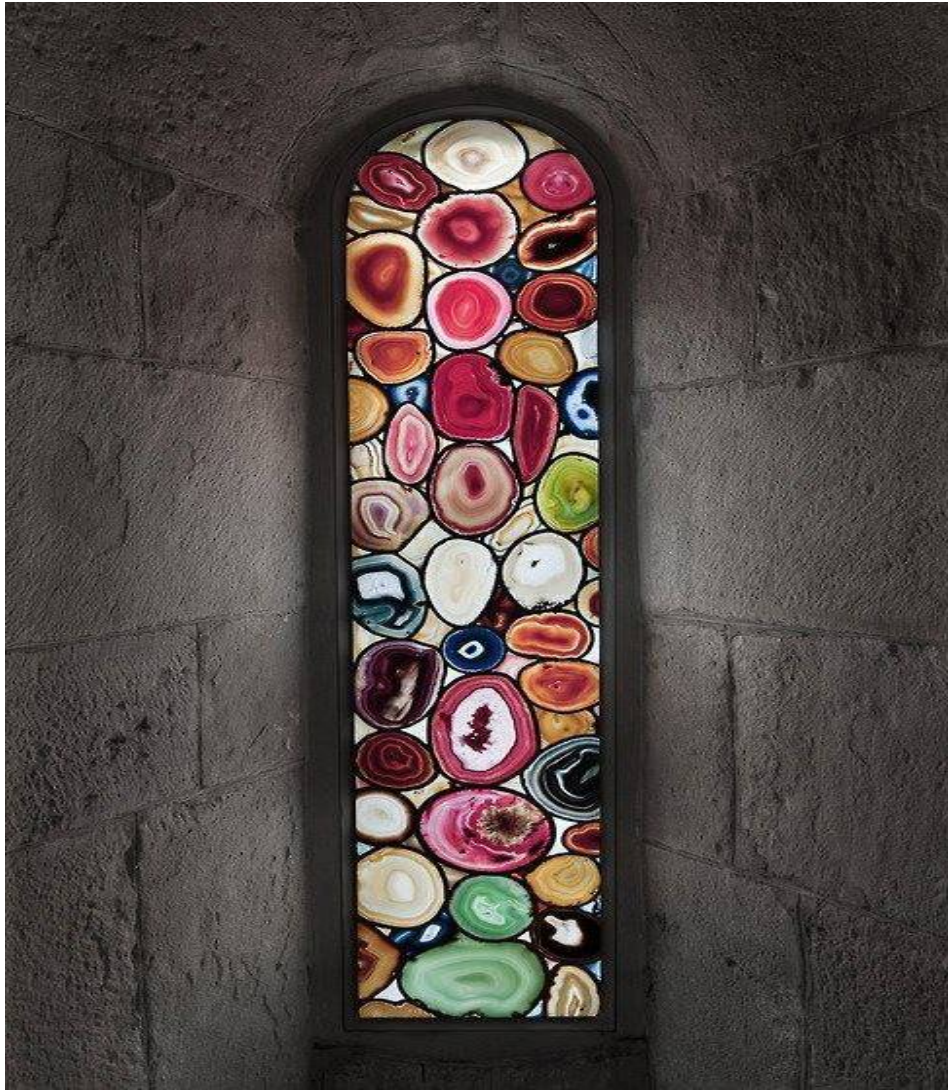


# HARBINGER<sup>TM</sup>

*Updates on regulatory changes affecting your business*

**MARCH 2014**



**B D Jokhakar & Co.**

*Chartered Accountants*

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## **COMPANY LAW**

### **Applicability of Section 185 of the Companies Act, 2013:**

MCA after receiving number of representations on the applicability of Section 185 of the Companies Act, 2013 with reference to loans made, guarantee given or security provided under Section 372A of the Companies Act, 1956, has come out with necessary clarification vide circular No. 3/2014 dated 14th Feb 2014, which will definitely provide much needed relief to corporates. It is clarified that in order to maintain harmony with regard to applicability of Section 372A of the Companies Act, 1956 till the same is repealed and Section 186 of the Companies Act, 2013 is notified, any guarantee given or security provided by a holding company in respect of loans made by a bank or financial institution to its wholly owned subsidiary company, exemption as provided in clause (d) of sub-section (8) of Section 372A of the Companies Act, 1956 shall be applicable. This clarification will, however, be applicable to cases where loans so obtained are exclusively utilized by the subsidiary for its principal business activities.

