

NEW DIRECT TAX LAW

Suggestions and submissions



The Institute of Cost Accountants of India

(Statutory body under an Act of Parliament)

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May 23, 2018

Shri Piyush Goyal

The Hon'ble Minister of Finance,
Government of India,
North Block,
New Delhi

Subject: Suggestions and Submissions in upcoming New Direct Tax Law.

Dear Sir,

Best wishes,

With the intention of the Government to simplify the present Income-tax Act, by way of enacting new Direct Tax Law, the Institute of Cost Accountants of India has made an attempt to revisit the entire Direct Tax gamut of the Country as well as the best practices followed in other countries in the world both developed and developing countries and to frame a hassle free Direct Tax Law for the citizen of India thereby protecting the Interest of Revenue.

With the opinion from our members and Resource Persons, working in the Industry & practice and taxpayers, the suggestions and submissions have been compiled and drafted in the context of upcoming New Direct Tax Law.

Further, we are enclosing herewith submissions on inclusion of "Cost Accountants" under the definition of "Accountant" u/s 288 (2) of Income Tax Act, 1961

If considered necessary, please give us an opportunity to present before you the above in person at your convenient date and time. We are eagerly looking forward to your confirmation for a suitable date.

Thanking you.

Yours Sincerely,

CMA Sanjay Gupta.

Enclosed – As above

Copy to:

1. Hon'ble Minister of State, Ministry of Finance, Government of India, North Block, New Delhi
2. Secretary-Expenditure & Finance Secretary, MoF, Government of India
3. Secretary, Department of Revenue, MoF, Government of India
4. Chairman, Central Board of Direct Taxes, Department of Revenue, MoF
5. Chairman, Task force for enacting new Direct Tax Law.

Preface

This Suggestions on the new Direct Tax Law and submissions on "inclusion of Cost Accountants" under the definition of Accountants u/s 288 (2) of the Income Tax Act, 1961 have been drafted after seeking note-worthy suggestions from its member and Resource Persons, who are working in the Industry and in practice. The opinion of taxpayers also sought while drafting the suggestions and submissions.

Also an attempt has been made to revisit the entire Direct Tax gamut of the Country as well as the best practices followed in other countries in the world both developed and developing countries and to frame a hassle free Direct Tax Law for the citizen of India thereby protecting the Interest of Revenue.

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SUBMISSION ON INCLUSION OF "COST ACCOUNTANTS" UNDER THE DEFINITION OF "ACCOUNTANT" U/S 288(2) OF INCOME TAX ACT, 1961

PART - I
SUGGESTIONS
ON
NEW DIRECT TAX LAW



The Institute of Cost Accountants of India
(Statutory body under an Act of Parliament)

Back Ground

During the Rajaswa Gyan Sangam held in September 2017, our Prime Minister Shri Narendra Modiji had observed that the Income Tax Act, 1961 was drafted more than 50 years ago and needs to be re-drafted. Following which, The Government of India has set up a Task force called the Task force for the New Direct Tax Law with the objective of drafting a new Direct Tax Legislation in the month of November, 2017. The task force has to submit its report to the Government within six months. The terms of reference of the task force are to draft an appropriate direct tax legislation keeping in view the following:

- (i) The direct tax system prevalent in various countries;
- (ii) The international best practices;
- (iii) The economic needs of the country; and
- (iv) Any other matter connected thereto,

The intention of the Government to simplify the present Income–Tax Act, 1961 is laudable. However, to submit a comprehensive report on or before May 2018 is an uphill task for the Committee.

The Institute of Cost Accountants of India in this regard, has taken the oath to contribute constructively, in this decision of our Honourable Finance Minister. For this, the Institution has sought note-worthy suggestions from its members and Resource Persons, who are working in the Industry and in practice, as well as various hierarchies. It is collated and added at the end of this report.

The Institute has the thought process that instead of changing the entire law, the Government may consider modifying the existing law so that the disputable provisions and litigations could be minimised and the Interest of the revenue will be protected delivering a hassle free service by the Tax Administration to the Citizen.

Keeping the above in mind, the Institute has made an attempt to revisit the entire Direct Tax gamut of the Country as well as the best practices followed in other countries in the world both developed and developing countries and submit a draft to the Government containing suggestions relating to the new Direct Tax Law. The Philosophy and basis that has been thought of while preparing the suggestions are:

Philosophy: <ul style="list-style-type: none">• Simplification• Protecting Government Revenue• Professional Involvement<ul style="list-style-type: none">▪ Avoiding Litigation▪ Taxpayer Satisfaction▪ Appropriate Tax Collection• Ease in doing Business• Size and Peculiarity of India	Basis <ul style="list-style-type: none">• Existing Direct Tax Law• International Best Practices• OECD Guidelines• UN Guidelines
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Executive Summary

The Institute of Cost Accountants of India has made some key suggestions or recommendations to make Income tax legislation/ Act more efficient and tax payer and investor friendly. The drafting has been made keeping in mind the progress and the vision of the country. These may be summarised as follows:

A. Simplification of Tax Rates:

- Opinions have been given on simplification of different areas including tax rates, MAT/AMT, ICDS etc.

B. Provisions on Corporate Restructuring

- Opinions have been given on realigning the provisions of Sections dealing with business restructuring, amalgamation and merger process.

C. General Anti-Avoidance Rule

- Recommendation given on applicability of GAAR provisions

D. Taxation of digital economy

- Taxation of the cross border transactions including tax on deeming provisions like equalization levy.

E. International taxation

- Opinions have been given on method for determination of appropriate value for Transfer Pricing with comparison among different methods.

F. Tax dispute resolution/prevention

- Opinions given on Advance Ruling Authority.

Some other Suggestions:

Topics like Taxation of Educational Institutions, Imposition of Tax liability, Capital gains, E-assessment, Tax incentive provisions to name a few has also been covered in the suggestions.

PART 1: General Suggestions:

- A.** It is desired that the process of bringing the new Income-tax Law should be done by discussing the implications of the same with the concerned stakeholders. It is opined that the members of the taskforce committee may reach out to small towns as well as large metropolitan cities and interact with professionals and small assesseees to understand the difficulties faced by the taxpayers. It may be an impossible task to reach and understand the concerns of the tax payers and professionals across the country and compile a comprehensive report within six months. Thus it is desired not to go for a hurried implementation.

- B.** Professionals like CMA, CA and CS as well as the citizens, bearing duties to the nation may have to consider sending objective suggestions for the consideration of the Committee and the Honourable Finance Minister. The Representation Committee of the professional institutes, Chambers of Commerce, Federation and other trade bodies should be discussed and reasoned response for acceptance as also for rejection may be minuted.

- C.** Views of the tax officials from the CBDT till the field officers and recovery officers should be solicited and similarly considered.

PART 2: Specific suggestions

1. Terms of reference

Terms of reference put before the committee should have been very broad. For example. "to examine the existing Income-tax Act, 1961, and to suggest changes that have become necessary for doing easy business and compliances".

Thus, the mandate is very clear to rewrite the new Income -tax Act, considering the need of our Country, it is not direct taxes code. The outcome will be a new Income-tax Act.

So, there will be a new Income-tax Act. It will be tax payer friendly. It will bring accountability on the part of the tax administrators as well as the tax payers.

ICAI Recommendation:

The working should be with clean slate and out of box thinking.

2. Time frame for submitting the report

The present Income-tax Act, 1961, refers to 98 Central Acts, various State Legislations and more than 800 Sections, Rules, Notifications and various case laws of the Apex Court, High Courts, Appellate Tribunals and Authorities for Advance Rulings.

ICAI Recommendation:

It may not be possible to consider all the aspects within a period of six months. Ideally, there has to be an on-going process for at least two years.

3. Accountability provision

One of the suggestions made by Dr. Raja J. Chelliah in his committee report (1992) 197 ITR 177 (St) (257) that ways must be found to hold the Assessing Officers accountable for kinds of assessments they make.

Suggestions received as;

"The Assessing Officers should be made accountable for their actions by being blamed for raising demands which are not upheld by a reasonable figure, say 50 per cent, the officer should be given a black mark and also reprimanded. On the other hand, an Assessing Officer should be protected and defended if he has observed instructions of the Board and followed the Court rulings even though audit might raise objections about his actions" (para. 5.9).

Representations have been sent from time-to-time to introduce the accountability provision in the Act.

ICAI Recommendation:

It is desired that the accountability provision as suggested by Dr. Raja J. Chelliah Committee may have to be incorporated in the proposed new Act. If accountability provision is not introduced, whatever may be the law, the desired object of simple tax law may not be achieved.

Bringing in accountability in tax administration is the first step in reducing avoidable litigation, and would benefit honest taxpayers of the country.

