



Newsletter

**Sharp View**

**April 2022**

**SHARP &  
TANNAN**

Assurance | Consulting | GRC | Taxation

Ahmedabad | Bengaluru | Chennai | Coimbatore | Delhi | Goa | **Mumbai** | Pune | Vadodara

# April 2022

April is the summer month of the year and in India it marks the beginning of the new financial year. The companies have closed their books of account and professionals are at the helm of the year end reviews and audits of their clients' businesses. April is the month of compliances of various laws and regulations of the financial year concluded in March.

## Compliance calendar for April 2022 (Key filings)

### Income Tax

7th	Deposit of TDS deducted for March 2022 by an office of the government
14th	Issue of TDS certificate (for February 2022) u/s 194-IA, 194-IB and 194-IM
15th	Quarterly Form 15CC - foreign remittances (to be furnished by authorized dealers)
	Monthly Form no. 3BB by stock exchanges for transactions in which client codes have been modified
	Form 24G - TDS without chalan by a government office
30th	Monthly chalan-cum-statement for TDS u/s 194-IA, 194-IB and 194M
	Monthly deposit of TDS by non-government assessee
	Half yearly statement - Form No 61 (particulars of transactions entered into without PAN)
	Quarterly uploading of TDS declarations received in Form 15G/15H
	Quarterly deposit of TDS under section 192, 194A, 194D or 194H.

### GST

7th	Monthly GSTR 7 - by the persons required to deduct TDS
	Monthly GSTR 8 - by the e-commerce operators required to deduct TCS
11th	Monthly GSTR 1 - by taxpayers having annual aggregate turnover of > INR 1.5 Crore
13th	Jan - March 2022 quarterly GSTR 1 under QRMP scheme
	Monthly GSTR 6 by Input Service Distributors
20th	Monthly GSTR 5 & 5A - by non-resident taxpayers and ODIAR service providers
	Monthly GSTR 3B - by dealers having annual turnover > INR 5 Crore

### ESI/PF

15th	Monthly ESI payment of Employees' State Insurance premium (ESI)
	Electronic Chalan cum Return (ECR) for e-payment of provident fund (PF)



# GRC

## FMCG Evolution in India

The FMCG sector is India's one of the promising sectors in terms of size, growth and market penetration. It comprises of packaged food and beverages, personal hygiene/care items, soaps, cosmetics, etc. Mr. Sajan Gour and Mr. Narayan Ravlani present how this sector has evolved and continues to develop on the background of consumer behaviour and government initiatives.



# GRC | FMCG Evolution in India

## Background

FMCG is the fourth-largest sector of the Indian economy. India's household and personal care is the leading segment in the FMCG market, accounting for 50% of the of total FMCG sales in the country. The sector grew by 36.9% in the Q1 of 2021 despite lockdowns in various parts of the country. Growing awareness, easier access and changing lifestyles are its key growth drivers. The FMCG market in India is expected to increase at a CAGR of 14.9% to reach US\$ 220 billion by 2025, from US\$ 110 billion in 2020.

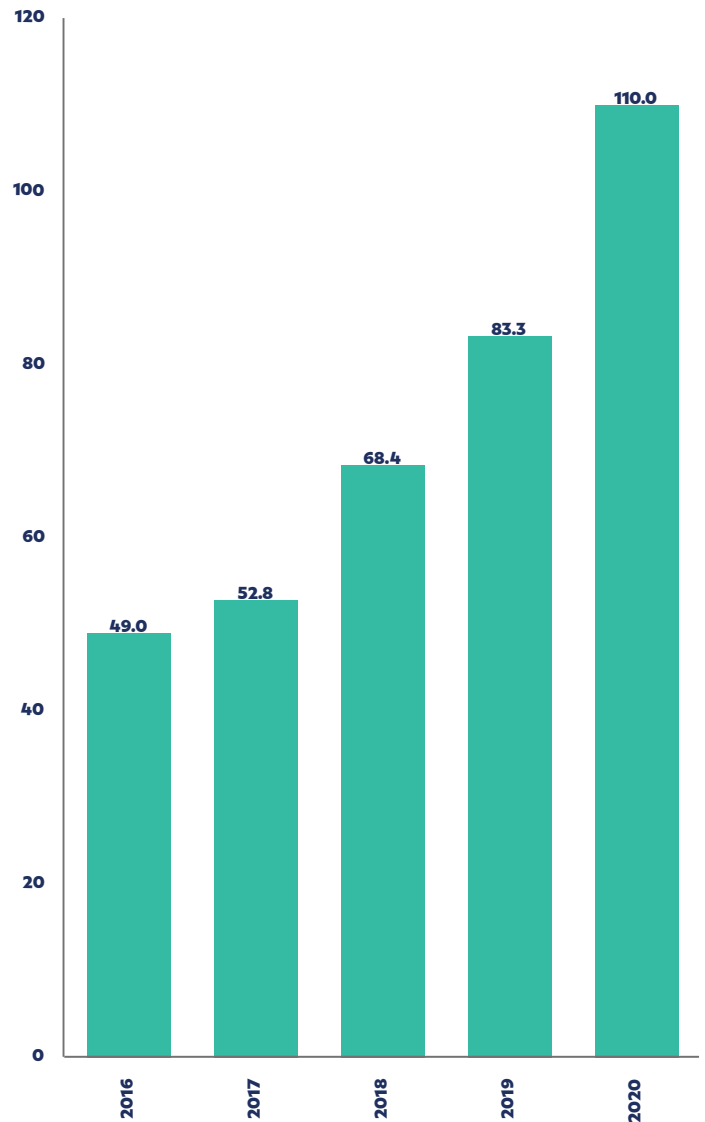
We discuss the sectorial highlights such as growth, foreign investments and the features of the PLI scheme of this sector.

