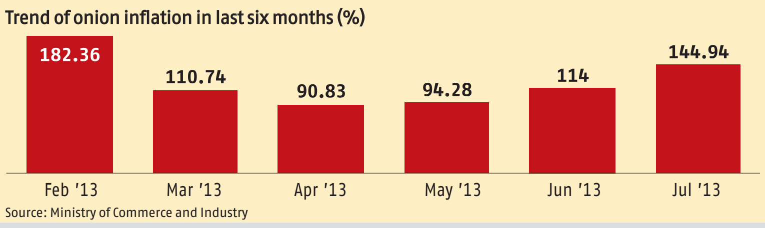
NEWS IN NUMBERS

Inflation of onion

Onion prices have soared to unprecedented levels in the last couple of weeks. In Mumbai and Delhi, the prices surged to ₹70 and ₹60 a kg, respectively, making Delhi Chief Minister Sheila Dikshit ask the Centre to stop onion exports immediately. During April–July, export of onion stood at 639,000 tonnes, against 694,000 tonnes in the corresponding period last year, according to official data



Source: Ministry of Commerce and Industry

"... we must have growth but it must be inclusive and sustainable. If that means we may have to sacrifice some growth, so be it"

FINANCE MINISTER P CHIDAMBARAM

FinMin proposes rules to reduce MNC tax litigation

BS REPORTER
New Delhi, 14 August

After a year of a record rise in transfer pricing disputes between the income tax department and multinational companies, the finance ministry on Wednesday announced a set of draft 'Safe Harbour Rules', detailing the circumstances in which the price declared by the taxpayer for cross-border transactions with an associated company would not be questioned.

The proposed rules, put up on the tax department's website for seeking comments, are broadly based on the recommendations of N Rangachary committee constituted by the Prime Minister in July 2012.

Companies are often suspected by the tax department of undervaluing the sale of goods and services to their foreign subsidiary to reduce profits and tax liability in India.

The rules are proposed to apply to six sectors—information technology, IT-enabled services, contract research & development in IT and pharmaceuticals, financial transactions-outbound loans, financial transactions-corporate guarantees, and automobile ancillaries-original equipment manufacturers.

To be applicable for the two assessment years beginning 2013-14, the rules will not apply to international transactions carried out with an associated enterprise in a tax haven.

"A taxpayer opting for safe harbour rules would not be allowed to invoke the Mutual Agreement Procedure provided under double taxation avoidance agreements," said revenue secretary Sumit Bose. He said the rules were expected to bring down litigation by providing certainty to taxpayers.

In the case of software development services and IT-enabled services where the total value of international transactions with the MNC parent does not exceed ₹100 crore, tax officials would not question the income of the Indian unit if the operating profit margin declared is 20 per cent or more. However, if less than 20 per cent, questions may be asked.

The safe harbour for knowledge process outsourcing firms and contract R&D relating to software development is prescribed at 30 per cent. It is 29 per cent for contract R&D of generic pharmaceutical drugs. It is 8.5 per cent for manufacture and export of non-core automobile components and 12 per cent for core components.

S P Singh, senior director at Deloitte Haskins & Sells, said the percentages proposed seem to be on the higher side. He said for IT and ITeS companies which form a major chunk of transfer pricing cases, the ideal rate should be in the range of 14-15 per cent.

The finance ministry has put a provision that if a loan is given by an Indian company to its group company outside India and the loan amount is less than ₹50 crore, the rate of interest should be equal to or greater than the base rate of State Bank of India plus 150 basis points. Singh said this was not in line with several decisions of the tax tribunals, which usually consider the Libor-dependent rate. The higher rate could become a sort of benchmark for loans.

Bishakha Bhattacharya, director of government relations at Nasscom, the IT sector's apex association, said they'd recommended a percentage between 12-14 per cent. "It's difficult to say right now if 20 per cent is too high, as we will have to see what the document proposes in terms of relief from audit, etc," she said.

"To positively impact dispute resolution, the margins or safe harbour rules might need to be recalibrated to a more acceptable zone. The exclusion of companies with turnover in excess of ₹100 crore would limit the number of takers for safe harbour. The high safe harbour for automobile components and corporate guarantees might dampen the acceptability," said Vijay Iyer, partner, EY.

