



NEWSLETTER

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1 Accounting and Auditing

1. Expert Advisory Opinion – Segment Reporting

FACTS OF THE CASE:-

1. An unlisted public limited company is engaged in the business of contract manufacturing engineering products, castings, etc. as per the design, engineering standards and specifications prescribed by the customers.
2. The company also manufactures industrial valves under brand name of its USA based customer (more than 95% of the valves manufactured by the company are supplied to USA). The company also manufactures castings both machined and unmachined and supplies the same to tractor and auto sector that are sold in India with a small portion of export. The company also supplies components to a public sector undertaking for use in earth moving equipment. According to the querist, the company has only one product sold in its brand name, i.e., gear boxes which account for less than 3% of the turnover.
3. The company does not have more than 12 customers who either use components supplied by the company in their own products or sell the products under their own brand name and the end customer does not recognize the company. Based on these facts, the Company has formed the view that it is operating as a single business and geographical segment and there are no reportable segments as per Accounting Standard 17 (AS 17) on 'Segment Reporting'. New auditors of the Company have asked to re-examine this position.

QUERY

On the facts and circumstances stated above, the querist has sought the opinion of the Expert Advisory Committee as to whether it is in order to continue the present practice of treating the business as a single segment, i.e., contract manufacturing.

POINTS CONSIDERED BY THE COMMITTEE

1. The components of an enterprise which are required to be reported separately have to first fall within the definition of the terms 'business segment' or 'geographical segment' before being considered as 'reportable segments' as per the threshold criteria laid down in AS 17.

2. To identify business and geographical segments, the Company needs to evaluate risks and returns of different components, organizational structure, its internal reporting system etc. subject to their fulfilling the criteria prescribed in AS 17.
3. The information about whether the risks and returns associated with the various products in which the company deals in, are different, was not clear from the facts of the case. Committee states that as per the provisions of AS 17 if various products of the company are subject to different risks and returns, these would constitute different business segments. For instance the risk & return may be different considering the following facts:
 - a. Valves sales are restricted to single customer whereas company may not be relying on single customer for its other products.
 - b. Products manufactured by machines may be different from the products which are hand-made.Company should also consider nature of the products produced, production processes involved in manufacturing and type or class of customers in evaluating that whether there can be different business segments.
4. The information as to whether or not the risks and returns associated with the different regions/countries in which the company supplies its products are different is not clear from the facts of the case. Committee is of the view that there may be different pricing strategies, credit risks and exchange control regulations involved for domestic and international sales. In such a case, the risks and returns in different geographical regions may be different and accordingly, the different geographical regions may be considered as different geographical segments. Thus committee states that company should evaluate whether there can be different geographical segments.
5. After identifying various business and geographical segments as discussed above, in the view of the Committee, the company should decide whether these segments can be considered as reportable segment based on the requirements of paragraphs 27 to 29 of AS 17.

Opinion

The Committee is of the opinion that the company should identify the reportable business and/or geographical segments based on the considerations mentioned above.

2. Exposure Drafts on Accounting Standards & Guidance Note on Schedule VI

- a. Five exposure drafts of Indian Accounting Standard (Ind AS) (Ind AS converged in line with IFRS) have been issued by the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) namely
 - i. Ind AS 27 (as amended) - Separate Financial Statements
 - ii. Ind AS 41 - Agriculture
 - iii. Ind AS 110 - Consolidated Financial Statements
 - iv. Ind AS 112 - Disclosure of Interests in Other Entities
 - v. Ind AS 111 - Joint Arrangements

- b. Exposure draft on guidance notes to Revised Schedule VI of the Companies Act, 1956 has been issued for comments by ICAI. The objective of the guidance note is to provide guidance on preparation and presentation of financial statements as per the revised schedule VI. The guidance note attempts to clarify some of the doubts which may arise in interpreting the requirements of the revised schedule VI. The draft guidance note also provides a comparison of revised schedule VI with the old schedule VI.

2 Company Law

1. Revised Time limit prescribed for approval / rejection by Registrar

Consequent to amendment in Companies Regulations, 1956, Registrar shall not keep any document for approval and registration or for taking on record or for rejection or otherwise for more than sixty days (earlier one hundred and twenty days) from the date of its filing. Time limit does not apply to cases where approval from the Central Government or Regional Director or Company Law Board or Court or competent authority is required. Notification is effective from 25th September 2011.

