Volume-20 March-2016 Pages 1-23

SBS Wiki

monthly e-Journal

By

SBS and Company LLP
Chartered Accountants

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INTERNAL AUDIT

SIGNIFICANCE OF INTERNAL AUDIT

Contributed by CA MHS Bhyrav & CA Sandeep Das

1. Introduction:

Internal audit provides effectiveness of organisation's internal control system, risk management, governance. Internal audit looks beyond the financial transactions and extends to advisory services, organisation growth, policy matters, work environment and relevant recommendations to the management etc.

Global regulations such as FCPA in US, UK Bribery Act, SOX Act, COSO, Fraud Risk Management (FRM) by RBI and introduction of IFC (Internal Financial Controls) in companies Act,2013 are the few witness stating the seriousness for requirement of Fraud detection mechanism.

There are instances where organisations extricated from frauds and financial hardship due to early detection and corrective measures by the internal audit team. Internal audit facilitates the organisation to take timely decisions and emphasize on proactive environment than reactive, which is vital in the dynamic economy.

2. Objective:

This article aims at illustrating few significant aspects explaining the benefits of internal audit.

3. What is Internal Audit?

According to the Institute of Chartered Accountants of India (ICAI), "Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system."

According to the Institute of Internal Auditors (IIA), "internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes".

Accordingly, Internal Audit can be broadly understand as management's independent activity to facilitate the management to -

- Improve and add value in governance mechanism.
- Strengthen the strategic risk management and internal control system.

4. Why Internal Audit?

Considering the objectivity of internal audit, it can be viewed as amanagement independent activity to strengthen its own organisation than a statutory requirement. Internal auditors provide the governing body and senior management with comprehensive assurance based on the highest level of independence and objectivity within the organization.

4.1 Major Benefits:

4.1.1 Facilitates strong system to compliance with law:"Ignorantia juris non excusat" means ignorance of law excuses no one. In the present world of business there are so many stringent norms mandated by regulators, further law is being revised continuously, which demands continuous updation. However it might be the difficult for organisational staff, who majorly concentrate on execution of day to day operations. Further, sometimes organisations may not afford as many professionals.

An effective internal audit team with versatile experts can provide organisation a strong system to compliance with the law.

4.1.2 Facilitates informed decisions by the management: in-time quality information helps in quality decisions; internal audit will provide the requisite analysed data to make effective decisions by the management. Instances are there where analysis done by the internal audit team helped management to take vital decisions wrt business expansion such as manufacture of profitable by product, optimisation of ideal resources etc.

4.1.3 Facilitates implementation of effective internal control system: Internal audit examines the policies and procedures of an organisation on a regular basis and ensures the effectiveness of internal control system in force. For instance finding the absence of maker checker control in bills processing will curb processing of fake bills by implementing maker checker control.

4.1.4 Facilitates to strengthen the risk assessment process: Due to increase of complexity in business process new risk factors are emerging. Internal audit plays vital role in evaluating inherent and non inherent risks exist in the business and thereby to mitigate the risk.

4.1.5 Facilitates dedicated review of operations and Fraud detection: with the expansion of business, management oversight dilutes in review of operations which gives ample of opportunities for fraudulent operations. Internal audit with dedicated review of operations will put check to the emerging frauds. Artificial entries in pay roll detected during internal audit will put an end to the fraud in salary payments.

4.1.6 Facilitates pro activeness than reactive nature: Internal audit facilitates the regular review of operations and through its timely review and information it enables the management to be a proactive than a reactive.

4.1.7 Protect interest of the investors: All investors can't be a part of management; they may not have insight into all the operations and process. Internal audit plays a vital role in protecting the interest of the investors. An effective audit system will boost up the confidence in the investors about the effective performance of their organisation.

4.2 Requirement under Indian Companies Act 2013 applicable to Companies only:

As per section 138 of Indian Companies Act 2013 read with Rule 13 of Companies (Accounts) Rules, 2014, appointment of internal auditor is mandatory for the following nature of companies.

Criteria	Listed Company	Unlisted Public Company	Private Company
Paid up share capital (during preceding F.Y.)	Always applicable	Not less than Rs. 500Millions	N.A.
Turnover (during preceding F.Y.)	Always applicable	Not less than Rs. 2000Millions	Not less than Rs. 2000Millions
Outstanding Loans / borrowings from banks/Financial Institutes (at any point of time during preceding F.Y.)	Always applicable	Not less than Rs. 1000Millions	Not less than Rs. 1000Millions
Outstanding deposits (at any point of time during preceding F.Y.)	Always applicable	Not less than Rs. 250Millions	N.A.

5. Conclusion:

Effective internal audit is one of the major pillars in the growth of an organisation. Internal Audit is a prerequisite for every emerging organisation in the dynamic business environment. However unless the Internal auditor treated as admonitor and backed by management, effectiveness will be mere fancy. Hence, pervasive perception towards internal auditor is required to be changed and to achieve its objectivity internal audit should be recognised as intramural mechanism of the organisation.

Establishing a professional internal audit activity should be a governance requirement for all organisations. This is not only important for larger and medium sized organisations but also may be equally important for smaller entities , as they may face equally complex environments with a less formal, robust organisational structure to ensure the effectiveness of its governance and risk management process.

