

NEWSLETTER

AUGUST 2012

M. V. DAMANIA & Co.
Chartered Accountants



Contents	Contributors	Page
Transfer Pricing	Malay Damania	2-3
Transfer Pricing	Bharat Jain	4-6
Service Tax	Mumtaz Ahmed	7-11
Service Tax on Director's Remuneration		7-8
Service Tax on Reverse Charge Mechanism		9-11



TRANSFER PRICING

Transfer Pricing Tolerance Range

The Transfer pricing regulations in India is based on the concept of arithmetic mean of the benchmarked Companies rather than a “Range concept”. Accordingly a 5% variation from the Arms’ Length Price was available from the actual international transaction price. This 5% variation is extensively litigated by the tax payers and the revenue authorities for its interpretation. While the tax payer understood this 5%

variation as a standard deduction available while the revenue authorities interpreted it otherwise.

In the Finance Act, 2011 the Government stated the 5% tolerance band has outlived its utility and hence a new tolerance band would be notified in future. However no such notification was given during the FY 2011-12. There was a big uncertainty about the tolerance band for the FY

2011-12.

In the meanwhile the Finance Act 2012, applicable for the FY 2012-13 and onwards, states for a tolerance band to be notified subject to an overall ceiling of 3%.

Recently on 17.08.2012, the Government through notification finally putting end to the uncertainty notified a tolerance range of 5% for the FY 2011-12.

TRANSFER PRICING *(cont.)*

To summarise, the tolerance range is available as follows:

Financial Year	Tolerance Range
Up to FY 2010-11	Up to 5%. Not to be considered as Standard deduction.
FY 2011-12	Up to 5%. Not to be considered as Standard deduction.
FY 2012-13	Industry specific tolerance band to be notified subject to ceiling of 3%.

The industry specific tolerance band is yet to be notified by Government.



Compiled by Malay Damania



TRANSFER PRICING

Transfer Pricing - Specified Domestic Transaction

Transfer pricing until now was applicable to companies having cross border transactions with their ASSOCIATED ENTERPRISE. However, Finance Bill 2012, honoring the supreme court ruling in case of CIT vs. M/S Glaxo Smithkline Asia (P) Ltd. (Special Leave to Appeal (Civil) No(s).18121/2007), expanded the ambit of transfer pricing to specified domestic transactions w.e.f 01 April 2013.

Transactions covered under the ambit of domestic transfer pricing:

- a. Any expenditure in respect of which payment is made or is to be made to a person referred to in Section 40A(2)(b) of the IT Act;
- b. Any transaction that is referred to in Section 80A
- c. Any transfer of goods or

services referred to in Section 80-IA(8) i.e. applicable to companies operating as industrial undertaking or enterprises engaged in infrastructure development;

- d. Any business transacted between the assessee and other person as referred to in section 80-IA(10);
- e. Any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable;
- f. Any other transaction, as may be prescribed by the board.

Provided that the aggregate value of the transaction entered into by the assessee with its domestic associated enterprise exceeds Rs 5 crores.

Implication of such amendment by Finance Act, 2012:

All the transactions entered into by the taxpayers operating in Special Economic Zones ('SEZs'); taxpayers entering into transactions with certain related parties specified under section 40A(2) and all the taxpayers claiming profit based deductions for undertaking specified business activities (under section 80A, 80-IA, etc.) will be covered.

The most likely affected industries are industries operating in SEZs, infrastructure developers and / or infrastructure operators, telecom services industries, industrial park developers, power generations or transmission, etc. Apart from these industries, the business conglomerates having significant intra-group transactions would

cont.

be impacted.

Most likely transactions under the scanner of the transfer pricing authorities would be:

- a. Interest Free Loans to group companies;
- b. Granting of Corporate Guarantees / Performance Guarantees by Parent Company to its subsidiaries;
- c. Intra-group purchase / sell / service transactions;
- d. Payment made to key personnel of the assessee, e.g. transactions with the directors / CFO / CEO, etc.;
- e. Payment made to key personnel of the group companies;
- f. Payment made to relatives of key personnel of the assessee / group companies.

Concerns for Certain Domestic Companies:

There is no clarification with regards to Indian companies having both international transactions as well as domestic transactions. Since the company has to comply with transfer pricing regulations owing to their international transaction, the question remains whether the specified domestic transactions are required to be reported in following scenario.

- When the value of aggregate of international transaction and specified domestic transaction is less than Rs. 5 crores;
- When the value of aggregate of international transaction and specified domestic transaction is more than Rs. 5 crores but the value of specified domestic transactions is less than Rs. 5 crores.

The company who has the aggregate value of domestic transaction more than Rs. 5 crores anyways has to comply with the transfer pricing regulations.

In view of the above, we are of the opinion that once the company has to comply with the transfer pricing regulation by virtue of the international transaction, specified domestic transaction should also be reported by way of abundant caution in order to avoid future litigation.

Further, in order to avoid litigation at the future date, companies who have domestic transaction with its related parties equal to or more than Rs. 5 cores or companies whose present domestic transaction less than Rs. 5 cores but is likely to increase beyond Rs. 5 cores in the financial year 2013-14 are advised to validate their present business model and pricing methodology from a transfer pricing perspective which will enable them to take corrective actions, if necessary.