Oil ministry mulls higher dose of diesel price increase

BS REPORTER
New Delhi, 14 August

The Union government is considering oil marketing companies' (OMCs') demand to increase diesel prices by more than 50 paise a month.

To eliminate OMCs' losses due to selling diesel below the market price, the government on January 17 had allowed phased decontrol of diesel prices, with a monthly dose of 50 paise. Although the underrecovery had come down to ₹3.8 a litre in May, the rupee's fall and rise in international prices pushed it up to ₹9.29 a litre as on August 1.

According to ministry sources, Indian Oil Corporation (IOC), Bharat Petroleum Corporation (BPCL) and Hindustan Petroleum Corporation (HPCL) have been repeatedly asking for a higher dose of monthly diesel price increase.

Petroleum Minister M Veerappa Moily told a news channel on Wednesday that the government was considering OMCs' proposal to increase the diesel price by more than 50 paise a month.

The fall in the rupee had impacted the underrecoveries of OMCs, largely in the last couple of months, as the currency was hovering above the ₹60 mark.

A ₹1 fall in the rupee would cost the OMCs ₹9,000 crore a year in the form of underrecovery, while every $1 increase in crude oil prices would add another ₹5,000 crore annually to the subsidy burden.

At current exchange rate, the underrecovery is likely to increase by at least another ₹60,000 crore, taking the figure to above ₹1.3 lakh crore. This is much higher than the ₹80,000 crore expected by the Centre during the beginning of the year, when the exchange rate was around ₹54. Diesel prices have been raised six times since the decontrol measures were adopted in January.

The government had also introduced dual pricing of diesel for bulk and retail customers in January. This was to save ₹12,907 crore from the subsidy burden, through which bulk customers such as defence, railways' and state transport utilities had to pay at the market price.

"The overall bulk market was nine million tonnes and we had around 78 per cent share in this. Since January, around 38 per cent of bulk customers have shifted to the retail platform. Of this, 50 per cent have shifted to IOC retail outlets," said R S Butola, chairman of IOC.

On Wednesday, Moily confirmed there would be no revision in prices of liquefied natural gas (LPG) and kerosene for the moment. The under-recovery on subsidised LPG now stands at ₹411.99 a cylinder, while that on kerosene stands at ₹33.54 a litre.

Musical chairs in PetroMin isn't new

JYOTI MUKUL & SHINE JACOB
New Delhi, 14 August

Since M Veerappa Moily assumed charge at the petroleum ministry, his decisions, especially those on Reliance Industries, have been closely followed by whistle-blowers.

Recently, Communist Party of India leader Gurudas Dasgupta wrote to Prime Minister Manmohan Singh on the reallocation of work within the ministry, following secretary Vivek Rae and joint secretary Giridhar Aramane proposing the order of the Cabinet Committee on Economic Affairs on a gas price rise be kept on hold. Despite Dasgupta blowing the whistle, Moily has fine-tuned the work allocation, and a final order on the matter was issued by an under-secretary on Wednesday.

Now, Aramane wouldn't be handling gas pricing, coal bed methane and shale gas and gas hydrates, though he would continue to look after exploration and production. Traditionally, the charge of gas pricing has been held by the joint secretary, exploration and production. This is because gas pricing is governed by the production-sharing contracts signed between the government and operators of oil and gas blocks. The pricing of gas produced from nominated blocks under the administered price regime was under the gas division.

Though Moily's order says the move is aimed at greater synergy, Dasgupta, in his letter to the prime minister, has likened the move to the suspension of Durga Shakti Nagpal, a sub-divisional commissioner in Noida, by the government in Uttar Pradesh.

Moily's predecessor, Jaipal Reddy, had carried out his own share of changes. He had S Sundareshan, then secretary in the ministry, moved to the heavy industries ministry. Reddy was understood to have told the Prime Minister's Office he wasn't comfortable with Sundareshan. Apurva Chandra, joint secretary (natural gas and marketing), was summarily asked to move out; he had to be accommodated in the human resource development ministry.