4. Culture of tax services

The Hon'ble Prime Minister has, on a number of occasions, asserted that he is the servant of the people of our country. This sentiment does not seem to be the case when it comes to tax administration. The honest taxpayers are finding it difficult to get the refund due to them – in time and in total (with due interest).

Rectification applications are not disposed off in time. Appeal effects are not given. Even taxes paid, TDS suffered is not reflected. This carouses needless harassment for the taxpayer.

The Bombay High Court in case of Bajaj Auto Finance Ltd. (www.itatonline.org) held that the Officers are not following the judgments of Jurisdictional High Court and Tribunal. The Hon'ble Court has held that if the decision of the Court/Tribunal interpreting a provision of law is to be ignored by the Assessing Officer, it shall bring in the death knell of Rule of law in the country.

It is only the rich assessee, who can afford to go to the High Court in appeal. A small assessee is at the mercy of the tax administration to get justice, refund, appeal effect or rectification of mistake.

The CBDT in the year 1955 has issued the Circular (XL-35 dated 11-4-1955) dealing with refunds and reliefs. The circular stated that the Officers should guide the assessee and if any claim which is rightfully due to the assessee is not claimed in the return, it must be allowed to the assessee. The Circular is neither withdrawn, however, nor observed in the field.

ICAI Recommendation:

The need of the hour is a change in the mind-set of the tax administration from that of tax collection to that of providers of tax services.

5. Pendency of tax litigation

The pendency of tax matters before High Courts is alarming. Appeals filed take nearly four to five years for High Courts to come up for admission. Once admitted in High Court, it takes another ten years for them to come up for final hearing and disposal. For example, presently, the Bombay High Court is taking up the matters which were filed in the year 2015 for admission and for final hearing matters which were admitted in 2002.

It takes more than two to three years to get an order from the CIT(A) and another two years from the Appellate Tribunal.

If the matters are taken to the Apex Court, another five years may be consumed before the matter comes for hearing. Thus, in India tax litigation takes nearly 20 years to attain finality.

The Government should make serious efforts to reduce the litigation. Because, without this, whatever may be the law, the desired objects of simplifying and streamlining the tax administration and adjudication may not be achieved.

ICAI Recommendation:

Before the introduction of new tax legislation, the Government must chalk out an action plan on how to reduce the pendency of tax litigation before Apex Court, various High Courts, the Appellate Tribunal, Commissioner of Income-tax (Appeals) and Prosecution matters before various designated Magistrate Courts.

Various forums have made various suggestions from time-to-time to the Government with respect to the ways and means to reduce tax litigation. One of the suggestions was to set up an e-Bench of Supreme Court, linking of the Supreme Court to various High Courts and that SLP in tax matters can be heard by arguing the matters from respective High Courts.

6. Special Courts

Similarly hosting of various issues pending before various High Courts by CBDT on their website as directed by the Bombay High Court and Independent National tax litigation cell separate legal cell should be seriously considered and acted upon. [CIT v. TCL Ltd. (2016) 241 Taxman 138 (Bom.) (HC)]

In Mumbai, more than 300 cases of prosecution have been launched in the year 2018. One will be surprised to know that the prosecution notice is issued for few days delay on filing of return though the taxes along with interest were paid.

ICAI Recommendation:

Setting up of special Courts to deal with prosecution in relation to direct and indirect taxes was proposed.

7. Tax deduction at source

A. Rates and source

Present Scenario:

In the Income-tax Act, 1961, there were only two sections under which the assessee was liable to deduct tax at source. Presently, there are more than twenty-five sections under which the assessee is required to deduct tax at source and file the tax return.

If there is a failure to deduct the tax at source such a 30% of the payment does not qualify for deduction.

Further, upon a few days delay in depositing the tax or return of tax deducted at source, he is made liable to pay interest, penalties and the threat of prosecution is omnipresent. Many a times, there is want of clarity on various issues that can be faced while deducting such tax.

ICAI Recommendation:

It is desired that one may think of having the concept of a passbook and only one return for all TDS deducted at source. The assessee may deposit the amount as advance or may adjust against various taxes to be deducted. This will help to reduce the compliance provisions.

B. TDS Certificates

Present Scenario:

Where TDS statements are furnished electronically, tax credit appears in the account of the payee.

Issuing of TDS Certificate stipulates and additional procedure that involves time, efforts and costs. The efforts are unnecessary, as the entire data is otherwise available with the concerned parties.

The non-compliance with issuing of TDS Certificate is visited with penalty.

ICAI Recommendation:

Therefore, provision for issuing TDS Certificate should be dispensed with.

C. Tax Deductor Efforts

By deducting the tax at source and depositing such amount to the Government Treasury, the assessee is doing the honorary duty of the Government. That's too, without any compensation.

ICAI Recommendation:

The tax deductor may be allowed some tax credit, based on his tax deduction, to compensate his administrative costs.

Present Scenario:

TDS is not the entire amount of tax that can be recovered from an assessee. It is a part of total tax. TDS is used to bring the masses under the tax bracket and it also helps to trace the amount of income earned by looking at the tax deducted. Presently there are different rates of TDS prevailing. Also the frequency of filing of return is quarterly. Since TDS is a mechanism for collection of Tax. Simplification of TDS will enhance ease of doing Business.

ICAI Recommendation:

4 quarterly returns to be replaced with one 9 monthly return and then last quarterly return.

1% or 2% rate of TDS for everything.

8. Advance Ruling for taxation for residents

Present Scenario:

It has been observed that on many occasions the assessee is not able to find out certain transaction would lead to what tax liability i.e. whether income is exempt or taxable, whether the expenditure will be capital or revenue, whether the said amount will be allowed as deduction or not, what is the rate of tax, etc.

Non-resident assessee's are provided with a facility of advance ruling. The mechanism answers doubts about the proposed or existing transactions. The advance ruling is binding on the income tax department.

ICAI Recommendation:

For the resident assessee, there should be a similar facility of the Advance Ruling. Initially, power can be given to the existing Income Tax Appellate Tribunals. Later on separate authority may be set up for the purpose. Rules and modality can be worked out to implement the advance ruling mechanism. The authority should work under the Ministry of Law and Justice rather than the Ministry of Finance.

This will greatly reduce tax litigation. Similar provisions exist in the Maharashtra VAT legislation. These can be considered as a guiding force.

9. Settlement Commission Composition

Present Scenario:

Tax Settlement Commission, a quasi judicial body, was set up under section 245B of Income-tax Act 1961 as a result of recommendations made by Direct Taxes Enquiry Committee with the objective of settling the tax liabilities in complicated cases avoiding endless and prolonged litigation and consequential strain on investigational resources of Income-tax Department. The Settlement Commission consists of a Chairman, Vice-Chairmen and Members.

ICAI Recommendation:

An ideal Settlement Commission should comprise of one representative from the revenue and one each from the legal and the accountancy professions like CMAs, CAs. The Members may be selected by inviting applications and following the due process of interviews in a transparent manner.

There has to be a minimum term of five years for serving as a member of the Settlement Commission. The scope of the Settlement Commission may be broadened wherein a once in a life time opportunity may be given to an assessee who comes before the Settlement and voluntarily pays the taxes.

10. Tax recovery measures in case of favourable court rulings

A. Tax Recovery

Present Scenario:

A taxpayer may adopt a position of no-taxation / low rate of taxation based on certain Tribunal/court rulings. However, the Tax authorities may have contested in further appeal, the judgements against them, before higher forum and hence do not take cognisance of the court rulings during tax assessments.

Payment of demand in such circumstances practically puts the tax payer in considerable hardship.

ICAI Recommendation:

The new law should provide that in case of favourable Tribunal / Court ruling, the tax authorities should take cognizance of favourable rulings and grant stay of demands. This will obliterate the need for taxpayers to keep knocking doors of Tribunals for getting stay of demands.

B. Penalties

Present Scenario:

Taxpayers at times resort to aggressive tax avoidance strategies to minimize tax costs

ICAI Recommendation:

The new law can provide stricter penalties for such wilful tax evaders, but at the same time incentivise honest taxpayers by providing certain privileges & respect to them.

11. Independent Committee to suggest amendment in tax law

A. Procedural

Present Scenario:

At times assessee and counsel fraternity face certain procedural hurdles. The bureaucracy is also subject to similar problems. For example, TDS or tax payment is made however, not appearing on site or some old demands though appearing on the site are erroneous. In return of income, although there is a small loss, the assessee does not want to claim it and carry it forward, the return form does not provide an alternative. There is no revenue implication. Both the parties want to address the issue. However, procedural hurdles do not permit the act or omission to be done.

ICAI Recommendation:

An independent committee consisting of representatives from the professional accountant like CMAs and CAs, tax administration, taxpayers, judiciary etc. should be constituted. This Committee will scrutinize suggestions on administrative reforms, relief, changes in forms, etc. received from various bodies on a concurrent basis.

