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SBS Wiki

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By

SBS and Company LLP
Chartered Accountants

CONTENTS

Dear Readers,

Greetings for the season!

In this edition, we bring you to quite a few interesting articles.

The article on 'Affordable Housing – Income Tax & GST Perspective' deals with tax incentives under both the taxation laws for a business which is engaged in making the goal of this government true. We have also commented on certain issues from both the taxation laws with respect to affordable housing.

We also have an article on 'Gifts, Discounts, Credit & Impact thereof', wherein one of the issues in GST with respect to the gifts, discounts and impact of credit is detailed. This is based on the recent rulings of AAR and Circulars issued by CBIC on the said subject.

The next article is on 'MSME vis-à-vis Internal Audit', which brings the importance of internal audit for MSMEs and the key challenges faced by Auditor in auditing such auditees.

The final one is on the new section introduced by Finance (No.2) Bill, 2019 in direct taxation, which deals with deduction of tax by individuals or HUFs when using the services of contractor or professionals. We have also contributed certain FAQs for the benefit of Clients.

Also, I am excited to share that this month and coming one are significant milestones in our journey. This month marks the completion of 5 years of the 'SBS Wiki' and next month marks the completion of 10 years of SBS. I take this as opportunity to thank all the Clients, well-wishers, advisers, Team SBS and other stakeholders who stood by us all the time and also wish that they shower their support in future also. Thanks a ton!

I hope that you will have good time reading this edition and please do share your feedback. I will also urge clients to mail us topics or issues on which you want us to deliberate in our future editions, so that we can contribute to the same.

Thanking You,

SANNAREDDY SURESH BABU
Digitally signed by SANNAREDDY SURESH BABU
Date: 2019.07.23 11:26:32 +05'30'

Suresh Babu S
Chairman & Managing Partner

GST

GIFTS, DISCOUNTS, CREDITS & IMPACT THEREOF

Contributed by CA Sri Harsha

Section 17(5) of Central Goods & Services Tax Act, 17 (for brevity CT Act) deals with blocked credits. The said section starts with non-obstinate clause overriding the general provisions of Section 16 of CT Act which deals with credit entitlements. In other words, despite of the fact that a particular goods or input services is used for furtherance of business, the credit of tax paid on such items shall not be entitled if such item is mentioned vide Section 17(5). In this article, we try to analyse, the sub-section (h) of Section 17(5) with the help of certain recent advance rulings.

Section 17(5)(h) states that input tax credit shall not be available with respect to goods lost, stolen, destroyed, written off or disposed by way of gift or free samples. That is to say, if a supplier who has purchased certain goods and disposed the same by way of gift or free samples, the supplier is not entitled to take credit despite of the fact such gifts or free samples would yield additional business to the supplier. With the above basics in place, let us proceed to examine certain advance rulings to better understand the ambit of Section 17(5)(h).

We have picked up four rulings of Authority for Advance Rulings (AAR) for the purpose of this write up. Among four rulings, three emanate from Maharashtra AAR and the one is from Kerala AAR.

Biostadt India Limited's Ruling – Maharashtra AAR
(20 Dec 18)

The applicant is engaged in business of developing, manufacturing and distributing crop protection chemicals and hybrid seeds. In order to achieve sales and marketing objectives, the applicant has launched various target based – sales incentive schemes for their distributors and retailers. The said schemes help the customers to be motivated to achieve a specified target and in turn helps the applicant to achieve their sales targets. Basis above, the applicant has announced two schemes, wherein the distributors or retailers would be entitled to gold coins depending upon the quantity of the products they lift from applicant and the time period in which they make payments for such products to applicant.

Applicants are purchasing gold coins from registered vendors and paying applicable tax on said purchases. The question before the AAR was whether the said tax paid on purchase of gold coins which is used to reward the distributor or retailers is entitled for availment of credit? The applicant believes that said credit of tax paid on gold coins can be availed as credit since the same is used for furtherance of his business. Further, applicant believes that said gold coins cannot be called as 'gifts' to fall under the blocked credits vide Section 17(5)(h), for the reason that 'gift' is a gratuitous payment and does not involve any consideration. Once a consideration is attached to a transaction, then it cannot be called as 'gift'. The applicant further states that gold coins are not gifted just like that to the retailers. Only if the retailer or distributor satisfies certain conditions, then he is entitled for gold coins, otherwise he would not. Hence, the applicant believes that gold coins are not 'gifts' and accordingly not covered vide Section 17(5)(h) and hence credit of taxes paid can be availed.

The contention of the jurisdictional officer was that since the gold coins are not given in furtherance of business, the said are nothing but pure gifts and accordingly the credit of taxes paid cannot be availed as credit by the applicant. The concerned officer has designed a three question set to decide when a transaction can be called as in course or furtherance of business and applied such questions to the applicant's case and decided that applicant has failed to satisfy such questions and accordingly the transaction of purchase of gold coins is not an activity in course or furtherance of business. Further the concerned officer has also stated that if the gold coins are given as discounts and recorded as a contractual obligation in the invoice/documents, then the credit of taxes paid on purchase of gold coins can be availed as it does not amounts to gifts in such case (more about this later).

The AAR after hearing both the views has stated that the intention under GST laws is non-granting/denial of setoff is envisaged in situations where there is no tax on output supply. The AAR held that in cases where the goods are procured with levy of input tax and are supplied without tax being paid on such output supplies, the scheme of GST act provides no input tax credit, except export.

