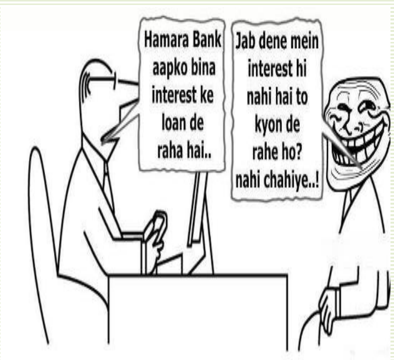
Professional Edge

For Professional People

May 2013 Issue Year 1, Vol 2

Before you start your work, always ask yourself three questions – Why am I doing it, What the results might be and Will I be successful. Only when you think deeply and find satisfactory answers to these questions, go ahead. ~ Chaanakya

Cartoon Corner



Jokes

Q.: What do you call a lawyer, who doesn't know the Law?
A.: A Judge

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Oxymoron is an English word which contains combination of contradictory words, for example, Small-crowd, original copy….
Happily-married and honest-lawyer

***

Q: Who is Accountant?
A: Someone who solve your problem you don't know, in such a way you don't understand, at a price you can't afford.

News Updates

Last Date of Filing Service Tax Return (Form ST-3) for the period from 1-Oct-2012 to 31-Mar-2013 has been extended from 25-Apr-2013 to 31-Aug-2013 vide CBDT order 3/2013 dated 23-Apr-2013.

SEBI has issued master circular for all Depositories and has prescribed new norms under following categories:

a. New BO Account: Account opening, fee to be charged grievance settlement system etc.
b. Issue Related: Activation of ISIN, ADR/GDR issue, ECS facilities
c. DP Related: Rajiv Gandhi Equity Scheme, Redressal of Grievance through SCORES etc.
d. Communications: Pledge, Transmission etc.

Government has declared New FDI Policy which will be effective from 5-Apr-2013 by which now investment in LLP has been permitted.

Finance Bill 2013 has been passed by Parliament on 30-Apr-2013 without any debate. As the Parliament sessions were not properly conducted due to Coalgate issue, ultimately consensus was made to pass the Finance Bill.

Income Tax, Wealth Tax and Service Tax updates published by ICSI (for CS Exe and Prof Students) click on following link:
http://www.icsi.edu/webmodules/student/22042013%20Tax%20Laws%20updates%20for%20June%202013%20Exams.pdf

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Academic Guidance

Foundation Course

Economics: Attempt following question, for answers, see at end.

1. Price taking firm are said to be "small" relative to market. Which of following best describes this smallness:
 (a)Firm is having less than 10 employees
(b)Firm has downward sloping demand curve
(c)Firm has assets of less than Rs 20 lakh
(d)Firm is unable to affect market price through its output decisions

2. When ____, we know that firms are earning just normal profit:
(a)AC = AR (b)MC = MR
(c)MC = AC (d)MR = MR

3. Excess capacity is not found in:
(a) Perfect competition (b) Oligopoly
(c) Monopoly (d) Monopolistic comp

4. Which of following is not characteristic of "price taker":
(a) TR = MR x Q (b) AR = P
(c) Negatively sloped demand (d) Diminishing MR

5. Which of following is false:
(a) Economic cost include opportunity cost
(b) Accounting cost include only explicit cost
(c) Economic profit will always be less than accounting profit if resources owned and used by firm have opportunity cost
(d) Accounting profit is equal to total revenue less implicit cost

6. If technology of manufacture of computer improves and users also find new uses of computer. Which of following is likely to happen:
(a) Increase in price, non determination of quantity
(b) Decrease in price, non determination of quantity
(c) Increase in quantity, non determination of price
(d) Decrease in quantity, non determination of price

7. Price discrimination is profitable if elasticity of demand in different market is:
(a) Uniform (b) Different
(c) Less (d) Zero

8. If at profit-maximisation level of output, market price is less than average total cost but more than average variable cost, which of following is true:
(a) Firm should shut-down (b) Firm should raise price
(c) Firm should more resources to other alternative
(d) Firm should continue to operate in short-run