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SERVICE TAX

EXPLORING THE CONTROVERSY OF SERVICE TAX APPLICABILITY ON GOODS TRANSPORT OPERATORS

Contributed by CA Manindar & CA Sri Harsha

Introduction:

Under the erstwhile positive based taxation scheme, service tax on road transport services was initially introduced in the year 1997 and the levy is on 'Goods Transport Operators'. Considering the hue and cry from the truck operators across the nation, levy of service tax is withdrawn. Levy of service tax is re-introduced in year 2004 on 'Goods Transport Agency Services'.Now under the Negative list regime effective from 01.07.2012, all goods transport services are covered under Negative list except the services of 'Goods Transport Agency' and Courier Agency

The above mentioned legal developments would certainly indicate that there is no service tax on services of 'Goods Transport Operator' services. However recent judicial decisions are contrary to this view on the reasoning that goods transport agency services includes services of truck operators. In this backdrop, an attempt is made to unleash various facets of this controversy.

Legislative Background in Levy of Service Tax on 'Goods Transport Agency' Service:

As discussed above, after the levy was withdrawn on the services of truck operators, Government has constituted a Committee(Bharadwaj Committee) to suggest the modalities to levy service tax on goods transport services. The key recommendations of this Committee are reproduced as under;

a. Recommended to levy service tax on services provided by any commercial concern which (is common carrier under the Carriers Act, 1865) books the goods for transportation by road, issues consignment note and provides value added services over and above the mere carriage of the goods be called the goods booking agency.

b. The committee recommended to make it mandatory to these agencies to issue a consignment note to the sender of goods against the receipt of goods for transportation. For this purpose, it is recommended to amend the Carrier Act, 1865. It is also suggested that till such time the said act is amended, the said requirement can be made mandatory under Service Tax laws or by notifications.

c. Any organization/person who possesses the vehicle by virtue of ownership under lease/hire agreement etc and is responsible only for affecting the carriage of goods and is not required to issue consignment note. The truck owner can alternatively be called as truck operator. Normal truck operators who hire their vehicles for transportation are not subject to service tax.

d. As transport sector is unorganized, the committee also recommended implementing reverse charge mechanism keeping the liability to pay service tax to Government either on the consignor or consignee responsible to pay freight.

With these recommendations, service tax is reintroduced in the FY 2004-05 on the services of 'Goods transport agency' i.e. those providing services in relation to transport of goods by road and are required to issue consignment note.

Accordingly, the term 'Goods Transport Agency' was defined under the erstwhile section 65(50b)— "means any person who provides service in relation to transport of goods and issues consignment note by whatever name called."

With these legal developments and committee recommendations, it is very clear that the legislative intent is not to tax the services of truck owners whether it is individual truck owners or organizations owning trucks. Otherwise there is no requirement to re-draft/rephrase the legal provisions when the levy is re-introduced in the FY 2004-05. Further, this legislative intent is clearly evident by budget speech of Finance Minister. The relevant extract is reproduced as under;

"149. 58 services have been brought under the net so far. I propose to add some more this year. These are business exhibition services; airport services; services provided by transport booking agents, transport of goods by air; survey and exploration services; opinion poll services; intellectual property services other than copyright; brokers of forward contracts; pandal and shamiana contractors; outdoor caterers; independent TV/radio programme producers; construction services in respect of commercial or industrial constructions; and life insurance services to the extent of risk premium. I may clarify that there is no intention to levy service tax on truck owners or truck operators....." (emphasis supplied)

Now under the Negative List regime, Section 66D provides for negative list of services. Entry(P) of this list provides that all services provided by way of transportation of goods by road except the services of a 'goods transport agency' or 'courier agency'. Further the term 'Goods Transport Agencny' has been defined under Section 65B(26) by reproducing the same definition as prevailing under section 65(50b) as stated above.

Thus the legal provisions both under erstwhile regime as well as under the negative list regime are same and moot the intention to levy service tax only on services of goods transport agency alone. However, the revenue went on to stretch the meaning of the word 'goods transport agency' to include services of truck operators also and accordingly the matter landed before the judicial forums.

Position upheld by Judicial Forums in the initial years of levy:

The judicial forums in the initial years of levy have resorted to the same interpretation considering the committee report and finance minister speech, concluded that services provided by truck owners are not subject to service tax. The following decisions are for reference.

a. Lakshminarayana Mining Co vs. CST, 2009(16)STR691(Tri-Bang)

b. CCE vs. Kanakadurga Agro Oil Products Private Limited, 2009(15)STR399(Tri-Bang)

c. KMB Granites Private Limited vs. CCE,2010(19)STR437(Tri-Bang)

Subsequent Regulatory Legislation 'The Carriage By Road Act, 2007' in congruence with above position:

Subsequently, a regulatory legislation 'The Carriage by Road Act, 2007 was passed by Parliament which repealed the earlier Carriers Act, 1865. As stated above, the committee recommended to levy service tax on services of common carriers alone excluding the truck operators. Accordingly, 'Common Carrier' is defined under section 2(a) of the Act as follows;

"Common Carrier" means a person engaged in the business of collecting, storing, forwarding, distributing goods to be carried by goods carriages under a goods receipt or transporting for hire of goods from place to place by motorized transport on road for all persons undiscriminatingly and includes a goods booking company, contractor, agent, broker and courier agency engaged in door to door transportation of documents, goods or articles utilizing the services of a person, either directly or indirectly, to carry or accompany such documents, goods or articles but does not include government.