## Strong Growth

- The FMCG sector's revenue reached US\$ 110 billion in 2020.
- In September 2021, rural consumption of FMCG increased 58.2% year-on-year (YoY); this is 2x more than the increase in the urban consumption (27.7%).
- The FMCG sector grew by 36.9% in the Q1 of 2021 despite lockdowns in various parts of the country.
- In June 2021, the month on month (MoM) growth in FMCG sales in urban and rural markets was 63.6% and 32.8%, respectively.
- The sector expects a revenue growth from 5-6% in FY21 to 10-12% in FY22.

- The sector will gain support for growth from Inland Waterways Authority of India's (IWAI) multi-modal transportation project of freight village at Varanasi, which will bring together retailers, warehouse operators and logistics service providers, and investment worth Rs.1.7 billion (US\$ 25.35 million).

Trends in FMCG revenues over the years (US\$ billion)



Source: [www.ibef.org.in](http://www.ibef.org.in)





Urban & Rural market – a comparative analysis

- Urban segment is the largest contributor (around 55%) to the overall revenue generated by the sector. Rural segment is rapidly growing with revenue share of 45%.
- In the last few years, the FMCG market has grown at a faster pace in rural India compared to urban India.
- Demand for quality goods and services is on an upward trajectory in rural areas on the back of improved distribution channels of manufacturing and FMCG companies.
- Number of households shopping on modern-trade channel grew by 29.15% YoY in the September 2021 quarter and shopping volume on the channel went up by 19.2% YoY.

- In the Q4 of FY21, e-commerce sales of Marico Ltd., Hindustan Unilever Ltd., Dabur India, ITC and Godrej Consumer Products Ltd. were 8%, 6%, 5%, 5%, and 4%, respectively, of the total FMCG sales.
- As of June 2021, e-commerce share touched 7-8% for some of the largest FMCG companies in the country.
- The gross merchandise value (GMV) of the online grocery segment in India is expected to increase 18 times over the next three years to reach US\$ 37 billion by FY25.

Growth in Online Users

- India’s increasing internet penetration and rising digital maturity along with developing infrastructure has helped boost the online transactions.
- The online FMCG market is forecast to reach US\$ 110 billion by the end of 2025.
- Around 72% Indian consumers are most likely to shop online locally for premium products.
- Many FMCG brands partner with e-commerce platforms such as Dunzo, Flipkart, Blinkit (former Grofers) and BigBasket to deliver products at the doorstep of consumers.

Growth in Online Users to drive Online FMCG Market



Source: www.ibef.org.in

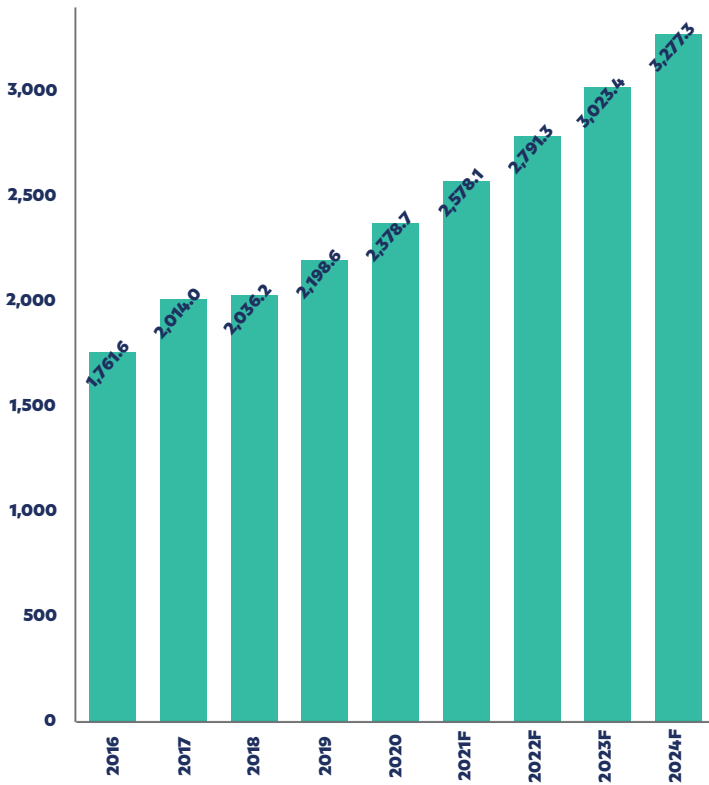
E - Estimated



**Higher Income leading to growth in urban and rural markets**

- Incomes have risen at a brisk pace in India and will continue rising given the country's strong economic growth prospects.
- This is evident in India's GDP per capita at current prices (expected to increase from US\$ 2,378 billion in 2020 to around US\$ 3,200 in 2024.)
- An important consequence of rising incomes is growing appetite for premium products, predominantly in the urban segment. Also, the increase in working population leads to higher per-capita income and spending on such products.

