

# NEWSLETTER

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## INCOME TAX

**Saurabh Enterprise - Allahabad High Court**  
**Worldwide Township Projects Ltd. Delhi High Court**

**Section 269SS/269T not applicable to Journal entries not involving cash transactions**

Two similar judgments have been recently reported by two different

high courts on these sections. The object of these sections is to prevent transactions in money. Any transaction of Loans or Advances where no cash transaction is involved and is by

way of mere book adjustment entry, there is no violation of Sections 269SS and 269T of The ITA. Consequently there is no question of levy of penalty under section 271D/271E.

### **Devdas Naik Bombay High Court**

**Availability of Section 54/54F in case two adjacent residential units purchased under two different agreements from two different sellers having common kitchen.**

The assessee purchased two adjacent residential units under two different agreements from two different buyers. The assessee claimed exemption under section

54/54F from the Capital Gain aroused out of sale of Long Term Capital Asset.

The Bombay High Court observed that although the assessee purchased two residential units under two agreements and from two different sellers, the general layout of the flats indicated that there was only one common

kitchen for both the flats. The flats were in reality converted into one single unit for the purpose of residence of the assessee. Thus, though the acquisitions of the flats were done independently but eventually they are a single unit and for the purpose of residence. Therefore, the exemption under section 54/54F were available to the assessee.

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## **HDFC Bank Limited Bombay High Court**

**Loss on account of reduction in the value of securities held as stock is not notional loss and is allowable as a deduction:**

A method of accounting adopted by the assessee consistently and regularly cannot be discarded by the tax officer on the view that he ought to have adopted a different method of keeping the accounts of for valuation. The method of valuation adopted by the assessee was to value the securities at cost or market value whichever is lower. This is in line with the acceptable accounting policy. The assessee was entitled to claim reduction in the value of securities held as stock in trade. The fact that the security was not sold to a third party does not make the loss notional. The assessee was eligible to claim reduction in the value of securities as allowable deduction.

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## **Shreenath Motors Pvt. Ltd. Bombay High Court**

**Expenditure on education of director is personal expense and not allowable as a deduction**

The expenditure incurred for the education of a director is for personal consideration and not for commercial consideration. The High Court referred case of Advocate D.C.Mehta, the facts of which case were as below:

Advocate D.C.Mehta spent Rs. 21 Lacs for higher education for her daughter and claimed the same as deduction from his income. She had joined the assessee's firm 3 months before and had given an undertaking that on attaining the higher education and on getting university degree she would join the firm and work for a minimum period of 5 years and therefore the expenditure incurred were for the purpose of business and allowable as deduction.

The High Court observed that the daughter had joined the firm just 3 months before being sent abroad for higher education. Further, the firm did not have any such policy or scheme for other employees or associates of the firm to send them abroad for higher education. This was just one off case. Despite the fact that some of the advocate associates were working in the firm for more than 15 years were never given any opportunity by the firm to go abroad for higher education. However within a short period of 2 to 3 months, his daughter was sent abroad for higher studies.

The Court ruled that the facts of the case in question is similar to the above facts and therefore the expenditure incurred were for personal purpose and not for the commercial purpose and hence not allowable as a deductible expenditure.

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## **Cortech Energy Pvt. Ltd. Gujarat High Court**

**Disallowance under section 14A**

In absence of any dividend income (exempt income) the provisions of Section 14A are not applicable and therefore there can be no disallowance of expense under section 14A of The ITA.

*Compiled by: CA Malay Damania, Partner*





# CORPORATE LAW

## I. WHAT IS CSR?

The term "**Corporate Social Responsibility (CSR)**" can be referred to as corporate initiative to assess and take responsibility for the company's effects on the environment and impact on social welfare. This term generally applies to the efforts undertaken by the companies which go beyond the statutory requirements posed by the regulators or environmental protection groups.