The AAR further held that the applicant's contention that they have contractual arrangement with the retailer wherein if the distributor purchases certain amount of company's product or makes payment, then he shall be entitled to a gold coin. This can be inferred as if the distributor of the applicant is providing services of increased sale for which consideration is in the form of gold coin and applicant has failed to prove that he has paid tax on such output supply[1] and hence the gold coins are nothing but gifts and accordingly credit of taxes paid cannot be availed by applicant.

Polycab Wires Private Limited's Ruling – Kerala AAR
(02March 19)

The applicant is a dealer in electrical goods, cables of all kinds including wires, pipes etc. The applicant has supplied electrical items to Kerala State Electricity Board (KSEB) through their distributors spread across the state in connection with reinstating connectivity in the flood ridden areas as part of the 'mission reconnect'. The materials are supplied free of cost as a part of Corporate Social Responsibility (CSR) activity. The applicant states that the distributors raised bills on applicant in relation to the materials supplies free of cost to KSEB. The distributors issued tax invoices to KSEB showing sale value, GST and total amount with 100% discount. The GST liability on such invoices was paid to government. The applicant believes that since the tax liability is paid to the government, the distributors are eligible to take the credit on such items at the time of purchase. The applicant reimbursed the total amounts to the distributors and accounted the same as donation in kind towards CSR expenses for Kerala Flood Relief, 2018.

The AAR has held that since the distributors valued the goods and shown such value as discount and paid tax on values (prior to the discount) and distributor claiming the total amounts which is offered as discount from the applicant, the distributor is entitled to claim input tax credit on the goods cleared to KSEB. Further, AAR also held that applicant's another activity, where in certain electrical items like switches, fans, cables etc to flood affected people under CSR expenses on free basis without collecting any money, the applicant is not entitled to avail credit, since such free supplies fall under the ambit of Section 17(5)(h).

[1]The view of AAR is that since applicant is receiving consideration from distributor not wholly in money because the distributor is also providing certain services to applicant, the applicant would have paid tax on such non-monetary consideration (services provided by distributor) while discharging tax on his outward supplies in accordance with rules for valuation. Since applicant has not paid such tax, the credit of gold coins cannot be availed.

Sanofi India Limited's Ruling – Kerala AAR
(24April 19)

The applicant is engaged in business of sale of pharmaceutical goods and services through group entities during the course of which they incur various marketing and distribution expenses, with a view to promote their brand/products and to enhance their sales under various schemes. The applicant distributes different types of products among its trade channels as promotional items or brand remainders. Applicant inter-alia, runs two promotional schemes namely 'Shubh Labh Trade Loyalty Program' and 'Brand Reminders Products'. The applicant states that vide 'Shubh Labh Trade Loyalty Program', the distributors based on their sales volume will be awarded reward points. Based on their reward points, distributors can redeem either goods or services. Once the distributor intimates his intention to applicant, the applicant purchases such goods or services and gives them to the distributors. For example, if the distributor is eligible for a watch based on his reward points, the distributor places a request that he wishes to redeem his reward points against the watch. The applicant then buys such watch and gives them to the distributor. Vide the 'Brand Reminders Products', the applicant distributes products like pens, notepad, key chains to distributors or doctors with their name embossed on it to promote brand and sales. The applicant states that he purchases all the products by paying appropriate taxes and the question before AAR is whether such taxes paid can be availed as credit.

The applicant believes that all such products which are given as part of marketing and promotional activity vide the two schemes are for the furtherance of business and hence the same are eligible for credit. Applicant states that the said items are not hit by the provisions of Section 17(5)(h) since they are not in the nature of 'gifts'. Since these items are not distributed on the voluntary basis and only out of contractual obligation, such items cannot be held as 'gifts' and accordingly credit is eligible on such items. The jurisdictional officer states that such products are given as free supplies and since there is no consideration the same would not be supply in terms of Section 9 of CT Act. Further, the officer states that such supplies merit classification of 'exempt supply' and accordingly credit pertaining to exempt supplies in terms of Section 17(2) cannot be availed. The officer also states that in light of provisions of Section 17(5)(h), credit is restricted in terms of goods disposed by way of gifts, credit cannot be availed. The officer also states that the applicant is not signing any contract with the customers so that to call such distribution as arising out of contractual obligation.

The AAR after hearing both the views has held similar to its earlier ruling in the matter of Biostadt India Limited (supra). The AAR also has considered the submission made by applicant in light of the Circular 92/11/2019-GST dated 7th March 19, wherein it was clarified that supplier would be eligible for credits even in the case of post supply/volume discounts, if the other conditions mentioned in section 15(3) are satisfied. AAR has held that the circular deals with instances of discounts, which is not the facts in the applicant's case.

Golden Tobacco Limited's Ruling –Maharashtra AAR
(04May 19)

The applicant is seller of cigarettes. The applicant was planning to introduce a promotional scheme, wherein if a distributor buys 100 packs of cigarettes, he will be entitled for additional 10 packs of cigarettes without any further cost. The distributor will pay for 100 packs and will receive 110 packs. The applicant makes two individual supplies, 100 packs and 10 packs at a price of 100 packs. The applicant also states that there will be also instances of staggered discounts, like, if a distributor buys 1000 packs of cigarettes, they would be entitled, say 150 packs of instead of regular 100 packs. Here also the distributor pays for 1000 packs but gets 1150 packs. The applicant proposes to pay tax only on 100 packs or 1000 packs and not on the additional cigarettes. The applicant believes that there is no requirement to reverse the credit pertaining to the additional cigarettes which were given to distributors even though there is no separate consideration for the same. The applicant believes that the additional pack of cigarettes which is being given to distributors was in the nature of discount and since the same is shown on the face of invoice, there is neither obligation to pay tax on the same or reverse the credit to the extent of such additional packs.