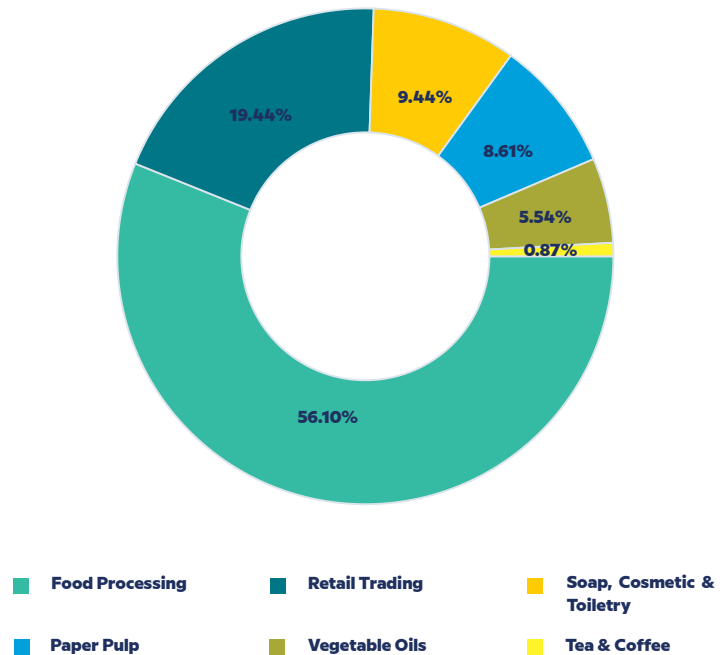
**GDP per capita at current prices (US\$ billion)**



**FDI inflows and investment**

- 100% FDI is allowed in food processing and single-brand retail and 51% in multi-brand retail boosting the employment and supply chains and will provide high visibility for FMCG brands in organised retail markets, increase consumer spending and encouraging more product launches.
- The sector recorded an FDI of US\$ 18.59 billion between April 2000 and June 2021.
- Investment worth Rs. 19,846 crore (US\$ 2.84 billion) have been made into the various FMCG Industries like paper pulp, sugar, fermentation, food processing, vegetable oils and vanaspati, soaps, cosmetics, and toiletries till December 2019.

**Cumulative FDI inflow share – from April 2000 to June 2021 (US\$ million)**



Source: www.ibef.org.in

Some major developments in Q2 of 2021:

- Apnaklub, a Bengaluru-based B2B wholesale marketplace for consumer goods, raised US\$ 3.5 million in a seed round from Sequoia Capital India's Surge, increasing the total funds to US\$ 5 million.
- Soothe Healthcare, an Indian personal hygiene products brand, raised Rs. 130 crore (US\$ 17.54 million) in a Series- C round of funding from A91 Partners.
- Adani Wilmar, a 50/50 joint venture between Adani Group and Singapore-based Wilmar, filed for initial public offering (IPO) to raise up to Rs. 4,500 crore (US\$ 607.13 million) for expansion.
- PepsiCo commissioned its Rs. 814 crore (US\$ 109.56 million) Kosi Kalan foods facility in Mathura, Uttar Pradesh; it is the company's largest greenfield manufacturing investment in India.
- Vahdam India, an Indian tea brand, raised Rs. 174 crore (US\$ 24 million) as part of its Series D round led by IIFL AMC's Private Equity Fund.



Government initiatives

Production Linked Incentive Scheme

The Production Linked Incentive Scheme (PLIS) proposes financial incentive to modernize and enhance competitiveness of the food processing industry by manufacturing specific categories of food products having high potential for growth in output and value addition.



Objective

The objective of the scheme is to support the creation of global food manufacturing champions; promote Indian brands of food products; increase employment opportunities for off-farm jobs, ensure remunerative prices of farm produce and higher income to farmers.



Product Segments

The scheme covers four food product segments viz. Ready to Cook/ Ready to Eat (RTC/ RTE) foods including millet products, processed fruits & vegetables, marine products and mozzarella cheese. Innovative / organic products of SMEs in these segments, including free range - eggs, poultry meat, egg products, are also covered.



Eligible Applicants

Applicants shall be (i) Proprietary Firm or Partnership Firm or Limited Liability Partnership (LLP) or a Company registered in India (ii) Co-operatives; and (iii) Small & Medium enterprises.



Tenure of the Scheme

The tenure of the Scheme is six years i.e. from FY 2021-22 to FY 2026-27.

Source: www.ibef.org.in

## Other government initiatives

### Concessions for Setting -Up of FPIS & Mega Food Parks in Hilly Areas:

Ministry of Food Processing Industries (MoFPI) has been implementing Central Sector Umbrella Scheme - Pradhan Mantri Kisan SAMPADA Yojana (PMKSY) since 2016-17 for the overall growth and development of the food processing sector, including the setting up of Food Processing Industries. Under the component schemes of PMKSY, special concessions are provided for setting up such industries and Mega Food Parks in the North Eastern States (including Sikkim) and difficult areas like Himalayan States/UTs, State notified Integrated Tribal Development Project (ITDP) areas and Islands. These concessions include lower eligibility threshold during evaluation and a higher rate of grants for selected projects.