9. Identify the false statement from below:
(a) Monopolist may suffer loss
(b) Firm in Perfect competition are price taker
(c) Price discrimination is beneficial for firms in perfect competition
(d) Kinked demand curve is seen in oligopoly market

10. In price taking firm:
(a) MR < Price (b) MR = Price
(c) MR > Price (d) None of above

11. Following are characteristics of oligopoly, except:
(a) Horizontal demand curve (b) Price leadership
(c) Too much importance to non-price competition
(d) Small number of firms in industry

Answers

1 D	2 D	3 A	4 B	5 D	6 C	7 B	8 D
9 C	10 B	11 A					

Professional Edge

Academic Guidance

Executive Course

MONEY MARKET INSTRUMENTS

By Mohd. Anish Khan CS (Prof) Student

The term "Money Market" refers to a market where requirement and availability of fund is for short-term, i.e. for a maximum period of one year. It does not include any equities and debentures. Money market instrument mainly includes Government securities, securities issued by banking sector and securities issued by private sector. The below mentioned instruments are normally termed as money market instruments:

1. Government Securities (G-secs)

Government Securities are securities issued by the Government, G-secs are sovereign securities mostly interest bearing dated securities which are issued by RBI on behalf of Government of India (GOI). GOI uses these borrowed funds to meet its fiscal deficit, while temporary cash mismatches are met through treasury bills of 91 days. G-secs consist of Government Promissory Notes, Bearer Bonds, Stocks or Bonds, Treasury Bills or Dated Government Securities. Government bonds are theoretically risk free bonds.

Types of Government Securities:

Dated Securities	Zero Coupon Bonds	Partly Paid Stock	Floating Rate Bonds	Bonds with Call/Put Option	Capital Indexed Bonds
A stock that has fixed redemption date.	Also called a discount bond or deep discount bond is bought at a price lower than its face value, and repaid at par at the time of maturity.	Payment of the principal amount of investment is made in installments over a given time frame.	A bond with a variable interest rate. The rate of interest is tied to a certain index plus a spread. There may be a cap n floor rate attached to interest rate.	Bond option is a financial instrument that facilitates an option to buy or sell a particular bond at a certain date for a particular price. Similar to stock option, However underlying asset is bond.	Inflation linked returns on both the coupons and principal repayments at maturity. The repayment at maturity would be the inflation-adjusted principal amount or par value, whichever is more.
Half yearly fixed Coupons on face value.	No coupons; Return=Face Value less Discounted Issue price.	No coupons; Return=Face Value less Discounted Issue price.	Half yearly Coupons on face value; coupon rate fixed as a % over a predefined Benchmark.	Half yearly Coupons; Coupon rate for the bonds would be specified in real terms, to be applied to the inflation adjusted principal to calculate the periodic semi-annual coupon payments.	
Government paper with tenor beyond one year is known as dated security. At present, there are Central Government Dated securities with a tenor up to 30 years in the market.	Zero coupon bonds may be Long (maturity dates typically start at 10-15 yrs) or short term (maturities of less than one year) investments. The bonds can be held until maturity or sold on secondary bond markets.	Meets the needs of the investor with regular flow of funds & with the need of government when it does not need the fund immediately.	Protect investors against a rise in interest rates.		The inflation protection for the coupons and the principal repayment on the bond is provided with respect to the Wholesale Price Index (WPI) for All Commodities.

2. MONEY AT CALL AND SHORT NOTICE

Money at call is a loan that is repayable on demand, and money at short notice is repayable within 14 days of serving a notice. The participants are banks & all other Indian Financial Institutions as permitted by RBI. The market is over the telephone market. Non bank participants act as lender only. Banks borrow for a variety of reasons, say to maintain their CRR.