Thus in view of the above definition, 'Common Carrier' means those engaged in transportation of goods simultaneously for various persons without discrimination i.e. whether the goods transported is of small quantity occupying a portion of space in truck or of huge quantity occupying the entire truck space.

The service receiver perceives the service as safe transportation of goods from one place to another. Under this case, the service receiver never bothers about the vehicle in which the goods are transported.

A common carrier is basically a facilitator of goods transport from place to another by through vehicles owned by him as well as through vehicles owned by others on hire basis. The services include collecting, storing, forwarding and distribution of goods. In view of this reason, it has been prescribed under Rule 4(1) of Carriage by Road Rules, 2011 that the person who intends to obtain registration as Common Carrier should own at least two vehicles. It has been prescribed under Section 9(1) of the said Act that it is mandatory for common carriers to issue a goods receipt (consignment note) in such form as prescribed.

Whereas in case of services of a truck operator, generally the service receiver perceives the service as making available the truck along with driver for transportation of goods. The truck operator may provide services to an agency or directly to a customer. Thus the distinction between services truck operators and that of services of goods transport agency is clearly recognized in the drafting of legal provisions both under the erstwhile regime and under the current regime.

Turnaround Created by Recent Judgments Decisions:

However, a contrary stand is taken recently by several tribunals on applicability of service tax on truck operators. The latest one is that of Bangalore Tribunal in the case of Sree Balaji Transport vs. CCE, 2015(38)STR651(Tri-Bang) wherein by distinguishing its own cases referred above, it was held vide para 5.1 as— "Section 65(105(zzp) defines taxable service as 'service provided or to be provided to any person, by a goods transport agency, in relation to transport of goods by road in a goods carriage'. From these legal definitions it is clear that any person (including individuals) who provides service in relation to transport of goods by road is liable to Service Tax. There is no exclusion of individual truck owners from the purview of Service Tax levy under the law".

Thus there is an ambiguity over the scope and ambit of 'goods transport agency' as to whether it includes the truck owners directly providing transport services to service receivers by transporting their goods from one location to other location. The Judicial forums which have taken the stand that services of trucks owners gets covered with in the ambit of 'goods transport agency' have gone by language of the Statute completely disregarding the above mentioned legal developments.

Further under the Negative list regime if the above interpretation is adopted, every service by way of transport of goods by road attracts service tax. Then there would have been no need of having an entry in Negative list to exclude certain transport services by road. Thus this interpretation creates a distortion.

Conclusion:

Before parting, the paper writer is of the opinion that in view of the ambiguity in legal position, legal interpretation rule 'contemporaneous expositio' would come handy here. According to this rule, the construction of law made shortly after its enactment when the reasons for its passage were then fresh in the minds of the judges, is considered as great weight in interpretation. Further, going by history of service tax levy in India and considering the business of goods transportation, transport operators and transport agencies are not considered as one and same. In such cases, the views expressed by judicial forums shortly after the enactment are given due weight age. However, the recent judicial decisions completely ignored the recommendations of the Committee and reasons behind re-introduction of levy only on services of goods transport agency but not on operators. Thus all the discussed pro assesse and contrary judgments needs to be reviewed by the Apex court to rest this ambiguity and the tussle between the Revenue and assesses.

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COMPANIES ACT

PROPOSED CARO, 2016 WITH ADDITIONAL REPORTING REQUIREMENTS

Contributed by CA Sandeep Das

Background

On 9th February, 2016 the Ministry of Corporate Affairs has proposed new Companies (Auditor's Report) Order (CARO), 2016. The Ministry had set-up a Committee on 16th September, 2015 to examine and recommend matter for inclusion in the statement to be attached with Auditor's Report under Section 143(11) of the Companies Act, 2013 (2013 Act) for the financial year 2015-16 onwards.

Section 143(11) of the Companies Act, 2013requires that the auditor's report of specified class of companies should include a statement on the prescribed matters. As per the section 143 of the Companies Act, 2013, every report of the auditor under this section should contain matters specified under applicable CARO.

The newly proposed CARO, 2016 contains 15 clauses, out of which some clauses have been carried forward from present CARO, 2015. MCA has issued exposure draft of CARO, 2016 for stakeholders' comments. The draft, if approved, shall be applicable for FY 15-16 onwards.

In comparison to CARO (2015), CARO (2016) proposes few additional reporting requirements and eliminates some of the reporting requirements.

1. Applicability

Every report made by the auditor under Section 143 of the 2013 Act for Financial Year commencing on or after April 1st 2015 would include CARO 2016. There is no difference between CARO, 2016 and CARO, 2015 from the point of view of applicability, except that CARO, 2016 is not applicable on private limited company, not being a subsidiary or holding of a public company, when its:

- Paid up capital and reserves and surplus does not exceed Rs. 1 crore as at balance sheet date; and
- Total borrowings from banks or financial institution at any point of time during financial year does not exceed Rs. 1 crore; and
- Total revenue, including revenue from discontinuing operations, does not exceed Rs. 10 crore.