After examining suggestions in detail, the Committee may suggest remedial action. The recommended action should be considered and forthwith implemented.

B. Substantive

Present Scenario:

There can be suggestions on issues of substantive matters, as well. Certain hardship, though unintentional or misdirected, may be faced by certain class of tax payers.

The Committee may be allowed to consider these suggestions, as well.

ICAI Recommendation:

After deliberating such suggestions in detail, the Committee may draft suitable change in law or propose a new piece of amendment. Changes and amendments of drafted by the Committee should be made public and debated. After public deliberations, the Committee shall revisit its proposal and forward it to the ministry duly modifying the same.

C. Changes by Government

ICAI Recommendation:

Where, income tax department or Finance Ministry, similar process may be tried in appropriate circumstances.

If this process is followed, substantial part of litigation will be reduced.

12. An ideal tax reform committee

ICAI Recommendation:

An Ideal Tax Reform Committee, should preferably be headed by a retired Judge of the Supreme Court or the High Court having experience of dealing with taxation matters as chairman. Former judges of the Income tax Appellate Tribunal, former Commissioner of Income tax (Appeals) can provide useful inputs on avoiding litigation.

Representatives from professional organisations like CMAs, CAs, trade associations, constitutional experts, economists, representatives from tax administration, etc. should constitute the remainder for the committee.

13. Continuous Review

ICAI Recommendation:

It is suggested that a permanent Committee should be set up. It should carry out research in development of law, loopholes noticed, difficulties faced, etc.

This Committee may invite suggestions from professional Institutes Bar Associations, eminent tax professionals and senior advocates who practice on direct taxes on certain specific issues.

There has to be on-going research to understand the implementation of tax law. This will result in quick response to the situation and developments.

14. Sum Up

The drafting of a new direct tax law for our Country requires members from different backgrounds who can think about the progress and vision of the country at least for another five decades or so. The law should be drafted in such a manner so that it spells out the objects behind the responsibility and duties expected of the taxpayers.

The Committee should prepare a draft report and publish it for public appreciation and comments. The draft law should be widely circulated for suggestions and such suggestions have to be carefully considered before the draft gets finalised.

There should be a reasonable time before a draft law or amendment is suggested and the enactment of such law.

PART 3: Substantive Law related suggestions

Here are some key suggestions/recommendations to make Income tax legislation/Act more efficient and tax payer/investor friendly.

These are broadly discussed as below.

- Tax Rates
- Corporate Restructuring
- General Anti-Avoidance Rule
- Taxation of digital economy
- International taxation
- Tax dispute resolution/prevention.

The details are as under:

A. Tax rates:

Present Scenario:

This may not be part of the Mandate of the Task Force but it would be good to bring Tax rates as part of Income tax Act (say in specific Schedule). This was one of the key recommendations in the draft DTC Bill, 2009. If implemented, this will obliterate the need to make changes in Finance Act every year and provide transparency and certainty.

Globally, tax rates in select countries are given below for a good comparison.

- USA - 15-20% (assuming US Tax code is overhauled)
- U.K. - 16% (will be reduced to this rate in near future)
- Singapore- 17%
- Hong Kong - 15%
- China - 25%.

ICAI Recommendation:

Irrespective of above, tax rates should be moderate to incentivise and promote investment climate - both domestic and foreign investments - By April 1, 2019 at the latest, the corporate tax rate should be reduced to 20-25% range with no surcharge, thus making effective tax rate in that bracket. This will also be in line with a 4 year path drawn by Honourable Finance Minister Mr. Arun Jaitley while presenting Union Budget of 2015.

With GST being successful, reduction in corporate tax rate can be a reality.

NON-CORPORATE

Present Scenario:

Individual - tax rate of max 30% appears to be very high as compared to the tax rate prevailing in other countries.

ICAI Recommendation:

The slabs need realignment and highest rate of 30% is recommended to brought down to 20%. Further the threshold limit of taxation slab should be escalated to ` 5,00,000 for normal citizen and ` 7,50,000 for Senior Citizen.

Partnership / Non Individual

For partnerships and other non-corporate entities, tax rate should be aligned with the corporate tax rate. This is because; small and medium income bracket tax payers from unorganized sectors form and run such entities.

ICAI Recommendation:

The existing rate of taxation on the profit of the corporate at the rate of 30% is significantly higher than the global standard and should be brought down to 20% to bring in parity among the tax rates prevailing in different countries.

DDT

Present Scenario:

Dividend distribution tax (DDT) is practically double taxation of the same income. Investors taking risk of capital can even loose the capital. If company earns income, entire tax liability is discharged. Mutual funds are also rendering useful service of being catalysts in investment field and capital building activities.

Thus, taxing dividend at the time of distribution is, in fact, a double taxation.

Further, certain shareholders are also required to pay tax on dividends earned by them. The reason cited is unnecessary benefit is conferred on them. Tax payers earning small income that is not liable to tax are not spared from tax on the similar considerations.

Where interest rates are receding, small and middle income groups are more relying on investments in shares and particularly, mutual funds. Senior citizens are also forced to this route on investments to meet the two ends. This sector of investment is not left only with the rich people now.

ICAI Recommendation:

Tax on Dividend need to be rationalized and it is proposed to be deleted. This would help the capital market to grow, open up the opportunity for investments by the common people in a channelized manner. This step will further risk based capital formation.

While tax on dividend is proposed to be deleted, related provisions like tax on distribution of income on units by mutual fund ,etc should also be abolished.

MAT, AMT

Present Scenario:

Profit-linked tax holiday is phased out and the focus of the government is more on providing investment-linked tax holiday. Levying MAT on companies takes away the benefits of providing the incentive- linked tax deductions. Given this MAT should be done away with in the new code. Alternatively, the MAT rate should be minimized for Businesses, domestic and international, would be keen to see what the new tax code has to offer.

Alternate Minimum Tax (AMT) practically denies tax incentives provided by the government on one hand. The incentive is provided for deserving caused. It gets confiscated by imposition of AMT.

ICAI Recommendation:

In view of moderate tax rates and phasing out of incentives, there is no need for Minimum Alternate Tax (MAT) and same should be removed. Removal of MAT will go a long way in incentivizing industry and reduce tax litigation on that count.

With the abolition of Minimum Alternative Tax (MAT) and AMT, the business segment would be getting a clarity about the rates and structure of taxation clearly and would be able to continue seamlessly. However, applicability of a lower rate of tax or a lower basis/lower tax base may be considered on a case to case basis and Advance Ruling Authority may look after any such issue.

STABLE TAX RATES

Present Scenario:

India is at the cusp of attracting huge foreign investments. The new code should ensure stability of tax laws in India to gain investor confidence. The new code should enable investors/ businesses to estimate tax costs with reasonable certainty.

The tax system should be brought in a clear structure of taxation of income from different sources and the slab of tax prevailing from time to time. A clear road map would make the entire process extremely transparent and clear before any investor intending to invest in India

Frequent change in tax rates becomes a hurdle for the entrepreneurs to make financial plans.

ICAI Recommendation:

Tax rates should be kept stable for 3-5 years and announcement should be made that these are the tax rates and we will not change it for 5 years unless there is some extraordinary condition like any natural calamity or war etc.

Tax Rates applicable to Corporate Assesseees which is prevailing at 30% need to be rationalized in line with international practice. It is recommended that a most revenue neutral affordable rate of approximately 20% may be adopted with applicability of surcharge in an exceptionally high PBT level.

NUMBAR OF TAXPAYERS

Present Scenario:

In India, number of tax payers is substantially less in comparison to the total population of the country. Despite witnessing a substantial expansion in the year 2017 in the number of taxpayers, further expansion of tax base is must and it will be achieved only through low/moderate tax rates.

Conscious efforts on field are called for in the direction of increasing number of taxpayers. This will enable sharing of tax burden and contributing to the exchequer in a meaningful manner.

Agricultural taxation is a distinct goal. However, through discussion, certain steps should be initiated.

ICAI Recommendation:

A clear roadmap and structured approach should be initiated for levy of taxes on Agricultural subject to certain exemption based on fixed benchmarks like Volume, economic transaction, demographical segmentation, etc. It is recommended that a more detailed tax base should be implemented for bringing in all and every person earning/receiving/accurring income in India whether from domestic transaction of cross border transaction.

ICDS

Present Scenario:

The corporate tax returns filed for the tax year 2016-17 was the first year with the applicability of Income Computation and Disclosure Standards (ICDS) and taxpayers have faced a lot of challenges in reporting the impact of ICDS in the corporate tax returns. Further, the Delhi High Court has struck down several provisions of the ICDS. Given this the government should reevaluate incorporation of ICDS in the new code, especially where they are in direct contradiction with well laid out principles & ratios of court rulings.