*(General circular no. 03/2014 dated 14th February, 2014.)*

### **Corporate Social Responsibility: Applicability of Section 135 & Schedule VII of the Companies Act, 2013:**

Central government has notified 1st April 2014 as date on which provisions relating to Section 135 of the companies act 2013 and Schedule VII of the said Act shall come into force.

Section 135 of the companies Act deals with corporate social responsibility rules and Schedule VII specifies the list of activities which may be included by the companies in their corporate social responsibility policy.

*(MCA Notification dated 27th February, 2014)*

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## **SEBI**

### **SEBI Board Meeting - Amendment to Listing Agreement:**

The SEBI in its board meeting held on 13 February, 2014 approved various amendments to the Listing Agreement regarding corporate governance norms for listed companies. The amendments align the Listing Agreement requirements with the Companies Act, 2013 and also provide for additional requirements to strengthen the corporate governance framework. Among other matters, the amendments include:

- Exclusion of nominee Director from the definition of Independent Director.
- Compulsory whistle blower mechanism.
- Prohibition of stock options to Independent Directors.

- Separate meeting of Independent Directors.
- Performance evaluation of Independent Directors and the Board of Directors.
- Prior approval of Audit Committee for all material Related Party Transactions (RPTs).
- Approval of all material RPTs by shareholders through special resolution with related parties abstaining from voting.
- At least one woman director on the Board of the company.
- Maximum number of Boards an independent director can serve on listed companies be restricted to 7 and 3 in case the person is serving as a whole time director in a listed company
- Widening the definition of RPT to include elements of Companies Act and Accounting Standards

The amendments are applicable to all listed companies with effect from 1 October 2014.

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## **RBI**

### **Foreign Direct Investments: Revision of Form FC – GPR:**

Indian companies are required to report the details of the amount of consideration received for issuing shares and convertible debentures under the Foreign Direct Investment (FDI) scheme to the Regional Office of the Reserve Bank in whose jurisdiction the Registered Office of the company operates, within 30 days of receipt of the amount of consideration. Further, in terms of Para 9 (1) B of Schedule ibid, the companies are required to report the details of the issue of shares / convertible debentures in form FC-GPR, to the Regional Office concerned, within 30 days of issue of shares / convertible debentures.

**In order to further capture the granular details of FDI as regards Brownfield/Greenfield investments and the date of incorporation of Investee Company, Form FC-GPR has been revised. Accordingly, the details of FDI should, henceforth, be reported in the revised Form FC-GPR.**

*(RBI Circular AP DIR series circular No 102)*

### **Foreign Direct Investment (FDI) into a Small Scale Industrial Undertakings (SSI) / Micro & Small Enterprises (MSE) and in Industrial Undertaking Manufacturing items reserved for SSI/MSE:**

In terms of the Schedule 1 of the Notification, an Indian company which is a small scale industrial unit and which is not engaged in any activity or in manufacture of items included in Annex A (Refer notification), may issue shares or convertible debentures to a person resident outside India, to the extent of 24% of its paid-up capital provided that such company may issue shares in excess of 24% of its capital if:

- (a) it has given up its small scale status,
- (b) it is not engaged or does not propose to engage in manufacture of items

Reserved for small scale sector, and  
(c) it complies with the ceilings specified in Annex B (Refer notification), to Schedule I of the Notification.

