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ADVANCED TAX LAWS AND PRACTICE UPDATES

**APPLICABLE FOR DECEMBER 2013 EXAMINATION
FOR PROFESSIONAL PROGRAMME**

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(A) INCOME TAX (INCOME TAX ACT, 1961)

(1) Tax Rates

(a) *In case of Individual (including women) or Hindu undivided family or association of persons or body of individuals or every artificial juridical person:-*

Upto ₹ 2,00,000	Nil
₹2,00,001 to ₹ 5,00,000	10 % of the amount in excess of ₹2,00,000
₹5,00,001 to ₹10,00,000	₹30,000 plus 20 per cent of the amount in excess of ₹5,00,000
₹10,00,001 and above	₹1,30,000 plus 30 % of the amount in excess of ₹ 10,00,000

(b) *In the case of every individual, being a resident in India, who is of the age of sixty years or more at any time during the previous year but not more than 80 years on the last day of the previous year:-*

Upto ₹2,50,000	Nil
₹2,50,001 to ₹5,00,000	10 % of the amount in excess of ₹2,50,000
₹5,00,001 to ₹10,00,000	₹25,000 plus 20 per cent of the amount in excess of ₹5,00,000
₹10,00,001 and above	₹1,25,000 plus 30 % of the amount in excess of ₹10,00,000.

(d) *In the case of every individual, being a resident in India, who is of the age of 80 years or more at any time during the previous year:-*

Upto ₹5,00,000	Nil
₹5,00,001 to ₹10,00,000	20 % of the amount in excess of ₹5,00,000
₹10,00,001 and above	₹1,00,000 plus 30 % of the amount in excess of ₹ 10,00,000.

(e) *In the case of every co-operative society:*

(1) where the total income does not exceed ₹10,000.	10 % of the total income;
(2) where the total income exceeds ₹10,000 but does not exceed ₹20,000.	₹1,000 plus 20% of the amount by which the total income exceeds ₹10,000;
(3) where the total income exceeds ₹20,000	₹ 3,000 plus 30% of the amount by which the total income exceeds ₹20,000.

(e) *In the case of every firm: On the whole of the total income @30%*

(f) *In the case of every local authority: On the whole of the total income @30%*

(g) *In the case of a company:*

(i) *In the case of a domestic company @30% of the total income.*

(ii) In the case of a company other than a domestic company:

(i) on so much of the total income as consists of;	
(a) royalties received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 31st day of March, 1961 but before the 1st day of April, 1976; or	
(b) fees for rendering technical services received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 29th day of February, 1964 but before the 1st day of April, 1976, and where such agreement has, in either case, been approved 50 %; by the Central Government	50%
(ii) Other income	40 %

Surcharge on income-tax

- (i) in the case of every domestic company having a total income exceeding one crore rupees @5% of such income-tax;
- (ii) in the case of every company other than a domestic company having a total income exceeding one crore rupees @ 2%

(2) Income which do not form part of Total Income

Section 10 of the Income-tax Act provides for certain incomes which are not included in the total income of a person subject to the conditions specified in the relevant clauses of the section. The following clauses of Section 10 are amended by the Finance Act, 2012;

(a) Exemption of income of Prasar Bharati (Broadcasting Corporation of India) [Section 10(23BBH)]

With effect from A.Y.2013-14, clause (23BBH) has been inserted in section 10 to exempt any income of the Prasar Bharati (Broadcasting Corporation of India) established under section 3(1) of the Prasar Bharati (Broadcasting Corporation of India) Act, 1990.

(b) Removal of sectoral restrictions on VCUs [Sections 10(23FB)]

Section 10(23FB) provides that income of a SEBI regulated Venture Capital Fund (VCF) or Venture Capital Company (VCC), derived from investment in a domestic company i.e. Venture Capital Undertaking (VCU), is exempt from taxation, provided the VCU is engaged in only nine specified businesses. The workings of VCF, VCC or VCU are regulated by SEBI and RBI. In order to avoid multiplicity of conditions in different regulations for the same entities, the sectoral restriction on business of VCU is removed from Income Tax Act and such VCU is to be allowed to be governed by conditions imposed by SEBI and RBI. Therefore, with effect from Assessment year 2012-14, the venture Capital undertaking shall have same meaning as provided in relevant SEBI regulations and there would be no sectoral restriction.

(c) Exemption in respect of income received by certain foreign companies in India in Indian currency from sale of crude oil to any person in India [Section 10(48)]

A new clause (48) has been inserted with retrospective effect from assessment year 2012-13 in section 10 of the Income-tax Act to provide for exemption in respect of any income of a foreign company received in India in Indian currency on account of sale of crude oil to any person in India subject to the following conditions:

- (i) The receipt of money is under an agreement or an arrangement which is either entered into by the Central Government or approved by it.
- (ii) The foreign company, and the arrangement or agreement has been notified by the Central Government having regard to the national interest in this behalf.
- (iii) The receipt of the money is the only activity carried out by the foreign company in India.

(d) *Assessment of charitable organization in case commercial receipts exceed the specified threshold [Section 10(23C) & 13]*

Sections 11 and 12 of the Act exempt income of any charitable trust or institution, if such income is applied for charitable purposes in India and such institution is registered under section 12AA of the Act. Section 10(23C) of Income Tax Act also provides exemption in respect of approved charitable funds or institutions. Section 2(15) of the Act provides definition of charitable purpose. It includes “advancement of any other object of general public utility” as charitable purpose provided that it does not involve carrying on of any activity in the nature of trade, commerce or business.

The Second proviso to said section provides that in case where the activity of any trust or institution is of the nature of advancement of any other object of general public utility, and it involves carrying on of any activity in the nature of trade, commerce or business; but the aggregate value of receipts from the commercial activities does not exceed ₹25,00,000/- in the previous year, then the purpose of such institution shall be considered as charitable, and accordingly, the benefits of exemption shall be available to it.

Thus, a charitable trust or institution pursuing advancement of object of general public utility may be a charitable trust in one year and not a charitable trust in another year depending on the aggregate value of receipts from commercial activities.

There is, therefore, need to expressly provide in law that no exemption would be available for a previous year, to a trust or institution to which first proviso of sub-section 2(15) become applicable for that particular previous year.

However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution.

Therefore, there is need to ensure that if the purpose of a trust or institution does not remain charitable due to application of first proviso on account of commercial receipt threshold provided in second proviso in a previous year. Then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year for which such proviso is applicable. Such denial of exemption shall be mandatory by operation of law and would not be dependent on any withdrawal of approval or cancellation of registration or a notification being rescinded.

It is, therefore, section 10(23C), section 13 and section 143 of the Act has been amended with retrospective effect from Assessment year 2009-10 to ensure that such organization does not get benefit of tax exemption in the year in which it's receipts from commercial activities exceed the threshold whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded.

Further, section 143(3) has been amended to provide that, in such a circumstance, no effect shall be given by the Assessing Officer to the exemption provisions under section 10(23C) while making an assessment of the total income or loss of the trust or institution for the previous year.

(3) Income from Business or Profession

(a) Additional depreciation to power sector undertakings [Section 32(1)(iia)]

With effect from Assessment Year 2013-14 the benefit of additional depreciation at 20% of the cost of new plant or machinery (other than ships and aircraft) acquired and installed during the previous year has been extended to assessee engaged in manufacture or production of any article or thing as well as assessee engaged in the business of generation or generation and distribution of power

(b) Weighted deduction for expenditure incurred on in-house scientific research and development [Section 35(2AB)]

- (i) Under section 35(2AB), a weighted deduction of 200% of expenditure incurred on in-house research and development facility as approved by the prescribed authority (not being expenditure in the nature of cost of any land or building) is allowed to a company which is engaged in the business of bio-technology or in any business of manufacture or production of any article or thing. However, the deduction was restricted to such expenditure incurred on or before 31st March, 2012.
- (ii) In order to encourage the corporate sector to continue to spend on in-house research and development, with effect from Assessment Year 2013-14 the benefit of weighted deduction has been extended by a further period of 5 years i.e. up to 31st March, 2017.

(c) Deduction in respect of capital expenditure on specified business under section 35AD

- (i) The investment-linked tax deduction under section 35AD has been extended to three new businesses, namely –
 - setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962;
 - bee-keeping and production of honey and beeswax; and
 - setting up and operating a warehousing facility for storage of sugar.

Deduction is allowed to the above mentioned new “Specified businesses” only if the date of commencement of operations of such business is on or after 1st April, 2012.

Further, the following “specified businesses” would also be eligible for weighted deduction@150% of the capital expenditure (including capital expenditure incurred before commencement of operations and capitalized in the books of account on the date of commencement of operations) under section 35AD(1A), if they commence operations on or after 1st April, 2012 – setting up and operating a cold chain facility;

- setting up and operating a warehousing facility for storage of agricultural produce;
- building and operating, anywhere in India, a hospital with at least 100 beds for patients;
- developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government. Such scheme should be notified by the CBDT in accordance with the prescribed guidelines; and

- production of fertilizer in India.
- (ii) As per section 35AD, as it stands at present, an assessee engaged in the business of building and operating a hotel, of 2-star or above category in India, becomes eligible for deduction under section 35AD only if he owns and operates the hotel himself.

However, on account of the franchisee business structure which is prevalent in hotel industry, the owner of the hotel generally outsources the operation of the hotel to another person.

Therefore, in order to clarify that the hotel owner would continue to be eligible for the investment-linked tax deduction in such cases, with retrospective effect from Assessment Year 2011-12, sub-section (6A) has been inserted in section 35AD.

New sub-section (6A) provides that where the assessee builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation of the said hotel to another person, the assessee shall be deemed to be carrying on the specified business of building and operating a hotel. Therefore, he would be eligible to claim investment-linked tax deduction under section 35AD.

(d) Weighted deduction in respect of expenditure incurred on notified agricultural extension project [Section 35CCC]

With effect from assessment year 2013-14, new section 35CCC has been inserted to provide a weighted deduction of a sum equal to 150% of expenditure incurred by an assessee on agricultural extension project in accordance with the prescribed guidelines. Only those agricultural extension project which are notified by the board shall be eligible for this weighted deduction.

(e) Weighted deduction in respect of expenditure incurred by companies on notified skill development project [Section 35CCD]

In order to encourage companies to invest on skill development projects in the manufacturing sector, with effect from assessment year 2013-14, a new section 35CCD has been inserted to provide for a weighted deduction of a sum equal to 150% of the expenditure (not being expenditure in the nature of cost of any land or building) on skill development project incurred by the company in accordance with the prescribed guidelines.

The skill development project eligible for this weighted deduction shall be notified by the Board.

(f) Increase in threshold limits of total sales / turnover / gross receipts for audit of accounts and presumptive taxation [Section 44AB]

In order to reduce the compliance burden on small businesses and on professionals, the threshold limit of total sales, turnover or gross receipts, specified under section 44AB for getting accounts audited has been increased from sixty lakh rupees to one crore rupees in the case of persons carrying on business and from fifteen lakh rupees to twenty five lakh rupees in the case of persons carrying on profession.

Presumptive taxation under section 44AD:

For the purposes of presumptive taxation under section 44AD, the threshold limit of total turnover or gross receipts has been increased from sixty lakh rupees to one crore rupees.

Finance (No.2) Act, 2009 substituted Section 44AD in the Income-tax Act to provide for a presumptive income scheme for small businesses with effect from 1st April, 2011. Under this

scheme a sum equal to 8% of the total turnover or gross receipts is deemed to be the profits and gains from business. This presumptive scheme is applicable only to a person carrying on any business, except business of plying, hiring or leasing goods carriage, having turnover or gross receipt of less than 60 lakh rupees.

Section 44AD has been amended to clarify that this presumptive scheme is not applicable to

- (i) a person carrying on profession as referred to in sub-section (1) of section 44AA;
- (ii) persons earning income in the nature of commission or brokerage income; or
- (iii) a or a person carrying on any agency business.

(4) Income under the head Capital Gains

(a) Capital gains in cases of amalgamation and demerger

- (i) Under the provisions of section 47(vii) any transfer by a shareholder, in a scheme of amalgamation of a capital asset being a share or shares held by him in the amalgamating company is not regarded as a transfer if,
 - (a) any transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
 - (b) the amalgamated company is an Indian company.

In a case where a subsidiary company amalgamates into the holding company, it is not possible to satisfy one of the conditions at (a) above, i.e. that the amalgamated company (the holding company) issues shares to the shareholders of the amalgamating company (subsidiary company), since the holding company is itself the shareholder of the subsidiary company and cannot issue shares to itself. Therefore, with effect from assessment year 2013-14, provisions of section 47(vii) has been amended so as to exclude the requirement of issue of shares to the shareholder where such shareholder itself is the amalgamated company. However, the amalgamated company will continue to be required to issue shares to the other shareholders of the amalgamating company.

