

NEWSLETTER

AUGUST 2010

M. V. DAMANIA & Co.



Contents	Contributor	Page
Foreign Exchange Management Act Compounding of Offenses under FEMA	Malay Damania	2
International Financial Reporting Standards Major items of GAAP differences (IFRSs vis a vis Indian GAAP)	Bharat Jain	4
Income Tax Section 206AA – Issues and Implications	Padmanabh Upadhye	7



FEMA

Compounding of Offenses under FEMA

What is Compounding of Offenses?

- A method to compromise or settle the contravention made either before or after adjudication but before the enforcement of the order of court.
- It is nothing but Penalty in lieu of Prosecution.

What Contraventions are Compoundable?

- Contravention of the Act, Rules, Regulations, Directives and Orders issued under the FEMA.
- Contravention of any of the conditions subject to which the RBI permission was granted.

What is the Scope and Applicability?

- Applies to whole of India
- It applies to:
 - Any transaction which takes place or is undertaken by Non-Resident in India.
 - All branches, offices and agencies outside India, which are owned or controlled by a person resident in India.

- Nationality or residential status of the person involved in the contravention has no relevance for the Compounding process.
- Once the penalty is paid, no prosecution can be initiated.

What is the approach of RBI in handling the Application?

- Whether the contravention is technical or minor in nature and requires only administrative cautionary advice.
- Whether the contravention is serious.
- Whether the contravention involves money laundering, national and security concerns.
- The amount of unfair advantage made as a result of such contravention.
- The amount of loss caused to any authority or agency as a result of such contravention.
- The track record of the applicant and the repetitive nature of contravention.
- The transparency, the disclosure of

full facts and the conduct of the contravener during the personal hearing.

What is the maximum penalty that can be levied?

- When the sum involved in the contravention is quantifiable, maximum penalty could be THREE TIMES the amount involved in the contravention.
- When the sum involved is not quantifiable, the maximum amount of penalty can be Rs. 2 Lakhs only.
- Over and above the above penalty, a recurring penalty of Rs. 5,000/- per day can also be levied during the continuance of the default.

What contraventions are not compoundable?

- Within THREE YEARS from the date of compounding of earlier contravention, the person has committed another contravention of the similar nature.
- An appeal has been filed before either Special Director (Appeals) or

Compounding of Offenses under FEMA

Appellate Tribunal.

- A contravention has been fully adjudicated and disposed off by the Adjudicating Authority.
- Contravention of any of the transactions due to inadequate approval from the concerned authority can be compounded only after the due approval is obtained from the concerned authority.

Who shall be responsible for contravention?

- The Company/Firm
- Every Director (Executive), Partner, Manager who were responsible for the conduct of the business at the time of the contravention.

Before whom the compounding application made?

- The application has to be made before the RBI with regards to all the transactions except under section 3(a) of The FEMA, which relates to hawala transactions.
- In case of compounding application for the offense relating to transactions specified under section 3(a) or an offense repeated within 3 years from the date of filing of application before the RBI, the same has to be made before the Enforcement Directorate.

Process for Compounding

- An application can be made either suo moto or on being advised of the offense through a memorandum.
- The application must specify facts of the case in detail and list out each of the defaults specifically.
- Application has to be accompanied by a fee of Rs. 5,000/-.
- Application has to be filed in the Central Office Building, Mumbai.
- Order will have to be passed before 180 days from the date of receipt of the application for compounding.
- The sum specified in the order will have to be paid within 15 days of the date of the order.
- If the payment is not made within the prescribed time, the application will be deemed never have been filed.
- Cases of contravention having money laundering, national and security concerns or involving serious infringement of the regulatory framework or where the applicant fails to make the payment within the specified period shall be referred to Enforcement Director, Anti-money Laundering Act and any other agencies as they may deem fit.
- No appeal can be filed against the order of Compounding.

Example:

- ICO has received Rs. 10 Lakhs from FCO towards share application money on 1st January 2010. The intimation to RBI about the receipt of funds was made on 15th February 2010. The shares worth Rs. 9 Lakhs were allotted on 1st August 2010 and the excess funds were refunded on the same day. Form FC-GPR was filed on 15th September 2010.

In the above example, although the default is related to one single transaction, there are actually multiple contraventions like:

- Delay in reporting to RBI, the receipt of funds.
- Delay in allotment of shares;
- Delay in refunding the excess share application money;
- Delay in filing of the FC-GPR form.

Accordingly, the application must specify each individual default separately.



