NEWSLETTER

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Chartered Accountants

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1 Accounting and Auditing

1. Expert Advisory Opinion

Disclosure of income tax expense / assets, interest expense and borrowings, etc., in the segment report

A. FACTS OF THE CASE

A Listed company is engaged through its subsidiaries, joint ventures (JVs) and associates, in generation of power, development of expressways, airport infrastructure facilities and special economic zones. As per the concession agreements with grantors, the company is required to carry out each of its infrastructure projects through a separately designated Special Purpose Vehicle (SPV) which is either a subsidiary, associate or a JV.

At present, the company has about 100 subsidiaries / associates/JVs. It prepares its standalone financial statements and also consolidated financial statements (CFS).

The querist has stated that under CFS, segment report is prepared considering business segment as the primary segment and geographic segment as the secondary segment. They have identified the business segments as Power, Roads, Airport, Engineering, Procurement & Construction (EPC) and others. Others include the operations, like, real estate development, investment companies which do not qualify for separate disclosure as segments as per the threshold limits prescribed under Accounting Standard (AS) 17, 'Segment Reporting'. Further, each sector has many SPVs which are independently incorporated companies. Further, it was stated that each of the SPVs prepares its stand alone annual accounts including computation of deferred taxes and current taxes and discharging its tax liability distinctly etc.

For the preparation of CFS, the company is of the view that the tax assets / expenses are part of the respective segments only, as the same are distinctly identifiable and directly attributable to those respective sectors/segments. Further since specific loans have been obtained by the SPV for the project, the interest and Loans taken are also to be disclosed under respective segment. Accordingly, the company has prepared the segment report by classifying the tax assets/expenses under each of the respective segments. However, the same is not acceptable to the auditors, who are of the view that the same should be disclosed as an unallocated item in the segment report and that interest expense relating to loans borrowed by SPVs for their projects, overdrafts and other operating liabilities should also not be included in the segment expense in the CFS.

B. QUERY

1. Whether the tax assets/expenses need to be disclosed under respective segments or to be disclosed as 'unallocated' in the segment report of CFS

2. Whether interest expense incurred by SPVs coming under individual sectors (which are treated as segments under CFS) needs to be disclosed under respective segments itself or to be disclosed under unallocated item.

3. What would be the position of borrowings/loans taken in each segment while preparing CFS?

C. POINTS CONSIDERED BY THE COMMITTEE

1. The Committee noted that interest and income tax expense are explicitly excluded from the definition of 'segment expense'. In view of the definition of 'segment result', interest and income tax expense are also excluded from the segment result. Similarly, the Standard specifically excludes income tax assets/liabilities from the segment assets/liabilities. Accordingly, the Committee is of the view that interest and income tax expense in the present case, though being specifically identifiable and related to particular segments cannot be included in the segment expense and in the calculation of segment result. Similarly, income tax asset/liability also cannot be included in the segment assets/liabilities in the segment report of the CFS.

2. Interest expense is included as a part of the segment result only when the interest is added to cost of inventories as per the requirements of Accounting Standard -16 and a note to the effect has to be given that the segment result has been arrived at after considering interest expense.

3. For reporting of borrowings/loans specifically related to a segment in the consolidated segment report, the Committee notes from the definition of the term 'segment liabilities', which states:

   "Segment liabilities are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. If the segment result of a segment includes interest expense, its segment liabilities include the related

interest-bearing liabilities. Segment liabilities do not include income tax liabilities."

The Committee is of the view that if the interest expense is not included in the segment result, segment liabilities would also not include the related interest-bearing liabilities. Accordingly, the Committee is of the view that borrowings/loans, even though, specifically raised by each segment, cannot be included in the calculation of segment liabilities.

4. Para 41 and 42 of the accounting standard also encourages additional disclosure regarding the segment performance without arbitrary allocation (in addition to mandatory disclosure required under this standard)

D. OPNION

1. The tax assets / expense cannot be included in the segment assets and segment expenses, respectively. However, if the company so desires, it may disclose the performance of each segment after income tax expense and income tax asset as additional information relating to these segments separately.

