We are publishing hereunder the best of the answers to the queries published in September 2005 Issue of our Journal as received by us from a large number of readers. All the Members of the ICAI, whose answers are published in the journal, will be awarded one hour CPE Credit for each answer.

ACCOUNTING

Cellular Telephone Companies at the time of activation of a Cellular Phone charge the user a one-time activation fee, which enables the user of the Cellular Phone to get access to the telephone line. The telephone company would like to explore the following options for recognising the activation fees to its Profit & Loss Account:

1. Take to income the activation fee in the year of receipt/activation;
2. Compute a statistical forecast based on the previous average usage of its subscribers and distribute the activation fee over that period.

Which of the above would be an appropriate methodology or whether any other methodology would be more appropriate?

ANSWER:

- Activation fee is one time charge by the Cellular Companies charged on day one of activation to get access to the telephone line, which is neither refundable nor adjustable against talk time/value.
- The income in cash is derived at the time of activation itself and there is no cash inflow during subsequent years.
- It is applicable to both 'pre-paid' as well as 'post-paid' facilities are available from very short period to long period. Majority 'pre-paid facilities, especially short period users, may not continue with the same company, and possibilities of switching over to other companies prevail, as lot of cellular companies, including multinationals, are in business in India and offering different attractive schemes to subscribers due to tough competition in the field.
- Due to fast emerging developments in technology, the entire scenario may change at any time and hence splitting such income may not be appropriate.
- Computing a statistical forecast based on the previous average usage for distributing the activation fee income over a period of years may not have consistency. Due to stiff competition and attractive schemes offered by various companies and considering the tremendous increase in subscribers every year as well as new companies entering the market, definitely there will be Huge Variance in the statistical forecast calculations if it is done every year based on the previous average usage method. Hence deriving/fixing the period of distribution by doing the statistical forecast in one particular year is not a feasible analysis for standard accounting practice. Also, every year such statistical forecast cannot be worked out and the period of distribution can not be changed every year and thus such statistical forecast cannot be worked out and the period of distribution cannot be changed every year, which will lead to total inconsistency in accounting methods.
- Though an overall activation fee received by a company in a year is huge, the amount charged by the company to each subscriber is very small.
- Considering the above points, the appropriate method would be to take the income of activation fee in the year of receipt/activation.

(Mr. V. Mohan, Membership No.200344)

LAW

Q. 2 A trust duly formed and registered with the Tax Authorities in India sells certain handicraft items made by tribal people to entities abroad. As a measure to ease the cash flow of the tribal, it receives advances from the importing entities (situated outside India), which is settled on invoicing of the product. One of the importing entities had sent an advance of US $ 100,000. Due to weather conditions the tribal people could not make the handicraft items and hence the trust offered to return back the advance to the importer situated outside India. However, the importer requested the trust to consider the advance as a donation to be utilised for the welfare of the tribal people.

Whether accepting the donation would contravene

the provisions of the Foreign Contribution (Regulations) Act, 1976.

ANSWER: Section 6 of the Foreign Contribution (Regulation) Act, 1976 prohibits any association having a definite cultural, economic, educational, religious or social programme from accepting a foreign contribution unless such association is:

(a) Registered with the Central Government in accordance with the rules made under the said Act and

(b) Agrees to receive such foreign contribution only through one of the branches of a bank as it may specify in its application for such registration.

The application for registration is to be made in form FC-8 prescribed in Foreign Contribution (Regulation) Rules, 1976. The trust should register with the Central Government.

In the instant case,

(a) The trust is duly formed and registered with the Tax authorities in India. The registration must be under section 12A of the Income Tax Act, which recognises the trust as a charitable entity.

(b) The object of the trust is to promote the sale of certain handcraft items made by tribal people to foreign entities. The object is to promote the economic welfare of the tribal people. So the predominant object of the trust is an economic programme as specified in Rule 6 of the Act.

(c) The trust has received certain sum in foreign exchange as an advance for the supply of goods. The trust has credited the sum in its books of accounts to an account called advance money received from buyers. The trust could not supply the merchandise. The trust offered to refund the money to the foreign entity. The foreign entity requested the trust to treat the advance as a donation to the trust.

The questions that arise in the above situation are:

1. Whether the trust should register itself with the Central Government under the provisions of the Foreign Contribution (Regulation) Act, 1976.
2. Whether the amount held by the trust in Indian Rupees is a foreign contribution and acceptance of the donation in the circumstances amount to acceptance of foreign contribution, and
3. Whether acceptance of the donation contravenes the provisions of the Foreign Contribution (Regulation) Act, 1976?