Shifting officials due to controversies has always made headlines, especially at the local and state levels. But often, such changes within the central government go unnoticed. With corruption charges flying high, bureaucrats are increasingly standing up to ministers.

INFLATION TRACKER

July WPI inflation at 4-month high of 5.79%

BS REPORTER
New Delhi, 14 August

Driven by vegetables, wholesale price index-based inflation again moved out of the comfort zone of the Reserve Bank of India to stand at 5.79 per cent in July against 4.86 per cent in the previous month. The rate was 7.52 per cent in July 2012.

Fuel prices also showed a rise in inflation and manufactured items saw a bit of increase in the rate of rise over the period.

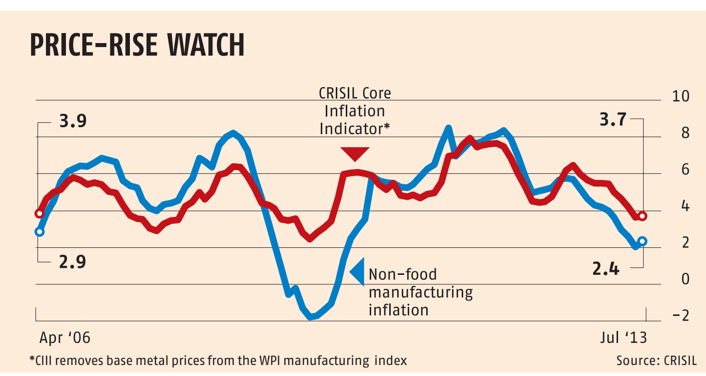
Inflation in vegetables soared to 46.59 per cent in July versus 16.42 per cent in June. It was 5.21 per cent in May and had declined in March and April, year-on-year. Economists had warned at the time that these could rise again once the rains came, due to supply disruption.

Within food, the rate of price rise in onions surged to 144.94 per cent in July against 114 per cent in June. However, onion has just 0.17 per cent weight in the overall WPI. This meant of the 0.93 percentage point increase in inflation, onions contributed 0.28 percentage points, according to data provided by office of the economic advisor, SBI Research. This caused overall food inflation to rise to 11.91 per cent against 9.74 per cent over the period. Surprisingly, retail price index-based food inflation in July softened to 11.24 per cent from 11.84 per cent in June.

In contrast to vegetable inflation, the rate of price rise in fruits fell to 4.80 per cent in July year-on-year against a 0.43 per cent fall in June.

MARGIN SHIELD

PRICE-RISE WATCH



*CIII removes base metal prices from the WPI manufacturing index
Source: CRISIL

CRISIL's Core Inflation Indicator (CCII), which excludes metal prices from the Wholesale Price Index (WPI) manufacturing index, rose to 3.7 per cent in July, after falling for five consecutive months. While non-food manufacturing inflation, the Reserve Bank of India's measure of demand-side pressure on prices, also rose, CCII remained above it. Non-food manufacturing inflation rose to 2.4 per cent in July after falling for 10 consecutive months. If not for falling metal prices, July's rise in non-food manufacturing inflation would have been even higher. Metal prices should be excluded in measuring domestic demand-side pressures, as price movements in metals are largely influenced by changing global demand and exchange rate volatility. Higher CCII and rising non-food manufacturing inflation appear to indicate that despite weak demand, firms are passing-though at least some of their rising input costs — particularly on account of a weak rupee and higher fuel prices — in a bid to protect margins.

CRISIL CORE INFLATION TRACKER

Is inflationary pressure back?