2. The interest expense incurred by SPVs coming under individual sectors (which are treated as segments under CFS) cannot be included in the segment expense. However, if the company so desires, it may disclose the performance of each segment after interest expense relating to these segments separately, without affecting the 'segment result'.

3. The borrowings / loans cannot be included in the calculation of segment liabilities. However, these may be shown by way of additional information separate from segment liabilities.

2. Standard on Assurance Engagement (SAE) 3402
Assurance Reports on Controls at a Service Organization

This standard deals with assurance engagement undertaken by a professional accountant to provide a report for use by other entities and their auditors on the controls at a service organization. Such service organizations provide services to the entity and are likely to be relevant in assessing the overall internal controls

In addition to providing an assurance report on controls, the auditor of the service organization may also be engaged to provide reports such as the following which are not dealt with in this standard

- A report on user entity's transaction or balances maintained by service organization
- Agreed upon Procedures report on controls at a service organization

This standard is effective for period ending on or after 1st April 2011.

2 Company Law

1. Revised Schedule VI notified

The Ministry of Corporate Affairs (MCA) has notified that the revised schedule VI for the preparation of balance sheet and profit & loss account would be applicable for the financial year commencing on or after 1st April 2011.

2. Amendment in Form 61

Form 61 is used for filing an application with Registrar of Companies (RoC). MCA has amended 'Application filed for' section in Form 61 by adding additional reason 'Normalising a dormant company'.

3. Compulsory e-payment of MCA Fees

In order to facilitate faster disposal of an application / e-form, MCA has decided to accept payments for these forms in electronic mode as under:

Value of payment for MCA 21 Services	Mode	Effective Date
Upto Rs.50,000	Electronic	27th March 2011
Above Rs.50,000	Electronic *	1st October 2011

** Option of making payment in electronic or paper challan mode upto 30th September 2011*

4. Rules for name availability & Changes in Form 1A

The Central Government has issued rules availability called Companies (Name Availability) Rules and has also proposed following changes in Form 1A for availability of name or change of existing name of the Company.

a. The applicant has to furnish a declaration that,

   i. Has used search facilities on MCA Portal for checking the resemblance of proposed name(s) with existing names.
   ii. Proposed name(s) is/are not infringing any registered trademark or trademark under application.
   iii. Proposed name(s) is/are not in violation of provisions of Emblems and Names (Prevention of Improper Use) Act, 1950.
   iv. Proposed name(s) is/are not offensive to any section of people.

v. Has gone through all the prescribed guidelines, understood the meaning and the proposed name(s) is/are in conformity.
vi. Undertakes to be fully responsible for the consequences in case the name is subsequently found to be in contravention of the prescribed guidelines.

b. In case the proposed name is containing more than one word, there will be an option in the Form 1A for certification by the practicing Chartered Accountants, Company Secretaries and Cost Accountants, who will certify that,

i. Applicant has used search facilities on MCA Portal for checking the resemblance of proposed name(s) with existing names and the search report is attached with the application form.
ii. Proposed name(s) is/are not undesirable name under provisions of section 20 of the Companies Act, 1956 and
iii. Proposed name(s) is/are in conformity with Companies (Name Availability) Rules, 2011 and Guidelines made therein.

c. In case Form 1A is certified by a professional as mentioned in para (b) above the name will be made available by the system online to the applicant without backend processing by the Registrar of Companies (ROC). This facility is not available for applications for change of name of existing companies.

5. Financial Statements to be filed in XBRL Mode

MCA has mandated following class of companies (Phase I) to file balance sheets and profit & loss account for the financial year 2010-11 onwards in Extensible Business Reporting Language (XBRL) mode based on existing Schedule VI format,

a. All companies listed in India and their subsidiaries, including overseas subsidiaries.
b. All companies having a paid up capital of Rs. 5 crore and above or a turnover of Rs 100 crore or above.

All companies falling in Phase I, are permitted to file upto 30th September 2011 without any additional filing fee.

6. Clarification on Interpretation of word 'Partnership'

The government has issued a notification regarding interpretation of the word 'Partnership' for the purpose of Chartered Accountants Act, Cost and Works Accountants Act and Companies Secretaries Act.

Accordingly, it is clarified that the words “partnership” wherever occurring in the said Acts shall be construed as including those Limited Liability Partnerships where all the other partners are natural persons(individuals).

