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EDITORIAL VINOD JAIN*

SECTION 277A — INCOME TAX ACT, A DRACONIAN PROPOSAL

The Hon'ble Finance Minister of India Mr. P. Chidambaram, has proposed insertion of a new section 277A in the Income Tax Act enabling the Assessing Officers to initiate criminal proceedings in case of falsification of books of account or documents. In terms of this section:

- If any person (first person) willfully and with intent to enable the other person (second person);
- to evade any tax or interest or penalty;
- make or causes to make any entry or statement, in any books of account or other documents;
- which is false and which the first person either knows to be false or does not believe to be true.
- Then the assessing officer may initiate criminal prosecution of the first person, punishable with rigorous imprisonment for a term, which shall not be less than 3 months, but may extend up to 3 years and with fine.

- In terms of explanation to section, it shall be sufficient in any charge under this section to allege a general intent without specifying any particular instance or sum of tax, penalty or interest, which has been or would have been evaded by such person.



The aforesaid proposal in the Budget 2004 has created a terror of potential harassment and corruption, which may result out of such formidable powers given to the Assessing Officers. The people who shall be worst affected by the proposed section would be the employees of the assessee, specially working in the finance department, the owners, partners, Directors and other persons in charge or person who may be alleged to be responsible for making or causing to make a false entry or statement with a view to

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GLOBAL TRUST BANK FIASCO — LESSONS TO BE LEARNED

The Reserve Bank of India recently announced a three month suspension of operations of Global Trust Bank (GTB), indicating that the bank has already lost its net-worth and it may not be able to meet its various liabilities towards its depositors and other stake holders. The Global Trust Bank has been having very wide operations in India with more than 100 branches, a very large portfolio of public deposits, clearing banker for National Stock Exchange and providing banking services to a large number of reputed industrial and business houses in India. The current action of Reserve Bank of India against Global Trust Bank, taken with a view to arrest further damage, has severely impacted millions of deposit holders, capital market, industry and businesses and various other stake holders.

This action becomes very serious, in view of the background that in March, 2002 the GTB's audited balance-sheet showed a networth of Rs.400.4 crores and a profit of Rs.40 crores. The RBI inspection as on 31st March, 2002 revealed that net-worth of the bank is actually negative. In view of very large variation in the assessment of GTB's financial position, as reported by the Bank Auditors and by RBI Inspectors, an independent Chartered Accounting Firm was appointed by RBI to reconcile the position. The report submitted on February, 2003 by the independent Chartered Accountant Firm confirmed the RBI assessment. In view of the alleged involvement of GTB in Ketan Parikh scam, Reserve Bank of India not only interfered by removing the Chairman of the Bank but also placed restrictions on GTB for certain type of advances, certain pre-matured withdrawal of deposits, declaration of dividend and

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Section 277A – Income evade tax.

The politicians, providing affidavits at the time of nomination for election as well as details of the election expenses to the Election Commission, could be subject to allegation of falsification of such statements. Especially when in view of the fact that the Election Commission is providing copies of these statements filed with it to the respective Income Tax Officers for their review. The senior bureaucrats heading as well as other employees working in the public sector undertakings, various local authorities, Government corporations and other bodies filing Income Tax Returns may be subject to a similar charge of falsification of books of account.

It is nobodies case that falsification of books of account should be allowed to happen, without any consequences but in a democratic set up such a rampant powers cannot be given to the Assessing Officers, a large number of whom in the public eye have doubtful integrity. These corrupt officials may misuse the power and raise these allegations in all those cases where their palms are not greased.

The allegation of general intent of falsification of books of account can be made, even in all genuine cases, where the assessing officer makes an addition in the income, disallowing certain expenditure, adding back share capital, subscription or loan receipts or any other similar cases of alleged concealment of income or even disputed classification between capital and revenue. This kind of powers will only increase the uncalled corruption and avoidable harassment by the tax department.

