PAPER 16: TAX MANAGEMENT & PRACTICE

INDIRECT TAX

Select case laws on Indirect Taxation

CENTRAL EXCISE

(A) VALUATION OF EXCISABLE GOODS

ISSUE: In a case where a product is sold below the cost price for penetrating the market, whether such price can be considered as transaction value?

SOLUTION: The Apex Court upheld in the case of **CCEx., Mumbai v. Fiat India Pvt. Ltd. 2012 (283) E.L.T 161 (S.C),** that in the instant case, the selling price could not be accepted as transaction value.

In the instant case, the assessee was selling cars at a loss, in wholesale trade, with the objective of market penetration. The cost of production of the cars was much more than the wholesale trade price. The Department contended that adoption of selling price, as transaction value was unacceptable in this case, as an extra commercial consideration was involved in this case.

The Court contended that **Section 4(1)(a) of the Central Excise Act 1944** would not be applicable in this case, as there was an extra commercial consideration of market penetration, in artificially depressing the price. Though the cars were not sold to the related persons, price could not be considered as the consideration of sale.

(B) CENVAT CREDIT UNDER CENTRAL EXCISE LAWS

ISSUE: Will two units of a manufacturer surrounded by a common boundary wall be considered as one factory for the purpose of CENVAT Credit, if they have separate central excise registrations?

SOLUTION: The High Court held in the case of **Sintex Industries Ltd. vs. CCEx 2013 (287) ELT 261 (Guj.)** that credit could be availed on eligible inputs utilized in the generation of electricity only to the extent the same were used to produce electricity within the factory registered for that purpose, and not for the production of electricity within the factory used for other purposes. The High Court rejected the contention of the assessee that separate registration of two units situated within a common boundary wall would not make them two different factories.
The assessee company had two separate divisions- textile division and plastic division, having separate central excise registrations. The assessee availed CENVAT Credit on furnace oil as fuel in generation of electricity. The electricity so generated was used for the factories of both the units. The Revenue objected to the availing of CENVAT Credit on furnace oil, used in generation of electricity and supplied to the other unit.
The High Court held that since each of the units had separate central excise registrations, these were separate units. Hence credit could not be availed on the furnace oil, used in generation of electricity, consumed in the other unit.

CUSTOMS LAWS

(A) VALUATION UNDER THE CUSTOMS ACT, 1962

ISSUE: Whether subsequent increase in the market price of the imported goods due to inflation would lead to increase in customs duty although the contract price between the parties has not increased accordingly?

SOLUTION: As per the Apex Court's decision in **Commissioner of Customs, Vishakhapatnam v. Aggarwal Industries Ltd. 2011 (272) E.L.T 641(S.C),** the increased price cannot be considered for valuation purposes.

In the instant case, the contract for supply of crude sunflower oil @ US$ 435 CIF/ metric ton was entered into on 26th June 2001. The performance of the contract was delayed. During such period of delay, the commodity suffered price fluctuations. But the contract was not altered to accommodate the price escalation. The supplier and the buyer were also not found to be in collusion. Hence, the increased price cannot be considered for valuation of crude sunflower seed oil.

SERVICE TAX LAWS

(A) VALUATION OF TAXABLE SERVICE

ISSUE: Whether expenditure like travel, hotel stay, transportation and the like incurred by service provider in course of providing taxable service be treated as consideration for taxable service and included in the value for charging service tax?

SOLUTION: Rule 5 of the Service Tax (Determination of Value) Rules 2006, provides that the above-stated expenses incurred by the service provider, in the course of providing taxable service shall be t6reated as consideration for taxable service and included in the value for charging service tax.

Whereas, Section 67 provides that the value of taxable services is the gross amount charged for by the service provider for 'such service'. Thus, Section 67 and Rule 5 hold conflicting positions relating to valuation of taxable services.

The High Court held that Rule 5(1) of the Service Tax (Determination of Value) Rules 2006 runs counter and is repugnant to Sections 66 and 67 of the Act and to that extent it is ultra vires the Finance Act 1994. Valuation under Rule 5 was not only subordinate to valuation under the sections, but also provided scope for double-taxation. For example, it will lead to double taxation of air-travel tickets, which were already taxed earlier.