*(RBI Circular A.P. (DIR Series) Circular No.107)*

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## **INCOME TAX**

### **Clarification regarding disallowance of expenses under section 14A the Income-tax Act in cases where corresponding exempt income has not earned during the FY –regarding:**

A controversy has arisen in certain cases as to whether disallowance can be made by invoking section 14A of the Act even in those cases where no income has been earned by an assessee which has been claimed as exempted during the financial-year.

The above position is clarified by the usage of term 'includible' in the heading to section 14A of the Act and also the heading to Rule 8D of Income Tax Rules, 1962 which indicates that it is not necessary that exempt income should necessarily be included in a particular year's income for disallowance to be triggered. Also section 14A of the Act does not use the word "income of the year" but "income under the Act". This also indicates that for invoking disallowance under section 14A, it is not material that assessee should have earned such exempt income during the financial year under consideration.

*(Circular 5/2014 dated 11 February 2014)*

### **Clarification regarding scope of additional income-tax on distributed 115R of the Income-tax Act:**

Section 115R (2) of the Act provides that any amount of income distributed by

(i) a specified company or

(ii) a mutual fund to its unit holders shall be chargeable to tax and such entities shall be liable to pay additional

income tax on such distributed income at the rates prescribed therein.

CBDT has clarified that additional income tax under section 115R(2) is to be levied on income distributed by way of dividend to unit holders of mutual fund or specified companies and receipts from redemption/repurchase of units or allotment of additional units by way of bonus units would not be subjected to levy of additional income tax under that section.

*(Circular 6/2014 dated 11 February 2014)*

### **Non-Filing of ITR-V in returns with refund claims-relaxation of time-limit for filing ITR-V and processing of such returns:**

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Central Board of Direct Taxes in exercise of powers under section 119(2)(a) of the Act further relaxes and extends the date for filing of ITR-V Form for Assessment years 2009-10, 2010-11 and 2011-12 till 31.03.2014 for returns e-filed with refund claims within the time allowed under section 139 of Income Tax Act.

The taxpayer concerned may send a duly signed copy of ITR-V to the CPC by this date by speed post.

*(Circular 4/2014 dated 10 February 2014)*

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## **INTERIM BUDGET**

The Interim Budget i.e. vote on account was presented on 17<sup>th</sup> February, 2014 at a time when the economy has been battling the twin challenges of inflation and sluggish growth. From a tax perspective, though amendments have not been proposed to the tax laws, there are some changes with regard to the indirect tax rates, with an eye on providing a stimulus, most specifically to the manufacturing sector.

The Finance Minister has provided a huge fillip to the manufacturing sector with across the board cuts in excise duties across cars, motorcycles, SUV's and commercial vehicles. This will provide a much needed impetus to component manufacturers who have borne the brunt of prolonged slow down and negative growth over the last year. A cut, across the board, in excise duty from 12% to 10% on goods under Chapter 84 & 85 will deliver stimulus to manufacturing across engineering, capital goods and consumer electronics sectors.

There have been no changes in Direct taxes in the interim budget issued.

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## SUMMARY OF IMPORTANT TAX JUDGEMENTS:

Unless otherwise stated, the sections mentioned hereunder relate to the Income Tax Act, 1961.

Sr. No	Tribunal / Court	Area/ Section covered	Nature	Case Law
1	ITAT- Delhi	Rule 10B of the Income Tax Rules	Adjustment to profit margin for "capacity underutilization" can be made. In choosing comparables, there cannot be a cherry picking for deciding parameters of rejection. All comparables must face the same test.	<i>DCIT Vs. Panasonic AVC Networks India Co Ltd</i>
2	ITAT- Hyderabad	Section 92C of the Income Tax Act	TPO cannot sit in judgement on commercial expediency. RBI approval means the payment is at ALP. If overall TNMM analysis done, royalty cannot be analyzed separately.	<i>DCIT Vs. Air Liquide Engineering India</i>
3	High Court – Calcutta	Section 14A of the Income Tax Act & Rule 8D of Income Tax Rules	Section 14A / Rule 8D disallowance cannot be made without showing how assessee's claim/computation is wrong.	<i>CIT Vs. REI Agro Ltd</i>
4	ITAT- Kolkata	Section 40(a)(ia) & Section 194A of the Income Tax Act	Expenditure on discounting/ factoring charges is not in the nature of interest for purposes of TDS u/s 194A or disallowance u/s 40(a)(ia).	<i>ITO Vs. M K J Enterprises Ltd</i>
5	High Court – Calcutta	Section 43B & Section 36 (1)(va) of the Income Tax Act	Employees PF/ ESI Contribution is also covered by section 43B & allowable as a deduction if paid by "due date" of filing ROI. ITC Ltd 112 ITD 57 (Kol) (SB) impliedly reversed.	<i>CIT Vs. Vijay Shree Ltd</i>