3. MONEY MARKET MUTUAL FUNDS (MMMFs)

A money market fund is a mutual fund that invests solely in money market instruments. Money market instruments are forms of debt that mature in less than one year and are very liquid. Treasury bills make up the bulk of the money market instruments. Securities in the money market are relatively risk-free. Money market funds are generally the safest and most secure of mutual fund investments. The goal is to preserve principal while yielding a modest return by investing in safe and stable instruments issued by governments, banks and corporations etc.

4. TREASURY BILLS

Treasury Bills are short term (up to one year) borrowing instruments of the Government of India which enable investors to park their short term surplus funds while reducing their market risk. These are discounted securities and thus are issued at a discount to face value. The return to the investor is the difference between the maturity value and issue price. Any person in India including Individuals, Firms, Companies, Corporate bodies, Trusts and Institutions can purchase Treasury Bills.

At present, RBI issues T-Bills for three different maturities: 91 days, 182 days and 364 days. Treasury Bills are available for a minimum amount of Rs.25, 000/- and in multiples of Rs. 25,000 thereafter. They are available in both Primary and Secondary market.

5. CERTIFICATES OF DEPOSITS (CD)

A CD is a time deposit, a financial product commonly offered to consumer by banks. In case of CDs the banks issue a certificate for a deposit made, such certificate is transferable, i.e. holder of CD is holder of deposit. CDs are negotiable instrument issued either in physical form transferable by endorsement and delivery or in demat form or as a Promissory Notes. CDs issued by banks should not have the maturity less than seven days and not more than one year. Financial Institutions are allowed to issue CDs for a period between 1 year and up to 3 years. They normally give a higher return than Bank term deposit.

6. INTER CORPORATE DEPOSITS (ICD)

An ICD is an unsecured loan extended by one corporate to another. Market allows corporates with surplus funds to lend to other corporates. Also the better-rated corporates can borrow from the banking system and lend in this market. As the cost of funds for a corporate is much higher than that for a bank, the rates in this market are higher than those in the other markets. Also, as ICDs are unsecured, the risk inherent is high and the risk premium is also built into the rates.

7. COMMERCIAL BILLS

Commercial bill is a short term, negotiable, and self-liquidating instrument with low risk. It enhances the liability to make payment within a fixed date when goods are bought on credit. Bills of exchange are negotiable instruments drawn by the seller (drawer) on the buyer (drawee) on the value of the goods delivered to him. Such bills are called trade bills. When trade bills are accepted by commercial banks, they are called commercial bills. The bank discounts this bill by keeping a certain margin. Banks can also get such bills rediscounted by financial institutions such as DFHI, LIC, etc.

8. COMMERCIAL PAPER

Commercial Paper is a money-market security issued by large banks and corporations to get money to meet short term debt obligations and is only backed by an issuing bank or corporation's promise to pay the face amount on the maturity date specified on the note. Since it is not backed by collateral, only firms with excellent credit ratings from a recognized rating agency will be able to sell their commercial paper at a reasonable price. Commercial paper is usually sold at a discount from face value, and carries shorter repayment dates than bonds. The longer the maturity on a note, the higher the interest rate the issuing institution must pay.

9. CALL MONEY MARKET AND SHORT TERM DEPOSIT MARKET

The borrowers are essentially the banks. Discount and Finance House of India (DFHI) plays a vital role in stabilizing the call and short term deposit rates through larger turnover and smaller spread. It ascertains the prospective lenders and borrowers, the money available and needed and exchanges a deal settlement advice with them indicating the negotiated interest rates applicable to them. When DFHI borrows, a call deposit receipt is issued to the lender against a cheque drawn on RBI for the amount lent. If DFHI lends it issues to the RBI a cheque representing the amount lent to the borrower against the call deposit receipt.

10. INTER BANK PARTICIPATION CERTIFICATES (IBPs)

With a view for providing an additional instrument for evening out short-term liquidity within the banking system, two types of Inter-Bank Participations (IBPs) were introduced, one on risk sharing basis and the other without risk sharing. These are strictly inter-bank instruments confined to scheduled commercial banks excluding regional rural banks. The IBP with risk sharing can be issued for 91-180 days. The IBP risk sharing provides flexibility in the credit portfolio of banks. The rate of interest is left free to be determined between the issuing bank and the participating bank.