Again, the Finance Act, 2018 has provided legitimacy for the ICDS, notwithstanding Court rulings and that too with retrospective effect.

ICDS also complicate the understanding of common tax payers as so many standards are required to be addressed by Company law, the Institute of Chartered Accountants of India. Listed companies and large enterprises have to negotiate SEBI standards also.

The ICDS does not contribute to any positive development in ascertainment of business income. Courts have amplified and clarified various aspects of income computation.

ICAI Recommendation:

With the introduction of Ind-AS in India which brings in the best practices in the financial reporting standards, the published Financial Reports represents all necessary disclosures as needed by all the stakeholders, a further introduction of standards for taxation would only complicate the entire issue and make the assessment proceedings extremely complicated and subjective. ICAI recommends that instead of applying a separate tax standard/ICDS, the requirement for disclosure and tax treatment thereof in respect of each category of income and expenditure should be embedded within the relevant provision of the statute itself.

B. Corporate Restructuring

Present Scenario:

- Cross border Merger/demerger - Current provisions provide tax neutrality (capital gains tax and other benefits) for mergers, demergers and corporate restructuring under Section 47 e.g. Amalgamation/Demerger is tax free/tax neutral provided the amalgamated/resulting company is an Indian company. Considering outbound investments and cross border mergers now permissible (under Section 230-234 of Cos Act 2013), such cross border amalgamation/Demerger should also be tax neutral to align with Cos Act and FEMA i.e. the condition of amalgamated/resulting Company being an Indian company should be removed. This will facilitate cross border mergers/demergers/restructuring done for business reasons.

- Corporate Restructuring - Section 56(2) has been introduced in Income tax Act since almost a decade to curb tax avoidance practices in case of restructuring of closely held companies. Whereas the objective is laudable, it has created lot of hardships and obstacles in genuine corporate restructuring. In that light, Section 56(2)(viib) dealing with tax on issue of share capital to a resident at more than fair value should be deleted. Also section 56(2)(x) needs to be revisited for genuine business restructuring cases. Guidelines in this regard may be notified soon.

ICAI Recommendation:

With the intent of the global business practices and business entity entering into Indian business segment, the erstwhile restrictions, limitations of the existing provisions relating to carry forward of the losses, conditional approval etc. need to be dispensed with. The provisions of Section 72, 73 of the Income Tax Act relating to carry forward of the business loss should also be realigned towards ease out the difficulties in business restructuring, amalgamation merger process.

C. General Anti-Avoidance Rule (GAAR)

Present Scenario:

GAAR has been introduced in Income tax Act effective FY 2017-18 (AY 2018-19). Overall, the objective of GAAR is to prevent and penalize tax avoidance schemes. This is perfect. However, considering the past litigative approach of tax administration, there is a general apprehension that this may lead to fresh rounds of tax litigation. Surely, that's not the objective behind introduction of GAAR. The tax administration has issued FAQs dated 27th January, 2017 to understand GAAR. That is not sufficient. The Tax administration should come out with detailed guidelines and illustrative examples to explain GAAR. Guidance is available from global best practices, including from U.K.

ICAI Recommendation:

GAAR is considered as a restrictive measure and a limiting factor towards corporate growth and horizontal/vertical integration process in any business. While, international participation are well accepted and welcome in India, the applicability of GAAR provisions is recommended to be deferred for at least five years.

D. Taxation of Digital Economy

Present Scenario:

This is one of the burning tax subjects and introduction of equalisation levy (as a separate levy - not as income tax) has created lot of uncertainty. Also considering that foreign recipients are much more powerful, there is a strong possibility of passing on this burden to Indian payer thus increasing the cost to the Indian payer. Even if the same is borne by the foreign recipient, there is an issue of foreign tax credit to the recipient in home country. Though the current levy is on advertising revenues, the Tax Committee has detailed about 13 kinds of services wherein equalisation levy could be introduced. This is clearly not desirable and looks like a short term tax collection objective. It is recommended that equalisation levy may be removed. The payer may likely be subject to GST on a reverse charge mechanism basis and hence, it can lead to double taxation.

For past years before equalisation levy came into force, there is tax litigation on account of large cases like Google/other cases (royalty and permanent establishment issues). This flip flop approach creates uncertainty and the same needs to be addressed.

ICAI Recommendation:

Taxation of the cross border transactions including tax on deeming provisions like equalization levy need to be aligned and rationalized. It is recommended that unless specific identification of the accrual of income, expenditure which may deemed to be considered as income like advertisement in souvenir in a foreign country may not be considered as taxable income in India.

E. International taxation/Transfer Pricing

Present Scenario:

India has been one of the key contributors to the Base Erosion and Profit Shifting (BEPS) initiative of OECD/G20. There have been amendments in Income tax Act and renegotiation of few Tax treaties to align with BEPS objective. These include introduction of CbCR Report on transfer pricing, Master and Local files, limiting interest deductions on account of payment of interest to related parties, entering into Protocols to Tax treaties like Mauritius, Singapore, Cyprus to address treaty shopping/abuse, signing of Multi Lateral Instrument (MLI), etc.

Whereas these are good measures, some suggestions may be considered.

- With India signing MLI, there has been confusion on certainty around Tax treaties on Mauritius, Singapore, Cyprus, etc. The moot question is whether the revised Protocols signed under these Tax treaties be still valid post MLI. It may be a good idea to clarify on few of these issues.

- Also it would be appropriate to remove Place of effective management as a test for residence of a foreign company and instead introduce CFC in future as relevant. This will be in line with Action 3 of BEPS.

- The issue of taxation of indirect transfer of shares is still very litigate and hampers genuine global restructuring cases. Though few suggestions of Dr. Shome Committee have found its way in Income tax Act through changes in the Act/issue of clarifications, many have been ignored till date. It would be good to revisit all important suggestions e.g. Exemption for listed companies, 26% stake criteria instead of 5%, better clarity on FII/FPI taxation, etc.

- **Marginal Costing method** should be there for calculating Arm's Length Price.

For Example – I am manufacturing Bicycles, my Variable Cost is 600 and Fixed Cost is 400, the overall cost would be 1000. In India I am selling the bicycles for 1200 but in Foreign Country I am getting order for ` 800 per bicycle. My Indian market is not affected by this since I am earning 200. The provision is you cannot sell below cost, since the total cost is ` 1000 I cannot sell at 800. But here, the proper costing needs to be done and Marginal Costing Method should be recognized.

If Arms Length price is considered through Marginal Costing Method, a Cost Accountant should certify the cost calculated. Because this is under the domain of Cost Accountant and not any other profession.

Comparable Uncontrolled Price Method

Under the Rules, the CUP method is described as under:

- (i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;
- (ii) such price is adjusted to account for 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 price in the open market;
- (iii) the adjusted price arrived at under sub-clause (ii) is taken to be an ALP in respect of the property transferred or services provided in the international transaction.

Application of CUP Method

CUP method may be easier to use:

- In case of transfer of homogeneous items, such as traded commodities.
- Interest rates charged on loans between related parties which are dependent upon market quoted rates, etc.
- In case of transactions which are dependent on publicly available market quotations.

The reliability of the results derived from the CUP method is affected by the completeness and accuracy of the data used and the reliability of the assumptions made to apply the method.

Issues to be considered while applying CUP Method

The results derived from applying the CUP method generally will be the most direct and reliable measure of an ALP for the controlled transaction if an uncontrolled transaction has no differences with the controlled transaction that would affect the price, or if there are only minor differences that have a definite and reasonably ascertainable effect on price and for which appropriate adjustments are made. If such adjustments cannot be made, or if there are more than minor differences between the controlled and uncontrolled transactions, the CUP method would not be the most appropriate method to apply. In practice it is the most difficult method to apply due to paucity of publicly available data.

The reliability of the results derived from the CUP method is affected by the completeness and accuracy of the data used and the reliability of the assumptions made to apply the method.

Example 1 – Comparable sales of same product

DSM, a manufacturer, sells the same product to both controlled and uncontrolled distributors. The circumstances surrounding the controlled and uncontrolled transactions are substantially the same, except that the controlled sales price is a delivered price to the buyer and the uncontrolled sales are made F.O.B. DSM's factory. Differences in the contractual terms of transportation and insurance generally have a definite and reasonably ascertainable effect on price, and adjustments are made to the results of the uncontrolled transaction to account for such differences. In this case the transactions are comparable and internal CUP can be applied by comparing the prices of both, the controlled and uncontrolled transactions, albeit after subtracting the costs of transportation and insurance of the controlled transaction.