- (ii) Similarly, in the case of a demerger, there is a requirement under section 2(19AA)(iv) that the resulting company has to issue its shares to the shareholders of the demerged company on a proportionate basis. However, it is not possible to satisfy this condition where the demerged company is a subsidiary company and the resulting company is the holding company.

Therefore, with effect from assessment year 2013-14 the provisions of section 2(19AA) has been amended so as to exclude the requirement of issue of shares where resulting company itself is a shareholder of the demerged company. The requirement of issuing shares would still have to be met by the resulting company in case of other shareholders of the demerged company.

(b) Cost of acquisition in case of transfer of assets by a sole proprietorship or a firm to a company on conversion

Where transfer of an asset from one person to another is not regarded as a transfer under section 47, then, for the purpose of computation of capital gains, the cost of the asset in the hands of the successor under section 49 is taken as that of the predecessor. Certain transactions like transfer of assets by a sole proprietorship or a firm to a company on conversion are not regarded as transfer under the provisions of section 47(xiv) and section 47(xiii). While

computing capital gains on subsequent sale of such assets by the company, there is no reference in the provisions of section 49 with regard to the cost to be taken for such assets.

Accordingly, with retrospective effect from assessment year 1999-2000, provisions of section 49 has been amended to provide that in case of conversion of sole proprietorship or firm into a company which is not regarded as a transfer, the cost of acquisition of asset in the hands of the company would be the same as that in the hand of the sole proprietary concern or the firm, as the case may be.

(c) Fair market value of the capital asset to be taken as sale consideration, where the consideration is not determinable [Section 50D]

Recently, some of the courts have ruled that, in case of transfer of a capital asset for which the sale consideration is not determinable, the gain arising from transfer of such asset shall not be taxable, due to failure of the machinery provision.

Consequently, with effect from assessment year 2013-14, a new section 50D has been inserted by the Finance Act, 2012 providing that, in case where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

(d) Extension of capital gain exemption under section 54B to a HUF [Section 54B]

Under section 54B, the capital gain arising on the transfer of land which was used for agricultural purposes by an individual or his parents during the 2 years immediately preceding the date of transfer shall not be charged to tax to the extent of cost of acquisition of new agricultural land acquired within a period of 2 years after the date of transfer.

The aforesaid exemption was so far available only to an individual assessee. Section 54B is now amended to extend the benefit of such an exemption to a Hindu Undivided Family also.

Therefore, the capital gain arising on the transfer of land used for agricultural purposes, for 2 years immediately preceding the date of transfer by an assessee, *being an individual or his parent, or a Hindu Undivided Family* shall not be charged to tax if such assessee purchases a new agricultural land within a period of 2 years after the date of transfer. The capital gain would be exempt to the extent of cost of acquisition of new agricultural land acquired.

(e) Capital gain exemption on transfer of residential property if invested in a manufacturing small or medium enterprise [New Section 54GB]

The Government had announced National Manufacturing Policy (NMP) in 2011, one of the goals of which is to incentivise investment in the Small and Medium Enterprises (SME) in the manufacturing sector. Therefore, with effect from assessment year 2013-14, a new section 54GB has been inserted so as to provide rollover relief from long term capital gains tax to an individual or an HUF on sale of a residential property (house or plot of land) in case of re-investment of sale consideration in the equity of a new start-up SME company in the manufacturing sector which is utilized by the company for the purchase of new plant and machinery.

This relief would be subject to the conditions that —

- the amount of net consideration is used by the individual or HUF before the due date of furnishing of return of income under sub-section (1) of section 139, for subscription in

equity shares in the SME company in which he holds more than 50% share capital or more than 50% voting rights.

- the amount of subscription as share capital is to be utilized by the SME company for the purchase of new plant and machinery within a period of one year from the date of subscription in the equity shares.

If the amount of net consideration subscribed as equity shares in the SME company is not utilized by the SME company for the purchase of plant and machinery before the due date of filing of return by the individual or HUF, the unutilised amount shall be deposited under a deposit scheme to be prescribed in this behalf.

Suitable safeguards so as to restrict the transfer of the shares of the company, and of the plant and machinery for a period of 5 years are proposed to be provided to prevent diversion of these funds. Further, capital gains would be subject to taxation in case any of the conditions are violated.

The transfer should take place during April 11, 2012 and 31st March, 2017.

(f) Reference to the Valuation Officer in case the assessee has taken the fair market value as the cost of acquisition of the asset in accordance with the estimate made by the Registered Valuer [Section 55A]

Under the provisions of section 55A, where in the opinion of the Assessing Officer value of asset as claimed by the assessee is less than its market value, he may refer the valuation of a capital asset to a Valuation Officer. Under section 55 in a case where the capital asset became the property of the assessee before 1st April, 1981, the assessee has the option of substituting the fair market value of the asset as on 1st April, 1981 as the cost of the asset. In such a case the adoption of a higher value for the cost of the asset as the fair market value as on 1st April, 1981, would lead to a lower amount of capital gains being offered for tax.

Accordingly, with effect from 1st July 2012, provisions of section 55A has been amended to enable the Assessing Officer to make a reference to the Valuation Officer where in his opinion the value declared by the assessee is at variance from the fair market value. Therefore, in case where the Assessing Officer is of the opinion that the value taken by the assessee as on 1.4.1981 is higher than the fair market value of the asset as on that date, the Assessing Officer would be enabled to make a reference to the Valuation Officer for determining the fair market value of the property.

(5) Income from other Sources

(a) Exemption of any sum or property received by an HUF from its members [Section 56(2)(vii)]

Under the existing provisions of clause (vii) of sub-section (2) of section 56 any sum or property received by an individual or HUF for inadequate consideration or without consideration is deemed as income and is taxed under the head "Income from other sources". However, in the case of an individual, receipts from relatives are excluded from the purview of this section and are therefore treated as not taxable. The definition of relative as given in this sub-clause is only in relation to an individual and not in relation to a HUF.

It is therefore with retrospective effect from 1st day of October, 2009 the provisions of section 56 has been amended so as to provide that any sum or property received without consideration or inadequate consideration by an HUF from its members would also be excluded from taxation.

(b) Share premium in excess of the fair market value to be treated as income [Section 56(2)(viib)]

With effect from 1st April 2013, a new clause (viib) has been inserted in section 56(2). The new clause will apply where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares. In such a case if the consideration received for issue of shares exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income tax under the head "Income from other sources. However, this provision shall not apply where the consideration for issue of shares is received by a venture capital undertaking from a venture capital company or a venture capital fund.

Accordingly, it is provided that the fair market value of the shares shall be the higher of the value—

- as may be determined in accordance with the method as may be prescribed; or
- as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value of its assets, including intangible assets, being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

(6) Deduction under Chapter VI

(a) Deduction for life insurance policies (Section 80C)

Under the existing provisions contained in section 10(10D) of the Income-tax Act, any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy, is exempt. For this purpose, it is necessary that the premium payable for any of the years shall not exceed 20% of the actual capital sum assured.

The threshold of premium payable is reduced to 10% from 20% of the actual capital sum assured. Accordingly, section 10(10D) has been amended so as to provide that the exemption for life insurance policies issued on or after 1st April, 2012 would only be available for policies where the premium payable for any of the years during the term of the policy does not exceed 10% of the actual capital sum assured.

Further, in order to ensure that the life insurance products are not designed to circumvent the prescribed limits by varying the capital sum assured from year to year, it is provided that the capital sum assured would be the minimum of the sum assured in any of the years of the policy. A new Explanation 2 has been Inserted towards this effect by referring to the new definition of "actual capital sum assured" under Explanation of section 80C(3A). This Explanation will apply to insurance policies issued on or after the 1st April, 2012.

(b) Deduction for investment by a resident individual in listed equity shares [New section 80CCG]

A new section 80CCG has been introduced to provide for a one-time deduction to a resident individual who has acquired listed equity shares in a previous year in accordance with a scheme notified by the Central Government.

The deduction would be 50% of amount invested in such equity shares or ₹25,000, whichever is lower. The maximum deduction of ₹25,000 would be available on investment of ₹50,000 in such listed equity shares.

The following conditions have to be satisfied for claiming the above deduction—

- The gross total income of the assessee for the relevant assessment year should be less than or equal to ₹10 lakh.
- The assessee should be a new retail investor as per the requirement specified under the notified scheme.
- The investment should be made in such listed shares as may be specified under the notified scheme.
- The minimum lock-in period in respect of such investment is three years from the date of acquisition in accordance with the notified scheme.

In addition to the above, other conditions may also be prescribed, subject to fulfillment of which, deduction under section 80CCG can be claimed.

If the individual, after having claimed such deduction, fails to comply with any of the conditions in any previous year, say, he sells the shares before three years, then, the deduction earlier allowed shall be deemed to be the income of the previous year in which he fails to comply with the condition. The income shall, accordingly, be liable to tax in the assessment year relevant to such previous year.

If deduction has been claimed and allowed under this section for any assessment year, the assessee would not be allowed any deduction under this section for any subsequent assessment year.

(c) Reduction of the eligible age for senior citizens for certain tax relief

The Finance Act, 2011 amended the effective age of a senior citizen being an Indian resident from sixty-five years of age to sixty years for the purposes of application of various tax slabs and rates of tax under the Income Tax Act, 1961 for income earned during the financial year 2011-12 (assessment year 2012-13). The following provisions are also similarly amended :

- (i) Section 80D of the Income-tax Act provides for a deduction in respect of premia paid towards a health insurance policy for the assessee or his family (spouse and dependant children) and a further deduction is also allowed for buying a health insurance policy for parent(s). Where the premium is paid to effect or keep in force an insurance on the health of any person who is a senior citizen, the deductions are allowable up to a higher sum of ₹20,000/- instead of ₹15,000/-.
- (ii) Section 80DDB of the Income-tax Act provides for a deduction up to ₹ 40,000/- for the medical treatment of a specified disease or ailment in the case, inter alia, of an individual or his dependant. This deduction is enhanced to ₹ 60,000/- where the amount actually paid is in respect of any of the above persons who is a senior citizen.
- (iii) Section 197A(1C) of the Income-tax Act provides that in respect of tax deduction at source under section 193 (interest on securities) or section 194 (dividends) or section 194A (interest other than interest on securities) or section 194EE (payments in respect of deposits under NSS etc.) or section 194K (income in respect of units), no deduction of tax shall be made in the case of a senior citizen, if such individual furnishes a declaration in the prescribed form (Form No. 15H) to the effect that the tax on his estimated total income of the previous year in which such income is to be included in computing his total income will be nil.

In order to make the effective age of senior citizens uniform across all the provisions of the Income Tax Act, the age for availing of the benefits by a senior citizen under the aforesaid sections (sections 80D, 80DDB and 197A) has been reduced from sixty-five years to sixty years.

(d) Deduction for expenditure on preventive health check-up [Section 80D]

With effect from assessment year 2013-14, this section has been amended to include any payment made by an assessee on account of preventive health check-up of self, spouse, dependant children or parents(s) during the previous year as eligible for deduction within the overall limits prescribed in the section. However, the proposed deduction on account of expenditure on preventive health check-up (for self, spouse, dependant children and parents) shall not exceed in the aggregate ₹5,000.

It is further amended to provide that for the purpose of the deduction under section 80D, payment can be made – (i) by any mode, including cash, in respect of any sum paid on account of preventive health check-up and (ii) by any mode other than cash, in all other cases.

(e) Prohibition of cash donations in excess of ten thousand rupees (Section 80G & Section 80GGA)

Section 80G of the Income-tax Act provides for a deduction in respect of donations to certain funds, charitable institutions, etc. subject to specified conditions. The deduction is allowed in respect of any donation being a sum of money. Similarly, section 80GGA of the Income-tax Act provides for a deduction in respect of certain donations for scientific research or rural development made to research associations, universities, colleges or other associations/institutions, subject to specified conditions.

Currently, there is no provision in either of the aforesaid sections specifying the mode of payment of money. Therefore, with effect from assessment year 2013-14, sections 80G and 80GGA has been amended so as specify therein that any payment exceeding a sum of ten thousand rupees shall only be allowed as a deduction if such sum is paid by any mode other than cash.

(f) Extension of sunset date for tax holiday for power sector [Section 80-IA(4)(iv)]

Under the existing provisions of section 80-IA(4)(iv) of the Income-tax Act, a deduction from profits and gains is allowed to an undertaking which,—

- is set up for the generation and distribution of power if it begins to generate power at any time during the period beginning on 1st April, 1993 and ending on 31st March, 2012;
- starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period beginning on 1st April, 1999 and ending on 31st March, 2012;
- undertakes substantial renovation and modernization of existing network of transmission or distribution lines at any time during the period beginning on 1st April, 2004 and ending on 31st March, 2012.