The explanation to Sec. 277A, expand the scope of the section, providing powers to prosecute even in those cases where there is only allegation of general intent and there

is no case of actual instance of evasion of any tax, penalty or interest. It is a matter of concern to provide such a wide criminal prosecution powers to Assessing Officers, in a democratic country like ours, even in genuine cases where there is no evasion of any kind.

It may be noted that the Income Tax Act already give substantial powers to the tax authorities to prosecute tax evaders vide section 276C – willful attempt to evade taxes, Section 278 – abetment of false return, Section 271(1)(c) for concealing particulars of income or furnishing inaccurate particulars of income. Even the Indian Penal Code in Section 477A has given ample powers to the State to prosecute the officers and employees of the company and others who are acting in such capacity, who undertake falsification of books of account for defrauding others. The resort to even this provision is adequate in case of falsification etc. to evade taxes.

Section 277A is not required in the statute book at all. On the contrary it is inevitable for the Government to examine the functioning of tax department to bring responsibility on the assessing officers, wherever there are wrongful assessments, harassment and corruption. This is simply achievable by amending section 293 of the Income Tax Act, 1961 by withdrawing a bar of suits against these officials in the courts. The revenue collection process with these measures shall be more effective and will go a long way to improve faith building in the taxpayer.

There is genuine apprehension in the minds of auditors and tax advisors about the potential misuse of section 277A by the corrupt income tax officials. Let the government consider not to enact a statute with blanket powers to its officials which may be used against the genuine professionals who work to discharge their professional obligations and responsibilities. Instead the Government should take tough action against actual evaders of tax including those who are tainted with the allegations of corruption.

The democratic India including the profession of Chartered Accountants cannot agree to have any right by the Government or by the Tax Department to harass or prosecute genuine auditors and tax advisors and persons working in the accounts departments just on allegation of "general intent", to evade tax without there being any actual evasion.

We, the profession of Chartered Accountants

is committed towards better tax compliance and always advise our clients to pay rightful and due taxes on their income in their self interest. There is a general belief in the accounting profession that payment of more taxes will always open up new doors of peace, growth and prosperity. Allegation in Times of India and other newspapers, trying to tarnish the image of the CA profession in general without any adequate basis is viewed very seriously by the profession and is hereby condemned. No one should generalize, certain specific exceptional instances of corruption to the whole class neither in case of Accountants nor in case of Bureaucrats, Politicians, media and other sections of the Society. We in our great nation have more honest citizens than the ones with doubtful character.

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GTB Fiasco - Lessons to

capital market exposure and appointed their nominees on the Board of Directors.

The Bank's accounts of March, 2003 reported marginally positive net-worth, in the backdrop of change of auditors at the instance of Reserve Bank of India. However, RBI's inspection again showed that the bank net-worth was further eroded and capital adequacy ratio was negative. In November, 2003 GTB was advised to take steps to infuse fresh capital to restore its capital adequacy ratio to 9% with a time bound program. The bank was also advised to explore options of raising capital through domestic source or through merger with another bank.

In July, 2004, the GTB came forward with the proposal for infusion of capital and restructuring. The sources informed that 2 leading Accounting Firms had valued the shares of GTB around Rs.50/- for the purpose of its restructuring and / or amalgamation with another bank. In the capital market also, the shares of GTB have been quoting above par and have recorded a 52 week high of Rs.36.50 per share during last one year. There are number of serious issues emerging out of the aforesaid scenario:

1. Why and how the auditors of Global Trust Bank, in March, 2002 gave a true and fair view to financial statements of GTB with a net-worth of Rs.400 crores, whereas the net-worth was actually negative.
2. Even in March, 2003, the Reserve Bank

of India found that the net-worth has been further eroded.

3. Was it not necessary for Reserve Bank of India (RBI) to disclose all material facts in this regard in a transparent manner, with a view to safeguard the interest of public depositors, investors and other stakeholders in the bank.

4. A large-scale speculation was made on possible merger of Global Trust Bank (GTB) with other banks at attractive prices, thereby inflating the share price of GTB, attracting fresh investors. A significant loss has occurred to all such investors in the equity shares.