Corporate Social Responsibility is not a new concept in India. However, the Ministry of Corporate Affairs, Government of India has recently notified the Section 135 of the Companies Act, 2013 along with Companies (Corporate Social Responsibility Policy) Rules, 2014 "hereinafter CSR Rules" and other notifications related thereto which makes it mandatory (with effect from 1st April, 2014) for certain companies who fulfill the criteria as mentioned under Sub

Section 1 of Section 135 of the 2013 Act to comply with the provisions relevant to Corporate Social Responsibility.

## II. WHAT CONSTITUTES CSR UNDER COMPANIES ACT, 2013?

The Companies (Corporate Social Responsibility Policy) Rules, 2014 has defined the term "**Corporate Social Responsibility (CSR)**" as follows: "*Corporate Social Responsibility (CSR)*" means and includes but is not limited to:

- i. *Projects or programs relating to activities specified in Schedule VII to the Act;* or
- ii. *Projects or programs relating to activities undertaken by the board of directors of a company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition*

*that such policy will cover subjects enumerated in Schedule VII of the Act.*

Meaning thereby, conducting all those activities which are either specified under Schedule VII to the Companies Act, 2013 or those which are recommended by the CSR Committee of the Board as per the CSR Policy and are undertaken by the Board of directors of the Company will be covered under the scope of activities of CSR.

The activities for CSR covered under the Schedule VII of the 2013 Act involve the following:

- Eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water;
- ? Promoting education, including special education and employment enhancing vocation skills especially

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- among children, women, elderly, and the differently abled and livelihood enhancement projects;
- Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
  - Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water;
  - Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art, setting up public libraries, promotion and development of traditional arts and handicrafts;
  - Measures for the benefit of armed forces veterans, war widows and their dependents;
  - Training to promote rural sports, nationally recognized sports, paralympic sports and Olympic sports;
  - Contribution to the Prime Ministers' National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
  - Contributions or funds provided to technology incubators located within academic institution which are approved by the Central Government;
  - Rural development projects.

The companies which are covered under the provisions of Section 135 shall be required to carry out any one or more of the activities as specified above along with following its CSR Policy.

### **III. METHODOLOGY OF CSR SPENDING:**

As per Rule 4(1) of the CSR Rules, the CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing) excluding activities undertaken in pursuance of its normal course of business.

As per Rule 4(2) of the CSR Rules, CSR activities can also be undertaken, if the Board of Directors so decides, through:

- a registered trust; or
- a registered society; or
- a company under Section 8 of the 2013 Act or otherwise
- established by the company or its holding or subsidiary or associated company.

If any of the above entities is not established by the company or its holding or subsidiary or associate company, it must have an established track record of three years in undertaking similar programs or projects.

### **IV. CSR APPLICABILITY:**

Section 135(1) of the 2013 Act states that a CSR Committee needs to be constituted by the following categories of companies:

- Every Company having during any financial year
  - Net worth of Rs. 500 crore or more; or
  - Turnover of Rs. 1000 crore or more; or
  - Net profit of Rs. 5 crore or more.

- The MCA has recently clarified that any financial year referred under sub section (1) of Section 135 of the Act read with Rule 3(2) of Companies CSR Rules 2014 implies any of the three preceding financial year.
- The CSR Rules further states that Every company including its holding or subsidiary, and a foreign company defined under Section 2(42) of the Act having its branch office or project office in India, which fulfills the criteria specified in Section 135(1) of the 2013 Act shall comply with the provisions of the Act and the Rules.
- Net worth has been defined in Section 2(57) of the 2013 Act and means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.
- Turnover has been defined in Section 2(91) of the 2013 Act and means the aggregate value of the realization of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year.
- Net Profit: Explanation to Section 135 of the 2013 Act states that, average net profit shall be calculated in accordance with the provisions of Section 198 of the 2013 Act. CSR Rules also defines Net Profit as the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely:
  - Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and
  - Any dividend received from other companies in India, which are covered under and complying with the provisions of Section 135 of the Act;

Provided that net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956, shall not be required to be re-calculated in accordance with the provisions of the 2013 Act.