7. License for registration of association under section 25

The Central Government has now delegated the powers relating to granting of licence for registration of Association under Section 25 of Companies Act to Registrar of Companies. Earlier the power was vested with Regional Director.

3 Service Tax

1. Notifications regarding CENVAT and Service Tax rules

a. Credit can be taken on the basis of the invoice provided that payment is made within 3 months and failing which input credit to be reversed. However the same will be admissible when subsequently paid. It is also provided that subsequently if the credit note is received or payment is refunded in whole or in part, credit taken on such input service, shall be reversed. In respect of bills issued prior to 1st April 2011, credit will be allowed only on payment basis.

b. Rule 6 of ST Rules pertaining to determining the exempt service in regard to trading goods has been altered from “difference between the sale price and the purchase price of the goods traded”, to “difference between the sale price and the cost of goods sold (determined as per the generally accepted accounting principles without including the expenses incurred towards their purchase) or ten percent of the cost of goods sold, whichever is more. Accordingly, 10% margin on cost of goods sold will be the minimum adjustment.

c. Rule 9 has been amended to give credit based on Supplementary Invoice where the point of tax is the date of payment while the invoice had already been issued e.g. rule 4 (b) (i) of Point of Taxation Rules.

d. Where invoice has been raised and subsequently the credit note is given for services not rendered or due to deficient service, the service tax which has been paid earlier can be adjusted provided credit note is issued or in cases where payment was received the amount has been refunded. (Service Tax Rules 6(3) was amended by the Finance Bill 2011). The clarification issued vide F.No.341/34/2010-TRU dt 31/3/11 mentions that adjustment is not possible in case of Bad debts.

2. Amendment to Point of Taxation Rules

a. Rule 3 – comparison between the existing rule and proposed rule is given below

Existing Rule	Amended Rule
Sub Rule (a): A provision of service shall be treated as having taken place at the time when service is provided or to be provided	Sub Rule (a): Provision of service will be treated as having taken place at the time when the invoice for the service provided or to be

	provided is issued
Sub Rule (b): If, before the time specified in (a) above, the person providing the service issues an invoice or receives a payment, the service shall, to the extent covered by the invoice or the payment made thereof, be deemed to have been provided at the time the invoice was issued or the payment was received, as the case may be, whichever is earlier	Sub Rule (b): In a case, where the person providing the service, receives a payment before the time specified in (a) above, the time, when the said person receives such payment, to the extent of such payment.

b. Rule 6 - Rule 6 defines the 'point of taxation' in case of continuous supply of service. Comparison between existing rules and amended rules as given below,

Existing Rule	**Amended Rule**
Sub Rule (1): In case of continuous supply of service, the whole or part of which is determined or payable periodically or from time to time, shall be treated as separately provided at the date on which the payment is liable to be made by the service receiver, if such date is specified in the contract.	Sub Rule (a): In case of continuous supply of service, the whole or part of which is determined or payable periodically or from time to time, shall be treated as separately provided at the time when the invoice for the service is provided or to be provided is issued
Sub Rule (2): If, before the time specified in sub-rule (1), the person providing the service issues an invoice or receives a payment, the service shall, to the extent covered by the invoice or the payment made thereof, be deemed to have been provided at the time the invoice was issued or the payment was received, as the case may be, whichever is earlier.	Sub Rule (b): In a case, where the person providing the service, receives a payment before the time specified in (a) above, the time, when he receives such payment, to the extent of such payment.

The Central Government has notified the provision of following services shall be treated as 'continuous supply of service'.

Clause	**Description**
zzq	commercial or industrial construction
zzzh	construction of complex
zzzx	telecommunication service

zzzu	internet telecommunication service
zzzza	execution of a works contract, excluding works contract in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams.

c. Amendment to Point of Taxation Rules – Rule 7

In respect of following services / persons, ‘point of taxation’ would be the date on which payment is received or made.

i. Services covered by sub-rule (1) of rule 3 of Export of Services Rules, 2005. This rule will not apply if the payment is not received within the period specified by RBI.

ii. The persons required to pay tax as recipients of services under reverse charge basis.

iii. Individuals or proprietary firms or partnership firms providing taxable services like Architect, Interior Decorator, Company Secretary, Cost Accountants, Scientist, Technocrat , any science or technology related institution and lawyers.