Other companies not covered under CARO 2016

- Banking company as defined under section 5(c) of the Banking Regulation Act,1949.
- Insurance company as defined under the Insurance Act, 1938
- Companies incorporated with Charitable objects, that is companies licenses to operate under the Section 8 of 2013 Act.
- One Person Company as defined under section 2(85) of the 2013 Act
- Small company as defined under section 2(85) of the 2013 Act

CARO, 2016 shall not apply to the auditor's report on consolidated financial statements whereas CARO, 2015 is applicable in such case. CARO is applicable to a foreign company as defined under Section 2(42) of the 2013 Act.

2. REPORTING REQUIREMENTS

As compared to CARO 2015, the reporting requirements under the CARO 2016 (draft) have been increased.

I. Additional reporting requirements in CARO, 2016

Fixed Assets

- Auditor should report whether title deeds of immovable properties are held in the name of the company. If not, provide details thereof.

Loans and investments

- Auditor should report whether the company has granted any loans, secured or unsecured to companies, firms or other parties covered by clause (76) of Section 2 of the Companies Act, 2013. If so whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest.

- Auditor should report in respect of loans, investment and guarantees, whether provisions of section 185 and 186 of the Companies Act, 2013have been complied with. If not, details should be provided.

Managerial Remuneration

- Auditor should report whether managerial remuneration has been paid / provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act, 2013? If not, state the amount involved and steps taken by the company for securing refund of the same.

Nidhi Company

- Auditor should report whether the Nidhi Company has complied with the Net Owned Fund in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining 10% liquid assets to meet out the unencumbered liability.

Note: This is the requirement under CARO (2003) which has been re-introduced by MCA this indicates MCA's effort to keep CARO requirements relevant from stakeholders' perspective.

Related Party Transactions

- Auditor should report whether all transactions with the related parties are in compliance with Section 188 and 177 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the accounting standards and Companies Act, 2013.

Preferential allotment / Private placement

- Auditor should report whether the company has made any preferential allotment / private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of Section 42 of the Companies Act, 2013 have been complied and the amount raised have been used for the purposes for which the funds were raised. If not, provide details thereof.

Non-cash transaction

- Auditor should report whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether provisions of Section 192 of Companies Act, 2013 have been complied with.

II. Deletion in reporting requirements from CARO, 2015

Inventory

- Auditor should report whether the procedures of physical verification followed by the management is reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies should be reported

Internal Control System

- Auditor should report is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system.

Statutory dues deposits

- Auditor should report whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956 (1 of 1956) and rules made there under has been transferred to such fund within time.

I ncurrence of cash losses and Accumulated Losses

- Auditor should report whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year.

Guarantee of loans taken by others from banks or financial institutions

- Auditor should report whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company.

III. Modification in reporting requirements of CARO, 2015

Modification requirements

- Are procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of the business.
- Whether the company is maintaining proper inventory records

Application of term loans/ public issue/follow-on-offer

➢ Auditor should report whether moneys raised by way of public issue/ follow-on offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays / default and subsequent rectification, if any, as may be applicable, be reported.

New requirement

It increases thes cope to public issue and follow-on-offer (including debt instruments).Previously it was restricted to term loans only.

Granting of loan to certain parties

➢ Auditor should report whether the company has granted any loans, secured or unsecured to companies, firms or other parties covered by clause (76) of Section 2 of the Companies Act, 2013. If so, if overdue amount is more than rupees five lakhs, whether reasonable steps have been taken by the company for recovery of the principal and interest.

New requirement

It relates to whether the terms and condition are prejudicial to the Company's interest and threshold of overdue amount has been increased from Rs. 1 Lakh to Rs. 5Lakh

Default in repayment of dues

➢ Whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holder?

➢ If yes, the period and amount of default to be reported (in case of banks and financial institutions, lender wise details to be provided).

New Requirement

It relates to lender – wise details of period and amount of default.

Overall conclusion

Draft CARO (2016) aims to improve quality of auditor's reporting, it is a step in the right direction. CARO (2016) would not be applicable on consolidated financial statement which is a welcome relief to the companies. CARO would be applicable to less number of private companies; MCA has relaxed the scope of CARO on private companies by increasing the applicability thresholds.

Reporting of maintenance of records of fixed assets and inventories including physical verification under IFC Vs. CARO2016 – The 2013 Act requires companies and auditors to report whether IFC is adequate and operating effectively. CARO 2016 continues to have clauses relating to fixed assets and inventories which would be dealt with under IFC reporting. Therefore the purpose of continuing with these clauses in CARO 2016 is not clear.

Reporting responsibilities of the auditor has been increased by CARO for the following key clauses:

- Loans to related parties covered under section 2(76) instead of Section 189
- Related party transactions under section 188 and 177 of the 2013 Act
- Loans, investments and guarantees comply with section 185 and 186 of the 2013 Act
- Nature and amount of frauds by officer and employees
- Non-cash transactions with directors or persons connected with him under Section 192 of the 2013 Act.
- Managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provision of Section 197 read with schedule V of the 2013 Act.
- Lender wise details in case of default of payment of dues to banks and financial institutions
- Compliance of section 42(offer or invitation for subscription of securities on private placement)
- Utilisation of public issue or follow-on –offer or term loans (including debt instruments)

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LABOUR LAWS

FREQUENTLY ASKED QUESTIONS - PAYMENT OF BONUS ACT,1936

Contributed by SV Ramachandra Rao

1. *To which companies / establishments, the payment of bonus act shall be applicable?*

   The Act is applicable to Factories employing 10 or more persons and other establishments employing 20 more persons on any day during the financial year.