Therefore, the value of taxable services is the gross amount charged for by the service provider for 'such service'.

[**Note:** Since, the judgment of the Delhi High Court was not taken in consonance with the judgments of the other Courts; this could be challenged in the Supreme Court as well.**]**

DIRECT TAX

"Profit and gains of business or profession"

1. Special provision for full value of consideration for transfer of assets other than capital assets in certain cases [Section 43CA] [W.e.f. A.Y. 2014-15]

Currently, when a capital asset, being immovable property, is transferred for a consideration which is less than the value adopted, assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, then such value (stamp duty value) is taken as full value of consideration under section 50C of the Income-tax Act. These provisions do not apply to transfer of immovable property, held by the transferor as stock-in-trade.

(A) Stamp duty value to be deemed consideration in certain cases [Section 43CA(1)]: The Act has inserted a new section 43CA to provide that where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration for the purposes of computing income under the head "Profits and gains of business of profession".

(B) Provisions of section 50C(2) and (3) made applicable to section 43CA [Section 43CA(2)]: The provisions of sub-section (2) and sub-section (3) of section 50C shall, so far as may be, apply in relation to determination of the value adopted or assessed or assessable under section 43CA(1).

Where valuation can be referred to the Valuation Officer [Section 50C(2)]: If the following conditions are satisfied, the Assessing Officer may refer the valuation of the relevant asset to a Valuation Officer in accordance with section 55A of the Income-tax Act:

(i) where the assessee claims before the Assessing Officer that the value adopted or assessed or assessable by the stamp valuation authority exceeds the fair market value of the property as on the date of transfer; and

(ii) the value so adopted or assessed or assessable by stamp valuation authority has not been disputed, in any appeal or revision or reference before any authority or Court,

Consequences where the value is determined by the Valuation Officer: If the fair market value determined by the Valuation Officer is less than the value adopted (assessed or assessable) for stamp duty purposes, the Assessing Officer may take such fair market value to be the full value of consideration. However, as per section 50C(3), if the fair market value determined by the Valuation Officer is more than the value adopted or assessed or assessable for stamp duty purposes, the Assessing Officer shall not adopt such fair market value and will take the full value of consideration to be the value adopted or assessed or assessable for stamp duty purposes.

(C) Stamp duty value on the date of agreement to be deemed consideration [Section 43CA(3)] : The Act has also provided that where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer and not as on the date of registration for such transfer.

However, this exception shall apply only in those cases where amount of consideration or a part thereof for the transfer has been received by any mode other than cash on or before the date of the agreement. [Section 43CA(4)]

[Note - Section 43CA has been inserted to cover sale of immovable property held as stock-in-trade.]

Advanced Financial Management

Foreign Exchange Market

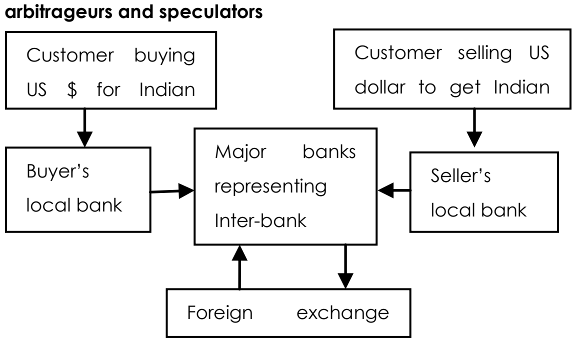
One of the major international financial functions is the exchange of currencies. Currencies are exchanged or, in other words, bought and sold in foreign exchange market that is spread around the globe.

