INCOME TAX AND CORPORATE LAW UPDATES

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CBDT'S CLARIFICATION ON 'ADVANCE TAX MOP-UP SIGNALS SLOWDOWN'

Central Board of Direct Taxes (CBDT), in response to ET's article "Advance tax mop-up signals slowdown" published on August 10, 2008, has clarified that the growth of 24.1 per cent in advance tax payments by the corporate taxpayers is quite healthy.

"Though the growth rate this year is less than the corresponding growth rate of 27.9 per cent for 2007-08, the growth in corporate TDS is 60.5 per cent this year as against 43.1 per cent in the last year. It is clear that the marginal decline in the growth of advance tax payment is because of substantially higher contribution from TDS of the corporate taxpayers," a CBDT statement said.

Regarding the lower-than-expected growth in advance tax for top 10 corporate tax payers in the country, CBDT has blamed the rising international crude prices. "In any case, if advance tax payments of the top 10 corporate taxpayers for the June quarter are compared, the growth rate comes to 7 per cent. This is due to the reason that some of the prominent oil distribution companies have been badly hit by the spike in international crude prices. If the top 100 companies are taken into account, the growth in advance tax payments is 17 per cent," the statement said.

The CBDT, however, has not contested the SundayET's list of prominent companies such as Bharti Airtel, JSW Steel, Grasim, Gujarat Ambuja, Bajaj Auto, Hero Motors, and NTPC whose corporate advance tax in June quarter this year rather dropped from that of the last year.

REFUND CLAIM AND TIME FACTOR

The Mumbai Income-Tax Tribunal has held that in case of a refund claim that was returned by the authorities to the assessee with directions to submit additional information, the limitation period in relation to such a claim will be computed from the date on which the original claim was filed. In this case, the assessee, a telecom service provider who was selling recharge coupons for pre-paid services to its distributors, filed a refund claim. The claim filed was returned by the revenue authorities after three months, directing the assessee to submit evidence. When the assessee resubmitted the claim providing the additional information, the department contended that the re-submitted application will be seen as a fresh refund claim and the relevant date of the claim would be date of the re-submitted application. The tribunal held that the refund claim re-submitted by the assessee was to be treated as being in continuation of the original claim. Hence, the resubmitted application could not be treated as a fresh claim and there was therefore no question of barring it on the ground of limitation.

NEW COMPANY LAW TO POST EMAIL AS EVIDENCE

The new company law, being drafted by the government, is likely recognise email as a valid piece of evidence. With corporates relying on emails for bulk of their communication, the ministry of corporate affairs is planning to recognise electronic communication by corporates as evidence during company law prosecutions.

The new company law, expected to be introduced in Parliament soon, would provide for necessary changes to this effect. The changes are likely to assist prosecuting agencies in their crackdown on infringement of company law provisions.

The new company law has accorded substantial importance to both means to check corporate frauds as well as ways to crack them. The government feels the companies should not be let off due to lack of evidence. It is also learnt that the government at various levels is trying to harmonise related legislation such as Information Technology Act and Evidence Act on the subject to avoid regulatory overlaps.

TAX CAN BE LEVIED EVEN IF THE RETURNED INCOME IS A LOSS

The Supreme Court has overruled its own decision of last year in Virtual Soft Systems Ltd vs. Commissioner of Income Tax and ruled that penalty can be levied **under Section 271 (1)(c) of the I-T Act** even if the returned income is a loss.

In the latest judgment, involving Gold Coin Health Food Ltd, a larger bench stated that the amendment made by the Finance Act 2002 to the provision was clarificatory and not substantive and it was applicable retrospectively.

The Supreme Court said that the purpose of the provision was to penalize the assessee for concealing income or furnishing inaccurate particulars. Therefore, whether the income returned was profit or loss did not matter.

IFRS Section

AWARENESS ABOUT IFRS NEEDS TO INCREASE MORE RAPIDLY

With the convergence of accounting standards across the globe gaining momentum, accounting bodies such as the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) have already initiated the groundwork on converging International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Standards (GAAP) in the US.

Some Important Opinions

- ✓ Awareness about IFRS and implementation issues is gradually building up within corporate India. However, the awareness needs to increase more rapidly and across a wider section of India Inc. if we are to achieve the proposed timelines for convergence.