5. What is the justification of RBI's announcement that GTB will be merged into Oriental Bank of Commerce without any payment to the existing shareholders of GTB, in the backdrop of such a high valuation done by independent accounting firms?

6. Why the RBI has not come out with a white paper on the GTB, properly elucidating all facts and figures relevant to this matter for the benefit of public investors and all other stakeholders.

7. Whether the role of auditors of the bank in March, 2002 and March, 2003 have been examined in detail, in the backdrop or RBI inspection report as well as the report of the independent accounting firm? If yes, what action has been initiated by the RBI, in consultation with Institute of Chartered Accountants of India (ICAI) in this regard? How can RBI just file a simple letter with ICAI, without a formal complaint with all relevant facts and figures.

It has been observed that during last 5 years, several financial scams, frauds and manipulations have taken place in the financial market, wherein a significant involvement of private sector banks, foreign banks and large co-operative banks have been noticed. It may also be noted that the regulatory mechanism of RBI on these banks significantly suffered from the absence of independent audit and detailed

reporting. The public sector banks are subjected to a detailed audit not only by a group of Central Statutory Auditors appointed by the RBI but also through appointment of branch auditors for an in-depth audit of branches. The auditors are appointed by RBI and their remuneration is also fixed by it. A detailed long form audit report and several other details are required to be submitted by these auditors with RBI, enabling not only RBI but also the management of the concerned banks to get benefit of an independent, in depth reporting by these audit firms. The RBI has also laid down severe restrictions on these auditors to associate with the concerned bank in any other manner, with a view to ensure their independence. The system has worked very effectively and is gaining further momentum by the involvement of ICAI in advising RBI on the scope, coverage and reporting requirements of these auditors of public sector banks.

RBI has even agreed in principle, to examine appointment of concurrent auditors and other internal auditors of public sector banks out of the panel to be prepared, in consultation with ICAI. The detailed modalities and the issues being raised by Indian Bankers' Association are in the process of being sorted out. On the other hand it is noticed that private sector banks, co-operative banks and foreign banks are only appointing one audit firm, of their choice, to not only act as central statutory auditors but also to conduct audit of all its branches. The auditors' appointment, remuneration as well as rotation is decided by the management of the bank whose deeds and misdeeds are required to be commented upon by the statutory auditors so appointed by the management. The independence of auditors is further impaired by appointment of these audit firms for several consulting and other assignments by the same banks. The internal auditors, including concurrent auditors are appointed by the management on their own. The RBI and ICAI do not play any role in the scope, coverage and reporting requirements of these banks. RBI also has no role in deciding appointment or remuneration of these auditors except that the auditors selected by the concerned bank has to be formally approved by RBI.

RBI and Government of India should examine to bring necessary regulatory changes to ensure that all the private sector banks, co-operative banks as well as foreign banks

operating in India are subjected to a detailed independent audit, conducted by auditors to be appointed by RBI, on the same basis on which they make appointment of the public sector banks. Separate auditors should be appointed, on a similar basis, for the various branches of these banks to ensure an independent, in depth review, besides ensuring adequate scope, coverage and reporting requirements, in consultation with ICAI. Adequate emphasis is required on Risk Management including Information System Risk

The RBI, ICAI as well as Government of India need to examine various issues raised by us in the aforesaid paragraphs in the interest of survival and growth of the financial sector. The growth of private sector banks, co-operative banks as well as foreign banks in India is crucial for the growth of the Indian economy. It is very important for the regulators to ensure that there are no more failures of system in the banking sector. The action should be immediately initiated to further strengthen the system and for ensuring transparent working of these banks as well as their relationship and monitoring by RBI.

Even in the insurance sector the Insurance Regulatory and Development Authority (IRDA) and the Government of India need to ensure a detailed independent supervision of private sector insurance companies who have been permitted to operate in India. It may be necessary to ensure a detailed independent, in depth review of the operations of private sector insurance companies including aspects of investments, claims, policy holders' rights as well as proper financial discipline in these private sector insurance companies. IRDA can consult with ICAI for a detailed scope, coverage and reporting requirements and should consider appointing independent audit firms from the panel that is already prepared by IRDA, in consultation with ICAI.