Foreign exchange market:

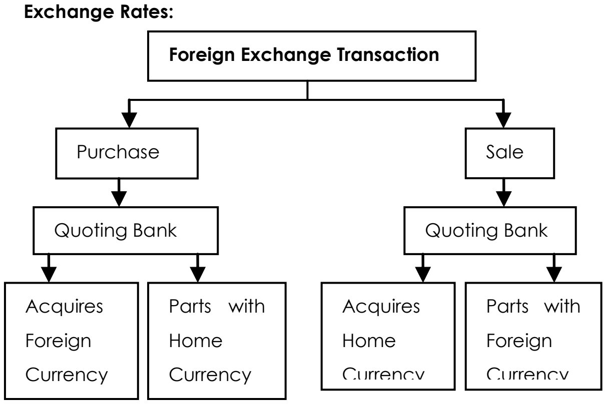
- Is over- the – counter market,
- Operates round the – clock,
- Involves normally transaction of strong, stable and convertible currencies.

MAJOR PARTICIPANTS

Participants are: individuals, firms, banks, central banks and international organizations. Functionally, they are hedgers, arbitrageurs and speculators

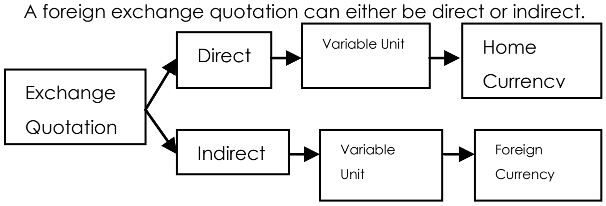


Exchange Rates:

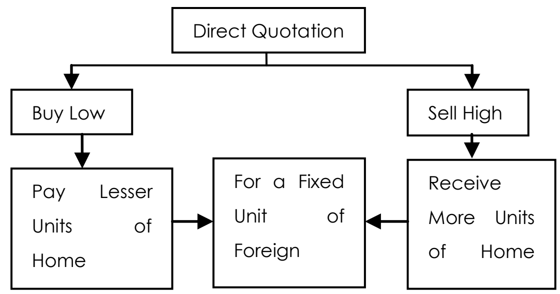


Direct And Indirect Quotations:

A foreign exchange quotation can either be direct or indirect.

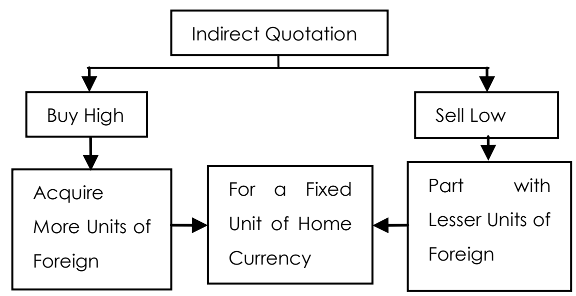


An foreign exchange quotation is said to be **direct** when it is quoted/expressed in a manner that reflects the exchange of a specified number of domestic currency vis-à-vis 1 unit of foreign currency. For example, US \$1=₹45 is a direct quotation for US\$ in India.



Direct Quotation- Buy Low: Sell High

In contrast, the foreign quotation is said to be **indirect** when it is quoted in a manner that reflects the exchange of a specified number of foreign currency vis-à-vis 1 unit of local currency. Our example ₹1=US \$ 0.022 is an indirect quotation in India.



Indirect Quotation- Buy High: Sell Low.

Example: calculate the direct quote from the following indirect quotes from the point of view of :
₹1=\$0.02212, ₹1=£0.01256, ₹1=yen 3.5587,
₹1=DM 0.04728,

Direct Quote = 1/Indirect Quote

\$1=₹45.21 (1/0.02212) £1=₹79.62(1/0.01256)
Yen1=₹0.281(1/3.5587) DM1= ₹21.15 (1/0.04728)

TWO-WAY QUOTATIONS/RATES:

It is convention for dealers to quote two-way rates, one for buying the foreign currency (known as Bid Price/Rate) and another for selling the foreign currency (referred to as Ask Price/rate). Since dealers expect profit in foreign exchange operations, the two prices obviously cannot be the same. Evidently, the dealer will buy the foreign currency at a lower rate and sell the foreign currency at a higher rate. For this reason, the 'bid' quote is at a lower rate and the 'ask' quote is a higher rate. Further, the quotations are always with respect to the dealer.

