Income Tax and Corporate Law Updates

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TDS RATE FOR PLAYERS RAISED TO 10 PER CENT

Sportspersons like Sachin Tendulkar and Mahendra Singh Dhoni will soon see a higher rate of tax deduction at source on their match fees and endorsement fee earnings.

The Income Tax Department has decided to hike the tax deducted at source (TDS) rate to 10 per cent, taking the total incidence to 11.33 per cent (including 3 per cent education cess and 10 per cent surcharge), as against the existing incidence of 2.33 per cent, official sources told Business Standard.

A notification in this regard, amending Section 194J of the Income-Tax Act, 1961, is likely to be issued within a week. The notification will put sportspersons in the same category of “professionals” like doctors, lawyers and engineers.

The revised rate will become effective from the date of the notification and all sports bodies like the Board of Control for Cricket in India (BCCI) will be have to deduct taxes at the new rate while making payments to the players.

Besides the players, the new TDS rate will also apply to all those associated with a sport. These include professionals like team managers, coaches, match referees, umpires, groundsmen, curators, administrators, physical trainers, physiotherapists and psychologists.

In effect, if a sportsperson earns Rs 1,00,000 as match fees, the payer will deduct Rs 11,330 at the source. The player can claim a refund on the amount deducted as part of his annual income-tax return.

At present many sports bodies do not deduct tax at source, although the BCCI does so at an incidence of 2.33 per cent.

The move to issue a notification for deducting TDS at a higher rate comes after earlier efforts by the Income-Tax Department to persuade sports bodies to deduct the tax, and at a higher rate.
The department stepped up its efforts in this regard after the Indian Premier League (IPL) became a money-spinner for all stakeholders. A sense of what lies at stake can be had from the fact that the tax authorities expect to collect Rs 200 crore from IPL matches this year.

Transition to IFRS - PPE

Property, plant and equipment (PPE) represent assets that the enterprise uses for production or administration. It does not intend to sell those assets in the normal course of business. Examples of PPE are land, building, machinery, furniture, vehicles, and computer. Fundamental principles stipulated in the Indian GAAP (AS -10) for the accounting of PPE are not significantly different from accounting principles stipulated in the international financial reporting standards (IAS-16).

But there is a gap between the principles stipulated in AS-10 and the practice being followed by many enterprises including listed companies in India.

Therefore, the pain in transition from the Indian GAAP to IFRS will vary between enterprises. There are some significant differences between AS-10 and IAS-16, but those may not pose much problem in transition to IFRS.

The first challenge in implementing IFRS is to apply the principle of component accounting. Component accounting requires that if an asset has several components, which can be physically separated from the principal asset and which have significantly different useful life . These should be recognised separately and should be depreciated based on their respective useful lives. Component accounting aims to improve depreciation accounting and thus improves the measurement of operating result. It also facilitates accounting for replacements.

When a component is replaced, the written down value of the component replaced should be charged off to the income statement and the cost of the new component should be capitalised, that is, should be recognised as an item of PPE. Component accounting requires allocation of the cost of the asset to different components based on their respective fair values at the date of acquisition. IFRS requires that component accounting should be applied retrospectively.

The challenge is to determine the extent to which the asset should be broken down into components for the purpose of separate recognition. We should apply the concept of 'materiality' in arriving at a decision. The most appropriate method for evaluating the materiality is to consider the cost of the component relative to the total cost of the asset.

For example, the engine of a vehicle should be recognised separately from the vehicle, because the cost of the engine is significant relative to the cost of the vehicle. Application of this method will require recognition of a large number of components separately, because enterprises use large number of such assets (items of PPE), which together constitute a significant proportion (in terms of number) of the total number of items classified as PPE, but in terms of cost they together may not constitute a significant proportion of total cost of PPE.

We may take another approach to facilitate transition to IFRS. We may evaluate 'materiality' in two stages. First stage should be to evaluate materiality by estimating the estimated impact on the gross profit or EBIT of not applying component accounting to less costly items of PPE, which together may not constitute a significant proportion of total cost of PPE . Those items may be excluded from component accounting. At the second stage, materiality should be assessed using the relative cost approach to identify components of assets to which component accounting will be applied. Auditors will prefer the apply component accounting to all the assets on the ground of higher accuracy.

This should not pose much problem while accounting for newly acquired assets. But, application of component accounting to all assets acquired much earlier (and still on the balance sheet) will involve huge work and some difficulties in estimating fair value of components. The two-stage approach will reduce the work significantly without impairing the true and fair view of the operating result materially. The Institute of Chartered Accountants of India (ICAI) should issue guidelines in this regard.

Under IAS-16 an enterprise may choose either the cost model or the revaluation model to measure PPE subsequent to the initial recognition. If, an enterprise chooses the revaluation model, it must ensure that the assets are carried in the balance sheet at an amount close to the current value at the balance sheet date. IAS-16 does not stipulate the frequency of revaluation.

