Direct Taxes and Company Law News

1. EXEMPTIONS Vs DEDUCTIONS

The distinction between exemptions and deductions is crucial to an understanding of the computation provisions. Deduction is that which is deducted, the part taken away, abatement. Deductions are made from gross income in arriving at the net income for tax purposes. Many of the deductions are itemised in detail under appropriate captions and subtracted to arrive at income subject to tax.

A provision does not become an exemption provision merely because the marginal notes to the section or the heading of the section call it so.

Tax law contains chapters dealing with incomes which do not form part of total income. Chapter III refers to various incomes which are exempt from tax. It excludes certain types of income from the ambit of ‘total income’ as defined under the Income-Tax Act, 1961.

The incomes enumerated in Section 10 of the Act are not only excluded from the taxable income of the assessee but also from his total income. They are not to be taken into computation for determining the taxable income. By their very nature certain classes of income are entitled to exemption — agricultural income and income held under charitable trust are cases in point.

Exemption is conferred indelibly on a particular kind of income and does not depend on the character of the recipient. There is a second category of exemption which depends on the character of the assessee. Incomes of local authorities and consuls are examples.

Chapter IV, on the other hand, deals with various heads of income and their computation. Chapter VIA deals with deductions to be made in computing total income

<u>RELEVANT CASE LAW</u>

The distinction between exemptions and deductions was brought forth forcefully by the Madras Bench of the Income-Tax Appellate Tribunal (ITAT) in the Lason India (P) Ltd case. The company was engaged in the business of providing software services and claimed deduction to the extent of 90 per cent of the profits from the undertaking which were eligible for deduction under Section 10B.

The company had brought forward losses from earlier year amounting to Rs 34 lakh against the balance of 10 per cent profits. The assessing officer (AO) rejected the claim for set-off. Section 10B (6)(ii) does not permit such set-off insofar as the loss relates to the business of the undertaking.

The Bench pointed out that the restriction is applicable only in respect of loss which is directly relatable to the loss of the undertaking which is subject to the provisions of Section 10B. It is not applicable to the losses in respect of other businesses.

The question arose whether the 10 per cent profits remaining after the deduction under Section 10B should be treated as business profits.

The answer to this question depended on whether the benefits given under Section 10B represented an exemption or a deduction. The Section allows a deduction from profits of a 100 per cent export-oriented undertaking. Section 10B is in Chapter III dealing with incomes not forming part of total income. **From April 1, 2003, the Section allows 90 per cent deduction.**

This means the whole of the income is not exempt but only a part. It is not an exemption provision. Merely because Section 10B is placed in Chapter III containing exempt incomes, it does not mean that it related to exempted income, particularly as only 90 per cent of the profits from eligible undertaking is allowed to be deducted.

Whatever remains after allowing the deduction has to be treated only as business income. Once it is treated as business income, the provisions of Section 72 of the Act come into play. The losses belonged to the business and should be allowed against the business income of the company. The Bench directed the assessing officer (AO) to allow set-off of the loss claimed by the assessee (301 ITR 306 (AT)).

ORIGINAL INTERPRETATION

Section 10AA (7) deals with tax incentives for newly established units in special economic zones (SEZs) and software technology parks (STPs).

Only a percentage of profit is eligible for exemption and not the entire amount. Under the SEZ Act, profits earned by the unit are 100 per cent tax-exempt in the first five years and 50 per cent is taxed for the next five years.

These units are struggling to get the benefits of 100 per cent exemption extended. Even if they don't succeed, wherever there is business loss from other units, they can reduce the taxable income from the partly exempt unit by applying the principles laid down in the Madras Bench ruling of the ITAT.

A provision does not become an exemption provision merely because the marginal notes to the section or the heading of the section call it an exemption provision. The contents of the Section will have to be analyzed, as the Bench pointed out, to find out whether it is an exemption or a deduction provision.

2. ICAI TO FOCUS ON SMALL, MEDIUM PRACTICE (SMP) UNITS

As the Institute of Chartered Accountants of India (ICAI) commemorates its 60th year, it plans to provide special attention to small and medium practice (SMP) units, which account for significant share of its practicing members.

"I am of the view that SMPs have a place and important role in India. In the diamond jubilee year, we will do everything possible to strengthen the SMPs, which will in turn help the SMEs. The institute will take the initiative of developing practice tools (software etc) for SMPs," Mr. Ved Jain, President of ICAI, told a press conference.