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6	High Court – Bombay	Section 254(2A) and Stay Petition	Rejection of stay application by ITAT on the ground that “the financial position of the assessee is very sound” and “government also needs liquid funds to manage its day to day affairs” & without discussing prima facie case is in disregard of law laid down in KEC International 251 ITR 158 (Bom)	<i>Deloitte Consulting India Pvt. Ltd Vs. ACIT</i>
7	Supreme Court	Section 276CC of the Income Tax Act	Supreme Court upholds initiation of prosecution for failure to file return	<i>Sasi Enterprises (Taxpayer) Vs. ACIT</i>



**1) Adjustment to profit margin for “capacity underutilization” can be made. In choosing comparables, there cannot be a cherry picking for deciding parameters of rejection. All comparables must face the same test:**

*DCIT Vs. Panasonic AVC Networks India Co Ltd (ITAT Delhi)*

Under Rule 10B (1)(e)(ii), an adjustment to the net profit margin has to be made for “capacity underutilization”. Capacity underutilization by enterprises is an important factor affecting net profit margin in the open market because lower capacity utilization results in higher per unit costs, which, in turn, results in lower profits. Of course, the fundamental issue, so far as acceptability of such adjustments is concerned, is reasonable accuracy embedded in the mechanism for such adjustments, and as long as such an adjustment mechanism can be found, no objection can be taken to the adjustment. On facts, the CIT(A)’s approach is reasonable and the adjustments are on a conceptually sound basis.

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**2) TPO cannot sit in judgement on commercial expediency. RBI approval means the payment is at ALP. If overall TNMM analysis done, royalty cannot be analyzed separately:**

*DCIT Vs. Air Liquide Engineering India (ITAT Hyderabad)*

The TPO is not entitled to sit on judgment on the business and

commercial expediency of the assessee in paying royalty to its’ parent company as per the provisions of the Act as laid down clearly by the Delhi High Court in EKL Appliances 345 ITR 241. It is also noted that various Tribunals such as DCIT vs. Sona Okegawa Precision Forgings (ITA No. 5386/Del/2010), Hero Motocorp (ITA No 5130/Del/2010), ThyssenKrupp Industries (ITA No 6460/Mum/2012), Abhishek Auto Industries (ITA No 1433/Del/2009) have taken a view that RBI approval of the Royalty rates itself implies that the payments are at Arm’s Length and hence no further adjustment needs to be made viewed from this angle too. Furthermore, we are of the opinion that once TNMM has been applied to the assessee company’s transaction, it covers under its ambit the Royalty transactions in question too and hence separate analysis and consequent deletion of the Royalty payments by the TPO seems erroneous. We draw support from Cadbury India (ITA No 7408/Mum/2010 and ITA No.7641/Mum/2010 wherein the ITAT upheld the use of TNMM for Royalty.

### **Observations:**

RBI approval indicates that necessary enquiries are done by Government Authorities and as such transaction is at Arm’s Length Price and hence no further adjustment needs to be made by TPO.

