

NEWSLETTER

DECEMBER 2012

M. V. DAMANIA & Co.
Chartered Accountants



Contents	Contributors	Page
INTERNATIONAL TAX	Malay Damania	2-5
Trilogy E-Business software - Bangalore Tribunal		2-3
Determination of Arms Length Price		
Abbey Business - Tribunal		4-5
Secondment of employees		
DOMESTIC INCOME TAX		6-11
Ethio Plastics - Ahmedabad Tribunal	Malay Damania	6
Disallowance under Section 14A		
Shri Subrata Roy - Kolkata Tribunal	Ruchi Shah	7-8
Dispatch of assessment order after limitation period		
Tax Accounting Standards	Bharat Jain & Chinmay Shende	9-10

for private circulation only



International Tax

Trilogy E-Business software - Bangalore Tribunal

Trilogy E-Business software India vs. DCIT (Bangalore Tribunal) on determination of Arms' Length Price.

Facts:

The Company was engaged in the business of providing software development and research services to its AE in USA. The Company was remunerated on cost plus basis. The AO, rejecting the claim of the Company's margin of 9.98%, made adjustment to the income.

Observations of Bangalore Tribunal:

The Tribunal had occasion to opine on following issues:

1. Whether, in selecting a comparable Company, a **turnover filter** has to be

adopted.

- Turnover filter is an important criteria in selecting a comparable Company because even if there is no functional difference in their activities, significant difference in size of the Company would affect comparability. Large size Companies can negotiate price better, they can attract more customers. They would also have broad based skilled people who are able to give better output. A smaller Company would not have such benefits leading to low turnover and lower margins.
 - As the assessee Company's turnover was Rs. 47 crores, Companies with turnover between Rs. 1 to Rs. 200 crores should be selected.
2. Whether Companies with

abnormal margin can be selected.

- There is no bar in selecting Companies with abnormal profits or abnormal losses as long as they are functionally comparable.
- Unlike OECD guidelines, Indian regulations follow arithmetic mean method to arrive at ALP. Under arithmetic mean method, all the Companies that are in the sample are considered, without any exception and average of all the Companies is considered as ALP. Hence the Companies with abnormal margins, under Indian TP regulations, cannot be ignored.
- However, if there is any specific reason for abnormal profit or loss, the assessee may demonstrate the existence of

cont.

such abnormal factor in which case the same may be excluded from sample.

3. Whether a filter has to be applied to distinguish between “**onsite services**” and “**offshore services**” even though there is no functional difference between them?
 - Though the functions performed by onsite and offshore service providers are same, one has to have regard to the assets employed, risks assumed by respective parties. The market conditions are different for onsite and offshore work.
 - Under onsite job, the Company does not employ assets or assume many risks. Companies which generate revenue from onsite job outside India have their own geographical markets, cost of labor etc. Their returns are also commensurate with the economic conditions in those countries.
 - Since the entire operations of the assessee Company took place offshore, it should be compared with the Companies with major offshore operations since the economics and profitability of onsite operations are difference from offshore business model.
4. Whether TPO is confined to information in public domain or can he collect Information under section 133(6)?
 - The TPO is entitled to collect information u/s. 133(6). However if he seeks to use this information against the assessee, the same must be furnished to the assessee and his objections taken into account. If the assessee seeks to cross examine the party, that opportunity must be given to him so that he can rebut the stand of that Company.



Compiled by: Mr. Malay Damania

Facts in brief:

- ICO and UKCO are associated group Companies.
- ICO was to provide financial and insurance services to customers of UKCO via Outsource Agreement. To ensure high quality services, UKCO entered into an agreement for Secondment of employees from UKCO to ICO.
- The key points of this Secondment agreement were:
 - The secondees were under direct management, supervision and control of ICO;
 - UKCO was not responsible for any damage, loss caused by the work done by secondees;
 - Secondees would perform their task at a place directed by ICO;
 - UKCO will be responsible for payment of Salary and other employment benefits to secondees;
 - ICO would reimburse the cost to UKCO.
- In terms of Sec. 192, UKCO withheld tax at source on the salaries paid to the secondees.
- ICO reimbursed to UKCO all the payments and expenses incurred by UCO in respect of seconded employees.
- Since this payment was mere reimbursement, ICO did not withhold any tax at source on such payment.
- In view of the AO, the reimbursement made to the UKCO was in the nature of FTS and hence the ICO ought to have deducted tax at source on such payment.