Instead of applying transfer pricing provisions only in respect of transactions having tax arbitrage, it has been applied on every transaction of income or expenditure entered into by associated enterprises. Therefore, one has

TRANSFER PRICING *(cont.)*

to see whether a clarification comes out with that the transfer pricing provisions will be applicable only to transactions entered into with persons covered u/s 40A(2)(b) where the assessee has a tax arbitrage.



Compiled by: Mr. Bharat Jain

cont.



SERVICE TAX

Service Tax on Director's Remuneration

Till 6th August 2012, the service tax department was silent on service tax payable by the person on the payments to part time or professional directors as remuneration, commission, sitting fees etc., denotes that service tax was payable by such directors on the above payments by way of collecting service tax from company and paying the same, taking benefit of threshold limit of Rs. 10 Lacs for the period from 1st July 2012 to 6th August 2012.

By way of notification no. 45/2012 - ST and 46/2012 - ST dated 7th August 2012, service tax is required to be paid by the company as per reverse charge mechanism on the payments made or to be made to the professional directors (other than salaried directors receiving Form 16 from the company) towards sitting fees, directors'

remuneration, commission etc. w.e.f. 7th August 2012. Since, benefit of threshold limit is not available in the case of service tax payment on reverse charge mechanism; the company will have to pay service tax on or above Rs. 1.

The notification no. 46/2012 - ST dated 7th August 2012 says "in relation to service provided or agreed to be provided by a director of a company to the said company, the recipient of such service". Since, provision of service by an employee to the employer in the course of or in relation to his employment is excluded from the definition of "service" under section 65B of the Finance Act, 2012, therefore directors' remuneration received by whole time directors having employer - employee relationship with the company are not required to pay service tax.

Since the service tax will be additional cost to the company in addition to remuneration payable to the company that may exceed the ceiling limit directors' remuneration under section 309 of Companies Act, 1956 that may be the case of 1% or 3% of the profit of the company.

In the above situation, approval of the Central Government under section 309 and 310 of the Companies Act, will not be required if the directors' remuneration and applicable service tax thereon exceeds 1% or 3% as the case may be of the profit of the company as clarified by the Ministry of Company Affairs for the financial year 2012-13.

Cenvat Credit will not be available for those companies, which do not provide taxable service or does not have

cont.

SERVICE TAX *(cont.)*

Service Tax on Director's Remuneration

manufacturing activity of excisable goods e.g trading company; hence the service tax payment will be the cost of such companies. Companies providing taxable service or manufacturing excisable goods will be entitled to take cenvat credit of such service tax payment after due payment of service tax.

It is pertinent to bring to the notice that the company will be paying service tax only after making payment of directors' remuneration means on cash basis and not on accrual basis. The statute has waived the benefit of threshold limit being of Rs. 10 lacs by making it payable on reverse charge mechanism. It seems that the statute wants to show the benefit of threshold limit in a showcase rather than giving benefit of such provision.

cont.

SERVICE TAX *(cont.)*

Service Tax on Reverse Charge mechanism

Description of service	Provided		Percentage of ST payable by the person providing service	Percentage of ST payable by the person receiving the service
	by	to		
1. Insurance	Insurance Agent	Any person carrying on insurance business	Nil	100%
2. Transportation of goods by road	Goods Transport Agency (GTA)	Any Factory registered under the Factories Act Society registered under the Societies Regi. Act Co-operative society established by or under any law Dealer of excisable goods registered under the Central Excise Act Body corporate established under any law Partnership firm / Association of persons	Nil	100%
3. Sponsorship	By any person	Anybody corporate or partnership firm located in the taxable territory	Nil	100%
4. Arbitral	Arbitral Tribunal	Any business entity located in the taxable territory	Nil	100%
5. Legal service	Individual Advocate or firm of advocates	Any business entity located in the taxable territory	Nil	100%
5A. Any Service	Director	Company	Nil	100%
6. Support Service	Government or local authority		Nil	100%

cont.

SERVICE TAX *(cont.)*

Service Tax on Reverse Charge mechanism

Description of service	Provided		Percentage of ST payable by the person providing service	Percentage of ST payable by the person receiving the service
	by	to		
7. Renting / hiring any motor vehicle designed to carry passenger on abated value	i) any individual ii) HUF iii) Proprietary firm iv) partnership firm v) Association of Persons Located in the taxable territory	i) Any company registered under the Companies Act ii) business entity located in the taxable territory	Nil	100%
8. Renting/hiring any motor vehicle designed to carry passenger on non abated value	i) any individual ii) HUF iii) Proprietary firm iv) partnership firm v) Association of Persons Located in the taxable territory	i) Any company registered under the Companies Act ii) business entity located in the taxable territory	60%	40%
9. Supply of manpower for any purpose including Security	i) any individual ii) HUF iii) Proprietary firm iv) partnership firm v) Association of Persons Located in the taxable territory	i) Any company registered under the Companies Act ii) business entity registered as body corporate located in the taxable territory	25%	75%

cont.

SERVICE TAX *(cont.)*

Service Tax on Reverse Charge mechanism

Description of service	Provided		Percentage of ST payable by the person providing service	Percentage of ST payable by the person receiving the service
	by	to		
10.Works Contract	i) any individual ii) HUF iii) Proprietary firm iv) partnership firm v) Association of Persons located in the taxable territory	i) Any company registered under the Companies Act ii) business entity registered as body corporate located in the taxable territory	50%	50%
11.any taxable services i.e. imported	any person located in a non-taxable territory	Any person located in the taxable territory	Nil	100%



Compiled by: Mr. Mumtaz Ahmed