In case of “associated enterprises”, where the person providing the service is located outside India, the point of taxation shall be the date of credit in the books of account of the person receiving the service or date of making the payment whichever is earlier.

d. Amendment to Point of Taxation Rules – Rule 9

Existing Rule	**Amended Rule**
These rules does not apply to invoices issued prior to the date from which these rules become effective	These rules does not apply where (a) provision of service is completed or (b) invoices are issued prior to the date on which these rules come into force.

Further in respect services for which provision is completed on or before 30th day of June, 2011 or where the invoices are issued upto the 30th day of June, 2011, the point of taxation shall, at the option of the taxpayer, be the date on which the payment is received or made as the case may be.

3. Withdrawal of service tax on Health Care Services

The government has withdrawn the service tax in entirety both in respect of services provided by hospitals as well as by way of diagnostic test.

4. Simplication measure – scheme for SEZ

Simplified scheme has been introduced for the units in SEZ to enable them to obtain tax free receipt of services wholly consumed within the SEZ and to get refunds in a faster manner.

4 FEMA

1. Consolidated FDI Policy 2011

The Department of Industrial Policy and Promotion (DIPP) has issued a consolidated FDI policy effective from 1st April, 2011. The key changes made by the policy are highlighted below:

No.	Topic	FDI Circular April 2011	FDI Circular October 2010
1.	Definition of capital	Besides the permitted instruments, only warrants and partly paid shares can be issued under the approval route	Besides the permitted instruments, any other type of instruments like warrants, partly paid share, etc. can be issued under the approval route
2.	Pricing of convertible capital instruments	• Conversion *formula* to be determined upfront at the time of issuance of the instrument • However the conversion price should not be lower than the fair value worked out at the time of issuance of the instrument in accordance with the prevailing valuation norms	Conversion *price* to be determined upfront at the time of issuance of the instrument
3.	Existing JV / technical collaboration in the "same field"	Prior approval of FIPB is no longer required to be obtained by a non resident investor in respect of new investment in the "same field" having an existing joint venture agreement as on January 12, 2005	Where a non-resident investor had an existing joint venture/ technology transfer/ trademark agreement as on January 12, 2005, new proposals in the 'same field' were to be approved by the Government through Foreign Investment Promotion Board (FIPB)/ Project Approval Board

4.	Issue of shares for non cash consideration	Issuance of equity shares for non cash consideration is now also permissible under the following categories with prior approval from FIPB subject to certain stipulated conditions: • Import of capital goods / machinery / equipment (including second hand machinery) • Pre-operative / pre-incorporation expenses (including payment of rent etc)	In case of the following categories, issuance of equity shares / CCPS is permissible under the automatic route: • Conversion of External Commercial Borrowings (ECB) • Lump-sum technical know how fee • Royalty • Import of capital goods by SEZ unit
5.	Guidelines relating to downstream investments	The earlier categorization of 'investing companies' and 'operating cum investing companies' has been done away with. However • FIPB approval still required for foreign investment in company engaged in investing activities • Downstream investments done by companies owned or controlled by non resident investors would be subject to the relevant sectoral conditions, caps etc.	• FIPB approval required for investing companies • Downstream investments done by operating cum investing companies owned or controlled by non resident investors would be subject to the relevant sectoral conditions, caps etc.
6.	Wholesale trading of items sourced from Micro, Small and Medium Enterprises	Wholesale trading of items sourced from MSE's has been placed under 100 % automatic route	100% FDI was permitted in trading of items sourced from MSE subject to approval from FIPB

	(MSE)		
7.	Issuance of Employee Stock Option Plans (ESOP)	The issuing company is now required to report the details of granting of options under the scheme to non resident employees to the Regional Office of the Reserve Bank	No such requirement was mentioned
8.	Investments made by FIIs	The individual limit of 10% and aggregate limit of 24% is applicable only to FII investment under the Portfolio Investment Scheme. Hence FII's can exceed this limit if invested under the FDI	The individual limit of 10% and aggregate limit of 24% is applicable for FII investment under the Portfolio Investment Scheme as well as FDI policy

2. Annual return on foreign assets and liabilities by Indian companies

Currently Indian Companies having foreign investments are required to make annual fillings with regards to the foreign investments to RBI in Part B of Form FC GPR. The same has been replaced by "Annual Return on Foreign Liabilities and Assets". The form has to be filed annually by 15th July each year.