   When once applicable, the Act will continue to be applicable even when the numbers of persons employed have reduced in the subsequent financial year.

2. *Is Payment of Bonus Act is applicable to newly established factories and establishments?*

   Yes. The Act is applicable to newly established factories and establishments from the date of profits being derived as stipulated under the Act irrespective of completing 5 years or not.

   For Clarity, the financial year in which the first invoice is raised is taken as the year of commencement of business. After the said year, during the first five years, bonus will become payable only for the financial years in which the new factory or establishment derives profit. If the company has not derived profit during the first 5 years of its existence after completion of the financial year in which first invoice has been raised, the company is not required to pay bonus under the Act.

3. *One company may have different units established at different times. Some unit may be profitable and some other units may be incurring losses. Whether all the units are entitled for bonus or not?*

   As long as separate accounts and individual balance sheets are maintained for distinct units, bonus is payable in accordance with profit derived by the respective units.

   In the matter of workmen of *Modern Mills Vs General Manager* [1986 (2) LLJ 329] it has been held that where a separate profit and loss account and balance sheet has been maintained by the employer as regards any unit or branch thereof, employees of that unit would be entitled to bonus on the basis of the financial statements of that unit but the requirement being that he has done so in the previous year also.

   The Supreme Court in the matter of workmen of HMT Vs National Tribunal [AIR 1973 SC 2300] held that in case where the different units have been treated separately for the purpose of computation of bonus and separate balance sheet, profit and loss accounts have been prepared in respect thereof the unit would not lose their separate identity as establishment.

4. Is employer liable to pay bonus even when the company has not made any profits?

   Yes.

   After completion of first 5 years from the financial year in which first invoice is raised, the company is liable to make payment of bonus to its eligible employees at a rate of 8.33 percent of the wages or salary earned during the financial year subject to other conditions stipulated in this regard even though the company does not have allocable surplus in the accounting year.

5. What is allocable surplus?

   Every company has to calculate available surplus as per the provisions of section 5,6 and 7 of the Payment of Bonus Act. 67 percent of the available surplus will be the allocable surplus. Based on the amount available in the allocable surplus, the percentage of bonus for the year shall be determined.

6. What is the maximum bonus payable?

   The maximum bonus payable under the act is 20 percent.

7. Who is an employee under the Act?

   Any person employed other than an apprentice for wages or salary of Rs. 21,000/- or below per month in any capacity.

8. Whether Part Time employees are covered under the Act?

   Yes. Part Time employees are covered under the Act.

   In the Case of Sweepers whose working hours are on part time basis and for fixed hours it was held they are to be taken as employees and hence eligible to an entitlement of bonus. Automobile Karamchari Sangh Vs Industrial Tribunal 1971 (22) FLR 98.

9. What components of emoluments constitute wages under the Act?

   Salary or wages means all remuneration capable of being expressed in terms of money, including dearness allowance and excluding any other allowance that is paid for time being, traveling concession and value of any house accommodation.

   As a practice over years, the industry has been taking Basic, DA, VDA and FDA as wages or salary for the purpose of coverage under the Act.

10. Will providing free food or food allowance given to an employee will constitute wage?

    Food Allowance is different from providing free food. If the employee is receiving 'Food Allowance' and not 'free food' the said allowance is not considered as wage

    The Madras High Court in the matter of United Shippers and Dredgers Ltd Vs Labour Court, Coimbatore [1992 LLR 607] held that cash site allowance and food allowance paid to an employee will not form part of salary in so far as payment of Bonus Act is concerned.

    But food provided free of cost, the cost of such food will be form part of the wages or salary of the employee and hence to be taken into account for the purpose of payment of bonus.

11. Will city compensatory allowance, constitute wage under the Act?

    Yes. Madras High Court [2004 LLR 802] held that City compensatory allowance will form part of wages for calculation of bonus.

12. Will retaining allowance paid to seasonal employees will constitute wage under the Act?

    Yes. Retaining allowance paid to seasonal employees will constitute wage and the Mumbai High Court n the matter of Sangammer Bhag Sahakari Sakhar Karkhana Ltd Vs Rashtriya Sakhar Kamgar Union [2001 II LLJ 707] held that retention allowance paid to seasonal employees will form part of wages under Payment of Bonus Act and such employees will be entitled to Bonus.

13. Is there any minimum period of working of an employee to become eligible for bonus?

    Yes. Employees who have worked 30 or more working days in the financial year are entitled under the Act.

14. When can an employee be disqualified from receipt of bonus?

    An employee shall be disqualified from receiving bonus, if he is dismissed from service for the acts committed by him which constitute (a) fraud or (b) riotous or violent behaviour or (c) theft, misappropriation or sabotage of any property of the establishment.

15. What is the method of calculation for payment of bonus to employees?

    The employees whose salary or wages are below Rs 21,000/- are covered under the act. If the salary or wage of an employee exceeds Rs 7,000/- per month or the minimum wage for scheduled employment whichever is higher, the bonus payable shall be calculated as if his salary or wage were Rs 7,000/- or the minimum wage whichever is higher.

16. Please give some examples of the method of calculation of bonus under various scenarios.

    With the amendment to the bonus act employees whose salary or wage is Rs. 21,000/- and below have become eligible for bonus. The method of calculation of bonus has also been amended wherein whose salary or wage is more than Rs. 7,000/- or the minimum wage, salary or wage should be treated as Rs.7,000/- or the minimum wage whichever is higher.