Thus, foreign exchange quotations contain two rates. By convention, buying rate follows the selling rate, i.e., the first rate is the buying rate and selling rate is the second rate. For example, when a dealer in Bombay quotes pound sterling 1 = ₹78.00 – ₹78.15. It implies that the dealer is prepared to buy British pound sterling at ₹78 and sell £ at ₹78.15. Though we have taken the quote upto 2 decimal points, quotations in practice are normally made upto four decimal points for most of the currencies.

SPREAD:

Spread is the difference between the ask price and bid price. The spread is affected by a number of factors: the currency involved, the volume of business and the market sentiments/ rumours about the currency are the mail variables reckoned by dealers/operators in the foreign exchange market.

Spread to the dealer is akin to the gross profit for a business firm, out of which it is to meet its establish expenses. In percentage terms, spread can be expressed in terms of:

Spread (percent) = [(Ask price - Bid price)/Ask price]x100

SPOT RATES AND FORWARD RATES:

Spot exchange rates are applicable to the purchase and sale of foreign exchange on an immediate delivery basis though in practice 48 hours are allowed for settlement.

Forward exchange rates are applicable for the delivery of foreign exchange at a future date.

FORWARD PREMIUM/ DISCOUNT:

In Forward Market, the currencies may either be strong or weak in comparison to the Spot Rates. One currency may be at a premium in the forward market in comparison to the spot market and the other currency may be at a discount in the forward market in comparison to the spot market. The percentage of forward premium or discount on a currency, in case indirect quotes are given from the point of view of that currency can be computed as follows:-

$$\frac{\text{Forward Premium or}}{\text{discount on a Currency}} = \frac{\text{Forward Rate - Spot Rate}}{\text{Spot Rate}} \times \frac{\text{12 months / 365 days}}{\text{Period of Forward Rate}} \times 100$$

Eg.:- Compute the Forward Premium/Discount on US$ from the following data:—

Spot Rate US \$1 = ₹ 53.50

6 months Forward Rate US \$1 = ₹ 55.50

Forward Premium/Discount on

$$\text{US\$} = \frac{55.50 - 53.50}{53.50} \times 100 \times \frac{12}{6} = 7.48\%$$

ZERO BASE BUDGETING (ZBB):

Meaning: ZBB means budgeting from the beginning without any reference to any base.

Steps in ZBB: ZBB involves the following three steps—

(i) Determining the objectives of budgeting.

(ii) Identification of 'decision units' and development of decision packages.

(iii) Evaluation and ranking of all 'decision packages' in order of importance through cost-benefit analysis or subjective evaluation.

(iv) Allocation of the resources accordingly.

It is an expenditure control device where each divisional head has to justify the requirement of funds for each head of expenditure and prepare the budget accordingly, without reference to the past budget or achievements.

It is an operating planning and budgeting process, which requires each manager to justify his entire budget requests in detail from "scratch" (zero-base).

Applicability: ZBB is more suitable to discretionary cost areas. These costs may have no particular relation to volume or activity; they are the result of management policy.

Example of ZBB: There are many ways to create company budgets. Let's take the marketing department of Company ABC as an example. Last year the department spent ₹ 1 million. What's the right way to set a budget for next year?

You might simply give the department ₹ 1 million again, but this might not reflect the changes in the marketing programs next year, the need to hire more marketing people due to additional sales, or other factors.

Another way might be to give all departments a 10% increase or decrease based on what the Board of Directors would like earnings per share to be next year. This would give the department ₹ 1.1 million or ₹ 900,000, depending on which way the board goes.

A third way would be zero-based budgeting, whereby the department starts with no budgeted funds and must justify every person and expense that should be included in the budget for the coming year. This might result in a budget of, say, ₹ 1,024,314, which is higher than last year but reflective of the actual needs next year.

Analysis of above example: Employees and managers often view budgeting as a game to beat rather than a cooperative planning exercise that incorporates goals and expectations. Many of us have heard of "slush funds" and "use it or lose it" philosophies in which departments try to hoard money for undetermined uses just to avoid being penalized later. Zero-based budgeting theoretically conquers this behavior by requiring department heads to understand every cash outflow and the costs of their operations. It also allows executives to get a genuine measure of what things will cost in the coming year and compare that to their performance expectations accordingly.