### Aatma Nirbhar Bharat Package for Micro Enterprises

As part of the Aatmanirbhar Bharat Initiative, MoFPI is implementing a Centrally Sponsored PM Formalisation of Micro food processing Enterprises (PMFME) Scheme for providing financial, technical and business support for setting up/ up-gradation of 2 lakh micro food processing enterprises through credit-linked grant during five years from 2020-21 to 2024-25 with an outlay of Rs. 10,000 crores.

### GOI has newly-formed the Plant Based Foods Industry Association (PBFIA)

Due to the PBFIA sector's potential for explosive growth, the GOI plans to turn it into a key industry catering to both domestic and global markets through policy changes, capacity building, enabling ease of business and other interventions. The global plant-based food market is expected to reach US\$ 77.8 billion in 2025.

Flipkart MoU with the Ministry of Rural Development of the Government of India (MoRD) for Deendayal Antyodaya Yojana – National Rural Livelihood Mission (DAY-NRLM) programme to empower local businesses and self-help groups (SHGs) by bringing them into the e-commerce fold.

## Key Take Away

### Growth in FMCG Sector

- The FMCG sector is one of the promising sectors in terms of size, growth and market penetration. Increasing consumer awareness, changing lifestyles and easy access to FMCG products are the sector's key growth drivers. The acceptability of FMCG products is fast growing for the rural population due to the rising disposable income. Digital technology (e-commerce and payment systems) has further accelerated the consumption of FMCG products, which are largely in the nature of personal care, food, grocery, beverages, etc.
- The government initiatives through the FDI, PLI and other schemes ensure deeper penetration, a rise in consumers, maintaining competitive prices and assurance of the quality of the products nationally and internationally.
- Boost to the FMCG sector will positively impact agriculture, employment, and the related service sectors like transport, logistics, advertising, banking, etc.



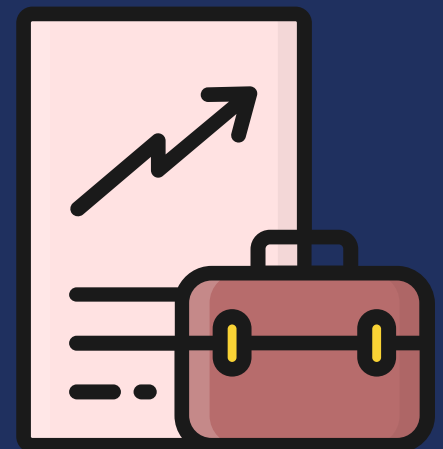




# Taxation

## Evolving jurisprudence on GST incidence on notice pay recoveries from employees

The Goods and Services Tax is leviable on the 'supply' of goods and services for 'consideration.' In order to attract GST, there must be a 'supply' and it should be for a 'consideration.' One such judicial issue before the assesses and the department is: whether the notice pay recovery of the salary by the employer from the employee attracts GST? While the revenue department attempts to tax this sum under GST, the assesses claim it to be otherwise. Mr. Shouvik Roy interprets the legal point behind the same while relying on judicial rulings.



## Introduction

The services by an employee to the employer in the course of or in relation to his/her employment have been kept out of the scope of 'services' since the erstwhile service tax regime. The said transaction has been kept out of the definition of supply even under GST as per Schedule III to CGST Act. However, the position is not the same in the reverse situation, i.e., services provided by an employer to the employee have not been excluded from the scope of service/supply and hence are taxable under GST. The most commonly raised issue regarding transactions between employer and employee is the levy of GST ( earlier service Tax ) on the recovery of notice pay by the employer.

## What is 'notice pay'?

- 'Notice Pay' is one of the terms in the employment agreement that essentially requires an employee to serve the notice period specified upon the termination of the contract. In case of failure, the employer is entitled to recover an amount/salary for the unserved notice period. While on the one hand, the revenue department claims the payment of such amount of notice pay is towards 'tolerating an act', which is a supply, on the other hand, the taxpayers claim such an amount to be in nature of liquidated damages (compensation) not constituting a 'consideration' for any supply whatsoever.

## Nature of notice pay under the Indian Contract Act

- Before studying judicial pronouncements under tax laws, understanding the concept of notice pay in light of the Indian Contract Act, 1872 (ICA) may be useful. The presence of consideration is *sine quo non* (essential ingredient) for taxing the said amount. Therefore, the distinction between 'consideration' and 'damages' is critical to determine the levy of tax on notice pay.
- 'Consideration' as per ICA takes the form of reciprocal promises or quid pro quo. Accordingly, consideration must be an exchange for something. On the other hand, 'damages' refers to a kind of compensation for loss or harm caused by a breach of contract. It is based on the concept of restitution. Liquidated damages as codified under Section 74 of the ITA are defined as 'compensation' expressed in the contract itself as a remedy for the breach of contract. It is essential to understand that liquidated damages are 'condition for contract' and not 'consideration for contract'.

## Scope of supply under GST

- With the advent of GST, the main taxable event is supply for consideration. The consideration is an essential ingredient of a supply, and consequentially, there shall be a clear nexus between consideration and supply to levy GST.