The following issues came before the Bangalore Tribunal:

1. Whether ICO was 'real and economic employer' of the seconded employees?

According to the secondment agreement, ICO had control of the seconded employees. If ICO so required, the UKCO was obliged to withdraw any seconded employee. UKCO was not responsible for any loss or damage caused due to work performed by any seconded employee. Thus direct control and supervision of the seconded employees vested solely with the ICO. UKCO remained the employer only to ensure social security and other benefits in UK of the seconded employees.

Therefore, UCO was a mere legal employer of while ICO was real and economic employer of the seconded employees.

2. Whether reimbursement made by ICO to UKCO constituted any income for UKCO?

As per agreement, ICO shall make tax payment equivalent to the costs and expenses incurred by UKCO in respect of seconded employees. Therefore the payments were mere reimbursement of salary and costs. Such reimbursement of salary and cost cannot be regarded as income in the hands of recipient since there was no element of profit in it.

3. Whether this payment will constitute as FTS under Sec. 9(1)(vii) of IT Act?

Under the agreement the payment was made only for secondment of staff and not to render any service. There was no managerial, technical or consultancy service provided by UKCO. Therefore the payment did not constitute FTS.

4. Whether this payment will constitute as FTS under Article 13(4) of DTAA with UK?

Reimbursement cannot be regarded as income of UKCO. Further if it is not an income under domestic Act, DTAA cannot impose tax which is not contemplated under domestic Act. Under Article 13(4) with UK, to

cont.

Abbey Business Services v DCIT - Bangalore Tribunal on treatment of secondment of employees:

constitute an FTS, two conditions have to be satisfied:

- a) Payment is for rendering technical or consultancy services;
- b) Such services 'make available' technical knowledge, experience, skill.... design.

First of all, UKCO did not render any service to ICO. Even if assuming secondment were to be a service, it could only be regarded as managerial service. However Article 13(4) includes only technical or consultancy services. Hence condition a) is not satisfied. Further condition b) requires that services 'make available' technical knowledge etc. Since no knowledge etc. was made available to ICO, it fails to satisfy condition b) too. Therefore the payment cannot be regarded as FTS under DTAA with UK.



DOMESTIC INCOME TAX

Ethio Plastics - Ahmedabad Tribunal

Ethio Plastics Pvt. Ltd. vs. DCIT (Ahmedabad Tribunal) on disallowance under section 14A:

Facts:

The assessee is a dealer in shares and held shares as stock in trade. It received Rs. 59 Lacs as dividend from these shares. The AO applied section 14A and made disallowance on account of exempt dividend income.

Tribunal decision:

As the assessee is engaged in the business of trading in shares and held shares as stock in trade, the intention of the assessee was not to earn dividend income. The dividend is only incidental to the main activity of trading in shares. Tribunal decided that no notional expenditure can be disallowed under section 14A

under such circumstances.



Compiled by Malay Damania

DOMESTIC INCOME TAX (cont.)

Shri Subrata Roy - Kolkata Tribunal

Dispatch of assessment order after limitation period renders it void.

Facts:

Last Date of passing s.143(3) Assessment Order for A.Y.2006-07 : 31st December, 2008.

Date on which AO passed the Order : 31st December, 2008.

Order served to the Assessee : 16th February, 2009.

On going through the envelope in which order was received, assessee claimed that the Order was delivered to the Post Office on 12th February, 2009. Thus, Assessee claimed that the Assessment Order was “passed” after the limitation period and was void.

Relevant Section:

Sub Section 1 of Section 153: Time limit for completion of Assessments.

“No order of assessment shall be made under section 143 or section 144 at any time after the expiry of-

(a) two years (twenty-one months for the given Assessment Year) from the end of the A.Y. in which income was first assessable; or

(b) one year from the end of F.Y in which return or a revised return relating to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year, is filed under section 139(4) or section 139(5),

whichever is later.”

Kolkata Tribunal Held:

Considering the provisions of Section 153, it implies that there is no need that the order under section 143 should be served to the assessee before the limitation date. However, an order can be said to be made / passed only when it leaves the control of the authority concerned. Mere signing on the order on the last date of the limitation period, does not mean that the order was passed on the day it purports to be passed on.

It should be issued so as to be beyond the control of the authority concerned for any possible change and modification within the limitation period. It may be served after the limitation period to the assessee.