In view of above, amendment sub-regulation which required Registrar to re-examine and intimate the defects in applications or e-filed documents that are pending in his office for more than 30 days is omitted w.e.f. 25th September 2011.

2. Filing of certain forms by defaulting companies

Circular 63 stating filing of certain forms by defaulting Companies is effective from 18th September 2011.

3. Modification in Form 5

Limited modification is under para 11(b) in form 5. The change is with respect to the payment of Stamp Duty in the state of Delhi, the same is made optional as per Delhi High Court as there is no provision in the Delhi Stamp Act for payment of stamp duty on "increased authorized capital". Notification is effective from 25th September 2011.

3 Service Tax

1. Services provided by sub-broker

Exemption from service tax is extended to services provided by an authorised person to Stock broker. Earlier exemption was restricted to services provided by sub broker to stock broker. The same shall come into force from date of its publication in the official gazette.

2. Exemption from service tax

Central Government has exempted services provided by arbitrators to business entities. The same shall come into force from date of its publication in the official gazette.

3. Service tax on amount of R&D cess

Earlier notifications exempted taxable services provided by consulting engineer and holder of Intellectual Property Right for technology import/transfer from so much of the service tax leviable thereon as is equivalent to the amount of R&D Cess actually paid. As per recent amendment exemption will be provided subject to below mentioned conditions:

- a. The amount of R & D Cess should be paid within six months from the date of invoice or in case of associated enterprises the date of credit in the books of account. However, exemption shall be available only if the R &D Cess is paid at the time or before the payment for the service and
- b. Records of Research and Development Cess are maintained for establishing the linkage between the invoice or the credit entry, as the case may be, and the Research and Development Cess payment challan.

4 SEBI

1. Takeover Code

SEBI has issued a new takeover code effective from 22nd October, 2011. The key changes made by SEBI are highlighted below:

No.	Topic	Erstwhile Takeover Code	New Takeover Code
1.	Increase in Initial Threshold limit	Open offer triggered on acquisition of more than 15% of shares or voting rights of the listed company	Open offer triggered on acquisition of more than 25% of shares or voting rights of the listed company
2.	Creeping Acquisition	Creeping Acquisition of 5% available in a financial year in the 15% to 55% bracket and one time increase of 5% beyond 55% to 75%	Creeping Acquisition of 5% available in a financial year in the single bracket of 25% to 75%. Promoters can now potentially increase their shareholding to 75%
3.	Minimum Offer size	20% of the capital	26% of the capital. Acquirers can potentially acquire a minimum 51% stake post open offer
4.	Individual shareholding	Consolidated promoter shareholding to be considered for determining Open Offer Trigger	Individual Acquirer Shareholding shall also be considered for determining the Open Offer Trigger
5.	Exempt Transfers	Interse transfer of shares amongst group as defined in MRTTP (Monopolies and Restrictive Trade Practices) Act	This exemption has been withdrawn
6.	Voluntary offers	Not provided	Shareholders holding 25% or more of the shareholding entitled to increase their shareholding by 10% through voluntary open offer. Promoters can increase their shareholding by 10% without being obligated to the 26% open offer
7.	Change of Control	Exemption from open offer available in case of	This exemption has been withdrawn Change in control

No.	Topic	Erstwhile Takeover Code	New Takeover Code
		change in control is passed through a special resolution by postal ballot process	shall be only after open offer process
8.	Voluntary Delisting	Voluntary Delisting was permitted on shareholding of the acquirer exceeding the minimum public shareholding threshold post open offer.	For a period of one year no voluntary delisting permitted, in case, post open offer, the shareholding of the acquirer exceeds the minimum public shareholding threshold.
9.	Indirect Acquisitions	Not defined	Defined as the ability to exercise or direct the exercise of voting rights which would otherwise attract the obligation of making a public announcement of an open offer. If this control or ability is 80% of assets or net sales or market capitalization of the target company, it would be deemed to be a direct acquisition
10.	Non compete fees	In respect of non-compete fees, any amount paid in excess of 25% of the offer price shall be added in offer price	Any amount paid to the Sellers whether as consideration, non-compete fee or control premium or otherwise, shall be added in Offer Price Public shareholders shall get the offer at the highest price.
11.	Disclosures	Acquirer who acquires more than 5% or 10% or 14% or 54% or 74% shares/voting rights shall disclose their shareholding at every stage	Acquirer who acquires more than 5% of shares/voting rights, to disclose their shareholding
12.	Offer price	Highest of: a. Negotiated price b. Highest price paid during 26 weeks preceding Public	Highest of: d. Negotiated price e. Volume weighted average price paid during 52 weeks preceding the PA