Example 2 – Effect of geographic differences

FM, a foreign specialty radio manufacturer, also exports its radios to a controlled U.S. distributor, AM, which serves the United States. FM also exports its radios to uncontrolled distributors to serve in South America. The product in the controlled and uncontrolled transactions is the same, and all other circumstances surrounding the controlled and uncontrolled transactions are substantially the same, other than the geographic differences. The geographic differences e.g. differences in purchasing power, levels of economic development, etc, in two different geographies, are likely to have a material effect on price, for which accurate adjustments cannot be made and hence the transactions are not comparable. Thus, CUP method cannot be applied.

Example 3 – External Commercial Borrowing

Pharma Ltd, an Indian company has borrowed funds from its parent company at LIBOR plus 150 basis points. The LIBOR prevalent at the time of borrowing is 4% for US\$, thus its cost of borrowings is 5.50%. The borrowings allowed under the External Commercial Borrowings guidelines issued under FEMA, for example, say is LIBOR plus 250 basis points, then it can be said that Pharma's borrowings at 5.50% is less than 6.50% and thus at arm's length.

In this connection, one may rely on Rule 10B(2)(d) which specifies that the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the laws and government orders in force.

However, when applying the CUP method, irrespective of whether an internal or external comparable is used, the circumstances of the two transactions must be comparable.

For such comparison to be useful, the relevant economic characteristics must be sufficiently alike.

ICAI Recommendation:

It is recommended that the most appropriate method being the best one under the existing situation should be considered for determination of appropriate value for Transfer Pricing. An audit/confirmation certificate should be obtained from any member in practice of the Institute of Cost Accountants of India in support of the claim about the reasonableness of the price with a complete study paper comprising detailed review and analysis of the documentary evidences in support of such price determination.

Resale Price Method

Under the Rules, the RPM is described as under:

- (i) 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;
- (ii) Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprises 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;
- (iii) 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;
- (iv) 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;
- (v) The adjusted price arrived at under sub-clause (iv) is taken to be an ALP in respect of purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

Application of RPM

The RPM is ordinarily used in cases involving distribution activity; i.e., the tested party purchases tangible products/ acquires services from related parties and resells the same to independent enterprises.

The use of RPM is appropriate where the reseller does not add substantial value to the goods through physical modification. Limited enhancements such as packaging, repacking, labelling or minor assembly ordinarily do not generally affect the use of RPM. The general principles being that the RPM may not be applicable if the reseller performs value added functions.

The RPM is more accurate where it is realized within a short time of the reseller's purchase of goods. The more time that elapses between the original purchase and resale, the more likely it is that other factors such as changes in the market, exchange rates, costs etc. will need to be taken into account in any comparison.

The RPM is ordinarily not used when the controlled reseller uses intangible property to add substantial value to the products. The other case where RPM cannot be applied is where the reseller alters the physical characteristics of the product.

The RPM focuses primarily on functional comparability and requires fewer adjustments to account for product differences than the CUP method.

This method requires detailed comparisons of functions performed, risks borne, and contractual terms of controlled and uncontrolled transactions. As a result, a higher degree of comparability is more likely to exist between controlled and uncontrolled resale of property by the same reseller (i.e., internal resale price comparable). In the absence of comparable uncontrolled transactions involving the same reseller, an appropriate comparison may be derived from comparable uncontrolled transactions of other resellers (i.e., external resale price comparable).

The RPM is unlikely to lead to accurate results if there are differences in:

- level of market; or
- functions performed; or
- products sold.

If there are material differences between the controlled and uncontrolled transactions that would affect the gross profit margin, adjustments should be made to the gross profit earned in the comparable uncontrolled transactions.

A reasonable number of adjustments may be made to compensate for the lack of comparability between controlled and uncontrolled transactions in:

- inventory turnover;
- contractual terms;
- transport costs; and
- other measurable differences.

The quality of data and assumptions are the most important factors in determining whether RPM is the MAM. The reliability of RPM analysis is heavily dependent on consistency in accounting practices, between the tested party and comparables that materially affect the margin. For example, differences in inventory valuation and other accounting practices would materially affect the gross profit margin. Further, the tested party and comparables should be consistent in the reporting of items (such as discounts, returns and allowances, rebates, transportation cost, insurance, and packaging) between cost of goods sold and operating expenses. The method relies on the financial reporting methodology adopted by the controlled and uncontrolled parties.

Issues to be considered while applying the RPM

The following issues should be considered while applying RPM:

- RPM is to be adopted only when goods purchased by the assessee from an AE are resold to unrelated parties.
- The gross profit margin to be applied may be either —
 - (a) that which accrued to the tested party from the sale of the same or similar property in an uncontrolled transaction; or
 - (b) that which accrued to an unrelated enterprise from sale of same or similar property in an uncontrolled transaction.
- The reference is to the gross profit margin derived from sale of same or similar property. The reference is thus to the overall gross profit margin earned by the tested party from such transactions.
- Adjustments have to be made also for accounting practices apart from functional and other differences. Some of the differences in accounting practices may be because:
 - (a) Sales and purchases have been accounted for inclusive of taxes or exclusive of taxes;
 - (b) Method of pricing the goods namely, Free on Board (FOB) or Cost Insurance Freight (CIF);
 - (c) Fluctuations in foreign exchange.
- As a general rule, it is expected that the gross profit margin would increase with increased risks, functions and assets.

Under the Indian Companies Act, there is no reporting requirement to report the gross profit of the companies. Thus, there is no consistency in the accountancy practices across the industry. The non-availability of gross margins of comparable companies from public databases is the biggest challenge in applying this method, and hence in practice this method is rarely used for testing the controlled transactions.

Example:

Situation

A Ltd. an Indian company purchases microwave ovens from its parent company situated in US. The same are sold to third party customers in India. The price of the microwave oven set is ₹ 9,000 and the same is sold for ₹ 12,000. A Ltd. also purchases washing machines from another company in UK who is not a related party for ₹ 10,000. The washing machines are sold to customers in India for ₹ 12,000. A Ltd. performs the same functions in case of both purchases of microwave oven and washing machines, that is reselling the goods to the Indian customers. Both the products are sold in the same market and in the same conditions.

Analysis

In this case A Ltd. has transactions with the US Company and the UK Company. The transactions with the US Company are controlled transactions and those with the UK Company are uncontrolled transactions. However, the functions performed in case of both type of transactions are same/similar, that is distributing the same to the third party customers in India without adding any value. Further, the product purchased from US Company and from UK Company are both consumer durables. Though the products need not be similar but the functions are similar and both products broadly fall within the same industry, (the white goods industry segment)

Hence, for the purpose of RPM, these transactions can be taken as the basis of comparison. The RPM for this product would be calculated as under:

	Microwave Oven (₹)	Washing Machine (₹)
Sale Value	12,000	12,000
Cost of Goods Sold	9,000	10,000
Other Expenses	1,500	1,000
Gross Profit (GP)	1,500	1,000
Gross Profit Margin (%)	12.5	8.33

In this case the gross profit margin in case of purchases made from related party is higher as compared to the margin in respect of purchases made from the unrelated party. Hence the controlled transactions are at Arm's Length.

ICAI Recommendation:

Resale Price Method should be determined with an appropriate computation of the product/service cost, applicable margin thereon and similar all other issues. It is recommended that the most appropriate method being the best one under the existing situation should be considered for determination of appropriate value for Transfer Pricing. An audit/confirmation certificate should be obtained from any member in practice of the Institute of Cost Accountants of India in support of the claim about the reasonableness of the price with a complete study paper comprising detailed review and analysis of the documentary evidences in support of such price determination.

Cost Plus Method

Under the Rules, the CPM is described as under:

- (i) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an AE, 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 referred to in sub-clause (ii) 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 cost 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 ALP in relation to the supply of the property or provision of services by the enterprise.

Application of CPM

The CPM is ordinarily used where:

- (i) Semi finished goods are sold between related parties;
- (ii) Contract/Toll Manufacturing arrangements;
- (iii) Long-term buy — and supply arrangements have been entered; and
- (iv) Services are provided.

When applying the CPM, attention should be paid to apply the third party comparable mark-up on a comparable cost. For example, if the supplier to which reference is made in applying the cost plus method in carrying out its activities

uses leased business assets, the cost basis may not be comparable without adjustment if the supplier in the controlled transaction owns its business assets.

The differences in the level and type of expenses should also be considered while applying the CPM.

The assets employed and functions performed by the parties have also to be taken into account while applying the CPM. However adjustments for efficiencies or inefficiencies of an enterprise may not be appropriate.

Appropriate adjustments should be made to ensure that there is accounting consistency between the controlled and uncontrolled transactions. The mark-ups must be measured consistently between the associated enterprises and the independent enterprises.

If the tested party employs valuable and unique assets, it would be difficult to apply this method, as comparables may not be available.