Of the 1, 45,000 members of ICAI, about 45,000 come under the category of small and medium practice units. The Prime Minister, Dr Manmohan Singh, inaugurated the ICAI's Diamond Jubilee year celebrations on July 1. The Finance Minister, Mr. P. Chidambaram, delivered a special address on the same day.

3. NEW SOFTWARE TO 'POP UP' INCOME TAX DEFAULTERS

Most computer users would do anything to get rid of pesky 'pop-up' windows, but the Income Tax Department has just turned on new software that will keep throwing up names of tax evaders left, right and centre.

The new software would also help sleuths clone data from hardware seized from suspects. The new software has been custom-made for the department. It will throw up the names of tax evaders, habitual or otherwise, after the entire data has been fed into it.

This is similar to the 'pop up' software on Internet. The new software has been developed by the Centre for Development of Advanced Computing (CDAC) and has been mastered to "digitally pursue" tax defaulters.

It will also enable the department in protecting digital evidence. After the trials we have found that this new system is more advanced than any such software available with any other investigating agency in the country.

The department has set up two such fully equipped and state-of-the-art forensic laboratories in Mumbai and one in Delhi. These laboratories will be handled by trained sleuths of the department with some technical assistance from outside technical wizards. Among the salient features of the new software set up are hard disk cloning, password cracking abilities and data encryption and retrieval techniques.

4. I-T DEPT TO SCAN REALTY DEALS FOR EVASION

Real estate sector is high on the radar of the income-tax department, which is going to keep a close watch on buyers or sellers of property.

Realty deals whose value is more than eight times the gross income of the buyer could come under the scanner of the I-T department, going by the latest scrutiny norms circulated to officials. So, if your gross income is Rs 10 lakh per annum and you have bought a house for more than Rs 80 lakh, you could get a call from the department.

For this purpose
Gross Income = Total Income + Exempted income - Tax paid

This norm is being adopted to ensure that there is no evasion and people who enter into such transactions pay taxes honestly.

Cash deposit of Rs 10 lakh in your savings account could also bring you on the scrutiny radar. Individual assesses now have to report transactions which get captured in Annual Information Return (AIRs). Sale or purchase of house above Rs 30 lakh is reported, under AIR, by registrars to the department.

Scrutiny on these counts would be generated though Computer Assisted Scrutiny System (CASS) and not through manual intervention. According to the criterion that were discussed at the recent annual conference of the chief commissioners and directors general of income-tax, capital gains of more than Rs 25 lakh could also attract scrutiny by the department in the current financial year.

Similarly, loss from house property of more than Rs 2.5 lakh would also invite the I-T department's scanner, sources told ET. The real estate sector, which is known to attract large quantum of black money, continues to draw the attention of tax department.

Real estate agents and builders having a turnover of more than Rs 5 crore could attract scrutiny. Professionals like doctors, architects whose gross receipts exceed Rs 40 lakh and those who report profit of less than 30% of the gross receipt, can also face scrutiny.

5. SEZ LAND PURCHASE UNDER TDS SCANNER

Land acquisition by special economic zones (SEZs) has come under tax scanner. The income tax department has upped the ante on tax deduction at source (TDS) on payments made for purchase of land for these projects. Inspections and surveys by the I-T department have revealed that in several recent SEZ land transactions; there was no deduction of tax. TDS, in such cases, has to be deducted at the rate of 1% for payments exceeding Rs 15 lakh.

Though most of the companies that plan to set up a SEZ largely acquire land on their own, they also form special purpose vehicles (SPVs) with state agencies or even acquire land through these bodies. Any such entity buying land has to deduct tax while making payment when the sale deed is registered.

Besides these project implementing authorities, public utilities implementing projects under fast track authorities will be under the watch in cases where implementation is not done directly by the state government.

TDS on SEZ land acquisitions issue figured at the annual conference of chief commissioners and directors general of income tax. Officials have been instructed to specially watch out for such transactions for additional revenue mobilization in the current fiscal, sources told ET.

The move comes close on the heels of the some state governments questioning the Centre's stamp duty exemption for such land purchases through provisions in the SEZ Act. States like MP and Orissa have written to the Centre, seeking a clarification on the issue.

There has been an increased focus on the TDS by the I-T department, which created a separate directorate to monitor collections under this head. The government's TDS collections grew by 51% in 2007-08 to Rs 1, 06,700 crore from a mere 2.36% in 2004-05. The total tax collection in the fiscal stood at Rs 3, 14, 486 crore.