No.	Topic	Erstwhile Takeover Code	New Takeover Code
		Announcement (PA) c. Higher of, average of weekly high and low of closing prices during 26 weeks or average of daily high and low of prices during 2 weeks preceding PA	f. Highest price paid during 26 weeks preceding PA g. Volume weighted average market price during 60 trading days preceding the PA

2. Extension of time for conversion of promoter holding in dematerialized form

SEBI has extended the deadline of September 2011 to December 2011 for conversion of 100% of promoter's/promoters' group's shareholding in dematerialized form for securities of listed companies to be allowed to be traded in the normal segment of the exchange.

3. Investment by FIIs

- a. Government of India has eased the norms for FII investments in long term infrastructure corporate bonds. The relaxation provided is tabulated below:

S. N.	Type of Investment Route	Lock in period	Upper cap (USD billion)	
			Erstwhile	Current
1	Total Long term Infrastructure investment limits for FIIs		25	25
2	Qualified Foreign Investor (QFI) Investments in Debt (Including investment in Infrastructure Debt Funds (IDFs))		3	3
3	FII investments in bonds with initial maturity of 5 years and 1 year residual maturity	1 year	-	5
4	FII investments in bonds with initial maturity of 5 years and 3 year residual maturity (including investment in IDFs)	3 years	22	17

- b. Further it is clarified that in case of bonds having call and put options, the date of put/call shall be determined as the maturity date for calculating the residual maturity.

4. Issue and listing of Structured Products/Market linked Debentures

SEBI has identified hybrid securities that differ from plain vanilla debt securities or offer market linked returns (Structured Products/Market linked Debentures). SEBI has decided to stipulate additional disclosures and the other requirements for issue of such Structured Products/Market linked Debentures that seek listing on the stock exchange.

Further SEBI has directed that those security which do not protect the principal amount, shall not be considered as debt securities and therefore not eligible for issue and listing under the said regulation.

The key conditions for issue and listing such products are as under

- a. Issuer to have a minimum net worth of at least Rs. 100 crores.
- b. Minimum ticket size of not less than Rs.10 Lakhs.
- c. Mandatory appointment of a third party valuer which shall be credit rating agency registered with SEBI and the cost of valuation shall be disclosed in the offer document and shall not be charged to the investor.

5. Standardization of Application-cum-Bidding Form.

SEBI has simplified the Application-cum-bidding form for public offer and henceforth there would be only a single form for ASBA and Non-ASBA applicants.

6. Amendment to ICDR

- a. SEBI has notified amendments to the “Issue of Capital and Disclosure Requirements: (ICDR). The key changes are tabulated below:

S. N.	Regulation	Extant Provisions	Amended Provisions
Common Conditions for Public Issues and Right Issues			
1	Underwriting	If the public issue is made with at least 10% public offer, then minimum 60% of the net offer to the public proposed to be compulsorily allotted to QIB cannot be underwritten.	This Provision has been deleted and henceforth for all issues, minimum 50% of the net offer to the public to be compulsorily allotted to QIB cannot be underwritten.
2	Conditions for Initial Public	▪ Not more than 50% of the net tangible assets	▪ This condition has been done away with

S. N.	Regulation	Extant Provisions	Amended Provisions
	Offer	<p>can be held in monetary assets</p> <ul style="list-style-type: none"> ▪ To have distributable profits for last 3 out of last 5 preceding years. ▪ No such provision 	<p>in case the public offer is made entirely through an offer of sale.</p> <ul style="list-style-type: none"> ▪ Both on a stand-alone as well as on consolidated basis this condition needs to be satisfied. ▪ In case where the issuer has a subsidiary / subsidiaries for less than 5 years, then it shall have net profits on consolidated basis in at-least 1 year for which consolidated accounts are prepared.
Qualified Institution Placements			
3	Condition for Qualified Institutional Placement	Minimum public shareholding shall be as specified under the listing agreement with the stock exchange	Minimum public shareholding shall be as per the Security Contracts Rules which is 25%