Liberalization and privatization in the financial segment must follow stringent financial discipline. Private Sector banking failures do not have a solution in merger with the healthy nationalized banks. GTB's merger gives over Rest. 300 crores tax advantage to OBC at the cost of exchequer. Unscrupulous beneficiaries who aided the borrowings turning to NPAs are the only gainers. Undoubtedly it calls for rigorous and constant monitoring of its functioning by the independent professionals.

1 Cheque Truncation and e-Cheque

For the purpose to introduce a system of cheque truncation in India, a Working Group on Cheque Truncation and e-cheques (Chairman: Dr. R B Barman, ED) was constituted by the RBI. The Working Group submitted Part I of its report in July 2003 and suggested a model for the cheque truncation in India.

The recommendations of the Working Group have been accepted. Accordingly, it has been decided that an Image based Cheque Truncation Pilot Project be initiated by the Reserve Bank for the Bankers Clearing House of the National Capital Region of Delhi and its nearby areas. The pilot project is expected to be made operational in early part of 2005.

The major recommendations of the Working Group are as under:

- The physical cheque will be truncated within the presenting bank.
- Within the presenting bank the point of truncation could be decided by each individual member bank providing for Service Bureau models where banks can approach or set up Service Bureaux for capturing images and MICR data.
- Settlement will be generated on the basis of current MICR code line data.
- Electronic images will be used for payment processing.
- Grey scale technology will be deployed for imaging.
- Images will be preserved for 8 yrs.
- A Centralised Agency per clearing location will act as an image warehouse for the banks. Group recommended norms for agencies to provide the service.
- Public Key Infrastructure will be deployed to protect images and data flow over the network.

(Source: RBI/2004-05/28 - July 01, 2004)

2 Requirement of minimum NOF for NBFCs

In terms of Notification No. DNBS.132 / CGM (VSNM) - 99 dated April 21, 1999, the minimum NOF requirement for the new companies applying for grant of CoR to commence business of an Non Banking Financial Institution (NBFI) was raised to Rs.200 lakhs. In the light of the above, it is considered necessary in the interest of the depositors and in public interest that the NBFCs which were granted Certificate of Registration (CoR) in the non-public deposit taking category should meet the minimum capital requirements of Rs.200 lakhs for being eligibility to apply to RBI for accepting public deposits.

Accordingly, such NBFCs are required to ensure compliance with this requirement before applying to RBI for approval to accept public deposits and that such request would be entertained only after two years of track record of performance of the company.

(Source: RBI/2004-05/69 - July 24, 2004)

3 Measures against Wilful Defaulters

As per RBI, banks / FIs are required to initiate the following measures against wilful defaulters:

- (a) No additional facilities should be granted by banks / FIs.
- (b) Entrepreneurs/promoters of companies, where diversion of funds, siphoning of funds, misrepresentation, falsification of accounts and fraudulent transactions have been identified by banks / FIs, should be debarred from institutional finance from banks / FIs, Government owned NBFCs, investment institutions, etc. for floating new ventures for a period of 5 years from the date the name of wilful defaulter is disseminated in the list of wilful defaulters by RBI.
- (c) Initiate legal proceedings and foreclosure for recovery of dues expeditiously, wherever warranted, against the borrowers / guarantors.
- (d) Banks/FIs should adopt a proactive approach for a change of management of the wilfully defaulting borrower unit, wherever possible.

(e) Initiate criminal proceedings against wilful defaulters wherever necessary.

(f) Incorporate a covenant in the loan agreement with the borrowing companies stipulating that they should not induct a person who is a director on the Board of a company which has been identified as a wilful defaulter and that in case, such a person is found to be on the Board of the borrower company, it would take expeditious and effective steps for removal of the person from its Board.