The jurisdictional officer believes that the benefit of reduction of discount from the invoice value is available for the recipient of supply and not for the supplier and put forwards his contention by quoting an illustration. He states if the supplier is making a supply of Rs 1,000/- on which 15% additional goods are being given as discount, then the supplier is required to pay tax on Rs 1,150/- and not on Rs 1,000/-. Then he proceeds to state that the recipient of supply would be entitled to take credit of full tax paid by him to supplier that is Rs 115/- (assuming rate of tax is 10%) and then reverse the credit of Rs 15/- is the same is attributable to the discount portion of Rs 150/-.

The AAR after hearing both the views, has stated that the contentions of applicant are found to be in accordance with the Circular 92/11/2019-GST, wherein it was clarified that the additional packs would not be an individual supply of free goods but a case of two or more individual supplies where a single price is being charged for the entire supply. It can be best treated as supplying two goods for the price of one. In such a case, the taxability of such supply will be dependent upon as to whether the supply is composite or mixed supply. The AAR therefore held that there is no requirement to pay tax on additional packs and the additional packs will not be considered as exempt supplies or free samples and accordingly the credit need not be reversed in terms of either Section 17(2) or Section 17(5)(h).

Circular 92 and Circular 105:

The Central Board of Indirect Taxes & Customs (CBIC) has issued two circulars on the subject issue.

Vide Circular 92, it is clarified that if goods are given as free samples or gifts, the same would not be treated as supply in terms of Section 7, in absence of consideration. Further, in terms of Section 17(5)(h), the credit pertaining to such free samples and gifts cannot be availed.

Circular 92 also clarified that in cases of 'buy one get one free', 'buy more save more', there is no individual supply of free goods and it is two or more individual supplies at a single price. It can at best be treated as supplying two goods for the price of one. If such two supplies for a price of one is a composite supply, then the principal supply would be taxable and if it is a mixed supply, the supply will be charged with item having highest tax rate. Further, the Circular also clarified that if the conditions mentioned in Section 15(3) are satisfied, then such value of goods can be reduced from the value of supply and supplier is not under obligation to reverse any credit.

Vide Circular 105, it is clarified that if the discount given by the supplier of goods to the dealer/distributor is for the post sale incentive requiring the dealer to do some act like undertaking special sales drive, advertisement campaign, exhibition etc., then such transaction would be a separate transaction and the additional discount will be the consideration for undertaking such activity and therefore would be in relation to supply of services by dealer/distributor to the supplier of goods and tax has to be paid on such supply. However, if the discount is extended to dealer/distributor without any further obligation or action required from the dealer/distributor's end, then the post discount given by the supplier of goods will be excluded from the value of supply subject to satisfaction of other conditions mentioned in Section 15(3).

Conclusion:

From the reading of all rulings and circulars issued in this connection, the taxpayer should have in place robust documentation to prove the bonafides of the benefits extended to the dealer/distributor. If the tax authorities categorise them as gifts to the dealers/distributors [as in matter of Biostadt India Limited (supra)], the taxpayer cannot avail the credit on such items. However, if the taxpayer can impress the tax authorities that such items are not gifts, but are given as contractual obligation with the dealer/distributor, then the value of such items will be reduced from the value of supply and also the taxpayer is not under an obligation to reverse the credit pertaining to such items. At the same time, the taxpayer has to make sure that if such items/gifts/discounts are given to dealer/distributor for additional services, then he has to appraise the dealer/distributor about the potential tax liability in the hands of the later. All said and done, the documentation is what saves the taxpayer from potential tax liability or reversal of credit.

CBIC should also clarify in situation where the discounts/incentives are offered by supplier of goods to dealers/distributors for receiving certain post sales activity, whether the supplier of goods is also liable to pay tax on such additional services received by him in terms of valuation rules, since the supplier of goods is receiving consideration not wholly in money but also non-monetary consideration in form of services from the dealer/distributor and the dealer/distributor takes such tax paid as credit and raises another invoice on the supplier of goods as contemplated by Circular 105 (in similar lines to builder and landowner transactions under joint development model). This assumes importance because the Maharashtra AAR in couples of rulings (supra) has brought this issue while deciding the eligibility of credit of gifts and other items.

This article is contributed by CA Sri Harsha Vardhan K Partners of SBS and Company LLP, hartered Accountants. The authors can be reached at harsha@sbsandco.com

DIRECT TAX

PAYEMNT OF CERTAIN SUMS BY INDIVIDUALS & HUFS

Contributed by CA Suresh Babu S & CA Ramaprasad T

Finance Bill (No.2) 2019 has inserted a new Section 194M (effective from 01.09.19) which provides deduction of tax at source @ 5% in relation to payment for carrying any work (including supply of labour for carrying out any work) in pursuance of contract or by way of fees for professional services by any Individual or Hindu Undivided Family [HUF] (collectively or individually referred as 'Payer') to a resident in case the payment or payments in aggregate exceeds Rs. 50 Lakhs during the financial year.

Memorandum to Finance Bill (No.2) 2019 provides that the provisions of Section 194M is proposed to introduce to plough the loophole for possible tax evasion where in individual or HUF is carrying on business or profession which is not subjected to audit, since there is no obligation to deduct tax at source on such payment to a resident, even if the payment is for the purpose of business or profession[1].