The return is required to be submitted by all Indian companies which have received Foreign Investments or which has Non Resident holding (unless the investments are held under Non repatriation scheme) or have made investments outside India.

3. Liberalization in realization and repatriation of export proceeds

Exporters are entitled to avail relaxation upto 30th September 2011 (earlier relaxation was available upto 31st March 2011) for realization and repatriation to India of the full export value of goods or software exported within 12 months instead of 6 months.

Other provisions regarding period of realization and repatriation to India of the full export value of goods or software exported by a SEZ unit as well as exports made to warehouses established outside India remains unchanged.

5 NBFC

1. NBFCs not to be partners in partnership firms

NBFCs (both deposit accepting and non deposit accepting) have been prohibited from making any capital contribution or to be partners in partnership firms.

In case of existing partnerships by NBFCs, NBFCs may seek early retirement from the partnership firms.

2. Amendment to definition of infrastructure loan

Infrastructure loan definition has been amended to include company engaged in developing, or operating and maintaining or developing, operating and maintaining of Telecom Towers as a company providing infrastructure facility to avail credit facility extended by NBFC.

3. Infrastructure Finance Companies

In order to be classified as an Infrastructure Finance Company, one of the requirements is to avail minimum credit rating of ‘A” from Credit Rating Agencies (CRA) under the NBFC Regulations. Henceforth only credit rating given by “**CRA accredited by RBI**” would be considered instead of “accredited CRA”, under the NBFC.

6 SEBI

1. Increase in the investment limit of FIIs

a. Investment limit of Foreign Institutional Investors (FIIs) in corporate bonds issued by infrastructure companies has been enhanced from the existing limit of USD 5 million to USD 25 million.

b. FIIs are now eligible to invest in unlisted bonds issued by companies in the infrastructure companies

c. Investments in such bonds shall have a minimum lock in period of 3 years. Further during the lock in period FIIs will not be allowed sell these investments to domestic investors but will be allowed to trade amongst themselves.

2. Listing agreement for securitized debt instruments

SEBI has notified the Securities and Exchange Board of India (Public offer and listing of Securitized Debt Instruments), Regulations 2008, These Regulation provides for a framework for issuance of and listing of securitized debt instruments/certificates by a company.

7 Others

1. Compulsory e-payment of ESIC

Employees' State Insurance Corporation has decided that w. e. f. 1st April 2011 all contributions shall be collected compulsorily via electronic mode in following states – Delhi, West Bengal, Karnataka, Madhya Pradesh, Maharashtra, Gujarat, Andhra Pradesh, Haryana and Punjab

2. Amendment to Prevention of Money Laundering Rules, 2005

RBI has provided certain administrative relaxations to individuals opening small accounts with any bank or financial institution or intermediary as the case maybe.

Small account has been defined as a savings account in a banking company where:

a. The aggregate of all credits in a financial year does not exceed Rs.1 lac

b. the aggregate of all withdrawals and transfers in a month does not exceed Rs.10,000

c. the balance at any point of time does not exceed Rs.50,000

3. Competition Act, 2002

Section 5, 6, 29, 30 and 31 of the Competition Act, 2002 has been notified by the Government of India.

Section 5 of the Act contains provisions relating to "Combination" and Section 6 of the Act contains provisions relating to "Regulations of Combinations". Sections 20, 29, 30 and 31 of the Act contain procedural provisions relating to regulations of the Combination.

Accordingly, effective from June 2011, no person or enterprise shall enter into a combination in the form of mergers, acquisitions and amalgamations which causes or is likely to cause an appreciable adverse effect on competition in the relevant market above following thresholds prescribed under the Competition Act, 2002.