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**3) Section 14A / Rule 8D disallowance cannot be made without showing how**

## **assessee's claim/ computation is wrong:**

*CIT Vs. REI Agro Ltd (Calcutta High Court)*

In AY 2009-10 the assessee earned dividend income of Rs.1.65 lakhs which was claimed exempt u/s 10(34) of the Act. The assessee claimed that no disallowance u/s 14A could be made because -

- No expenditure had been incurred to earn the said dividend.
- No new investment was made during the year.
- No loans were taken for making the investments for earning the dividend income.

The AO was not convinced with the reply of the assessee and computed the disallowance at Rs. 32.43 lakhs u/s 14A by making calculation under Rule 8D. This was deleted by the CIT(A). The department filed an appeal before the Tribunal which was dismissed. The Tribunal relied on *J. K. Investors (Bombay) Ltd (ITAT Mumbai)* and noted that the AO had not examined the accounts of the assessee and had not recorded satisfaction about the correctness of the claim of the assessee before invoking Rule 8D. It held that while rejecting the claim of the assessee with regard to expenditure or no expenditure, as the case may be, in relation to exempted income, the AO had to indicate cogent reasons for the same and was not entitled to disregard the assessee's claim and straightaway embark upon computing disallowance under Rule 8D.

## **On appeal by the department to the High Court HELD dismissing the appeal:**

The AO disallowed the expenditure u/s 14A without first recording that he was not satisfied with the correctness of the claim as regards the claim that "no expenditure" was made by the assessee. The disallowance u/s 14A of the Income-tax Act, 1961 is plainly contrary to the provisions of the statute. The CIT allowed the appeal of the assessee and the Tribunal did not interfere. Challenging the order of the tribunal, the present appeal has been filed. We are of the opinion that no point of law has been raised. Therefore, this appeal is dismissed.

### **Observations:**

AO has to indicate rational reasons to disregard the assessee's claim and cannot straightaway embark upon computing disallowance under Rule 8D.

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## **4) Expenditure on discounting/ factoring charges is not in the nature of interest for purposes of TDS u/s 194A or disallowance u/s 40(a)(ia):**

*ITO Vs. M K J Enterprises Ltd (ITAT Kolkata)*

The term "interest" relates to a pre-existing debt, which implies a debtor creditor relationship. Unpaid consideration gives rise to a lien over goods sold and not for money lent as held in *Bombay Steam Navigation Co. Pvt. Ltd. Vs. CIT (1963) 56 ITR 52 (SC)* where interest on unpaid purchase price was not treated as interest on loan. It is

clear from the definition that before any amount paid is construed as interest, it has to be established that the same is payable in respect of any money borrowed or debt incurred. According to us, discounting charges of Bill of Exchange or factoring charges of sale cannot be termed as interest.

The assessee in the present case is acting as an agent. Now what is this, is to be seen. A Del Credere is an agent, who, selling goods for his principal on credit, undertakes for an additional commission to sell only to persons for whom he can stand guarantee. His position is thus that of a surety who is liable to his principal should the vendee make default. The agreement between him and his principal need not be reduced to or evidenced by writing, for his undertaking is a guarantee. A Del Credere Agent is an agent who not only establishes a privity of contract between his principal and the third party, but who also guarantees to his principal the due performance of the contract by the third party. He is liable, however, only when the third party fails to carry out his contract, e.g., by insolvency. He is not liable to his principal if the third party refuses to carry out his contract, for example, if the buyer refuses to take delivery. In the present case before us the assessee has assessed the income as Del Credere being trading in goods and merchandise and also dealing in securities and which is assessed as income from business and not income from other sources. The expenditure incurred is also on account of business expenditure and not interest expenditure in the nature of interest

falling u/s. 194A of the Act. Accordingly, these discount/factoring charges do not come within the purview of section 194A and assessee is not liable to TDS on these charges.

### **Observations:**

This ruling provides guidance that discounting and factoring charges do not answer the definition of "interest" under the Income Tax Act and, hence, do not attract TDS obligation for the Taxpayer.