(g) Banks / FIs should closely monitor the end-use of funds and obtain certificates from borrowers certifying that the funds are utilised for the purpose for which they were obtained. In case of wrong certification by the borrowers, banks / FIs may consider appropriate legal proceedings, including criminal action wherever necessary, against the borrowers.

In this connection it is essential to recognise that there is scope even under the existing legislations to initiate criminal action against wilful defaulters depending upon the facts and circumstances of the case under the provisions of Sections 403 and 415 of the Indian Penal Code (IPC) 1860. Banks / FIs are, therefore, advised to seriously and promptly consider initiating criminal action against wilful defaulters, wherever considered necessary, based on the facts and circumstances of each case under the above provisions of the IPC.

(Source: RBI/2004-05/63 - July 23, 2004)

4 Gold Card Scheme for Exporters

In reference to RBI Circular No. IECD.No.12/04.02.02/Gold Card/2003-04 dated May 18, 2004 on the captioned subject, it has been reported that some banks have fixed certain minimum annual turnover for issuance of Gold Card, as an eligibility criterion.

As the objective is to extend this Scheme to all credit worthy exporters, including those in SME segment, to simplify credit access, banks are advised not to prescribe such a criterion for eligibility for the Gold Card Scheme.

(Source: RBI/2004-05/56 - July 20, 2004)



5 6.5% Savings Bonds, 2003 (Non Taxable)

It has been decided by the Government of India vide their Notification F.No.4(9)-W&M/2003 dated July 9, 2004 that the issue of 6.5% Savings Bond, 2003 (Non Taxable) shall cease with effect from the close of business on Friday, July 9, 2004.

(Source: RBI/2004-05/31 - July 09, 2004)

6 Issue of Credit Card by NBFCs

NBFCs are not allowed to undertake credit card business without prior approval of RBI. However, RBI has been regularly receiving requests from NBFCs for permission to issue debit cards, stored value cards, smart cards, value added cards, etc. In this connection, RBI has advised that the issue of such cards have a characteristic akin to demand deposits as they are payable at the convenience of the card holders and acceptance of deposits payable on demand which is a banking function. The issue of such cards is, therefore, violative of the extant NBFC Directions.

RBI has advised banks that they should not issue smart / debit cards in tie-up with any other non-bank entities (cf. DBOD.NO.FSC.BC. 106/24.01.019/2003-04 dated June 30, 2004).

In regard to credit card business, it is clarified that any company including a non-deposit taking company intending to engage in this activity requires a Certificate of Registration, apart from specific permission to enter into this business, the pre-requisite for which is a minimum net owned fund of Rs.100 crore and subject to such terms and conditions as the Bank may specify in this behalf from time to time.

(Source: RBI/2004-05/22 - July 07, 2004)

7 Sovereign guarantee extended to all GTB deposits

The central government extended sovereign guarantee to all deposits lying with the beleaguered Global Trust Bank (GTB) after the RBI imposed a three-month moratorium on the private sector bank. Mr. N.S. Sisodia, banking secretary assured depositors that their entire funds are safe.

8 US Fed lifts rates by 50 bps

The Federal Reserve raised US interest rates for the first time in four Years by half of a percent point in two tranches of quarter a percent point each, for the purpose to head off potential inflation.

The decision moves the benchmark federal funds rate to 1.5%. The fed action boosted the dollar and weighed on US government bonds and the stock market.

9 Master Circulars issued by RBI

RBI issued following Master Circulars in the month of July, 2004:

- (a) Direct Investment by Residents in Joint Venture (JV)/Wholly Owned Subsidiary (WOS) abroad.
- (b) Export of Goods and Services.
- (c) Para-banking Activities, which includes
 - Subsidiary Companies; • Investment ceiling in financial services companies;
 - EL, HP business and factoring services; • Mutual Fund business;
 - Credit Card & Smart/Debit Card Business; • Money Market Mutual Funds (MMMFs); • 'Cheque Writing' Facility for investors of MMMFs;
 - Entry of banks into Insurance business;
 - Underwriting of Corporate Shares and Debentures.
- (d) Credit Exposure Norms and Statutory / Other Restrictions on Loans & Advances.
- (e) Lending to Priority Sector.
- (f) Import of Goods and Services.
- (g) Guarantees and Co-acceptances.
- (h) Guidelines for Issue of Commercial Paper.