RAINFALL SUMMARY

No. of sub-divisions with rainfall	Aug 6 2008	Aug 5 2009	Aug 4 2010	Aug 10 2011	Aug 8 2012	Aug 7 2013
	From June 1 to the corresponding date					
Excess	9	1	11	5	0	17
Normal	20	10	20	24	18	13
Total	29	11	31	29	18	30
Deficient	7	23	5	9	13	6
Scanty	0	2	0	0	5	0
No rain	0	0	0	0	0	0
Total	7	25	5	9	18	6
Data inadequate	0	0	0	0	0	0
Total	**36**	**36**	**36**	**36**	**36**	**36**

Source: IMD

KUNAL KUMAR KUNDU

NEWS ANALYSIS

India's official inflation data (WPI) for July 2013 showed a trajectory that was in contrast to the retail inflation data (CPI). While CPI eased a tad in July (to 9.64 per cent, down from 9.87 per cent in June), the WPI jumped by nearly one per cent (from 4.86 per cent in June to 5.79 per cent in July), clearly indicating that the inflationary pressures persist.

Not surprisingly, high and rising food inflation perked up the overall inflation. With food inflation rising to 11.91 per cent (the highest since February 2013), it added 37.8 per cent to the headline inflation, led by sky rocketing vegetable prices, which rose 46.59 per cent in July.

Within vegetables, onion prices have been witnessing a sharp rise over the past six months, with prices going up by nearly 123 per cent annualised rate every month. While this is attributed to the hoarders playing havoc with the supply chain, this does have ominous portent. The general expectation of analysts across the board is that food inflation will ease soon, as India is scheduled to have a normal monsoon this year.

However, a normal monsoon is more a statistical phenomenon and it is quite possible that parts of India may experience flood while other parts may experience drought and yet India will still have a normal monsoon on an average.

As of now, several states in India has experienced flood. Rainfall has been normal only in 13 of the 36 regions while it was excess in 17 states. According to IMD, there's a 15 per cent deviation from the normal at the all-India level till date, while any deviation above 20 per cent is considered excess.

With flood likely to impact agriculture production in the affected states, expectation of substantial easing of food inflation may not materialise going forward. And, with the government failing to check the menace of hoarding time and again, there is every possibility of an abnormal spike in prices for the affected products.

Also, while core inflation continues to be low and within RBI's comfort level, there's some sign of price pressure coming back. While overall demand is pretty weak, rural demand still remains robust, as is evidenced from the general performance of FMCG companies and the generally rising trend in production of non-durable goods. Core inflation moved up from 2.02 per cent in June to 2.35 per cent in July, after having declined continuously since August 2012.

As the weak rupee weighs in on the input costs, further price pressure is inevitable, despite poor overall demand. One may, therefore, need to brace for gradually inching inflation.

The author is a Delhi-based independent economist

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THE EXCHANGE CRISIS

'NSEL brokers have no legal, monetary liability'

JOYDEEP GHOSH & SACHIN MAMPATTA
Mumbai, 14 August

Sharad Saraf, convenor of the National Spot Exchange Ltd (NSEL) Investors' Forum, who has invested through NSEL, is clear about who is responsible for the payment crisis. "We entered into a contract which was facilitated by the broker but whose counter-party was the exchange. The liability is that of the exchange, not of the broker," he says.

Many agree brokers don't have any monetary liability. They term meaningless the debate on whether brokers are trying to escape legal hassles by their public outbursts against the exchange.

Jehangir Gai, consumer lawyer, said, "The liability lies with the exchange to repay the investor."

Market players said what prompted the brokers to blame the exchange for the NSEL crisis on Tuesday was rising insecurity about repayments. The brokers are under pressure from clients to ensure repayment. Though they aren't responsible legally or monetarily for NSEL's inability to repay, they fear there would be unnecessary legal hassles with clients.

Also, though NSEL has come up with a 30-week repayment plan, many brokers are stuck with clients because there is pressure to repay immediately.

Market players said the brokers were prompted to blame the exchange for the NSEL crisis due to rising insecurity about repayments

"There is no personal liability on the broker or the firm, as we acted as pass-through vehicles," said the head of a broking firm whose clients' funds were stuck in NSEL contracts.

Lack of information has also led to uncertainty. "Till there is a third-party audit of stocks, there would be doubts about it. Obviously, brokers are trying to do their own research, but it is not comprehensive enough," said the brokerage chief, adding, "The goods, once verified, can be pledged with banks and borrowers can repay the creditors immediately. If that happens, everyone will be happy."