Sec 194M would apply in case of individual or HUF who are not required to deduct tax under Section 194C or 194J as the case may be. In other words, the provisions of Section 194M would apply only in situations where the payer is not obliged to deduct tax in terms of Section 194C or Section 194J. Hence, it assumes importance to understand under what circumstances payer is obliged to deduct tax under Section 194C or Section 194J to determine the applicability of Section 194M.

Section 194C – Payments to Contractors:

Any person responsible for paying any sum to any resident contractor for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between contractor and specified person is required to deduction tax at source subject to monetary limits of Rs. 30,000/- for single transaction or Rs. 1,00,000/- for aggregate transactions during the financial year.

Section 194C (4) provides that the where sum credited or paid to the contractor ***which is exclusively for personal purpose*** of such an Individual or member of HUF is not obliged to deduct tax when making such payments.

The payer under Section 194C is any person being an individual or HUF who is liable to audit od accounts under Section 44AB during the financial year in which obligation to deduct tax arises.

Section 194J – Fee for Professional or Technical Services:

Any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any sum by way offees for professional services (among others) shall at the time of credit or payment deduct tax at source subject to a monetary limit of Rs. 30,000/- subject to certain exceptions.

[1]Even though the memorandum states that the insertion of Section 194M is to reduce the possible tax evasion arising from non-deduction of taxes by individuals or HUF when expending for business or profession, the proposed section also covers the expenses incurred by individuals or HUF for personal purposes also.

However an obligation is fixed on individual or HUF, whose total sales, gross receipts or turnover from the business or profession carried on by them exceed the monetary limits specified under Section 44AB during the financial year immediately preceding the financial year in which such sum by way of fees for professional services or technical services is credited or paid, to deduct tax under Section 194J (second proviso to Section 194J).

Further, the above obligation on individual or HUF is relaxed if such individual or HUF uses the said services ***exclusively for personal purposes***(third proviso to Section 194J).

Hence, from the above reading of Section 194C and 194J, it is evident that an individual or HUF will not be obliged to deduct tax under the said sections, if such individual or HUF satisfies any of the following conditions:

- sum referred to there in is for work or fees for professional services exclusively for personal purposes

- In case Individual or HUF is engaged in business or profession whose books of accounts are not subject to tax audit under Section 44AB in the financial year in which obligation arises for deduction

Hence, it is evident that if an individual or HUF who is falling under the exceptions listed above, would be obliged to now deduct tax under Section 194M provided the sum or aggregate of sum exceeds Rs. 50 Lakhs during the financial year.

For the purpose of Section 194M the term 'contract', 'work' and 'professional services' have the same meaning as defined under Section 194C and Section 194J respectively.

'Work' shall include-

(a) Advertising;
(b) Broadcasting and telecasting including production of programmes for such broadcasting or telecasting;
(c) Carriage of goods or passengers by any mode of transport other than by railways;
(d) Catering;
(e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer but does not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person, other than such customer.

(clause (iv) of Explanation to Section 194C)

'Contract' shall include sub-contract ***(clause (iii) of Explanation to Section 194C)***

'Professional Services' means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or advertising or such other profession as is notified by the Board for the purposes of section 44AA or of this section

(clause (a) of Explanation to Section 194J)

FAQs on Section 194M -

FAQ #1 Is Section 194M is applicable in case the Payer is a Non-Resident and payee is a resident?

Yes, if an individual or HUF becomes non-resident during the financial year, the obligation under Section 194M would continue to apply.

FAQ #2 Is Payer under Section 194M is required to obtain TAN?

No. Payer should have Permanent Account Number (PAN).

FAQ #3 Whether TDS is required to be made on sum including GST levied there in?

TDS is to be made on sum excluding GST in case shown separately.

FAQ #4 Is deduction required to be made in case payment to transporter having less than 10 goods carriages (Payee)?

Yes, no exception is provided in the section and transport of goods by carriage is covered under the definition of 'work' as per Section 194M read with Section 194C.

FAQ # 5 Can application under Section 197 be made by the payee for no deduction of tax or lower deduction of tax?

Yes.

FAQ #6 Mr. A is getting his house constructed in India. For this purpose, he has taken services of interior decorator and contractor for construction of house. The consideration payable to interior decorator is Rs. 25 Lakhs and to contractor is Rs. 35 lakhs. Is tax to be deducted to be made under Section 194M?

No. As the sum payable to each person does not exceed Rs.50 Lakhs.

This article is contributed by CA Suresh Babu S & CA Ram Prasad Partners of SBS and Company LLP, Chartered Accountants. The authors can be reached at suresh@sbsandco.com & caram@sbsandco.com

AUDIT

MSME & INTERNAL AUDIT

Contributed by CA Sandeep Das

Internal audit function has potential to improve operating efficiency and improving the health of the organisation for achieving long-term sustainability for MSMEs

What is MSME?

Micro, Small and Medium Enterprises (MSME) constitute the backbone of an economy in maintaining an appreciable growth rate and in generating employment opportunities. This sector has been regarded as engine of economic growth and social development in many developed and developing countries. Contribution of MSMEs to the Indian economy in terms of employment generation, containing regional disparities, fostering equitable economic growth and enhancing export potential of the country has been quite phenomenal. Despite some infrastructural deficiencies and challenges like flow of institutional credit and inadequate market linkages, this sector has registered remarkable success about increase in number, quantum of investment, scale of production and overall contribution to national GDP.

