

NEWSLETTER

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INTERNATIONAL TAX

DCIT vs. BP India Services Pvt. Ltd. – Mumbai Tribunal

Facts: The assessee Company was engaged in providing support and advisory services to BP group Companies – its Associated Enterprises. It entered into international transactions with its AEs pursuant to which it made payments for Business Support Services. The Company adopted TNMM method and claimed that the transactions with the AEs were at Arms' length since its profits rate were better as compared with that of the comparables. In the list of comparables selected, there were two Companies which were loss making and two Companies with high profit margins.

The TPO rejected the loss making Companies on the ground that they were having different functional and product profile than the assessee Company. In the appeal, the CIT(A) held that it is not correct to exclude the loss making Companies. He upheld the

alternate argument that if the loss making Companies were to be excluded, the Companies with high profit margins should also be excluded. On the appeal by the Department, the Tribunal held as follows:

Tribunal held that:

The term “uncontrolled transaction” is defined to mean “a transaction between enterprises other than associated enterprises, whether resident or non-resident.” The conditions require that the case should not only be comparable but also have uncontrolled transactions. Both these conditions have to be satisfied cumulatively.

Rules 10B (2) and (3) specifies the circumstances with reference to which the comparability of international transactions with uncontrolled transaction has to be judged. The decisive factors for

determining inclusion or exclusion of any Company are the specified characteristics of services provided, assets employed, risks assumed, the contractual terms and conditions including the geographical location, size of the market, cost of labour and capital in the markets etc. **The fact that the comparable has higher or lower profits is not a determining factor to make a case uncomparable.** This is because the profit is not a factor in itself but a result of the above factors. **Only if the higher or lower profits results on account of the effect of factors as prescribed above, such case shall merit omission.** However, if the higher or lower profits results due to the factors other than what is prescribed in the rule, such Companies will continue to find its place in the list of comparables.

On facts, though the two loss making Companies were excluded

cont.

from the list of comparables, they were not eligible to be taken as comparables as their majority of transactions were with related parties. The transactions were not “uncontrolled transactions.” The alternative argument that if the loss making companies are excluded, the high profit making companies should also be excluded is not accepted. As stated, the question of inclusion or exclusion from the list of comparables has to be determined on the basis of characteristics of services provided, assets employed, risk assumed, contractual terms and conditions including geographical location etc and not on the basis of high or low profit margins.

Four Soft Limited – Hyderabad Tribunal

Facts: The assessee Company is engaged in the business of providing software development and IT enabled services to its Associated Enterprises (AEs) and Non Associated Enterprises (Non-AEs.) During the financial year 2005-06, the Company provided software development services to its AEs. To benchmark the international transaction, the Company used segmental data for AE and Non-AE segment using Transaction Net Margin Method (TNMM) as the most appropriate method.

The TPO rejected the segmental data prepared by the Company and computed the adjustment. This resulted in allocating Bad Debts and reimbursement of expenses to AE segment which is clearly the result of third party transactions.

Further, the TPO considered the foreign exchange gain as non-operating in nature.

On the loan given by the Company to its AE, the TPO applied interest rate on corporate bonds at 14% p.a. for benchmarking such loan transaction with the AE.

The TPO also concluded that the corporate guarantee given by the Company to the bank in respect of loan taken by AE is an international transaction and determined the ALP on the corporate guarantee provided by the Company at 3.75% of the guarantee amount.

Ruling of the Tribunal:

Provision of services:

- For computing the net margin, segmental financials between the AEs and non-AEs has to be considered.
- Bad debts and reimbursement of expenses essentially relate only to the non-AE transactions and hence should be included in computing the profitability of Non-AEs only.
- Foreign exchange rate fluctuations arise in the normal business transactions and hence the same should be treated as operating in nature.

Interest rate on loan:

- The ALP as regards the foreign currency loans is to be determined as per the international loan and not domestic loan. Therefore the Indian corporate bond rate cannot be taken as a base comparability.
- The Tribunal further held that LIBOR is an internationally recognized rate for benchmarking the interest rate on transactions in foreign currency.

cont.

Corporate Bank Guarantee:

- The Tribunal held that the corporate bank guarantee given by the Indian Company to its subsidiary outside India would not fall within the meaning of term “international transaction.”
- Corporate guarantee is very much incidental to the business of the Company. The same cannot be compared to a bank guarantee transaction of the bank.