11. GILT EDGED GOVERNMENT SECURITIES

These are issued by governments such as Central Government, State Government, Semi Government authorities, City Corporations, Municipalities, Port trust, State Electricity Board, Housing boards etc.

The gilt-edged market refers to the market for Government and semi-government securities, backed by the Reserve Bank of India (RBI). Government securities are tradable debt instruments issued by the Government for meeting its financial requirements. The term gilt-edged means of the best quality. This is because the Government securities do not suffer from risk of default and are highly liquid. The open market operations of the RBI are also conducted in such securities.

Academic Guidance

Professional Course

Forex Management

Question 1: If one unit of currency A is equal to 0.35B and one unit of currency C is equal to 0.38A. What is C/B exchange rate?
Answer:
Given:
1A = 0.35B, 1C = 0.38A, We need C/B. We can say that:
C/B = C/A x A/B
= 1/0.38 x 1/0.35
= 7.5188
Thus 7.5188 units of currency C can be bought from one unit of currency B.

Question 2: Determine how many Rupees can be bought from 100¥ on the basis of following data:
Rs / £ = 75.35 – 38, £ / $ = 1.565 – 568, $ / 100¥ = 1.042 – 45
Answer: As bid and ask, both rates are given and we are required to calculate 100¥ = ?Rs, hence we need ask quote:

$$Ask\left(\frac{Rs}{¥}\right) = Ask\left(\frac{Rs}{£}\right) \times Ask\left(\frac{£}{\$}\right) \times Ask\left(\frac{\$}{¥}\right)$$

= 75.38 x 1.568 x 1.045 = 123.4655 Rupees per 100¥

International Taxation

Transfer Pricing

By CS Arvind Kumar Yadav, Practicing Company Secretary

Sec 92: Computation Of Income From International Transaction Having Regard To A.L.P.

- Transfer pricing relates to determination of correct market price i.e. Arm's length price.
- Any income from an international transaction shall be computed as per A.L.P.
- Even an allowance of expenses or interest arising from an international transaction shall be determined as per A.L.P.

If an international transaction is entered into by two or more associated enterprises for allocation of expenses or cost in connection with the services provided, then such allocation of expenses or cost shall be on the basis of A.L.P. of the service provided.

Provisions of transfer pricing shall not apply where the computation of income or allowance of expenses of cost has the effect of reducing the income chargeable to tax or increasing the loss of the assessee. This is because, the objective of transfer pricing is to increase the tax base of the country.

International Transaction Matrix:

Transaction by	Transaction with	
	Resident	Non Resident
Resident	X	✓
Non Resident	✓	✓

Note: if both the enterprises are non residents, the income of at least one of the enterprise should be taxable in India.

Sec 92A: Meaning of Associated Enterprise

Associated enterprises mean an enterprise which participates directly or indirectly in the management or control or capital of other enterprise.

Meaning Of Deemed Associated Enterprises:

Two enterprises shall be deemed to be associated enterprises if at any time during the previous year:

- One enterprise holds directly or indirectly, shares carrying not less than 26% of voting power in other enterprise
- Any person hold directly or indirectly, shares carrying not less than 26% of voting power of each of such enterprise
- A loan is advanced by one enterprise to other enterprise of not less than 51% of the BOOK VALUE OF THE TOTAL ASSETS of the other enterprise (BV of the borrower enterprise)
- One enterprise guarantees of not less than 10% of the total borrowings of the other enterprise
- One enterprise appoints more than 50% of the B.O.D. of the other enterprise or appoints one or more executive directors of the other enterprise
- Any person appoints more than 50% of B.O.D. or one or more executive director of both the enterprises
- 90% or more raw material required by one enterprise is supplied by the other enterprise
- When one enterprise is controlled by an individual or HUF and the other enterprise is also controlled by the same individual or HUF
- One enterprise is a firm/AOP/BOI and the other enterprise hold at least 10% interest in such firm/AOP/BOI
- There exists between the two enterprises any mutual relationship as may be prescribed.