With effect from assessment year 2013-14, the above provision has been amended to extend the terminal date for a further period of one year, i.e., up to 31st March, 2013.

(g) Deduction in respect of interest on deposits in savings accounts [New Section 80TTA]

With effect from assessment year 2013-14, section 80TTA has been introduced to provide that in case the gross total income of an assessee, being an individual or a Hindu Undivided Family, includes any income by way of an interest on deposits in a saving account (not being time deposits, which are deposits repayable on expiry of fixed periods), deduction up to ₹10,000 in aggregate shall be allowed while computing the total income of such assessee. Such deduction shall be allowed in case the saving account is maintained with:

- a banking company to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act);
- a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank); or
- a post office.

However, if the aforesaid income is derived from any deposit in a savings account held by, or on behalf of, a firm, an AOP/BOI, no deduction shall be allowed in respect of such income in computing the total income of any partner of the firm or any member of the AOP or any individual of the BOI.

In effect the deduction under this section shall be allowed only in respect of the income derived in form of the interest on the saving bank deposit (other than time deposits) made by the individual or Hindu Undivided Family directly.

(6) Taxation of Firms/Limited Liability Partnership

Alternate Minimum Tax (AMT) on all persons other than companies

From the assessment year 2012-13 onwards, where the regular income tax payable for a previous year by a limited liability partnership is less than the alternate minimum tax payable for such previous year then the adjusted total income shall be deemed to be the total income of the LLP for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus education & SHEC @ 3%.

Upto Assessment Year 2012-13, Alternate Minimum Tax (AMT) is levied on limited liability partnerships (LLPs). However, no such tax is levied on the other form of business organisations such as partnership firms, sole proprietorship, association of persons, etc.

In order to widen the tax base vis-à-vis profit linked deductions, the provisions regarding AMT has been broaden to cover all persons other than a company, who has claimed deduction under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" or under section 10AA, shall be liable to pay AMT.

Accordingly, where the regular income-tax payable for a previous year by a person (other than a company) is less than the alternate minimum tax payable for such previous year, the adjusted total income shall be deemed to be the total income of such person and he shall be liable to pay income-tax on such total income at the rate of eighteen and one-half per cent.

For the purpose of the above,

- (i) "adjusted total income" shall be the total income before giving effect to provisions of Chapter XII-BA as increased by the deductions claimed under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" and deduction claimed under section 10AA;
- (ii) "alternate minimum tax:" shall be the amount of tax computed on adjusted total income at a rate of eighteen and one half per cent; and
- (iii) "regular income-tax" shall be the income-tax payable for a previous year by a person other than a company on his total income in accordance with the provisions of the Act other than the provisions of Chapter XII-BA.

It is further provided that the provisions of AMT under Chapter XII-BA shall not apply to an individual or a Hindu undivided family or an association of persons or a body of individuals (whether incorporated or not) or an artificial juridical person referred to in section 2(31)(vii) if

the adjusted total income of such person does not exceed twenty lakh rupees.

It is also provided that the credit for tax (tax credit) paid by a person on account of AMT under Chapter XII-BA shall be allowed to the extent of the excess of the AMT paid over the regular income-tax. This tax credit shall be allowed to be carried forward up to the tenth assessment year immediately succeeding the assessment year for which such credit becomes allowable. It shall be allowed to be set off for an assessment year in which the regular income-tax exceeds the AMT to the extent of the excess of the regular income-tax over the AMT.

Every person to which this section applies shall obtain a report, in such form as may be prescribed from an accountant certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report on or before the due date of filing of return under sub-section (1) of section 139.

(7) Filing of Returns, Signature, E-filings, Assessment and Re-assessment

(a) Mandatory filing of ROI by every resident having any asset (including financial interest in any entity) located outside India [Section 139(1)]

With retrospective effect from Assessment year 2012-13, every resident and ordinarily resident having –

- any asset (including financial interest in any entity) located outside India or
- signing authority in any account located outside India
- is required to file a return of income in the prescribed form compulsorily, whether or not he has income chargeable to tax.

The return of income should be verified in the prescribed manner and provide such particulars as may be prescribed.

(b) Reassessment of income in relation to any asset located outside India

With effect from 1st July 2012, income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person is found to have any asset (including financial interest in any entity) located outside India. Accordingly, the Assessing Officer can serve a notice under section 148 on such assessee requiring him to furnish a return of income within the specified period, for the purpose of making an assessment, reassessment or recomputation under section 147.

The first proviso to section 147 provides that, where an assessment under section 143(3) has already been made by the Assessing Officer for the relevant assessment year, then, no action under the said section can be taken after expiry of 4 years from the end of relevant assessment year. The exception would be in cases where income has escaped assessment on account of failure on the part of the assessee to file a return of income under section 139 or in response to a notice issued under section 142(1) or section 148 or to disclose, fully and truly, all material facts necessary for his assessment for that assessment year.

A second proviso has now been inserted in section 147 to provide that the provisions of the above mentioned first proviso shall not apply in a case where income chargeable to tax, in relation to an asset (including financial interest in an entity) located outside India, has escaped assessment for any assessment year. In effect, in such cases, the Assessing Officer can initiate assessment proceedings under section 147 even after the expiry of 4 years inspite of the assessee having –

- duly furnished his return of income and fully and truly disclosing all material facts necessary for his assessment for that assessment year.

An extended time limit of sixteen years would be available for issue of notice under section 148 for an assessment or reassessment, in case income in relation to such assets (including financial interest in any entity) located outside India has escaped assessment [Section 149]. The provision of an extended time limit is due to the reason that gathering information relating to assets located outside India takes substantially more time due to extra procedural requirements and laws of other nations.

Similar amendments have been made in section 17 of the Wealth-tax Act, 1957 on the above lines (i.e. sections 147 and 149 of the Income-tax Act, 1961), i.e., -

- deeming wealth to have escaped assessment where a person is found to have any asset (including financial interest in any entity) located outside India, non-applicability of the four year time limit for issue of notice and provision of an extended time limit of sixteen years for issue of notice for assessment or reassessment in such cases where wealth is deemed to have escaped assessment.

(8) Tax Deducted and collected at source

(a) Threshold for TDS on payment of interest on debentures (section 193)

Under the existing provisions of section 193 of the Income-tax Act, a person responsible for paying interest to a resident individual on listed debentures of a company, in which the public are substantially interested, is not required to deduct tax on the amount of interest payable if the aggregate amount of interest paid during a financial year does not exceed ₹2,500/- and the interest is paid by account payee cheque. However, in the case of unlisted debentures of a company, no threshold limit is specified for deduction of tax on payment of interest.

In order to reduce the compliance burden on small assesseees and companies, with effect from 1st July, 2012 no deduction of tax should be made from payment of interest on any debenture, (whether listed or not) issued by a company, in which the public are substantially interested, to a resident individual or Hindu undivided family, if the aggregate amount of interest on such debenture paid during the financial year does not exceed ₹5,000 and the payment is made by account payee cheque.

(b) TDS on remuneration to a director (Section 194J)

Under the existing provisions of the Income-tax Act, a company, being an employer, is required to deduct tax at the time of payment of salary to its employees including Managing director/whole time director.

However, there is no specific provision for deduction of tax on the remuneration paid to a director which is not in the nature of salary. With effect from 1st July, 2012, section 194J has been amended to provide that tax is required to be deducted on the remuneration paid to a director, which is not in the nature of salary, at the rate of 10% of such remuneration.

(c) Threshold for TDS on compensation or consideration for compulsory acquisition

Under the existing provisions of the section 194LA of the Income-tax Act, a person responsible for paying any compensation or consideration for compulsory acquisition of immovable property (other than agricultural land) is required to deduct tax at the rate of 10% in case the consideration exceeds one lakh rupees.

In order to reduce the compliance burden of small assesseees, With effect from 1st July, 2012, the aforesaid threshold limit has been increased from one lakh rupees to two lakh rupees.

(d) TCS on sale of certain minerals [Section 206C(1)]

Mining sector is an important segment of Indian economy but the trading of minerals remained largely unregulated resulting in non-reporting or under-reporting of trading in minerals trading transactions for the taxation purpose.

In order to collect tax at the earliest point of time and also to improve reporting mechanism of transactions in mining sector, with effect from 1st July, 2012, tax at the rate of 1% shall be collected by the seller from the buyer of the following minerals:

- (a) Coal;
- (b) Lignite; and
- (c) Iron ore.

However, the seller shall also not collect tax on sale of the said minerals if the same are purchased by the buyer for personal consumption. Further, the seller of these minerals shall not collect tax if the buyer declares that these minerals are to be utilized for the purposes of manufacturing, processing or producing articles or things. This amendment will take.

(e) Tax Collection at Source (TCS) on cash sale of bullion and jewellery [Section 206C(1D)]

Under the existing provisions of the Income-tax Act, tax is required to be collected at source by the seller at the specified rate on certain goods like alcoholic liquor, tendu leaves, scrap etc. at the time of sale.

In order to reduce the quantum of cash transaction in bullion and jewellery sector and for curbing the flow of unaccounted money in the trading system of bullion and jewellery, with effect from 1st July, 2012 the seller of bullion and jewellery shall collect tax at the rate of 1% of sale consideration from every buyer of bullion and jewellery if sale consideration exceeds five lakh and two lakh rupees respectively and the sale is in cash. This would be irrespective of the fact whether buyer is a manufacturer, trader or purchase is for personal use.

(f) Deemed date of payment of tax by the resident payee [Section 201]

Under the existing provisions of Chapter XVII-B of the Income-tax Act, a person is required to deduct tax on certain specified payments at the specified rates if the payment exceeds specified threshold. In case of non-deduction of tax in accordance with the provisions of this Chapter, he is deemed to be an assessee in default under section 201(1) in respect of the amount of such non-deduction.

However, section 191 of the Act provides that a person shall be deemed to be assessee in default in respect of non/short deduction of tax only in cases where the payee has also failed to pay the tax directly. Therefore, the deductor cannot be treated as assessee in default in respect of non/short deduction of tax if the payee has discharged his tax liability.

The payer is liable to pay interest under section 201(1A) on the amount of non/short deduction of tax from the date on which such tax was deductible to the date on which the payee has discharged his tax liability directly. As there is no one-to-one correlation between the tax to be deducted by the payer and the tax paid by the payee, there is lack of clarity as to when it can be said that payer has paid the taxes directly. Also, there is no clarity on the issue of the cut-off date, i.e. the date on which it can be said that the payee has discharged his tax liability.

In order to provide clarity regarding discharge of tax liability by the resident payee on payment of any sum received by him without deduction of tax, section 201 has been amended to provide that the payer who fails to deduct the whole or any part of the tax on the payment made to a

resident payee shall not be deemed to be an assessee in default in respect of such tax if such resident payee –

- has furnished his return of income under section 139;
- has taken into account such sum for computing income in such return of income; and
- has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

The date of payment of taxes by the resident payee shall be deemed to be the date on which return has been furnished by the payer.

With effect from 1st July, 2012, it is provided that where the payer fails to deduct the whole or any part of the tax on the payment made to a resident and is not deemed to be an assessee in default under section 201(1) on account of payment of taxes by the such resident, the interest under section 201(1A)(i) shall be payable from the date on which such tax was deductible to the date of furnishing of return of income by such resident payee.

Amendments on similar lines are also made in the provisions of section 206C relating to TCS for clarifying the deemed date of discharge of tax liability by the buyer or licensee or lessee.

(g) Senior Citizens, not having profit and gains of business or profession, exempt from payment of advance tax [Section 207]

Under section 208, every assessee is required to pay advance tax if the tax liability for the previous year is ₹10,000 or more. It is observed that, in case of senior citizens who have passive source of income like interest, rent, etc., the requirement of payment of advance tax causes genuine compliance hardship.

Therefore, in order to reduce the compliance burden on such senior citizens exemption from payment of advance tax has now been provided to a resident individual-

- not having any income chargeable under the head “Profits and gains of business or profession” and of age 60 years or more.

With effect from 1st April 2012, such senior citizens need not pay advance tax and are allowed to discharge their tax liability (other than TDS) by payment of self-assessment tax.

9. Removal of the cascading effect of Dividend Distribution Tax (DDT)

Section 115-O of the Act provides for taxation of distributed profits of domestic company. It provides that any amount declared, distributed or paid by way of dividends, whether out of current or accumulated profits shall be liable to be taxed at the rate of 15%.

The tax is known as Dividend Distribution Tax (DDT). Such distributed dividend is exempt in the hands of recipients. Section 115-O of the Act provides that dividend liable for DDT in case of a company is to be reduced by an amount of dividend received from its subsidiary after payment of DDT if the company is not a subsidiary of any other company. This removes the cascading effect of DDT only in a two-tier corporate structure.