6. NO INTEREST ON UNEVEN DEDUCTION OF TDS

The Bangalore Income-Tax Tribunal has held that where an assessee has deducted the tax at source (TDS) on salary every month and adjusted the shortfall of tax in the last month of that year in view of change in structure of salary payment, it cannot be considered as short-fall in deduction of TDS on a month-to-month basis.

The assessee deducted TDS on salary every month and adjusted the shortfall in the last month. The assessing officer (AO) compared the average monthly TDS with that deducted by the assessee month-wise and found that the monthly deduction was less. The AO levied interest for short deduction of TDS on salary.

The tribunal held that Section 192(3) of the I-T Act provides liberty to the employer at the time of making of deduction, to increase or reduce the amount to be deducted for the purpose of adjusting any excess or deficiency in the deduction in the financial year. The assessee having exercised this liberty has adjusted the shortfall in the last month of the year and so there was no case of shortfall. Hence, it was held that interest for short deduction of TDS was not leviable.

7. NEW COMPANY LAW BILL TO BE TABLED IN PARLIAMENT SOON

The much-awaited new Company Law Bill will be introduced in Parliament very soon as it is almost ready.

The ministry is working in close coordination with the law ministry and it is likely to be tabled very shortly.

The new Bill would replace the existing Company Act, 1956.

The new law would promote shareholders democracy, replace the approval-based system with a system of responsible disclosures, promote good corporate governance and effective protection of investors.

Talking about other initiatives, Goel said, insolvency reform was another area that the ministry was looking into. The matter is before the Supreme Court.

As and when it is cleared by the apex court, it would be implemented.

The ministry is also in the process of setting up Indian Institute of Corporate Affairs at Manesar at a cost of Rs 211 crore.

The institute would work as a think tank and help in capacity building and a partnership agreement would be signed with IIT Kharagpur soon, which will help in implementing the project.

There would be five centers of excellence, including one on investors' protection.

8. COMPANY LAW CHANGES TO CATALYSE FUSION WITH GLOBAL NORMS

Corporate houses going for overseas purchases as well as selling stake to foreign investors need not worry about the ongoing exhaustive revision of the company law delaying the convergence of Indian accounting standards with globally-accepted norms.

The government is likely to go in for quick amendments to the existing company law rather than wait for the new company law to get legislative accord so that the country meets the April 2011 deadline for convergence with international financial reporting standards (IFRS).

Accounting convergence would make it easier for investors to compare the financial health of companies in more than 100 nations that follow IFRS. This requires reclassification of some financial instruments in line with global practices.

While the government is set to introduce the new companies Bill this monsoon session of Parliament, the process to get the law passed and vetted by the President may take some time. The new Bill is likely to be referred to a parliamentary standing committee which would hear views of all the stake holders. The governments expected move is to ensure that domestic companies are made IFRS-compliant before 2011, even if the thorough exercise of drawing up a sophisticated new company law may consume more time.

One of the possible areas for legislative changes is reclassification of certain financial instruments. Preference shares that are to be redeemed, for example, are classified as capital under the company law, while it is a liability under IFRS.

The ministry of corporate affairs recently stated its intention to converge the country's accounting standards with IFRS to reassure regulatory bodies abroad so that they would give respite to Indian companies listed on their bourses on their auditing requirements if the Indian government is committed to harmonization in accounting standards.

However, apprehensions are being raised by the accounting community that a mere IFRS convergence announcement by the government cannot save Indian companies unless the global accounting norms are applied in practice.

Unless legal and accounting provisions on key aspects such as business combinations and determining the fair value of investments and derivatives are amended and made effective in line with the global norms, the convergence initiative of the government may not fructify.

Schedule VI of the company law that prescribes specific disclosure requirement and format of balance-sheet is also significantly inconsistent with the requirements of the IFRS norms, experts said. The ministry of corporate affairs is likely to introduce amendments to the essential provisions of the existing company law so that the government's IFRS convergence initiative could be settled well before time.

The IFRS-compliance standards in the country, which have been proposed by ICAI and enforced by the National Advisory Committee on Accounting Standards (NACAS), recommends to companies adopting IFRS by April 2009 while making it mandatory by April 2011. IFRS calls for stringent disclosure norms and would work towards a transparent and effective accounting system worldwide.

Thank you