## Taxation | Evolving jurisprudence on GST incidence on notice pay recoveries from employees

- Clause 5(e) to Schedule II of the CGST Act treats 'agreeing to the obligation to refrain from an act, tolerate an act or situation, or do an act' as a supply of service. The said clause is a repetition of Section 66E(e) of the Finance Act, 1994, which has held such 'acts of tolerance' as 'Declared Services' under the service tax regime.
- It is worth noting that the term 'supply' under Section 7(1)(d) of the CGST Act formerly encompassed Schedule II activities under its scope. However, post its amendment *vide* CGST Amendment Act, 2018, transactions listed under Schedule II must first fulfil the pre-requisites of a supply in order to be leviable to GST.

### Evolving case laws

On the notice pay recovery, the revenue has been consistently alleging the applicability of service tax/GST under the erstwhile regime/current GST regime. Verdicts and judgments of higher appellate authorities in most of the cases are passed against the department's stand on this matter.

### Major judgments under the service tax regime

Citation	Forum	Verdict in Brief
<i>GE T &amp; D India Limited vs .Deputy Commissioner of Central Excise, LTU, Chennai</i>	Madras HC	Revenue claimed before the High Court that the Notice Pay amount would be subject to service tax since the petitioner had "tolerated the act of immediate resignation from service" by the employees.  The Court held that the employer had not given any service <i>per se</i> , much less a taxable activity. It is observed that employer had merely eased the employee's exit by imposing a fee on him for his abrupt departure.
<i>Rajasthan Rajya Vidyut Utpadan Nigam v. Commissioner for Central Goods and Services, Customs and Central Excise, Jodhpur I</i>	CESTAT DELHI	Court held that Notice pay is a fall-back option/ compensation in case of breach of contract and not the purpose of the employment contract. Consequently, notice pay <u>is not a consideration</u> for the contract but merely a condition in case a party fails to fulfil its obligation and does not constitute supply of service. Hence no service tax on the same.
<i>M/s HCL Learning Limited v. Commissioner of Central Goods &amp; Service Tax, Noida</i>	CESTAT Allahabad	Held that upon resignation, the employer can recover from his employee a portion of the salary that has already been paid. The Tribunal held that any such recovery by the employer is not taxable as requirements of service tax do not apply to salaries in accordance with Section 65B(44) of the Finance Act.
<i>Amit Metaliks Limited v. Commissioner CGST, Bolpur</i>	CESTAT Kolkata	It was held that payments received towards the compensation for non-performance of the contract will not fall under Section 66E(e) of the Act and hence not a service attracting service tax.
<i>Jaipur Jewellery Show v. CCE &amp; S.T., Jaipur-I</i>	CESTAT	The Tribunal decided on whether cancellation charges attract service tax liability. For the reason that no service was provided by the appellant, the cancellation charges recovered by the appellant were held not to be the consideration for providing business exhibition services.

# Taxation | Evolving jurisprudence on GST incidence on notice pay recoveries from employees

## Rulings under the GST Regime

Citation	Forum	Verdict in Brief
<i>Re: Bharat Oman Refineries Limited</i>	AAR	The Authority held that the GST is not applicable on payment of notice pay by an employee to the employer in lieu of notice period and observed that "merely because <i>the employer is being</i> compensated does not mean that any services <i>have been provided by him or that he has 'tolerated' any act of the employee for premature exit.</i> " Hence not taxable.
<i>M/s Emcure Pharmaceuticals Limited</i>	AAR	Held that the employee who chose to resign by paying a month's salary in lieu of notice did so in conformity with the contract, and there was no question of forbearance or tolerance. In addition, it was held that the employer played neither an active nor a passive role reciprocal to the resignation and payment of notice period wage by the employee. It was also highlighted that Schedule II does not apply to notice pay since the recovery does not amount to supply under the Act.
<i>M/s Amneal Pharmaceuticals Pvt Ltd</i>	AAR	AAR held that the GST is not applicable on the activity of collection of employees' portion of amount by the employer for notice pay, as no supply of goods or service was made by employer to its employees in this regard.

*In view of the above-mentioned decisions, the dominant conclusion that emerges is that 'notice pay' is not exigible to service tax/GST as no service whatsoever is provided by the employer for a consideration.*

## Inferences/conclusions considering the ICA provisions jointly with the tax laws

- It is an established legal position that GST can be levied on a taxable supply, and 'consideration' is a precondition to constitute a supply. On the other hand, claim for compensation or liquidated damages arises only in the event of a breach of a contract. Liquidated damages thus do not constitute 'consideration for a contract' but merely a 'condition for a contract.'
- Both the notice period and the compensation for the same are incorporated in the employment contract itself, but these are not the main objective of entering into the employment contract. Main objective is engagement for employment. Consequently, notice pay recovery is compensation for breach of the employment contract. Above all, payment of notice pay does not necessitate a *quid pro quo* transaction, unlike consideration. A contracting party may be compelled to fulfil certain contract terms such as payment of compensation, but this would not be tantamount to consideration. Therefore, notice pay is a 'condition for contract,' not a 'consideration for contract'. Hence GST cannot be levied on such recovery due to absence of consideration.
- Employers may therefore consider contesting this issue in higher appellate forums when faced with a demand from the revenue officers.