The application of CPM is less likely to be reliable if material differences exist between the controlled and uncontrolled transactions with respect to:

- (i) intangibles;
- (ii) cost structure;
- (iii) business experience;
- (iv) management efficiency;
- (v) functions performed; and
- (vi) products.

Some of the factors in respect of which adjustments may be required for application of CPM are:

- (i) Complexity of manufacturing or assembling;
- (ii) Manufacturing, production and process engineering;
- (iii) Procurement, purchasing, and inventory control activities;
- (iv) Testing functions;
- (v) Selling, general and administrative expenses;
- (vi) Accounting treatment of costs between controlled and uncontrolled transactions
- (vii) Foreign currency risks; and
- (viii) Contractual terms for example scope and terms of warranties provided, sales or purchase volume, credit terms, transport terms

Issued to be considered while applying the CPM

In this method, the direct and indirect costs of production are to be identified. The terms "direct" or "indirect" costs are however not defined. A reference may therefore be made to the industry practice.

In identifying and adopting the direct and indirect costs, the following factors would also have to be borne in mind:

- (a) utilisation of the plant; for example, if the plant has been under utilised the method of absorbing fixed costs may have to be suitably adjusted;
- (b) method of absorbing costs; absorption costing method is normally to be preferred;
- (c) in abnormal situations, marginal-costing principles may have to be applied; for example, substantial degree of under utilisation of plant facilities. Thus incremental costing or marginal costing can be used as a basis if the transactions represent a disposal of marginal functions.

Under the Indian Companies Act, there is no requirement to report distinctly the gross profits of companies. Thus, there is no consistency in the accountancy practices across the industry. The non-availability of gross margins of comparable companies from public databases makes the application of this method rare, and hence in practice this method is rarely used for testing the controlled transactions.

Example:

The example how CPM will work is explained below:

Indco, an Indian company, manufactures specialized stamping equipment for uncontrolled companies in the manufacturing industry using designs supplied to them by the arm's length parties. Indco realizes its costs plus a mark-up of 8% on this custom manufacturing. Under the arm's length agreements, costs are defined as the sum of direct costs (i.e., labour and materials) plus 50% of the direct costs. The additional 50% of direct costs is intended to approximate indirect costs, including overhead. Indco also manufactures stamping machines for its Chinese subsidiary, Chco, using designs supplied by Chco. Under the Chco agreement, costs are defined as the sum of the direct costs plus the indirect costs, including overhead is also computed at 50% of direct costs, and the mark-up earned is 10% of the direct and indirect costs.

The objective of this example is to illustrate that the cost base of the tested party and the comparable transaction must be expressed in equivalent terms.

Thus, it can be seen that the methodology for computing the mark up on cost of manufacturing is the same for both controlled and uncontrolled transactions, and hence the controlled transactions are at arm's length.

The cost plus mark up is calculated as follows:

Calculation of mark-up under the uncontrolled transaction

Direct costs	1,000
Indirect costs (50% * 1,000)	500
Total costs	1,500
Mark-up 8%	120

Calculation of mark-up under the controlled transaction

Direct costs	3,000
Indirect costs (50% * 1,000)	1,500
Total costs	4,500
Mark-up earned on controlled transactions at 10%	450

Calculation of arm's length cost mark up

Cost plus mark up from uncontrolled transactions	8%
Cost plus mark up from controlled transactions	10%

Thus the controlled transactions are at Arm's Length.

ICAI Recommendation:

Cost Plus Method should be considered as one of the most difficult and elaborated process wherein the price of the goods/services should be determined with reference to each element of cost, directly or indirectly, proportionately of apportionately being levied towards determination of the appropriate cost of the product/service towards bringing in a transparent basis for computation of transfer pricing. This would further added with an appropriate computation of the product/service cost, applicable margin thereon and similar all other issues. It is recommended that the most appropriate method being the best one under the existing situation should be considered for determination of appropriate value for Transfer Pricing.

An audit/confirmation certificate should be obtained from any member in practice of the Institute of Cost Accountants of India in support of the claim about the reasonableness of the price with a complete study paper comprising detailed review and analysis of the documentary evidences in support of such price determination.

Profit Split Method

Under the Rules, the PSM is described as under:

- (i) the combined net profit of the AE arising from the international transaction in which they are engaged, is determined;
- (ii) the relative contribution made by each of the AE 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 the similar circumstances;
- (iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (ii);
- (iv) the profit thus apportioned to the assessee is taken into account to arrive at an ALP in relation to the international transaction;

Application of PSM

The extent of economies of backward and forward integration, the existence of intangibles on both sides of the transaction, and complex functional and transactional structures may limit the use of standard approaches to economic analysis for transfer pricing purposes (i.e., performing comparable company searches to apply the TNMM). In those circumstances, the arm's length nature of transactions may better be evaluated by considering the transaction from an end-to-end perspective, and thus PSM can be applied.

One of the key differences between TNMM and PSM is that while the TNMM generally analyzes financials of one side of the transaction (the tested party, which is often the entity performing the simplest functions, assuming lower risks and that does not own valuable intangibles), PSM relies on an analysis of the combined profits of the transacting parties instead. The purpose of any profit split analysis is the allocation of combined profits. From a computational aspect, this method therefore requires the preparation of combined profit and loss and balance sheet statements.

This method can be used in situations where economies of integration differentiate the tested party from the comparables, provided these are taken into account in the principle for allocating profits. The method enables accounting for valuable intangibles being developed on both sides of the transaction. The allocation of profit can be calculated based on principles that take into account the contribution of intangibles in the industry's or the group's value creation process.

Finally, this method is also well suited to complex transactions where several entities are involved in the same functions and it is not possible to define precisely the scope of functions and responsibilities. While this method has not been widely used, it has been somewhat popular in the financial services industry.

The Indian TPR affirms that the PSM may be applicable mainly in the following cases:

- (a) Transactions involving transfer of unique intangibles;
- (b) Multiple inter-related international transactions which cannot be evaluated separately for determining the ALP of any one transaction.

Though there are a number of approaches for estimating the division of profits, two methods which have been discussed by the OECD Guidelines are :

- (a) Contribution Analysis
- (b) Residual Analysis

Under the contribution analysis, the combined profits, which are the total profits from the controlled transactions under examination, would be divided between the AEs based upon the relative value of the functions performed by each of the AEs participating in the controlled transaction, supplemented as much as possible by external market data that indicate how independent enterprises would have divided the profits in similar circumstances. In cases where the relative value of the contributions can be measured directly, it may not be necessary to estimate the actual market value of each participant's contributions.

Under the contribution analysis, the operating profit is to be combined and divided among the participants. The relative value of the contribution of each of the parties is to be determined by comparing the nature and degree of each party's contribution of different types (for example, provision of services, development expenses incurred, capital invested) and assigning a percentage based upon the relative comparison and external market data.

As recommended by the OECD, performing a contribution analysis based on a detailed analysis of functions, assets, risks, and variables used to divide combined profits among participants should be economically justified. Otherwise, the overall PSM may be confused with the global apportionment formula.

A residual analysis divides the combined profit from controlled transactions under examination in two stages. In the first stage, each participant is allocated sufficient profit to provide it with a basic return appropriate for the type of transactions in which it is engaged. In the second stage, any residual profit (or loss) remaining after the first stage division would be allocated among the parties based on an analysis of the facts and circumstances that might indicate how this residual profit would have been divided between independent enterprises. Use of unique and valuable assets possessed by the participants, extent of contribution of intangible property and bargaining positions are some of the indicators on which the profits may be divided in the second stage.

The residual PSM relies on a characterization of functions, risks and assets according to which "routine" functions are distinguished from non routine/entrepreneurial functions.

Routine functions are presumably relatively simple functions (that could be sub-contracted, for example). In terms of market structure, these functions are likely to correspond to perfectly competitive market structures, where there are no barriers to entry. These functions should require no valuable intangibles and involve limited risks. In this respect, they fit both with the conditions for the application of the TNMM and the availability of comparable companies' financial data. Entrepreneurial functions and/or risks on the other hand, involve financing the development of valuable intangibles and/or assuming substantial risks. Entrepreneurial functions fit well with the risk profile of investment centres, that is, profit centres in which responsibility is linked to the continuity of the business. These entrepreneurial functions would then be determinative of splitting the residual profits amongst the MNE group members.