10 Don't punish tax advisers - ICAI

The Institute of Chartered Accountants of India (ICAI) has objected to certain provisions of the proposed section in the Finance Bill, 2004, that makes the advisers to tax evaders liable for imprisonment. The Institute has taken up the issue with the finance ministry.

The main objection is against the explanation attached to the proposed section, where professionals like Chartered Accountants and Tax Advocates can be implicated under the section without giving any specifications like the amount evaded.

A delegation consisting of Mr. Vinod Jain (FCA), Mr. Ramesh Chandiwala (FCA), Sh. Avneesh Matta (FCA), Mr. Rajiv Kohli (FCA), Mr. Ashok Goyal (FCA) and Mr. Rajesh Jain (FCA) met the President, ICAI and submitted a memorandum against Section 277A, as it would cause unnecessary harassment to innocent people also.

The provision could be misused, with wilful evaders simply putting the blame on the professionals handling the accounts.

The memorandum sent to finance minister has also expressed discontent against the Section 277-A, saying that the existing provision was sufficient to check misconduct on the part of the professionals.

Moreover, under the existing section, the prosecution of defaulters happened only after the establishment of guilt, which is required by the criminal law prevailing in the country.

The memorandum has stated that offences like tax evasion are of economic nature and called for financial penalties only.

INMAGS

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CAPITAL MARKET

1 SEBI releases Draft Norm for IDRs

SEBI has come out with draft norms for foreign companies interested in raising funds from India through the issue of Indian Depository Receipts (IDRs).

As per SEBI the minimum size of an IDR issue should not be less than Rs.50 crore and it will be open only to QIBs. The market regulator has also come out with disclosure norms for the IDR issues.

The applicable Regulatory Body should not have prohibited the company proposing to issue IDRs to issue securities and the company should have good track record with respect to compliance with Securities market regulations.

2 Norms for Employee Stock Options

SEBI has amended the Employee stock option scheme (ESOS) and employee stock purchase scheme (ESPS) guidelines to include provisions of mandatory disclosures of employee compensation cost using fair value of employee stock option and purchase schemes.

3 BSE's Weekly Options Plan

SEBI has cleared a plan for weekly equity options for equity derivatives products- index option and stock option- proposed by the

- ❑ BSE proposal aims to revive its virtually dead F&O business.
- ❑ New option contracts to be introduced every Monday
- ❑ Settlement of options series will be every fortnight.
- ❑ BSE to introduce weekly stock options on 10 stocks initially

Stock Exchange, Mumbai (BSE). The new products are likely to be launched in September.

TAXATION

1 Income Tax Decisions

a) Validity of Notice under Section 148

Hon'ble Bombay High Court in the matter of *ICICI Bank Ltd. Vs K. J. Rao and Another* held that claim for depreciation at a higher rate is not a failure to disclosed material fact. Hon'ble High Court pointed out that a conscious decision to grant depreciation at a particular rate is taken by the assessment officer at the time of framing assessment and later on another assessing officer arrives at the conclusion that the rate of depreciation allowed by the earlier assessing officer was at the higher rate then it is only a change of opinion. Revenue can not take the view that assessee failed to disclose material facts. Notice issued by revenue u/s 148 for reassessment is not valid and liable to be quashed. [268 ITR 203]

b) Lease rent for extracting granite

Hon'ble Madras High Court in the matter of *Enterprising Enterprises Vs. Deputy Commissioner of Income Tax* held that lease rent paid to the Government for acquiring the right to excavate the quarry for granite, on lease was capital expenditure. The similar decision was given by Hon'ble Supreme Court of India in the matter of *Pingle Industries Ltd Vs. CIT* (1960) 40 ITR 67 [268 ITR 95]