A lot of articles have been written in recent times depicting the trends in terms of role of Internal Auditors and increasing expectations of various stakeholders from the Internal Auditors. However, much of this information essentially provides perspectives on roles played by internal auditors in large organizations, which already have established systems and processes. The audit departments in these companies are fairly evolved with independent Charters and reporting to the Board Audit Committees.

In this article we are trying to assess whether the same concepts can be applied for even smaller enterprises or whether the role of Internal Auditor in such setups can be tweaked in order to meet the demands of the organisation.

Typically, MSME has following challenges:

- Lack of Adequate Capital and Credit
- Poor and Inadequate Infrastructural Facilities
- Inadequate Access and Marketing Linkages
- Lack of Skilled Human Resources
- Lack of Access to New Technology
- Dilatory and Cumbersome Regulatory Practices

What is Internal Audit?

Internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations.

It is needless to emphasize that profit making is the primary motive of any entity in the business. Internal auditing helps an organisation accomplish this objective by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Every entrepreneur aspires to see that his firm remain healthy and growing. However, raising concerns for business failure among MSMEs have been prompting the promoters to appreciate the need for appropriate risk management and internal audit.

Why Internal Audit for MSMEs?

Investment in internal auditing can add value to an organisation via operating efficiencies, safeguarding assets, more reliable financial statements, and realizing an organisation's goals and objectives leading to reward to stakeholders.

It is obvious that in the MSME space, the stakeholders are closely associated with the business. Promoters are largely focusing on the targets and performance.

All entrepreneurs are so obsessed with such a continuous routine that they remain oblivious to certain vital elements that have a positive impact on a firm's operational performance and sustainability.

Further, MSMEs tend to have characteristics such as fewer financial controls, more related-party transactions, lower accuracy of accruals and provisions, etc. People within the organisation tend to avoid examination of such issues for obvious reasons.

The scope of Internal Audit:

There is no structured scope to deliver internal audit. Organisation need to be free to choose what works for them according to the nature of what they do, how the organisation is structured, the way processes operate, their financial circumstances and the risks to their strategic objectives. The scope of internal auditing within an organization cover:

- Effectiveness and efficiency of operations.
- Reliability of financial and management reporting.
- Compliance with laws and regulations.
- Safeguarding of Assets

Some of the roles an auditor can play are as follows:

- Act as a bouncing board to the management on key risk management decisions
- Assist in identifying areas of cost and manpower optimization.
- Keeps track of key developments in the field of economy, commerce and legislation and tracks its potential impact on the company
- Bring pragmatic approach to implementing systems and processes
- Help in deploying tailor-made best practices that are suitable to the needs of the organization

Internal Audit and Managing Risks:

With a risk management focus, internal audit can move beyond its monitoring role to help influence and improve how risks are managed before they become challenges. Businesses today are knowledge-intensive and such orientation creates processes and theme that is very complex. So is the gamut of risks and magnitude of impact.

The success of MSMEs in overcoming these challenges has been achieved largely due to the overwhelming spirit of entrepreneurship displayed by the promoters of these organizations. However, often during adverse economic crises or situations beyond comprehensions of these promoters, the organisation fail in risk mitigation and lose the considerable value of the business.

During times of such distress, an internal auditor who got a better view of the business can chip in with valuable advice.

Independence – Critical to the success of Internal Audit:

Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.

Business Owners should encourage the internal auditor to engage in the job fearlessly and it is necessary to effectively carry out the responsibilities of the internal audit activity.

It is very important for MSMEs because many a time the employees in MSMEs are somehow related to promoters or may be associated with them for a long time. Thus there could be chances of embarrassment or at least he may find difficult to bring all the employees on board. Promoters should prevail upon the employees & partners and make them understand that such an examination is important for the sustainability of firm and brings common good.

Key Challenges and Insight for the auditor conducting audits of MSMEs:

1. The auditor of a small business is required to be as proficient in all relevant standards as the auditor of a large, listed entity. Keeping up with changing requirements and maintaining the required knowledge base can be challenging. However, having complete knowledge of relevant auditing standards, coupled with experience in making good professional judgments, is essential for audit efficiency.

2. Simpler businesses do not necessarily mean an easier audit. Small businesses tend to have particular characteristics that require increased attention, for example, fewer financial controls, more related-party transactions, inappropriate books closure (i.e., accuracy of accruals and provisions), and can be subject to some complex taxation requirements.

3. Having fewer, more experienced professionals involved in the audit can bring many benefits and efficiencies to the audit process. Experienced auditors often have an in-depth understanding of the Industry / sector and business processes which allows them to work quickly and effectively, performing the right amount of work and avoiding over documentation.

4. The downward pressure on MSME audit fees is largely due to the market viewing the audit opinion as highly standardized. On the other hand, the audit process is labor intensive, and auditors are subject to initial and continuing knowledge advancement requirements, so the challenge for many auditors is how they can grow audit revenues while maintaining audit quality.

5. Smaller clients are ready to pay for audits that they perceive add value. Also, small businesses are willing to pay their auditors for good business advice. It is pertinent the auditor must learn how to operate with a "Trusted Business Advisor" model.

6. Evolving markets and new services will require practitioners to make significant investments in skills and technology, as well as to move away from the traditional practice model and develop new ways of operating. This innovation is essential to maintaining profitability in light of fee pressure on MSME audits and the need to provide other value-added services in order to grow revenue.