Sec 92B: Meaning Of International Transaction

International transactions includes the transactions between associated enterprises in the nature of –

- Sale or purchase of tangible of intangible property or
- Provisioning of service or
- Lending or borrowing of money
- Any other transaction having an impact on profits, income or assets of such enterprises.

A transaction is said to be an international transaction if it is entered between two associated enterprises AND at least one of the enterprise should be a non resident.

Note: if both the enterprises are non residents, then the provisions of transfer pricing shall apply only if the income of one of the nonresident is assessable in India as per Income Tax Act.

Arithmetic Mean: (Computation Of ALP If More Than One ALP Is Determined)

Where more than one price is determined by the most appropriate method, the A.L.P. shall be taken to be the arithmetical mean of such prices. It has been further defined the, A.L.P so determined and the price at which the international transaction has actually been undertaken does not exceed 5% of the later (The price of the international transaction), the price at which the international transaction has been undertaken shall deemed to be the A.L.P.

Steps To Be Followed For Determining The A.L.P.

Step 1- identify the price charged or paid in Comparable Uncontrollable Transaction

Step 2- such price is then adjusted for the functional differenced between international transaction & comparable uncontrolled transaction, which could materially affect the price in the open market

Step 3- such adjusted price is the Arm's length Price.

A.O. Can Himself Determines The A.L.P.

During the course of assessment if the assessing officer is of the opinion that

- The price charges or paid in an international transaction is not determined as per the most appropriate method or
- Information and data relating to an international transaction have not been kept and maintained by the assessee in accordance with the law or
- Information or data used to determine A.L.P is not reliable or not correct or
- Assessee failed to furnish any information required to be furnished

A.O. may after giving an opportunity of being heard to the assessee by serving him a notice, calling him why the A.L.P. should not be fixed on the basis of the information or documents in the possession of the A.O.

The A.O may re compute the income of the assessee having regard to the A.L.P. determined by him.

If the A.L.P determined by the A.O. is -+5% of the A.L.P so determined by the assessee, the A.L.P determined by the assessee may be accepted.

Reference To Transfer Pricing Officer – Sec 92CA

When the A.O. is unable to determine the A.L.P. then with the prior approval of the Chief Commissioner, may refer the computation of A.L.P. to the transfer pricing officer.

When such reference is made, the Transfer Pricing Officer shall serve a notice on the assessee requiring him to produce the evidence based on which the assessee has determined his A.L.P.

After considering such evidences and other materials gathered, the transfer pricing officer shall determine the A.L.P in writing and shall send a copy of the order to the A.O. and the assessee. Based on the A.L.P. determined by the Transfer Pricing Officer, the A.O. shall determine the taxable income of the assessee.

Safe Harbor Rules- Sec 92CB

Safe harbor means circumstances in which the income tax authorities shall accept the transfer price declared by the assessee. The provisions of sec 92C and sec 92CA shall be subject to safe harbor rules. The CBDT is empowered to make rules for safe harbor.

Transactions With Persons Located In Notified Jurisdictional Area- Sec 94A

This section is applicable only if the following conditions are fulfilled

a) There is a country or territory outside India which with whom India does not have effective exchange of information on tax matters
b) Such country or area is specified by notification in official gazette.
c) As assessee enters into a transaction where one of the parties to the transaction is a person located in NJA

Person include an individual or body corporate or a permanent establishment

If all the pre conditions are satisfied, the parties to the transactions shall be deemed to be associated enterprise within the meaning of sec 92A and the transaction shall be deemed to an international transaction. The provisions of transfer pricing shall apply having regard to A.L.P.

Deduction of interest: any payment made to F.I. located in NJA shall be allowed as deduction only if the assessee furnishes an authorization in the prescribed from, authorizing the CBDT or any other income tax authorities acting in its behalf to seek the information from the said F.I. Also, such interest should be allowed on the basis of A.L.P.