There is no one way of determining the basic return or a division of the residual profits. The following may serve as a guide in undertaking a residual profit split:

- (i) One approach to residual analysis would seek to replicate the outcome of bargaining between independent enterprises in an open market;
- (ii) In some cases, an analysis can be performed, perhaps as part of residual profit split or as a method of splitting profits in its own right, by taking into account the discounted cash flow to the parties to the controlled transactions over the anticipated life of the business¹⁸;
- (iii) If there is a close relationship between cost and the value generated, the development expenditure to create the factors that gave rise to the residual profit or loss may also provide an indication of the relative contributions of the enterprises, and may in some cases be an appropriate basis for allocating the residual profit or loss;

- (iv) A systematic assessment of the relative values created by the factors that are not otherwise rewarded e.g., in some cases, the residual profit may be attributable to either an intangible shared between the enterprises or there may be several intangibles contributed by separate enterprises. These cases may require a systematic assessment of the relative contributions of each enterprise to the factors that give rise to the residual profit and have not been rewarded in the basis return.

The PSM has the following strengths and weaknesses

- (i) One of the strengths of PSM is that it relies more on internal financial data of the group and can be used in case where no direct independent comparables are available. However, external data from independent enterprises is relevant in the PSM to assess the value of the contributions that each controlled tax payer makes to the transactions, and not to determine directly the division of profit. The PSM therefore, offers flexibility of taking into account specific, possibly unique, facts and circumstances of the controlled tax-payers that are not present in independent enterprises. The greater the economic robustness of the principle for the allocation, the greater the explanatory power of the method.
- (ii) Another strength of PSM is that it takes into account all the parties of the MNE group involved in the transactions and analyzes the contributions made by the parties in respect of the intangible property employed for allocation of profits.
- (iii) Another strength of PSM is that it considers the business from an end-to-end perspective, and is thus akin to the real life situation and therefore more closely grounded to the economic realities of conducting business. The PSM may reflect how actually the profit pool is divided amongst a group of members, by factoring in each one's contribution to the common profit pool, as sometimes the MNEs group working is reflective of independent behaviour.
- (iv) One of the weaknesses of PSM is that the external market data considered in valuing contribution are less closely connected to the controlled transactions than in case of other methods. Further, to get an external data to value contribution itself creates an issue on applicability of PSM. This so, because the division of combined or residual profit, as the case may be, may not always be comparable to a third party outcomes.
- (v) An application of PSM will require measuring combined costs and revenues of all the parties in the controlled transactions, which would entail restating the books and records on a common basis and making adjustments in accounting practices and currencies.

The above strengths and weaknesses of PSM should be taken into consideration in determining whether PSM can be considered as a MAM given the facts and circumstances.

As MNEs are increasing their presence globally the valuable functions that are integral to the business are performed in a number of jurisdictions and are made available to the group or a business unit. Moreover, a large number of functions may not be performed in a few well defined centers but in many jurisdictions with significant intercompany transfers of tangible goods, services, and intangibles among them. In those cases, a large number of comparable searches would be required to produce transfer pricing documentation. In such a case, PSM may offer a solution to test the controlled transactions, whether they adhere to the Arm's Length Standard.

However, in practice, globally it is found that it is not feasible to apply this method.

Example explaining the application of PSM

An example of applying the profit split method under residual profit method is explained below:

Indco, an Indian company, has developed and manufactures a robot to be used for multiple industrial applications. The robot is considered to be an innovative technological advance. Chco, a Chinese subsidiary of Indco, has developed and manufactures a software programme which incorporates the new programme in the robot and makes it more effective. The success of the robot is attributable to both companies for the design of the robot and the software programme.

Indco manufactures and supplies Chco with the robot for installing of the new software programme for assembly and manufacture of the robot. Chco manufactures the robot and sells to an arm's length distributor.

In light of the innovative nature of the robot and software, the group was unable to find comparables with similar intangible assets. Because they were unable to establish a reliable degree of comparability, the group was unable to apply the traditional transaction methods or the TNMM.

However, reliable data are available on robot and software manufacturers without innovative intangible property, and they earn a return of 10% on their manufacturing costs.

The total profits attributable to manufacture of robots are calculated as follows:

Sales to the arm's length distributor		1,000
Deduct		
Indco's manufacturing costs	200	
Chco's manufacturing costs	300	
Total manufacturing costs for the group		500
Gross margin		500
Deduct		
Indco's development costs	100	
Chco's development costs	50	
Indco's operating costs	50	
Chco's operating costs	100	
Sub-total		300
Net profit		200
Indco's return to manufacturing (200*10%)	20	
Chco's return to manufacturing (300*10%)	30	
	50	
Residual profit attributable to development	150	

The split of the residual profit has been considered on the basis of the development cost considering the significance of technology in the manufacturing process.

Based on proportionate development costs

Indco's share of residual profit $[100/(100+50)]*150$	100
Chco's share of residual profit $[50/(100 + 50)] *150$	50

Indco's transfer price is calculated as follows:

Manufacturing costs	200
Development costs	100
Operating costs	50
Routine 10% return on manufacturing costs	20
Share of residual profit	100

Transfer price	470
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ICAI Recommendation:

Allocation of the cost and applicable profit thereon should be decided precisely. This method should be considered as one of the most difficult and elaborated process wherein the price of the goods/services should be determined with reference to each element of cost, directly or indirectly, proportionately of apportionately being levied towards determination of the appropriate cost of the product/services towards bringing in a transparent basis for computation of transfer pricing. This would further added with an appropriate computation of the product/service cost, applicable margin thereon and similar all other issues. It is recommended that the most appropriate method being the best one under the existing situation should be considered for determination of appropriate value for Transfer Pricing.

An audit/confirmation certificate should be obtained from any member in practice of the Institute of Cost Accountants of India in support of the claim about the reasonableness of the price with a complete study paper comprising detailed review and analysis of the documentary evidences in support of such price determination.

F. Tax Dispute Resolution/Prevention

Detailed guidelines and commentaries may be provided for all (or at least important ones) sections by CBDT to address tax payers' concerns and provide regulator perspective. Similar best practices may be drawn from say, US IRS. These should be binding on Revenue. This can act as a prevention more than getting into dispute as far as tax payer is concerned.

Advance pricing arrangement and advance ruling for non-residents have been very successful and have led to reducing disputes and providing certainty to tax payers.

Maharashtra VAT Model can be considered for settlements, advance ruling etc.

ICAI Recommendation:

It is recommended that a well-defined Advance Ruling Authority to decide proactively on any such issues along with a specific detailed rules should be prescribed. Each such application before ARA should be documented with

detailed of the issue in dispute, financial impact, fiscal impact and all these should be certified/verified by a member in practice of ICAI

Robust 'negotiated' tax amnesty may be introduced to settle past tax disputes. - Govt. of India and CBDT has been making substantial efforts in right direction to simplify tax laws and prevent/reduce/minimize tax disputes. Tax laws should be aligned with business realities and assist tax payers in better compliance which will lead to robust tax collections and assist in growth of the economy.

PART 4: Other suggestions

Taxation of Educational Institution, section 10(23C):

Present Scenario:

When the Govt. Grant to any educational institution exceeds 50% of the total receipts including any voluntary contribution to such institution during the previous financial year, the institution is said to be substantially financed by Government, such receipt is not included in the total income of such institution and is exempt from income tax. However, the Govt. is asking the institutions to be self-sufficient and lose the exemption.

Anyhow the institutions earn from sources other than Govt. Such as training programme, examination etc. and receipts from such other sources become more than 50% of total earning.

- 1) If an Institutions income from the outside sources are 60% and receipt of Govt. Grant is 40% of total receipt, the govt. grants are also being taxed.

Example: If university is earning 5 crore, 3 crore earnings are from non govt. sources and 2 crore are received as govt. grants then, the entire earning of 5 crore will be taxed as the earnings from non govt. sources are more than 50% of total earnings.

ICAI Recommendation:

The condition that substantially financed by Govt. condition shall be removed because if it is an educational society it will impart education and there should be no criteria for substantially financed by Govt. for claiming exemption

Imposition of Tax Liability:

Present Scenario:

Presently, all the sectors of the economy are not covered under taxation especially the unorganised sectors which is a major barrier to bring maximum population under the tax bracket.

ICAI Recommendation:

All sector should be covered, no sector should be immune from tax liability.

For Example: If a person has one Autorikshaw, the person has an idea about his lump sum income, so he can pay a certain amount of tax, it can be a minimal amount but paying tax will increase patriotism and accountability of the citizens for the country.

Presumptive tax can be extended to all the sectors including organised and unorganised

Income Tax Return:

ICAI Recommendation:

All income should be reported including exempted income. All incomes should be disclosed in the return including taxable and exempted

Capital Gain:

Present Scenario:

Presently 75% of wholesale indexation is taken care off.

ICAI Recommendation:

Instead of 75% it should be 100%. It should be 100% rise in wholesale indexation.

E-Assessment:

Present Scenario:

E Assessment should be high handed.