Compiled by: Mr. Malay Damania



CORPORATE LAW ALERTS

Revision under section 314 of the companies Act:

Section 314 prohibits appointment of directors or their relatives or firms or companies in which directors are interested to hold office or place of profit without approval of members in all cases and approval of the Central Government in certain cases. Such approvals are required when the office or place of profit carries a monthly remuneration beyond a threshold limit stipulated in the respective provisions. Since the existing threshold limit was abysmally low, all such appointments to hold office or place of profit were subjected to the required approvals as discussed in the section. Having taken cognisance of this, the Ministry of Corporate Affairs (MCA) has issued a notification to enhance the limits of total monthly remuneration. This MCA notification is applicable from 7 July 2011. The prevailing limits along with the revision carried out under the relevant provisions of section 314 have been summarised below:

Criteria	Section 314(1b)	Section 314 (1B)
Appointment	Special resolution of shareholders for the appointment of a covered person under the section other than director of the company	Prior approval of shareholders by way of special resolution and approval of Central Government for appointment of covered person under the section
Prevailing limit of total monthly remuneration	Not less than INR 10,000	Not less than INR 20,000
Revised limit of total monthly remuneration	Not less than INR 50,000	Not less than INR 250,000

cont.

Revision under section 314 of the companies Act:

Amendment to Schedule XIII of Companies Act, 1956:

Schedule XIII of the Companies Act, 1956 which deals with appointment of managerial personnel, remuneration along with required approvals has been amended to alleviate listed companies and their subsidiaries from the requirement of seeking the Central Government approval subject to certain conditions being met for payment of managerial remuneration beyond the prescribed limits. These amendments were made pursuant to the MCA notification dated 14 July 2011. Approval of Central Government is not required for a subsidiary of a listed company subject to certain conditions being fulfilled such as consent being provided by the remuneration committee along with board of directors of the holding company, shareholders' approval by special resolution, all members of the subsidiary being bodies corporate, etc.

Further to the above, an exemption provision has been introduced whereby the Central Government approval is not required if the managerial person has no interest in the capital of the company or its holding company and is independent of the directors or promoters of the company or its holding company at anytime for a period of two years prior to such appointment and possesses the required qualification and specialised knowledge in the field. Having education qualification as one of the criteria required for gaining exemption is a welcome step since shareholders would prefer to have the right person with requisite knowledge and experience at the helm of affairs.



Compiled by Mr. Bharat Jain



ACCOUNTING STANDARDS

Brief on Applicability of Accounting Standard 15 “EMPLOYEE BENEFITS”:

A. In case of Partnership Firm / Proprietorship concern:

Applicable Accounting standard: As issued by ICAI- AS 15 (Revised) “Employee Benefits”

Particulars	Gratuity	Short-term Leave	Long-term Leave	Disclosure
Less than 10 employees	Not Applicable (Refer Note)	Provision to be made as per last salary drawn	Provision to be made as per last salary drawn	Note should be given in notes to accounts for non applicability alongwith reasoning
>10 and Less than 50 employees	Provision to be made as per rational method	Provision to be made as per last salary drawn (Vested)	Provision to be made as per last salary drawn	Partial disclosure
> than 50 employees	Actuarial Valuation as per Project unit credit method	Provision to be made as per last salary drawn (Vested and non vested)	Actuarial Valuation	Partial disclosure
Level 1 Entities (Refer Note 2)	Actuarial Valuation as per Project unit credit method	Provision to be made as per last salary drawn. (Vested and non vested)	Actuarial Valuation	Full disclosure along with tables

Note:

- Being total employee strength is less than 10 and hence the payment of gratuity act is not applicable. But with the further condition that no contractual obligation/ informal practices prevailing in the concern.
- For definition of Level 1 Entities, please refer guidance issued by ICAI in its announcement "Applicability of Accounting Standards"

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ACCOUNTING STANDARDS *(cont.)*

Brief on Applicability of Accounting Standard 15 "EMPLOYEE BENEFITS":

B. In case of Private and Public Ltd Companies:

Applicable Accounting standard: As notified by Companies (Accounting standard) Rules 2006 - AS 15 "Employee Benefits".

Particulars	Gratuity	Short-term Leave	Long-term Leave	Disclosure
Less than 10 employees	Not Applicable (Refer Note)	Provision to be made as per last salary drawn (Vested)	Provision to be made as per last salary drawn	Note should be given in notes to accounts for non applicability alongwith reasoning
SMC	Actuarial Valuation as per Project unit credit method	Provision to be made as per last salary drawn (Vested)	Actuarial Valuation	Partial disclosure
Non-SMC	Actuarial Valuation as per Project unit credit method	Provision to be made as per last salary drawn (Vested and non vested)	Actuarial Valuation	Full disclosure along with tables as referred in AS

Note:

- Being total employee strength is less than 10 and hence the payment of gratuity act is not applicable. But with the further condition that no contractual obligation/ informal practices prevailing in the concern.
- For definition of SMC and NON SMC Entities, please refer clause 2 (f) of Companies (Accounting Standards) Rules 2006.

"Firm/ Co. does not provide for gratuity as it has no Contractual/constructive obligation to provide for retirement benefit and is not covered under gratuity act since its total employee strength is less than 10."

Compiled by MVD Audit Study Group