With a view to remove the cascading effect of DDT in multi-tier corporate structure, with effect from 1st July 2012, Section 115-O of the Act has been amended to provide that in case any company receives, during the year, any dividend from any subsidiary and such subsidiary has paid DDT as payable on such dividend, then, dividend distributed by the holding company in the same year, to that extent, shall not be subject to Dividend Distribution Tax under section 115-O of the Act.

10. Tax Residence Certificate (TRC) for claiming relief under DTAA

Section 90 of the Income Tax Act empowers the Central Government to enter into an agreement with the Government of any foreign country or specified territory outside India for the purpose of -

- (i) granting relief in respect of avoidance of double taxation,
- (ii) exchange of information and
- (iii) recovery of taxes.

Further section 90A of the Act empowers the Central Government to adopt any agreement between specified associations for relief of double taxation.

In exercise of this power, the Central Government has entered into various Double Taxation Avoidance Agreements (DTAA's) with different countries and have adopted agreements between specified associations for relief of double taxation. The scheme of interplay of treaty and domestic legislation ensures that a taxpayer, who is resident of one of the contracting country to the treaty, is entitled to claim applicability of beneficial provisions either of treaty or of the domestic law.

It is noticed that in many instances the taxpayers who are not tax resident of a contracting country do claim benefit under the DTAA entered into by the Government with that country. Thereby, even third party residents claim unintended treaty benefits.

Therefore, w.e.f 1st April 2013, Section 90 and Section 90A of the Act has been amended to make submission of Tax Residency Certificate containing prescribed particulars, as a necessary but not sufficient condition for availing benefits of the agreements referred to in these Sections.

11. Extension of time limit for completion of assessment or reassessment where information is sought under a DTAA

During the course of assessment proceedings, in the case of an assessee having income or assets outside India, information is being sought from the tax authorities situated outside India, while completing an assessment. Under the provisions of section 90 or section 90A of the Income-tax Act, information can be exchanged with the foreign tax authorities for prevention of evasion or avoidance of income tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be.

The time limit for completion of an assessment or reassessment has been provided in the provisions of section 153 and 153B of the Income-tax Act. These provisions were amended vide Finance Act, 2011 to exclude the time taken in obtaining information (from foreign tax authorities) from the time prescribed for completion of assessment or reassessment in the case of an assessee. This time period to be excluded would start from the date on which the process of getting information is initiated by making a reference by the competent authority in India to the foreign tax authorities and end with the date on which information is received by the Commissioner. Currently, this period of exclusion is limited to six months.

Foreign inquiries generally by nature take longer time for obtaining information. It is, therefore, this time limit of six months has been extended to one year.

12. Appeal against the directions of the Dispute Resolution Panel (DRP)

The institution of Dispute Resolution Panel (DRP) was created by Finance Act, 2009 with a view to bring about speedy resolution of disputes in the case of international transactions particularly involving Transfer Pricing issues.

Under the provisions of sub-section (8) of section 144C, the DRP has the power to confirm, reduce or enhance the variations proposed in the draft order. The Income Tax Department does not have the right to appeal against the directions given by the DRP. The taxpayer has been given a right to appeal directly to the Income Tax Appellate Tribunal (ITAT) against the order passed by the Assessing Officer in pursuance of the directions of the DRP.

As the directions given by the DRP are binding on the Assessing Officer, it is accordingly proposed to provide that the Assessing Officer may also file an appeal before the ITAT against an order passed in pursuance of directions of the DRP.

It is therefore the provisions of section 253 and section 254 of the Income-tax Act has been amended with effect from 1st July 2012 to provide for filing of appeal by the Assessing Officer against an order passed in pursuance of directions of the DRP in respect of an objection filed on or after 1st July, 2012.

13. Power of the DRP to enhance variations

Dispute Resolution Panel (DRP) had been constituted with a view to expeditiously resolve the cases involving transfer pricing issues in the case of any person having international transactions or in case of a foreign company. It has been provided under sub-section (8) of section 144C that DRP may confirm, reduce or enhance the variations proposed in the draft order of the Assessing Officer.

In a recent judgement, it was held that the power of DRP is restricted only to the issues raised in the draft assessment order and therefore it cannot enhance the variation proposed in the order as a result of any new issue which comes to the notice of the panel during the course of proceedings before it.

This is not in accordance with the legislative intent. It is an Explanation has been inserted in the provisions of section 144C to clarify that the power of the DRP to enhance the variation shall include and shall always be deemed to have included the power to consider any matter arising out of the assessment proceedings relating to the draft assessment order. This power to consider any issue would be irrespective of the fact whether such matter was raised by the eligible assessee or not.

This amendment is retrospectively effective from the 1st day of April, 2009 and will accordingly apply to assessment year 2009-10 and subsequent assessment years.

14. Completion of assessment in search cases referred to DRP

Under the provisions of section 144C of the Income-tax Act where an eligible assessee files an objection against the draft assessment order before the Dispute Resolution Panel (DRP), then, the time limit for completion of assessments are as provided in section 144C notwithstanding anything in section 153. A similar provision is proposed to be made where assessments are framed as a result of search and seizure to provide that for such assessments, time limit specified in section 144C will apply, notwithstanding anything in section 153B.

It is also amended to provide for exclusion of such orders passed by the Assessing Officer in pursuance of the directions of the DRP, from the appellate jurisdiction of the Commissioner (Appeals) and to provide for filing of appeals directly to ITAT against such orders. Accordingly, consequential amendments are proposed to be made in the provisions of section 246A and 253 of the Income-tax Act.

These amendments in the provisions of the Income-tax Act are retrospectively effective from the 1st day of October, 2009.

15. Minimum Alternate Tax (MAT)

I. Under the existing provisions of section 115JB of the Act, a company is liable to pay MAT of eighteen and one half per cent of its book profit in case tax on its total income computed under the provisions of the Act is less than the MAT liability. Book profit for this purpose is computed by making certain adjustments to the profit disclosed in the profit and loss account prepared by the company in accordance with the Schedule VI of the Companies Act, 1956.

As per section 115JB, every company is required to prepare its accounts as per Schedule VI of the Companies Act, 1956.

However, as per the provisions of the Companies Act, 1956, certain companies, e.g. insurance, banking or electricity company, are allowed to prepare their profit and loss account in accordance with the provisions specified in their regulatory Acts. In order to align the provisions of Income-tax Act with the Companies Act, 1956, section 115JB has been amended to provide that the companies which are not required under section 211 of the Companies Act to prepare their profit and loss account in accordance with the Schedule VI of the Companies Act, 1956, profit and loss account prepared in accordance with the provisions of their regulatory Acts shall be taken as a basis for computing the book profit under section 115JB.

II. It is noted that in certain cases, the amount standing in the revaluation reserve is taken directly to general reserve on disposal of a revalued asset. Thus, the gains attributable to revaluation of the asset are not subject to MAT liability.

It is, therefore, section 115JB has been amended to provide that the book profit for the purpose of section 115JB shall be increased by the amount standing in the revaluation reserve relating to the revalued asset which has been retired or disposed, if the same is not credited to the profit and loss account.

III. The reference of Part III of the Schedule VI of the Companies Act, 1956 has been omitted from section 115JB in view of omission of Part III in the revised Schedule VI under the Companies Act, 1956.

These amendments take effect from 1st April, 2013 and will, accordingly, apply in relation to the assessment year 2013-14 and subsequent assessment years.

16. Related person for the purpose of making an application before Settlement Commission

Currently, an application can be filed before the Settlement Commission under the provisions of section 245C of the Income-tax Act

The definition of related person which is currently being used is "...the substantial interest is found to exist, where a person holds more than 20% shares or 20% share in profits, at any time during the previous year". It has been provided that the substantial interest should exist as on the "date of the search" in place of "at any time during the previous year" as the proceedings before the Commission are filed for many previous years.

It is therefore, the provisions of section 245C of the Income-tax Act has been amended with effect from 1st July 2012 so as to provide that a person shall be deemed to have a substantial interest in a business or profession if such person is a beneficial owner of not less than 20% of shares or of 20% share in profits on the date of search.

17. Fee for filing of applications before Authority for Advance Rulings (AAR)

Under section 245Q of the Income-tax Act, the prescribed fee for filing an application before the Authority for Advance Rulings (AAR) is ₹2500. This fee was prescribed in 1993, when the provisions for Advance Rulings were first introduced and there has been no change/review thereafter.

It is therefore with effect from 1st July 2012, the provisions of section 245Q has been amended so as to provide for increase in the fee for filing an application for advance ruling from ₹2500 to ₹10,000 or such fee as may be prescribed, whichever is higher.

18. Transfer Pricing

STUDY X: BASIC CONCEPTS OF INTERNATIONAL TAXATION

Note: Student of Professional Programme shall note that the portion relating to Transfer pricing shall be replaced with the following matter:

In the present age of globalization, diversification and expansion, most of the companies are working under the umbrella of group engaged in diversified fields/sectors leading to large number of transactions between related parties.

Related Party transaction means the transaction between/among the parties which are associated by reason of common control, common ownership or other common interest.

The mechanism for accounting, the pricing for these related transactions is called Transfer Pricing.

Transfer Price refers to the price of goods/services which is used in accounting for transfer of goods or services from one responsibility centre to another or from one company to another associated company. Transfer price affect the revenue of transferring division and the cost of receiving division. As a result, the profitability, return on investment and managerial performance evaluation of both divisions are also affected.

This may be understood well by the following example

1. Arihant & Companies is a group of Companies engaged in diversified business. One of its units i.e. Unit X is engaged in manufacturing of automotive batteries. Another Unit Y is engaged in manufacturing of Industrial Trucks. Unit X is supplying automotive batteries to Unit Y. In such cases transfer price mechanism is used to account for the transfer of automotive batteries.
2. XYZ Co. is expert in providing electrical and electronic services. It is engaged in providing support to its associated company as well as it is engaged in outsourcing contract. If XYZ Co. provides some services to its associated company, the transaction should be accounted at price calculated using transfer price mechanism.

IMPORTANCE OF TRANSFER PRICING

Transfer pricing mechanism is very important for following reasons:

1. Helpful in correct pricing of Product/Services - An effective transfer pricing mechanism helps an organization in correctly pricing its product and services. Since in any organization, transaction between associated parties occurs frequently, it is necessary to value all transaction correctly so that the final product/ services may be priced correctly.
2. Helpful in Performance Evaluation : For the performance evaluation of any entity, it is necessary that all economic transactions are accounted. Calculation of correct transfer price is necessary for accounting of inter related transaction between two Associated enterprises.
3. Helpful in complying Statutory Legislations : Since related party transaction have a direct bearing on the profitability or cost of a company, the effective transfer pricing mechanism is

very necessary. For example, if the related party transactions are measured at less value, one unit may incur loss and other unit may earn undue profit. This will result in income tax imbalances at both parties end. Similarly, wrong transfer pricing may lead to wrong payment of excise duty, custom duty /sales tax (if applicable) as well.

TRANSFER PRICING PROVISIONS IN INDIA

Increasing participation of multi-national groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same group. Hence, there was a need to introduce a uniform and internationally accepted mechanism of determining reasonable, fair and equitable profits and taxes in India. Accordingly, the Finance Act, 2001 introduced law of transfer pricing in India through Sections 92 to 92F of the Income Tax Act, 1961 which guides computation of the transfer price and suggests detailed documentation procedures. Year 2012 brought a big change in transfer pricing regulations in India whereby government extended the applicability of transfer pricing regulations to specified domestic transactions which are enumerated in Section 92BA. This would help in curbing the practice of transferring profit from a taxable domestic zone to tax free domestic zone.

As stated earlier, the fundamental of transfer pricing provision is that transfer price should represent the arm's length price of goods transferred and services rendered from one unit to another unit.

WHAT IS ARM'S LENGTH PRICE?

In general arm's length price means fair price of goods transferred or services rendered. In other words, the transfer price should represent the price which could be charged from an independent party in uncontrolled conditions. Arm's length price calculation is very important for a company. In case the transfer price is not at arm's length, it may have following consequences

- A. Wrong performance evaluation
- B. Wrong pricing of final product (In case where the goods/services are used in the manufacturing of final product)
- C. Non compliances of applicable laws and thus attraction of penalty provisions.

The same may be explained with the following examples

Company X and Company Y is working under the common umbrella of Mohan & Company. Company X manufactures a product which is raw material for Company Y.

Case	Criteria	Effect on Company X	Effect on Company Y
1	Company X charges price more than the Arm's length price from Company Y	The revenue of company X will increase.	The total cost of company Y will increase. This will result into wrong pricing of its product which may further lead to uncompetitiveness of its product
2	Company X charges price less than the Arm's length price from Company Y	The revenue of company X will decrease. The parent company may close the company X treating it as loss making entity.	The total cost of company Y will decrease. Therefore, the company Y may charge lower price which may lead to loss at an entity level.