    The minimum wages will change once in six months in the some states and once in three months in some states. Hence, the applicable minimum wage for the relevant period has to be taken into account for calculation of bonus payable.

    As the minimum wage is different in the first six months and second six months of the financial year, the bonus eligibility is different for the two six months period. That is to say, higher the minimum wage higher the bonus entitlement.

Scenario 1: Actual Salary/Wage > Minimum Wages & Rs 7,000/-:

When the salary or wage of the employee is more than Rs. 7,000/- and the minimum wage, the bonus will become payable on minimum wage.

Name	Design	Basic + DA	Other allowances	Salary pm	Min Wage 1	Min Wage 2	Bonus 1	Bonus 2	Total Bonus
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Ram	Chemist	21,500	4,000	25,500	11,568	11,741	Nil	Nil	NIL
Gopi	Chemist	17,000	4,000	21,000	11,568	11,741	5,784	5,871	11,655
Shyam	Chemist	15,000	4,000	19,000	11,568	11,741	5,784	5,871	11,655

Note:

1. Minimum bonus of 8.33% is being calculated;
2. Minimum Wage 1 is for first six months and Min Wage 2 is for second six months;
3. Bonus 1 is calculated on the basis of Min Wage 1 and Bonus 2 accordingly;
4. Since, minimum wage is greater than Rs 7,000/-, minimum wage has to be considered;
5. Hence, Bonus 1 is arrived as 11,568*8.33%*6 monthsfor Ram and Bonus 2 accordingly;
6. Allowances other than DA shall not be considered as salary/wage – Refer FAQ 9.

Scenario 2: Actual Salary/Wage < Minimum Wages & Rs 7,000/-:

When the salary or wage of the employee is below Rs. 7,000/- or the minimum wage, the bonus will become payable on actual wage or salary. Hence there will be no impact of minimum wages in these cases.

Name	Design	Basic + DA	Other allowa	Salary PM	Min Wage 1	Min Wage 2	Bonus 1	Bonus 2	Total Bonus
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Reddy	Bottle filler	5,500	5,000	10,500	7,643	7,816	2,750	2,750	5,500
Raju	Bottle washer	5,500	4,500	10,000	7,499	7,672	2,750	2,750	5,500
Yadav	Helper	5,500	4,000	9,500	7,253	7,426	2,750	2,750	5,500

Note:

1. Minimum bonus of 8.33% is being calculated;
2. Minimum Wage 1 is for first six months and Min Wage 2 is for second six months;
3. Bonus 1 is calculated on the basis of Min Wage 1 and Bonus 2 accordingly;
4. Since, Actual wage is less than Rs 7,000/- and minimum wage – actual wage/salary to be considered;
5. Hence, Bonus 1 is arrived as 5,500*8.33%*6 months for Reddy and Bonus 2 accordingly;
6. Allowances other than DA shall not be considered as salary/wage– Refer FAQ 9.

Scenario 3: Actual Salary/Wage > Rs 7,000/- but below Minimum Wages:

If the wages or salary of the same employees is above Rs 7,000/- and below the minimum wage,the bonus entitlement will not be restricted to Rs 7,000/- for the purpose of calculation of bonus and actual wage is considered.

Name	Design	Basic + DA	Other allowa	Salary PM	Min Wage 1	Min Wage 2	Bonus 1	Bonus 2	Total Bonus
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Reddy	Bottle filler	7,500	5,000	13,500	7,643	7,816	3,750	3,750	7,500
Raju	Bottle washer	7,300	4,500	12,800	7,499	7,672	3,650	3,650	7,300
Yadav	Helper	7,100	4,000	12,100	7,253	7,426	3,550	3,550	7,100

Note:

1. Minimum bonus of 8.33% is being calculated;
2. Minimum Wage 1 is for first six months and Min Wage 2 is for second six months;
3. Bonus 1 is calculated on the basis of Min Wage 1 and Bonus 2 accordingly;
4. Since, Actual wage is greater than Rs 7,000/- but less than minimum wage – actual wage/salary to be considered;
5. Hence, Bonus 1 is arrived as 7,500*8.33%*6 months for Reddy and Bonus 2 accordingly;
6. Allowances other than DA shall not be considered as salary/wage– Refer FAQ 9.

In both the above examples, the bonus payable will be the actual wage of the employee and there will be no effect of minimum wage or Rs. 7000/- restriction of wage for computation of bonus.

Scenario 4: Actual Salary/Wage > Minimum Wages but Minimum Wages < Rs 7,000/-:

If the wages or salary of the same employees is above the minimum wages, the bonus entitlement will be calculated as if the salary or wage is minimum wage or Rs 7,000/- whichever is higher, as the wage for purpose of calculation. In the below mentioned example, as the minimum wage is less than Rs7,000/- and the actual wage of the employee is above Rs 7,000/-, the ceiling limit will be Rs 7,000/- and bonus payable is as if his wage is Rs. 7,000/-

Name	Design	Basic + DA	Other allowa	Salary PM	Min Wage 1	Min Wage 2	Bonus 1	Bonus 2	Total Bonus
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Reddy	Bottle filler	7,500	5,000	13,500	6,900	6,950	3,500	3,500	7,000
Raju	Bottle washer	7,300	4,500	12,800	5,700	6,850	3,500	3,500	7,000
Yadav	Helper	7,100	4,000	12,100	6,500	6,750	3,500	3,500	7,000

As the minimum wage is less than Rs. 7000/-, in the concept of whichever is higher, Rs. 7000/- will become the limit for calculation.