### Our Comments

In our opinion, the payment by the employer to the employee during the notice pay must not attract GST on the following grounds:

1. Notice pay is merely compensation/liquidated damage to the employer for an early exit and not a 'consideration' for the employment contract, as rightly laid down in the judicial pronouncements cited above.
2. The notice pay merely ensures some time margin available to the employer for finding a suitable replacement for the outgoing employee. The employee is bound by the rules of employment even during the notice period like normal working hours, employee code of conduct, availment of declared holidays, filling up of timesheets, reporting to the senior levels, etc.
3. The employer has the right to forfeit the notice pay salary if the employee fails to provide an advance notice of his leaving the organization.

Considering the above facts, the notice pay is merely an adjustment of certain incidental rights and obligations spelt out in the terms of employment and cannot be construed as a supply of service.







# Consulting

## Related party transactions (RPT) and Arm's length price (ALP) mechanism

The term related party has been widely regulated in India. Though the RPT are not prohibited, the law requires the companies to adopt certain safety measures while entering into RPT. Mr. Pramod Bhise discusses the various regulatory aspects of RPT under the Companies Act and the transfer pricing law.



## Introduction

The term related-party transaction refers to a deal or arrangement made between two parties who are joined by a pre-existing business relationship or common interest. Companies often seek business deals with parties with whom they are familiar or have a common interest. The Act (either Companies Act / Income Tax Act etc.) does not prohibit RPT. However, it lays down safety measures needed to follow while dealing with RPT.

Section 2(76) of the Companies Act, 2013 defines a related party with reference to a company, to mean:

- Director or a key managerial person or their relatives or
- A firm, private company in which the partner, director/ manager or his relative is a partner or
- A public company in which a director or manager is a director and holds along with his relatives, more than 2% of its paid-up share capital.

The definition also includes:

- A corporate entity whose Board of Directors, Managing Director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager, and
- Any person on whose advice, directions or instructions a director or manager is accustomed to act as related party transactions.
- A holding, subsidiary, or an associate company and an investing company or a joint venture of the Company.

RPTs are regulated by certain conditions as provided in Section 188 of the Companies Act, 2013, by the means of which they are to be disclosed to the Board and shareholders.

Under Rule 15 of the Companies (Meetings of Boards and its Power) Rules 2014; every related party transaction needs prior approval from the Board of Directors. Transactions that are on an arm's length basis– transactions when conducted as if the parties are unrelated so that there is no conflict of interest, do not fall under the ambit of Section 188 and require no Board or shareholder ratifications.

## Regulation of RPT under the Companies Act

### Role of Audit Committee in RPT

- Section 177 of the Act requires prior approval of Audit Committee for all the RPT including any subsequent modifications therein.
- The committee may also ascertain whether or not the transaction is an ordinary transaction and also determine the Arm's length for taking up the applicable approvals.
- The Audit Committee can also give omnibus approval to certain related party transactions.
- The committee shall consider the following factors while specifying the criteria for making omnibus approval i.e.

## Consulting | Related party transactions (RPT) and Arm's length price (ALP) mechanism

1. Repetitiveness of the transactions (in the past or in the future); and
2. Justification for the need for omnibus approval (on annual basis).
3. Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

### Other Important points

- Approval Mechanism:
  1. The Audit Committee shall approve the related party transactions or approve any modification to the related party transactions and forward the same for the consideration of the Board.
  2. The Board shall review the transaction at its meeting only.
- Interested Director: Should abstain from the meeting in which such discussions and approvals are made.
- Company should maintain the Register of Contracts/Arrangements in which directors are Interested.
- Disclosure in Board Report: Every contract or arrangement entered into by the company shall be referred to in the Board's report to the shareholders along with the justification for entering into such contract or arrangement in prescribed form.
- As SEBI Rules (effective April 1, 2022), a listed entity shall make RPT disclosures every six months in the format provided by SEBI.

### Consequences of non-compliance

(i) In case RPT was entered into by a director or any other employee without obtaining the requisite approval(s), such RPT needs to be ratified by the Board or Shareholders as the case may be within 3 months; otherwise, they have to bear the following consequences:

- Such RPT shall be voidable at the option of the Board /Shareholders.
- If such RPT is with a related party of the director or where it is authorized by any director, the director(s) concerned shall indemnify the Company against any loss incurred by it.
- Moreover, a company can proceed against such a director or any other employee for recovery of any loss sustained by it as a result of such RPT.

(ii) Any director or any other employee, who had entered into or authorized RPT in violation of the provisions of section 188 of the Act, shall be liable for a penalty:

- In case of a listed company: INR 25 lakh
- In case of any other company: INR 5 lakh

(iii) Any director convicted of an offence of dealing with RPT under section 188 will be disqualified from being appointed as a director in a company for a period of 5 years and will be liable to vacate the office of director.

### Types of Related Party Transactions (U/s 188 of the Companies Act, 2013)

Except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject

## Consulting | Related party transactions (RPT) and Arm's length price (ALP) mechanism

to such conditions as may be prescribed, no company shall enter into any contract or arrangement with a related party with respect to -

- i. Sale, purchase or supply of any goods or materials;
- ii. Selling or otherwise disposing of, or buying, property of any kind;
- iii. Leasing of property of any kind;
- iv. Availing or rendering of any services;
- v. Appointment of any agent for purchase or sale of goods, materials, services or property;
- vi. Underwriting the subscription of any securities or derivatives thereof, of the company;
- vii. Such related party appointment to any office or place of profit in the company, its subsidiary or associate company.