In the case of payment disputes between brokers and investors in the past, arbitrators were appointed by both the sides. If the case is ruled in the favour of the investor, the exchange pays the investor from the settlement guarantee fund. However, now, the payment crisis is at the exchange level, and the exchange doesn't have enough money. According to reports, the settlement guarantee fund is only ₹65 crore. NSEL has claimed it has goods worth ₹6,500 crore, but this, too, is being disputed by brokers.

There are reports that SGS India, part of Switzerland's SGS Group Management, has been mandated to audit 21 commodities across 89 NSEL warehouses. That neither the brokers nor investors would want a million tonnes of paddy or wheat or castor seed is a different matter. They would want cash, and cash is what the buyers don't have.

'We don't see the possibility of a default now'

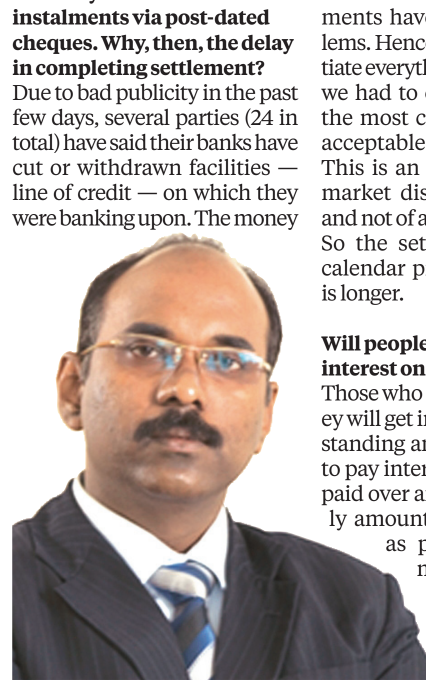
ANJANI SINHA, managing director and chief executive officer of National Spot Exchange Ltd (NSEL), spoke to **Rajesh Bhayani** on the exchange's settlement plan proposed on Wednesday. Edited excerpts:

The exchange had said over ₹2,000 crore will come by maturity and the rest in 20 instalments via post-dated cheques. Why, then, the delay in completing settlement?
Due to bad publicity in the past few days, several parties (24 in total) have said their banks have cut or withdrawn facilities — line of credit — on which they were banking upon. The money that was expected early was not received as those who were comfortable in making payments have also found problems. Hence, we had to renegotiate everything and we had to come to the most common acceptable terms. This is an issue of market disruption and not of a default. So the settlement calendar proposed is longer.

Will people continue to get interest on their investment?
Those who have invested money will get interest on their outstanding and buyers will have to pay interest. Interest will be paid over and above the weekly amount we have declared as part of the settlement.

Will this be acceptable?
We have discussed the settlement with buyers and took feedback from members; this settlement was found acceptable. According to our proposal, those who have put in money will get interest and the money back. Since their purpose was to get returns, they should not have any issues. Buyers will get time to pay and the exchange will ensure settlement and default can be avoided.

Q&A



ANJANI SINHA
MD, NSEL

According to exchange norms, in case of a default, who is declared a defaulter? A client who is not making payment or a broker-member through whom he has entered the deal on the floor of the exchange?
We don't see the possibility of a default now, but exchange rules suggest a broker-member will be declared defaulter. However, all 25 buyers in this case were members of the exchange.

For full reports, visit www.business-standard.com

Onion gets export floor price again

BS REPORTER & PRESS TRUST OF INDIA
New Delhi, 14 August

The Union government on Wednesday re-imposed a minimum export price of $650 a tonne on onions to check export. It also decided on a host of measures like stock-holding limits to check hoarding, import of onion from Pakistan through the National Agricultural Cooperative Marketing Federation of India (Nafed) and a possible regulation of export through release orders to check spiralling prices, which have threatened to touch ₹100 a kg in the next few days.

The decision to curb onion exports and increase imports was taken at a high-level inter-ministerial meeting of representatives from the ministries of consumer affairs, agriculture, commerce and finance, among others. The government had lifted the minimum export price of onion more than a year before after prices stabilised in the domestic market.

COMMODITIES, II, 3
▸ Onion prices bring tears