Person/Enterprise	Rs		USD/ Rs	
	In India		In or Outside India	
	Assets	Turnover	Assets	Turnover
Acquirer + target	>1500 crores	> 4500 crores	USD >75 crores including atleast Rs 750 crores should be in India	USD > 225 crores including atleast Rs 2250 crores should be in India
Group Post Acquisition	>6000 crores	> 18000 crores	USD >300 crores including atleast Rs 750 crores should be in India	USD > 900 crores including atleast Rs 2250 crores should be in India

Further the value of assets and turnover prescribed under the Competition Act has been enhanced by 50% for the purpose of determining the threshold prescribed.

The regulation shall not be applicable in the following cases:

a. Enterprise, whose control, shares, voting rights or assets are being acquired has assets of the value of not more than Rs 250crores or turnover of not more than Rs 750 crores for a period of 5 years

b. Group exercising less than 50% of the voting rights in other enterprise for a period of five years

If any proposed Combination exceeds the threshold of assets and / or turnover specified in the Act (as aforesaid), the person / enterprise need to intimate the same to the CCI within 30 days of board approval / entering into of the agreement for Combination for approval.

A Combination cannot come into effect until a period of 210 days has passed from the day on which the notice was given to CCI or CCI has passed an order, whichever is earlier.

Above mentioned requirement of obtaining approval of CCI for the combination is not applicable to share subscription/ financing facility or any acquisition by public financial institution, Foreign Institutional Investor (FII), Venture Capital Fund, Bank pursuant to any covenant of a loan / investment agreement.

8 Amendments to Finance Bill, 2011

The Finance Bill 2011 has received the assent of the President of India on 08.04.2011 with the following amendments to the original proposals presented by the Finance minister on 28.02.2011

a. Contribution to New Pension System (NPS)

Sub section (iva) to Section 36(1) is proposed to be inserted to allow deduction for contribution made to NPS to the extent of 10% of salary of the employee.

Consequential change is proposed in section 40A(9) to provide that disallowance under Section 40A(9) will not apply to sums contributed as specified u/s. 36(1)(iva) above.

b. Dividend from Foreign Subsidiary

Dividend from foreign subsidiary is proposed to be taxed at 15% plus applicable surcharge and cess. Further no expenditure or deduction in respect of such dividend will be allowed. [Foreign subsidiary company was defined to mean a foreign company in which the Indian company holds more than half in nominal value of the equity share capital of the company]

The amendment proposes to relax the condition to the effect that dividend from foreign company in which the Indian Company hold 26% or more (instead of more than 50% originally proposed) will be taxed at 15% plus applicable surcharge and cess and no expenditure or deduction in respect of such dividend will be allowed

c. Minimum Alternate Tax (MAT)

In explanation to Section 115JB(2), clause (ia) has been added which provides for omission of clauses (iv), (v) & (vi) w.e.f 01.04.05 which means that profits eligible for deduction u/s 80 HHC, 80HHE, 80HHF would not be reduced while computing book profit u/s 115JB and are deemed to be so from 01.04.05

9 Income Tax - Case Laws

1. Capital asset treated as stock-in-trade of proprietary business has to be valued at market value

Madhu Rani Mehra vs. CIT (Delhi High Court)

Facts: The assessee a partner of a firm, received stock-in-trade on dissolution of the firm. The stock-in-trade was used by the assessee to start a proprietorship business which related to gold and diamond jewellery. The Assessing Officer (AO) valued the opening stock at cost price on the ground that the proprietorship concern had acquired the stock from the dissolved firm and continued the same business; thus opening stock could not be valued at a price higher than the book value since the assessee has not paid anything in excess of the cost price. The Commissioner of Income Tax (Appeals) [CIT(A)] and the Income Tax Appellate Tribunal (Tribunal) confirmed the order of the AO.

Issue: Whether capital asset received from the partnership firm on its dissolution and converted as stock-in-trade of the proprietary business has to be valued at market value or book value as appearing in the books of erstwhile partnership firm?

Held: The H'ble High Court held that when a partnership firm is dissolved and the erstwhile partner receives stock, it is a capital asset in the hands of the partner and when the same is introduced in a business as stock, it gets converted into stock in trade.