### Regulation of RPT under the Income-tax Act

#### Determining the Arms' Length Price of the Transaction

Determining the real value of the transactions between the related parties has always been a matter of great concern for the revenue authorities and other stakeholders of the businesses. This is due to the reason that such transactions are highly prone to tax avoidance, tax evasion, shifting of profitability from one related entity to the other related entity, etc.

Therefore, there are various laws and regulations implemented by various authorities at various levels to curb the mischiefs or negative impact on the operations of the business entities in the interest of various stakeholders, which has evolved over the time and implemented to constantly keeping checks on the business entities or groups so that no undue advantage is taken by these entities being the related parties who can control the transactions amongst themselves.

Chapter X pertaining to Transfer Pricing provisions under the Income-tax Act, 1961 deals in great details in arriving at the Arm's Length Price. These methods are summarized as under:

**i. Comparable Uncontrolled Price (CUP) Method:** This method is applied when price is charged for a product or service. This is a comparison of prices charged for the property transferred or service provided in a controlled transaction to a price charged for property or services transferred in a comparable uncontrolled transaction.

**ii. Resale Price Method (RPM):** This is applicable when property is purchased or services are obtained from associated enterprises and the same are sold to unrelated enterprises. This is based on the price of a property or service purchased or obtained from an associated enterprise and further resale of the same to unrelated enterprise.

**iii. Cost Plus Method (CPM):** This method is applicable where some semi finished goods are sold between related parties or similar situations or in respect of joint facility agreements, long term buy and supply arrangements of provisions of services.



## Consulting | Related party transactions (RPT) and Arm's length price (ALP) mechanism

iv. **Profit Split Method (PSM):** This method is applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the Arm's length price of any one transaction.

v. **Transaction Net Margin Method (TNMM):** Under this method, the net profit margin realized by an associated enterprise from a related party transaction is computed in relation to a particular factor such as costs incurred, sales, assets utilized, etc. The net profit margin earned by an associate enterprise is compared with net profit margin of uncontrolled transactions to arrive at Arm's length price.

vi. Such other methods as may be prescribed by the CBDT. This is a residual method.

We will discuss the various transactions and documentation required to arrive at the ALP:

Type of Transaction	Documents required for Justification for ALP (List is not exhaustive)
Sales of Goods and Services	<ul style="list-style-type: none"><li>• Valid Sales Order.</li><li>• Document justifying the competitive sales prices like copies of the invoices of material sold to other un-related parties at competitive rates / lower rates.</li><li>• Details of any volume discounts or other benefits receivable in future can be documented.</li><li>• Payment terms, lower credit period, previous payment history, risk on bad debts etc. can be pointers for selling goods / rendering services to related parties.</li><li>• Comparative of Profit earned with the peers in the market (TNMM). TP Study Report prepared for earlier year for domestic and international transactions (Mandatory under Income Tax Act).</li><li>• Any other appropriate document to justify the ALP.</li></ul>
Purchase of Goods and Services (including capital goods)	<ul style="list-style-type: none"><li>• Valid Purchase Order.</li><li>• Quotes from the other vendors (non-related) for the same goods (quality, grade etc.) – Minimum 3 quotes.</li><li>• Justification letter / note for buying from related party if quote not available from un-related party specifying reasons considering the various aspects like size, volume of purchases, availability, urgency, transportation etc.</li><li>• If customer approved supplier, then specific letter document in this regard.</li><li>• Quality of the product and services, payment terms, higher credit period, warranty claims processing, after sales services etc. can be justification pointers for purchasing the goods / services from the related parties.</li><li>• If Intellectual Property Rights (IPR) / Confidentiality or sensitive nature of issues, then letter / note from higher authorities with justification.</li><li>• Copies of email exchanged with the parties and approval of higher authorities (without compromising on the confidentiality of the contract, sensitive data etc.)</li><li>• In case of payments of royalty, ensure following:<ol style="list-style-type: none"><li>i. Appropriate agreement is executed and is registered (if required by law),</li><li>ii. The agreement is as per applicable laws (FEMA, RBI Rules etc.),</li><li>iii. The transfer of technical know-how is properly documented,</li><li>iv. The data from licensor about royalty charged to other non-related parties,</li><li>v. Benefits availed by the company by use of technical know-how and brands etc.</li><li>vi. If company charges royalty to its customers, then the rates are comparable of royalty paid and royalty charged.</li><li>vii. Compliance with the withholding tax provisions (if applicable).</li></ol></li><li>• Any other appropriate document to justify the ALP.</li></ul>