- b. SEBI has introduced new a chapter with regards to Rights issue of Indian Depository Receipts (IDRs)

5 FEMA

1. External Commercial Borrowings (ECB)

a. Rationalization and Liberalization

- i. Enhancement of ECB Limit under the automatic route
 - In the real sector-industrial sector-infrastructure sector from the present limit of USD 500 million to USD 750 million or equivalent per financial year.
 - In specified service sectors viz. hotel, hospital and software, from the present limit of USD 100 million to 200 million or equivalent during a financial year.
- ii. ECBs designated in INR
 - The same can be availed from foreign equity holders under the automatic/ approval route, as the case may be.
 - NGOs engaged in micro finance activities will, however, be permitted to avail of ECBs designated in INR, as hitherto, under the automatic route from overseas organizations and individuals.

b. Infrastructure Liberalization

- i. The extant guidelines did not permit repayment of existing Rupee loans from the ECB raised. However, it has been now decided to allow Indian companies which are in the infrastructure sector to utilize 25% of the fresh ECB raised towards refinancing of the Rupee loan/s availed by them for 'capital expenditure' of earlier completed infrastructure project under the approval route, subject to at least 75% of ECB raised to be utilized for capital expenditure towards new infrastructure projects.
- ii. Infrastructure sector are now allowed to import capital goods by availing of short term credit (including buyers'/suppliers' credit) in the nature of 'bridge finance', under the approval route, subject to the condition that the bridge finance shall be replaced with a long term ECB and prior approval shall be sought from the Reserve Bank of India (RBI) for replacing the bridge finance with a long term ECB.
- iii. It has been decided to consider Interest during Construction (IDC) as a permissible end-use for the Indian companies which are in the infrastructure sector under the automatic/approval route, as the case may be provided IDC is capitalized and is part of the project cost.
- iv. It has been now decided to allow Indian companies which are in the infrastructure sector, to avail of ECBs in Renminbi (RMB), under the approval route, subject to an annual cap of USD 1 billion.

c. ECB from the foreign equity holders

As per the extant ECB policy, a 'foreign equity holder' to be eligible as 'recognized lender' under the automatic route would require to hold for:

- i. ECB up to USD 5 million – minimum paid-up equity of 25 % (direct equity) &
- ii. ECB more than USD 5 million – minimum paid-up equity of 25 % and debt-equity ratio not exceeding 4:1 (i.e. the proposed ECB does not exceeds four times the direct foreign equity holding).

In this regard, the following clarifications have being issued:-

- i. The term 'debt' in the debt-equity ratio to be replaced with 'ECB liability' and the ratio to be known as 'ECB liability'-equity ratio;
- ii. For calculating the ECB liability, not only the proposed borrowing but also the outstanding ECB from the same foreign equity holder lender to be reckoned. No other debt/borrowings to be considered.
- iii. For calculating the equity of the foreign equity holder, besides the paid-up capital, free reserves (including the share premium received in foreign currency brought in by the lender concerned) as per the latest audited balance sheet to be reckoned.

d. ECB from group companies under approval route

It has now been decided, to permit ECB proposals from foreign equity holders (direct/indirect) and group companies under the approval route as under:-

- i. Service sector units, in addition to those in hotels, hospitals and software, could also avail ECB if the loan is obtained from foreign equity holders. This would facilitate borrowing by training institutions, R &D, miscellaneous service companies, etc.
- ii. ECB from indirect equity holders may be considered provided the indirect equity holding by the lender in the Indian company is at least 51 % ; and
- iii. ECB from a group company may also be permitted provided both the borrower and the foreign lender are subsidiaries of the same parent.
- iv. However, total outstanding ECBs (including the proposed ECBs) from a foreign equity lender not to exceed 7 times the equity holding, either directly or indirectly of the lender (in case of lending by a group company equity holdings by the common parent would be reckoned).

e. ECB Structured Obligation

As per the extant guidelines, credit enhancement to Indian companies engaged exclusively in the development of infrastructure is provided only by multilateral / regional financial institutions and Government owned development financial

institutions. However, now even direct and indirect foreign equity holders can provide credit enhancements to such companies.

