ACCOUNTING STANDARDS

Q.1. Accounting Standard (AS-28) issued by the Institute of Chartered Accountants of India (ICAI) in 2002 deals with "Impairment of Assets". This Standard has come into effect to Level 1 entities from the Accounting Year 1st April 2004. This Statement should be applied all assets, other than inventories, assets arising from construction contracts, investments (that are included in the scope of AS 13), and deferred tax assets. It should be also noted that AS 28 does not apply to Financial Assets viz., investments included in the scope of As 13 "Accounting for Investments".

Para 2(d) of AS 13 dealing with "Accounting for Investments", states that "this statement does not deal with – (d) mutual funds and venture capital funds and/or the related asset management companies, Banks and public financial institutions formed by a Central or State Government Act or so declared under the Companies Act 1956." This makes it clear that the aforesaid entities are exempt from the application of AS 13.

Under par 2 of AS 28, the rationale for excluding assets listed in Para 1 of AS 28, is because there do exist Accounting Standards applicable to the assets mentioned in para 1 of the Standard wherein the respective Standards contain specific requirements for recognizing and measuring the impairment related to these assets.

Hence does it mean investments categorized under Held Till Maturity (HTM), (which are carried at face value or book value whichever is lower) by mutual funds and venture capital funds and/or the related asset management companies, Banks and public financial institutions formed by a Central or State Government Act or so declared under the Companies Act 1956 since not governed by As 13 will covered by the AS 28 and therefore the investments held in HTM be tested for impairment?

We are publishing hereunder the best of the answers to the queries published in June, 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.

ANSWER: The guidelines for valuation of investments categorised under HTM are issued by the RBI every year. On the basis of such valuation, provisions are made for impairment in carrying cost of such investments. Accordingly there is no need to test the HTM for impairment. However, there is large scale impairment in carrying cost of investments which will affect true and fair view of Financial Statements or solvency of the investor and then provision of AS –28 will have to be applied.

(Arun Jain, Membership No. 37387)

TAXATION

Q 2. As per the Organization for Economic Co-operation and Development (OECD) Model Convention on Double Tax Avoidance Treaties a building, construction or an installation project of an enterprise would become a Permanent Establishment Source State if it has a continuous presence in the Source State for more than 12 months.

If an enterprise simultaneously undertakes many unrelated projects in the Source State under totally independent contracts with different parties and for the execution of the contracts the enterprise is present the Source State for more than specified period even though its presence for individual contracts is less than the specified period whether the presence of the enterprise in the Source State is to be aggregated to determine whether the enterprise has an permanent establishment in India?

ANSWER: If the presence of an enterprise from date of undertaking first project till execution of last than 12 months it cannot said to have permanent establishment in India.

However, if total time taken for execution of each project is less than 12 months but all the projects undertaken or executed over a period exceeding 12 months , than such enterprise shall be a permanent establishment in India .

The benefit under Double Taxation Avoidance Treaties will be available only to those enterprises whose overall presence in India is for less than 12 months.

If enterprise is executing projects over a period exceeding 12 months, then their intention is to carry on business

in India and as such they will be deemed to have permanent establishment in India, unlike those enterprises who undertake only those projects, which are executed within 12 months with no intention to prolong their stay in India.