Conclusion:

All MSMEs are spiritedly focusing on increasing the business. MSMEs over the years have assumed greater significance in our growing national economy by contributing to employment generation and rural industrialization. This sector possesses enough potential and possibilities to pushbutton accelerated industrial growth in our developing economy and well-poised to support national programme like 'Make in India'

Even then they are all carrying an unspoken desire that their firm remains sustainable and that effective controls are in place and operating properly. Internal Audit can help them to attain this goal. There are studies that have argued that the effective internal audit functions improve the overall health of the organizations.

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

INCOME TAX & GST

AFFORDABLE HOUSING - INCOME TAX & GST PERSPECTIVE

Contributed by CA Suresh Babu S & CA Sri Harsha

'Housing for All' is one of the biggest agendas of the current government. To achieve this agenda, the government has been granting various tax sops have been extended from time to time to builders/developers and other stakeholders. In this article, we explore the some of the sops pertaining to taxation of affordable housing from the perspective of goods and services tax laws (GST laws) and income tax laws.

Incentives under Income Tax Laws:

For Seller:

Section 80 IBA of Income Tax Act, 1961 (for brevity 'Income Tax Act') deals with deductions in respect of profits and gains from certain housing projects. Vide such section, where the gross total income of an assessee includes any profits and gains derived from business of developing and building housing projects, subject to certain conditions, 100% of such profits and gains are allowed as deduction.

Such deduction is allowed to the assessee only if he satisfies all the conditions mentioned vide Section 80 IBA. Earlier the said deduction was extended vide Section 80 IB(10). Now, the deduction is provided to assessee vide Section 80 IBA. The conditions attached to the said section have undergone certain amendments vide Finance (No.2) Bill, 2019, which is dealt at appropriate place.

The conditions that the assessee has to satisfy to be eligible for deduction of profits and gains are as under:

Projects approved - 1st June 16 to 30th Aug 19	Projects approved - 1st Sept 19 to 31st March 20	Remarks
The project is approved by the competent authority after 1st June 2016 but on or before 31st March 2020	The project is approved by the competent authority ***after 1st September 19*** but on or before 31st March 2020	-
The project is completed within a period of 5 years from the date of approval by the competent authority	The project is completed within a period of 5 years from the date of approval by the competent authority	-
The carpet area of the shops and other commercial establishments included in the housing project does not exceed 3% of the aggregate carpet area	The carpet area of the shops and other commercial establishments included in the housing project does not exceed 3% of the aggregate carpet area	-
The project is on a plot of land measuring not less than 2000 Square meters, in case where the land is located other than cities of chennai, delhi, kolkata or mumbai. In case of cities of chennai, delhi, kolkata or mumbai, the project is on a plot of land measuring not less than 1000 Square meters	The project is on a plot of land measuring not less than 2000 Square meters, in case where the land is located other than cities of chennai or delhi or kolkata or mumbai or hyderabad or bangalore. Incase of cities of chennai, delhi, kolkata or mumbai, hyderabad or bangalore, the project is on a plot of land measuring not less than 1000 Square meters	Hyderabad and Bangalore are added to list of metros
The project is the only housing project in the plot of land mentioned above	The project is the only housing project in the plot of land mentioned above	-
The carpet area of residential unit comprised in the project should not exceed 60 square meters, where the project is located other than cities of chennai, delhi, kolkata or mumbai. In case of residential unit in cities of chennai, delhi, kolkata or mumbai, the carpet area should not exceed 30 square meters.	The carpet area of residential unit comprised in the project should not exceed 90 square meters, where the project is located other than cities of chennai, delhi, kolkata or mumbai. In case of residential unit in cities of chennai, delhi, kolkata or mumbai, the carpet area should not exceed 60 square meters.	Maximum carpet area has been increased to align with GST laws.
The residential unit in housing project is allotted to an individual, no other residential unit in housing project shall be allotted to the individual or spouse or minor children of such individual	The residential unit in housing project is allotted to an individual, no other residential unit in housing project shall be allotted to the individual or spouse or minor children of such individual	-

The project utilises not less than 80% of such floor area ratio where such project is located in any place other than cities of chennai, delhi, kolkata or mumbai. In other cities, not less than 90%.	The project utilises not less than 80% of such floor area ratio where such project is located in any place other than cities of chennai, delhi, kolkata or mumbai or hyderabad or bangalore. In other cities, not less than 90%.	Hyderabad and Bangalore are added to list of metros
The assessee maintains separate books of account in respect of the housing project	The assessee maintains separate books of account in respect of the housing project	-
-	The stamp duty value of a residential unit in the housing project does not exceed Rs 45 lakhs	New Condition
The assessee should not execute such housing project as a works contract awarded by any person (including central government or state government)	The assessee should not execute such housing project as a works contract awarded by any person (including central government or state government)	-

Only on satisfaction of all the conditions, the assessee shall be eligible for deduction of 100% of profits or gains arising from developing such residential projects. If the housing project is not completed within 5 years period, the total amount of deduction so claimed and allowed in one or more previous years, shall be deemed to be the income of previous year under head profits or gains from business or profession (for brevity PGBP) of the previous year in which the period of completion expires.

Certain Issues:

Issue: Deduction for Builder and Landowner under JDA model:

One of the contentious issues for allowing deductions under Section 80 IBA [erstwhile Section 80 IB(10)] is, whether the builder who undertakes the project on joint development model is eligible for deduction under this section. The builders were claiming deductions and tax authorities state that the builders are not eligible for deduction as one of the conditions is that the assessee should not execute such project as a works contract and claim of tax authorities was that builder being a works contractor and executing the same on behalf of the land owner, he is not eligible for deduction as he failed to satisfy one of the conditions attached to Section 80 IBA or erstwhile Section 80 IB (10).

