Income Tax and Corporate Law Updates

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Consequences for failure to deduct Tax at Source

For failure to deduct tax at source where one should have as well as for failure to deposit the tax deducted at source with the treasury within the prescribed time, interest at 1 per cent per month or part thereof is payable in terms of Section 201(1A).

In addition, such failure also gives rise to presumption of assessee being in default attracting a discretionary penalty not exceeding the tax in arrears in terms of Section 221 read with Section 201(1).

Section 271C duplicates the penalty by once again slapping a penalty not exceeding the amount of tax not deducted at source. While compensatory interest and penalty may be distinguished from each other, one is at a loss to find penalty being imposed twice over for the same offence. The assessee thus in default may in addition also have to cool his heels behind the bars for a term ranging from three months to seven years in terms of Section 276B.

Section 40(a) (ia) targets select expenditures for disallowance while computing business income where tax has not been deducted at source. Interest, commission or brokerage, rent, royalty, fees for professional services, etc., are not deductible until and unless tax thereon deductible under the Income-tax Act has not only been deducted but also deposited with the treasury.

One can even understand the disallowance under Section 40(a) (ia) of the related expenditure till such time the tax deducted thereon is actually deposited because one should not be allowed to take advantage of his own delinquency. But Section 40(a) (ia) goes beyond.

Depreciation allowances for intangible assets

Section 32 of the Income-Tax Act, 1961 was amended to grant depreciation allowance on knowhow, patents, copyrights, trademarks, licenses, franchisee and other business or commercial rights of similar nature, being intangible assets acquired on or after April 1, 1998.

Explanation 3 defined tangible assets as buildings, machinery, plant or furniture and intangible assets as knowhow, patents, etc. Explanation 4 gives a separate meaning for knowhow as any industrial information or technique likely to assist in the manufacture or processing of goods. We can all understand that knowhow can depreciate with rapid advances being made in science and technology.

Depreciation allowance is granted to compensate the assessee for depreciation suffered by him in respect of specified assets. Depreciation is a measure of the effective life an asset owing to use or obsolescence.

Mere existence of a capital asset is not sufficient to claim depreciation allowance. It should be shown that the asset in question is capable of diminishing in value over time.

No Deduction for Seminar Expenses

Internal Revenue Code Section 212(1) allows a deduction to individual taxpayers for expenses relating to the production or collection of income. Therefore, if one attended a seminar to learn investment trading techniques that should be deductible, right?

That's what Carl Jones thought, when he deducted the expenses of a day- trading seminar that he attended to improve his day trading skills. Unfortunately, both the IRS and the Tax Court disagreed, based on an obscure, but directly on point, provision of the Internal Revenue Code Section 274(h)(7).

This provision provides in plain and simple language that "[n]o deduction shall be allowed under section 212 for expenses allocable to a convention, seminar, or similar meeting." This provision is hard to locate, in large part because the title of Section 274 gives only the faintest warning of the existence of the prohibition - "Disallowance of certain entertainment, etc., expenses."

Carl Jones' case is not that interesting, but I mention it here as a public service because I am sure that Carl Jones is not the only one out there that is unaware of the deduction prohibition for seminar attendance. As a tax matter, note that Section 274(h) (7) only applies for Section 212 expenses. If attendance at a seminar qualifies as a Section 162 "trade or business" expense, the provision does not apply.

IFRS Section

India to converge with IFRS but not adopt it

India will go in for convergence with the International Financial Reporting Standards (IFRS) in an organized manner though it will not “adopt” this numero-uno accounting framework.

Indications are that the country would retain the right to remain sensitive to local conditions. Currently, India does not follow IFRS, but its national GAAP (Generally Accepted Accounting Principles) is inspired by IFRS. More than 100 countries require or permit IFRS.

IFRS, which is principles-based, has now been required or permitted in more than 100 countries across the world. The application of IFRS requires increased use of fair value for measurement of assets and liabilities.

The issue of full convergence with IFRS is closely followed by Ministry of Corporate Affairs (MCA). We are however distinguishing between full convergence and outright adoption.

Full convergence was not a simple job and that there were hurdles and impediments in achieving it. There was a need to ensure that the process of convergence took into account consistency with the legal and regulatory requirements. This complex task of convergence called for partnership among all stakeholders.

Case Law - 1

M Shahul Hameed Batcha Vs Income Tax Officer

Section 271 (1)(c) of the Income-tax Act, 1961 – Penalty – For concealment of income-Assessment year 1982-83-Immediately after a search was conducted at premises of assessee, he filed a revised return offering higher income-Assessing Officer accepted revised return but levied penalty under section 271(1)(c) - on appeal, Tribunal upheld penalty holding that there was no material with assessee to show that mistake had crept in original return accidentally without any intention – Whether on facts, Tribunal was justified in confirming penalty – Held, yes

Case Law - 2

Commissioner of Income Tax Vs Saraya Industries Ltd

Section 271 (1)(c) of the Income-tax Act, 1961 – Penalty – for concealment of income-Assessment year 1992-93 – Whether where even on a detailed perusal of assessment order, no satisfaction of Assessing Officer that penalty proceedings were required to be initiated against assessee was discernible, penalty proceedings could be sustained – Held, no

Case Law - 3

V V Projects & Investments Pvt Ltd Vs Deputy Commissioner of Income Tax

Section 271 (1)(c) of the Income-tax Act, 1961 – penalty – for concealment of income – Assessment year 1995-96 – Whether finding on issue whether assessee has concealed his income or has deliberately furnished inaccurate particulars thereof is essentially a finding of fact which has to be spelt out by way of recording satisfaction of Assessing Officer as required under Section 271 (1) and in absence of such a finding in assessment order, no penalty proceeding can be initiated – Held, yes – Assessee-company, engaged in business of running a hotel, claimed in its return depreciation on solar equipment acquired by it – Subsequently, assessee filed its revised return giving up its claim for depreciation as company, which supplied solar equipment, expressed its inability to produce evidence for equipment supplied – Assessing officer passed assessment order accepting revised return but levied penalty under Section 271 (1)(c) - Whether since assessment was completed accepting income as per revised return of income and assessment order as well as show-cause notice did not reflect any satisfaction of Assessing Officer as required under Section 271 (1)(c), penalty levied upon assessee was to be set aside – Held, yes