AS-10 does allow revaluation of PPE but does not consider it as a model alternative to the cost model. Therefore, under the Indian GAAP, an enterprise can revalue the assets once in a while and continue with the cost model. IFRS -1, which stipulates principles for the first time adoption of IFRS, allows an enterprise, which revalued assets earlier, to select the cost model. In that situation the revalued amount reduced by accumulated depreciation will be deemed as acquisition cost.

But, if an enterprise selects the revaluation model, it has to revalue the asset at the balance sheet date of the first balance sheet prepared using IFRS. Therefore, transition to IFRS will not be difficult even for an enterprise, which revalued its PPE earlier.

The schedule XIV of the Companies Act provides rates and methods of depreciation for computing depreciation to be charged to calculate divisible profit and profit that will form the basis for the calculation of managerial remuneration. ICAI and the government have taken the view that a company should recognise depreciation at an amount equal to or higher than the amount of depreciation calculated in accordance with schedule XIV.

If, the government decides to retain schedule XIV, it will become irrelevant for the preparation of financial statements after the implementation of IFRS. IFRS requires that depreciation should be charged based on the best estimate of the management of the useful life and residual value of the asset.

Therefore, companies that are charging depreciation calculated in accordance with schedule XIV may like to revise depreciation rates/methods. IAS-16 considers change in depreciation rates and depreciation method as a change in estimate. Therefore, new rates and methods should not be applied retrospectively. Thus, transition to IFRS, so far the depreciation accounting is concerned, will not be difficult.

Whenever, I meet professional accountants in any forum, I get the confidence that we are quickly gearing up to face the challenges. I am sure that the government and regulators will bring necessary changes in the legal environment well in time to ensure seamless transition. In this column, for next few months, we shall continue to discuss in transition to IFRS.

SAVINGS MAY GET LEVEL FIELD

In a move that would impact the small investor, the government has decided to revisit tax treatment of the new pension scheme (NPS), employees provident fund (EPF), unit-linked insurance plans (ULIP) and mutual funds. This follows demand from regulators such as SEBI and IRDA for a level-playing field between the windows which serve as major avenues of savings and investment for a large number of people.

Chief economic adviser Arvind Virmani has initiated a study to identify the tax changes necessary for a level playing field for NPS and EPF, ULIPs and MFs. For example, withdrawal from NPS is subject to exempt-exempt-tax (EET) while the levy is not applicable on EPF withdrawals.

A similar disparity between ULIPs and MFs has been discussed by an apex panel comprising financial sector regulators. Entry load has been scrapped on open-ended and close-ended MFs. However, there is no restriction on ULIPs, which are aggressively marketed by insurance companies, doling out huge commissions. A technical paper covering all the aspects would be prepared by Mr Virmani.

The paper would be presented to the High-Level Coordination Committee On Financial Markets (HLCCFM), which comprises representatives from RBI, PFRDA, IRDA and SEBI, that discussed the issue at its recent meeting. The panel had decided the inconsistencies in the tax system, particularly with respect to instruments in the financial markets, should be studied by the chief economic adviser.

Disparities in the tax treatment of various schemes also figured in the meeting. It may be pointed out that NPS is subject to EET regime, denying tax benefit at the time of withdrawal of the proceeds, in contrast with tax-free EPF withdrawals. Even though both schemes are similar in nature, tax treatment is different.

The view within the panel is that all contractual savings such as investments in PF and insurance schemes should enjoy tax benefits. There is no need to extend such benefits to non-contractual savings, the regulators feel. However, the decision has been left to the chief economic adviser.

In the MFs-versus-ULIPs debate, SEBI has circulated a paper seeking level playing field to serve retail investors better. The parity should be extended to all areas including tax benefits, regulations governing marketing, operations and expenses. In response, IRDA has argued about the uniqueness of ULIPs and the logic behind the different regulations. However, both the regulators will discuss the issue to examine the nature and characteristics of ULIPs and MFs and see if there is a need for level-playing field between them in terms of regulations and tax benefits.

As the capital market is hit by volatility and downturn, investment avenues such as MFs and ULIPs are of significance to the small investor. For the salaried class, returns on EPF and NPS are important as they serve as key post-retirement support.