Important IFRS-related technical matters and industry-related issues

- ✓ Application of IFRS would generally make the financial reporting process more complex than the past - for example, in several areas such as accounting for consolidation, stock options and financial instruments; current Indian GAAP prescribes accounting that requires limited judgment.

- ✓ Application of IFRS will result in significant use of judgment, estimates and fair values that would make the financial reporting process more complex. For example, under IFRS acquisitions are accounted for by the purchase method that requires intangible assets to be valued and separately recorded. This is a new and complex concept for most Indian companies.

- ✓ Similarly, the rules on financial instruments have provisions for application of hedge accounting principles for certain derivatives. This is again a complex area.

- ✓ The use of fair values for several financial instruments (including derivatives) would result in increased volatility in the income statement and reported profits. Estimating fair values for several financial instruments may also be a challenge given the lack of deep financial markets for several structured derivatives.

- ✓ IFRS requires extensive disclosures. Several of these disclosures would require changes to existing systems and processes for collating the required information.

- ✓ To make implementation of IFRS sustainable, several companies would need to change their existing processes and IT systems. For example, investments are classified as trading, available for sale and held to maturity under IFRS. These classifications have to be decided at inception for each investment. Treasury systems would need to be modified to ensure that each investment is correctly classified at inception and the subsequent accounting is correctly reported.

- ✓ In certain instances, application of IFRS may also change business practices. For example, certain derivative contracts that are economic hedges may not qualify for hedge accounting under IFRS because of their nature (for example, leveraged options that are routinely used by several Indian companies). In such cases, if an entity wants to ensure that it wants to achieve hedge accounting (that prevents income statement volatility), it may decide to change the nature of the instruments (for example, to plain vanilla forward contracts) to ensure that the financial reporting matches the economic objectives.

India has the second largest pool of accountants in the world. While substantially all of this resource pool is currently not familiar and trained under IFRS, there is a potential to train this pool and upcoming chartered accountants, through imbibing IFRS into the chartered accountancy curriculum.

BANKS MAY INCUR LOAN LOSSES WITH IFRS

The proposed convergence of Indian accounting norms with the international standards is likely to impact available capital with banks as it will result in higher loan losses, says consultancy firm KPMG. “Application of International Financial Reporting Standards (IFRS) may result in higher loan losses and impairment charges, thereby impacting available capital and capital adequacy ratios.

DOUBLE STANDARDS

A lot has already been said about the opportunities that International Financial Reporting Standards (IFRS) would create for India.

Given that in the next couple of years, more than 150 countries would have adopted IFRS, the question ‘why IFRS?’ has become irrelevant. Rather seamless implementation of IFRS is now the matter of discussion. The Institute of Chartered Accountants of India (ICAI), in a proactive move, took the first initiative by issuing a concept paper last year to adopt IFRS by 2011. Unfortunately, the ICAI’s recommendations will have to be legislated before they become binding.

Under the Companies Act, mandatory standards are notified in the Companies (Accounting Standards) Rules. Therefore, one approach to adopt IFRS may very well be to notify the standards in the Rules. However, there are two problems here.

- ✓ First, the notification process will have to be quick enough to keep pace with frequent changes in IFRS and,
- ✓ Second, the existing position is that accounting standards (even if notified in the Rules) cannot override any Act or main legislation and if there are conflicts, the Act will prevail.

Unfortunately, many IFRS provisions actually conflict with the existing provisions of the Companies Act. Some of these comprise presentation under Schedule VI, depreciation under Schedule XIV, treatment of preference capital and preference dividend, capitalisation of exchange difference, definition of subsidiary, to name a few. Therefore, adoption of IFRS in India would require amendments to the Companies Act.

Assuming that the Act is not amended, it is highly likely that Sebi may require IFRS accounts through the listing agreement. In this scenario, companies would be required to file two different sets of financial statements, one under IFRS as required by Sebi, and another under the Companies Act, in compliance with the its requirements and Indian GAAP. That would be cumbersome indeed.

In the case of banks, amendments would have to be made in the Banking Regulation Act. In addition to this Act, a large number of accounting promulgations are issued by RBI, some of which conflict with the existing IFRS. Take, for instance, the impairment of loans and advances. Impairment, as per RBI rules, is determined on specific formulae, whereas under IFRS, it is calculated using a discounted cash flow method.