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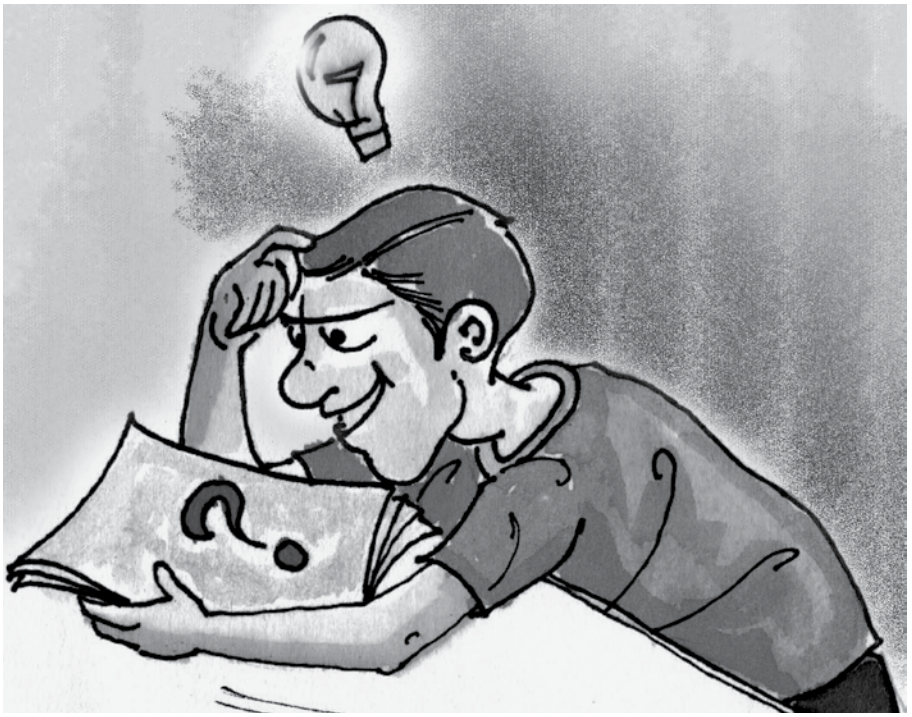

Q 3. What are the circumstances under which the principle of resjudicata and promissory estoppel are not applied?

ANSWER: Joint Family of Udayan Chinubhai v.CIT [1967] 63 ITR 416 / Dwarkadas Kesardeo Morarka v.CIT [1962] 44 ITR 529 (SC) :

An assessment year under the Income Tax Act, is a self contained assessment period and a decision in the assessment year does not ordinarily operate as per judicata in respect of the matter decided in any subsequent year, assessing officer is not a Court and he is not precluded from arriving at a conclusion inconsistent with his conclusion in another year. It is open to the ITO, to depart from his decision in subsequent years, since the assessment is final for the particular year for which it is made. A decision reached in one year would be a cogent factor in the determination of a similar question in a following year, but ordinarily there is no bar against the investigation by the ITO of the same facts on which a decision in earlier year is arrived at.

M.M.Ipoh v. CIT/M Chettiappan v.ITO [1968] 67 ITR 106/CIT v. Durga Prasad More [1971] 82 ITR 540/ Dalhouise Investment Trust Co.Ltd. v. CIT [1968] 68 ITR 486(SC) :

The doctrine of res judicata does not apply so as to make a decision on a question of a fact or law in a proceeding for assessment in one year binding in another year. The assessment and the facts found are conclusive only in the year of assessment; the finding on questions of fact may be good and cogent evidence in subsequent year, when the same question falls to be determined in another year, but they are not binding and conclsive .

Karnani Properties Ltd. V. CIT [1971] 82 ITR 547 (SC)

Dalhousie Investment Trust Co.Ltd.v. CIT [1968] 68 ITR 486 (SC):

The rule of res judicata does not apply to taxation proceedings decision of high court in one assessment year based on Tribunal's finding does not preclude a consideration in future assessments of question whether those facts and circumstances were correctly found by Tribunal.

Doctrine of Promissory Estoppel

Motilal padampat Sugar mills Co.ltd.v. state of Uttar Pradesh [1979] 118 ITR 326 (SC) :

The true principle of promissory estoppel, seems to be that where one party has by his words or conduct made to other a clear and unequivalent promise which is intended to create legal relations or effect a legal relationship to arise in the future, knowing or intending that it would be acted upon by the other party to whom the promise is made and it ia in fact so acted upon by the other party, the promise would be binding on the other party making it and he would not entitled to go back upon it , if it would be unequitable to allow him to do so having regard to the feelings which have taken place between the parties , and this would be so irrespective of whether there is any pre- Existing relation ship between the parties or not .