International Financial Reporting Standards

Foreign Exchange Transactions

Presentation of Financial statements:

Major items of GAAP differences (IFRSs vis a vis Indian GAAP):

S.No	Particulars	As per IFRSs	As per Indian GAAP
	Relevant Text	IAS 1	AS 1 and Schedule VI of the Companies Act, 1956
		Presentation of Financial statements	Disclosure of Accounting Policies/ Presentation of Financial statements
1.	Components of Financial statements	IFRS set of financial statement includes: <ul style="list-style-type: none"> ■ Statement of financial position ■ Statement of comprehensive income or statement of income and other comprehensive income ■ Statement of cash flows ■ Statement of changes in equity ■ Explanatory Notes including accounting policies 	Governed by schedule VI and other acts in case of banking/ insurance/ mutual funds/ govt cos etc in addition to Accounting standards issued by ICAI and Companies (Accounting standards) Rule 2006. Components of Financial statements includes: <ul style="list-style-type: none"> ■ Balance sheet ■ Profit and Loss account ■ Cash Flow (mandatory only for specified entities) ■ Explanatory Notes including accounting policies
2.	Applicability	All profit oriented entities including partnership firm, Proprietary concerns etc	Applicable to Private Ltd and Public Ltd cos. For other entities, no specific format is prescribed. In case of entities covered by specific statute then the form and contents of financial statement as referred in concerned statute.

International Financial Reporting Standards (cont.)

S.No	Particulars	As per IFRSs	As per Indian GAAP
	Relevant Text	IAS 1	AS 1 and Schedule VI of the Companies Act, 1956
		Presentation of Financial statements	Disclosure of Accounting Policies/ Presentation of Financial statements
3.	Components of Financial statements	Mandatory	Mandatorily Applicable to listed cos only otherwise applicable if the company opts for consolidation.
4.	Presentation- Assets and Liabilities items	Statement of Financial position should be presented with classification as Current and non-current assets and Current and non-current liabilities unless presentation based on liquidity provide information that is more reliable and relevant.	Presentation of financial statement with respect to form and content is governed by Schedule VI of the companies act or any other applicable/ relevant statute.
		Separate Disclosure of assets / liabilities items expected to be recovered/ settled within 12 months or more than 12 months is must.	No such specific requirement
5.	Presentation- Expenses	Analysis of expenses is presented by using classification based on either nature or their function which one provides more reliable or relevant information. If presented by function, specific disclosure by nature needs to be made in notes.	As per schedule VI, analysis of expenses should be presented by nature only.
6.	Minority Interest	Share of profit / (Loss) of minority shareholders (Non controlling interest) and parent equity shareholders disclosed as allocation of profit and loss for the period in Comprehensive Income/ Income statement.	Share of Profit/ (Loss) of minority interest is disclosed as deduction from the profit and loss for the period as an item of expense or income.
7.	Statement of other comprehensive Income	Components of other Comprehensive income includes changes in revaluation surplus, actuarial gain or losses, translation reserves, effective portion of gains/ (losses) of hedging instruments etc. Tax components of each item of other comprehensive income needs to be shown separately.	No concept of other comprehensive income. All the items should be routed through profit and loss accounts including tax disclosure.

International Financial Reporting Standards (cont.)

S.No	Particulars	As per IFRSs	As per Indian GAAP
	Relevant Text	IAS 1	AS 1 and Schedule VI of the Companies Act, 1956
		Presentation of Financial statements	Disclosure of Accounting Policies/ Presentation of Financial statements
8.	Statement of changes in equity	A statement of changes in equity presented with details in respect of: <ul style="list-style-type: none"> ■ Total comprehensive income ■ Transaction with owners ■ Reconciliation of each component of equity (Opening to closing) 	No such statement is required. Changes in equity/ reserves needs to be disclosed in schedules to financial statements.
9.	Extraordinary items	Prohibited	Separate disclosure
10.	Reclassification of comparatives	Disclosure to be made of nature, amount and reason thereof.	General note without any additional disclosure
11.	Critical judgments in applying accounting policies	Disclosure required	No such specific requirement
12.	Estimation of uncertainty	Disclosure reqd for assumptions made about future and other key source of estimating uncertainty with nature and carrying amount of those assets and liabilities at the end of reporting period for which material adjustments needs to be done in future due to risk element.	No such specific requirement
13.	Capital- Disclosure	Entity's objective, policies and process of managing capital	No such specific requirement
14.	Compliances with applicable GAAPS	Explicit and unreserved statement in notes about compliances with IFRSs	Disclosure required but may have option of reserved comment.
15.	Change of reporting period	Disclosure to be made for Reason for change including fact about non comparability with previous period.	Disclosure to be made about non comparability with previous period only.
16.	Proposed Dividend	Disclosed in the notes about amount of dividend proposed/ declared with related amount per share	Recognized in profit and loss accounts as proposed dividend with corresponding liability as payable.

Note: ICAI has already presented Exposure Draft on AS 1 (Revised) in line with IAS 1 and the same can be referred at the CA Institute's website.

Compiled by: Bharat Jain



INCOME TAX

Section 206AA – Issues and Implications

Objective

One of the important proposals which were introduced by the Finance (No.2) Act, 2009 is insertion of Sec 206AA in the Income Tax Act. The main objective of introduction of this section is to strengthen the PAN mechanism. Till now, the onus of collecting PAN was with the deductor. Now, with the introduction of this section, the onus has been shifted to the deductee. Relevant extract from explanatory memorandum on section 206AA is reproduced below:

“In order to strengthen the PAN mechanism, it is proposed to make amendments in the Income Tax Act to provide that any person whose receipts are subject to deduction of tax at source i.e. the deductee, shall mandatorily furnish his PAN to the deductor failing which the deductor shall deduct tax at source at higher of the following rates”

Key Provisions of Section 206AA

- Quoting of PAN is compulsory from 1–April–2010.
- Every person whose receipts are subject to TDS should furnish his

PAN to the deductor.