ZBB in Practical Context: An example of an organization successfully implementing this system is the Florida Power and Light Company. In 1977 zero-based budgeting became required for all Florida Power and Light general office staff departments. Ben Dady, the company's director of management control, favored the system because when managers develop the zero-based budget, they begin with nothing in terms of budgeted dollars, and have to justify or prove why they need to spend money on each activity or project for all the dollars they expect to spend. New and old problems are treated equally. Every managerial activity is properly identified and then evaluated by analyzing more efficient ways and alternative levels of performing the same activity. These alternatives are then ranked and relative priorities are established.

The publicity in the 1970s surrounding zero-based budgeting gave the impression that the system was a relatively new technique, although the system was not new at all. Zero-based budgeting is quite similar to the Planning – Programming - Budgeting system, implemented in the 1960s. Both systems involve evaluating the inputs and outputs for specific activities, as opposed to the traditional line-item format.

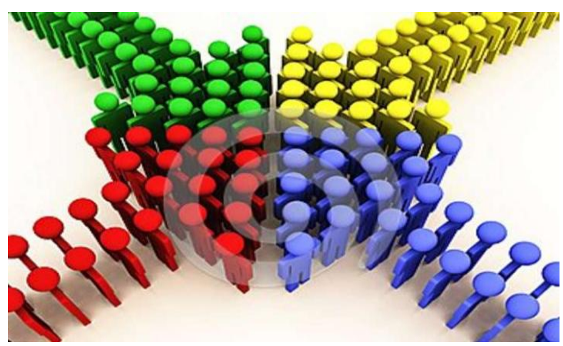
ZBB in Indian Scenario: ZBB has been adopted by departments of the Central Government from April 1, 1987. This is intended to help in the judicious allocation of scarce national resources and in deriving optimum benefits out of the resources allocated. It will be applied to both ongoing programmes as well as new programmes, developmental programmes as well as non-developmental programmes.

A circular dated July 10, 1986, issued by the Secretary, Ministry of Finance, Government of India, calls upon the public sector undertakings to use ZBB for revenue budget initially; as for the capital budgets, there is already an elaborate system of evaluation at various levels.

CORPORATE FINANCIAL REPORTING

AMALGAMATION

Whether to apply Pooling Interest Method or Purchase Method while solving any problem on amalgamation, when no method is mentioned:



AS – 14 (Accounting for Amalgamation) is applicable to determine the exact type of amalgamation.

Types of Amalgamation

Amalgamation in the nature of Merger- the following conditions are required to be satisfied:

- All the assets and liabilities of the transferor company are taken over by the transferee company
- The shareholders holding at least 90% or more of the equity shares of transferor company become the equity shareholder of the transferee company (shares already held by the transferee and its subsidiary are not considered)
- Consideration is paid in shares by the transferee to the shareholders of the transferor (fractional shares can be paid in cash)
- Business of the transferor is carried on by the transferee
- No adjustment is made in the book values of the assets and liabilities of the transferor company by way of revaluation or otherwise except the adjustments to ensure uniformity of accounting policies.

Amalgamation in the nature of Purchase – If any of the above conditions is not satisfied amalgamation will be treated to be in the nature of Purchase.

Method of Accounting is clearly based on the type of amalgamation.

In case of Merger – Pooling Interest Method is applied and in case of Purchase – Purchase Method is applicable.

For example:

P Ltd. and Q Ltd. amalgamated on and from 31st March, 2013. A new Company C Ltd. was formed to take over the businesses of the existing companies.

Balance Sheet as on 31.03.2013

(₹ in '000)

Liabilities	P Ltd.	Q Ltd.	Assets	P Ltd.	Q Ltd.
Equity Shares of ₹ 100 each	60,000	70,000	Sundry Fixed Assets	85,000	75,000
General reserve	15,000	20,000	Investments	10,500	5,500
Profit and Loss A/c	10,000	5,000	Stock	12,500	27,500
Investment allowance			Debtors	18,000	40,000
Reserve	5,000	1,000	Cash and Bank	4,500	4,000
Export profit reserve	500	1,000			
12% Debentures	30,000	40,000			
Sundry creditors	10,000	15,000			
	1,30,500	**1,52,000**		**1,30,500**	**1,52,000**

C Ltd. issued requisite number of equity shares to discharge the claims of the equity shareholders of the transferor companies; the total shares issued as consideration is to be aggregate of paid up capital of P Ltd. and Q Ltd.