The Tribunal's reasoning that the assessee cannot value the stock introduced in the business at market value on the ground that she has not paid more than cost price is inconsistent because if the assessee had sold her distributed share of stock of jewellery from the dissolved firm and thereafter commenced her proprietorship business of jewellery again; within short span by buying the jewellery from the market from the sale proceeds of stock received from dissolved firm, the stock of the proprietorship concern would without doubt be valued at market value.

The stock received as capital asset was converted and introduced in the business as stock-in-trade. Applying the above principle, if the assessee used her share of the stock obtained from the dissolved firm in the new business, the value of stock will be the market value on the date of introduction in the proprietorship business.

2. Despite s. 50B, transfer of undertaking for non-monetary consideration not taxable if "cost of acquisition" not determinable

Bharat Bijlee Limited vs. ACIT (ITAT Mumbai)

Facts: The assessee company pursuant to a scheme of arrangement u/s 391 to s.394 of the Companies Act, 1956 transferred its lift field operations division. In consideration, the transferee allotted preference shares & bonds to the assessee. The assessee in its return of income has not offered the transfer of division for capital gain tax on the ground that the transfer of the undertaking took place in exchange for preference shares and bonds issued by the transferee, therefore the transfer is an exchange and not a sale and since the cost of the undertaking is not ascertainable, computation of capital gain is not possible. The AO treated the transaction as a "slump sale" as defined in s. 2(42C) and assessed capital gain u/s 50B. The CIT(A) confirmed the order of the AO.

Issues:

i) Whether transfer of an undertaking in exchange for issue of preference shares and bonds is taxable as slump sale u/s 50B?
ii) Whether the transfer of the undertaking attracts capital gains tax u/s. 45 since the cost of acquisition is not determinable?

Held: The H'ble ITAT held that:

i) Any transfer of an undertaking otherwise than as a result of sale will not qualify as a slump sale. In order to constitute a "slump sale" u/s 2(42C), the transfer must be as a result of a "sale" i.e. for a monetary consideration and not by way of an "exchange". The transfer of the undertaking had taken place in exchange for issue of preference shares and bonds. If the consideration is not money but some other valuable consideration it may be an exchange or barter but not a sale. Therefore, the provisions of section 2(42C) read with section 50B of the Act, relating to computation of capital gains in case of slump sale are not applicable.

ii) As regards taxability u/s 45 is concerned, the "capital asset" which was transferred was the "entire undertaking" and not individual assets and liabilities forming part of the undertaking. The transfer is of one of the going concern; there was no basis for apportioning any consideration amongst the various assets comprised in the undertaking and cost of acquisition/cost of improvement. In absence of cost of acquisition, it is not possible to ascertain the profit or gain on transfer.

Since, the provision of computation mechanism prescribed u/s 48 fails, therefore such transfer cannot be taxed u/s 45 of the Act.

3. **Merely because shares are purchased by taking loan does not mean gains are taxable as business profits**

   CIT vs. Niraj Amirdhar Surti (Gujarat High Court)

   Facts: The assessee offered income from profession, long term capital gain (LTCG), short term capital gain(STCG) & speculation profit. The assessee borrowed funds at 30% p.a. to invest in shares of Home Trade Ltd at Rs. 50 and the same were pledged as security for the loan. After 14 months, the assessee repaid the loan & sold the shares at Rs. 750 each for a profit of Rs. 1.73 crores. The profit of Rs. 1.73 crores was offered as LTCG.

   The AO held that as the assessee has borrowed loan to invest in shares at high rate of interest, the transaction was an "adventure in the nature of trade" and the profits is taxable as business profits. This was reversed by the CIT (A) & Tribunal.

   Issue: Whether income from sale of shares which were purchased by taking loan, is taxable as business profit or capital gains?

   Held: The H'ble High Court held that merely because the shares had been purchased from borrowed funds obtained on high rate of interest would not change the nature of transaction from investment to one in the nature of an "adventure in the nature of trade". Since the shares were held for a long-period of 14 months, intention of the assessee was that of making investment in shares and not dealing in shares.

   Further, the shares had not been treated as stock in trade by the assessee. A capital investment and resale of the same does not lose its capital nature merely because the resale was made for the possibility of enhanced values. Thus, considering the nature of transaction, the profit on sale of shares was treated as long tern capital gain and not as business profits.

