



N.A. Shah Associates

NEWSLETTER

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1 Accounting and Auditing

1 Expert Advisory Opinion

Accounting treatment of advance to subsidiary pending finalization of modalities of issue of the shares

Facts of the case

- A subsidiary of listed Government Company (referred to as company) is in the business of exploration of oil and gas and other hydrocarbon related activities. The company acquires oil and gas blocks by way of acquisition of blocks or participating interest therein or by acquisition of the entity owning the right in block.
- Company has acquired a Cyprus based company (ABC). In the same year 'ABC' acquired the entire share capital in a UK based company (XYZ) which through its direct/indirect subsidiaries and joint venture operates in oil and gas blocks in Russia. The company remitted to 'ABC' (which in turn utilized it for acquisition of XYZ) USD 1922 million to be treated as share application money without entering into a formal agreement at the time of remitting the funds. Further the company advanced USD 53 million to 'ABC' for being advanced to 'XYZ's' for its business requirements.
- The company subsequently entered into the 'shareholders investment agreement' with 'ABC' as per which 'ABC' has to issue preference/equity shares at a premium. The agreement makes clear that the advance given to 'ABC' was for acquisition of preference/equity shares of 'XYZ'; however, no concrete modalities were firmed up till the balance sheet date. As regards advance of USD53 million there is no written agreement but the company intends to convert the same in equity / preference shares as it was not likely to be returned in near future. As the shares were yet to be issued amount paid to 'ABC' was shown as Advance to 'ABC' under 'Loans and Advances'.
- The company intends to convert aggregate advance of USD 1975 million into preference/equity shares and thus the advance was considered as extension to company's net investment in 'ABC'. As per para 15 and 16 of AS 11 the company revalued the advance of USD 1975 million at the exchange rate as on year end, increasing the advances by INR 442 crores and crediting the same to 'Foreign Exchange Translation Reserve'.
- As per the C&AG auditors
 - The amount of USD 1922 million paid to 'ABC' for financing acquisition cost of 'XYZ' should have been treated as 'Investment' (Share Application Money pending allotment) and thus the amount could not be revalued in accordance of AS 13.

- Further the exchange difference arising on the advance of USD 53 Million being revenue in nature should be taken to profit and loss a/c instead of 'Foreign Exchange Translation Reserve'.

Query

- Whether accounting treatment followed by company for treating the payment of USD 1922 million as Advance to 'ABC' is appropriate or be shown as Investment
- Whether Credit of foreign exchange revaluation be taken in 'Foreign Exchange Translation Reserve' or be shown as revenue gain.

Points considered by the Committee

- The committee while analyzing the query has presumed that the company has correctly classified investment in ABC as non-integral foreign operation in accordance with AS 11- The Effects of Changes in Foreign Exchange Rates.
- As per the committee the accounting of exchange gain/loss would depend upon whether funds advanced to 'ABC' are regarded as monetary item or non-monetary item as per AS 11.
- In respect of advance of USD 1922 million, though the company has entered into shareholder's investment agreement with 'ABC' but there was no concrete modalities as on balance sheet date. In respect of advance of USD 53 million by company to 'ABC', though the company intends to convert it to shares but formal agreement has not been entered. Thus the committee is of the view that both are monetary items. Generally exchange difference arising out of settlement or reinstatement of a monetary item are accounted as an income or expense as the case may be unless it is covered by the exception given in para 15 of the accounting standard.
- As per para 15 of the Accounting Standard 11, exchange difference arising out of an item which in substance forms a part of enterprises net investment in a non-integral foreign operation should be accumulated in a foreign currency translation account.

Opinion

- Since the intention of the company is to convert the amounts advanced into equity/ preference shares and there is no possibility of repayment of the loan in foreseeable future, the committee is of the view that the said advances should be treated as an extension to net investment in 'ABC'. Considering that 'ABC' is a non-integral extension of the company, the exchange difference arising on the balance sheet date should be accumulated in a 'foreign currency translation reserve'
- However in case the presumption of conversion in equity / preference share and regarding the amount not being repaid in foreseeable future does not hold good , the advances cannot be treated as extension of company's net investment in 'ABC' and the exchange difference be recognised as income or

expense in profit and loss statement of the company. With respect to the disclosure of the advances the committee feels it to be appropriate to disclose under the head of 'loans and advances'.