Though rule of estoppel is not applicable to assessments, the income tax authorities may take into consideration the behaviour of the assessee over along period of time is deciding a question of fact .

CITv. Durga Prasad More [1971] 82 ITR 540(SC)

Where public duties cast by status are involved, private parties cannot prevent performance by invoking estoppel.

CIT v. B.N. Bhattachargee [1979] 118 ITR 461 (SC)

The soul of estoppel against statue permissible because public policy animating a statutory provision may then become the casualty.

(Arun Jain, Member Ship no. 37387)

Q.4. Does the decision of the Supreme Court in the case of IPCA Laboratories (266 ITR 521) means that the profit on sale of export entitlements cannot be taken into account for the determination of exempted profits u/s 80HHC?

ANSWER: The point for consideration before the Hon'ble Supreme Court was to laid down the procedure for computation of profits eligible for deduction u/s 80HHC where the assessee is engaged in the export of both manufactured as well as trading goods.

Where the assessee is engaged in the export of manufactured and trading goods, the case is falling within Clause (C) of sub section (3) of section 80HHC. This clause provides for separate computation of eligible deduction for manufactured and trading goods with the word "and" in between them and the Hon'ble Supreme Court interpreted that the word "and" means that the losses in any one are to be adjusted against profits of the other and only the net result of computation becomes eligible for deduction u/s 80HHC.

The controversy has arisen because while delivering judgment the Hon'ble Supreme Court said "if there is a loss then no deduction would be available u/s 80HHC(1) or

(3)(a) or (3)(b). In arriving at the figure of positive profits, both the profits and the losses will have to be considered. If the net figure is a positive profits then assessee will be entitled to a deduction. If the net figure is a loss then the assessee will not be entitled to the deduction."

On account of the above, a doubt has arisen as to whether export incentives would be eligible for deduction when the net result of computation under Clause(a), Clause(b) and (c) of sub-section (3) is a negative figure.

First of all, the context in which the Hon'ble Supreme Court has given the decision and the reason for using the word positive and negative profits in Ipca laboratory case are relevant. The Hon'ble Supreme Court was only concerned with losses either in manufacturing or trading activity or both and did not discuss the impact on export incentives. Therefore the IPCA Laboratory decision has limited application to a case where assessee is engaged in export of both and manufactured and trading goods and there is negative profits in on of the activities. The export incentives in my opinion will be still eligible for deduction in spite of negative profits for the reasons given below.

1. If the intention of the legislature was to combine the negative profit and positive incentive, there was no necessity to deduct 90% of the incentive from profits of the business and then make two separate computation. In that case explanation (baa) was not required clarifying the meaning of "Profits of the business" as net profit minus 90% of incentive. One single computation on net profit including incentives would have served the purpose.

2. The words in proviso to section 80 HHC(3) is "provided that the profits computed under clause (a) or clause (b) or clause (c) of this sub-section shall be further increased by the amount which bears to ninety percent of the sums referred in clause (iiia)

The proviso makes it clear that the computation as per 80HHC (3)(b) is to be only increased by the computation made in proviso to sub-section If the intension was to increase or decrease the legislature would have used the word "further increased or decreased" as is found in many other section of the Act. Therefore if the result of computation under clause (b) of section 80HHC is negative then the same to be ignored because the proviso provides for only increasing the benefit of deduction by 90% of incentives.

The Bombay High Court in Rohan Dyes case (270 ITR page 350) has applied the decision of Hon'ble Supreme Court in IPCA Laboratory to a case and has held that the profits under Clause (a) (b) (c) of sub section (3) of Section 80 HHC are to be netted against the amount computed in proviso of sub-section (3) dealing with export incentive which is in my opinion for the reasons given above as is not the correct application of law declared by the Hon'ble Supreme Court.

(Roshan Pinto, Membership No: 204112)