c) Cash Credit in the books of partnership firm

Hon'ble Patna High Court in the matter of *CIT Vs. Md. Perwez Ahmad and Others* did not find any substantial question of law from the order of the Tribunal when the Tribunal after having considered the materials on records has found that section 68 of the Income Tax Act, 1961, is not attracted in the case for the reason that in this case credit in the books of account of the assessee- firm is on account of introduction of capital by the partner and the firm has failed to prove the amount credited in the books of account and as such it would be assessed in the hand of the partners as unexplained investment. [268 ITR 381]

d) Gain on cancellation of exchange forward contract

Hon'ble Income Tax Appellate Tribunal Special Bench, New Delhi in the matter of *Apollo Tyres Ltd. Vs. ACIT* held that gain on cancellation of the foreign exchange forward contract for hedging purposes is a capital receipt and should be deducted from the cost of asset of the company. [268 ITR(AT) 1]

e) Deduction of expenses only on payment basis

According to Section 43 of the Income Tax Act, Excise duty is deductible only on payment basis. But Advance payment of Excise duty will not be deductible, which is so decided by Hon'ble Income Tax Appellate Tribunal, Hyderabad Bench, in the matter of *DCIT Vs. C.W.C. Wines (P) Ltd.* [268 ITR (AT) 23]

SERVICE TAX

1 Recovery of Service Tax Credit

Service Tax Credit utilized by the Output Service Provider shall not be recovered from him when the Input Service Provider after collecting the amount of service tax from the former fails to deposit it in Government exchequer.

This amendment has been made by amending Rule 6 of Service Tax Credit Rules, 2002 vide notification no. 6/2004 - Service Tax, dated July 9, 2004

(Source: F.No. 334/3/2004-TRU)

2 Service Tax on Commission Agents

Business Auxillary Services provided by Commission Agents (engaged in sale or purchase of goods) were hitherto exempt from service tax vide Notification No. 13/2003 - Service Tax, dated 20th June, 2003.

Now Notification No. 8/2004 - Service Tax, dated 9th July, 2004 has amended the above notification bringing the Commission Agents (except those engaged in sale or purchase of agricultural produce) in the Service Tax net.

(Source: F.No. 334/3/2004-TRU)

1 ICAI to write to GTB auditors

On the GTB matter, the ICAI intends to seek information and views from the auditors concerned, the management of GTB and even the RBI. Once collected from the parties, the information and evidence would be submitted to the Central Council, which can take a final call on whether the matter needs to be referred to the Disciplinary Committee of the institute or not.

Asked whether the institute's letter would be only to the auditor of GTB for the financial year 2002-2003, the ICAI President indicated that the letters would be sent to the auditors concerned of GTB for the financial years 2001-2002 and 2002-2003.

"The letter that we received from the central bank pertained to more than one financial year and more than one auditor," Mr Sunil Goyal, President, ICAI said.

2 Applicability of AS 11

ICAI recently issued an Announcement on Applicability of AS 11 (revised 2003), the Effects of Changes in Foreign Exchange Rates, in respect of exchange differences arising on a forward exchange contract entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction.

Some persons have expressed a view that the Announcement amounts to withdrawal of AS 11 with regard to forward exchange contracts. It is hereby clarified that AS 11 continues to be applicable to exchange differences in respect of all forward exchange contracts other than those entered into, to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction.

3 Clarification on AS 21

ICAI has decided that elimination of unrealised profits and losses in respect of transactions entered into during accounting periods commencing on or before 31-3-2001, is encouraged, but not required on practical grounds. The above position also applies in respect of AS 23, Accounting for Investments in Associates in Consolidated Financial Statements and AS 27, Financial Reporting of Interests in Joint Ventures while applying the 'equity method' and 'proportionate consolidation method' respectively.

4 Prudential Norms on Agricultural advances

In order to align the repayment dates with harvesting of crops, banks are advised that with effect from September 30, 2004 the following revised norms will be applicable:

- a) A loan granted for short duration crops will be treated as NPA if the instalment of the principal or interest thereon remains unpaid for two crop seasons beyond the due date.
- b) A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains unpaid for one crop season beyond the due date.