Answers:

1. Since the objects of the trust are in nature of economic programme, the trust should register it self with the Central Government under the provisions of the Foreign Contribution (Regulation) Act 1976.
2. The Term Foreign Contribution refers to the source of the money received. In the instant case, the trust has received the money from a foreign source for a definite purpose. Instead of the purpose for which it is sent, the said contribution is being utilised for a different purpose. Therefore, the source of the contribution continues to be foreign only and the fact that it is credited in the books of the trust in Indian Rupees does not alter the situation.
3. The acceptance of the donation contravenes the provisions of the Foreign Contribution (Regulation) Act, 1976 because the Trust has not registered itself with the Central Government as required by Section 6 of the said act. It has not made an application in form FC-8 for registration and has not mentioned any specified branch of a bank to receive the foreign contribution. Therefore, receipt of the donation amounts to acceptance of foreign contribution in contravention of the provisions of the Foreign Contribution (Regulation) Act, 1976.

(A Seshadry, Membership No.19946)

TAXATION

Q. 3 An Indian company has a branch in the United States (US). One of its US clients requested the Managing Director of the Company (who is situated in India) to come for a meeting to the United States. The branch in the US purchased the ticket for the Managing Director and also spent for his other expenses in US. Is Fringe Benefit Tax (FBT) attracted towards the cost of the ticket and other expenses incurred

for the Managing Director in the following circumstances?

1. If the profits/losses of the US branch is included in the overall profits/losses of the Indian company;
2. If the branch offers for assessment in the US the profits/losses of the US branch and excludes the same from the income computation for tax in India in light of the provisions of the DTAA.

ANSWER: 115WA.

Charge of fringe benefit tax

(1) In addition to the income-tax charged under this Act, there shall be charged for every assessment year commencing on or after the 1st day of April, 2006, additional income-tax (in this Act referred to as Fringe Benefit Tax) in respect of the fringe benefits provided or deemed to have been provided by an employer to his employees during the previous year at the rate of 30 per cent on the value of such fringe benefits.

(2) Notwithstanding that, no income-tax is payable by an employer on his total income computed in accordance with the provisions of this Act, the tax on fringe benefits shall be payable by such employer.

115 WB. *Sub Sec. (2): The fringe benefits shall be deemed to have been provided by the employer to his employees, if the employer has, in the course of his business or profession (including any activity whether or not such activity is carried on with the object of deriving income, profits or gains) incurred any expense on, or made any payment for, the following purposes, namely: -*

(A)*Entertainment;*

(B) *Provision of hospitality of every kind by the employer to any person, whether by way of provision of food or beverages or in any other manner whatsoever and whether or not such provision is made by reason of any express or implied contract or custom or usage of trade but does not include—*

(i) any expenditure on, or payment for, food or beverages provided by the employer to his employees in office or factory;

(ii) ……..

In the instant case:

(a) The Managing Director of the Company is requested to visit the overseas branch in connection with a meeting. (it is presumed that such meeting is a business meeting)

(b) The overseas branch has incurred expenditure on purchase of Air Ticket and also has incurred other expenditure while the Managing Director is in that country

(c) The Profits/losses of the branch is either included (a) in the overall profits/losses of the Indian company and offered to taxation in India or (b) excluded from the Indian computation of tax and offered to tax in US.

The questions that arise in this situation are:

(1) Whether FBT is attracted on the expenditure incurred on air ticket in connection with the business meeting of the Managing Director.

(2) Whether other expenditure is incurred while the Managing Director is in USA.

(3) Whether it makes any difference if the Indian company includes the profit/loss of the overseas branch in the overall profit/loss of the company and offers the same to Indian taxation.

(4) Whether it makes any difference if the Indian company excludes the profit/loss of the overseas branch from the overall profit/loss of the company and offers the same to US taxation alone availing the benefits under DTAA with that country.

Answers:

(1) The Expenditure incurred on air ticket is not liable to FBT as the same is incurred in connection with a business meeting of the company. The purpose of the travel is not as specified in 115 WB (1b), hence exempt from FBT.

(2) Other Expenditure incurred while the M.D. is in US is liable to FBT under the provisions of 115WB (2) (b).

(3) FBT is liable to be paid on Other Expenditure when the company includes the profit/loss of the overseas branch with profits/losses of Indian Operations and pays Indian Income-tax there on.

(4) FBT is liable to be paid on Other Expenditure even if the branch profits are excluded from the Indian Income-tax Computation in view of the provisions 115 WA (2). The exclusion of the branch profits in terms of DTAA is in accordance with the provisions of Section 90 of the Income-tax Act, 1961. Indian company is liable to pay FBT even when the income is not to be included in the taxable income under Income-tax Act, 1961.

(A.Seshadry, Membership no. 19946) ❐