There are other legislations also that need to be studied, like the Electricity Act in the case of power companies, Insurance Act and IRDA promulgations in the case of insurance companies, Clause 41 and other Sebi promulgations.

Conversion is not an accounting exercise but an all-pervasive exercise that affects business, IT, tax, compensation schemes, debt covenants and selling arrangements. Considering the conversion is a lengthy process, if IFRS provisions are to be adopted in India by 2011 (actually 2010 because of comparability), the regulatory changes should have already been in place. The ICAI, corporate entities, industry associations and professionals and the government should make an all-out effort for appropriate amendments as soon as possible. It would enable corporate entities to anticipate the regulatory change and start preparing for IFRS conversion.

Case Laws

Section 2 (15) Charitable Purpose

DIRECTOR OF INCOME-TAX vs. BHARAT DIAMOND BOURSE

Section 2(15), read with section 11, of the Income-tax Act, 1961 - Charitable purposes - Assessment years 1989-90 and 1990-91 - Whether where primary or dominant purpose of ‘institution’ is charitable and other objects which, by themselves, may not be charitable, but are merely ancillary or incidental to primary or dominant object, same would not prevent ‘institution’ from validly being recognized as a charity - Held, yes - Whether where principal object of establishment of assessee-bourse was to facilitate diamond trade so that maximum revenue could be earned by way of foreign exchange and also to make diamond trade more competitive at international level, it was to be held that assessee a diamond bourse was an institute established for charitable purpose - Held, yes

Section 44AA Compulsory Maintenance of Accounts

HIGH COURT OF KARNATAKA H.A.K. Rao vs. Union of India

Chandrakantaraj Urs, J.—In this petition, the petitioner who is a chartered accountant has challenged the constitutional vires of section 44AA of the Income-tax Act, 1961, *inter alia*, on the ground that, between the professions not enumerated in sub-section (1) of section 44AA and other professions, a discrimination is made in as much as the professions enumerated are required to maintain books of account to be inspected by the Income-tax Officer to ascertain their income while other professions not so enumerated in sub-section (1) but falling under sub-section (2) if the income exceeds the amount mentioned in the said sub-section are required to maintain the accounts. *Prima facie*, we do not find any such discrimination because the enumerated professions under sub-section (1) to section 44AA fall definitely into a category of professions by and large regulated by statutes which in turn cast more obligations on those persons to maintain accounts such as lawyers, chartered accountants, doctors, etc. Therefore, the petitioner cannot press into service article 14, when, under article 14, classification of persons to achieve the purpose of a legislation is permissible.

The object of the Income-tax Act is to see that tax is levied on persons who have income from the source of profession and organised professions or professions which are in categories like interior decorators who charge considerable fees for the services rendered, perhaps are not regulated by any enactment to subserve the object of bringing to tax their income.

What falls outside the enumerated class, practicality is the guiding force to prescribe a monetary limit which will compel them to maintain accounts. It would be futile to call upon an ordinary pan seller or a street vendor or a road-side hawker or cabin shop owner or vegetable vendor and persons like those who also carry on profession to maintain books of account. Viewed in that fashion, we are unable to see any discrimination or need to attract the equality assured under article 14 of the Constitution. It cannot be said that the professions which we have mentioned such as street hawkers, ordinary pan sellers, etc., belong to the same category or class of persons as advocates, doctors and engineers.

Therefore, there is no vice of discrimination if they are treated separately and distinctly. Within that profession, a further classification is made, *viz.,* those who earn more than Rs. 25,000 and those who earn less than Rs. 25,000. Those who earn more than Rs. 25,000 are required to maintain books of account. Therefore, we do not see any unreasonableness in such classification.

However, it is rightly pointed out by Mr. S.P. Bhat, learned counsel for the petitioner, that the vice of discrimination, if at all it was there, has been eliminated since by inserting rule 6F in the Income-tax Rules by which such a financial limit has been imposed on the professions enumerated in sub-section (1) of section 44AA of the Act as well.

Therefore, there is no merit in this petition. It is rejected.

Source: Internet, e-mails, Newspapers and Library Books

Thank You

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