2 Exposure Draft on preparation and presentation of Financial Statement

The Framework sets out the concepts that underline the preparation and presentation of financial statements for external users. The purpose of the Framework is to:

- assist in the development of future Accounting Standards and in its review of existing Accounting Standards;
- assist in promoting harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by Accounting Standards;
- assist preparers of financial statements in applying Accounting Standards and in dealing with topics that have yet to form the subject of an Accounting Standard;
- assist auditors in forming an opinion as to whether financial statements conform with Accounting Standards;
- assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with Accounting Standards; and
- provide information about accounting standard and approach to their formulation.

The Framework is not an Accounting Standard and hence does not define standards for any particular measurement or disclosure issue and nothing in this Framework overrides any specific Accounting Standard.

2 Company Law

1 Exemption to publish accounts of subsidiary companies

In order to reduce the administrative burden and considering the globalization, development of the regulatory framework, accounting standards etc, the Central Government through a circular has notified that the requirement of attaching the accounts of the subsidiary company along with that of the Holding company in terms of Section 212 will not apply to those companies which fulfill following conditions:

- Board of Director has passed resolution not to attach the balance sheet of subsidiary companies.
- The company shall present the consolidated financial statements of holding company and all subsidiaries duly audited by its statutory auditors.
- The consolidated financial statement shall be prepared in strict compliance with applicable Accounting Standards and, where applicable, Listing Agreement as prescribed by the Security and Exchange Board of India (SEBI).
- The company shall disclose in the consolidated balance sheet the following details in aggregate for each subsidiary including subsidiaries of subsidiaries:-
(a) capital (b) reserves (c) total assets (d) total liabilities (e) details of investment (except in case of investment in the subsidiaries) (f) turnover (g) profit before taxation (h) provision for taxation (i) profit after taxation (j) proposed dividend.
- The holding company shall undertake in its annual report that annual accounts and the related detailed information of the subsidiaries company shall be kept for inspection for the shareholders of the holding and subsidiary companies at the head office of the holding company and at the subsidiary companies concerned and a note of above effect will be included in the annual report of the holding company. Also, it shall furnish a hard copy of details of accounts of subsidiaries to shareholder on demand.
- The holding and subsidiary companies in question shall regularly file such data to the various regulatory and Government authorities as required by them
- The company shall give Indian rupee equivalent of the figures given in foreign currency appearing in the accounts of the subsidiary companies along with exchange rate as on closing day of the financial year.

2 Easy Exit Scheme , 2011

Easy exit scheme which was notified to help defunct companies to strike off their name has been extended for another three months i.e. upto 30th April, 2011 and all the terms & conditions notified earlier remains the same.

3 General Exemption under Section 211

The companies are required to provide in its Notes to Account various disclosure (particularly quantitative details) as required by Schedule VI of the Companies Act, 1956. Considering that similar disclosure standards do not prevail in other countries putting Indian companies to a disadvantage the Central Government has, by notification, issued a general exemption whereby certain class of companies will be exempted from giving the disclosures as given below:

Sr. No	Class of Companies	Exemptions as provided in respect of Part-II of Schedule VI.
1.	Companies producing Defense Equipments including Space Research	<p>Details of turnover (i.e sales value and quantity sold for each class of goods),,</p> <p>Nature and quantity of Raw material consumed,</p> <ul style="list-style-type: none"> ▪ Value and Quantity details in respect of Opening and closing stock of finished goods manufactured ▪ in respect of trading purchases, quantity and value by class of items of purchases made as also opening /closing stock details. ▪ Licensed capacity, Installed capacity & Production details ▪ CIF value of imports, ▪ Details of Expenditure (other than payments on account of dividend to non resident shareholders which is required to be disclosed) and Earnings in Foreign currency ▪ value of imported/ indigenous consumption of raw material/ spare parts and consumables
2.	Export Oriented company (whose export is more than 20% of the turnover)	<ul style="list-style-type: none"> ▪ Details of turnover (i.e sales value and quantity sold for each class of goods), ▪ in respect of manufacturing companies raw material consumed, opening and closing stock/ value of finished goods manufactured, ▪ in respect of trading purchases details of purchases made and opening /closing stock details.
3.	Shipping companies (including Airlines)	<ul style="list-style-type: none"> ▪ CIF value of imports, ▪ Details of Expenditure (other than payments on account of dividend to non resident shareholders which is required to be disclosed) and Earnings in Foreign currency

		<ul style="list-style-type: none"> ▪ value of imported/ indigenous consumption of raw material/ spare parts and consumables
4.	Hotel companies (including Restaurants)	<p>Details of turnover (i.e sales value and quantity sold for each class of goods),,</p> <p>Nature and quantity of Raw material consumed,</p> <ul style="list-style-type: none"> ▪ Value and Quantity details in respect of Opening and closing stock of finished goods manufactured ▪ in respect of trading purchases, quantity and value by class of items of purchases made as also opening /closing stock details.
5.	Manufacturing companies/multi-product companies	<ul style="list-style-type: none"> ▪ Details of turnover (i.e sales value and quantity sold for each class of goods), ▪ in respect of manufacturing companies raw material consumed, opening and closing stock/ value of finished goods manufactured,
6	Trading companies	<ul style="list-style-type: none"> ▪ Details of turnover (i.e sales value and quantity sold for each class of goods), <p>in respect of trading purchases, quantity and value by class of items of purchases made as also opening /closing stock details.</p>

4 Managerial Remuneration in unlisted public companies

Schedule XIII of the Companies Act 1956 have been amended to provide that unlisted public companies (i.e other than subsidiaries of listed companies) shall not require Government approval for paying managerial remuneration even in cases of where there are no profits/ inadequate profits, provided they meet the other conditions stipulated in the Schedule XIII of the Companies Act, 1956.

3 Service Tax

1 Clarifications

- A clarification is given that exemption from levy of service tax is available on customized group insurance policy schemes known 'Janata Personal Accident Policy' (JPAP), to extend risk cover to target populations, and to fulfill the prescribed 'rural or social sector' obligation.
- A clarification is given that the activity of fumigation of export cargo including agricultural / horticultural produce, whether loaded into containers or otherwise is not falling under a taxable service 'cleaning services' i.e. it is exempt from levy of service tax.

4 SEBI

1 Introduction of Derivative Contracts on Foreign Stock Indices

SEBI has decided to permit the Stock Exchanges in India to introduce derivative contracts (i.e. futures and options) based on foreign stock indices in the equity derivatives segment. These contracts would be denominated, traded and settled in Indian rupees. Trading in these derivatives is currently restricted only to residents in India

5 NBFC/CIC

1 Provisioning norms for Non Banking Financial Companies (NBFCs)

The Reserve Bank of India (RBI) has introduced provisioning norms on the standard assets of NBFCs. The extant regulations require NBFCs to make provisions only for Non Performing Assets (NPAs). The key amendments are as under:

- i. NBFCs are required to make general provision at the rate of 0.25% of their outstanding standard assets.
- ii. However, the above provision shall not be considered while arriving at the net Non Performing Assets.
- iii. The provision on standard assets will not be required to be netted off from Gross Advances, but the same shall be shown separately in the balance sheet as 'Contingent Provisions against Standard Assets'.
- iv. NBFCs will be allowed to include the provision on standard assets in Tier II Capital along with the other 'General Reserves / Loss Reserves', however, this shall be subject to the maximum limit of 1.25 % of the total risk weighted assets.