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### **5) Employees PF/ ESI Contribution is also covered by section 43B & allowable as a deduction if paid by "due date" of filing ROI. ITC Ltd 112 ITD 57 (Kol) (SB) impliedly reversed**

*CIT Vs. Vijay Shree Ltd (Calcutta High Court)*

The assessee collected ESI & PF from its employees but did not pay the sum to the respective funds within the due date prescribed in relevant legislation. The amount was, however, paid before the due date u/s 139(1) for filing the ROI. The AO & CIT(A) disallowed the payment u/s 36(1)(va) read with section 2(24)(x). Before the Tribunal, the department justified the disallowance by relying on Ashika Stock Broking Ltd 139 TTJ 192 (Kol) (which in turn relied on ITC Ltd 112 ITD 57 (Kol) (SB) where it was held that section 43B does not apply to employees' contribution). However, the Tribunal declined to follow that law and allowed the appeal by relying on Sabari Enterprises 298 ITR 141 (Kar) and P.M. Electronics Ltd 220

CTR 635 (Del) where it was held that section 43B applied also to employees' contribution to ESI and PF and that if a payment was made within the due date u/s 139(1) of filing the ROI, the disallowance cannot be made.

**On appeal by the department to the High Court HELD dismissing the appeal:**

The only issue involved in this appeal is as to whether the deletion of the addition by the AO on account of employees' contribution to ESI and PF by invoking the provision of section 36(1)(va) read with s. 2(24)(x) of the Act was correct or not. In CIT vs. Alom Extrusion Ltd 390 ITR 306 the Supreme Court has held that the amendment to the second proviso to section 43(B) as introduced by Finance Act, 2003, was curative in nature and is required to be applied retrospectively with effect from 1st April, 1988. Such being the position, the deletion of the amount paid by the Employees' Contribution beyond due date was deductible by invoking the aforesaid amended provisions of section 43(B) of the Act. We, therefore, find that no substantial question of law is involved in this appeal and consequently, we dismiss this appeal.

**Observations:**

There are different views by different High Courts on the captioned matter. One needs to exercise prudence while taking the decision on the same.

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**6) Rejection of stay application by ITAT on the ground that "the financial**

**position of the assessee is very sound" and "government also needs liquid funds to manage its day to day affairs" & without discussing prima facie case is in disregard of law laid down in KEC International 251 ITR 158 (Bom)**

*Deloitte Consulting India Pvt. Ltd Vs. ACIT (Bombay High Court)*

The assessee filed a revised return in which it withdrew a claim for deduction of Rs.5.86 crore paid to its AE. The assessee claimed section 10A deduction on the enhanced income. The AO held that the revised return was filed to get over section 92-C(4) and the proviso thereto which provides that no deduction u/s 10-A would be allowed in respect of income enhanced having regard to the Arms Length Price (ALP). The AO's stand was upheld by the Tribunal. The AO levied penalty of Rs. 2.05 crore and refused to grant stay. The assessee filed a Writ Petition. The High Court held that that the assessee held a prima facie case on merits and granted partial stay of the demand till the decision of the CIT(A). Subsequently, the CIT(A) dismissed the penalty appeal and the assessee filed a stay application before the Tribunal. The Tribunal (order attached) rejected the stay application on the ground that "the financial position of the assessee is very sound" and "government also needs liquid funds to manage its day to day affairs".

**The assessee filed a Writ Petition to challenge the said order of the Tribunal. HELD by the High Court:**

The impugned order of the Tribunal has been passed in total disregard of the

principles laid down in KEC International Ltd 251 ITR 158 (Bom) wherein a Division Bench of this Court laid down parameters to be observed by the Authorities while considering the stay application. The Tribunal has not even given short prima facie reasons recording the Petitioner's case. The Petitioner does have a strong prima facie case on merits before the Tribunal. Thus, having regard to the fact that the Petitioner has already paid the full tax amount and also 25% of the penalty amount earlier, the Tribunal ought not to have required the Petitioner to deposit a further sum of Rs.50.00 lakhs. In fact, the Tribunal while passing the impugned order has not only ignored the directions in KEC but also the observations made by this Court in the Petitioner's own case.