3	Company X charges Arm's Length price from Company Y	The revenue of company X will be representing true and fair view of its operation.	Company Y will be paying the price as equivalent to market price of Company X product and its cost will be correct. On the basis of the cost arrived after considering the arm's length price of company X product, company Y will be able to take correct price decision.
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“The concept of associated enterprises and International transaction are very important for applying the transfer pricing provisions. Section 92A and Section 92B deals with these two important concepts of chapter X of Income Tax Act, 1961.”

ASSOCIATED ENTERPRISES (AE)

Associated Enterprises has been defined in Section 92A of the Act. It prescribes that “associated enterprise”, in relation to another enterprise, means an enterprise—

- (a) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- (b) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Thus, from above definition we may understand that

The basic criterion to determine an AE is the participation in management, control or capital (ownership) of one enterprise by another enterprise whereby the participation may be direct or indirect or through one or more intermediaries, control may be direct or indirect.

Deemed Associated Enterprises

As per Section 92(2), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,—

- (a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or
- (b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or
- (c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or
- (d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or
- (e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or
- (f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or
- (g) the manufacture or processing of goods or articles or business carried out by one enterprise

is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

- (h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or
- (i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or
- (j) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or
- (k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or
- (l) where one enterprise is a firm, association of persons or body of individuals, the other

Quantum of Interest	Criteria applied for Associated Enterprises
26% or more	Shareholding with voting power – either direct or indirect
51% or more	Advancement of loan by one entity to other constituting certain percentage of the book value of the total assets of the other entity
51% or more	Based on the board of directors appointed by the governing board of the entity in the other
90% or more	Based on the quantum of supply of raw materials and consumables by one entity to the other
10% or more	Total Borrowing Guarantee by one enterprises for other
10% or more	Interest by a firm or association of Person(AOP) or by a body of Individual (BOI) in other firm AOP or firm or BOI

enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or

- (m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed

MEANING OF INTERNATIONAL TRANSACTION

International Transaction have been defined vide Section 92B of Income Tax Act. It provides that “International Transaction” means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

Deemed International Transaction

As per Section 92B(2) of Income Tax Act, A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

Finance Act, 2012 has added an explanation for the purpose of Definition 92B and it provides that the expression “international transaction” shall include —

- (a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;
- (b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;
- (c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;
- (d) Provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;
- (e) A transaction of business restructuring or reorganization, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.

The term Intangible assets have also been elaborated and explanation to Section 92B provides that the expression Intangible shall include :

- (a) Marketing related intangible assets, such as, trademarks, trade names, brand names, logos;
- (b) Technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;
- (c) Artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;
- (d) Data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;
- (e) Engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schematics, blueprints, proprietary documentation;
- (f) Customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;
- (g) Contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;
- (h) Human capital related intangible assets, such as, trained and organized work force, employment agreements, and union contracts;
- (i) Location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;

- (j) Goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;
- (k) Methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;
- (l) Any other similar item that derives its value from its intellectual content rather than its physical attributes.'

The above explanation has added a wide range of Intangibles and the purpose of the explanation is to extend the applicability of Transfer pricing code to all International transaction involving the exchange of Intangibles which are not expressly available for trade .

TRANSFER PRICING – APPLICABILITY TO DOMESTIC TRANSACTIONS

Honourable Supreme court in the case of *CIT v. Glaxo SmithKline Asia (P) Ltd.*, (2010) 195 Taxman 35 (SC) has advised that it needs to be considered whether the regulations should be applied to domestic transactions in cases where such transactions are not revenue-neutral. The facts and ruling of Honourable Supreme Court is following:

CIT v. Glaxo SmithKline Asia (P) Ltd., (2010) 195 Taxman 35 (SC)

Facts

1. Glaxo SmithKline Asia (P) Ltd (GSK) entered into an agreement with Glaxo Smith Kline Consumer Healthcare Ltd ("GSKCH") whereby GSKCH would provide all administrative services relating to marketing, finance, Human Resource (HR) to GSK for cost +5% markup.
2. The AO disallowed a part of the charges reimbursed on the ground that they were excessive and not for business purposes. On appeal by GSK, CIT (Appeals) upheld the decision of AO.
3. GSK appeal to Income Tax Appellate Tribunal (ITAT) and ITAT ruled that AO has no power to disallow any expenditure as excessive or unreasonable unless the case falls within the scope of Section 40A(2). The revenue appeal to high court and revenue appeal was dismissed by High court.
4. For subsequent years AO continued to follow the same approach and GSK continued to get relief from ITAT. Having regard to the delay on the part of revenue to give effect to ITAT order GSK filed a writ petition before the High Court and High court issued direction to the Revenue to issue refund of taxes along with applicable interest.

Supreme Court Ruling

1. The revenue filed a Special Leave Petition (SLP) before the Honorable supreme court and supreme court held that since the exercise is revenue neutral and both the parties are not related parties in terms of Section 40A(2) of Income tax act, no interference is called for and the SLP filled by the Revenue is dismissed.
2. The honourable Supreme then stated that the larger issue is whether Transfer Pricing provisions should be limited to cross-border transactions or whether the Transfer Pricing Regulations be extended to domestic transactions. In domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage such as where one of the related entities is (i) loss making or (ii) liable to pay tax at a lower rate and the profits are shifted to such entity;
3. The Supreme court further held that the complications arise in cases where the fair market value is required to be assigned to transactions between related parties u/s 40A(2). The Central Board of Direct taxes (CBDT) should examine whether Transfer Pricing provisions

can be applied to domestic transactions between related parties u/s 40A(2) by making amendments to the Act. The AO can be empowered to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties and can apply any of the generally accepted methods of determination of arm's length price, including the methods provided under Transfer Pricing provisions. The law can also be amended to make it compulsory for the taxpayer to maintain Books of Accounts and other documents on the lines prescribed in Rule 10D and obtain an audit report from his Chartered Accountant (CA) that proper documents are maintained;

4. Finally it was held that though the Court normally does not make recommendations or suggestions, in order to reduce litigation occurring in complicated matters, the question of extending Transfer Pricing regulations to domestic transactions require expeditious consideration by the Ministry of Finance and the CBDT may also consider issuing appropriate instructions in that regard.

SPECIFIED DOMESTIC TRANSACTIONS

Finance Act, 2012 has made a very important change and it has extended the applicability of Transfer Pricing Provisions to specified domestic transaction w.e.f. 1st April, 2012.

The specified domestic party transactions would essentially include payment made by a company to a related person referred to in Section 40A(2)(b) of the Act including payment to a director of the company or any person who has a substantial interest in the company (that is, has a beneficial ownership of shares carrying not less than 20 per cent of voting power); transactions referred to in Section 80A(6) of the Act (for example, transfer of goods or services from a tax-incentivised unit/entity to a non-tax-incentivised unit/entity and vice-versa); and transactions referred to in Section 80IA(8), 80IA(10) and 10AA(9) of the Act (carried out by industrial undertakings, infrastructure companies and units operating in special economic zones).

Section 92BA has been added in Transfer Price Code by Finance Act, 2012 which provides that

"Specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:—

- (i) Any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;*
- (ii) Any transaction referred to in section 80A;*
- (iii) Any transfer of goods or services referred to in sub-section (8) of section 80-IA;*
- (iv) Any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;*
- (v) Any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or*
- (vi) Any other transaction as may be prescribed,*

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.'

Thus a specified domestic transaction means a transaction which is covered by criteria as given in section 92BA and the aggregate value of such transactions exceeds ₹5 crore in a year.

TRANSFER PRICING – METHODS

Section 92C of Income Tax Act defines the methods which are to be used in determination of Arm's Length prices for International Transaction and specified domestic transaction. The arm's length price in relation to an international transaction/specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :-

- (A) Comparable Uncontrolled Price Method (CUP)
- (B) Resale Price Method (RPM)
- (C) Cost Plus Method (CPM)
- (D) Profit Split Method (PSM)
- (E) Transactional Net Margin Method (TNMM)
- (F) Such other method as may be prescribed by the Board.

Various transfer pricing methods which are prescribed by Income Tax Act, 1961 are as under:

(A) COMPARABLE UNCONTROLLED PRICE METHOD

Comparable Uncontrolled Price ("CUP") method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

An Uncontrolled price is the price agreed between the unrelated parties for the transfer of goods or services. If this uncontrolled price is comparable with the price charged for transfer of goods or services between the Associated Enterprises, then that price is Comparable Uncontrolled Price (CUP). This is the most direct method for the determination of the Arms' length price.

Methods of CUP

CUP can be either

- (a) Internal CUP or
- (b) External CUP

Internal CUP is available, when the tax payer enters into a similar transaction with unrelated parties, as is done with a related party as well. This is considered a very good comparable, as the functions performed, processes involved, risks undertaken and assets employed are all easily comparable – more so, on "an apple to apple basis".

The external CUP is available if a transaction between two independent enterprises takes place under comparable conditions involving comparable goods or services. For example an independent enterprise buys or sells a similar product, in similar quantities under similar term from / to another independent enterprise in a similar market will be termed as external CUP.

Applicability of the CUP Method

Comparable Uncontrolled Price method is treated as most reliable method of transfer pricing calculation but it is not easy to find the controllable price method easily. The CUP is believed to be the most reliable / best method, if one could identify and map it. CUP method can be applied without any difficulty in following circumstances.

- (1) Interest payment on a loan
- (2) Royalty payment
- (3) Software development where products are often licensed to a third party
- (4) Price charged for homogeneous items like traded goods

(B) RESALE PRICE METHOD

Rule 10B (1) (b) of Income Tax Rules, 1962 prescribes Resale Price method by which,

- A. The price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise is identified;
- B. Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;
- C. The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
- D. The price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;
- E. The adjusted price arrived at under sub-clause (iv) is taken to be an arms length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

Example

1. A sold a machine to B (Associated enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for ₹2,10,000 but without making any additional expenses and change. Here Arm's length price would be calculated as

Sales price to B	=	2, 10,000
Gross Margin	=	10,000 × 30% = 63,000
Transfer price	=	1, 47,000

2. A sold a machine to B (Associated enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for ₹4,00,000 but B has incurred 4000 in sending the machine to C. Here Arm's length price would be calculated as

Sales price to B	=	4, 00,000
Gross Margin	=	4,00,000 × 30%=1, 20,000
Balance	=	2, 80,000
Less: Expenses incurred by B	=	4,000
Arm's length price	=	2,76,000

(C) COST PLUS METHOD

Rule 10B (1) (c) of Income tax Rules, 1962 prescribes Cost Plus Method, by which,

- (i) The direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;
- (ii) The amount of a normal gross profit mark-up to such costs (computed according to the same

accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

- (iii) The normal gross profit mark-up so determined is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;
- (iv) The costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);
- (v) The sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise.

Under the Cost Plus Method, an arm's-length price equals the controlled party's cost of producing the tangible property plus an appropriate gross profit mark-up, defined as the ratio of gross profit to cost of goods sold (excluding operating expenses) for a comparable uncontrolled transaction.

The formulas for the transfer price in inter company transactions of products are as follows:

$$TP = COGS \times (1 + \text{mark-up}), \text{ where:}$$

- TP = Transfer Price of a product sold between a manufacturing company and a related company;
- COGS = Cost of goods sold of the manufacturing company
- Cost plus mark-up = gross profit mark-up defined as the ratio of gross profit to cost of goods sold

Gross profit is defined as sales minus cost of goods sold.

As an example, let us assume that the COGS in a transaction between two associated enterprises is ₹ 5,000. Assume that an arm's length gross profit mark-up that Associated Enterprise 1 should earn is 50%. The resulting transfer price between Associated Enterprise 1 and Associated Enterprise 2 is ₹7,500 [i.e. ₹ 5,000 × (1 + 0.50)].

In this method, calculation of cost of goods sold and gross margin are the most important factor.

(D) PROFIT SPLIT METHOD

Rule 10B (1) (d) of Income tax Rules, 1962 prescribes Profit Split Method, which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which:

- (i) The combined net profit of the associated enterprises arising from the international transaction in which they are engaged, is determined;
- (ii) The relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
- (iii) The combined net profit is then split amongst the enterprises in proportion to their relative contributions, as computed above;
- (iv) The profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction.

However, the combined net profit as determined in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction.

Two step Approach of Profit Split Method

Step 1: Allocation of sufficient profit to each enterprise to provide a basic compensation for routine contributions. This basic compensation does not include a return for possible valuable intangible assets owned by the associated enterprises. The basic compensation is determined based on the returns earned by comparable independent enterprises for comparable transactions or, more frequently, functions.