2 FAQs for CICs

RBI has issued FAQs for Core Investment Companies (CICs) and Systematically Important CICs (CIC-ND-SIs). Certain key clarifications issued in the FAQ are given below:

- i. As per the guidelines 90% of the net assets of CICs/CIC-ND-SIs need to be in group companies, it is clarified that the balance 10% of net assets would include real estate or other fixed assets which are required for effective functioning of a company, but should not include other financial investments/loans in non group companies. It would however include investments in other group entities that are not companies eg: Trusts etc.
- ii. CIC-ND-SIs are allowed to raise public funds. However it is clarified, that even though public funds include public deposits in the general course, CICs-ND-SI cannot accept public deposits.
- iii. The definition of group companies provided for CICs/CIC-ND-SIs is an exhaustive definition and said definition is not applicable to NBFCs.

6 FEMA

1 Forex Derivatives / Hedge of Commodity Price & Freight Risks

RBI has introduced comprehensive guidelines on Over the Counter (OTC) Foreign Exchange (Forex) Derivatives and hedging of Foreign Exchange Exposures which are effective from 1st February 2011.

The key changes introduced in the guidelines are provided below:

- i. Guidelines for hedging by Person Resident in India – Products are categorized under Contracted Exposures, Probable Exposures and Special Dispensation.
 - a. Contracted Exposures - Products in this category include Forward Forex Contracts, Cross Currency Options, Foreign Currency INR Options, Foreign Currency INR Swaps, Cost Reduction Structures and products for Hedging of Borrowing in foreign exchange

Product	Purpose	Conditions
Forward Forex Contracts	Hedging of Overseas Direct Investment (ODI)	<ul style="list-style-type: none"> ▪ Contracts can be cancelled or rolled over on the due date. Cancelled contracts can be rebooked only to the extent of 50% of the original contract. ▪ Forward INR contracts covering: <ul style="list-style-type: none"> ○ Current account transaction of any tenor and capital account transaction falling due within one year – cancellation and rebooking permitted ○ Capital account transaction falling due after one year – Subject to certain conditions, cancellation & rebooking permitted only if rebooked with a different authorized Bank.
Foreign Currency – INR Swaps	Conversion of Rupee liability to Foreign Currency liability.	Permitted for all companies which fulfill the minimum prudential requirements or listed and unlisted companies having a minimum net worth of Rs. 200 crores can avail this facility.
Cost Reduction Structure	Hedging of Trade transactions and ECB's	<ul style="list-style-type: none"> ▪ Restricted to listed companies and unlisted companies having minimum networth of Rs. 100 crores ▪ Companies need to be compliant with Accounting Standard 30 and 32 ▪ Writing of options on a standalone basis is not permitted

b. Probable Exposures based on past performance –

Available Products	Purpose	Conditions
<ul style="list-style-type: none"> ▪ Forward Forex Contracts ▪ Non INR Cross Currency Options ▪ INR Foreign Currency Options ▪ Cost Reduction Structures. 	<ul style="list-style-type: none"> ▪ Hedging transaction risk by importers and exporters of merchandise goods and services. 	<ul style="list-style-type: none"> ▪ Value of Contracts of the current financial year as well as outstanding contracts not to exceed the Permissible Limit which is higher of average Import/Export Turnover of previous 3 Financial years or the previous year's Import/Export Turnover ▪ Contracts constituting 75% or more of the permissible limit shall be allowed only on delivery basis and cannot be cancelled. ▪ Only companies having a minimum net worth of Rs. 200 crores and a minimum annual import / export turnover of Rs. 100 crores can use cost reduction structure. ▪ An Exporter shall be eligible for a hedge only if the over due bills does not exceed 10% of the turnover. ▪ In case of outstanding contracts exceeding 50% of the permissible limit, permission for this facility to be granted subject to certain conditions.

c. Special Dispensations

- RBI has now permitted Small and Medium Enterprises to freely book / cancel / rollover forward contract without production of underlying documents, to manage their exposures efficiently, subject to approval of necessary credit limits by their bankers.
- Resident individuals can hedge their foreign exchange exposures arising out of actual or anticipated remittances without production of underlying documents upto a limit of USD 100,000 based on self declaration.