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IFRS SECTION

CONVERGENCE WITH IFRS TO HAVE BIG IMPACT ON INDIAN BANKS: KPMG

Convergence with International Financial Reporting Standards (IRFS) from April 2011 may have a significant impact on banks in India and they should start preparing for it, a report prepared by global consulting giant KPMG said on Thursday. The Institutute of Chartered Accountants of India has proposed convergence to IFRS for entities like listed companies as also banks in line with the global trend. Convergence from April 2011 would mean India joining a league of over 100 countries which have converged with IFRS. KPMG report released on the sidelines of a conference on IFRS here today said the financial impact of convergence with IFRS will be significant for banks in India in areas like loan loss provisioning, financial instruments and derivative accounting. The report said, "This is likely to have significant impact on financial position and financial performance, directly affecting parameters like capital adequacy ratios and outcome of valuation metrics that analysts use to measure and evaluate performance." Commenting on the report, K Ramakrishnan, chief executive, Indian Banks' Association said IFRS convergence will affect reported networth, available capital and capital adequacy for Indian banks. "Banks should develope a roadmap for successful convergence at the earliest", he said

COMPANIES ADOPT IFRS NORMS AHEAD OF TIME

India's blue-chip companies have begun to align their accounting standards to the International Financial Reporting Standards (IFRS), three years ahead of the mandatory time for the switchover. The list of companies includes IT firms like Wipro, Infosys Technologies and NIIT, automakers like Mahindra & Mahindra and Tata Motors, textile companies like Bombay Dyeing and pharma firm Dr Reddy's Laboratories.The companies are moving on despite being compliant with the US GAAP standards, the current global accounting norms. This is because the IFRS has become mandatory for listing in the European markets after 2007. The other reason is that the new norms provide for stiffer provisioning for mark-to-market losses, also known as AS-30 standards.For companies with exposure in European markets through equity or debt, such transparency is essential to raise capital cheap and hence, the proactive approach. The Indian accounting standards body, the Institute of Chartered Accountants of India (ICAI), has set a time line of 2011 for compulsory switchover to the new standard. IFRS is the accounting benchmark developed by the International Accounting Standards Board.Suresh Senapaty, CFO and executive director, Wipro Ltd, said, "We welcome the initiative of ICAI in driving convergence with international financial reporting standards by 2011. We have adopted AS-30 from April this year, much ahead of its scheduled implementation. We are also actively considering early adoption of AS-31, which is the next standard."Ved Jain, president, ICAI, said, "Many companies have already started following the new accounting standards because these ensure transparency and uniformity. The implementation would strengthen the confidence of stakeholders in the companies' financial statements, which, in turn, will bring value to the corporates."The ICAI's accounting standard -30 mandates companies to provide for mark-to-market losses as well as profits from April 2009 on a voluntary basis. All complexities regarding derivatives have been addressed in AS-30, which is in line with the IFRS norms.If an entity does not opt for either AS-30 or AS-1, the auditors will need to make a suitable disclosure. Analysts note that the total mark-to-market losses of Indian companies from forex derivative exposures could be about $5 billion.The company auditors would need to disclose the figures separately if the company balance sheet does not bring them out. Companies with international presence are not willing to take this risk. Says Rajendra S Pawar, chairman, NIIT Technologies: "AS-30 was started from January 2008, and by 2012, it is expected that we would start following AS-31 as well as AS-32 as they both happen to be a continuation of AS-30, which we have already started off with."A large number of Indian firms are currently battling how to write in huge losses on their exposure to forex derivatives, when their currency bets went wrong

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TDS Special Case Laws

SECTION 194C/INCOME-TAX ACT

Commissioner of Income-tax Delhi-XVII Vs Prasar Bharti (Broadcasting Corpn. of India)

Section 194C, read with section 194J, of the Income-tax Act, 1961 - Deduction of tax at source - Contractors/sub-contractors, payments to - Assessment years 1995-96 to 2001-02 - Whether once there is a specific provision introduced by way of an Explanation III(b) to section 194C, to bring within its ambit contractual work concerning broadcasting and telecasting which includes production of programmes for such broadcasting and telecasting revenue cannot resort to section 194J, which is in more general terms - Held, yes - Assessee a Government body, engaged in controlling and managing various doordarshan channels, while making payments to outside producers had been deducting tax at source, under section 194C at rate 2 per cent, by treating them as contract payments - Revenue, observing that television programme producers should be treated as professional/technical persons and that payments made to them should be subjected to deduction of tax at source under section 194J, treated assessee in default - Whether revenue was not justified in holding so - Held, yes

SECTION 194-I/INCOME-TAX ACT

Commissioner of Income-tax Vs Lally Motors

Section 194-I of the Income-tax Act, 1961 - Deduction of tax at source - Rent - Assessment years 1999-2000 to 2004-05 - Assessee took on rent some premises at different places and in each case there were two landlords - Rental income received by said co-owners was duly disclosed in their individual returns for past several assessment years and same was accepted as such - Rental income from those properties was never assessed in hands of AOP - Whether for purposes of deduction of tax at source by assessee, provisions of section 194-I(a) would be attracted and not provisions of section 194-I(b) - Held, yes

Thank You

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Source: Net, News Papers, Mails and Our Library Books, FAPCCI