In the case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of Section 381(1)(a) read with Section 198 of the Act.

## V. **CSR Committee and its composition:**

Once a company is covered under the ambit of the CSR, it shall be required to comply with the provisions of the CSR. The companies covered under the sub-section 1 of Section 135 of the 2013 Act shall be required to do the following activities:

- the companies shall be required to constitute Corporate Social Responsibility Committee of the Board "hereinafter CSR Committee".
- The CSR Committee shall be comprised of 3 or more directors, out of which at least one director shall be an independent director.
- The Board's report shall disclose the compositions of the CSR Committee.
- All such companies shall spend, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.

The CSR Rules further clarifies the constitution of the CSR Committee for companies where no Independent

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Director (ID) is mandated such as private companies/foreign companies, as follows:

- Where an unlisted public company or a private company is otherwise not required to have an ID, the CSR Committee for such company need not have an ID.
- In the case of a private company having only two directors, both should be on the CSR Committee.
- In the case of a foreign company, the CSR Committee should comprise of at least two persons of which one person should be nominated by the foreign company and one person should be an Indian resident, authorised to accept notices on behalf of the company.

## VI. ROLE OF CSR COMMITTEE

The CSR Committee constituted in pursuance of Section 135 of the Companies Act, 2013 shall be required to carry out the following activities:

- Formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
- Recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
- Monitor the Corporate Social Responsibility Policy of the company from time to time.

## VII. REPORTING FOR CSR:

### a. Disclosure in Financial statements:

Rule 7 of the CSR Rules specifies the expenditure that would qualify as CSR expenditure. As per the Rule, CSR expenditure shall include all expenditure including contribution to corpus, or on projects or programs relating to CSR activities approved by the Board that is in conformity with Schedule VII.

As per Schedule III to the 2013 Act, CSR spending is to be disclosed as part of a company's Statement of Profit and Loss as an **expense**.

### b. Disclosure in Board Report:

Rule 8 of the CSR Rules provides that the Companies, upon which the CSR Rules are applicable on or after 1st April, 2014 shall be required to incorporate in its Board's report an annual report on CSR containing the following particulars:

- A brief outline of the company's CSR Policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs;
- The composition of the CSR Committee;
- Average net profit of the company for last three financial years;
- Prescribed CSR Expenditure (2% of the amount of the net profit for the last 3 financial years);
- Details of CSR spent during the financial year;
- In case the company has failed to spend the 2% of the average net profit of the last three financial year, reasons thereof;
- A responsibility statement of the CSR committee that the implementation and monitoring of CSR policy, is in compliance with CSR objectives and policy of the company.

## VIII. WHAT IF A COMPANY CEASES TO BE COVERED UNDER SECTION 135?

Rule 3(2) of the Corporate Social Responsibility Rules, 2014 provides that every company which ceases to be a company covered under section 135(1) of the Act for three consecutive financial years shall not be required to:

- constitute a CSR Committee ; and
- comply with the provisions contained in sub-section (2) to (5) of the said section till such time it meets the criteria specified in sub section (1) of Seciton 135.

Accordingly, if a company, for 3 consecutive years, ceases to be covered under the ambit of section 135(1), it shall not be required to fulfill the conditions relating to the constitution of CSR Committee and other related provisions.

## IX. CONCLUSION

Considering the increasingly vast and complex business environment, the move of the Ministry of Corporate Affairs is a welcoming step which apart from contributing towards society, plays a major role in various ways which includes attracting and retaining employees in a such a way as to increase morale of the employees along with creating a sense of belongingness to the company and contributes towards enhancement of company's own goodwill, positive image along with bringing competitive advantages. Also, as rightly mentioned by the United Nations Industrial Development Organization (UNIDO), CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives ("Triple-Bottom-Line-Approach"), while at the same time addressing the expectations of shareholders and stakeholders.

*Compiled by: CA Bharat Jain, Partner*