### **Observations:**

Income tax officer should not give the decision on the *prima-facie* situation without going into the merits of the case.

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### **7) Supreme Court upholds initiation of prosecution for failure to file return:**

*Sasi Enterprises (Taxpayer) Vs. ACIT (Supreme Court)*

The assessee, a registered partnership firm, of which Ms. J. Jayalalitha and Mrs. N. Sasikala are partners, did not furnish returns of income despite several opportunities. The AO made a best judgement assessment u/s 144 and filed a complaint with the Magistrate against the assessee for committing

offences punishable u/s 276CC. The assessee challenged the filing of the complaint on the ground that as the assessment had not attained finality no offence had taken place and so the complaint was pre-mature. It was also pointed out that in the individual returns of the partners it was stated that as the accounts of the assessee-firm had not been finalized, its return of income could not be filed. The Magistrate and High Court dismissed the challenge to the complaint.

### **On appeal by the assessee to the Supreme Court, HELD dismissing the appeal:**

SC held that prosecution can be initiated against a taxpayer who fails to furnish return of income (ROI) within the statutory due date or in response to a notice issued by Tax Authority. The SC also reiterated that, in the prosecution proceedings for failure to file ROI on time, the initial burden lies on the taxpayer to prove the circumstances which prevented the taxpayer from filing ROI on time and it is not for Tax Authority to prove that taxpayer had wilfully committed the default. Further, the fact that taxpayer's assessment has not become final due to pendency of appeal proceedings would not act as bar against initiating prosecution proceedings.

The SC ruling emphasizes the need for strict adherence to statutory due date for furnishing ROI. This is imperative not only for claiming certain benefits such as of carry forward of losses and/or claiming tax holiday benefit but

also for avoiding risk of prosecution. Furnishing of ROI in due time in response to Tax Authority's notice assumes greater importance due to absence of protection against prosecution even if substantial taxes have been paid.

**Observations:**

Directors of company and partners of firm need to be particularly careful of the harsh consequence of personal prosecution for default by the company/firm/LLP.

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**DUE DATES CHART FOR THE MONTH MARCH 2014 (Various Acts):**

Date	Particulars
5 <sup>th</sup>	Service Tax payment for the previous month (6 <sup>th</sup> if paid electronically)
6 <sup>th</sup>	Payment of Excise Duty for all assesses (including SSI Units) for the previous month
7 <sup>th</sup>	TDS remittance for the previous month
10 <sup>th</sup>	Monthly Excise return by all assesses (except SSI Units) coming under CEA in Form ER1
10 <sup>th</sup>	Monthly Excise return by specified class of assesses regarding principal inputs coming under CEA in Form ER 6
15 <sup>th</sup>	Advance Income Tax- Final Instalment all assesseees.
20 <sup>th</sup>	MVAT- TDS Payment of February
20 <sup>th</sup>	Payment of contribution under Employee EPF & MP Act, 1952 (including 5 days of grace)
21 <sup>st</sup>	Payment of contribution under Employees State Insurance Act, 1948
21 <sup>st</sup>	Payment of Monthly MVAT under MVAT Act, 2002
31 <sup>st</sup>	Service Tax payment by other than Companies for January to March
31 <sup>st</sup>	Service Tax Payment by Companies for March
31 <sup>st</sup>	Payment of Excise Duty for month of March by all the Assesseees
31 <sup>st</sup>	Payment of Profession Tax for the employees
31 <sup>st</sup>	Profession Tax Annual Return F.Y 13-14
31 <sup>st</sup>	Last date for filing belated Return of Income and Wealth for A.Y. 2012-13

\*If payment of MVAT is made as per time prescribed, additional 10 days are given for uploading e-return.

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*This communication is intended to provide general information, guidance on various professional subject matter and should not be regarded as a basis for taking decisions on specific matters. In such instances, separate advice should be taken.*