Compute the Purchase Consideration and mode of discharge thereof and draft the Balance Sheet of C Ltd. after amalgamation.

This problem will be solved applying Pooling Interest Method as :

(i) Assets and Liabilities are taken over at their book value and
(ii) Purchase consideration is paid in equity shares

Example:

The following are the Balance sheets of F Ltd. and T Ltd. for the year ending on 31st March, 2013.

(Figures in Crores)

	F Ltd.	T Ltd.
Equity Share capital. @ ₹ 10 each	50	40
Preference Share capital - in 12% preference shares of ₹ 100 each	-	60
Reserves and surplus	200	150
	250	250
Loan – Secured	100	100
Total	**350**	**350**
Fixed assets (at cost less depreciation) – Tangible	150	150
Current assets less Current liabilities	200	200
Total	**350**	**350**

Note : Secured Loan is repayable within 12 months.

The present worth of Fixed assets of F Ltd. is ₹ 200 crores and that of T Ltd. is ₹ 450 crores. Goodwill of F Ltd. is ₹ 40 crores and of T Ltd. is ₹ 75 crores.

T Ltd. absorbs F Ltd. by issuing equity shares at par in such a way that intrinsic net worth is maintained.

Goodwill account is not to appear in the books. Fixed assets are to appear at old figures.

(a) Show the Balance Sheet after absorption.

(b) Draft a statement of valuation of shares on intrinsic value basis and prove the accuracy of your workings.

In case of this problem consideration is discharged in equity shares but and only the fixed assets are to appear at their old value, hence the problem can be solved applying Purchase method.

Example:

The Balance Sheets of S Ltd. and H Ltd. as on 31.3.13 were as follows.

(₹ in Lakhs)

Liabilities		***S Ltd.***		***H Ltd.***
Equity Share capital		80		25
Reserves and surplus		400		75
10% 25,000 Debentures of ₹ 100 each		-		25
Other Liabilities		120		-
		600		**125**
Assets				
Fixed assets at cost	200		75	
Less: Depreciation	100	100	50	25
Investments in H Ltd. 2 Lakhs Equity shares of ₹ 10 each at cost	32			
10% 25,000 debentures of ₹ 100 each at cost	24	56		
Current assets	800		300	
Less: Current Liabilities	(356)	444	(200)	100
		600		**125**

In a scheme of absorption duly approved by the Court, the assets of 'H' Ltd. were taken over at an agreed value of ₹ 130 lakhs. The liabilities were taken over at par. Outside shareholders of 'H' Ltd. were allotted equity shares in S Ltd. at a premium of ₹ 90 per share in satisfaction of other claims in 'H' Ltd. for purposes of recording in the books of 'S' Ltd. Fixed assets taken over from 'H' Ltd. were revalued at ₹ 40 lakhs.

The scheme was put through on 1st April, 2013.

(a) Journal Entries in the books of 'S' Ltd.

(b) Show the balance of 'S' Ltd. after absorption of 'H' Ltd.

In the above case the amalgamation is in the nature of Purchase and it will be treated accordingly, as the assets are revalued.

If there is anything mentioned as:

- **block of assets were valued at 10% over their book value or, value of the assets are appreciated by any percentage**
- **The Fixed assets were to be taken at the value placed on them by an independent valuer**
- **The stocks of the transferor were to be reduced by any amount because of obsolete items**
- **Debtors and creditors are to be taken at above or below their book value**
- **Goodwill was to be valued at two years' purchase of the average profits of the last three years subject to some adjustments or, there is given any other value/way to value the goodwill etc.**

Purchase Method will be applicable but if it is mentioned that all the assets and liabilities are taken at their book value the problem will be solved applying Merger method.