Note:

1. Minimum bonus of 8.33% is being calculated;
2. Minimum Wage 1 is for first six months and Min Wage 2 is for second six months;
3. Bonus 1 is calculated on the basis of Min Wage 1 and Bonus 2 accordingly;
4. Since, Actual wage is greater than Rs 7,000/- but minimum wage is less than Rs 7,000/- –then, Rs 7,000/- has to be considered;
5. Hence, Bonus 1 is arrived as 7,000*8.33%*6 months for Reddy and Bonus 2 accordingly;
6. Allowances other than DA shall not be considered as salary/wage– Refer FAQ 9.

Scenario 5: Actual Salary/Wage >Rs 7,000/-& Minimum Wages and Minimum Wages are different:

In continuation to the above scenario, for the same employees if the wages are above Rs 7,000/- and also above the minimum wage, for the purpose of calculation of bonus, the minimum wages will be taken into consideration.

Name	Design	Basic + DA	Other allowa	Salary PM	Min Wage 1	Min Wage 2	Bonus 1	Bonus 2	Total Bonus
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Reddy	Bottle filler	8,000	4,500	12,500	7,643	7,816	3,820	3,906	7,726
Raju	Bottle washer	8,000	4,500	12,500	7,499	7,672	3,748	3,834	7,582
Yadav	Helper	8,000	4,500	12,500	7,253	7,426	3,625	3,712	7,337

Note:

1. Minimum bonus of 8.33% is being calculated;
2. Minimum Wage 1 is for first six months and Min Wage 2 is for second six months;
3. Bonus 1 is calculated on the basis of Min Wage 1 and Bonus 2 accordingly;
4. Actual wage is greater than Rs 7,000/- and minimum wage- minimum wage has to be considered;
5. Hence, Bonus 1 is arrived as 7,643*8.33%*6 months for Reddy and Bonus 2 accordingly;
6. Allowances other than DA shall not be considered as salary/wage– Refer FAQ 9.
7. It could be seen from the above, though the wages of all the three employees is same, the bonus payable is different as applicable minimum wage is different for all the three employees.

17. Is there any time limit set in the act for payment of Bonus?

    Yes. Bonus should be paid within eight months from the close of the accounting year.

18. Can an employer deduct any amount from the bonus payable to the employee?

    Only in the case of established misconduct as per industrial employment standing orders act resulting in financial loss to the company, the employer can deduct the amount of loss from the bonus payable to the employee.

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INCOME TAX

REMISSION OR CESSATION OF FUTURE LIABILITY - TAX IMPACT

Contrinuted by CA Ramprasad

Income Tax Act, 1961("Act") provides for deduction of allowance or expenditure while computing business income chargeable to tax . However if after claiming the amount as expenditure earlier, any benefit is derived in subsequent year, such amount will be brought to tax by virtue of provisions of section 41 of the Act.

The benefit obtained may be in the form of cash or any other manner. In order to attract the provisions of section 41(1) the benefit is with reference to loss or expenditure or some benefit in respect of trading liability by way of remission or cessation thereof.

In case of succession of business[1] the taxability, of any benefit with reference to loss or expenditure or cessation or remission of trading liability, is on the successor.

The Loss or expenditure or remission or cessation of trading liability may be by way of writing off such liability unilaterally by the assessee or successor in business. [Explanation 1 to Section 41(1)].

The remission or cessation is of trading liability in order to attract the provisions of section 41(1) -Nectar Beverages (P.) Ltd. v. Dy. CIT [2004] 139 Taxman 70/267 ITR 385 (Bom.).

Creation of Provision and it's impact:-

Issue1:- If assessee creates a provision towards the liability to be incurred in future and such liability ceases to exist in the next year, will it attract the provisions of section 41(1)?

Issue2:- Whether cessation of future liability will attract the provisions of section 41(1)?

These issues came up before Bombay High Court in CIT Vs Jet Airways (India)Ltd(High Court Bombay- 66 taxmann.com 166)

Issue1:-

Brief Facts of the case:- Assessee had made a provision of Rs. 3.28 Crores up to 31st March, 2005 in respect of expenses likely to be incurred on redelivery of the four air craft's taken on lease.

During the relevant assessment year, the lease period in respect of the four aircrafts was to expire. However, the lease of the four air crafts was extended/renewed for a further period. As a result, the Respondent was not required to redeliver the four aircrafts to the lessor during the subject assessment year.

[1][Explanation 2].—For the purposes of this sub-section, "successor in business" means,—
(i) where there has been an amalgamation of a company with another company, the amalgamated company;
(ii) where the first-mentioned person is succeeded by any other person in that business or profession, the other person;
(iii) where a firm carrying on a business or profession is succeeded by another firm, the other firm;
(iv) where there has been a demerger, the resulting company

On the basis of the above, the Assessing Officer invoked Section 41(1) of the Act and held that there was cessation of liability and sought to bring the entire amount which was provided for on the above account of Rs. 3.28 Crores to tax.