Type of Transaction	Documents required for Justification for ALP (List is not exhaustive)
Investment, Advances and Others like interest on loan etc.	<ul style="list-style-type: none"> <li>• 'Minutes of Investment Committee' approving all investments and Advances, should be kept handy for noting the justification for investments in related parties.</li> <li>• The audited accounts on investee Company should be kept on records.</li> <li>• Net worth, profitability, dividend history, strategic alliance, special purpose vehicles etc. can be a good pointers for the said justification.</li> <li>• Regarding the Advances given, the document making this business case should be kept on record to justify the advance.</li> <li>• Existing Policy of the company for Interest on Loans i.e. SBI Rate + (as resolved by the BOD/ Investment Committee) should be followed, any deviation from the same should be substantiated with proper working.</li> <li>• For loans in Foreign exchange Libor + % should be documented.</li> <li>• Any other appropriate document to justify the ALP.</li> </ul>
Rent (Lease of immovable Property)	<ul style="list-style-type: none"> <li>• Quotes from unrelated parties for leases given / taken to be maintained. Also communications (emails, letters etc.) should be kept on record to document the negotiations.</li> <li>• Copies of agreements to be kept on records. Preferably, the registered agreements should be made in all the cases.</li> <li>• Alternatively data / rates from the public domain like Magicbricks.com / No Broker.com or other corporate property brokers etc. should be obtained to substantiate the lease rent charged / paid to related parties.</li> <li>• In case of lower rents inflows (or higher rent outflows), justification should be made considering other term like convenience of location, quantum of deposit amount, bearing of maintenance cost, period of the lease agreement, brokerage amount etc.</li> <li>• Any other appropriate document to justify the ALP.</li> </ul>
Re-imbursement of Expenses (payable / receivable)	<ul style="list-style-type: none"> <li>• All Re-imbursement at cost to cost should be strictly backed up by the cost working, invoices for the expenses and / or any other valid / appropriate documents.</li> <li>• Many times the reimbursement are done with cost + markup % to cover the administrative costs.</li> <li>• This markup % should be reasonable and uniform while charging the expenses and also while accepting the expenses claims from related parties.</li> <li>• Appropriate analysis should be made to justify the markup % considering the term like volume of transactions, economies of scale, credit period, cash outflow and interest costs, bearing of GST debits and / or credits, TDS compliances etc.</li> <li>• Any other appropriate document to justify the ALP.</li> </ul>

### Transfer pricing policy

To regulate and also to justify the ALP, it is strongly advised that all organizations have a well-documented and robust transfer pricing policy. Transfer pricing policy should provide guidelines on how prices are or will be set for related party transactions. The aim of a good 'Transfer Pricing Policy' is to ensure that everyone within the organization is 'on the same page'. Moreover, it should demonstrate that pricing has been considered and implemented correctly, creating a record for internal and external stakeholders.

This policy can generate significant commercial benefits, especially if the same is tailored to the unique footprint of a multinational entity. These benefits include:

## Consulting | Related party transactions (RPT) and Arm's length price (ALP) mechanism

- Minimized disputes with tax administrations (reduced TP adjustments, reduced internal resources allocated to audits and reduced spend on adviser fees);
- Minimized leakage (e.g. reduced TDS and PE challenges and adjustments);
- Good revenue enhancement tool and good cost control measure.
- Competitive advantage over rivals through proper costing and pricing, etc.

### Conclusion

In order to protect the interest of stakeholders not involved in the day-to-day operations and decision making and for maintaining transparency in business, transactions with Related Parties shall continue to be under scrutiny and regulation in the future as well. While RPTs in a company are unavoidable, the management and auditor must ensure that the financial statements must be, in substance and form, beyond any suspicion.



## Ahmedabad

A2-807, "Palladium", Near Vodafone House,  
Corporate Road, Prahalad Nagar,  
Ahmedabad - 380015.  
Phone: (91) (079) 2970 2082.

## Bengaluru

103, Midford House, 1, Midford Gardens  
Bengaluru 560 001.  
Phone: (91) (80) 2555 0987.

## Chennai

Parsn Manere, A Wing Third Floor,  
602 Anna Salai, Chennai 600 006.  
Phone: (91) (44) 2827 4368, 2822 9534.

## Coimbatore

09, Verivada Street, Redfields,  
Pase Course, Coimbatore 641 045 .  
Phone: (91) (422 ) 427 4500.

## Goa

SF-9 , 2nd Floor , Block A Palmer Premises  
Holders Co-op Soc Journalist Colony Road  
Bardez Goa 403 521.  
Phone: (91) 9820284854.

## Mumbai - 1

Ravindra Annexe 194, Churchgate  
Reclamation Dinshaw Vachha Road,  
Mumbai 400 020.  
Phone: (91) (22) 66338343 to 8347.

## Mumbai - 2

87, Nariman Bhavan, 227 Nariman Point  
Mumbai 400 021.  
Phone: (91) (22) 6153 7500 / 2202 2224 / 8857.

## New Delhi

205-207 Ansal Tower 38,  
Nehru Place, New Delhi 110 019.  
Phone: (91) (11) 4103 2506, 4103 3506.

## Pune

802 Lloyds Chambers , Dr. Ambedkar Road  
Opp. Ambedkar Bhavan, Pune 411 011.  
Phone: (91) (20) 605 0802.

## Vadodara

8th Floor, West Wing Aurum,  
Behind Vasna HP Petrol Pump, Makrand  
Desai Road, Vadodara - 390.007.  
Phone: (91) 97268 95000 / 97278 95000.

# 2022

Learn more at: [www.sharpandtannan.com](http://www.sharpandtannan.com)

Social Media

in

**SHARP &  
TANNAN**