- In case of such failure, the deductor has to deduct the tax at a rate *higher* of
 - A) The rate prescribed under the Act **or**
 - b) The rate in force (rates as mentioned in the Finance Act) **or**
 - c) The rate of 20%
- Certificate U/s 197 shall not be granted by the tax authorities unless the applicant quotes PAN in the application.
- These provisions will be applicable even if the deductee files declarations U/s 197A in Form 15G or Form 15H
- Quoting of PAN is compulsory in all the correspondence, bills and vouchers exchanged between deductor and the deductee.

Some of the Issues:

Issue – 1

Applicability of Sec 206AA in case of payments made to non-resident/foreign companies:

Since section 206AA starts with non-obstinate clause which overrides any

other provisions of the Act, and as such this section is applicable in case of non availability of PAN of non-resident/foreign companies. Hence, tax should be deducted at 20% rate.

Whether Sec 206AA overrides double taxation avoidance agreements?

As per section 90(2) of the Act, the taxpayer can opt for the provision of the relevant tax treaty over the provisions of the Act to the extent the same are more beneficial to that taxpayer. In this regard the relevant paragraphs of Circular 333 issued by Central Board of Direct Taxes (CBDT) on 2 April 1982 dealing with this issue can be discussed. The same reads as under;

“Where a double taxation avoidance agreement provides for a particular mode of computation of income, the same should be followed, irrespective, of the provisions in the Income-tax Act. Where there is no specific provision in the agreement, it is the basic law, i.e., the Income-tax Act that will govern the taxation of income”

Since Sec 206 AA presides over all other provisions of the Act, the same

Key Aspect - Financial Instruments

will also override the provisions of Sec 90(2).

In the absence of any specific provision in the tax treaty, the provision of Income Tax Act will prevail. Since the tax treaty does not have any similar provisions in the lines of Sec 206 AA, it appears that the provisions of Sec 206 AA will prevail over Sec 90(2). This implies that nonresident will not be able to avail treaty benefits in the absence of PAN.

Issue – 2

Applicability of this section in case of TDS U/s 192

- “The circular No.1 of 2010 specifies that no tax is required to be deducted at source in any case unless the estimated salary income including the value of perquisites for the FY exceeds Rs. 160,000 or Rs. 190,000 or Rs. 240,000 (or the applicable limit for the financial years as may be notified by the Department) as the case may be depending upon the age and gender of the employees.”

The “Receipts” in question are subject to TDS, only when the same crosses prescribed threshold limits in its respective nature of payment.

Issue – 3

Applicability of this section in case of payments (other than salaries) to residents when payment does not exceed the threshold limit specified in respective sections

- In case of payments or credits of payments which are covered by Sec 193 – Sec 194 LA the threshold limit as notified under the respective sections should be taken into consideration.
- The sections mentions clearly that no tax is required to be deducted where the amount or income or as the case may be the aggregate amounts of such income are paid or likely to be paid during the financial year by the aforesaid person to the account of the payee does not exceed the threshold limit mentioned in the respective sections.
- Thus when tax is not required to be deducted under these sections, Sec 206 AA cannot be activated even if the recipient does not furnish his PAN.

Issue – 4

Applicability of surcharge and education cess to the rate of 20% as specified U/s 206 AA.

Surcharge is applicable when recipient is a foreign company and the payment or credit subject to TDS is more than Rs. 1 crore. This is imposed by sub-sections (5)/(6) of section 2 of the Finance Act, 2010 read with Part II of the first schedule to the Finance Act.

Subsection (5) of Section 2: In cases in which tax has to be deducted under sections 193, 194, 194A, 194B, 194BB, 194D and 195 of the Income-tax Act, at the rates in force, the deductions shall be made at the rates specified in Part II of the First Schedule and shall be increased by a surcharge calculated in cases wherever prescribed, in the manner provided therein.

Subsection (5) of Section 2: In cases in which tax has to be deducted under sections 194C, 194E, 194EE, 194F, 194G, 194H, 194-I, 194J, 194LA, 196B, 196C and 196D of the Income-tax Act, the deductions shall be made at the rates specified in those sections and shall be increased by a surcharge in the case of every company, other than a domestic company, calculated at the rate of two and one-half per cent of such tax, where the income or the aggregate of such incomes paid or likely to be paid and subject to the deduction exceeds one crore rupees.”

There is no reference of section 206AA in the two sub-sections of section 2 of the Finance Act, 2010. Likewise, a reference of section 206AA is missing in the First Schedule to the Finance Act.

Education cess is imposed by sub-sections (11) and (12) of section 2 of the Finance Act, 2010. Even in these sub-sections, one fails to find out a reference of section 206AA. Consequently, the rate of 20 per cent under section 206AA cannot be increased by surcharge and education cess.



Compiled by : Padmanabh Upadhye