But, if the same is served to the assessee after an unreasonable delay, for which no sufficient explanation can be given, then it can be presumed that the order was not passed on the date which it purports to be have been passed on. Thus, it can be safely presumed that the order was passed after the expiry of limitation period.

On facts, the Department could not produce any evidence that the order was passed on 31st December, 2008.

cont.

DOMESTIC INCOME TAX *(cont.)*

Shri Subrata Roy - Kolkata Tribunal

Thus, the assessee's contention was held that the assessment order was not passed on 31.12.2008 and the order was barred by limitation rendering the order void.



Compiled by: Ruchi Shah

Tax Accounting Standards

Brief overview Recommended Tax Accounting Standards:

From 2012-2013 onwards, taxpayers may have to file their income-tax return as per the standards laid down by the Central Board of Direct Taxes (CBDT). The new standards will reduce the discretion which is currently available with the taxpayers under the standards prescribed by the Institute of Chartered Accountants of India (ICAI), thus bringing down chances of litigation with the tax department.

The Tax Accounting Standards (TASs), however, will be applicable only to computation of taxable income under the Act. A CBDT committee, in its draft report submitted recently, has suggested that separate books of account are not required to be maintained under the TASs and thus reducing the compliance burden on businesses. CBDT had further clarified the new standards would not put extra burden on taxpayers as they merely addressed the issue of too many alternatives under the ICAI standards.

Computation of income is a major area of disputes between the tax department and the taxpayers. The TASs are expected to bring certainty in treatment of various items. The standards may affect sectors such as real estate, construction and mainly differ in treatment of contracts, government grants, and foreign exchange treatment.

At present, Section 145 of the Income Tax Act, provides that the method of accounting for computation of income under the head 'Profits and gains of business or profession' and 'Income from other sources' can either be the cash or mercantile system of accounting. Since TASs are based on the mercantile system of accounting, they will not be applicable to the taxpayers following cash system of accounting. They standards may also provide that in case of a conflict between the Income Tax Act and TASs, the law would prevail.

The final recommendations of the Committee are included in a report that was issued for public comment on October 26, 2012. The report also includes drafts of 14 individual TAS (these include the TAS on Construction Contracts and Government Grants that were initially issued in October 2011).

Key Recommendations of the Committee Summarized:

- The TAS would need to be in harmony with the provisions of the Act. Further, the TAS would need to lay down specific rules which would enable computation of taxable income with certainty and clarity. Similarly, to ensure horizontal equity and uniformity, the TAS should eliminate alternatives, to the extent possible.
- The TAS should be applicable only to computation of taxable income and taxpayers will not be required to maintain separate books of accounts on the basis of the TAS.
- The TAS should apply to all taxpayers without specifying any thresholds relating to turnover/income in order to bring certainty and uniformity in computation of taxable income.
- In case of a conflict between the Act and TAS, the provisions of the Act will prevail.
- Transition provisions will be notified with each TAS as relevant, in order to prevent any tax leakage of any double taxation.

DOMESTIC INCOME TAX *(cont.)*

Tax Accounting Standards

- To monitor compliance with TAS, appropriate modifications should be made to the return of income. For entities subject to tax audit, form 3CD should be modified so that a tax auditor is required to certify that computation of taxable income is in accordance with TAS.
- Suitable amendments be made to the Act to provide certainty on recognition of various conflicting issues.

Key Differences between TASs and ASs and other significant proposed changes in TAS are as follows:

1. Recognition of changes in Accounting Policies
2. General provision for recognition of unrealized gains and losses
3. Concept of Prudence and recognition of expected losses
4. Deemed cost in case of conversion of capital assets into stock in trade
5. Recognition of revenue in uncertain circumstances and provision for expected loss in case of construction contracts
6. Absence of guidance for recognition of revenue in case of principal or agent (gross vs. Net)
7. Maintenance of Fixed asset register for non corporate entity
8. Exchange rate for recording of foreign exchange transactions
9. Recognition of exchange difference on translation of non-integral foreign operation
10. Valuation of securities
11. Recognition of goodwill and valuation of intangibles
12. Recognition of research and development expenses
13. Recognition norms for provisions from probable to reasonably certain
14. Norms for recognition of contingent assets
15. Recognition of foreign currency option contracts and premium, discount or exchange difference on foreign currency derivatives
16. Govt grant recognition (basically Capital approach)
17. Finance lease transaction and depreciation thereon
18. Accounting treatment of Initial direct cost for negotiating the lease



Compiled by: Bharat Jain & Chinmay Shende