For the purpose of these guidelines, "long duration" crops would be crops with crop season longer than one year, and crops which are not "long duration" crops, would be treated as "short duration" crops.

(Source: RBI/2004-05/37 - July 12, 2004)

5 "Credit Lyonnais" - Exclusion from the Second Schedule to the RBI Act

It has been advised by the RBI that the name of "Credit Lyonnais" has been excluded with effect from 22nd May 2004 from the category of "Scheduled Banks" provided under the Second Schedule to the Reserve Bank of India Act, 1934.

(Source: RBI/2004-05/19 - July 06, 2004)

6 Accounting for Taxes on Income in Interim Financial Results

The Hon'ble Finance Minister has introduced the Finance Bill, 2004, on 8th July 2004. The Bill proposes certain changes in the tax rates and tax laws including increase in the tax rate by levy of surcharge of two percent as additional surcharge to be called education cess on income-tax. Such proposals in the Finance Bill have an effect on the measurement of the tax expense including deferred tax expense and amounts of deferred tax liability and deferred tax assets. In this regard, an issue is being raised as to whether these proposals should be taken into consideration for accounting for taxes on income for preparation of the quarterly financial results for the quarter ending June 30, 2004.

Accounting Treatment

The proposals with regard to changes in tax rates and tax laws announced on July 8, 2004, should not be taken into consideration while accounting for taxes on income for the quarter ending 30th June, 2004. Therefore, the tax expense for the quarter ending 30th June, 2004, should be measured without taking into consideration the proposals with regard to changes in tax rates and tax laws announced on July 8, 2004. Similarly, the balance of the deferred tax liability/asset as on March 31, 2004, is not required to be remeasured in the context of such proposals.

In the quarterly financial results for the period ending 30th June, 2004, the disclosure of the fact of the proposed changes in the tax rates and tax laws, to the extent relevant in the enterprise's context should be made as per the requirement (relating to disclosure of material event or transactions subsequent to the end of the quarter) contained in Clause 41 of the Listing Agreement entered into between stock exchanges and listed enterprises, if the change in tax rates and tax laws is considered material in the context of the facts and circumstances of the enterprise.

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UNITED STATES OF AMERICA (U.S.A.) TAXATION

TAXATION OF INDIVIDUALS IN U.S.A.

The United States of America (U.S.A.) imposes income taxes at both the federal and state levels. State income tax systems vary widely; some states charge just a percentage of the federal tax, others impose rates on net income defined under state laws, and others charge different rates on earned income and passive income. Only the federal income tax is considered here.

Federal income tax is imposed on both resident and non resident individuals and entities (Internal Revenue Code (IRC) "1, 2(d), 11(a) and 11(d)).

US citizens and tax residents are subject to US income tax on worldwide income. This contrasts to non resident alien individuals (NRAs), who are taxed only on certain items of US-source income and on income "effectively connected with the conduct of a trade or business" in the United States (IRC' 871(a) and (b)).

Residents

Tax residents status is obtained in one of three ways (IRC' 7701(b)):

- (1) lawful admission to the United States as a permanent resident (i.e. possession of a "green card")
- (2) meeting an objective "substantial presence test" by physically being in the United States for at least 183 days, counting all of the days of presence in the current year, plus one third of the days of presence in the first preceding year, plus one sixth of the days of presence in the second preceding year, or
- (3) by electing in certain circumstances to be treated as a US tax resident during the first year of presence.

Presence for certain purposes and under certain visa categories may be ignored in determining "substantial presence" (IRC' 7701 (b) (5)).

Income Tax treaties with the United States may also affect an individual's residency status for some purposes.

Credit for Taxes paid in foreign jurisdiction

A US citizen or tax resident is subject to US income tax on worldwide income, with credits generally allowed for income taxes paid to foreign jurisdictions (IRC'901). Income earned by a partnership is considered earned directly by its partners and generally has the same tax character to them as it had to the partnership (IRC' 702(b)).

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