ii. Guidelines for hedging by Persons Resident Outside India (PROI):

Key amendments for PROI having FDI in India are as follows:

- Forward contract entered to hedge the exchange rate risk shall not exceed 6 months. Any period beyond 6 months shall require the approval of RBI
- Exchange gains, if any, on cancellation shall not be passed on to the overseas investor

iii. Guidelines for Commodity Hedging:

Facility of hedging price risk in commodities is now available under:

- Delegated Route – Banks authorized by the RBI to grant permission for hedging. The sectors specified under this route are:
 - Listed companies engaged in import & export of commodities (except gold, silver and platinum)
 - Domestic companies engaged in refining crude oil to hedge anticipated price risk on crude oil imports and to hedge domestic purchases of crude oil and domestic sales of petroleum products.
 - Listed companies engaged in production/ purchase and sale of select metals like aluminium, copper, lead, nickel and zinc subject to higher of permissible limit
 - Domestic users of Aviation Turbine Fuel
 - Domestic oil marketing and refining companies
- Approval Route – Residents in India, other than listed companies, engaged in import and export of commodities or exposed to systemic international price risk require the permission of RBI through authorized Banks.

The authorized Banks are permitted to issue guarantees/standby letters of credit to cover payment obligations related to commodity derivatives.

iv. Guidelines for Freight hedging:

- Except for domestic oil refining companies and shipping companies exposed to freight risk which are permitted to hedge their risk by authorized Banks, all other companies need to seek specific approval from RBI for hedging its freight risk.
- Hedging can be undertaken using Plain vanilla OTC or exchange traded products in the international market / exchange.
- Operational Guidelines:
 - Maximum tenor permissible is one year forward
 - Additional conditions need to be fulfilled by domestic oil refining companies and shipping companies as specified under the circular

7 Income Tax

1 Case Laws

i. No disallowance u/s.14A of administrative expenses pre Rule 8D

CIT vs. Catholic Syrian Bank Ltd (Kerala High Court)

Facts: The assessee earned tax free income from investment in units, shares, bonds etc. The assessee did not maintain separate books of account for the tax-free securities but claimed that the same had been invested from its own funds and no part of the interest on the borrowed funds could be disallowed. AO took the view that the interest paid by the assessee on its borrowings together with the admin expenses had to be disallowed u/s 14A. On appeal, the Tribunal held that as no rules had then been prescribed for computing the disallowance, no disallowance u/s 14A could be made.

Issue: Whether administrative expenses can be disallowed prior to insertion of rule 8D r.w.s 14A of the Act?

Held: The H'ble Tribunal held that though Rule 8D inserted w.e.f. FY 2007-08 provides the precise formula for working out the disallowance to be made u/s 14A, the fact that there is no precise formula for proportionate disallowance of administrative expenses is concerned, no disallowance is called for, for proportionate administrative cost attributable to earning of tax free income until Rule 8D came into force. The proportionate disallowance under Section 14A should be limited to only interest liability and not overheads or administrative expenditure; which should be considered for disallowance under Rule 8D from F.Y. 2007-2008 onwards.

ii. Transfer Pricing: +/- 5% Variation only if more than one price determined.

ACIT vs. Essar Steel Ltd (ITAT Vizaq)

Facts: The assessee sold iron ore pellets to STEMCOR, Singapore, an Affiliate Entity (AE) for Rs. 66.08 crores. The assessee sold similar items to "Non Associated Enterprises" (NAE) in Hong Kong and Switzerland. There was no dispute that the "Comparable Uncontrolled Price" method was to be adopted for determining the arm's length price (ALP). The transfer pricing officer (TPO) determined the ALP at Rs.67.20 crores by comparing the ratio of "Net Profit/Cost" in the transactions entered with AE and NAE, which was 12.35% in respect of AE and 14.04% in respect of NAE. Thus there was a shortage of 1.69% in respect of transaction entered with AE vis-à-vis NAE. The TPO directed that an addition of Rs. 1.11 crores be made. In appeal, the CIT (A) relied on Circular No.12 dated 23.8.2001 issued by CBDT and held that as the variation between in transactions with AE and NAE was less than 5%, no addition could be made.