The issue was answered in favour of builder by various courts, wherein it was stated that the builder cannot be equated with a works contractor as mentioned in the conditions attached to the said sections. A works contract would not be taking any risk and works for agreed amounts, whereas the builder in a joint development model carries huge risk of sale of inventory and other issues. Hence, the courts on various occasions have held that the builder executing such projects under joint development model can also claim the deduction under Section 80 IB(10) or Section 80 IBA, since he cannot be called as works contractor for the purposes of said sections.

The above view is expressed by Honourable Income Tax Appellate Tribunal of Ahmadabad in the matter of Madhav Builders[1] . Even though the judgment is in the context of interpretation of Section 80 IB(10), the rationale would help in the interpretation of Section 80 IBA, since both the sections have similar conditions. The Honourable Tribunal after making a thread bare analysis of various judgments have concluded vide Para 25 as under:

25. By going through the various clauses of the development agreement dated 28.8.2003 between the assessee ***and the land owner Shree Madhav Co-op. Housing Society, it can be construed that the assessee is having much wider authority –rights and powers for accomplishing the plan of the housing project and certainly such type of powers and rights which are exercised along with collection of revenue from each unit of the housing project and successful completion of each part of the housing project very well justify to large extent that assessee was working as developer and not works contractor.*** *Further we have also examined the financial statement of the assessee and find that in the audited balance sheet as on 31.3.2006 assessee has shown sundry debtor of ₹1,99,21,445/-, the list of which includes 42 parties including Shri Madhav Co-op. Housing Society Ltd. being a sundry debtor of ₹ 8,87,166/- and the remaining amount of debtor i.e. ₹ 1,90,34,279/- are being debit balance in the names of various flat owners from whom the assessee had yet to receive the amount which it has spent for the housing project.* ***This shows that assessee was not working only as a work contractor on behalf of Shree Madhav Co-op. Housing Society Ltd. else the assessee would have been showing the complete outstanding balance in the name of Shree Madhav Co-op. Housing Society Ltd. This fact has not been controverted by the revenue at any stage below and, therefore, looking to the terms and conditions of the development agreement and audited financial statement of the assessee, we are of the view that assessee comes under the category of developer and not of works contractor and, therefore, comes within the definition of developer as referred in the provisions of section 80IB(10) of the Act.***

Hence, as of now, we can conclude that the above issue is squarely in favour of the assessee and the builders can very well claim the deduction under Section 80 IBA if he satisfies all other conditions.

Another question would arise, whether the landowner, who is the other party in the joint development model is eligible for claiming deductions under Section 80 IBA or erstwhile Section 80 IB(10). The landowner certainly is not struck with the condition of works contract, because, he does not engage in any sort of construction activity. The only issue arises for claiming the deduction under the said sections is whether landowner can be said to be engaged in carrying of business or profession by entering a joint development agreement with the builder.

It is natural that the landowners would be offering tax under the head capital gains as far as the transfer of development rights are concerned in a typical joint development agreement model. If the landowner offers income under the head capital gains, it would be tough for him to claim deduction under Section 80 IBA or Section 80 IB(10), since such deductions are applicable only for the assessee who are engaged in generating income classifiable under PGBP.

The Honourable Madras High Court in the matter of Commissioner of Income Tax v Anjali Foundations[2] in interpretation of benefit of deduction under Section 80 IB(10) held as under:

[1]2016 (3) TMI 408 – ITAT Ahmedabad
[2]2019 (5) TMI 109 – Madras High Court

Having hearing the learned counsel for the Revenue, we are satisfied that there is nothing in Section 80IB(10) of the Act to deny the benefit of Deduction to the land owner also, who is equally a partner in the "development" of Industrial Undertaking other than the Infrastructure Development Undertaking. Without the land, obviously, the construction of building cannot be undertaken and therefore, the landowner is an integral part of the development of the Buildings. It is considered to be an Industrial Undertaking other than Infrastructure Development in view of the said provision. Merely because the landowner does not undertake the construction work himself, the landowner cannot be excluded from the ambit and scope of Section 80IB(10) of the Act.

It is evident that the Honourable High Court has not gone into the aspect as to whether the deduction is eligible despite of the fact that income is offered by landowner is classified as capital gains. However, the said judgment is currently occupying the field and landowners can take a calculated risk of claiming deduction under Section 80 IBA or Section 80 IB(10) for incomes earned from sale of their share of flats in the joint development model.

For Buyer:

The Finance (No.2) Bill, 2019 has also introduced a new section vide Section 80 EEA which allows deduction of interest payable on housing loan to the extent of Rs 1.5 lakhs subject to condition that the stamp duty value of such residential unit does not exceed Rs 45 lakhs and assessee is not claiming deduction under Section 80EE[3] and other specified conditions.

Incentives under Goods & Services Tax Laws:

A concessional rate of 1% is applicable for construction services provided by suppliers with respect to the affordable residential apartment under goods and services tax laws. The normal rate of tax applicable for supply of construction services pertaining to residential apartments is 5%. However, if such residential unit falls under the definition of affordable residential apartment, the same is reduced by 4%, making the effective rate of tax at 1%. The said concessional rate comes with conditions which the supplier has to satisfy, which are detailed hereunder.