Step 2: Allocation of residual profit (i.e. profit remaining after step 1) between the associated enterprises based on the facts and circumstances. If the residual profit is attributable to intangible property, then the allocation of this profit should be based on the relative value of each enterprise's contributions of intangible property.

Example on the Profit Split Method (Residual Analysis Approach)

Company A is an Indian Company and deals in telecommunication products. It has developed a Microprocessor and it holds the patent for manufacturing of the microprocessor. Company B which is an overseas subsidiary of Company A is engaged in manufacturing of Mobile equipment at Australia. Company A supply the microprocessor to company B for using it in Mobile equipment and company B in turn after manufacturing the mobile sends the mobile to company "A" in India. Company A sells all the mobile in India.

Both companies contribute to the success of the mobile equipment through their design of the microprocessor and the equipment. As the nature of the products is very advanced and unique, the group is unable to locate any comparable with similar intangible assets. Therefore, neither the traditional methods i.e. CUP Method, RSP Method nor the TNMM is appropriate in this case.

Nevertheless, the group is able to obtain reliable data on hand phone contract manufacturers and equipment wholesalers without unique intangible property in the telecommunication industry. The manufacturers earn a mark-up of 10% while the wholesalers derive a 25% margin on sales.

Company A's and Company B's respective share of profit is determined in 2 steps using the profit split method (residual analysis approach).

Step 1 – Determining the basic return

The simplified accounts of Company A and Company B are shown below:

	<i>Company B</i> (₹ in Lakhs)	<i>Company A</i> (₹ in Lakhs)
Sales	100	125
Cost of Goods Sold	(60)	(100)
Gross Margin	40	25
Sales, General & Administration		

Expenses	(5)	(15)
Operating Margin	35	10

The total operating profit for the group is ₹ 45 Lakhs.

Company B

<i>Particulars</i>	<i>Amount (₹ in Lakhs)</i>
Cost of goods sold	60
Margin @10%	6
Transfer price based on Comparable (without considering Intangibles)	66

Company A

<i>Particulars</i>	<i>Amount (₹ in Lakhs)</i>
Sales to third party customers	125
Resale margin of wholesalers comparables (without intangibles) @25%	31.25
Gross Margin	31.25

	<i>Company B (₹ in Lakhs)</i>	<i>Company A (₹ in Lakhs)</i>
Sales	66	
Cost of Goods Sold	(60)	
Gross Margin	6	31.25
Sales, General & Admin Expenses	(5)	(15)
Routine operating margin	1	16.25

The total operating margin of the group is ₹ 17.25 Lakhs.

Step 2 : Dividing the residual profit

The residual profit of the group is = ₹ 45 Lakhs – ₹ 17.25 Lakhs = ₹ 27.75 Lakhs

On further study of the two companies, two particular expense items, R&D expenses and marketing expenses, are identified as the key intangibles critical to the success of the mobile equipment. The R&D expenses and marketing expenses incurred by each company are:

Company A	12 Lakhs (80%)
Company B	3 Lakhs (20%)

Assuming that the R&D and marketing expenses are equally significant in contributing to the residual profits, based on the proportionate expenses incurred:

Company A's share of residual profit (80% × 27.75)
= ₹ 22.20 Lakhs

Company B's share of residual profit (20% × 27.75)
= ₹ 5.55 Lakhs

Therefore, the adjusted operating profit of

Company A is = ₹ 22.20 L + ₹ 16.25 L = ₹ 38.45 Lakhs

Company B is = ₹ 5.55 + ₹ 1 = ₹ 6.55 Lakhs.

The adjusted tax accounts are as follows:

	<i>Company B</i> (₹ in Lakhs)	<i>Company A</i> (₹ in Lakhs)
Sales	71.55	125
Cost of Goods Sold	(60)	(71.55)
Gross Margin	11.55	53.45
Sales, General & Admin Expenses	(5)	(15)
Operating Margin	6.55	38.45

Hence, the transfer price determined using the profit split method (residual analysis approach) should be ₹ 71.55 Lakhs

(E) TRANSACTIONAL NET MARGIN METHOD (TNMM)

Rule 10B (1) (e) of Income Tax Rules, 1962 prescribes, Transactional net margin method, by which,

- (i) The net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- (ii) The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- (iii) The net profit margin referred to in (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- (iv) the net profit margin realized by the enterprise and referred to in (i) is established to be the same as the net profit margin referred to in (iii);
- (v) The net profit margin thus established is then taken into account to arrive at an arms length price in relation to the international transaction.

Example

Nikhil & Co is an India manufacturer of dishwashers. All Nikhil & Co's dishwashers are sold to an overseas associated enterprise, Company G, and bears Company G's brand. Company G, a household electrical appliances brand name, sells only dishwashers manufactured by Nikhil & Co.

The CUP method is not applied in this case because no reliable adjustments can be made to account for differences with similar products in the market. After the appropriate functional analysis, Nikhil & Co was able to identify an Indian manufacturer of home electrical appliances, Company H, as a suitable comparable company. However, Company H performs warranty functions for its independent wholesalers, whereas Nikhil & Co does not. Company H realizes a net mark up (i.e.

operating margin) of 10%.

As the costs pertaining to the warranty functions cannot be separately identified in Company H's accounts and no reliable adjustments can be made to account for the difference in the functions, it may be more reliable to examine the net margins in this case. The transfer price for Nikhil & Co's sale of dishwashers to Company G is computed using the TNMM as follows:

Nikhil & Co's cost of goods sold	₹ 5,000
Nikhil & Co's operating expenses	₹ <u>1,500</u>
Total costs	₹ 6,500
Add : Net mark up @ 10% (10% x 6,500)	₹ <u>650</u>
Transfer price based on TNMM	₹ <u>7,150</u>

SELECTION OF TRANSFER PRICING METHOD

Rule 10C of the Indian Income Tax Rules, 1962 states that:

In selecting a most appropriate method, the following factors shall be taken into account namely,

- (a) The nature and class of the international transaction.
- (b) The class or classes of Associated Enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises.
- (c) The availability, coverage and reliability of data necessary for application of the method.
- (d) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions.
- (e) The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions.
- (f) The nature, extent and reliability of assumptions required to be made in the application of a method.

The starting point to select the most appropriate method is the functional analysis which is necessary regardless of what transfer pricing method is selected. Each method may require a deeper analysis focusing on aspects relating to various methods. The functional analysis helps to:

- Identify and understand the intra-group transactions;
- Have a basis for comparability;
- Determine any necessary adjustments to the comparables;
- Check the accuracy of the method selected; and
- Over time, to consider adaptation of the policy if the functions, risks or assets have been modified.

Functional analysis also forms part of the documentation. The major components of a functional analysis are:

- 1. Identification of Functions Performed: For the purpose of determining comparability, functions of the entities play an important role.*
- 2. Identification of Risk Undertaken: A risk-bearing party should have a chance of higher earnings than a non-risk bearing party, and will incur the expenses and perhaps related loss if and when risk materializes.*
- 3. Identification of Assets used or contributed: The functional analysis must identify and*

distinguish tangible assets and intangible assets as this is very important for functional analysis.

The functional analysis provides answers to identify which functions risks and assets are attributable to the various related parties. In some cases one company may perform one function but the cost thereof is incurred/ paid by the other party to the transaction. The functional analysis could emphasize that situation. The functional analysis includes reference to the industry specifics, the contractual terms of the transaction, the economics circumstances and the business strategies. A checklist with columns for each related party and if needed for the comparable parties could be used to summarize the functional analysis and give a quick idea of which party performs each relevant function, uses what assets and bears which risk. But this short-cut overview should not be used by tax auditors to count the number of enumerated functions, risks and assets in order to determine the arm's length compensation. It should be used to consider the relative importance of each function, risk and asset. Once the functional analysis is performed and the functionality of the entity as regards the transactions subject to review (or the entity as a whole) has been completed, it can be determined what transfer pricing method is most suitable to determine the arm's length price for the transactions under the review (or the operating margin for the entity under review).

There is no universally accepted method or model which describes the technique for choosing a transfer pricing method. Traditionally comparable Uncontrolled Pricing Method, Profit Split Method, Resale Price Methods are being used in transfer pricing. Other method as TNMM may also be used after the functional analysis and global practices analysis.

REFERENCE TO TRANSFER PRICING OFFICER

Section 92CA of Income Tax Act deals with Reference to Transfer Pricing Officer by assessing officer.

It provides that Assessing Officer with prior approval of Commissioner may refer the computation of Arm's Length Price in an International Transaction to transfer pricing officer if he considers it necessary or expedient to do so. On reference by Assessing officer, Transfer Pricing Officer (TPO) shall serve a notice to the Assessee requiring him to produce the evidence in support of computation made by him of Arm's Length Price in relation to an International transaction.

WHO IS TRANSFER PRICING OFFICER (TPO)

For the purpose of Section 92CA "Transfer Pricing Officer" means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorized by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

DETERMINATION OF ARM'S LENGTH PRICE BY TRANSFER PRICING OFFICER

Transfer Pricing Officer after hearing the evidences, information or documents as produced by assessee and after considering such evidence as he may require on any specified points and after taking into account all relevant materials which he has gathered, shall, by order in writing, determine the arm's length price in relation to the international transaction/specified transaction and send a copy of his order to the Assessing Officer and to the assessee. On receipt of the order from Transfer Pricing officer, the Assessing Officer shall proceed to compute the total income of the assessee in conformity with the arm's length price as determined by the Transfer Pricing Officer.

RECTIFICATION OF ARM'S LENGTH PRICE ORDER BY TRANSFER PRICING OFFICER

If any mistake is observed which is apparent from record, the Transfer Pricing Officer may amend any order passed by him and the provisions of Section 154 w.r.t. rectification of mistake shall apply accordingly. Where any amendment is made by the Transfer Pricing Officer, he shall send a copy of his

order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

POWERS OF TRANSFER PRICING OFFICER

1. Power to call evidences/Information from Assessee:

As per Section 92CA(2), the Transfer Pricing Officer may issue a notice to the Assessee and ask him to furnish records, evidences, information in support of the computation of Arm's Length Price relating to the International Transaction.

2. Power to amend the Order made in regard to computation of Arm length price for the transaction referred to him:

As stated earlier, if any mistake is observed which is apparent from record, the Transfer Pricing Officer may amend any order passed by him and the provisions of section 154 w.r.t. rectification of mistake shall apply accordingly

3. Power to proceed if the report under Section 92E is not furnished for some International transactions:

Finance Act, 2012 has inserted section 92CA(2B) in the Act which provides that w.e.f. 1st June, 2002 if the assessee has not furnished return u/s 92E and the transfer pricing officer observe International transaction or specified domestic transactions during the course of the proceedings before him, he may proceed with deeming that such transaction has been referred to him under this section 92CA provided that the provision of this section shall not empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year, proceedings for which have been completed before the 1st day of July, 2012

4. Power to proceed into the cases not referred to him:

As per amendment made by Finance Act, 2011 the jurisdiction of the Transfer Pricing Officer shall extend to the determination of the Arm's Length Price (ALP) in respect of other international transactions which are noticed by him subsequently, in the course of proceedings before him. These international transactions would be in addition to the international transactions referred to the TPO by the Assessing Officer

5. Power to exercise all of the following powers specified in Sections 131(1)(a) to 131(1)(d) or 133(6) or 133A of Income Tax Act:

Power u/s 131(1)(a) to 131(1)(d)

TPO have the same powers as are vested in a Court under the Code of Civil Procedure, 1908 (5 of 1908), when trying a suit in respect of the following matters, namely:—

- (a) discovery and inspection;
- (b) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
- (c) compelling the production of books of account and other documents; and
- (d) Issuing commissions.

6. Power u/s 133(6)

Under Section 133(6), TPO may require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by him giving information

in relation to such points or matters as his opinion will be useful for, or relevant to, any enquiry or proceeding under this Act.

7. *Power u/s 133A - Power of Survey*

Finance Act, 2011 has made an amendment which provides for the power of Survey to TPO through introduction of Section 133A. In course of the proceedings, a TPO may carry out the survey as per section 133A of Income Tax Act.

ADVANCE PRICING AGREEMENT

As per Section 92CC of Income Tax Act, 1961, w.e.f. 1st July, 2012, the Central Board of Direct Taxes (Board), with the approval of the Central Government, may enter into an Advance Price Agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person.

Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority (Board) on an appropriate transfer pricing methodology for fixing the arm's length price for a set of transactions over a fixed period of time in future. Importance of APA may be understood with the fact that in financial year 2011-2012, addition of about ₹ 40,000 crore income has been proposed by Transfer pricing officers.