Assessee has filed appeal before CIT(Appeals) against the order of the assessing officer. The CIT(Appeals) held that there was no cessation of liability as the lease has been extended for a further period. Thus, *expenses which are likely to be incurred at the time of redelivery of the four air crafts continue* and the provision made continue. Thus, there was no occasion to invoke Section 41(1) of the Act and the addition was deleted.

Department has filed an appeal against the order of CIT(Appeals) to the Tribunal. Tribunal upheld the findings of the CIT(Appeals). Further, the department has filed an appeal against the order of Tribunal to the High Court.

The Bombay High Court held that the lease for the air crafts has been extended for further period and liability of expenses at the time of redelivery of the aircrafts has not ceased. Thus, the same would have to be provided for, as it is likely to be incurred when the lease expires and said four air crafts are redelivered.

"Section 41(1) of the Act has application only when there is cessation and/or remission of liability incurred (which has been duly paid and/or provided for) in the subsequent years, consequent of which some benefit in cash or in any other manner were obtained by the party whose liability has ceased. In this case, in fact, there is no cessation or remission of liability nor any benefit obtained by the Respondent-Assessee for the purposes of Section 41(1) of the Act to be invocable."

Issue2:-

Brief Facts of the case:-

Assessee purchased five aircrafts under hire purchase agreement and claimed depreciation on them. Later Assessee sold five aircrafts which had been taken on hire purchase basis and in view of the fact that the air crafts have been sold the balance amount of instalments payable in future would not now be payable.

The Assessing Officer held that non-payment of balance instalments resulted in benefit referred to in section 41(1) and hence taxable. Thus, made an addition of the benefit of Rs. 100.52 Crores a result of the difference between sale consideration received and instalment payable which is now not payable. This benefit of Rs. 100.52 Crores being chargeable to tax under Section 41(1) of the Act.

Assessee filed an appeal before CIT (Appeals) challenging the order of the assessing officer. CIT (Appeals) held that "Assessee was the owner of the said aircrafts as held in the earlier assessment years and the claim of depreciation on this aircraft has also been allowed. However, on the sale of the five aircrafts, their value was also reduced from the block of assets. Thus, there was no question of any cessation or remission of liability for the purpose of Section 41(1) of the Act to apply".

Department filed an appeal against the order of CIT (Appeals) before Tribunal. Tribunal upheld the order of CIT (Appeals).

On further appeal to High Court the court held that the amount of Rs. 361.72 Crores being instalment payable in the future was never claimed as a deduction/expenditure/loss or trading liability by the Respondent-Assessee.

Thus, no occasion arises for the purposes of Section 41(1) of the Act being invoked. Accordingly, the findings of the CIT(Appeals) and Tribunal that Section 41(1) of the Act is not applicable in the facts of the present case is self-evident. Therefore, the proposed of question of law as formulated does not give rise to any substantial question of law and not entertained.

Conclusion:-

Cessation of future liability is not a benefit within the meaning of provisions of section 41(1) as no deduction or allowance was claimed. Though the expenditure under section 41(1) covers capital expenditure[2] also mere cessation of future liability towards it will not warrant applicability of provisions of section 41(1).

[2] - Nectar Beverages (P.) Ltd. v. Dy. CIT [2004] 139 Taxman 70/267 ITR 385 (Bom.)

This article is contributed by CA Ram Prasad, Partner of SBS and Company LLP, Chartered Accountants. The author can be reached at caram@sbsandco.com

TECHNICAL SESSIONS:

S.No.	Event	Date	Speaker	Venue
1	"FEMA Regulations-NRI Transactions".	11/03/2016	CA Murali Krishna G	SBS - Hyd
2	Analysis of CARO	18/03/2016	CA MHS Bhyrav	SBS - Hyd
3	Case Study on Forensic Audit	25/03/2016	CA Sandeep Das	SBS - Hyd
4	Impact of technology on Accounting Environment	02/04/2016	CA Saran Kumar U	SBS - Hyd

Note:

The timings for the above events shall be from 17:30 hrs to 19:30 hrs. We request the recipients of "SBS Wiki" who are interested to attend the above events to send confirmation of your participation 2 days in advance to make appropriate arrangements and sharing of the relevant material, if any.

Basics of Foreign Trade Policy - CA Sri Harsha

Overview of Direct & Indirect Taxes- CA Sri Harsha

Incisive Analysis of Exemptions under Service Tax-Part 2 - CA Manindar

SBS BUDGET MEET 2016 – SCHEDULE

Date	Topic	City	Venue
02-03-16	Budget 2016 – Hospital Industry	Hyderabad	Apollo Hospitals, Jubliee Hills
04-03-16	Budget Analysis on DT & IDT for CA students	Hyderabad	ICAI Bhawan
05-03-16	Interactive session on Budget Proposals	Hyderabad	The Golkonda Hotel
07-03-16	Clause by Clause Analysis – Budget 2016	Ongole	ICAI Bhawan
16-03-16	Interactive session on Budget Proposals	Tada (SriCity)	Bigstay

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Nellore: 16-6-259, 1st Floor, Near Santi Sweets Opp: SBI ATM, Vijayamahal Centre, SPSR Nellore, Andhra Pradesh
Tada: 8-3-425/2, Flat No. 202, 2nd Floor, Bigsun Avenue, Near SRICITY, TADA, SPSR Nellore Dist, Andhra Pradesh
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