Issue: Whether the proviso to s. 92C(2) is applicable if only one price determined under the "most appropriate method" ?

Held: The Hon'ble Tribunal held that under the proviso to s. 92C(2) (pre-amendment w.e.f. 1.10.09) the option to the assessee to choose a price which may vary from the arithmetical mean by an amount not exceeding five per cent is available only where more than one price is determined and not where there is only one comparable instance. In the instant case, since only one price has been determined under "most appropriate method", it was held that the question of application of the proviso does not arise.

iii. Super normal profit making companies must be excluded from comparables in computing Arm's Length Price for Transfer pricing

Adobe Systems Indian Pvt. Ltd – ITAT (Delhi)

Facts: The assessee company is engaged in providing software development services to its associated enterprise. The TPO noted that the assessee is showing Operating Profit/Cost Margin (OP/CM) of 14.96% which he considered as quite low as compared to other companies engaged in the similar IT field. The TPO rejected the arm's length analysis of the assessee and determined the operating margin at 24.91% by rejecting certain comparables selected by the assessee and adding some new comparables. Assessee claimed that the comparables added by the TPO includes three companies which are super-normal profit making companies which cannot be considered as representative of the Industry and that if the said companies are excluded, the arithmetic mean of the OP/CM of companies was 17.15% which was within the +/- 5% range permitted by section 92C(2).

Dispute Resolution Panel (DRP) also summarily dismissed the objections of the assessee.

Issue: Whether super normal profit making companies should be excluded from comparables for determining arm's length price for international transaction?

Held: Tribunal allowed the appeal in assessee's favour and held that DRP has dismissed the objections by passing a very cursory and laconic order without going into details of the submission. It is undisputed that the three companies have shown super-normal profits as compared to other comparables. Their exclusion from the list of comparable is quite correct.

iv. Employer cannot claim revenue expenditure u/s 37 for ESOP expenses being the difference between market price of the shares and exercise price

VIP Industries Limited vs. ACIT – ITAT (Mumbai)

Facts: The assessee company has allotted 8 lakhs shares to its employees under Employee Stock Option Plan (ESOP) Scheme at a price of Rs.30/- per share which was less than the market price of Rs.53.80/- per share. The assessee claimed deduction of difference between market price of shares and price at which shares were granted to the employees as revenue expenditure u/s 37 of the Act. The AO disallowed the expenditure on the ground that it was a capital expenditure and not revenue expenditure.

Issue: Whether difference between the market price of the share and exercise price be treated as revenue expenditure eligible for deduction u/s 37 of the Act?

Held: Tribunal allowed the appeal in revenue's favour. The difference between the market price and exercise price of the shares cannot be considered as revenue expenditure. The assessee has not incurred any expenditure and a mere receipt of lower amount could not be treated as deemed expenditure. It was only a notional loss and not an actual loss. The accounting treatment of debiting the difference to P&L account as expenditure specified by the SEBI Rules cannot be extended for tax purposes.

v. TPO cannot reject transfer pricing method adopted by the assessee on the ground that the comparables are wrongly chosen. Further the ALP has to be determined with respect to an international transaction and not at an entity level.

Star Diamond Co. (Belgium) - ITAT (Mumbai)

Facts: The assessee is engaged in the business of importing rough diamonds and selling in the local market. In the year under consideration, the assessee had purchased diamonds worth Rs. 0.94 crores net off of purchase return worth Rs. 4.68 crores from its AE. The assessee had bench marked these transactions by using Resale Price Method (RPM). The TPO rejected the RPM and applied Transactional Net Margin Method (TNMM). The TPO applied the operating margin of comparables to the entire turnover of the assessee. Further the TPO considered the gross purchase value while calculating the value of international transaction.