2. Consolidated FDI Policy:

The Department of Industrial Policy and Promotion (DIPP) has issued a consolidated FDI policy effective from 1st October, 2011. The key changes made by the policy are highlighted below:

No.	Topic	FDI Policy October 2011
1	Types of Instruments	Equity instruments issued/transferred to NR having in-built options or supported by options sold by third parties would have to comply with the extant ECB guidelines. Hence only equity instruments with no built-in options would qualify as FDI.
2	Issue of the equity shares under the FDI policy for pre-operative/pre-incorporation expenses	<ul style="list-style-type: none"> ▪ Earlier foreign investors had to make payments directly to the company, now it is clarified that even payment made through the bank account opened by the foreign investor is permissible. ▪ It is clarified that application for capitalization of pre-operative/pre-incorporation expenses has to be done within 180 days from the date of incorporation of the company.
3	Financial Services	<p>Following sectors have now been classified under 'Financial Services'.</p> <ul style="list-style-type: none"> ▪ Asset Reconstruction Companies. ▪ Banking - Private & Public Sector. ▪ Commodity Exchanges. ▪ Credit Information Companies. ▪ Infrastructure Company in Securities Market. (Stock Exchanges, depositories and clearing corporations). ▪ Insurance <p>It is clarified that foreign investment in financial services other than those specified above shall require prior Government approval.</p>

Sector specific changes are highlighted below:

No.	Topic	FDI Policy October 2011
1.	Agriculture and Animal Husbandry	Apiculture (bee keeping) has now been included under the 100% automatic route within the permitted activities in agriculture subject to fulfillment of controlled conditions

No.	Topic	FDI Policy October 2011
2.	Terrestrial Broadcasting FM (FM Radio)	Foreign investment limit has now been increased to 26% from 20%
3.	Construction Development: Townships, Housing, Built-up infrastructure	FDI in undertaking construction and development activities in the Education Sector and Old Age Homes are exempted from the conditions of minimum area, minimum capitalization, lock in and completion parameters
4.	Industrial Parks	FDI upto 100% is now allowed under the automatic route in case of basic and applied R&D on bio-technology, pharmaceutical sciences / life sciences
5.	Single Brand product retailing	To undertake single brand retailing, foreign investors need to be the owner of the brand

Notes:

1. RBI had enhanced the limit of the aggregate value of security to be transferred as gift by person resident in India to a person resident outside India from rupee equivalent of USD 25000 per calendar year to USD 50000 per financial year. However, this change has not been incorporated in the above FDI policy of 1st October, 2011.
2. The Previous FDI Policy issued on 1st April 2011, had among the permitted sectors, power as a sector in which 100% FDI was allowed under automatic route. However, the consolidated FDI policy issued on 1st October, 2011 does not specifically mention power as a sector.

6 Income Tax

1. Circulars / Notifications

a. **Sec. 80CCF - Deduction on Long Term Infrastructure Bonds specified for F.Y.11-12**

Notification No. 50/2011/F. No. 178/43/2011-SO (ITA. 1)

Section 80CCF provides Rs.20,000/- extra deduction for subscribing to long term infrastructure bonds. For financial year 2011-12, CBDT has notified that the infrastructure bonds issued by the following five companies can be valid for subscription for 80CCF deductions:

- i. The Industrial Financial Corporation of India
- ii. The Life Insurance Corporation of India
- iii. The Infrastructure Development Finance Company Limited
- iv. The India Infrastructure Finance Company Limited
- v. A non banking finance company classified as an Infrastructure Finance Company Limited by RBI

b. **Circular no. 7/2007 on sec. 239 – refund of TDS u/s 195 modified**

Circular No. 07/2011 [F.NO. 500/135/2007-FTD-I], Dated 27-9-2011

The board had earlier issued circular laying down the procedure for refund of tax deducted at source u/s 195 to the person deducting tax at source from the payment made to non resident. The earlier circular also lists down various situations under which provision of the said circular shall apply. Now this circular is issued to cover a situation where deduction of tax at a higher rate under the relevant DTAA has been made by resident deductor while a lower rate is prescribed under the domestic law resulting in excess deduction.

2. Case Laws

a. **No refund of Dividend Distribution Tax (DDT) on dividend paid post amalgamation**

Tata Power Co. Ltd v/s The Addl. Commissioner of Income Tax (Mumbai ITAT)

Facts:

The Assessee declared interim dividend on 23.3.2000 and paid the same on 10.5.2000. DDT in terms of Sec.115-O was paid by the Assessee on 6.4.2000. The Assessee declared final dividend in its AGM on 10.8.2000 and paid on 23.8.2000.

