory or otherwise, under which the purchaser would be liable to pay the amount of excise duty to the dealer. And, on this reasoning, it would make no difference whether the amount of excise duty is included in the price charged by the dealer or is shown as a separate item in the bill.

Thus statutorily the only manner in which taxes or duties are payable by the purchaser of goods or receiver of services is as a part of consideration towards goods/services. So the price realized would be regarded as inclusive of duty/taxes because by necessary implication the manufacturer or service provider has taken on the liability to pay all taxes on such transaction. The other party is relieved from all liabilities with respect to procurement of such goods and services.

This presumption holds good unless and until the revenue proves otherwise or there is express contractual obligation between the parties for reimbursement of taxes required to be payable if any in future on this transaction.

Thus upon harmonious interpretation of the provisions of both Sections 12A, 12B, along with Explanation to Section 4(1) of Central Excise Act, 1944 and Section 67(2) of the Finance Act, 1994 it is very clear law that does not permit collection of excise duty/service tax by issuing invoice as taxes inclusive in price of goods or gross amount charged for services as the case may be. Whenever excise duty/service tax is not charged separately, the invoice amount shall be treated as inclusive of excise duty or service tax and accordingly the benefit of cum-tax is required to be extended to assessee.

Ambiguity created by decisions of Supreme Court:

Let us have a look at various decisions of the Supreme Court on this issue. Latest one on this issue is the case of Amrit Agro Industries Ltd vs. CCE, 2007-TIOL-244-SC-CX. In this case, the Appellant has classified the roasted peanuts under Chapter 21.01 and claimed exemption. Revenue contended that the same is classifiable under Chapter and excise duty is payable. As roasted peanuts are cleared by claiming exemption, the Appellant has not collected excise duty separately from the customer. In this context, the issue of whether cum-tax benefit is available to Appellant was considered by SC.

Supreme Court by placing reliance in the Judgment of ACCE vs. Bata India Ltd, 1996 (84) ELT 164(SC) affirmed the view that unless it is shown by the manufacturer, that the price of goods includes an amount of excise duty payable to him, there is no question of exclusion of duty element from the price for determination of value.

It is a well settled legal position that facts of a decision relied upon have to be shown to fit the factual situation of a given case. Without such discussion reliance could not be placed on a decision. With due respect to the views of Supreme Court in Amrit Agro Industries Ltd case (supra), the paper writer is of the view that reliance was placed in the proposition of Bata India Ltd case(supra) without appreciating the factual context in true perspective.

Coming to Bata India Ltd case (Supra), the issue that came up for consideration before the Supreme Court is regarding eligibility to a conditional exemption with reference to value of excisable goods. An exemption notification was inforce which provided exemption from excise duty when the value of the footwear does not exceed Rs. 60 per pair. The assesse claimed that the benefit of this exemption is also applicable even when the price of the goods is above Rs.60 to Rs. 66 on the argument that if excise duty element is taken away from price, then the value of the goods would be within the limit of Rs. 60.

Supreme Court held that the intention behind the notification was to give relief to the consumers who could not afford to pay high price foot wear. If the argument of assesse is accepted, the consumer will end up in paying higher amount (more than 60) bearing excise duty component as contemplated, but the manufacturer need not remit to Central Government, the excess amount though collected representing as excise duty.

It was in this context, Supreme Court held that when manufacturer has included in the wholesale price any amount by way of tax, even when no such tax is payable, he is increasing the profit element which cannot be excluded as representing the element of excise duty.

In this factual context, it was held that unless it is shown by the manufacturer, that the price of goods includes an amount of excise duty payable to him, there is no question of exclusion of duty element from the price for determination of value.

In another case, CCE vs. MarutiUdyog Ltd, 2002(141)ELT3(SC) wherein the assesse has removed waste and scrap arose during manufacture without paying any excise duty. Revenue demanded excise duty on sale of such waste and scrap. In this context, the Supreme Court has referred to the judgment of Bata Ltd case(supra) and held that when cum-duty price is charged, then in arriving at the excisable value of goods, the element of duty which is payable has to be excluded.

Thus Supreme Court itself, in this case, has drawn the correct proposition with regard to Cum Tax benefit. In many cases, Revenue is denying cum-tax benefit by placing reliance in subsequent favorable judgment of Amrit Agro Industries Ltd case. To add to the misery of assessees, various tribunals have also denied cum-tax benefits in several cases by upholding such reliance without appreciating the correct legal position with reference to other Supreme Court Judgments on this issue.

Conclusion:

In view of the above discussion, it is very clear that Revenue Contention that Cum-Tax benefit is available only when invoice issued expressly states that price/gross amount charged is inclusive of excise duty/service tax as the case may be is clearly based on wrong footing of one Supreme Court decision. On the other hand, such compliance is impracticable without contravening the law. Thus Cum-Tax benefit is a straightforward one available to assessees in all cases where excise duty/service tax is not collected separately. However until the matter is settled, assesse is required to face the misery of revenue biased adjudication.

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TECHNICAL SESSIONS:

S.No.	Event	Date	Speaker	Venue
1	Preparation of Boards report & Annual return	16/10/2015	CS Phanindar DVK	SBS - Hyd
2	Over view on Sexual Harassment at Work Place	23/10/2015	Syslex Law Firm	SBS - Hyd
3	Audit of Internal Financial Controls Over Financial Reporting	30/10/2015	CA Aruna	SBS - Hyd
4	Impact of Income tax on Property development	06/11/2015	CA P Samba Murthy	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.

Road Map for implementing IFRS in India- CA Aruna

Over view of Project Finance-CA Rajesh

Filing of Service Tax returns-CA Manindar & CA Harsha Vardhan

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