CALCULATION OF ARM'S LENGTH PRICE UNDER ADVANCE PRICING AGREEMENT

Arm's Length Price under Advance Pricing Agreement shall be calculated as per method enumerated in section 92C(1) or any other method with such adjustment and variation as may be necessary and expedient so to do.

Section 92C(1) of Income Tax Act prescribes that the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe (see rule 10B) namely:—

- (a) Comparable uncontrolled price method;
- (b) Resale price method;
- (c) Cost plus method;
- (d) Profit split method;
- (e) Transactional net margin method;
- (f) Such other method as may be prescribed by the Board.

Notwithstanding anything contained in Section 92C or Section 92CA, if the Advance Pricing Agreement has been entered between an assessee and Board in respect of one international transaction, the arm's length price will be calculated as per the provisions of Advance Pricing Agreement.

VALIDITY OF ADVANCE PRICING AGREEMENT

The Advance Pricing Agreement shall be valid for a period as specified in the Advance Pricing Agreement. However, this period will not be more than 5 consecutive years.

BINDINGNESS OF ADVANCE PRICING AGREEMENT

Advance Pricing Agreement shall be binding on:

- (a) the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and
- (b) on the Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction

However the advance pricing agreement shall not be binding if there is a change in law or facts having bearing on the agreement so entered.

DECLARING AN ADVANCE PRICING AGREEMENT *VOID AB INITIO*

The Board may, with the approval of the Central Government, by an order, declare an agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.

EFFECT OF DECLARING AN ADVANCE PRICING AGREEMENT *VOID AB INITIO*

If an agreement is declared *void ab initio* —

- (a) All the provisions of the Act shall apply to the person as if such agreement had never been entered into; and
- (b) Notwithstanding anything contained in the Act, for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of order for declaring an Advance Pricing Agreement *void ab initio* shall be excluded. Provided that where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.

PROCEDURE AND SCHEME OF ADVANCE PRICING AGREEMENT

The Board may, for the purposes of this section, prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the Advance Pricing Agreement. Where an application is made by a person for entering into Advance Pricing Agreement, the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act.

FILING OF MODIFIED RETURN FOR ANY ASSESSMENT YEAR RELEVANT TO A PREVIOUS YEAR TO WHICH APA APPLIES

As per Section 92CD of Income Tax Act, 1961, w.e.f. 1st July, 2012 notwithstanding anything to the contrary contained in Section 139, where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished under the provisions of Section 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a period of three months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement. Save as otherwise provided in Section 92CD, if modified return is furnished under Section 139, all other provision of the Act shall apply accordingly.

Thus, Section 92CD provides an opportunity to taxpayer to avoid the litigation even for the years for which return has already been filed.

Reassessment of Total Income in the cases where Modified return has been filed but the Assessment/Reassessment proceedings have been completed before the expiry of period allowed for furnishing of modified return

As per Section 92CD(3), if the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies have been completed before the expiry of period allowed for furnishing of modified return under Section 92CD, the Assessing Officer shall, in a case where modified return is filed under this Section, proceed to assess or reassess or recompute the total income of the relevant assessment year having regard to and in accordance with the agreement.

Application of APA in the pending assessment or reassessment for an assessment year relevant to the previous year to which the agreement applies and modified return has been filed under Section 92 CD.

Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return in accordance with the provisions of sub-section (1), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so furnished.

Extension of Limitation Period in the cases where modified return is filed under Section 92CD

As per Section 92CD (5), notwithstanding anything contained in Section 153 or Section 153B or Section 144C—

- (a) The order of assessment, reassessment or recomputation of total income under Section 92CD (3) shall be passed within a period of one year from the end of the financial year in which the modified return under sub-section (1) is furnished;
- (b) The period of limitation as provided in Section 153 or Section 153B or Section 144C for completion of pending assessment or reassessment proceedings referred to Section 92CD(4) shall be extended by a period of twelve months.

This may be observed from above provision that Advance Pricing Agreement, although styled as "advance" agreements, may be a good arm in the resolution of transfer pricing issues pending from prior years—and in some cases it can provide an effective means for resolving existing transfer pricing audits or adjustments.

By virtue of Advance Pricing Agreement, the taxpayer is assured about the Tax Liability arising out of International transaction. No surprises or challenges will arise if the agreement is followed. The scope of certainty includes tax treatment of covered transactions as to amount and characterization, elimination of potential penalties for substantial tax understatement and a limitation of record-keeping requirements.

TRANSFER PRICING – DOCUMENTATION

The legal framework for maintenance of information and documentation by a taxpayer is provided in Section 92D of Income Tax Act, 1961 which lays down that every person who enters into an international transaction with an associated enterprise shall maintain prescribed information and documents. The various types of information and documents to be maintained in respect of an international transaction, the associated enterprise and the transfer pricing method used are prescribed in Rule 10D of the Income Tax Rules, as under:

- (a) A description of the ownership structure of the enterprise and details of shares or other

ownership interest held therein by other enterprises;

- (b) A profile of the multinational group of which the assessee enterprises i.e. taxpayer is a part and the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been made by the taxpayer and the ownership linkages among them;
- (c) A broad description of the business of the taxpayer and the industry in which it operates and the business of the associated enterprises;
- (d) The nature, terms and prices of international transaction entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
- (e) A description of the functions performed, risks assumed and assets employed or to be employed by the taxpayer and by the associated enterprise involved in the international transaction;
- (f) A record of the economic and market analysis, forecasts, budgets or any other financial estimates prepared by the taxpayer for its business as a whole or separately for each division or product which may have a bearing on the international transaction entered into by the taxpayer;
- (g) A record of uncontrolled transactions taken into account for analysing their comparability with the international transaction entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be relevant to the pricing of the international transactions;
- (h) A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;
- (i) A description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;
- (j) A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transaction;
- (k) The assumptions, policies and price negotiations if any which have critically affected the determination of the arm's length price;
- (l) Details of the adjustments, if any made to the transfer price to align it with arm's length price determined under these rules and consequent adjustment made to the total income for tax purposes;
- (m) Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Rule 10D also prescribes that the above information is to be supported by authentic documents which may include the following:

- (a) Official publications, reports, studies and data bases of the government of the country of residence of the associated enterprise or of any other country;

- (b) Reports of market research studies carried out and technical publications of institutions of national or international repute;
- (c) Publications relating to prices including stock exchange and commodity market quotations;
- (d) Published accounts and financial statements relating to the business of the associated enterprises;
- (e) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transaction similar to the international transactions;
- (f) Letters and other correspondence documenting terms negotiated between the taxpayer and associated enterprise;
- (g) Documents normally issued in connection with various transaction under the accounting practices followed.

BURDEN OF PROOF

It is noteworthy that the information and documentation requirements referred to above are linked to the burden of proof laid on the taxpayer to prove that the transfer price adopted is in accordance with the arm's length principle. One of the conditions to be fulfilled for discharging this burden by the taxpayer is maintenance of prescribed information and documents in respect of an international transaction entered into with a associated enterprise. A default in maintaining information and documents in accordance with the rules is one of the conditions which may trigger a transfer pricing audit under Section 92C(3). Any default in respect of the documentation requirement may also attract penalty of a sum equal to two percent of the value of the international transaction (Sec 271AA).

SUBMISSION OF DOCUMENTS WITH THE TAX AUTHORITIES

There is no reference in the provisions included either in the Income Tax Act or the Income Tax Rules about any requirement to submit the prescribed information and documents at the stage of initial compliance in the form of submission of report under Section 92E. All that Section 92E requires is that the concerned taxpayer shall obtain a Report from an Accountant in the prescribed form (Form 3CEB) and submit the Report by the specified date.

Form 3CEB contains a certificate from the Accountant that in his opinion proper information and documents as prescribed have been maintained by the taxpayer. Rule 10D requires that the information and document maintained should be contemporaneous as far as possible and should exist latest by the specified date for filing the report under Section 92E. Section 92D also provides that information and documentation may be requisitioned by the Assessing Officer or the Appellate Commissioner on a notice of thirty days which period may be extended by another period of 30 days.

NON APPLICABILITY OF DOCUMENTATION REQUIREMENT

Although the law has prescribed no monetary limit in respect of international transaction covered by the transfer pricing requirements, an exception is provided in para 2 of Rule 10D in respect of the maintenance of information and document requirement in respect of international transactions not exceeding ₹ 100 Lakhs . It is provided that the above requirement will not apply to such transactions. However, the concerned taxpayer may be required to substantiate on the basis of available material that the income arising from the international transaction is computed in accordance with the arm's length rule.

RETENTION PERIOD OF DOCUMENTS KEPT UNDER RULE 10D

The prescribed information and documents are required to be maintained for a period of six years from the end of the relevant Assessment years thus the information and documents are required to be maintained for a period of eight years. Rule 10D absolves a taxpayer entering into an international transaction which continues to have effect over more than one year from maintaining separate set of documents for each year. However separate documents are required for each year if there is any significant change in the terms and conditions of the international transaction which have a bearing on the transfer price.

TRANSFER PRICING – PENALTY FOR CONTRAVENTION

Contravention of Transfer Pricing provisions as contained in Chapter X of the Income tax Act, 1961 may invite hefty penalties. The details of penalties under different sections of Income tax Act, 1961 are as follows :-

A. Penalty for concealment of income or for furnishing inaccurate particulars of such income under Section 271(1)(c)

If the Assessing Officer or Commissioner (Appeals) or the Commissioner in the course of any proceedings under this Act, is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income, he may direct that such person shall pay by way of penalty in addition to tax, if any, payable by him, a sum which shall not be less than, but which shall not exceed three times, the amount of tax sought to be evaded by reason of the concealment of particulars of his income or the furnishing of inaccurate particulars of such income.

Explanation 7 to Section 271(1)(c) - Where in the case of an assessee who has entered into an international transaction defined in section 92B, any amount is added or disallowed in computing the total income under sub-section (4) of section 92C, then, the amount so added or disallowed shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that Section, in good faith and with due diligence.

B. Penalty for failure to furnish information or document - Section 271G

As per Section 271G of Income Tax Act, If any person who has entered into an international transaction fails to furnish any such information or document as required by sub-section (3) of section 92D, the Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of the international transaction for each such failure.

C. Penalty for failure to keep and maintain information and document in respect of International transaction - Section 271AA

Without prejudice to the provisions of Section 271 or Section 271BA, if any person in respect of an International transaction Fails to keep and maintain any such information and document as required by sub-section (1) or sub-section (2) of Section 92D.

The Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of each international transaction entered into by such person.

D. Penalty for failure to furnish report under Section 92E - Section 271BA

If any person fails to furnish a report from an accountant as required by Section 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of one hundred thousand rupees.

E. Penalty for failure to answer questions, sign statements, furnish information, returns or statements etc. - Section 272A

If any person,—

- (a) being legally bound to state the truth of any matter touching the subject of his assessment, refuses to answer any question put to him by an income-tax authority in the exercise of its powers under this Act; or
- (b) refuses to sign any statement made by him in the course of any proceedings under this Act, which an income-tax authority may legally require him to sign; or
- (c) to whom a summons is issued under sub-section (1) of Section 131 either to attend to give evidence or produce books of account or other documents at a certain place and time omits to attend or produce books of account or documents at the place or time, he shall pay, by way of penalty, a sum of ten thousand rupees for each such default or failure.

(B) WEALTH TAX (WEALTH TAX ACT, 1956)

(a) Exemption of residential house allotted to an employee etc. of a company [Section 2(ea)]

Under the existing provisions of section 2 of the Wealth-tax Act, the specified assets for the purpose of levy of wealth tax do not include a residential house allotted by a company to an employee or an officer or a whole time director if the gross annual salary of such employee or officer, etc. is less than five lakh rupees.

Considering general increase in salary and inflation since revision of this limit, with effect from Assessment Year 2013-14, the existing threshold of gross salary has been increased from five lakh rupees to ten lakh rupees for the purpose of levying wealth-tax on residential house allotted by a company to an employee or an officer or a whole time director.

(b) Exemption from Wealth Tax - Reserve Bank of India

Under the existing provisions of the Wealth-tax Act, wealth-tax is levied on individual, HUF and company. The definition of "Company" under the Act includes a corporation established by or under the Central, State or Provincial Act. Therefore, the Reserve Bank of India (RBI), being a corporation established under the Central Act, would be deemed as company for the purpose of levy of wealth-tax and shall be liable to pay wealth-tax. However, there is no provision for exempting RBI from the levy of wealth-tax either in the Wealth-tax Act or in Reserve Bank of India Act, 1934.

In order to provide that the RBI is not liable to pay wealth-tax, section 45 has been amended with retrospective effect from assessment year 1957-58 to provide that wealth-tax shall not be levied on the net wealth of RBI.