4. **Non – compete compensation received before AY 2003-04 is a capital receipt**

   Guffic Chem P. Ltd vs. CIT (Supreme Court)

   Facts: In AY 1997-98 the assessee company received fee of Rs. 50 Lakhs from Ranbaxy for agreeing not to compete for 20 years in the territory of India with Ranbaxy. The asseessee company treated the same as capital receipt. However the AO assessed the receipt as business income.

   The CIT (A) & Tribunal upheld the assessee's claim that the receipt was for loss of a source of income and was therefore capital in nature. On appeal by the department,

the High Court reversed the order of Tribunal and held the receipt to be revenue in nature.

Issue: Whether non-compete fees received before AY 03-04 is capital receipt or taxable as business profits?

Held: The H'ble Supreme Court held that there is a difference between receipt of compensation by an assessee for the loss of agency and receipt of compensation attributable to the negative/restrictive covenant**.** While the former is a revenue receipt, the latter is a capital receipt. On facts, as the compensation was received for a non-compete, it was attributable to negative covenant and thus was capital in nature. Further, money as non-competition fee was always be treated as a capital receipt till AY 2002-03.

It is with insertion of s. 28(va) by Finance Act, w.e.f. 1.4.2003 compensation received for not carrying out any activity in relation to any business is taxable as business profit**.**

5. **Applicability of capital gain tax on sale of leasehold land with under construction building**

Commissioner of Income Tax vs. Hindustan Hotels Ltd. & ANR 237 CTR 32 (Bombay High Court)

Facts: Assessee acquired leasehold land by lease deed dated 17th March 1988. The assessee commenced construction of a hotel building on land from 1990 and incurred construction cost during the period 1990 to 1995. In June 1995, the assessee sold the entire hotel project before completion of hotel building for a composite consideration of Rs.11 crores and offered the entire sale proceeds as long tern capital gain. The AO held that the building which was under construction was not held by the assessee for a period of more than three years and therefore the profit arising on sale of the incomplete hotel project was a short term capital gain. The AO after deducting cost of acquisition of the land and cost of construction form sale proceeds of Rs. 11 crores assessed the entire gain as short term capital gain (STCG).

In first appeal, the CIT(A) directed the AO to apportion the capital gain on the basis of amount incurred upto 18th June 1992 i.e. three years prior to the sale date as long term capital gain and amount spent thereafter as short term capital gain.

The Tribunal held that leasehold interest in land being different asset than the building, the profit arising from the sale of land is treated as long term capital gain (LTCG). The Tribunal estimated Rs. 2.15 crores attributable to the sale of superstructure and the balance consideration of Rs. 8.85 crores attributable to the sale of land. Profit arising out of sale of the superstructure of Rs. 30.00 lacs (Rs. 2.15 crore less cost of construction Rs. 1.85 crore) to be assessed as STCG.

Issue: Whether sale on leasehold interest in land with under construction building is taxable as LTCG or STCG?

Held: The H'ble High Court confirmed the decision of ITAT and held that the concept of dual ownership is recognized in the sense that the land may belong to one person and the building standing thereon may belong to another. Once the concept of dual ownership is accepted it does not matter whether the construction of the building is completed or not by the owner of the land or somebody else. Further, leasehold right in leasehold land is capital asset as defined u/s. 2 (14) in the hands of the lessee.

The H'ble High Court affirmed the action of the tribunal in holding that the capital gain arising out of the sale of the leasehold interest in the land and incomplete building will have to be bifurcated into the gain arising out of a sale of leasehold interest in the land and the sale of the incomplete building. The tribunal based on the report of approved valuer's estimated the value of the building at Rs. 2.15 crores as against the construction cost of Rs.1.85 crore. The tribunal has also considered appreciation to the extent of approximate 15% for the building under construction. In the absence of any material on record that this was an erroneous, the decision of the Tribunal cannot be held in any way to be perverse or contrary to the provisions of the Income Tax Act.

Therefore, the High Court has confirmed the order of the Tribunal holding that sale of leasehold interest has to be assessed as LTCG and sale of superstructure has to be assessed as STCG and LTCG in the ratio of expenditure incurred within three years and beyond.

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