Entry 3 of Notification No (NN) 11/17 deals with rates of taxes applicable for construction services. Vide Entry 3(i), the rate of tax for construction of affordable residential apartment by a promoter in a ***residential real estate project*** (RREP) which commences after 1st April 19 is notified to be 0.75%[4] . Hence, total rate of tax would be 1.5% (0.75% - CT and 0.75% - ST). Further, a deduction of 1/3rd of total amount charged for supply would be deemed to be the value of undivided share of land and accordingly the effective rate of tax would be 1% (1.5% * 2/3).

Vide Entry 3(ic) of NN 11/17, the rate of tax for construction of affordable residential apartment by promoter in a ***real estate project*** (REP) other than RREP is notified to be 1.5%. However, as stated earlier, the deduction towards value of land has been extended to this entry also, making the effective rate of tax is 1%.

[3]Deduction in respect of interest on loan taken for residential house property

[4]To this, state tax (ST) at 3.75% has to be added, which comes through a separate legislation namely State Goods & Services Tax Act, 2017

The only difference is the earlier one deals with RREP and later with REP. The expression 'residential real estate project' has been defined vide 4(xix) of NN 11/17 to mean a REP in which the carpet area of the commercial apartments is not more than 15% of the total carpet area of all the apartments in REP.

Hence, if assessee is contemplating the project with commercial space which is not more than 15% of the total carpet area of all the apartments in REP, then such project would be called as RREP and tax rate of 1% is applicable vide Entry 3(i). Further, the rate of tax applicable to such commercial space in a RREP is 5%[5] as notified vide Entry 3(ib). Except for this difference, there is no other difference between RREP and REP. All other conditions equally apply to RREP and REP.

The phrase 'affordable residential apartment' assumes significance in the current context. The said phrase has been defined vide 4(xvi) of NN 11/17 under two limbs. The first limb assumes significance for the projects being started after 1st April 19. Vide such limb, if a residential apartment having carpet area not exceeding 90 square meters in cities or towns other than metropolitan cities and for which the gross amount charged is not more than Rs 45 lakhs.

Hence, in order to fall under the definition of affordable residential apartment under the CT Act and to be eligible for concessional rate of 1% for residential apartments and 5% for commercial apartment in RREP, assesse has to satisfy twin conditions. One, the carpet area of residential apartment should not exceed 90 square meter and two, gross amount charged[6] should not be more than Rs 45 lakhs. On satisfaction of both the conditions, the said residential apartment would fall under the definition of 'affordable residential apartment' and accordingly eligible for concessional rate.

Further the assessee should also satisfy additional conditions that no credit of input tax can be claimed, 80% of the value of input and input services shall be procured from registered supplier (else, tax has to be paid by assessee on shortfall at 18% excluding cement purchased from unregistered supplier).

[5]Rate of tax is notified as 3.75%. Adding ST to that and claiming the deduction towards value of land, the effective rate of tax is 5%.

[6]Gross amount shall be the sum total of consideration charged for construction services provided, amount charged for transfer of undivided share of land and any other amount charged from buyer including preferential location charges, development charges, parking charges, common facility etc

Snapshot of Conditions under Income Tax and GST laws:

Condition	Income Tax laws for deductions	GST laws for concessional rates
Timelines for Approval	June 2016 to March 2020	No timelines
Time limit for Completion	5 years from the date of approval	No timelines
Commercial Area	Not more than 3% of total carpet area	Not more than 15% of total carpet area
Minimum Land	Not less 2000 (non-metro) /1000 (metro) sq mts	No such condition
Other Projects	Only such project on land, no others	No such condition
Max Carpet Area of Unit	30 (metro) /60 (non-metro) Sq mts (till 30.08.19)	60 (metro) /90 (non-metro) Sq mts
Max Carpet Area of Unit	60 (metro)/90(non-metro) Sq mts (from 01.09.19)	60 (metro) /90 (non-metro) Sq mts
Max Units an individual can hold	Only one	No such condition
Min Floor Area Usage	80% (metro)/ 90% (non-metro)	No such condition
Separate Books of Accounts	Yes	No such condition
Works Contract	Assessee should not be a works contractor	No such condition
Maximum Value of Unit	No Restriction (till 30.08.19)	INR 45 lakhs
Maximum Value of Unit	INR 45 lakhs (from 01.09.19)	INR 45 lakhs

It is evident from the above that vide amendments made to Finance (No.2) Bill, 2019 an effort was made to bring alignment of conditions mentioned in Income Tax laws with GST laws to make the sops attractive and optimise the benefits available to tax payers.

This article is contributed by CA Suresh Babu S &CA Sri Harsha Vardhan K Partners of SBS and Company LLP, Chartered Accountants. The authors can be reached at suresh@sbsandco.com & harsha@sbsandco.com

By

Team SBS

Hyderabad: 6-3-900/6-9, Flat # 101, 103 & 104, Veeru Castle, Durganagar Colony, Panjagutta, Hyderabad, Telangana - 500 082.
Kurnool : 40/838, #302, 3rd Floor, V V Complex, R.S. Road, Near SBI Main Branch, Kurnool, A.P – 518 004.
Nellore : 16-6-259, 1st Floor, Near Santhi Sweets, OPP. SBI ATM, Vijaymahal Centre, Nellore , A. P - 524 002.
Sri City: Sri City Trade Centre, Ground Floor, Suite No 102, 2880, Central Expressway, Sri City Post, Tada, A.P - 517 646
Visakhapatnam: 50-50-32/3, 1stFLOOR, T.P.T Colony, Seethammadara, Visakhapatnam, A. P – 530 013.

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