In appeal, CIT-(A) held that the RPM method adopted by the assessee cannot be accepted for the reason that two comparable companies cited by the assessee, are engaged in export of cut and polished diamonds and are not resellers of rough diamond as claimed by the assessee. The CIT- (A) considered the arithmetic mean of operating margins of three other comparables along with comparables adopted by the assessee and arrived at an average of 2.68%.

The CIT (A) held that there is no provision for calculating profit only on sale of goods purchased from the AE. The CIT-(A) applied the percentage on the total turnover of the assessee on the ground that the operating profit will always be arrived at the entity level and cannot be segmented unless the margins of the external comparables are also segmented.. The contention of the assessee to consider net purchase instead of gross purchase was also rejected. The CIT-(A) reduced the adjustment as made by the TPO as the

profit margin of comparables as selected by CIT-(A) earned a lower profit margin as compared to TPO.

Issue:

Whether TPO can reject the Transfer Pricing method adopted by the assessee on the ground that the comparables are wrongly chosen?

Whether the operating profit margins arrived is to be compared at an entity level and not at transaction level unless the margins of the external comparables are also segmented?

Whether purchases returns are to be ignored while calculating the value of international transaction?

Held:

The method adopted by the assessee cannot be rejected merely on the basis that the comparables are wrongly chosen. If the comparables are not found appropriate, then fresh comparables can be searched but the method adopted need not be rejected. Further since the assessee is a trader and RPM method was accepted in earlier years; it is the most appropriate method for determining the arm's length price

ALP has to be determined with respect to an international transaction and hence any adjustment to the ALP proposed by the TPO cannot be made at the entity level.

If there is purchase as well as purchase return of goods to the AE, then value of net purchases (Purchase – Purchase Return) should be the value of international transaction and arm's length value should be calculated on the value of net purchases.

The Tribunal set aside the order and directed TPO/AO to arrive at ALP on the basis of net purchases only and directed the Taxpayer to submit a fresh TP Study in view of the peculiar facts and circumstances of the case as an exception. Further after relying on the decision of Tribunal in case of BASF India Limited and second proviso to s 92C(2), Tribunal directed TPO/AO that in case the difference between price charged by the AE and the ALP is less than 5% no adjustment should be made.

vi. Outsourced clinical trial expenditure is not eligible for weighted Research and Development deduction

Concept Pharmaceuticals Ltd. v. ACIT

Facts:

The taxpayer is engaged in the business of manufacturing and trading of medicines, pharmaceutical formulations, bulk drug etc. for which it had set up an in-house Research and Development facility.

For AY 2005-06, the taxpayer claimed weighted deduction of INR 36 million on scientific research under Section 35(2AB) of the Act. The claim included an expenditure of INR 1.5 million incurred on clinical trials which were conducted by external agencies since the taxpayer did not have the required facility within its Research and Development centre. The AO observed that Section 35(2AB) of the Act was concerned only about the expenditure incurred on in-house research and development facility. Accordingly, the AO disallowed the claim of INR 1.5 million on the ground that the clinical trials expenditure was incurred outside the taxpayer's Research and Development facility.

Issue: Whether outsourced clinical trial expenditure is eligible for weighted deduction u/s 35(2AB) of the Act?

Held:

The phraseology used in Section 35(2AB) of the Act is "on in-house research or development facility" and therefore only the expenditure incurred on in-house research and development for scientific research is eligible for the weighted deduction.

The Explanation to Section 35(2AB)(1) of the Act has only clarified that expenditure incurred on clinical trial in relation to drugs and pharmaceuticals and for which approval has been taken from the regulatory authority will be part of the expenditure on scientific research. Section 35(2AB) refers to expenditure incurred 'on' in-house R&D facility and not 'by' in-house R&D facility, the expenditure incurred within the R&D facility alone is entitled to weighted deduction.

Accordingly, the Tribunal held that the expenditure on clinical trial though the same is an integral part of scientific research will be eligible for weighted deduction under section 35(2AB) only if the expenditure is incurred on an in-house Research and Development facility. Clinical trials which are not done in the in-house facility would not be eligible for weighted deduction.

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