Subsequently, the Assessee amalgamated with Andhra Valley Power Supply Co. Ltd (AVPSCL) w.e.f 1.4.2000. The Hon'ble Bombay High Court sanctioned the Scheme of Amalgamation by its order dated 18.10.2000. Assessee claimed before the Assessing Officer (AO) that the DDT to the extent it relates to dividend payable to AVPSCL, but not paid because of Amalgamation, should be treated as not payable and to that extent the DDT paid should be refunded to the Assessee. The AO rejected the claim of the assessee.

Issue:

Whether the assessee is entitled to refund of DDT on dividend paid post appointed date of amalgamation?

Held:

The Mumbai Tribunal confirming the action of the AO held that that the payment of DDT is not dependent on the ultimate chargeability to tax in the hands of the recipient of the dividend. Amalgamation was sanctioned by the Hon'ble High Court on 18.10.2000 and the appointed date was 1.4.2000; as on the date of sanction, dividend was already paid by the Assessee. The incidence of tax u/s.115-O of the Act is on distribution of dividend. Any subsequent act by which the dividend itself does not become taxable in the hands of the recipient of the dividend will not be relevant.

Note: Chennai ITAT has taken a contrary view in the case of ACIT v. TVS Motors Company Ltd (128 ITD 47)

b. Transfer Pricing & “Cost Contribution Agreements”: Law Explained

Dresser- Rand India Pvt Ltd v/s The ACIT (Mumbai Tribunal)

Facts:

The assessee entered into a 'cost contribution agreement' (CCA) with its parent company pursuant to which it paid a sum of Rs. 10.55 crores as its share of the costs. The Transfer Pricing Officer (TPO), Assessing Officer (AO) & Dispute Resolution Panel (DRP) disallowed the expenditure on the ground that (i) the ALP was 'Nil' as no real services had been availed by the assessee and the arrangement was not genuine, (ii) the cost sharing could not be on the basis of head count but on the basis of actual services availed by the assessee, (iii) the expenditure was "excessive & unreasonable" u/s 40A(2) and (iv) as there was no TDS, the disallowance u/s 40(a)(i) had to be made. The assessee also rendered field services to its associated enterprises where it granted a discount of 10% over the price charged to third parties on the basis that such discount was a part

of reciprocal global policy. It was held that the Arms Length price (ALP) had to be computed by ignoring the discount.

Issues:

- i. Whether the ALP under the CCA could be determined at “Nil”?
- ii. Whether the cost sharing could be on the basis of head count?
- iii. Whether the expenditure was “excessive & unreasonable” u/s 40A(2)?
- iv. Whether the AO was justified in holding that even otherwise the payment under CCA could not be allowed u/s 40(a)(i)?
- v. Whether the TPO was justified in disallowing 10% of commission/ discount on the ground that there was no justification for allowing discounts to the associated concerns?

Held:

- i. How an assessee conducts his business is entirely his prerogative and it is not for the revenue authorities to decide what is necessary for an assessee and what is not. Further, the TPO’s argument that the assessee did not benefit from the services is irrelevant because whether there is benefit or not has no bearing on the ALP of the services. The fact that similar services may have been granted in the past on gratuitous basis is also irrelevant in determining the ALP. The TPO’s objection that the cost should be shared in the ratio of actual use of services and should be charged as per Indian employee costs is not acceptable because such an allocation will deal with some hypothetical pricing.
- ii. The disallowance of payment under the CCA u/s 37(1) & 40A(2) is not justified because the payment did not involve mark-up and was at ALP. The services were for furtherance of the assessee’s business interests and are, thus, wholly exclusively for the purposes of business.
- iii. The disallowance of payment u/s 40(a)(i) for want of TDS is not justified because the payment was not taxable in the AE’s hands under Article 5 & 12 of the India-USA DTAA as the AE did not have a PE and the services did not constitute “fees for included services”. Obligations to deduct tax at source come into existence only when recipient has a tax liability in India. This vicarious tax withholding liability cannot be invoked unless primary tax liability of the recipient is established
- iv. The TPO’s argument that in charging for the services rendered to the AE, a 10% discount could not be given is not acceptable because (i) the assessee had followed the TNMM for determination of ALP which had not been disputed as the appropriate method, (ii) Even under CUP, all sales need not be at the same price and there can be variations of prices for the same

product or services on grounds such as quantum of business, risk factors, etc. When assessee is dealing with an AE, at least there are no commercial risks, no marketing cost and several other factors justifying discount offered by assessee

c. A firm can be treated as 'shareholder' for attracting deemed dividend

CIT vs. M/s. National Travel Services (Delhi High Court)