(B) CENTRAL EXCISE (CENTRAL EXCISE ACT, 1944)

(I) Amendments made by Finance Act, 2013

(1) Offences and Penalties (Section 9)

Section 9 provides that an offence case involving evasion in which the duty leviable exceeds thirty lakh rupees shall be punishable with a term of imprisonment extending to seven years with fine. This section is amended so as to substitute the amount of thirty lakh rupees with fifty lakh rupees.

(2) Certain offences to be non-cognizable (Section 9A)

Section 9A is amended to make an offence cognizable and non-bailable where the duty liability exceeds ₹50 lakh and punishable under clause (b) for evasion of duty or clause (b) for contravention of central excise provisions in relation to credit of any duty allowed to be utilized towards payment of excise duty under sub-section (1) of section 9.

(3) Recovery of sums due to government (Section 11)

Section 11 is amended so as to provide for;

(i) recovery of money due to the Government from any person other than from whom money is due after giving a proper notice, if that other person holds money for or on account of the first person;

(ii) the other person to whom such notice has been issued is bound to comply and

(iii) if the other person to whom the notice is served fails to comply, he shall face all the consequences under this Act.

(4) Recovery of duties not levied or not paid or short levied or short paid (Section 11A)

Section 11A is amended to insert sub-section (7A) providing that service of a statement containing details of duty not paid, short levied or erroneously refunded shall be deemed to be a service of notice under sub-section (1) or (3) or (4) or (5) of this section.

(5) Provisional attachment to protect revenue in certain cases (Section 11DDA)

Reference to sub-section (1) in section 11DDA is omitted.

(6) Procedure to be followed by officer-in-charge of police station (Section 20)

Section 20 is amended so as to make the provisions applicable only to offence which is non-cognizable.

“The officer-in-charge of a police station to whom any person is forwarded shall, where the offence is non-cognizable, either admit him to bail to appear before the Magistrate having jurisdiction, or in default of bail forward him in custody to such Magistrate in accordance with the provisions of this Act.”

(7) Inquiry how to be made by Central Excise Officers against arrested persons forwarded to them under section 19 (Section 21)

Section 21 is amended so as to make the provisions regarding release of arrested person on bail or personal bond applicable only to offence which is non-cognizable.

(8) Definition of Activity under Advance Ruling (Section 23A)

Clause (a) of section 23A is amended to expand the definition of the term "activity" to include any new business of production or manufacture proposed to be undertaken by the existing producer or manufacturer.

9) Application for Advance Ruling (Section 23C)

The existing sub-section (2) of section 23C provides for the admissibility of application for advance ruling, inter alia, for credit of excise duty paid or deemed to have been paid. The scope of admissibility has been expanded to include credit of service tax paid or deemed to have been paid on input services.

10) Advance ruling to be void in certain circumstances (Section 23F)

Reference to section 28-I in section 23F is substituted with section 23D.

11) Orders of Appellate Tribunal (Section 35C)

A new proviso is inserted in sub-section (2A) of section 35C so as to provide that in cases where delay in disposing of the appeal is not attributable to the appellant, the Tribunal may extend the period of stay by a period not exceeding 185 days subject to the condition that if the appeal is not disposed of within the total period of 365 days from the date of order, the stay shall stand vacated.

12) Procedure of Appellate Tribunal (Section 35D)

Section 35D is amended to enhance the monetary limit of the Single Bench of the Tribunal to hear and dispose of appeals from "ten lakh rupees" to "fifty lakh rupees".

13) Service of decisions, orders, summons etc. (Section 37C)

Section 37C is amended to specify additional modes of delivery of specified documents i.e. by speed post with proof of delivery or through courier approved by the Central Board of Excise & Customs.

(II) Amendments made by Notifications

(1) Notification No. 02/2013-Central Excise (N.T.) dated 01.03.2013 - Provisional Assessment Rule 7 of Central Excise Rules, 2002

Sub rule (5) of Rule 7 shall be substituted by the Central Excise (Amendment) Rules, 2013 vide Notification No. 02/2013-Central Excise (N.T.) dated 01.03.2013 as follows:

"(5) Where the assessee is entitled to a refund consequent to an order of final assessment under sub-rule (3), then, subject to sub-rule (6), there shall be paid an interest on such refund as provided under section 11BB of the Act."

(2) Notification No. : 04/2013-Central Excise (N.T.) Dated: 01.03.2013

Central Government has specifies Resident public limited company as a class of persons mentioned in section 23A(c)(iii) and in this regard the this term is explained as follows;

(a) "public limited company" shall have the same meaning as is assigned to "public company" in clause (iv) of sub-section (1) of section 3 of the Companies Act, 1956 (1 of 1956) and shall include a private company that becomes a public company by virtue of section 43A of the said Act;

(b) "resident" shall have the same meaning as is assigned to it in clause (42) of section 2 of the Income-tax Act, 1961 (43 of 1961) in so far as it applies to a company.

(3) Notification No. : 07/2013 Central Excise (N.T.), Date: 23.05.2013 - Warehousing provisions (RULE 20)

As per rule 20, the Central Government may by notification, extend the facility of removal of any excisable goods from the factory of production to a warehouse, or from one warehouse to another warehouse without payment of duty.

Vide Notification No. : 07/2013 Central Excise (N.T.), Date : 23.05.2013 the Central Government hereby extends the facility of removal of all excisable goods falling under the First Schedule to the Central Excise Tariff Act, 1985 (5 of 1986) from the factory of production, intended for storage in a godown or retail outlet of a Duty Free Shop in the Departure Hall or the Arrival Hall, as the case may be, of International Airport, appointed or licensed as "warehouse" under Section 57 or 58 of the Customs Act, 1962 (52 of 1962), as the case may be, and for sale therefrom, against foreign exchange to passengers going out of India or to the passengers or members of crew arriving from abroad, subject to limitations, conditions and safeguards as may be specified

(4) Notification No. : 09/2013 Central Excise (N.T.), Dated: 23.05.2013 - Registration (Rule 9 of Central Excise Rules, 2002)

Notification No. 36/2001 has been amended Vide Notification No. : 09/2013 Central Excise (N.T.), Dated: 23.05.2013 thereby includes the following in the list of person exempt from registration; "where a godown or retail outlet of a Duty Free Shop is appointed or licensed under the provisions of sections 57 or 58 of the Customs Act, 1962 (52 of 1962).

CENVAT CREDIT RULES, 2004

(1) Notification No. : 03/2013-Central Excise (N.T.), Dated: 01.03.2013 - CENVAT Credit Rules, 2004

(i) In the CENVAT Credit Rules, 2004 (hereinafter referred to as the said rules), in rule 3, after the proviso to sub-rule 5B, the following shall be inserted, namely:-

Explanation – If the manufacturer of goods or the provider of output service fails to pay the amount payable under sub-rules (5), (5A), and (5B), it shall be recovered, in the manner as provided in rule 14, for recovery of CENVAT credit wrongly taken."

THE CUSTOMS ACT, 1962

(I) Amendments made by Finance Act, 2013

(1) Power to prohibit importation or exportation of goods (Section 11)

Clause (n) of sub-section (2) of section 11 is amended to include "designs and geographical indications" so as to provide for protection of these rights.

2) Claim for refund of duty (Section 27)

Section 27 is amended to provide that if the amount of refund claimed is less than rupees hundred, the same shall not be refunded.

3) Recovery of duties not levied or short levied or erroneously refunded (Section 28)

Section 28 is amended to provide that show cause notice will not be served where the amount demanded is less than rupees one hundred.

4) Provisional attachment to protect revenue in certain cases (Section 28BA)

Section 28BA is amended to provide for provisional attachment of property belonging to any person to whom notice under sub-section (4) of section 28 has been served.

5) Definition of activity under advance ruling (Section 28E)

Clause (a) of section 28E is substituted so as to include any new business of import or export proposed to be undertaken by the existing importer or exporter within the meaning of "activity".

6) Arrival of vessels and aircrafts in India (Section 29)

Section 29 is amended to empower the Board to permit landing of vessels and aircrafts at any place other than customs port or customs airport.

7) Delivery of import manifest or import report (Section 30)

Section 30 is amended to provide for electronic filing of import manifest and also to provide that the Commissioner of Customs may, in cases where it is not feasible to deliver the import manifest by presenting electronically, allow the same to be delivered in any other manner.

8) Delivery of export manifest or export report (Section 41)

Section 41 is amended to provide for electronic filing of export manifest and also to provide that the Commissioner of Customs may, in cases where it is not feasible to deliver the export manifest by presenting electronically, allow the same to be delivered in any other manner.

9) Clearance of goods for home consumption (Section 47)

Sub-section (2) of section 47 is amended to reduce the interest free period for payment of import duty from five days to two days.

10) Storage of imported goods in warehouse pending clearance (Section 49)

Section 49 is amended to restrict the period of storage of imported goods, pending clearance, in a public or private warehouse to thirty days and to provide that the Commissioner of Customs may extend the period of storage for further period not exceeding thirty days at a time.

11) Clearance of warehoused goods for exportation (Section 69)

Section 69 is substituted to provide that any warehoused goods may be exported to a place outside India without payment of import duty if a shipping bill or a bill of export in prescribed form or label or declaration accompanying the goods as referred to in section 82 has been presented in respect of such goods.

12) Power to arrest (Section 104)

Under the existing sub-section (6) of section 104, all offences under the Act are bailable. Sub-section (6) is substituted with sub-section (6) and (7). Sub-section (6) provides that the following specified offences punishable under section 135 shall be non-bailable, namely:-

- (a) evasion or attempted evasion of duty exceeding ₹50 lakh;

- (b) prohibited goods notified under section 11 which are also notified under sub-clause (C) of clause (i) of sub-section (1) of section 135;
- (c) import or export of any goods which have not been declared in accordance with the provisions of this Act and the market price of which exceeds ₹ 1 crore;
- (d) Fraudulently availing of or attempt to avail of drawback or any exemption from duty provided under this Act, if the amount of drawback or exemption from duty exceeds ₹50 lakh.

Sub-section (7) provides that all other offences except those specified in sub-section (6) shall be bailable.

13) Orders of Appellate Tribunal (Section 129B)

A proviso is inserted in sub-section (2A) of section 129B to provide that in cases where the delay in disposing of the appeal is not attributable to the appellant, the Tribunal may extend the period of stay by a period not exceeding 185 days subject to the condition that if the appeal is not disposed of within the total period of 365 days from the date of order, the stay order shall stand vacated.

14) Procedure of Appellate tribunal (Section 129C)

Section 129C is amended to enhance the monetary limit of the Single Bench of the Tribunal to hear and dispose of appeals from ₹10 lakh to ₹50 lakh.

15) Evasion of duty or prohibition (Section 135)

In sub-clauses (B) and (D) of clause (i) of section 135(1), the threshold limit for punishment in an offence relating to evasion or attempted evasion of duty or fraudulently availing of or attempting to avail of drawback or any exemption from duty in connection with export of goods, has been increased from ₹30 lakh to ₹50 lakh.

16) Recovery of sums due to government (Section 142)

A new clause (d) is inserted in section 142 to provide (i) for recovery of money due to the Central Government from any other person other than the defaulter after giving such other person a notice in writing, (ii) that the person to whom such notice has been issued shall be bound to comply, and (iii) that if the person to whom the notice is issued fails to comply, he shall be deemed to be a defaulter in respect of the amount specified in the notice.

17) Duty Deferment (Section 143A)

Section 143A is omitted.

18) Power to make samples (Section 144)

Sub-section (3) of section 144 is amended to remove the duty liability on any sample of goods which is consumed or destroyed during the course of testing or examination.

19) Custom House agents to be licensed (Section 146)

Section 146 is substituted to change the nomenclature of "customs house agents" to "customs brokers" considering the global practice and internationally accepted nomenclature.

20) Appearance by authorised representative (Section 146A)

Section 146A is amended so as to:

- (a) substitute the phrase "customs house agent" with the phrase "customs broker";
- (b) include any offence committed under the Finance Act, 1994 as a disqualification for person to act as an authorized representative in customs matters.

21) Liability of principal and agent (Section 147)

Sub-section (3) of section 147 is amended to expand the scope of the liability of agents of the owner, importer or exporter of any goods.

(II) Amendments made by Notification

(1) Notification No. : 25/2013-Customs (N.T.), Date : 01.03.2013 – Baggage Rules, 1998

Baggage Rules are amended to,-

(i) raise the duty free allowance in respect of jewellery for an Indian passenger who has been residing abroad for over one year or a person who is transferring his residence to India from ₹10,000 to ₹50,000 in case of a gentleman passenger and from ₹20,000 to ₹1,00,000 in case of a lady passenger.

(ii) raise the duty free allowance for crew member of vessel/aircraft from ₹600 to ₹1500.