Various issues to be considered in E-Assessment:

1. Physical Verification of stock, fixed assets should be a provision in E-Assessment and it shall be done by the local professionals appointed by AO.
2. Voluminous documents (Purchase, sale) cannot be uploaded electronically. It shall also be checked physically by the local professionals appointed by AO.
3. Tampering and falsification of scanned documents shall be taken care off.
4. Application given in vernacular language by the people can be an issue in E-Assessment.

ICAI Recommendation:

A panel of Tax Practitioners may be created for locating the professionals who will be helping in handling the issues at local level. Professional Institutes like ICAI shall facilitate the jurisdictional panel. It will add to ease of doing business.

Tax Incentive Provision:

Present Scenario:

If manufacturing is done in backward area, exemption is given as a part of tax incentive. In GST such provision has been withdrawn.

ICAI Recommendation:

In direct tax also it should be withdrawn and instead a provision for subsidy shall be inserted.

Subsidy can be claimed by submitting relevant documents and those documents needs to be certified by a Cost Accountant.

Mark to Market Valuation:

Present Scenario:

In case of Mark to Market Valuation, appreciation of value of assets is being done.

ICAI Recommendation:

Unearned profit shouldn't be taxed.

Standard Deduction:

ICAI Recommendation:

Standard Deduction in case of 'Income of Salary' should be `60000 and it should be indexed so as to avoid every year consideration.

Section 14A:

Present Scenario:

As per Section 14A, expenditure incurred by taxpayer in relation to income which does not form part of total income at all as per the provisions of the Act should not be allowed as deduction while computing total income of taxpayer.

ICAI Recommendation:

Expenses are incurred for both taxable income and tax free income. Such expenses should be apportioned and the quantification of such expenses should be certified by a Cost Accountant if it is more than 1 crore and there should be a limit to avoid further litigation.

Prosecution:

ICAI Recommendation:

For prosecution, a threshold limit should be there and it should be decided by a high level committee (3 commissioners) + members of professional institutes like ICAI.

Financial Year

ICAI Recommendation:

To Change the current Financial Year to January-December. So that the companies having Multinational Business comes under the same page and need not reconcile their accounts twice

Certificate for E-Scrutiny:

ICAI Recommendation:

There is no jurisdiction for assessee, there is a jurisdiction for e-scrutiny, a certificate shall be issued for approaching a particular person.

Interest:

ICAI Recommendation:

- *Interest rate on tax payable and tax receivable should be uniform because interest is compensatory and both should be in tax bracket either deductible or receivable.*
- *Making PPF interest income taxable but the rate of interest should be at par with the market rate.*

E-hearing:

ICAI Recommendation:

To be implemented to reduce litigation and timings

Benefits to handicapped and disabled Assessee:

In case of handicapped person, the nature has already been unkind to them. We should be more considerate and their subsidy or exemption shall be increased.

Individuals suffering from disabilities are allowed certain income tax benefits. Section 80U and Section 80DD of the Income-Tax Act provide tax benefits to individuals and their family members with disabilities. An individual suffering from disability himself gets tax benefit under Section 80U, while an individual gets tax benefits under Section 80DD if any dependent family member of the individual is suffering from a disability.

According to Institute's view point by discussing with all India Direct Tax Experts, Section 80U provides deduction to an individual who is resident of India during the year and is suffering from physical disability as specified under this section. Deduction under section 80U is not available to NRIs. However, a foreign citizen who is a resident in India during the financial year for which deduction is to be claimed is eligible under this section.

For deciding the quantum of deduction, individuals with disability are categorized into two types depending upon the percentage of severability of diseases:

- Person with 40 % or more disability: If an individual is suffering with at least 40% of a disability, then he is eligible for a deduction of Rs 75,000.
- Person with 80% or more (severe) disability: If an individual is suffering with 80% or more disability, then he is eligible for a deduction of Rs. 1,25,000/=.
- Another issue is that the specific disabilities like Low vision, Leprosy-cured, Hearing impairment etc, which are covered under this section, were defined in "The Persons with Disability (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995". However, the same has been repealed by the newly-enacted law, i.e. 'The Rights of Persons with Disabilities Act, 2016' w.e.f. 28.12.2016.
- However, those diseases have not been recognized in the Income Tax Act. So, the advantage in real sense may not being provided to the deprived persons.

ICAI Recommendation:

It may be noted that this deduction can be claimed irrespective of the actual amount of expenditure incurred by the resident individual. However, considering the huge expenditure that requires to be incurred these days on medical treatment as well as other expenses required to keep such persons fit, these limits need significant revision in New Tax Laws.

Levy of Penalty

The taxpayer is paying Tax and filling return on good faith within deadlines in past few years but due to some exigency he/she may not file one return/payment of tax within time.

ICAI Recommendation:

Govt. should understand the exigency and keep one provision that if last five year there are proper filling of return and payment of Tax then Govt. will verify the reason of late filling or underpayment/non payment of Tax in the current F Y. If Govt. would found it unintentional or justifiable then Govt. should release the concern assessee from levying penalty.

Other Recommendations:

- *In case of salary, advance given by the employer on advance for medical treatment shall not be taxed as Tax Authority should take it sensitively and it's time to change the sentiment of Taxpayer towards tax administration.*
- *Subsidy given by Govt. should not be taxed. In certain cases income tax deduction of certain percentage from that particular subsidy amount may not fulfill the reason behind the subsidy. There is no point of giving subsidy if the concern person wouldn't use the amount full in right cause.*
- *Sec 207A - No discretionary power- penalty shall be maximum to the tax amount (100%) because generally discretionary power leads to corruption.*
- *PF/ESI liabilities provision for companies shall be amended. Institute is proposing discussion related to this topic.*
- *Allowing CSR Expenditure - The expenses like CSR expenses may be allowed in computing income from business to encourage taxpayers to assume more social welfare measures subject to certification of the expenses by a practicing Cost Accountant.*

Acronyms:

Serial No.	Acronyms	Abbreviation
1	DTC	Direct Tax Code
2	APAs	Advance Pricing Agreements
3	US	United States
4	US SEC	United States Securities and Exchange Commission
5	PCAOB	Public Company Accounting Oversight Board
6	USA	United States of America
7	CA	Chartered Accountant
8	CMA	Cost & Management Accountant
9	IFAC	International Federation of Accountants
10	CAPA	Confederation of Asian and Pacific Accountants
11	SAFA	South Asian Federation of Accountants
12	B- schools	Business Schools
13	GST	Goods and Services Tax
14	ICDS	Income Computation Disclosure Standards
15	UK	United Kingdom
16	WTO	World Trade Organization
17	UTs of India	Union Territories of India
18	PNB	Punjab National Bank
19	SBI	State Bank of India
20	C&AG	Comptroller and Auditor General
21	SMEs	Small and Medium Enterprises
22	MSME	Micro, Small and Medium Enterprises
23	CBDT	Central Board of Direct Taxes
24	ITR	Income Tax Return
25	CIT(A)	Commissioner of Income Tax (Appeal)
26	E- Bench of Supreme Court	Electronic Bench of Supreme Court
27	HC	High Court
28	Bom.	Bombay
29	CIT	Commissioner of Income Tax
30	TDS	Tax Deducted at Source
31	VAT	Value Added Tax
32	DDT	Dividend distribution tax
33	MAT	Minimum Alternate Tax
34	AMT	Alternate Minimum Tax
35	ICAI	The Institute of Cost Accountants of India
36	ICDS	Income Computation and Disclosure Standards
37	SEBI	The Securities and Exchange Board of India
38	Ind AS	Indian Accounting Standard
39	FEMA	Foreign Exchange Management Act
40	GAAR	General Anti-Avoidance Rule
41	FAQs	Frequently Asked Questions
42	BEPS	Base Erosion and Profit Shifting
43	OECD	Organisation for Economic Co-operation and Development
44	CbCR	Country-by-country reporting
45	MLI	Multi Lateral Instrument
46	CFC	Controlled foreign corporation

47	FPI	Foreign Portfolio Investor
48	FII	Foreign institutional investors
49	CUP	Comparable uncontrolled price
50	ALP	Arm's length principle / Arm's length price
51	FOB	Free on Board
52	LIBOR	London Interbank Offered Rate
53	RPM	Resale Price Method
54	MAM	Most Appropriate Method
55	AE	Associated Enterprise
56	CIF	Cost Insurance Freight
57	CPM	Cost Plus Method
58	PSM	Profit Split Method
59	TNMM	Transactional Net Margin Method
60	MNE	Multinational Enterprises
61	US IRS	United States Internal Revenue Service
62	PF	Provident Fund
63	ESI	Employees' State Insurance
64	Jan Dec	January – December
65	ARA	Advance Ruling Authority
66	E- Assessment	Electronic assessment
67	E- Scrutiny	Electronic Scrutiny
68	E-Hearing	Electronic hearing