Facts:

The assessee is a partnership firm consisting of three partners namely Mr. Naresh Goyal, Mr. Surinder Goyal and M/s Jet Enterprises Pvt. Ltd. M/s. Jet Air Private Limited (JAPL) has advanced loan of Rs. 28.52 crores to the assessee. The assessee was beneficial owner of 48.18% of the share capital of JAPL which were held in the name of partners. The AO held that the said advance is taxable as deemed dividend in the hands of the assessee. Tribunal reversed the AO's order. Department went in further appeal to High Court

Issue:

Whether the partnership firm can be treated as "a shareholder who is the beneficial owner of the shares" as stated in the first limb of section 2(22)(e) of the Act and accordingly whether loan or advance can be treated as deemed dividend in the hands of partnership firm?

Held:

Hon'ble High Court has held that:

- i. To attract the first limb of section 2(22)(e), it is necessary that the person who receives loan or advance is a shareholder and also a beneficial owner, however if this interpretation is given to the words used in first limb then in no case a partnership firm can come within the mischief of section 2(22)(e) because shares would be purchased by the firm in the name of its partners as the firm is not having any separate entity of its own and the said partner shall be the 'shareholder' in the records of the company but not the beneficial owner as 'beneficial owner' is partnership firm.
- ii. This would mean that the loan or advance given by the company would never be treated as deemed dividend either in the hands of the partners or in the hands of partnership firm. Thus the very purpose of the section gets defeated. Hence it is the partnership firm which is to be treated as shareholder for section 2(22)(e)

Note: In this appeal, Court was concerned with the first limb of sec. 2(22)(e) of the Act in contradiction to question that arose in the decision of Ankitech Pvt Ltd wherein the second limb of the section i.e. payment made to a 'concern' in which such shareholder has substantial interest was under interpretation.

d. Despite s. 209(3) of the Companies Act, company can follow cash system for tax purposes

DCIT Vs. Stup Consultants Private Limited (ITAT Mumbai)

Facts:

The assessee is a private limited company rendering professional services in the field of civil/structural engineering and architecture. It receives income from fees for services rendered. From AY 1983-84 the assessee changed its method of accounting from mercantile system to cash system and has been following this system from AY 1983-84 onwards. Further the assessee changed the accounting method as its income is in the form of fees and it does not indulge in any trading activities. The bills raised on the parties are subject to revision and hence there is uncertainty about the correct income figures. The assessee felt that it was not practical to pay taxes on accrual basis since the realization of income is later and not certain. The assessee maintains the mercantile system of accounting for calculating the book profit u/s 115JB.

Issue:

Whether the company can follow cash system of accounting for the tax purposes?

Held:

Hon'ble ITAT, Mumbai, held that the assessee has given proper reasons as to why it has changed its system of accounting which has been regularly followed by the assessee. Further there was no valid reason for AO's action in rejecting the cash system followed by the assessee and the department has accepted assessee's system for the past several years. In the absence of any fresh facts to show that the assessee's system of accounting is not uniform, the principles of consistency should apply. Hence, the appeal of the revenue is dismissed.

- e. **Interest received on income tax refund can be set-off against the interest paid on delayed payment of income tax**

DCIT v. Bank of America NT & SA (ITAT Mumbai)

Facts:

The assessee is an American Bank having its branch in India. The assessee received interest on income tax refund which it set-off against the interest on delayed payment of income tax and offered the net interest received for tax. The Commissioner of Income Tax (Appeals) confirmed the order of the Assessing Officer of disallowing the total interest paid on delayed payment of income tax and taxing the gross interest received.

Issue:

Whether interest received on I-T refund can be set-off against the interest paid on delayed payment of Income Tax?

Held:

Hon'ble ITAT Mumbai held that neither the interest paid to the government is business expenditure nor the interest received from the Government is a business income. Both of them have to be assessed under the head 'Income from other Sources' and further since both are of same nature, only the net income i.e. interest received less interest paid, is to be taxed. Accordingly, the case was judged in the favour of the assessee.

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